Unedited Transcript

Central Bank Independence After the Inflation Is Gone

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Hiro Miyazaki: Thank you for all who weren't able to join us for the earlier sessions. I'd really like to welcome you to this conference, Changing Forms of Central Banking organized by the Health Center [inaudible 00:00:11] 180 and the Finance Ministry also. Also I'd like to thank our conference co-sponsors, ED Institute for the Social Sciences and the [inaudible 00:00:21] Project. I also want to thank our participants, some of whom have come from a very far way to be with us on this sunny day.

Before I introduce our keynote speaker, I would like to invite you all to the 2016 Postal Affairs Lecture. [Inaudible 00:00:47] who is about to arrive here from Bristol. Professor Finder will talk about the evolving political economy of Central Banking, which will happen in the afternoon at 4:30 PM at the Stockwell Auditorium. And there will be a public reception following that lecture and I hope many of you will be able to join us for that.

So we've been having a really wonderful, really substantive conversation about all things of Central Banking and what both the science and anthropology have to say about this subject. Okay, and it is a real honor to introduce our keynote speaker, Adam Posen.

Dr. Posen is a classic example of a fork major. He's a man who is most informed on the financial voices on the complex issues we have discussed earlier this week. He also happens to be one of the foremost authorities on the Japanese economy, a topic that is really near to my heart.

Adam Posen is currently president of the Peterson Institute for International Economics in Washington, DC. His work has been international. That, really, that his work has been international is an understatement. Educated in the United States, he worked in finance in Germany for the reunification. Worked at the [inaudible 00:02:32] on Japan’s economic crisis of the 1990s, advised the government that got Japan out of that crisis. Co-authored a book with Ben Bernanke, a reform program for the US Federal Reserve and served both as an advisor to the UK government and a member of the Bank of England’s Monetary Policy Committee.

An article we had found a few years ago named Dr. Posen. He and his international team of superstar central bankers. We feel very fortunate to have him here with us. Please join me in welcoming him.

Adam Posen: Thank you Professor Miyazaki for that very generous introduction. Thank you to all of you who came across campus to be here in person instead of watching this on live stream while flipping back and forth to the NBA playoffs.

I am very grateful to Hiro Miyazaki, to Annelise Riles, to Jonathan Kirshner, to Hank Michaelson and everyone involved who included me in this conference. It is indeed an exciting interdisciplinary event. Interdisciplinary is a word that gets tossed around quite a bit. This is one where it actually seems to be real and working and to give various component institutions credit; I'm also very glad and grateful to have the opportunity to be addressing an audience, not just of all the distinguished guests participating in the conference but here at Cornell. Peter Katzenstein is in the audience. Peter's work and the work that Peter inspired and guided through the years has been something I've looked to since the early 80s. And he and Jonathan Kirshner in particular here are leading the kinds of political economy that I am very much in favor of and I'm delighted to be able to speak in front of them even if not for them.

Let me pick up though on something. This is the Mario Einaudi Center. And as I've learned, Mr. Einaudi's father was the governor of the Bank of Italy. So if we're going to talk about central bank independence, why don't we start with the Banco de Italia, which in many ways symbolizes what really goes on with central bank independence.

By the way, speaking of independence, you didn’t tell me how long I'm supposed to speak for so I will go indefinitely. Anyway, the Bank of Italy has an interesting history, which I have a small amount of knowledge of, but I won't bore you with. But essentially it has a culture and a role that is common among a number of Central Banks in countries with different economies.

It was the repository of experts in economics and relatively uncorrupt people in a country where many policymakers were either inexpert or expert on corruption. And this took place in a country where for many decades, fiscal policy in particular was seen as very difficult to make in a stable fashion.

And this is, again, this isn't unique to Italy. You can look around many countries not just in Europe, but in Latin America in particular. You see Central Banks in this situation. Whether it was in Brazil or Argentina or you go to Africa and you look at Central Banks. Where, whether it's the IMF coming in, the financial reporters, the people coming in, there is the sense that the Central Bank is the place of the sensible people, the honest people, the sophisticated people. And even if they have absolutely no power over what's going on around them, they are the people the technocrats want to deal with. And this is understandable.

But it also tells you something about the contingent nature of what Central Bank independence is. Central Bank independence is something you get when you have—I'd like to say earned it. But let's at least say you have built up a coalition in your society that thinks it's a good idea. It's not a gift from God. It's not an inherently optimizing response. It's not something that usually comes exogenously. And this is where the politics of central banking comes in. It comes out of an environment.

And so, when we think about the Bank of Italy, there are several interesting pieces of it. Its history that we can talk about in the context of the 70s and 80s which were, in a sense, the period for forming the standard notions with central bank independence that are around today, both in academia and policy circles.

So first is in 1979 the Bank of Italy has what's called a divorce, divorce Italian style, from the government. That it had been like most other Central Banks during the Second World War, including the Fed. Under legal constraint to essentially buy as many bonds from the government as the government wanted. All the other Central Banks relatively rapidly after the war, at least in the major economies, backed away from that whereas in Italy, it took a while.

But it was seen that by 1979, that had something to do with the inflation that was going on in Italy that they would buy on request on demand anything the fiscal authorities wanted so there was a divorce. And this led into a period of increasing European integration. And there were many people—some associated directly to the Banca d'Italia, some of the many friends of the Banca d'Italia—who contributed to the idea that, well, if we actually give up more power to Europe, we will bind our hands.

And then it will be more credible whatever it is we're doing and the local domestic political pressures wont' get to us as much. We will be in a sense more independent to do the right thing if we're less independent by giving up power to the center. A concept I wish some of my friends in Britain understood better at the moment. But you have this context and then it grows up around it a series of intellectual arguments which I have referred to in the past as the Italian school of political economy. And such noted economists as Alberto Alesina and Guido Tabellini as well as a Swede person—excuse me, I forget his first name—person and an Israeli Albert Drayson, various of these people came out.

And the reason I called it the Italian school of political economy was not just it was centered in Bocconi which is an Italian business school and a feeder to these places, but that it basically embodied this premise that you had to put in a new institution everywhere to bind the hands of government. And usually you do that through an international agreement, possibly through a constitutional amendment, if necessary through domestic legislation because the real problem, the lesson coming out of the 60s and 70s was democratic demands are too much. And when governments get too many democratic demands, they inflate, they bust the budget, they do terrible things, and that's what we need to prevent.

And that is, in the end, the model of Central Bank independence that later gets rationalized by Kenneth Rogoff in his famous 1986 article Optimal Degree of Commitment to the Intermediate Monetary Policy Target and the various things that came afterwards with Alesina and Summers and Alex Cukierman and various others.

And for those of you who were not brought up in this tradition and not imbued with the 70s mentality, you may find this very strange. It sounds like, in some ways, a right wing coup. And in many ways it actually was. But it was presented by the economics profession as a straight-up Pareto optimization. That this over-excess of democracy pushing for inflation made everybody worse off, and because of this thing called timing consistency, in the end you weren't saving one group versus another. What you were doing was just getting the whole society to be more patient and everyone would be better off in the end.

And this is a very powerful concept and extended to various other institutional arrangements around the world and particularly in European political economy. And obviously, the many Central Banks beyond the Banca d'Italia. But I think it encapsulates what the story was. And so that's what was going on in the 80s into the early 90s, and then you have the event that there is the Maastricht Treaty in Europe and in part of this Italian School of Political Economy. And in part because of political demands from German officials, the Maastricht Treaty says everyone will someday have to be part of the Euro, exceptions will be made later.

