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Comments of “Goal Dependence for Central Banks: Is the Malign View Correct”

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Comment on
Goal Dependence for Central Banks:
Is the Malign View Correct?

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IMF, 14th Jacques Polak Annual Research
Conference

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Outline of Paper

- Malign view of goal dependence:
 - Increases time-inconsistency problem because enables government to reset policy objectives for political advantage
- Benign view of goal dependence:
 - Allows deviation from default loss function when it is optimal
- Empirical evidence seems to mildly support malign view:
 - For EMEs, inflation is higher and more persistent for goal dependent central banks

Is Evidence Convincing?

- No:

Without knowing what the shocks are, can't say whether higher persistence and target misses aren't optimal

Empirical analysis in paper does not condition on shocks, so it doesn't answer question of whether goal dependence is malign or not

- Author's don't seem to be convinced by their empirical analysis either, because they essentially come out in support of goal dependence

Is Paper's Argument for Benign View the Right One?

- Paper makes use of Barro-Gordon model to argue for benign view
- Assumes that time-inconsistency problem resides in central bank because it wants to achieve output above natural rate
- Solution is “conservative central banker” to remove inflation bias, but with goal dependence to override when shocks are big
- Wrong model of time-inconsistency problem:
If central bankers understand time-inconsistency problem they can easily avoid it by not trying to exploit the short-run tradeoff between output and inflation (McCallum, 1995)

Is Paper's Argument for Benign View the Right One?

- Time-inconsistency problem doesn't come from central bankers but from politicians who can't stick to long-run optimal plan because they are short sighted
- Mishkin-Westelius (2008) shows that central bankers with same preferences as public will produce optimal long-run policy if they are completely instrument independent
- So paper's argument for goal dependence is weak

Better Argument for Benign View

- Optimal policy requires goal dependence with objectives for central bank set by public for central bank, with preferences that match public's (but with instrument independence)
 - If central bankers have different target objectives and preferences, it is unstable because public (politicians) will want to replace them
- Good policymaking requires accountability of policymakers to solve principal-agent problem
 - Policymakers are agents of public and if they are not accountable, they won't have sufficient incentives to do a good job
- Efficiency requires removal of poorly performing agents

Example: Bank of Japan

- Before December 2012, BOJ was goal independent
- BOJ Inflation target too low
- BOJ did not adopt effective policy measures
- Result: Poor policy outcomes

- Solution: Take away goal independence
- Result: BOJ under Kuroda with higher inflation target and far more aggressive policies appears to be getting much better outcomes:
 - end of deflation
 - higher growth rate of the economy

Example: Bank of Japan

- Important Danger:
- BOJ may not only have lost goal independence, but also instrument independence
- When inflation starts to rise above 2% target, will government pressure BOJ to pursue overly expansionary monetary policy?
- Supports theme of paper: Need to differentiate between goal and instrument independence to get policy right