Key Issues in the Choice of Monetary Framework

Chapter 1: Introduction

by Maxwell Fry

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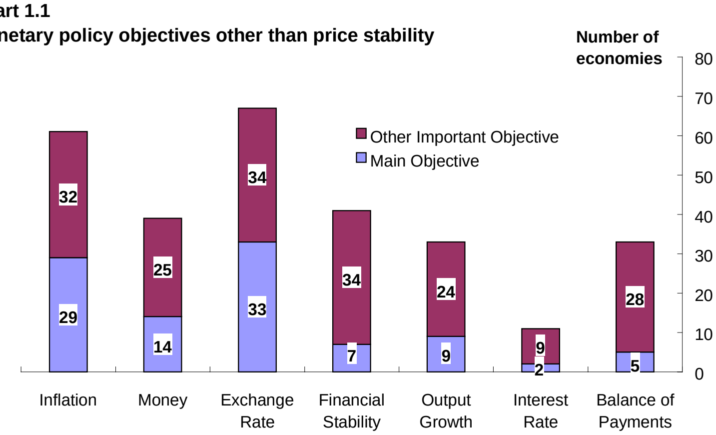
Introduction

1.1 Overview

A monetary policy framework comprises “the institutional arrangements under which monetary policy decisions are made and executed” (McNees, 1987, p.3). Necessarily, therefore, analysis of any monetary policy framework extends considerably beyond the confines of the central bank. Indeed, only in a few countries is much of the monetary policy framework decided by the central bank itself. Monetary policy frameworks are normally politically determined, and may well depend, for example, on the country's financial institutions, and the degree of expertise in monetary policy matters that exists both inside and outside the central bank, as well as other institutional economic features.

This chapter focuses on several aspects of the monetary policy frameworks used by central banks and governments in their attempts to achieve their various goals, among which price stability is becoming increasingly popular. Chart 1.1 gives us a flavour of what our 94 surveyed central banks said their objectives, apart from price stability, were.

Chart 1.1
Monetary policy objectives other than price stability



Answers to question: 'Please rank objectives (other than price stability) that the central bank pursues'
Source: Bank of England Survey of monetary frameworks.

One should note, however, that the stated immediate objectives of monetary policy in a number of developing countries still include rapid economic growth, as well as the sectoral allocation of credit, full employment, etc. (Fry 1995, 1997; Fry, Goodhart and Almeida 1996). Another trend worth noting is the increasing popularity of explicit, i.e. publicly announced, targets, be they for the exchange rate, money, or inflation, in all types of economies. One of the reasons for using explicit targets is the role they can play in securing credible monetary policy. In this Report we analyse the empirical links among targets and central bank independence, accountability, and the transparency of monetary policy in differing economic circumstances.

Much of the analysis presented in this report is based on data collected through a questionnaire completed by 94 central banks in a remarkably diverse group of economies, listed in Table 1.1. We are extremely grateful to our fellow central bankers for providing this information. These data enable analysis of how monetary policy frameworks as well as monetary policy actions and outcomes are determined by an array of different economy characteristics.

Table 1.1 Economies included in the survey

Industrialised	Transitional	Developing	
Australia	Albania	Argentina	Lebanon
Austria	Armenia	Bahamas	Malta
Belgium	Bosnia Herzegovina	Bahrain	Malaysia
Canada	Bulgaria	Bangladesh	Mauritius
Denmark	Croatia	Barbados	Mexico
Finland	Czech Republic	Belize	Mongolia
France	Estonia	Botswana	Mozambique
Germany	Georgia	Chile	Namibia
Greece	Hungary	China	Nigeria
Hong Kong	Kazakhstan	Cyprus	Peru
Iceland	Kyrgyz	Eastern Caribbean	Sierra Leone
Ireland	Latvia	Ecuador	Sri Lanka
Israel	Lithuania	Egypt	South Africa
Italy	Macedonia	Fiji	Tanzania
Japan	Moldova	Ghana	Thailand
Korea	Poland	Guyana	Tonga
Netherlands	Russia	India	Turkey
New Zealand	Romania	Indonesia	Uganda
Norway	Slovakia	Jamaica	Uruguay
Portugal	Slovenia	Jordan	Vietnam
Singapore	Turkmenistan	Kenya	West African MU
Spain	Ukraine	Kuwait	Zambia
Sweden			
Switzerland			
Taiwan			
United Kingdom			
United States			
Euro Area (European Central Bank)			

