Recent Trends in Federal Reserve Transparency and Accountability

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Chairman Duffy, Ranking Member Green and other members of the Subcommittee, thank you for inviting me to testify at this hearing on "Fed Oversight: Lack of Transparency and Accountability"

To address current concerns in Congress about a lack of transparency and accountability at the Fed—as expressed by the title of this hearing—it is useful to consider recent historical trends. As Ben Bernanke put it in 2008, "The Congress has also long been aware of the importance of Federal Reserve transparency and accountability. In particular, a series of resolutions and laws passed in the 1970s set clear policy objectives for the Federal Reserve and required it to provide regular reports and testimony to the Congress."

One of the most important moves toward transparency and accountability in the past 25 years occurred in February 1994 when the Fed began to announce its target for the federal funds rate and to report publicly whenever it decided to increase it or decrease it. While Fed monetary policy decisions in the years before that were made in terms of a federal funds rate target, markets had to guess what the target was. The decisions were often communicated by the Fed through the financial press and Fed-watchers in vague and confusing ways, and the Fed was misinterpreted on a number of occasions. The lack of transparency gave an advantage to market

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participants who could get some kind of information about what the decision was. It also adversely affected accountability to Congress and the public about what the Fed was doing, and made it difficult for economists outside the Fed, or people in "civil society" more generally, to comment or do research and analysis on Fed policy.[2] This 1994 transparency reform changed much of that.

The Fed took a number of additional steps to increase transparency in more recent years.[3] In 2005 it cut the time between FOMC meetings and the release of minutes to three weeks, and by 2011 it was releasing economic and interest rate projections of FOMC members and holding quarterly press conferences with the Fed Chair.[4] And in 2012, the Fed announced a numerical target of 2% for the inflation rate.

However, there have been important countervailing trends in transparency during this more recent period. For example, in 2000 the Fed stopped reporting its "ranges of growth or diminution of the money and credit aggregates," for the current and upcoming year. The reporting requirements on the monetary and credit aggregates—first added to the Federal Reserve Act in 1977—were completely eliminated in the American Homeownership and Economic Opportunity Act of 2000. Thus in its Monetary Policy Report in July 2000, the Fed

[2] The fact that the Fed was not talking publicly about its settings for the federal funds rate back then was a source of confusion and much initial criticism over my design for a policy rule for the interest rate in the early 1990s.

[3] By way of comparison economists have found that similar changes were occurring at other central banks. Using numerical indices of transparency, Dincer and Eichengreen (2014) considered 120 countries and found that from 1998 to 2010 only one central bank had a decrease in transparency, 109 had an increase, and ten had no change. The biggest increases were for central banks in emerging market countries—Hungary, Thailand, Turkey, and the Philippines. The central banks of Sweden, New Zealand, Hungary, Czech Republic, England, and Israel were the most transparent by this measure.

[4] In recent years there also has been an increase in the number of speeches and commentary by members of the FOMC, but it is unclear whether this is an increase in transparency, and there is a reasonable argument that so many different voices create confusion.

simply reported that "the FOMC did not establish ranges for growth of money and debt in 2000 and 2001." Labonte (2014) reports that the finding of Crowe and Meade (2008) that the Fed became less transparent from 1998 to 2006 can be traced to the Fed ending its reports on plans and outlook for money growth.

While the reduction in Fed transparency about its strategy for money growth might not seem significant in light of the difficulty of defining and measuring money, it is symptomatic of a broader lack of transparency about the Fed's reporting its strategy for setting the instruments of monetary policy whether they are money growth, the federal funds rate, or the unconventional policy instruments such as quantitative easing, forward guidance or nascent macro-prudential tools.[5]

The inherent difficulty of devising a strategy for the unconventional instruments is one of the reasons the Fed has been reluctant to establish and report a strategy. When he was a Federal Reserve governor, Jeremy Stein stressed the importance of having a rules-based strategy for quantitative easing, but it was difficult because of uncertainty and disagreement about the impacts of quantitative easing on the economy.

There is another reason why the Fed may be reluctant to establish or be transparent about a strategy for the policy instruments, and the reason applies to all the instruments. It is the view that a strategy is not needed if the Fed has goals for the inflation rate or other variables; rather than have a strategy policymakers simply need to do what they think needs to be done with the policy instruments at each point in time. They do not need to articulate or describe a strategy, a decision rule, or a contingency plan for the instruments. But having a specific numerical goal or

[5] Numerical transparency measures such as those used by Dincer and Eichengreen (2014) do not include information about macro prudential instruments.

objective is not a rule for the instruments of policy; it is not a strategy and it ends up being all tactics.

The Fed needs to have a systematic strategy and be clear about it if it is going to be transparent and accountable. As Charles Plosser (2014), former president of the Federal Reserve Bank of Philadelphia, put it: “transparency…could be enhanced if the central bank was more explicit in articulating its systematic approach to policy.”

Consider the Fed’s “Statement on Longer-Run Goals and Monetary Policy Strategy.” It sets the goal for inflation and employment, and it says that the Fed “seeks to mitigate deviations of inflation from its longer-run goal and deviations of employment from the Committee’s assessments of its maximum level” (goals respectively defined as an “inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption” and a “central tendency of 5.2 percent to 5.5 percent” for the unemployment rate).

So while the goals are stated, a strategy for achieving the goals is not, despite the appearance of the word “strategy” in title of the statement. Instead the Fed will apparently do as it sees fit in a discretionary way. As economists Michael Belongia and Peter Ireland (2015) put it “For all the talk about ‘transparency,’… the process—or rule—by which the FOMC intends to defend its two-percent inflation target remains unknown.” At the least the Fed should report on a rule or strategy it uses as a basis for policy decisions. As is well known from Fed transcripts, the Fed uses policy rules and discusses deviations from such rules, so the Fed should report them. It’s a matter of transparency.

The current situation creates a lack of transparency and an environment conducive to benefiting those with information at the expense of others without it. Controversy over the alleged leak of information about quantitative easing in October 2012 provides an example of the problems caused by the discretionary nature of unconventional monetary policy. The decisions about quantitative easing are not something about which the timing, the amount, the path or the exit can be easily described as a strategy. Thus, there is less transparency. Instead there is a series of unpredictable discretionary tactical decisions, and knowledge of each one benefits market participants who can get it. If there were a clear and publically announced strategy for setting the policy instrument over time—as is possible in the case of a conventional instrument like the federal funds rate—then more information about policy would be available to all.

In sum, while changes at the Fed—such as the establishment and announcement of a numerical inflation goal— have increased transparency and accountability in recent years, reluctance to establish and announce a strategy to achieve this goal has created a countervailing trend. Requirements for the Fed to report its strategy for its policy instruments and other procedural reforms are needed to address the resulting lack of transparency and accountability.

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