If you're going to be part of the Euro, you have to have an independent Central Bank now or soon, and the Central Bank that runs the Euro will have to be independent as well. And that then, is a sense, the tipping point. So what had been an idea in New Zealand, in the Federal Reserve, in Switzerland, and most importantly in Germany, suddenly becomes the norm. And it's not just the norm for Western Europe, for the members of the EU at the time. It becomes the norm basically for anybody who's setting gaps.

So the IMF crowd, my various distinguished senior colleagues in academia who ran around the world consulting, various central bankers doing technical assistance, they all said it's a really good idea to have Central Bank independence. And ultimately, what was their proof? Well, the proof was twofold. First, there were some very obvious nasty instances of when Central Banks got overridden directly by politicians and bad things happened, so. And this was true throughout the world. Arthur Burns overridden by Nixon at the US Federal Reserve in the 70s. [Inaudible 13:07] when my friends Beijing were accused of being the chancellor's poodle as the phrase went, in the political business cycles in the 60s and 70, obviously the Italian record. And then to get more dramatic you go to Brazil and Argentina and various others.

Now about this time, and you unfortunately are subject to the one occasion on which I am going to be a really self-crediting old fart, in 1993 I wrote my dissertation. And I wrote a paper—didn't finish the dissertation for a while, but I'll let you grad students pretend it's easy. Wrote a paper called There is No Institutional Fix for Politics in which I said Central Bank independence is not something that gets descended from God and just gets put in. You got independent Central Banks prior to this fad where there was a political constituency that liked anti-inflation with light legislature.

And therefore, if you impose this on various places where you do not have that political background, it's not going to work at least it's not going to work as well. And two additional points I made at the time were that this premise—and this I was too cowardly to really push—partly too cowardly and partly insufficiently skilled technically in mathematics. But I said many of the claims that are made for the so-called time inconsistency model that if you put up inflation now, expectations will react and you will end up with higher inflation and no advantage inflation to stay up. Or if a Central Bank violates that, people will immediately react and the inflation rate would go up and the Central Bank will lose credibility.

I pointed out at the time some things that even among those Central Banks that were independent for a long time like the German Bundesbank, like the Swiss National Bank, like the Federal Reserve, the economies did not seem to behave that way. And so I wasn't sure about this time inconsistency act.

The final thing I pointed out at the time that was worth remembering—and sure, I forgot a lot of the stupid things—was I said, by the way, this is in 1993. If the European Central Bank ends up being designed in a way they say in the Maastricht Treaty, it will be the most independent and most autonomous Central Bank anyone's ever had because it'll be guaranteed by the international treaty. And so you can't put pressure on it. Someone—I think it might've been Jonathan Kirshner—said this morning something very similar and I argued at that time which was if you were the Federal Reserve, you could call yourself independent. But ultimately the people in the Senate can always change their Federal Reserve Act.

So as the formal political scientist Susan Lowman modeled it, there was some cost to changing that. So you don't do it just trivially, but the threat was there. And I saw this very viscerally in my first job after grad school. I was a junior economist at the Federal Reserve Bank of New York. And we were getting ready to do recruiting of the next year's economists and suddenly the directive came down, you can't interview anybody from a foreign country or at least who is a foreign citizen.

Why? Well, Congressman Gonzalez, Chair of the House Banking Committee had hearings on the amount of money the Federal Reserve Bank of Minneapolis and Federal Reserve Bank of Dallas spent on their new buildings and he's really mad. And it'll only make him madder, so we don't want to hire any foreign citizens. And I said, “Oh, that's interesting!” And it's just an example of the real world that the Central Banks live in. It's a very trivial example. But it shows you how finely sensitive even the Federal Reserve is to its legislative masters.

And so you put all this together. As much as I respected the individuals working and running in these Central Banks and there were ways in which the policies certainly seemed to be better in the independent Central Banks, this seemed to me much too packed, much too overrated, and most of all much too denied politics behind it.

All right, it's now 20, 23 years later. What happened out of sample as we say in the social science business? Well, what happened out of sample partly supports what I said, partly doesn't. But generally isn't ready for the general framework of Central Bank independence. The first thing that isn't great for the general effect of Central Bank independence is what one finds if one looks at the data carefully is that generally you get Central Bank independence after inflation has been brought down in the country. It's not that you get Central Bank independence and that causes inflation to come down.

Now you can rationalize this in perfectly reasonable ways and say, well that's because the Central Bank has demonstrated competence and has demonstrated that it's committed to low inflation after it gets independence. But that's long winded way of saying that the Central Bank independence is more of a marker of having successfully handled the society coalition against inflation than cost. It also turned out to be completely wrong by consensus because one of the side implications of this view, that it's always foreign looking expectations, the Central Bank credibility matters a lot was as argued by Tomas Sargent and Robert Lucas and many others was that if you have a credible Central Bank, diminishing inflation, disinflation is very cheap because everyone believes you. If you believe in this kind of consistency theory, once you realize that the Central Bank is going to take inflation down, there's no point in fighting it.

There's no point in raising prices, no point in demanding higher wages, you're just going to suffocate and you go right back down. And this was repeatedly repudiated by the data, whether in cross section or individual time series, we can go into if you want. But this model didn't work. It also was a little strange when we think about Central Bank independence. They didn't really have the effects, the knock-on effects people had. And this wasn't strictly part of the economics models, but it was part of the conversation certainly in the setting of the Euro, certainly at the Banca d'Italia, and many other places.

It was the idea that if you set up an independent Central Bank, it will induce other changes in the economy. So in your bank graph, if you've got a credible monetary commitment, you would not be bailing out the fiscal authorities, suddenly Italy would become a neoliberal paradise. Suddenly unions in France would become much less obstructionist. Suddenly people's behaviors and expectations would change a lot. This did not happen. In fact, if there's one message you should take away from the Euro crisis, it's that having an incredibly credible Central Bank that tries to tough it out, and bear out the documents involved, it does not induce change.

I referred to this sometime ago long before the Euro crisis. I think it was in mid-90s, or mid-to-late-90s as the herring olive oil fantasy. That if you suddenly gave Sweden Italian institutions you'd have olive trees in Sweden and if you suddenly gave Italy Swedish institutions you'd suddenly have herring in the Mediterranean. That was not going to happen. And it didn't.

Another point worth thinking about with regard to Central Bank independence is the contextual aspect. This is something that was discussed a number of times during our conference. That these models have a certain understandability, to some degree because of [inaudible 00:21:16] overlooked this. But again, if you think about historically you get a Central Bank independence submerging as a result of international fads or a record of low inflation or a new coalition. That is not a surprise.

But I pointed out in the ‘95 paper that Central Bank independence does depend critically on the context. So during the hyperinflation in Brazil or in Russia, these independent Central Banks were very eagerly continuing to promote hyperinflation because by the point, the banks have insulated themselves. Various other groups in society, and the elites have insulated themselves and doing the contraction, the anti-inflation efforts, would have been contrary to what the coalition wants in fact. And so again, it’s not—in a sense that's good news. We can salvage the concept of Central Bank independence. It's not all about just this one miracle new low inflation attack. But it's also an important reminder that it is about historical political contexts.

So in a sense what I'm telling people, again, is there's no institutional fix for politics, that the institutions you have in your society do reflect underlining patterns. And I'm sure for many in this conference and many in this room, that’s not so surprising. But there has been this sense of purity about Central Banking that’s denied that for many years. And another way of looking at this, one of the social science aspects of this which again was discussed by some very good grad student papers this morning, is the idea of having measures of [inaudible 00:22:59].