By comparing experiences in a broad range of economies, we show how the detailed characteristics of a monetary policy framework depend upon:

1. Structural differences, e.g., the structure of the financial sector, types and amounts of debt, openness to trade, commodity dependence, fiscal discipline, etc.
2. Varying degrees of indexation and other nominal rigidities that affect the speed of transmission from monetary policy instruments to inflation.
3. Institutional arrangements and analytical constraints (such as data availability) that influence the way in which monetary policy can respond.

Empirical analyses of these relationships are presented in subsequent chapters of this report.

1.2 Post-war Origins

During the 1945 to 1970 period, one could distinguish two distinct types of monetary policy framework. The first was based on the Bretton Woods system. Under these arrangements, a considerable part of the monetary policy framework of members of the International Monetary Fund (IMF) was determined, or at least constrained, by the Fund's Articles of Association. Members were expected to maintain fixed exchange rates to the US dollar and, after the resumption of general convertibility to permit all foreign-exchange dealings for current-account transactions under Article 8 of the Articles of Association. In countries where there no exchange controls or existing controls failed to insulate the economy from the rest of the world was in practice at most limited scope for an independent national monetary policy. In this period most countries imposed exchange controls on capital movements but in many cases they did not provide lasting insulation from external influences on monetary policy.

In the second typical monetary policy framework, fiscal exigencies dominated monetary policy (See Box 6A in Chapter 6). Many developing countries opted out of Article 8, maintaining exchange controls to insulate their economies from world prices. They could then extract more revenue from their financial systems through financial repression and the inflation tax (Fry 1997, 1998). Consequently, these countries experienced high inflation and currency depreciation. In such countries, the monetary policy framework was designed in practice to raise government revenue from the inflation tax. Higher government deficits led to higher inflation, as the government turned to its central bank as its revenue source.

For at least a decade after the collapse of the Bretton Woods system in the early 1970s, monetary policy frameworks changed surprisingly infrequently. While some countries adopted floating exchange rates, smaller countries as well as several European economies continued with pegged exchange rate systems. Even the floaters made few formal changes to their monetary policy frameworks. This may well have been due to the general view that monetary policy was not very effective. Furthermore, only 25 years ago, Karel Holbik (1973, p. xxv) could write of monetary policy in twelve OECD countries (including Germany): "There is hardly a central bank in existence which does not conform to, co-operate with, and support national economic, social and other objectives. All central banks are sensitive to governmental authority."

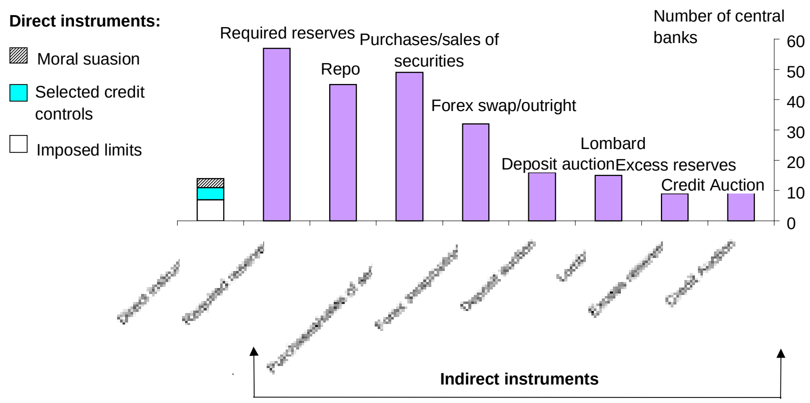
All this has changed dramatically over the past two decades. Much more attention has been devoted to devising appropriate monetary policy frameworks essentially to secure price stability in industrial, developing, and transitional countries. This follows the increasingly widespread acceptance of the view that price stability fosters improved economic performance.

