The House Financial Services Committee held a hearing on Federal Reserve reform on July 10. The hearing didn’t get much press attention. But it was remarkable. While the House can’t manage to engage on important issues like tax reform, immigration reform and the minimum wage, it’s more than willing to propose radical “reform” of one of the few national policies that is working well.

The bill under consideration is called the Federal Reserve Accountability and Transparency Act. (That’s right: FRAT.) To be fair to an otherwise dreadful bill, accountability and transparency are worthy objectives, and FRAT does include some reasonable ideas, such as trimming the news blackouts before and after meetings of the Federal Open Market Committee. But it also includes some corksers, such as requiring public disclosures—in advance—before entering into international negotiations, disclosures that could make such negotiations next to impossible. How would you like to play your poker hand open?

But the meat-and-potatoes of the House bill has little to do with either transparency or accountability. Instead, it seeks to intrude on the Fed’s ability to conduct an independent monetary policy, free of political interference.

As the title of Section 2 puts it, FRAT would impose "Requirements for Policy Rules of the Federal Open Market Committee." A "rule" in this context means a precise set of instructions—often a mathematical formula—that tells the Fed how to set monetary policy. Strictly speaking, with such a rule in place, you don’t need a committee to make decisions—or even a human being. A handheld calculator will do.

In the debate over such rules, two have attracted the most attention. More than 50 years ago, Milton Friedman famously urged the Fed to keep the money supply growing at a constant rate—say, 4% or 5% per year—rather than varying money growth to influence inflation or unemployment.

About two decades ago, Stanford economist John Taylor began plumping for a different sort of rule, one which forces monetary policy to respond to changes in the economy—but mechanically, in ways that can be programmed into a computer. While hundreds of “Taylor rules” have been considered over the years, FRAT would inscribe Mr. Taylor’s original 1993 version into law as the "Reference Policy Rule." The law would require the Fed to pick a rule, and if their choice differed
substantially from the Reference Policy Rule, it would have to explain why. All this would be subject to audit by the Government Accountability Office (GAO), with prompt reporting to Congress.

In a town like Washington, the message to the Fed would be clear: Depart from the original Taylor rule at your peril. Federal Reserve Chair Janet Yellen understands this and, as she made clear in her semiannual testimony to the House Financial Services Committee on Wednesday, opposes the bill.

So what is this rule that FRAT would turn into holy writ? It's a simple equation, which starts by establishing a baseline federal-funds rate that is two percentage points higher than inflation; that's about 3.5% now. It then adds to that baseline one-half of the amount by which inflation exceeds its 2% target (that "excess" is now roughly minus 0.5%). Next, it adds one-half the percentage amount by which gross domestic product exceeds an estimate of potential GDP (that gap is controversial but is perhaps minus 4% today). Thus Taylor's mechanical rule wants the current fed-funds rate to be about 3.5 – 0.25 – 2.0 = 1.25%—which is vastly higher than the actual near-zero rate.

Fed staff could no doubt concoct an alternative rule that instructed the FOMC to set the fed-funds rate close to zero today, and the committee could pretend it was using that rule. That's transparency?

But there is a deeper problem. The Fed has not used the fed-funds rate as its principal monetary policy instrument since it hit (almost) zero in December 2008. Instead, its two main policy instruments have been "quantitative easing," which is now ending, and "forward guidance," which means guiding markets by using words to describe future policy intentions. If words are the Fed's main policy instrument, how is the FOMC supposed to set them according to a rule? And how can the GAO determine whether that rule resembles the "Reference Policy Rule"?

The Taylor rule probably would give the Fed sensible instructions in normal times. But what about when the world is far from normal? The Fed claimed to be using Friedman's money growth rule during the tumultuous disinflation of 1979-82—with miserable results. Luckily for all of us, the Taylor rule wasn't tried during the 2008-09 financial crisis. That could have been disastrous, effectively tying the Fed's hands just when extraordinary monetary stimulus was most needed. Should we now bet the ranch that the world will remain placid forever?

Conservatives distrust concentrated government power—an idea embraced by our Constitution. They worry that human beings, who are fallible and maybe not even trustworthy, will make poor policy choices. Yes, to err is human. But humans can often recognize extraordinary events and try to adapt. Mechanical rules can't.

There is another conservative principle in which I've always believed: If it ain't broke, don't fix it.
Monetary policy is one of the few things in today’s Washington that "ain’t broke." The mischievous FRAT wouldn’t fix it.

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