So there was foreign in the 90s—I think we finally got rid of it—but there was this college industry coming up with various indexes of Central Bank independence and we code their prospects to how long is the term of the governor and how do the meetings work and what's the legal status vis-à-vis the constitution and so on. Ken Kuttner, who’s now a professor at Williams and I did a little work on this and we found that basically none of these components individually had any predictive power for inflation. There were essentially two components to that.

If you were relatively rich country or you were in a democracy, a well established democracy, basically going back to the divorce of Banca d’Italia, if there were some legal barrier like in Japan that prevented you from being forced to buy whatever the treasury issued, that was good for low inflation. And if you were a less developed economy or a weak democracy, if the central bank governor got fired on a whim, that was bad for inflation. That's it! And even turnover didn't really matter for the rich countries and the barriers to the fiscal policy didn't really matter for the poor countries. Just these things, which if you think about it are quite political qualities. These are not some abstract technocrat things.

And so if you're thinking about this world, it is a world that doesn't look a lot like the theory. Not a surprise, perhaps. But it's worth thinking through then what is Central Bank independence. Why do we care? Why is it so controversial right now? So let me go from Italy to a couple of other examples. In the most recent issue of the Brookings Papers on Economic Activity which should be out within the last few weeks or right around now, there are two papers worth noting. There's one on inflation expectations in New Zealand and I apologize that I forgot four co-authors of that. And there was one on Japan and the house of appeals in which I in the admission discussed.

And there were various versions to these two [inaudible 00:25:12] good academic papers by young scholars, but the main point of both papers, I would argue, was that even when you have incredibly credible transparent Central Bank policies, they did not have the expected effect on inflation. So when you look at the New Zealand data as these people did very seriously and I know we have a gentleman right here from the Kerr Bank. There is no convergence over time long-term inflation expectations through the stated target level. Maybe it doesn't matter because the inflation expectations are pretty stable! It might be true for policy purposes. But it's kind of odd that the Central Bank is now going on, oh I don’t know, 25-plus years of its inflation [inaudible 00:25:58] tattooed on the governor's forehead every month. The number is X 2%.

And there is no motion in popular polling data and financial markets data, anything to get into that. There's all kinds of bizarre things for the New Zealand inflation data and it's not because New Zealand is a small country subject to inflationary shocks. The whole point of the regime is supposed to be that if you do this credibly for a couple of decades, at some point people should notice. It doesn’t seem to work that way. Many have produced good results but that may be because an independent Central Bank is a more pleasant place to work. So the bright people, who otherwise would have left New Zealand, stayed in New Zealand to work for the Central Bank! It might have been because being an independent Central Bank going back to an international aspect—I haven’t given enough importance to yet, is that it’s seen as a good housekeeping seal.

The product market is the same way the gold standard was in the 19th century—that New Zealand got less profited by capital market trust! One of the reasons why it might have done, but has nothing to do with credibility. Then we look at Japan. And again, we have Hamada [inaudible 00:27:13] a number of ex DOJ and current DOJ people in the room. But I do know a little bit about Japan, so they are [inaudible 00:27:21]. The important thing to know about Japan is Governor Kuroda comes in as the new governor of Bank of Japan in this April 1 officially, 2013. And he makes an incredibly public and specific commitment to have the inflation rate to 2% within two years which may or may not have been a good idea, but it's there.

He does so at the same time that there's turnover of the deputy governors and other members in the [inaudible 00:27:53], which is then in a sense stacked to vote that way. He has the full backing of Prime Minister of the day, which ostensibly should be bad for Central Bank independence in some sense and therefore making it more likely that it will be inflationary whatever he does. He announces a new commitment to the inflation targeting regime that is in the [inaudible 00:28:19] of 2%, and the Bank of Japan finally starts buying longer term assets rather than cash, which inevitably has an effect on inflation and expectations anyway.

This goes on for two years. I completely supported it publicly and privately. So did a vast majority of other monetary economists. It probably was the right move. But just as in Italy, just as in New Zealand, just as in the Euro area very large, it has almost no effect on expectations. You look at the survey data; they finally get expectations up about 0.5 but they stop rising basically after that. There is almost no change in wage or price setting behavior, even though I and many others had really hard to try and hoped there was.

And most recently we've seen a series of negatives shocks to the Japanese price level including the energy price, including the small rise of the Euro and the Yen recently. And what's interesting isn't that this had an effect short term expectation but that this shrank down, rapidly, long term inflation expectation which says there is no credibility, no anchor coming out of the [inaudible 00:29:31] plan.

I feel very bad for Governor Kuroda, because they did everything right by the textbook. So I'm in no way criticizing that. And we're taking about Central Bank independence and credibility this whole time inconsistency model of inflation. The idea that as credible a commitment to positive inflation is perhaps that has ever been made by someone who's starting near zero failed to work tells you something about the nature of these problems.

So I think it's very interesting to think about Central Bank independence therefore as not being driven by this economic model and not having the effects people think, but as a political matter. And Jonathan Kirshner earlier this afternoon made a parallel that I think is very powerful which is, you know, we're very accustomed in free trade talking about trade issues as economists and political economists and political scientists and lobbyists to say, okay, well, we know that there's—it's overall good when trade is expanded generally, couple of exceptions. But there's also clearly losers who vote for Trump who are pretty mad about it and we have to buy them off or ignore them or something. And that we've generally abjured talking that way about Central Bank monetary policy.

Now, there are a number of reasons politically and tactically why you would make that choice, why you would decide, okay, if I can get away with tit as well-meaning Central Banker and I can pretend that there's no distributional consequences and no political consequences to my action, or at least they're not direct or are not overt, I can do my job better. I can understand that. And so, you know, it's fine for a sitting governor to try to keep this issue under wraps and maybe be very careful not to give speeches about inequality, say, because that draws attention to the fact that maybe you should talk about distributional issues.

This has become harder in the year of quantitative easing. There's no reason it should. There's actually frankly nothing more unequal in terms of the impact about quantitative easing versus any other policies Central Banks have gotten At least not in very large sense. But amongst us as scholars or want to be scholars upon this, let's stop kidding ourselves. Monetary policy is about distribution as well. And even if it's useful and nice to avoid it—talking about it.

And again this comes up very much in the issue of quantitative easing and this is something where Paul Tucker and I both agreed many of the various economists and various people in this room have spoken about this. So as was mentioned earlier, Ben Bernanke occasionally rejects the use of the word unconventional policy for quantitative easing. I was rejecting that from the very first speech I gave, as a matter of fact, in the monetary policy. I stood up and I said this is crazy. If you read any monetary history, Central Banks have been buying and selling [inaudible 00:32:55] assets for their entire history. Go back to 300 years ago in Beijing, go back to 300-plus years in Swedish insurance banks. Hell, go back to almost any Central Bank except the Federal Reserve before the 70s. And you didn't have some nice, neat yield curves and a nice calm, deep treasury money market. You were dealing in banker's acceptances, liquid assets, giving winks and nods of the eyebrows and discovering [inaudible 00:33:23] types!

It was messy. You got your hands dirty. And so there were a number of reasons why it was politically convenient and much nicer, as well as somewhat predictable and efficient, during this beautiful period from, say, the early 70s in the US, maybe a little later, in the early 80s in most other European and Japanese economies. Where the Central Bank can play around with the short end of the deal curve by open market operations that take care everything and they didn't have to do anything messy. But this was an historical accident over a particular period.

