INFLATION TARGETING GOALS FOR THE FEDERAL RESERVE

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Executive Summary

Recently, growing support has emerged endorsing the concept of price stability as the principal policy objective for Federal Reserve monetary policy. After outlining current monetary institutional arrangements and related congressional responsibilities, this paper details the reasons for and benefits from stabilizing the purchasing power of money. This objective has been endorsed not only by many of the world's most esteemed monetary economists but also by many Federal Reserve officials. Evidence demonstrates that price stability in the form of inflation targets can work quite well. Under such an approach, the central bank would set upper and lower bounds of inflation target ranges defined as percentage increases in a broad price index. Furthermore, the approach allows for ample monetary policy flexibility and there are several reasons why now is an opportune time to adopt this approach. Finally, certain market price indicators appear to be especially well-suited to serve as policy guides in such a price stabilizing monetary policy strategy.

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INTRODUCTION

In recent years, several Members of Congress have endorsed the concept of price stability as the principal policy objective for Federal Reserve monetary policy.[1] The Joint Economic Committee (JEC) has published several studies examining the viability of such an approach for our central bank.[2] This paper builds on these earlier contributions in making the case for establishing inflation goals for the Federal Reserve. After outlining current monetary institutional arrangements and related congressional responsibilities, this paper details the reasons why the goal of stabilizing the purchasing power of money is appropriate. The paper proceeds to demonstrate that a price stability goal (1) has a rich historical heritage, (2) recently has been successfully adopted in several countries, (3) has worked informally in the United States in recent years, and (4) has been endorsed by a number of Federal Reserve officials.

Although inflation has receded and Chairman Greenspan has substantial credibility as an inflation fighter, the paper highlights several important reasons why now is an opportune time to adopt explicit inflation targeting. Finally, while inflation targeting can theoretically operate successfully with alternative intermediate indicators under "instrument (or indicator) independence," in practice, certain market price indicators appear to have performed quite well as policy guides and offer a number of distinct advantages over existing alternatives in helping to achieve price stability.

BACKGROUND: INSTITUTIONAL ARRANGEMENTS, CONGRESSIONAL RESPONSIBILITIES, AND PREVIOUS APPROACHES

In order to assess the appropriateness of adopting the monetary policy goal of price stability, some background material—a brief review of the current monetary regime as well as associated congressional responsibilities—is essential.

The Current Monetary Regime

A cogent description of current monetary institutional arrangements perhaps is best provided by Milton Friedman:

> ... a world monetary system has emerged that has no historical precedent: a system in which every major currency in the world is, directly or indirectly, on an irredeemable paper money standard . . . It is worth stressing how little precedent

[1] In the context of this paper, the policy of "price stability" will generally refer to inflation targeting whereby target bands for changes in a conventional broad price index or measure of inflation are used to guide policy.
[2] See, "Compendium of Staff Studies on Monetary Policy," Joint Economic Committee, November 1998.

> there is for the present situation. Throughout recorded history . . . commodity money has been the rule. So long as money was predominantly coin or bullion, very rapid inflation was not physically feasible . . . The existence of a commodity standard widely supported by the public served as a check on inflation . . . The key challenge that now faces us in reforming our monetary and fiscal institutions is to find a substitute for convertibility into specie that will serve the same function: maintaining pressure on the government to refrain from its resort to inflation as a source of revenue. To put it another way, we must find a nominal anchor for the price level to replace the physical limit on a monetary commodity.[3]

In other words, the emergence of fiat money, flexible exchange rate arrangements (after the demise of the Bretton Woods System in the early 1970s), means there is no reliable mechanism anchoring the price system; no reliable store or standard of value exists.[4] Instead, the stability of the current monetary regime fully depends on the competence of central bankers to provide these critical functions of a dependable monetary system: to substitute for the reliability of a commodity standard.

