SOMC Panel Communication and Transparency

Opening Panel Remarks

Gregory D. Hess
Wabash College

SOMC | SHADOW OPEN MARKET COMMITTEE

Shadow Open Market Committee Meeting
Princeton Club, New York City
March 6, 2020

E21 Manhattan Institute

ECONOMIC POLICIES FOR THE 21ST CENTURY

Current Monetary Policy: The Influence of Marvin Goodfriend
SOMC Panel Communication and Transparency
Opening Panel Remarks by Gregory D. Hess
President of Wabash College and SOMC Member
March 6, 2020

Marvin Goodfriend was a substantial and thoughtful person and economist. His communication style echoed this intrinsic nature. Never wobbly or sloppy in his comments, Marvin liked precision. He had a radar for weak and inconsistent thinking, and he could almost always find a way to be direct and gentle about it. He embraced the toughest intellectual challenges with humility and, by his thoughts and actions, he lived the reason why the first course we take in economics is called "Principles of Economics" not "Answers for Economics."

Substantial, thoughtful, precise, humble and principled – core necessary ingredients in effective central bank communications. Sorry everyone, but as today's panel will confirm, there are no sufficient conditions for effective central bank communications.

Our topic in the first panel is to engage in thoughtful dialogue about central bank communication and transparency as well as Marvin's influence. I'll add a third piece to this couplet – namely, accountability. I would like to inject into this opening panel some of Marvin's principles as they relate to central bank communication, and take them in chronological order.

To begin with, Marvin understood that the Federal Reserve resides in a political context and, to be specific, in an open democratic society. In Goodfriend [1985], written at a time when the popular Fed book of the era was entitled, <u>Secrets of the Temple</u>, Greider [1989], Marvin wrote:

> *The discussion highlighted a number of potential benefits and costs of central bank secrecy, and identified some conditions under which secrecy could be socially desirable. At best, however, given the inconclusiveness of the theoretical arguments and the presumption that government secrecy is inconsistent with the healthy functioning of a democracy, further work is required to demonstrate that central bank secrecy is socially beneficial. p. 92.*

Third, Marvin also had principled and timeless insights into how central bank communications and transparency would make monetary policy work better. In Goodfriend [2007], written during the monetary policy consensus period that emerged before the 2008 financial crisis, Marvin articulates on pages 60-64 "how consensus theory supports monetary policy practice" as follows: "The priority for low inflation," "targeting core rather than headline inflation," "the importance of credibility for low inflation," and "preemptive interest rate policy supported by transparent objectives and procedures." In Goodfriend [2008], he goes on to say that:

"The primary role of transparency and communication must be to convey clearly the central bank's long-run inflation objective in order to anchor inflation expectations firmly, so that a central bank can manage short- and longer-term real interest rates reliably with its nominal interest rate policy instrument." P. 444

Third, the lexicographic primacy of the Fed's price stability mandate is an oft-repeated principle and legacy of Marvin's. Surprisingly, Marvin's commitment to the primacy of price stability only strengthened post-financial crisis. Marvin's SOMC April 2012 article, "Securing the Promise of Price Stability," emphasizes that there must be legislative accountability for the Fed's adopted 2% inflation target. Accountability for its actions is a key concept that links the Fed's communications and actions to its legitimacy as an institution in a democratic system. He emphasized this further in his November 2012 SOMC article, "The Fed Should Put its 2% Inflation Goal to Work." Starting at the bottom of page 1, he emphasizes the uncertainty generated by the Fed's post meeting statement of September 13, 2012. He states on page 2,

Why not adhere to its principles, reassure markets, and tie down inflation expectations firmly by reiterating its intention to target 2% inflation on average over time? Failure to reiterate the 2% longer-run inflation goal only months after its announcement undermines its credibility, and defeats its professed purpose of anchoring inflation expectations to improve the flexibility of monetary policy to act against unemployment.

The market is left to wonder, how much inflation is the FOMC willing to accept and for how long? What is to be gained by matching open-ended reserve creation with an open-ended tolerance range for inflation and open-ended horizon over which a departure from 2% inflation would be tolerated? Might not that lack of clarity destabilize inflation expectations and facilitate the uncertainty so detrimental for employment?"

Marvin returns to this theme again, of using the leverage inherent in its 2% inflation price-stability commitment in his May 2017 SOMC article, "The Fed Needs a Credible Commitment to Price Stability." Goodfriend [2017] states on page 6:

Finally, the FOMC should declare its intention in the "Statement [of Longer-Run Goals and Monetary Policy Strategy]" to invite the legislature to accept the inflation target to further enhance its credibility. And the FOMC should declare its intention to strengthen the legislative oversight process to help enforce the systematic pursuit of monetary policy, that is, the period-by-period mitigation of fluctuations of inflation around its 2 percent target while keeping employment close to its sustainable level over time. To do so, the Fed should include in the "Statement" its intention to improve legislative oversight by presenting the FOMC's independently chosen monetary policy decisions against a familiar Taylor-type reference rule for monetary policy.

Deeply principled and with opinions arrived at from a sense of humility stemming from the Fed's past struggles with inflation scares, Marvin's laser-sharp focus on the primacy of price stability and his emphasis on the importance of transparency in monetary policy objectives and decision-making required from an independent Fed in a democratic society defined the arc of his substantial and out-sized contribution to monetary policy. We owe him our great thanks.

References

Goodfriend, Marvin, 1986. "Monetary mystique: secrecy and central banking," Journal of Monetary Economics, vol. 17(1), pages 63-92, January.

Goodfriend, Marvin, 2007. "How the world achieved consensus on monetary policy," Journal of Economic Perspectives, vol. 21(4), pages 47-68, Fall.

Goodfriend, Marvin, 2008."Commentary on "Announcements and the role of policy guidance"," Review, Federal Reserve Bank of St. Louis, July, pages 443-446.

Goodfriend, Marvin, 2012. "Securing the Promise of Price Stability," SOMC, April. https://www.shadowfed.org/wp-content/uploads/2012/04/Goodfriend-SOMC-Apr2012.pdf

Goodfriend, Marvin. 2012. ""The Fed Should Put its 2% Inflation Goal to Work," SOMC, November. https://www.shadowfed.org/wp-content/uploads/2012/11/Goodfriend-SOMC-Nov2012.pdf

Goodfriend, Marvin. 2017. "The Fed Need a Credible Commitment to Price Stability," SOMC, May. https://www.shadowfed.org/wp-content/uploads/2017/05/GoodfriendSOMC-May2017.pdf

Greider, William, Secrets of the Temple, 1989, Simon and Schuster, New York.