And again, it's based on very, very strong assumption about how things, how markets interact that the short end of the yield curve somehow prices everything out the rest of the way. And so I've said, multiple times in the last few years including at the IMF research conference in the closing panel QE last fall, if you want to be effective as a Central Banker from now on, you're going to have to get your hands dirty. You're going to have to deal with some specific asset classes. You're going to have to do buying and selling of quantities rather than just play with the yield curve. And they're very responsible [inaudible 00:34:41] about how, for example, Federal Reserve can still use the balance sheet in various ways going forward even you get the interest rate is suddenly above zero.

There are many other sophisticated arguments you can make. But I don't think there can be clean hands. But if you can't have clean hands and you can't have this fiction of clean hands and you can't have this image distance and mechanism then the politics gets really bad. Because now it is like tax policy. Now it is like trade policy. Now it is like environmental regulation. You may have a technocrat who's doing the right thing on both the cost benefit analysis and in terms of the mandate they were given by the legislature, but you also have lobby groups and populists and individuals coming after you.

My good friend, Eric San Juan, who is part of Meridian 180, part of people we're lucky to have in the US Civil Service said this afternoon—or actually said in the blog—part of the job of bureaucrats is to keep the bureaucracy out of the funny papers. It's hard to do that when things are going badly and when you're going [inaudible 00:35:56]. And so, let me go back to—we mentioned this earlier—a comparison between the ECB and the Fed in this recent period of crisis.

And to me there are several interesting things. On paper as I've mentioned, the ECB is actually more independent than I forecasted just 20-plus years ago. More independent than Fed, because in the end whatever the fantasies [inaudible 00:36:28] they would have to reopen to the Maastricht Treaty which is an international treaty in order to change the powers and the qualities of ECB.

Federal Reserve, they don't have to do anything because in the constitution, this is the Federal Reserve Act. A simple 60 filibuster-proof majority in the Senate changes the Federal Reserve Act. But it's very interesting. You have an ECB that was told repeatedly by leaders in Germany, by popular opinion in Northern Europe, alright, alright, alright. You want to do something about the padding in the bond markets, you want to do something about all the inflation, fine. But don't you dare buy a country's government bonds from south, so then you're bailing them out.

You want to buy private paper from French banks. They call it an LTRO, okay. But don't you dare buy government paper [inaudible 00:37:40].

But then the Federal Reserve comes out at the same time and is told by the US Congress, “Oh yeah, yeah, the financial markets are in peril, things are going on. But whatever you do, I only want you buying government guaranteed paper. Don't you dare buy something from the private sector if you can avoid it.” And this is fascinating! Okay? We're talking about the same quantitative easing perspective, the same process. And what's taboo in the Euro area is completely different from what's taboo, the mirror image of what's taboo in the US. And you’ve seen this evolve! So we were mentioning earlier today, Article 13.3 which is about the Fed's emergency powers to buy stuff. And I'm using the word stuff consciously. Usually I don’t like to use the word stuff in academic circles, but it’s stuff.

The whole idea was, if there's a panic, you want Central Bank at appropriate discount with some concern for everyone’s policy yada, yada, yada. If you want the Central Bank, they will buy whatever stuff needed to stop the bank. And what's happened repeatedly since the crisis is further and further constraint on what the Federal Reserve is allowed to buy. And so now, if, God forbid and we have another crisis, the Federal Reserve either has the hope that the Congress doesn't enforce what it’s now passed that essentially constrains the Fed from buying anything but government guaranteed paper, without the guaranteed paper or they have to let the system go down.

Meanwhile the ECB, while despite being all under attack, has powers to buy essentially anything it wants. Very interesting development. I'm not saying there's a clear answer here. I'm just saying politics matters which is, in a sense, the message of the conference.

Similarly, Paul Tucker raised this in our discussions this afternoon and I was going to raise it now so I'm glad to repeat it. It's very interesting to think about this issue of what's called Central Bank capital. So as many of us have argued through the years, Central Bank capital actually is a fiction, okay? If the Central Bank runs out of capital to do its operations, it can print more money. Now it is a politically important symbol because you don't really want to do that indefinitely. And so we want the government that’s going to replenish the capital if through good means dealing with a crisis, your capital is low. And the great thing about Bank of England, for example, was that the Bank of England upfront had an indemnity, if Paul can correct my usage of the word, but had an indemnity [inaudible 00:40:28] match the treasury which was affirmed by successive transfers in successive parties, that if the Bank of England lost money as a result of executing its duties in line with its standing, the bank’s treasury would be automatically replenished. And this is completely different from the early days of the ECB in the crisis. When Jean-Claude Trichet repeatedly insisted that he couldn't do things that most people wanted him to do because [inaudible 00:40:57] the Central Bank run out of money, or the capital, [inaudible 00:41:00] or we'd have to go to the Germans and ask for it and then they'd have leverage. Or the Federal Reserve, where for politically understandable reasons, the independent Central Bank has been very skittish about what it does with its balance sheet because it doesn't want the implication of too much congressional interference.

And there are a number of these kinds of contrasts and I don't think they simply map to anyone's notion of Central Bank independence or even measures of transparency. They might map to longstanding political cultures. So it's very interesting to think about the fact that the Bank of England has had a less confrontational relationship in my view, and I think Paul said much the same, with parliamentary oversight than the Federal Reserve.

Now, a part of this might be that parliament doesn't have much teeth in the same way that the Central Banking committee can really make life horrible for commerce. Part of that may be a cultural issue, that the culture of having permanent nonpartisan civil servants even if the Bank of England top officials aren't technically that, it's respected in the UK in a way that is not respected in the US.

I have some [inaudible 00:42:15] for you versus [inaudible 00:42:16] the constitutions. I leave that for the political scholars in this room to consider. But it sure as hell doesn't have anything to do about being caused by rules about something like independence with statements about credibility, with inflation expectation. It's hugely important for what the Central Bank gets to do, what its capabilities are, what policies it pursues, but it's not determined by all this bank independence foo-fah.

So to put it in sort of political science terms, and I'm about 20 years out of date on my political science so I'll ask my colleagues to forgive me, but international factors matter a lot, ideational factors matter a lot, and organizational factors matter a lot. And Al Blinder actually deserves credit. He's done some of the few studies that are serious out there about Central Bank's organizations, about the structure of committees.

One of the things I love to do with visitors of the Central Bank nerd profession, which I have [inaudible 00:43:19] to have while I was at the Bank of England, was take them into the room where Paul and the governor and I and the rest of the MPC would meet. Because when we met in that small room, you know, four sided hall square with basically four seats on the side. You didn't have nameplates or anything. They were movable tables and chairs because the room was used for other things occasionally.

And so you have nine members of the committee, you had three staff who were there taking notes, and they never spoke unless asked a question. And you had one representative of the treasury, senior officer to the treasury officer was there to observe. He usually asked the question. That's it. As Alan and others can attest, the Federal Reserve's Open Market Committee Room is a little different. It's this enormous long and narrow room. It has this enormous wooden stone [inaudible 00:44:15] looked like stone to me, anyway—enormous, very heavy table. Each Federal Reserve Bank president and governor gets a big bronze metal name plate and a chair.

So there's three rows of senior staff and, you know, people would accompany each Reserve Bank president at the meeting. It was roughly about 67 people in the room, [inaudible 00:44:37] most people were voting at different time. A completely different organization. A completely different culture. And for me, I would have been privileged in any event, to serve in any Central Bank responsible position. I'm so grateful to have had that opportunity. But I got particularly [inaudible 00:44:56] into [inaudible 00:44:56]. Because MPC, the way it ran, was really not entirely colleagues. But broadly speaking, we were just a bunch of colleagues, who every month, over two-day period, really just discussed. And the Federal Reserve Open Market Committee has a somewhat different dynamic. And I think the people who were governors there don't always enjoy it quite as much as I enjoyed [inaudible 00:45:23].