Congressional Authority

At the same time, the Congress has clear legal authority over regulating the value of money. Specifically, the U.S. Constitution (Article I, Section 8) explicitly gives Congress the power over money and the regulation of its value. This responsibility was delegated by Congress to the Federal Reserve; the Federal Reserve was created by an act of Congress. This delegation implies that Congress has important responsibilities for overseeing the conduct of Federal Reserve monetary policy.

Of course, at the time of the creation of the Federal Reserve and for most of the period until the demise of the Bretton Woods System, the United States was on some form of commodity standard so that no explicit price anchor mandate was essential.[5] With the emergence of fiat money/flexible exchange rate arrangements in the early 70s, however, such a mandate—which Congress clearly has the authority to implement—is appropriate.

The Failure of Other Approaches

Unfortunately, inappropriate or multiple and conflicting monetary policy goals for the Federal Reserve have been prescribed and found wanting during much of the period since the

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[3] Milton Friedman, "Monetary Policy in a Fiat World," in Money Mischief: Episodes in Monetary History, Harcourt Brace Jovanovich, New York, 1992, pp. 249, 252-4.

[4] Furthermore, current monetary arrangements are unlikely to change in the near future. Specifically, because the potential for sharply changing demands for international monetary reserves is associated with the rapid growth of emerging markets and the evolution of the European Monetary Union, a near-term stable, international monetary anchor appears unlikely.

[5] With the existence of a fixed exchange-rate gold standard at the time the Federal Reserve was created, monetary policy was not seen as a potent tool of government economic policy making. (Federal Reserve policy was guided by the behavior of the gold reserve ratio following Central Bank practice under the gold standard.) Accordingly, congressional oversight was not seen as a high priority responsibility. With the emergence of the fiat system described above, this mechanism has changed, and monetary oversight now is accorded more importance.

demise of Bretton Woods. In part, such prescription reflects Keynesian predilection for attempting to manage real economic activity and full employment macroeconomic policy goals, culminating in the *Full Employment and Balanced Growth Act of 1978* (Humphrey-Hawkins Act). This Act prescribes multiple and sometimes conflicting policy goals and, accordingly, has made it more difficult to achieve the key objective of monetary policy -- price stability.

But (intermediate) monetary targeting for the Federal Reserve also was prescribed during this period. These monetary targets proved less reliable than expected for a number of reasons relating partly to financial deregulation.

This post-Bretton Woods experience has culminated in the growing awareness that price stability is the single preeminent goal for monetary policy; a monetary standard securely anchoring the price system is essential. This view is now embodied in current inflation targeting legislation introduced by Congressman Saxton in previous Congresses. This legislation would require the Federal Reserve to define upper and lower bounds of inflation target ranges.

RATIONALE FOR ADOPTING THE GOAL OF PRICE STABILITY

Given this background, it is natural that Congress should move to consider making price stability the explicit key objective for monetary policy. A number of specific reasons indicate why price stability is the appropriate primary monetary policy goal; these reasons relate not only to efficient provision of monetary services but also to minimizing the disruptive costs of inflation.

- **Price stability enables money to best perform its various functions:** Money can best provide its functions of a medium of exchange, a store of value, and a standard of value under a regime fostering price stability. Such stability anchors the price system so that comparative values can be established and accurately measured.

- **Price stability enables the price system to work better:** Price stability enables the price system—the information or signaling mechanism of free-market economies—to function effectively by directing resources to their most beneficial use. Price stability is associated with both lower inflation volatility and with lower (relative) price dispersion than inflationary circumstances. Lower inflation reduces the variability between individual prices or reduces the noise and distortion in the price system.[6] This allows the price system to better serve its information and allocative functions. As a result, the economy operates more efficiently and therefore grows faster.

- **Price stability promotes transparency, accountability, and credibility:** Explicitly adopting price stability as the principal monetary policy goal serves to promote transparency, accountability, and credibility to monetary policy.

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6 See, for example, Guy Debelle and Owen Lamont, "Relative Price Variability and Inflation: Evidence From U.S. Cities," Journal of Political Economy, vol. 105, no. 1, February 1997.

