Panel Discussion

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We academics hold at least two different views of central banking. The first looks on it as an arcane and mysterious craft—something really too dangerous to leave to central bankers. Only we dogmatic scholars can be entrusted to prescribe for it in our seminars. And in accordance with the dictum that nature abhors a vacuum, economists have rushed forward in great numbers to supply the nostrums we think the real world practitioners need to have prescribed to them. As will be enumerated, within my own lifetime as an economist, I have seen rule after rule prescribed. Each rule came and each rule went. One thing all the rule-makers have agreed upon is that, while each past rule was ill-conceived, now the correct one finally has been arrived at.

The second way of looking at central banking is almost the reverse of all that. It holds that what central banking requires is essentially a little good sense. Note that I did not speak of common sense, because good sense is anything but common. To run the Bank of England or the Federal Reserve, you must keep your focus on the time profiles of the price level and of real output-employment levels and be prepared to lean against the perverse winds affecting them. Notice that I specify two goals, and not simply the goal of the price level, as the concern of the central bank. God gave us two eyes and we ought to use them both—whatever the constitutions of the Bundesbank and the Bank of New Zealand say, and despite the rhetoric of recent presidents at some Ohio branch of the Federal Reserve System.

I personally incline toward this second view. My skepticism toward each new proposed nondiscretionary rule comes from their analyzed

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non-optimality in achieving a tolerably satisfactory society with limited gyrations in price levels and in utilization of resources.

The independent central banks of the past and present, when we score them objectively, have not been doing very good jobs. It is ironical, therefore, that they enjoy such current popularity among people of affairs everywhere. Price levels are generally not stationary; and in those places where inflation rates have been somewhat tamed, this has *not* been the result of costless improvements in "credibility." The costs—both in Europe and Japan—have been intense in terms of lost output and productivity.

Our Fed, in my reading, has done a much better job than the Bundesbank, the Bank of Japan, the Bank of Canada, and the like. Two of its finest moments came first, when Paul Volcker helped bring down our stagflation; and then in 1982, when Volcker flouted Bundesbank dogmas and, in strong contradiction to the dicta of the Lucas-Sargent New Classicists, took an activist position promoting the desirable 1983-89 recovery. Alan Greenspan in turn earned his A in the handling of the October 1987 stock market crash.

From 1989 to 1991, the Fed was somewhat too late and too little in leaning against the wind of the 1990-91 recession. But in comparison with the Banks of France, Spain, and Italy, the Fed earned brownie points. If it had stuck to a goal of a stationary price level by 1995-96 (à la the Neal Amendment and much current dogma), its grade in my classroom would have fallen significantly—and so would have the U.S. Main Street economy.

For fifty years the Fed has not seemed to me mysterious or perverse. Like the old farmer who found his donkey by asking himself, "Where would I go if I were a jackass?" I could mostly guess in which direction the Fed would move. This despite its own talk. Who remembers "bills only" from Chairman Martin's days? Or 100 percent money from Chicago petitions and Irving Fisher books? Or the automatic gold standard along with money creation to meet the legitimate rediscounting demands of manufacturing, trade, and agriculture? Fixed gold reserve ratios? Or fixed marginal reserve ratios, for gold? Or separation of the Bank of England's sections for currency and credit lending? Or prefrozen rates of growth for M2, for M1, for high-powered M0, or for M17 1/2? Only we older economists remember them.

Only professors of the chair believe that a *sophisticated* group exists out there in the bond market who need to be coaxed into credibility. The truth is that the people out there primarily do not have independent judgments about the objective probabilities of inflation. What they do have is non-paranoid fears about what the Fed is going to do. A veritable terror used to occur every Thursday, when the M numbers came out. It cut short the Long Island weekends of the whole bond fraternity. A higher-than-expected rate of growth of M1 would cause a sell-off in bonds. This was not because traders believed in monetarism. I knew those guys. What they believed (somewhat wrongly) was that the Fed believed in monetarism. And so it has been. When Dr. Greenspan says he must do this or that to be in accord with the bond market, I am reminded of a monkey who for the first time has seen a mirror. He sees an image of himself in the mirror and thinks that by looking at the reactions of that monkey—including its surprises—he is getting new information. Well, what Greenspan is getting from the market is what the market heard Greenspan say before, that the Fed is getting worried about inflation, independently worried. Now the truth is, those guys have a lot to lose on overnight decisions. And they are very worried about what the Federal Reserve is going to do.

Somebody, it could have been Charles Goodhart, enunciated a [Goodhart's] law. I will vulgarize it out of ignorance. "As soon as you identify a good rule, it self-destructs." Well, I think that chap had it almost right. The simpler fact, though, is that there was never any truth to self-destruct, to destroy itself, in *any* of the rules. All of the simple nostrums, things I have enumerated and the ones that I have spared you, failed as universal rules, being right only a small amount of the time. And in Darwinian fashion, we only stay with a fad while it is in phase with the moon. Each new fad is really like new Kleenex; it just has not yet been contaminated, and can get a short run for its money.

What alone is left? I think what is left is good sense—which, alas, is eclectic and very hard to recognize. Most of the discussions that I have heard here have to do with a fundamental distrust of democracy. A populist democracy is even more distrusted. We are looking for ways of putting into a constitution restrictions that shield the decisionmakers from populist democracy. In the end, that is not going to work; it is only going to make the constitution itself a yo-yo instrument in which amendment number 67 is going to repeal amendment number 55 in the fashion of one of our own amendments with respect to liquor. Bertold Brecht once said, "The government is displeased with the people. It's going to disband the people and get itself a new set of people." Actually, central bankers, like the rest of us, must live with the only political system we have or will ever have.