Does it matter? As I used to say to visitors I'd like to think because we were able to deliberate, make mistakes, change positions rather than be set pieces and be witnessed all the time. I'd like to think we were more intellectually stimulating open-minded policymaking or at least what policymaking there was actually took place in the committee rather than outside with a few other people. I think that's an accurate statement but I'm not sure the policy outcomes show that. It's worth thinking about.

So let me try to get this concluded. On a personal level, I made the comparison, or rather picked up on Jonathan's comparison earlier about making trade policy say, for example, versus making monetary policy. And now I'm President of the Peterson Institute for International Economics. I'm very proud to have that role. Fully, a third to half of our staff and our output is oriented towards trade policy. So over the last three years I've gotten to dive pretty deep with US trade representatives, congress, counterparts in Japan, in UK, in Canada, in Indonesia about trade policy.

And often I walk out of meetings on trade policy with a certain economical [inaudible 00:46:52] in Washington, that Washington has. Because it's all about making deals in a very base level. It's all about even very good public servants who go off and negotiate, say U.S. and Japan bilateral common [inaudible 00:47:09]. And all the economists and most of the trade negotiators on both sides know that this is really no good for either economy. And it's a huge waste of time. Except for the fact that there are people in the Congress [inaudible 00:47:22] who will kill you and kill any hope of an agreement if you don’t try to do something appropriate for Canada, to them, or at least will talk like you weren't giving anything away.

And there's this enormous sense of farce. Very powerful and hardworking level [inaudible 00:47:40] farce of those of trade negotiation. And there's enormous sense of people coming in the door and saying to you, well, you know, the most important thing is there's a viable textiles industry in the US. And you can't say to them you've got to be blinking kidding me. You have to say yes, Senator, I’m really convinced that the viability of the U.S. textiles industry is critical for our stability, yes.

My experience in 25 years of consulting for Central Banks, visiting Central Banks and briefly being a Central Bank decision-maker is you are indeed an independent [inaudible 00:48:15]. And I think that's true of ECB and at the Bank of England, at the Fed, Bank of Japan. There are, as I said, political pressures out there, there are things that matter. But on the decision day you can call it [inaudible 00:48:30] independence. You actually do sit there and you're actually debating with people about what you think the forecast is, what you think the effective policy is, what you think the effect of your statement will be, what's the statement about.

And that’s a very rare privilege in public service to get to do that. And I know this isn’t supposed to be a personal talk, but let me just say that for the record, it’s a very great privilege. And that comes down to what in the technical speaking you would call instrumenting [inaudible 00:49:03]. That basically Central Banks that are called independent really do get to set their policy week to week, month to month, maybe even year to year on the basis of a technocratic government subject to the mandate they were given.

And that's not about time inconsistency models of inflation, credibility, with anything [inaudible 00:49:30] because that affects credibility and predictability in some ways. And it's not because this was some God-given institutional design back when it started. It's because you’ve won some sort of constituency in society that says, okay, we back this. And here is the problem. Here’s where I’ll end.

We are in an environment now where independent Central Banks are under greater attack than they ever have been at least in 30 years. And interestingly, given that the Fed, surprisingly, the attack is coming from the right rather than from the left. It has been the right saying that this is a Central Bank that has gone wild, it has outstripped its mandate, it's going after markets and interfering with markets. It's too powerful! And it's particularly ironic, not just that this comes from the right, but that this comes at a time when there's whole drumbeat of some justification from the markets on whether or not Central Banks can deliver what they want to deliver. They say they don't want to [inaudible 00:50:36] cause inflation, they can't do it. They say do you want to do this, we can't, we can't. And so if we want there to be Central Bank independence, you have to be willing to think about the independence of the institution and not a [inaudible 00:50:54] individual decision, which is a shame.

So let me close by explaining what I mean by that. In formal terms, there is a very good paper written by [inaudible 00:51:06] earlier, to give credit where credit is due, by [inaudible 00:51:11] about 20 years ago called [inaudible 00:51:13]. This is by [inaudible 00:51:16] called Credibility of Policymakers versus Credibility of Policies. And it basically says, yes, it may be at a circumstances saying when this is [inaudible 00:51:31] they're refusing to cut breaks and you've been insisting on a particular forecast. And it may hurt your credibility if you [inaudible 00:51:38] yourself in this case but it might help the credibility in longer term of the machine if you don't do something stupid. This is [inaudible 00:51:44].

But I think in light of this conference and in light of everything I said, I hope you'll see that, also, non-cynically, that that's a political reality. So justices of the Supreme Court at various times in the US held off from making a decision until they could get, for example, Brown vs. Board of Education. It was politically wrong to let the world stand the way it was. The Chief Justice and the majority of members of the US Supreme Court knew that. They did not make the decision on Brown vs. Board of Education until they could get a [inaudible 52:26].

More recently, about 20 years ago, there was a key decision on abortion where the middle of the court at that time, Sandra Day O'Conner, Anthony Kennedy—and I apologize for forgetting the third relevant justice's name—came out and basically said, whatever my personal views on abortion, I am not going to overturn your precedent and discredit the court in the eyes of the American people. So I'm going to vote to oppose, to upload this judgment against the [inaudible 00:52:58].

These are the kinds of compromises that independent institutions, in reality, have to do. And intellectually that means independence means something a little different to economists that solely about Central Banks. Politically, it means you need some kind of statesmanship communication going forward if you want to do the right thing. Thank you very much.

So, Hiro, I think you said I should take questions or comments or objections if everybody doesn't leave at the break which is very nice of them. Anybody? Please.

Speaker: [Inaudible 00:53:45]. They said that transparency, it's very hard to get [inaudible 00:54:01]. By listening about [inaudible 00:54:04], many people are now advocating that we use stocks with some cash investment. What does that scheme come from?

Adam Posen: Yeah, thank you. I was very conscious since I was already going long. I didn't include comments on fiscal monetary cooperation which is obviously at the heart of the helicopter money issue of Professor [inaudible 00:54:36] and is one of the most pressing issues of the Central Bank independence.

Before I respond to [inaudible 00:54:43] specifically, I'll just say in general I tend to be much less worked up about this than most people. Again, it's the idea of being pragmatic without being cynical. I think there is a lot of occasions on which some loose coordination between Central Bank and Finance Ministry or Chief Executive can be useful, and it doesn't automatically lead to a collapse of credibility or a problem.

What went on between Prime Minister Abe, Governor Kuroda arguably in the first half of 2013, I think is a good example. There are others. I gave a speech while I was still at the Bank of England taking on some of the Bundesbank opposition to fiscal policy interventions in the Euro crisis by saying Central Banks aren't virginal creatures that if they dabble in buying public debt, suddenly their credibility goes poof! And that they are ruined forever.

But when we talk about helicopter money specifically, for example, and they are—Turner I guess has a new book, or a relatively new book talking about this, and others. I actually, there I start talking like a practical Central Bank nerd. I am not sure what the advantage is of calling something helicopter money and drawing a lot of attention to it and making it sound like it's something more than it is than simply having a one-off or short term agreement between the Central Bank and the fiscal authority.