Furthermore, explicit inflation targets reduce incentives of the monetary authority to renege or backslide on its commitment to price stability.

- **Price stability enhances fiscal discipline:** Explicit price or inflation targeting prevents the use of inflation as a revenue source for the government. More specifically, price stability minimizes seignorage as well as government's ability to reduce its outstanding debt via inflation. Moreover, price stability minimizes those interactions of inflation with non-indexed portions of the tax code that effectively result in higher taxation. Lowering inflation, therefore, in some ways acts like a tax cut by removing these potential sources of revenue.[7]

Moreover, adopting the goal of price stability and moving to lower inflation has a number of beneficial economic effects relating to minimizing the distortive costs of inflation:

- **Price stability lowers interest rates:** A credible, sustained reduction of inflation will lower expectations of future inflation. Accordingly, the inflationary expectations component of interest rates will dissipate from the structure of both short- and long-term interest rates and interest rates will decline.

- **Price stability works to stabilize financial markets and interest-sensitive sectors of the economy:** As inflation diminishes, the variability of inflation also is reduced. Lower inflation is associated with lower volatility of inflation. Accordingly, financial markets have less tendency to overshoot or undershoot their fundamental values. This lower volatility has the effect of reducing uncertainty premiums of interest rates, resulting in lower real interest rates. And financial markets tend to become more stable and predictable. Thus, lower inflation stabilizes financial markets. As a result, market participants tend to become more confident or self-assured and more willing to invest, take risk, and innovate. Businesses are better able to plan and coordinate, thereby improving efficiency. Furthermore, this enhanced financial stability works to stabilize interest-rate-sensitive sectors of the economy and, therefore, the macro economy as well.

- **Price stability promotes growth:** By enabling the price system to work better, enhancing fiscal discipline and minimizing tax distortions, lowering interest rates, and helping to stabilize both financial markets and interest-sensitive sectors of the economy, price stability promotes economic growth. Resources can engage in productive activities rather than finding ways to circumvent costs of inflation. Several recent empirical studies have found that lower inflation is associated with higher growth.[8]

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[7] This argument is especially relevant in circumstances when tax limitation provisions and/or balanced budget regimes are being implemented: i.e., when stricter fiscal regimes are put in place. It is in these circumstances that government likely will look for new revenue sources.

[8] See, for example, Robert Barro, "Inflation and Economic Growth," National Bureau of Economic Research Working Paper No. 5326, October 1995; Brian Motley, "Growth and Inflation: A Cross-Country Study," Center for Economic Policy Research, publication no. 395, March 1994; and Todd E. Clark, "Cross-Country Evidence on Long-Run Growth and Inflation," Economic Inquiry, vol. 35, no. 1, January 1997.

- **Price stability in the U.S. can serve to foster global price stability:** In an increasingly integrated financial world, the U.S. dollar continues to serve as the world's principal international money, acting as the world's leading key, reserve, and vehicle currency. Further, a number of countries have (officially or unofficially) dollarized their economies and others continue to attach or peg their currencies to the dollar. Given this international reserve status, it is recognized that the Federal Reserve can serve as an international lender of last resort.[9] As a consequence of these characteristics, changes in U.S. monetary policy can have important international repercussions for the world's industrial, emerging and transition economies.[10] In these circumstances, the pursuit and achievement of price stability by the U.S. can significantly contribute to promoting world price stability; it fosters dollar-based-area stability and a stable global benchmark or "standard." Such a stable price environment simplifies the pursuit of price stability in many other countries.

ADDITIONAL CONSIDERATIONS

In addition to these important reasons for adopting price stability as the primary goal of monetary policy, a number of additional considerations lend further support to the argument.

(1) Historically, this view has been endorsed by many of the world's most preeminent monetary economists: Support for the goal of price stability under fiat money is, of course, not novel. Many of the economic profession's most revered monetary writers have supported this objective.

