Evidence, and ‘evidence’ on the benefits of central bank independence.

James Forder

The first problem: What is evidential support for independence?
- The absence of political business cycles in countries with independent central banks (Alesina, Cohen and Roubini (1992; Alesina and Roubini (1992): West Germany had PCB, most did not)
- Superior performance where policy is rule governed: Friedman (1972))
- More credible policy where central banks are independent. Posen (1998) finds high sacrifice ratios in counties with independent central banks
- Lower inflation where central banks are independent

The second problem: How to measure independence
- The statute reading methodology
  - Very influential, e.g. in the press (Forder (1998) p. 307
  - Are they serious? This is supposed to be economics. It is the incentives, not the rule book that matter. If we take the argument seriously, we take these things seriously too:
    - Statutory independence and actual independence
    - Is policy set on the golf course?
    - Actual independence and the use of power
      - When the bank sets policy, maintaining its independence may be one of its goals
    - The use of power to affect the non-monetary determinants of inflation (ssshh: to rig an election)

The third problem
- A variety of measures, ‘all showing the same thing’
  - Different approaches to measurement deliver different measures. What is the concept of ‘independence’ to which the ‘test’ relates?
  - To which definition do the newly ‘independent’ banks conform, and what is the basis for supposing the benefits are demonstrated?

The fourth problem
- Implementation of the measures has left something to be desired
  - Emerson, Gros et al. (1992) amended their data without explanation, not that it was much good, having already been varied
  - Cukierman, Webb and Neyapti (1992) treat Greece and Portugal as ‘developing’
  - Mangano (1998) tears the literature apart
  - Alesina (1988) considered ‘political’ and ‘financial’ independence and observed the first ‘appeared more relevant’, so he ‘emphasised’ it. (p. 41)

And Issing (1996) called the inflation-reducing power of independence an ‘established finding of our discipline’!

Unconsidered matters
- The co-ordination of policy instruments
  - Fiscal policy (not quite unconsidered: e.g. Doyle and Weale (1994))
A. The American influence in theoretical thinking?
   - Government solvency (e.g., Sargent and Wallace (1981))
   - Trade policy
   - Specifying the policy objective
     - Inflation targeting and asset prices
     - The crash and inflation targets
   - The democracy issue
     - Careful now. What is the point of democracy?
     - Policy setting or leader selection? Schumpeter (1943), and in a modern setting: Forder (2011).

Understanding the adoption of central bank independence

Britain is an interesting case... pretty well the last

Policy targets and central bank independence
   - the era of ‘discretion’
     - Fiscal management in the UK
     - Occasional fiscal intervention in the US
   - monetarism and monetary targeting
     - Restarted by Friedman (1956) – Keynesian or anti-Keynesian?
       - $MV = PT$
     - Stability of V, stability of T, direction of causation
       - All problematic
       - Money targeting failed in the 1980s. Well, it failed to meet the targets
   - New Zealand CBI 1987
     - ‘Policy targets agreement’
   - Britain and the European Monetary System, 1990-1992
   - ‘Independence’ a condition of joining the euro 1993; the planned ECB was independent in a fanatically-designed way
     - It is hard for it not to be ‘independent’, but like that?
   - ‘Inflation targeting’ as a replacement for EMS
   - The Ken and Eddie Show before 1997 election
   - Surprise move by Labour government 1997

What went wrong?
   - Plenty.
   - An intellectual debacle of giant proportions. Go ahead and quote me.
     - The case for central bank independence as it was made in the academic economic literature was a professional disgrace
   - The European Monetary Union (‘nough said)
   - Central bank independence and the crash
     - Complacency of ‘the great moderation’
     - A kind of Lucas critique incorporating the ‘Greenspan put’
       - Beware not-quite rational expectations

How did that happen?
   - Cui bono? Well, who does benefit from central bank independence? Central bankers, perhaps politicians who can blame-shift, and, let’s see... who wants a job on the MPC? If you can’t work it out try Forder (2005).
Most of the arguments here drifted into my head while I was writing my DPhil and I wrote them up in Forder (1996), Forder (1998) and Forder (1999)