I'm not even sure it gives you any extra punch. As you've argued in the Japanese context, and some many neutral friends of ours have argued, you do not have helicopter money. It's in something else, don't worry. As many mutual friends of ours have argued in other G7 countries, there’s a lot of room when interest rates at this level to do with fiscal policy. And it may not even mean helicopter money. It may just mean the Central Bank that doesn't increase rates rapidly if you do infrastructure spending. In addition, if you get outside US or Japan and specifically you’ll get European Central Banks for example, there are issues to what's called the state aid rules that are there for good microeconomic and political reasons in the European context that you don't want to violate overtly.

So I think there's a lot of room to do agreements on fiscal policy and monetary policy or more accurately for -- be it Japan or US to do fiscal expansion along lines you’ve advocated and the Central Bank to accommodate that. But I'm not sure doing something called helicopter money doesn't just make it less effective and more politically dangerous for no good reason. That would be my take. Yeah, please.

Speaker: I believe that there are so many combinations of monetary and fiscal policy even though most are quite effective, both fiscal and monetary policy are effective, I think there's no way always [inaudible 00:58:01].

Adam Posen: Thank you. Just to point for the political economy, political science and other fields in the room. Again, if you come out of this Italian school tradition I talked about or sort of the formal political economy economist tradition which, can be attributed to the person Alesina, or Kevin Kolik, or whatever lineage you want, you would be very surprised to look around the world now and see all these countries where people are reluctant to engage in fiscal spending.

Now some of the hardboiled people of this ilk will tell you, “Oh my God, no, look at the deficits in the buy out control”. The control of the business cycle is not true. What we've seen time and again is fiscal financial industries, finance industries, basically saying again in the rich world, in the rich democracies, “No, I really don’t want to spend the money. I'm going to do everything possible to keep from spending the money”. Whether it's 2,000 or 2010. The Ministry of Finance at every possible point in Japan, certainly the German Ministry of Finance in Europe or Dutch Ministry of Finance.

So again, in the same sense that I’ve taken on intellectually I hope, Central Bank independence is an example of mistaken political economy or misplaced political economy. I think it's a good topic for people to think about also on the fiscal side. That there's ideational matters, there's international fads, there are other things going on rather than the standard model that came out in the 70s that democratic governments always spend themselves into oblivion. Anyway, next comment?

Speaker: [Inaudible 00:59:43]. So my question is how do think China is influencing in the politics of Central Banking [inaudible 1:00:02] at a cheap price, so somehow influencing inflation worse and worse. And more and more, they giving launch the Brazil, Argentina [inaudible 01:00:16] at various rates, cheaper rates than that are fixed by the Central Banks of those countries. So how do you think China with its unauthorized policies is influencing the politics of Central Banking?

Adam Posen: Well, I'm less sure that China is influencing things with its unorthodox policies than simply by its size. And I think that actually is a distinction that matters. So there is a paper that recently came out by three very good empirical trade economists [inaudible 01:00:49]. And it documents that there was a period in the early 2000s when contrary to what pro free trade advocates would say or expect to say that there were some people—that US manufacturing industry really did get hit by low-wage, low-cost Chinese products. And that most importantly a bunch of workers who lost their jobs in that process were unable to find new jobs, at least not for a reasonable length of time.

And they do their repair work very well and I don't think there's much to dispute their results. What I think we talk about is trade implications on their occasion, and what I think is interesting about the results is it really doesn’t tie to China in a very specific period. It wasn't true when US did NAFTA, it wasn't true in earlier periods of China, when they were coming off of the Eastern Europeans in the world market. So in the sense that that's your point, if there's some specific China shock that was very low wage, very low prices, very large stocks. The US on the other—everybody, Brazil, Argentina [Inaudible 1:02:05].

And so in a sense we should have been better about handling it at the time. But in another sense we're kind of past it if you look at the same kind of data, that China has a large [inaudible 01:02:20] value chain and wages increased enough in China that you’re not getting the same kind of effect now. There are specific cases where you are, there are obviously [inaudible 01:02:30] in steal in the world market, okay, and this is hurting a lot of people. And for all my yammering about not wanting to pander to their trade policy, if we're ever going to imagine the circumstance under which anti [inaudible 01:02:44] rules might be useful, we’d probably steal right back from China.

There are things you can talk about. But I actually don't think that is the major driving force on the monetary side today. And in particular we mentioned the issue of loans. And it’s a very interesting issue. Actually, our institute’s releasing a set of studies later this week on Thursday, go ahead and watch the webcasts, download them for free, just like here at Cornell, at the Peterson Institute, www.piie.com but nobody laughed, the world is a changed place! Anyway, and we’re looking at the One Belt, One Road initiative, or Belt Road initiative, the Silk Road initiative whatever you want to call it. And it's clear that the Chinese are going to pump out loans to a lot of places at very low rates. It’s also clear that the amount they’ve pumped out so far is tiny. But compared in size, even the economies of Brazil [Inaudible 01:03:41] that’s actually gone through this program. And so, I think, it's there. I think it has distortions. I think the recipient countries have to think hard about what to do with money, but I’m not terribly worked up about the Chinese involvement at this time. Yeah, over there.

Paul Tucker: I wonder whether you could offer some reflections or comparisons between Central Banks and the supreme court, or institutional courts. So you think about the—based on the Supreme Court of the 20th century, Justice Holmes comes out and says, oh yeah we're not actually reading the law. We're bringing our own values to it. And then through the critical [inaudible 01:04:34] there is no restraint and there’s just politics. And if you sit where I do in the world, we're in the middle of a lot of oceans, this ends up with Gore versus Bush where it just splits. It's now the worst nightmare of what it is to have unelected power that then serves partisan purposes. Remember, I would say that by the way, whichever way it had gone. It has nothing to do about the results.

And I worry that when people talk about—and normally there is. But when Central Banking is fused with politics, we need to be very careful and say that's not the same as saying it shouldn’t be insulated from day to day politics and restraint. Judicial restraint seems to me to be a virtue of a democratic society and Central Bank restraint is a virtue, I would argue, of a democratic society. So whilst I completely agree with you that Central Banking can’t be pristine. It seems to me that it should be parsimonious, consistent with achieving the objectives it’s being given in the real world. But I want to hear whatever you have to say what you say about those parallels.

Adam Posen: Paul is being very gracious. That's Paul Tucker as you know from [inaudible 01:06:14] Bank of England. And he has thought about these issues very deeply. I know over the last few years he and I had some exchanges about these kinds of issues. For the real political science junkies, there is a lot of [inaudible 01:06:26] going back and forth with what they're saying, the [inaudible 01:06:28], the soldier, the state [inaudible 01:06:29]. But stay with us for now.

I probably don’t have anything that sophisticated to add to you, and certainly I know a number of friends who are legal scholars. So let me just take you up on these very practical applications of this. I think it is exceedingly difficult no, post Gore versus Bush, because the number of the decisions made the last 10, 15 years. Clarence Thomas remaining silent for a few days on the bench. Antonin Scalia's, let us say, checkered record. It is extremely difficult not to be cynical or to be [inaudible 01:07:10] critical studies about the Supreme Court.

And what's fascinating is there's news and articles that are probably well known in the legal scholarship and only making their way out to us in certain broader pseudo-intellectuals recently about, like Felix Frankfurter, who was supposed to be this great justice and who went on the FDR supreme court just pandering, pandering.

So I think you've actually put it be very much right which is can you do things to insulate the institution and are there self-restraining behaviors that the decision makers of the institution as non-elected people should undertake. And I think having that kind ethos and having that even made a certain sort of statement of conduct, I think, is very helpful. I think there are limits to what you can do. On the other hand, I think, these institutions are surprisingly resilient.