Probably history's most famous monetary debate occurred during the Napoleonic era when Britain went off the gold standard. During this period, classical bullionist writers such as Henry Thornton and David Ricardo recognized that under these circumstances the Bank of England had responsibility to regulate the value of money; in effect, to provide a stable monetary standard substitute for gold convertibility. This endorsement of price stability under fiat money was later supported by such eminent economists as John Stuart Mill and Alfred Marshall. Knut Wicksell further refined existing approaches to achieving price stability; his views were widely embraced by other Swedish economists such as Gustav Cassel. Famous British economists during the interwar period such as Ralph Hawtrey and John Maynard Keynes also endorsed price stability as the appropriate goal for monetary policy.[11] The view was also supported by respected economists in the United States such as Irving Fisher, Henry Simons, and Lloyd Mints, as well as most modern-day monetarists.[12]

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[9] See Robert E. Keleher, "An International Lender of Last Resort, the IMF, and the Federal Reserve," Joint Economic Committee, February 1999.

[10] See Robert E. Keleher, "International Dimensions to U.S. Monetary Policy," Joint Economic Committee, August 2000.

[11] This support is especially evident in Keynes' Tract on Monetary Reform, as well as his Treatise on Money.

[12] A history of the price stabilization movement was published by Irving Fisher in 1934. See Stable Money: A History of the Movement. Adelphi Co., New York, 1934.

(2) Both historical and contemporaneous evidence indicate that the price stability objective can work quite successfully: A good deal of empirical evidence shows that price stability or inflation targeting regimes have worked successfully. Historically, the first such regime was the Swedish price stabilization regime of the early 1930s. Upon suspending gold payments in 1931, Swedish authorities explicitly announced the adoption of a price stability standard, a monetary policy explicitly directed to stabilize the internal purchasing power of the Swedish krona. The policy was remarkably successful: prices were stabilized, contributing significantly to the stability of the domestic economy and insulating the Swedish economy from the 1930s' worldwide depression.[13]

More recently, inflation targeting regimes have been implemented in a number of countries. Explicit, quantifiable inflation targets have been adopted, for example, in 18 countries as recently documented by Mishkin and Schmidt-Hebbel (2001). These countries include industrialized, emerging market, and transitional economies. After reviewing and assessing recent empirical research evaluating a decade of worldwide experience with inflation targeting, these authors conclude that "inflation targeting has proven to be a very successful new monetary framework, both in comparison to inflation targeters' preceding experience and relative to alternative monetary regimes adopted by a control group of highly successful industrial countries that had in place other monetary arrangements during the 1990s."[14]

Other studies corroborate these conclusions. In general, the evidence to date is promising and indicates that inflation targeting policies for the most part have been quite successful. Those countries adopting a price stability goal, for example, significantly improved their inflation performance. Specifically, most of these countries have dramatically lowered their inflation rates since adopting targets for inflation, often to lower rates not observed for decades. One preliminary study showed that those countries adopting explicit inflation targets outperformed other countries not only in terms of lowering inflation but in a number of other criteria as well.[15] Overall, this evidence underscores the argument that explicit, quantifiable goals of price stability can be implemented successfully.

After examining the recent evidence on inflation targeting, the IMF's former Acting Managing Director Stanley Fischer stated that:

> …the experience shows that this (inflation targeting) approach has done well under a variety of circumstances that 10 years ago would have raised legitimate doubts on whether the framework would hold up.[16]

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[13] The Swedish experience led Irving Fisher to assert that "This achievement of Sweden will always be the most important landmark up to its time in the history of (price) stabilization," Irving Fisher, Stable Money, Adelphi Co., New York, 1934, pp. 408-9. (parenthesis added). For further documentation of this episode, see Manuel Johnson and Robert Keleher, Monetary Policy, A Market Price Approach, chapter 13, Quorum Books, Westport, Connecticut, 1996.

[14] Frederic S. Mishkin and Klaus Schmidt-Hebbel, "One Decade of Inflation Targeting in the World: What Do We Know and What Do We Need to Know?" National Bureau of Economic Research, Working Paper 8397, July 2001, p.11.

