Yellen Balks at Proposal to Tie Rates to Formula

Fed Chief Says Republican Bill Would Lead to Political Meddling in Central Bank's Affairs

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Federal Reserve Chairwoman Janet Yellen pushed back against House Republicans’ proposal to require the central bank to adopt a formal, mathematical rule to guide its interest-rate decisions.

Ms. Yellen, responding to some of the toughest questioning she has faced on Capitol Hill since becoming the Fed’s leader in February, said provisions in a recently introduced House bill would lead to greater political meddling in the Fed’s affairs, curtailing its independence and constraining the ability of policy makers to manage crises.

"It would be a grave mistake for the Fed to commit to conduct monetary policy according to a mathematical rule," Ms. Yellen told the House Financial Services Committee on Wednesday, amplifying her message in testimony to the Senate Banking Committee a day earlier.
The House bill would require the Fed to adopt a mathematical formula for determining the appropriate level for its benchmark short-term interest rate, which influences other borrowing costs across the economy. The bill's proponents cite as an example the so-called Taylor rule, devised by Stanford University economics professor John Taylor, which calculates the ideal level of the rate based on changes in several economic variables.

Ms. Yellen defended the Fed's position of holding interest rates lower than such a rule would prescribe, saying, "It is utterly necessary for us to provide more monetary-policy accommodation than those simple rules would have suggested."

Several GOP lawmakers challenged her view. "The overwhelming weight of evidence is that monetary policy is at its best in maintaining stable prices and maximum employment when it follows a clear, predictable monetary policy rule," said committee Chairman Jeb Hensarling (R., Texas).

The debate comes as Fed officials are considering when to start raising interest rates. They have held their benchmark rate near zero since late 2008 to boost economic growth. Mr. Taylor, who testified in favor of the bill at a House committee hearing last week, has said his rule indicates the rate should be above 1%.

Economists have been debating for years the relative merits of basing interest rate policy on rules versus discretion—that is, whether they should adhere to a mathematical formula or maintain some flexibility to respond based on circumstances and judgment. Mr. Taylor and some Fed officials are in the first camp, saying rules-based policy-making creates more predictability and transparency, leading to better economic outcomes. Ms. Yellen and other Fed officials are in the latter camp. She said Wednesday that the recent recession would have been deeper if the Fed had stuck closely to the Taylor rule.

The House bill also would allow the Government Accountability Office to audit the Fed's monetary policy discussions if the Fed doesn't adopt a rule for guiding interest rates.

The central bank's leaders have long opposed lawmakers' proposals to audit the Fed's interest rate deliberations, arguing it would undercut the central bank's ability to set rates free of political interference.

Congressional Republicans have led a number of efforts in recent years to overhaul the Fed or open its operations to greater scrutiny. A bill that would have led to an audit of the central bank's policy deliberations passed the House in 2012 with bipartisan support but died in the Senate without a vote.

Public criticism of the Fed has grown since the 2008 financial crisis, when the central bank began engaging in high-profile and unconventional policies intended to stabilize the financial system and, subsequently, to bolster the U.S. economy.

Attitudes toward the Fed's leaders have become more polarized along party lines in recent years. When Chairman Alan Greenspan left office in 2006, he was popular among Democrats, Republicans and independents. When Chairman Ben Bernanke stepped down early this year, a Gallup poll found most Democrats approved of him while most Republicans disapproved.

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