We used to say half-jokingly with apologies to [inaudible 01:08:21], that I was amazed people didn't burn down the Bank of Japan in the 90s and early 2000s. No seriously, I mean there was fights and suicides in Japan as a result of the deflationary policies pursued by the leadership of the Bank of Japan. And nothing happened to the Bank of Japan. There's a lot of security at the ECB right now, and you know, I would not want to be sitting in Mario Draghi's shoes. but realistically, nothing has happened to the ECB. Now I could say the same thing about bankers and other things. These institutions are surprisingly persistent. Or maybe for political scientists and anthropologists they're not. But for policy blogs, they're surprisingly resilient and persistent. And so if you look at the US Supreme Court, you can go back to Plessy versus Ferguson, you can go back to Dred Scott, you can go back to outrageous decisions throughout the US political history, and yet the Supreme Court does fairly well.

And so you have to ask yourself, was that because the institution only deviates that badly occasionally? Is that because it really is on average a slave of the political winds so you can't realistically expect better? I don't know. But when it comes to Central Banking, again for what it's worth, just a personal opinion, it's very similar to what I think you just articulated Paul and I'm sure you've written and developed further in other places. I think self-restraint is very important.

I think this goes to the discussion we had on the last session of the conference. I was sort of putting overemphasis on communication but you and others rightly pointed out that the importance of communication as you're going through the exercise visibly of being accountable to people.

So as you know when I was in the Bank of England, I did an enormous number of going around individual little pubs and schools and businesses around the UK. I think it is a little bit, he’s the American [inaudible 01:10:14], but I think I counted up, I think I met with counting everybody -- 17,000, 18,000 people in the course of my three years. And I think that it's very important symbolically, especially for me as a foreign citizen sitting on the ECB, saying that I’m accountable. So I think all these kinds of things matter and, I think, the kinds of things that [inaudible 01:10:38] said about lack of transparency and sort of patting yourself on the back for being non-transparent should have been bad at a time, and you certainly can't get away with it now.

So here is why -- I'm going to say one other thing, and this from Paul to me not pleasing to you or may not be pleasing to other people we know. Another piece of this it seems to me is Central Banks should shut up about policy that is not really in their area. I am really sick of Central Bankers, whether it is the Bank of England, European Central Bank, Federal Reserve, going out there and commenting on fiscal policy, on social security. It's not their area. And they can play this game and say, well, ultimately is has no effect on the [inaudible 01:11:22]. And this goes back, again, to the Banca d ’Italia problem where there were no banks in South Africa problem, or whatever.

If we're the only non-corrupt competent people here, we feel a duty. We have to be the ones to talk. And I remember I said this to a group of African Central Bankers. I said, you know, I really think this is a bad idea. I think it adds to the trouble. You have to restrain yourself even if you know the people in charge are doing something stupid. And they were all over me. They were like, you’re such a naïf. You know in our context the mistakes are disastrous and everybody looks to us for being the only experts known that are relatively unbiased people.

And it’s a fear of [inaudible 01:12:09]. But I think even in the US context where you could argue that a great deal of political deadlock and incompetence, it still would be good if the Federal Reserve never talked about this or [inaudible 01:12:19] mandate. And again, non-partisan, I don't think Alan Greenspan should have ever been able to open his mouth about fiscal policy and I don’t think [inaudible 01:12:29].

Speaker: Adam, thanks for that. Just on the [inaudible 01:12:43]. But there's no doubt that they are congressional when it comes to procurement. But the professionals of this-- almost perfectly rational expectations amongst the professional community. I want to make a comment about your characterization of differences between regulated baking payments, and Central Bank independence. If I just [inaudible 01:13:11] and the visuals on Central Bank independence that was heading on two targets so it's a problem for time consistency. And even any independent Central Bank has an inconsistency problem. And that was what we broke in New Zealand, the inflation caused by time inconsistency problems. So independence isn't about inflation and time consistency aren't the issue. It's a simple target, and it very time consuming as you can see. Now our problem with, as macroeconomists is we never know what the counterfactual is right? So you say anything, and it doesn't have any effect because we don't know what the effect has been, because we never see the counterfactual. And that's the same for the people who propose the opposite about independence. Not macroeconomists and micro econometricians, unfortunately.

But then to give you some examples so before it was in New Zealand, we had a three-year election cycle of monetary policy. Every third year monetary policy was expansional for the period of 20 years, okay? Again, once there was no three-year election cycle again in monetary policy. Shortly after Brazil Bank became independent, and the new government said at the time said, "This is terrible. If we—because of this independent Central Bank, if we run an expansion on fiscal policy, the exchange rate will go through the roof, because we have to borrow so much" And the Minister of Finance at the time, who was sort of the only responsible one said, "Well, that's what gave us Central Bank independence and therefore we have to run a responsible fiscal policy. And actually, so the equilibrium changed from being a fiscal leader, to becoming a monetary leader. So in other words, the Central Bank independence disciplined the fiscal authority. Before, it was the other way around. So I take issue with your concluding that Central Bank independence didn't have any effect. I think it did, but neither of us can prove.

Adam Posen: Well, actually though I think I can prove you wrong so let's just go right to it. So as I said, the reason I went back to '93, '94, '95 papers was not just my ego indulgence—although of course that was the main motivation. It was [inaudible 01:15:36]. That there were a bunch of predictions that had been made in Central Bank independence literature based on the New Zealand experience and based on the scattered thoughts of Alesina and Summers and [inaudible 01:15:48] in 1990 and they didn't come out right. And I predicted they wouldn't come out right and that's what happened.

Speaker: There are a number of [inaudible 01:15:58] financial crisis and things like that, you wouldn't get these breakouts that were there before, would you?

Adam Posen: But again, if you want to argue that New Zealand had that impact and all you guys have long time series observations. I can probably do a bunch of archival and other political examination of New Zealand, I'll come up with a bunch of better explanations for it. If you look cross-sectionally, cross-nationally panel data, for example, on political business cycles and political monetary cycles which were done by [inaudible 01:16:40] of grad students who didn’t know better, throughout the 90s, you'll find that for example Germany hadn't been even been in central banking [inaudible 01:16:48] discovered, there were huge political monetary cycles. There was no change in political monetary cycles before and after Central Bank independence in several European countries including UK and Italy.

So again, you got one-time series with just one observation. And therefore if may just be something idiosyncratic to the wonderful New Zealand model. None of this stuff holds up out of sample and none of this stuff holds up cross-sectionally. So if you want to call it evidence, you’re entitled.

Speaker: Banks are breaking these rules.

Adam Posen: No, you don't.

Speaker: Yes, they do. You’re talking generalities, and I’m talking specifics.

Adam Posen: No. Last I checked econometrically, a one-time plot for one country is one observation. And if you don't think that it can transfer out of sample or across-countries that’s like saying that the dummy variable, if I put New Zealand dummy in that cross section.

Speaker: [Inaudible1:17:55]—what I’m just arguing, is that you’re—neither of us can prove whether independence was actually, particularly effective, or not particularly effective. Because we have to know what the counterfactual is, right?

Adam Posen: But we do know what the counterfactual is. Because we know that there were countries that didn’t have independence, and they were given independence, and very little changed. And you know there were occasionally [overlapping conversation]. No, no, that's actually [inaudible 01:18:24] always do. So let's go back [inaudible 01:18:31], okay? So they set up this two variable thing and the whole thing moves there. Go through those things. I'm sure you'll have many more theoretical publications [inaudible 01:18:40]. Let’s just go to the essence of it.