So price stability has been adopted by more countries as the sole, or at least primary, objective of monetary policy since the early 1980s, a trend that has accelerated during the 1990s. Specifically, the early 1990s witnessed a rapid rise in the number of industrialised countries that adopted explicit inflation targets pursued by relatively independent central banks. Somewhat ironically, however, explicit inflation targets are now becoming popular in developing and transitional economies just when industrialised economies in Europe have moved towards monetary union, the ultimate form of fixed exchange rate target.

1.3 What Monetary Policy Can and Cannot Do

To devise a logical framework for the conduct of monetary policy, it is first essential to know what monetary policy can and cannot do. In most industrial countries, by far the most important instrument of monetary policy is a short-term interest rate set by the central bank to influence financial conditions that, in turn, affect aggregate demand. In some other countries, particularly where financial markets are not well developed, the central bank exerts its influence through reserve requirements applied to commercial banks and administrative controls over commercial bank interest rates and the allocation of credit.

Chart 1.2
Operating instruments of monetary policy



Source: Bank of England Survey of monetary frameworks.

Chart 1.2, drawn from the answers in the survey, shows how most monetary policy is now implemented using indirect operating instruments of monetary policy. Of the sample of 94 economies, 61% use required reserves, 48% use repos to manage or influence short-term interest rates and 52% operate through buying or selling securities. Only eleven countries from our sample of 94 use direct controls on interest rates or credit allocation.

The standard monetary model has the central bank interest rate affecting aggregate demand in the economy: a lower interest rate increases the quantity of reserve money demanded as banks find profitable uses for the extra reserves that boost aggregate demand, while when interest rates are increased, banks find the cost of funds now exceeding potential returns, and the demand for reserve money decreases.

Alan Blinder (1998) stresses that a logical monetary policy must start with an objective function and at least one macroeconomic model showing how at least one monetary policy instrument affects the economy. Blinder (1998, Ch. 1) shows convincingly that effective monetary policy must be based on at least one macroeconomic model and the underlying concept of dynamic programming—“think ahead in order to make today’s decision” (Blinder 1998, p. 14). In other words, the policy-maker should work out a path from the present to the desired future situation.

The dynamic programming approach can help to avoid overshooting which might otherwise result from time lags in economic reactions. The alternative static approach, “looking out the window” in Blinder’s terminology (p. 16), of tightening monetary policy if the current inflation rate is too high and loosening policy if it is too low, is bound to result in monetary policy being kept tight or loose for too long. Blinder concludes that “the dynamic programming way of thinking is not sufficiently ingrained into the habits of monetary policy makers, who too often just ‘look out the window’ and base policy judgements on present circumstances. I believe this is a fundamental mistake and is one reason why central banks often overstay their policy stance” (Blinder 1998, p. 23).

Blinder illustrates the dynamic-programming strategy with the 'pre-emptive strike' adopted by the US Federal Reserve (Fed) in early 1994 in which monetary policy was tightened before inflation rose. One practical difficulty Blinder points out is that the central bank will appear to be implementing unnecessarily restrictive monetary policy. If successful, the pre-emptive strike ensures that inflation does not increase, (so critics will complain that tighter monetary policy was unnecessary!) And, of course, perfect pre-emptive monetary policy implies that no observable relationships will be observed between monetary policy actions and macroeconomic variables. For example, if monetary policy successfully maintains inflation at exactly 2½%, it would be impossible to detect the effect of any policy instruments on inflation—the dependent variable is a constant.

