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RESEARCH SUMMARY

How the Federal Open Market Committee Can Start Learning from Experience

The Federal Reserve's FOMC lacks systematic procedures for learning from experience what monetary policies have stabilized the economy and what monetary policies have destabilized it. The standard Fed narrative prevents such learning by assuming that all adverse outcomes arise from external shocks and that the Fed prevents these outcomes from being even worse. In "How the Federal Open Market Committee Can Start Learning from Experience," Robert Hetzel argues that if the Fed cannot admit that it makes mistakes, it cannot learn.

The FOMC Must Articulate the Nature of Its Monetary Standard

The monetary standard is the connection between Fed policy and the behavior of the economy. The Fed should be explicit about the nature of the monetary standard it has created, instead of merely repeating the mantra of how it always pursues "maximum employment" and "price stability." Such explicitness would

- allow evaluation of what monetary policies are optimal for stabilizing the economy; and
- make Fed predictions clear and defensible based on what kind of monetary policies have been stabilizing or destabilizing in the past.

The FOMC Should Have Structured Debate to Clarify Its Monetary Standard

To properly structure this debate, the FOMC should do the following:

- *Establish a monetary history group.* This group would engage FOMC participants in a discussion on the nature of the Fed's monetary standard and place the standard within historical perspective.
- *Restructure the Board of Governors staff document that offers forecasts prior to FOMC meetings.* The staff could use models to explain the evolution of the economy through the current period and to help ensure they do not revert to the standard "Fed narrative" described above. The document would be periodically reviewed and made available to the public with only a brief lag.
- *Modify the Summary of Economic Projections (SEP).* A new SEP would embody a consensus view of all FOMC participants. It would highlight the FOMC's influence over the growth of nominal GDP, which is absent from current policy. It would be presented by the chair at his press conference and include the Board staff forecast, with discrepancies between the two documents explained by the chair.

These changes would force the Fed to articulate the monetary standard that it has created and defend it within the context of past mistakes and successes. Such action would help restore public trust in the central bank and ensure a more stable macroeconomy through increased transparency, accountability, and institutional learning.

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