[15] See, for example, Bennett T. McCallem, "Inflation Targeting in Canada, New Zealand, Sweden, the United Kingdom, and in general," National Bureau of Economic Research Working Paper no. 5579, May 1996. p. 9.

[16] Stanley Fischer, "Opening Remarks Given at the IMF Institute's High-Level Seminar on Implementing Inflation Targets," the IMF, Washington, D.C., March 20-21, 2000, p.5. (parentheses added)

In short, the evidence indicates that explicit inflation targeting can prove quite successful for a variety of different types of economies.

(3) Recent Federal Reserve policy focus on price stability has also been successful: The Federal Reserve's emphasis on price stability in recent years has also worked to lower inflation, and contributes to sustaining economic expansion. While the Federal Reserve has not adopted explicit, quantifiable inflation targets like the central banks of countries cited above, Fed Chairman Greenspan has suggested that, in essence, "informal" inflation targeting has been pursued, although he later testified that he was not currently in favor of strict, quantifiable inflation targets.[17]

Indeed, several researchers have examined U.S. monetary policy in recent periods and concluded that the Federal Reserve has likely pursued an implicit or informal inflation targeting rule. Mishkin, for example, argues that the Federal Reserve has pursued a monetary policy that involved an implicit nominal anchor, close to an explicit inflation targeting strategy.[18] Mishkin goes on to argue that "through their testimony and speeches, high officials in the Federal Reserve System, and especially Alan Greenspan, have made it quite clear that the overriding long-run goal for Fed monetary policy is price stability… and it is fair to characterize the Fed as having an implicit nominal anchor."[19] Other researchers have employed empirical techniques to estimate the Fed's goals and objectives. For example, Dennis (2002) estimates the Fed had an implicit inflation target of about 1.4% and argues that his results are consistent with the Federal Reserve having a long-run inflation target.[20]

Over time, this Federal Reserve anti-inflation policy has gained credibility and worked to lower interest rates, stabilize financial markets and interest sensitive sectors of the economy, promote the efficient operation of the price system, and, in effect, act like a tax cut in many ways.[21] All of this has contributed to promoting sustained economic expansion and further demonstrates the value of price stability as a principal monetary policy goal.

(4) Price stability as the principal goal of monetary policy has been endorsed by several Federal Reserve policy-makers: Adopting price stability as the primary goal of monetary policy has received the support of many academic economists as well as many officials and policy-makers within the Federal Reserve system itself. For example, Federal Reserve regional bank presidents from the New York, Richmond, St. Louis, San Francisco, and

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[17] See, for example, Chairman Greenspan's testimony before the Joint Economic Committee; *The Economic Outlook and Monetary Policy*, Hearing before the Joint Economic Committee, One Hundred Fifth Congress, First Session, October 29, 1997, p.14.
[18] See, for example, Mishkin and Schmidt-Hebbel, op. cit., p.8; Frederic S. Mishkin, "Monetary Policy," NBER Reporter, Winter 2001/2002, p.10; see also N. Gregory Mankiw, "U.S. Monetary Policy During the 1990s", NBER Working Paper 8471, September 2001, p.53.
[19] Frederic S. Mishkin, "What Should Central Banks Do?" Review, Federal Reserve Bank of St. Louis, November/December 2000, Volume 82, Number 6, p.8-9.
[20] Richard Dennis, "Inferring Policy Objective from Policy Actions," FRBSF Economic Letter Number 2002-10, April 5, 2002, pp.2-3.
[21] See Robert Keleher, "The Roots of the Current Expansion," a Joint Economic Committee study, April 1997, and Robert Keleher, "Assessing the Current Expansion," a Joint Economic Committee study, February 2000, for a more detailed discussion of the contribution of monetary policy to the sustainability of economic expansion.

Cleveland banks have all explicitly endorsed price stability as monetary policy's primary policy goal.