The essence of it is simply where there's a trigger there. Then expectations will jump if they’re violated. If there's a change in regime or a surprise. That is the demonstrably false repeatedly. That does not show up in any data for the US, the UK, or Italy for anybody. Maybe it shows up in New Zealand. I don’t follow the New Zealand paper. But the fact remains—

Speaker: [Inaudible 01:19:09] at a very different angle.

Adam Posen: Yeah, but the time inconsistency data shows [inaudible 01:19:14] 1979. The other important is 1983. Then we got a bunch of people who actually believed the theory because ideologically it suited the idea that the bias against inflation wasn't reflecting a particular right wing association. It was something that's greatly improving and that the problem with democracy wasn't about the agreement. It was the wrong people were asking for too much. And the problem with the 70s wasn't that we had mismanagement on the fiscal side in a political sense. It was that the Central Banks were too big! This was an ideological agenda. And so that everybody took their own [inaudible 01:19:49] and said, gee, I'm going to take that forward! [Inaudible 01:19:54]. And it has failed completely in Europe! And it has failed repeatedly Brazil and Argentina. And it has failed many countries! It has failed in Eastern Europe, and it has failed in Russia! So maybe the New Zealand dummy—in my cross-sectional regression, it said there's something magic about New Zealand. That theory is wrong!

Speaker: And there's another question over here, final question.

Johnson King: I'm Johnson King. I'm the director of research of the TOKEN Project. And I love this exchange. I have a question about the thrust of your remarks this evening. You've critiqued the evidentiary basis of thinking in Central Bank independence matters in the ways that people have said that it matters. But at the end of your remarks you had us on a tone of mourning about the potential loss of the Central Bank independence. And so I guess I was wondering in the spirit of us being in a great university, what is it that it seems to you, the reasonable sort of things that we should be trying to learn about as we understand how to make Central Banking better for countries and for the world. Is it that we need better data to see the ways in which independence might actually matter or that we need to be slicing the salami differently so that some of the political culture elements that were driving the positives of deep independence but we're not there merely got the independence matter or something totally different?

But I sense there's something more than just the pleasure the bureaucrats got from getting to interact in a deeply independent place that was driving your sense of at the end that something valuable might be under pressure and I was just really curious where we ought to be looking about to be able to sort of – to build a strong venture [inaudible 01:21:52].

Adam Posen: I mean I think I'm sorry that I was unclear on any of this and that I gave the idea of contradictory feelings. Basically I associate myself very strongly with remarks made by my colleague Paul Tucker, that I think it is mistaken, and I'm probably stronger, if anything, more on this wicket that Paul is, to pretend that Central Bank independence is particularly clean, pure whatever, the policy conversion of that. But I think if you go back to the history of Central Banking, there's a lot of politics in the general sense behind the ways these institutions developed, when this so-called independence emerged or didn't emerge, how it was used…

And so as an intellectual exercise in a sense what I'm giving is impetuous agreement to what I understood from the conference organizers to be part of this session, part of this conference that is why I believe that I have to do it… That, as the independent variable, if you're deep into variables [inaudible 01:22:55] in either Central Bank behavior or form of Central Bank institution, there are some political, social, cultural ideational—if that's the right word—factors that are determinative of that. And it is not a technocratic fix. And so as an intellectual pursuit if you just want to understand some of those variables, you need to broaden your set of explanatory variables. That's the first step.

The second thing is from a policy perspective, and again I think, Paul's discussion on the Supreme Court and my response to that is on target. I hope. Some of the things Alan has written about in the context of the committees in his more popular books. You have non-leaders in the institution, what matters in a sense is conduct. Conduct actually matters. It doesn't save you necessarily. If [inaudible 01:23:48] with President Cruz, you're going to have a really bad monetary policy and obviously really terrible recessions because the removal of discretion for very tight monetary policy could be a disaster! Okay?

But that's not-- To some degree that's out of our control. But to some degree I think if Central Bankers are restrained in what they do and so it's like you talk about conduct in generals who report to political overseers for Supreme Court Justices and other judges are going to provide, you try to at least give the —not just the impression but the behavior of someone who is not terribly motivated by partisanship or short term motivations. You try.

And part of the reason I think my remarks might have been confusing or unclear is because I was spending a lot of my time unpacking the economist notion of independence which to me put too much pretense and it's not all the economists, but the economists of that ilk. Pretense of neutrality and that the institution was in control. And it's actually about how do the individuals involved conduct themselves that matters a lot.

And so let me just give you one final story. Three years ago, almost four now, literally my last day as an official of central—I wasn't even an official, I was only a member of the MPC [inaudible 01:25:24]—I was speaking at the Fed's Jackson Hall conference. And I was asked to discuss a paper by the brilliant Michael Woodford on what was called Forward

Guidance. And I had two [inaudible 01:25:40] talking about today. [Inaudible 01:25:42].

First was I stood up and I said—I thought nicely but probably not—forward guidance is really stupid because you cannot make a commitment that you're not going to do something in the future and not respond to data. And if people just listen to that they're just going to focus on your every little move, and it's going to be bad. And again, out of sample. The theory was beautifully elegant, and based on the power of consistency and forward looking models. All this stuff, out of sample. The disaster of [inaudible 01:26:15] policy of Bank of England, I predicted, okay?

The other thing was a conversation I had with—I won't name who—but she was one of the people who would be on the short list to be Fed Chair if a non-Trump republican won the election. If Trump won the election, who the hell knows who they'd pull for that. Anyway, so this conversation—I won't identify the people, but with two of the heavy hitter, very academically credible individuals who would be candidates for Fed Chairman [inaudible 01:26:56]. And they both said to me, Adam, we're really advocating that you buy more stuff, and that you buy all kinds of stuff. I said yes. And both individually said to me I think that's a bad idea not even necessary because I disagree with you right now but because that will undermine the independence of the Fed. There are people who won't stand for it.

And I ex post did turn out to be right, I would say. Now if I was sitting at the Fed at that time instead of the Bank of England. I honestly don't know how I would have reacted. Part of me would say, okay, I'm talking to this game about political constraints, independence, [inaudible 01:27:46] and you've cited [inaudible 1:27:53] and all things about being willing to trade off short term policy for long term viability. Maybe they got it right and you should just shut up, and just back off.

And then there's another part of me that said, you know, if this was just something small, don't worry about it. You know, 2012 things are still not that great. There's still a lot—it wasn't quite as bad in the US, thank God, as it was, but Euro prices were—you know, things were still looking pretty bad. You know, and partly is that I'm hopeful for independence, right? Whatever you call it is do the right policy, what you believe to be the right policy irrespective of politically. And so I honestly agonized over that hypothetical for a long time and I was thinking about it again as I prepared my notes for this speech. And so I'm grateful for your question as I have been working on it.

I think that illustrates the realities. And part of me says maybe if I had been more circumspect or said different things, maybe we wouldn't be in such a mess right now. My strong suspicion is, though, that that's not right. That the backlash against the Fed has more to do with our failure to address the problem in particular and has more to do with certain cultural things that I don’t want to spell out, that many of you would guess about how people would vote in the right wing of the Republican Party view Central Banks, and a general tone of distress of government institutions.

And so part of me says, no, you had to be right in any ways because, a, it wouldn’t have mattered, and b, [inaudible 01:29:33]. But again, that just gets us back to it's not about the institution on paper and it's not about the time inconsistency model. It's about the conduct of the Central Bankers and political context in which it takes place. Thank you very much!

Speaker: Thank you very much as well, Adam!