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Trump's Fed pick advocates return to a 'rule' that may never have existed

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WASHINGTON (Reuters) - In the op-ed column that may vault think tank analyst Stephen Moore to a spot on the Federal Reserve Board of Governors, he argues the Fed could have skirted recent rate hikes and dodged a wave of criticism by tying monetary policy to commodity prices.

The Fed, Moore wrote in the Wall Street Journal https://www.wsj.com/articles/the-fed-is-a-threat-to-growth-11552518464 earlier this month, should take a page from the playbook of Paul Volcker, the former Fed chairman who battled back rampant inflation in the early 1980s. According to Moore, Volcker's success was rooted in his use of a commodity-price rule that prompted the Fed to lift interest rates when commodity prices were rising and cut them when they were falling.

One problem: It appears Volcker and the Fed never used such a system.

In the 1980s "there was some discussion of this and some board members paid some attention to commodity prices," Donald Kohn, a Fed staffer through most of Volcker's tenure and eventually a vice chair of the Fed himself, told Reuters. "But it did not play a central role."

A review of Fed transcripts from that era shows months going by without commodities being mentioned at all at policy meetings. In cases when they were discussed they were cast as just another bit of data, not as a core anchor for policy.

And in Volcker's recent book "Keeping At It," which includes an account of the inflation war, he never mentions a commodity index. Volcker did not respond to a request for comment left with an aide at his nonprofit organization.

Moore did not respond to repeated interview requests through the Heritage Foundation, the conservative think tank where he is a distinguished visiting fellow.

His Journal column, which lambastes the Fed and Chairman Jerome Powell for raising rates at the end of last year, appeared on March 13 and was shown to Trump by White House economic adviser Larry Kudlow, a friend of Moore's, according to Bloomberg and the Washington Post. Trump, who has been a harsh critic of the Fed's rate increases and of Powell, whom he appointed Fed chair, lauded the article and last week said he would nominate Moore to one of two vacancies on the Fed board.

Although his name has not yet been formally submitted to the Senate Banking Committee for confirmation, Trump's promise to nominate Moore has been met with criticism from economists across the political spectrum.

It potentially also ends any sense of truce between Trump and the Fed, placing an ardent partisan on Powell's board even as the Fed put the recent round of rate hikes on hold.

LOOSE LANGUAGE

Use of a commodity index to set monetary policy was pushed in the 1980s by the supply-side economists and politicians who were influential in the Reagan administration years and saw commodities as a sort of stand-in for the gold standard, which the U.S. government abandoned in the 1970s.

That included Arthur Laffer, a member of Reagan's economic team and Moore's mentor. The two co-wrote a 2010 book, "Return to Prosperity," that also mentions Volcker's purported adoption of a monetary rule based on commodities.

George Selgin, a senior fellow at the Libertarian Cato Institute, where Moore worked in the 1990s, said in a blog post https://www.cato.org/blog/stephen-moores-other-volcker-rulethis week that Moore's and Laffer's assertions about Volcker and commodities were not grounded in fact.

"(D)espite what Stephen Moore has written, there's no evidence that either Paul Volcker or any later Fed chair ever deliberately 'linked Fed monetary policy to real-time changes in commodity prices,'" Selgin wrote.

Like many others who have reviewed the commodity price targeting idea, Kohn, the former Fed vice chair and now a senior fellow at the Brookings Institution, said the notion of tying Fed policy to commodity prices overlooks the uncertain connection between those prices and the general rate of inflation that the Fed tries to control.

Moreover, it could tie the U.S. central bank to an index that could fluctuate wildly on the basis of trade war tariffs or Chinese demand for copper.

The Fed in fact emphasizes core price readings that strip out energy and food on the view measures excluding such volatile commodities are a more reliable indicator of underlying inflation.

Wayne Angell, the Fed board member from that era most focused on commodity prices, later acknowledged in a 1992 article for the Cato Journal that while commodity prices "yield useful information," they are "not perfect monetary indicators and should be neither the sole indicator nor the target for monetary policy."

Moore's columns may have caught the president's eye, but critics, including some at the organizations where Moore studied and developed his career, say his loose use of language is a drawback in a technical setting like the Fed.

"If I was someone in Congress I would be very concerned," with the concept Moore laid out, said David Beckworth, an economist at the Mercatus Center at George Mason University, where Moore received his masters degree in economics.

"It could be destabilizing," Beckworth said, with so many world prices now hinging, for example, on Chinese demand.

Moore, he said, "is being loose and careless in language."