RESPONSE TO CRITICISM

A number of criticisms have been directed at price stability or inflation targeting as the primary goal of monetary policy. One of these criticisms is that such a strategy would remove monetary policy's flexibility. With fiscal policy focused on renewed deficits and thereby constrained so that it cannot readily be used for stabilization policy, it is argued that monetary policy is the only macropolicy tool left for this purpose and therefore should remain relatively unencumbered.

This criticism is misplaced for several reasons. Certainly the international experience with inflation targeting provides ample evidence that, in practice, inflation targets leave room for considerable flexibility. In particular, inflation targets normally consist of bands rather than point estimates and are often multi-year in nature. The relevant targeted inflation index often is adjusted for volatile (supply-side) components. And even after such adjustment, some countries allow for further exceptions or escape clauses to specified targets. All of these considerations allow for considerable flexibility, yet maintain a focus on long-term price stability.

Furthermore, if unanticipated shocks are "demand-side" in nature, inflation targets automatically direct appropriate monetary policy responses that work to stabilize the economy. Finally, by adopting inflation rather than price level targets, some accommodation of unanticipated one-time supply-side shocks are allowed for (i.e., inflation targets do not require offsetting deflation and hence associated economic disruption as do price level targets).[22] In sum, inflation targets retain a good deal of flexibility for monetary policy.

A number of other criticisms directed at price stability or inflation targeting as the primary goal of monetary policy also have been addressed and refuted in earlier JEC studies; these arguments will not be repeated here.[23]

THE OPPORTUNE TIME TO ADOPT INFLATION TARGETS

Although inflation has receded and hence price stability is no longer emphasized so often in the headlines, there are several important reasons why now is an opportune time to adopt inflation targets.

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[22] Because offsetting deflation is not required by inflation targets, these targets embody "base drift" (an ever-increasing price level). In other words, inflation targets imply that the price level becomes "non-stationary"; once disturbed, the price level does not return to its previous level. Because of this characteristic, inflation targets are associated with greater long-term variance and uncertainty of prices. Nonetheless, because inflation targets enhance policy flexibility, they are viewed as more realistic politically.

[23] See Robert Keleher, "A Response to Criticisms of Price Stability," a JEC study, September 1997.

- **Cement current gains:** Adopting inflation targets would ensure that many beneficial economic effects of low inflation are maintained. Such targets are easiest to implement when inflation is already low, political opposition is relatively weak, and price stability has attained a degree of credibility as a proper goal for monetary policy. In short, the current period is a politically opportune time to cement gains and hard won credibility, thereby minimizing the cost of moving to price stability.[24] Adopting formal inflation goals now when political barriers are relatively low ensures that procedures for maintaining price stability are in place when inevitable difficult tightening decisions have to be made in the future.

- **Remove incentives to backslide:** As memories of high inflation fade, interest groups increasingly emphasize near-term benefits of stimulative monetary policy: demands for monetary relief from adverse changes in interest rates, foreign exchange rates, or output proliferate. Implementing explicit inflation targets would serve to insulate the Federal Reserve from such political pressures.

  Furthermore, without inflation targets, incentives grow for inflationary policies when inflation is low. Specifically, shortsighted policy-makers recognize that surprise (unexpected) expansionary policies are more potent than expected policy changes. So when inflation is reduced and is expected to remain subdued, stimulative policies that are a surprise have a larger economic-boosting impact. In short, as inflation is reduced, incentives increase for policy-makers to unexpectedly stimulate the economy. Pre-commitments to explicit inflation targets reduce these perverse incentives.

- **Govern by rules rather than by men:** While the Federal Reserve has performed admirably under the regimes of Chairman Volcker and Greenspan, there is no guarantee that it will continue to perform so well in the future under different management. Institutionalizing and depersonalizing the goal of price stability will help ensure that Federal Reserve performance depends more on a transparent system of rules rather than upon the vagaries of individuals and is less prone to political manipulation or pressure. Adopting such rules would provide a political buffer, preventing future administrations from manipulating monetary policy when there are incentives to do so.

  The current period and economic environment provides a window of opportunity for establishing inflation targets. Implementing inflation targets under such circumstances would be easier and timelier than establishing inflation targets under the reign of a newly-appointed Chairman and potentially undermining that individual's inflation-fighting credibility.

