

President's Perspective



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For centuries, economic sages have warned us in different ways that governments with the power to control their nations' money would most certainly misuse it. To promote economic stability and prosperity, many have advocated delegating that power to a central bank that operates independently of political influences.

Among these illustrious scholars is a humble and soft-spoken Norwegian named Finn Kydland, who shared the 2004 Nobel Prize in economics with his colleague Ed Prescott. I am proud to say that Finn has been consulting with the Dallas Fed's Research Department for 14 years.

Kydland and Prescott demonstrated the dangers of too much discretion in monetary policymaking. They identified a paradox of "optimal" monetary policy: It will not always appear to be optimal. Future monetary policymakers will therefore be tempted to re-

place it with an alternative that seems better suited for the circumstances of the day.

Capitalism thrives under a stable set of rules that everyone understands and obeys. Knowing this, Kydland and Prescott showed how unsettling a change in monetary policy rules can be. People will then expect the next set of rules to be replaced. And the next, and all the rules that follow. By changing these rules, monetary policymakers tarnish their reputations and lose their ability to credibly implement the best policies. They will be limited to suboptimal policies that lead to poor economic outcomes.

Kydland and Prescott argued that the best approach to monetary policy is strict adherence to a set of transparent rules from year to year and decade to decade, even when alternative policies appear better. When individuals and firms have faith that monetary policymakers will stick to the rules over time, they can better anticipate the future and make economic decisions accordingly.

Even with the best intentions, few political leaders would be able to resist the intense pressure to stray from the rules. Many central banks have failed to resist these pressures, too. Properly designed independent central banks are positioned to maintain discipline and follow the rulebook. Even in trying times, they will be calm and steady, untainted by the passion of the moment and immune to political exigency and interference.

I invite you to learn more about Finn Kydland and his work in this issue's "On the Record" interview.

A handwritten signature in dark ink that reads "Richard W. Fisher". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Richard W. Fisher
President and CEO
Federal Reserve Bank of Dallas