

Hold for Release Until 11:00 a.m., Monday, December 5, 2005

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WASHINGTON, DC -- The Shadow Open Market Committee today applauded Alan Greenspan for his successful chairmanship of the Federal Reserve and stated that Ben Bernanke would be an excellent successor. Noting that Bernanke has publicly supported explicit inflation rate targeting in the conduct of monetary policy, the committee urged him to “take the appropriate steps to move the Federal Reserve in that direction.”

To do so, he will need to develop a consensus within the Fed and educate the public that maintaining price stability is consistent with the Fed’s dual statutory mandate to maintain low unemployment as well as low inflation.

“Keeping inflation low and stable is the best way to promote economic growth and employment, thus satisfying both objectives,” the committee stated at its semiannual meeting.

Noting that headline inflation has crept up to 4.9 percent, the committee urged the Fed to adopt a more aggressive monetary stance “to ensure that inflation and inflationary expectations do not take root.” The committee said that further increases in the federal funds rate will likely be required to keep the monetary base growth rate near the desired 4 percent level.

The SOMC said the new chairman faces other tasks beyond consensus building for inflation rate targeting. The Fed must continue progress toward more transparency and address regulatory issues such as Fannie Mae and Freddie Mac. The committee also urged that the Fed reconsider its publication decision on the M3 measure of the money supply.

The committee cautioned against responding to recent energy price spikes with an easing of monetary policy designed to offset perceived economic output shortfalls. The more perilous danger from high oil prices is the extent to which upward pressure on the overall price level translates into permanently higher rates of inflation and inflationary expectations. Thus the Fed should be more inclined to tighten money to prevent long-term inflation consequences.

On international trade, the committee urged that the U.S. unilaterally implement its recent proposals to lower subsidies and tariffs rather than insist on reciprocity by other nations, because reducing trade barriers, even by the U.S. alone if necessary, will benefit the American consumer as well as developing countries.

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With respect to China's exchange rate, some members of Congress have expressed concern about its effects on the China-U.S. trade balance, whereas the U.S. Treasury has focused instead on the need for China, for its own economic health, to have a monetary policy directed toward Chinese macroeconomic conditions. The latter suggests that an exchange-rate float would be appropriate, a position that is economically quite sensible. Suggestions based on trade-balance considerations, by contrast, are economically indefensible as they are fundamentally inconsistent with the doctrine of free trade.

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