

RESEARCH SUMMARY

Getting Monetary Policy Right: What Should the Federal Reserve Have Learned from Its Pandemic Response?

Over time, the Federal Reserve has pursued monetary policies to achieve different goals. Sometimes those policies have concentrated on the goal of price stability, and at other times the Fed has compromised its goal of price stability through policies that seek to deliver a socially desirable low rate of unemployment. In “Getting Monetary Policy Right: What Should the Federal Reserve Have Learned from Its Pandemic Response?” Robert L. Hetzel says the Fed should be able to explain to Americans why it has chosen its current strategy.

WHAT THE FEDERAL RESERVE CONTROLS AND WHAT IT DOESN'T

There is general agreement that in the long run the Fed controls inflation. Less agreement exists about its control in the short run. Yes, the Fed has a dual mandate to pursue “maximum employment” as well as “price stability.” But does that make it a master of the economy with the ability to control employment in a predictable manner?

Rather than pretending to be all things to all people, the Fed should concentrate on price stability and leave market forces and the stabilizing properties of the price system to determine employment. Why? Because when the Fed tries to trade off its price stability objective to achieve low unemployment, it may become a source of instability in the economy.

QUESTIONS FOR THE FED TO ANSWER

The Fed needs to answer the following questions:

- (a) What is the Fed's strategy for returning to price stability, and how does it intend to maintain that stability over the long term?
- (b) Does the Fed's pursuit of price stability come at the expense of its employment goal, or is price stability the foundation for achieving maximum employment?

In the interests of accountability and transparency, the public should persuade the Fed to provide answers.

WHERE TO GO FOR ANSWERS

The Federal Reserve should engage in a systematic study of its whole history, judging what policies have worked and what policies have not. Unfortunately, the Fed has had no systematic way of learning from the past. To learn from the experiments in which the Fed has engaged, the makers of monetary policy would have to admit that they have made mistakes. Doing so would go a long way to dispelling the myth that the Fed is a master puppeteer pulling the strings to control the economy while producing an acceptable amount of inflation.