WASHINGTON, DC—A group of economists who watch and critique the Federal Reserve’s conduct of monetary policy today urged the Fed to slow the growth of the money supply and resist pressures to lower interest rates.

“The risk of higher inflation remains,” said the six-member Shadow Open Market Committee in a statement. “It would be a mistake for the Federal Reserve to lower interest rates and expand money growth.”

Fears of deflation expressed in some quarters are founded on faulty premises, the group said. Instead, it asserted, there is continuing evidence of broad inflationary pressure and consequently a need to reduce growth of the monetary base. The group said the Federal Reserve should slow the growth of the base to 4 percent per year, a rate consistent with long-term economic growth and price stability.

“Domestic demand growth continues strong, while domestic production has been suppressed with the widening trade deficit,” said the committee.

The committee also advised against the Federal Reserve’s trying to cure the economic ills of other countries or rescue their creditors by adjusting interest rates here downward.

“The Federal Reserve has responsibility to serve as lender of last resort to domestic financial markets. The Federal Reserve is not—and it cannot be—manager of the world economy. U.S. monetary policy cannot offset the effects on the world economy of a decline in the relative prices of oil or commodities. Nor can it correct for the misguided policies in Japan or Brazil,” the statement said.

The committee’s sessions yesterday and today marked completion of 25 years of semiannual meetings, and it noted that there have been gratifying improvements in the Federal Reserve’s conduct of monetary policy in that time.

“Our initial purpose was to improve monetary policy and policy discussion,” said the group’s statement. “At the time we advocated a policy of gradual disinflation,” it noted, a view that it said, “differed from the mainstream view of that time.”
“We are pleased to look back and see the change in mainstream thinking that has occurred,” the statement continued. “We have often been able to praise the Federal Reserve during the past five years. The Federal Reserve has improved its actions, its discussions, and its accountability;”

While the committee believes the conduct of monetary policy is much improved, it said more remains to be done to guard against a return to what it views as mistaken behavior of the past.

“The Federal Reserve has not made a formal commitment to long-term price stability, to be achieved at lowest cost. Once memories of the costs of inflation fade, or there is a change in membership and leadership, the Federal Reserve could return to past policies. Indeed, our statement today reflects the fact that recent discussions, pressures from the financial community, and from abroad encourage a return to the policies that failed in the past.”

To avoid such a retreat to failed policies, the committee said, “We will continue to urge the Federal Reserve to develop and adopt systematic rules for monetary policy. These rules should aim at the long-term goal of zero inflation. Several other countries have moved decisively in that direction with good results. It is past time for the Federal Reserve to do the same.”