[24] Inflation targets should be introduced when there is a realistic chance of reducing inflation (i.e., when inflation is low or trending down); credibility is important for inflation targeting and hitting the first target is especially significant for establishing such credibility. See Charles Freedman, "The Canadian Experience with Targets for Reducing and Controlling Inflation," Inflation Targets, edited by Leonard Leiderman and Lars Svensson, Center for Economic Policy Research, Glasgow, 1995, p.28.

PROMISING POLICY INDICATORS

Hypothetically, there are several types of policy guides that the Federal Reserve can use to target inflation or pursue a price stabilizing monetary policy. In practice, successful inflation targeting has for the most part involved establishing explicit inflation goals while allowing for instrument (or intermediate indicator) independence (that is, establishing explicit objectives for the central bank but allowing the monetary authority determine for itself the best methods and guides to use in achieving these specified goals).

The JEC, however, has recommended using a market price approach in pursing price stability. A detailed description of this approach has been given elsewhere and will only be briefly summarized here.[25] This approach uses certain market price indicators -- broad indices of commodity prices, various measures of the foreign exchange value of the dollar, and long-term bond yields -- as guides for price-stabilizing monetary policy. All of these sensitive market prices yield early warning signals pertaining to changes in the value of, or price of money; i.e., relevant to movements in the general price level. These market prices are intended to serve as informational indicators, not policy targets. Other things equal, each indicator can signal the relative “ease” or “tightness” or monetary policy.

These market prices have numerous distinct advantages over competing intermediate indicators of monetary policy. Such market price data, for example, are observable, easy-to-understand, timely, and readily available, literally minute-by-minute. They are accurate, less subject to sampling error, and unaffected by revision, rebenchmarks, seasonal adjustments, or shift-adjustments that sometimes plague quantity data. Several formal studies investigating the usefulness of various forms of economic statistics conclude that market price data are superior to other forms of data.[26] Furthermore, they are forward-looking and can signal future changes in inflation and inflationary expectations. If these market price indicators are carefully assessed in conjunction with one another, they can be useful forerunners of inflation and helpful guides for a price-stabilizing monetary policy.

Indeed, these indicators appear to have yielded accurate signals to price stabilizing monetary authorities and performed quite well as intermediate guides in an “inflation targeting” context.[27] These market price indicators, therefore, readily complement the goal of inflation targeting and thus appear to be an appropriate set of guides for such an objective.

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[25] For a thorough description of this approach see Manuel Johnson and Robert Keleher, Monetary Policy: A Market Price Approach, Quorum Books, Westport Connecticut, 1996.
[26] See, for example, Oskar Morgenstern, On the Accuracy of Economic Observations, Princeton University Press, Princeton, N.J., 1963, and Victor Zarnowitz, “On Functions, Quality, and Timeliness of Economic Information,” NBER Working Paper Series, No. 608, December 1980.
[27] See, for example, Robert Keleher, “The Performance of Current Monetary Policy Indicators” A JEC Study, October 2000; and Johnson and Keleher, op. cit., chapter 12 and 13.

SUMMARY AND CONCLUSIONS

Currently, our fiat money system has no reliable price anchor or standard of value. At the same time, Congress has the legal authority and oversight responsibility for regulating the value of money and providing for such an anchor. There are many reasons for and benefits from adopting price stability as the primary goal of monetary policy. This objective has been endorsed not only by many of the world's most esteemed monetary economists but also by many Federal Reserve officials. Evidence demonstrates that price stability in the form of inflation targets can work quite well. Furthermore, the approach allows for ample monetary policy flexibility and there are many reasons why now is an opportune time to adopt this approach. Finally, certain market price indicators appear to be especially well-suited to serve as policy guides in such a price stabilizing monetary policy strategy.

The time has come to introduce price stability as an explicit legislative goal for monetary policy. Such legislation deserves the support of both Houses of Congress.

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