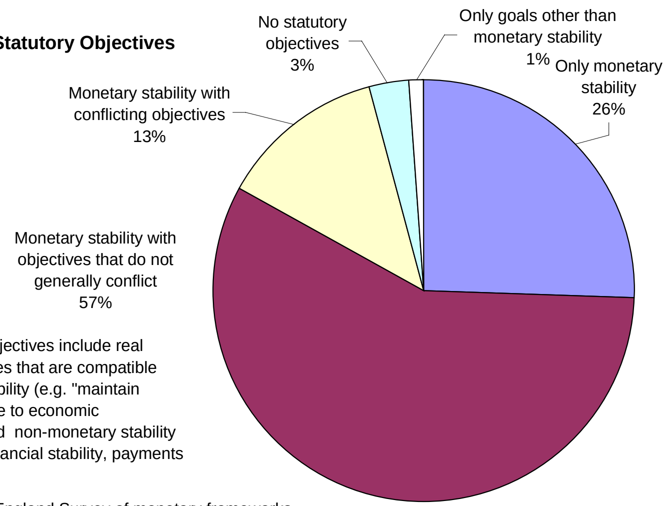
As Charles Goodhart (1994, pp. 1424–25) stresses, monetary policy cannot control in any mechanistic way the quantity of reserve money through control over an interest rate. There are just too many shocks to the demand for reserve money to enable such control within any reasonable range of interest rates. So the central bank is always obliged to adjust the supply of reserve money to demand at some acceptable interest rate, i.e., to offer an elastic supply of reserve money. Nevertheless, influence over the quantity of reserve money through short-term interest-rate control should be achievable over time, if not immediately, in virtually all market-based banking systems.

Debate still continues over the appropriate objectives of monetary policy, in large part because of disagreement over what monetary policy can and cannot achieve. On the one hand, some advocate that monetary policy can and should be targeted at employment and economic growth in addition to price stability.[12] The alternative view is that monetary policy should be directed solely at price stability.

The apparent conflict between these two views is resolved if it can be established that monetary policy is conducive to high employment and growth only if it maintains stable prices. In such a case, price stability is a necessary condition for sustained economic growth and there is no conflict between the two objectives: they always imply the same policy.

The debate has a long history. It suffices to say here that it has a major influence on choices of monetary policy framework. At present, the pendulum has swung in favour of the second view: an increasing number of recent central bank laws establish price stability as the predominant, if not the exclusive, monetary policy objective. This, however, reflects a growing belief that there is in fact no conflict between price stability and sustainable economic growth, and that inflation is likely to be harmful to long-term growth prospects. Chart 1.3 demonstrates that price and currency stability (monetary stability) is primary among the statutory objectives of most central banks. In fact, debate over the objectives of monetary policy has to a large extent been replaced by debate over how to maximise economic growth.

Chart 1.3
Categories of Statutory Objectives



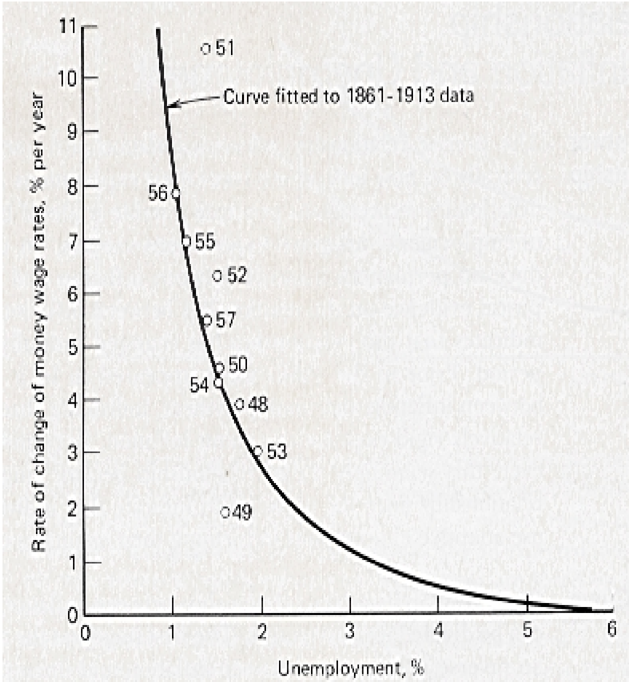
Non-conflicting objectives include real economy objectives that are compatible with monetary stability (e.g. "maintain stability conducive to economic development") and non-monetary stability objectives (e.g. financial stability, payments system)

Source: Bank of England Survey of monetary frameworks.

Views on what monetary policy can do have changed radically during the twentieth century. While Irving Fischer's (1922) quantity theory suggested that monetary policy's primary effect was on changes in the price level through changes in the quantity of money, Keynesians as represented in the UK Radcliffe Report (1959) found a far less clear-cut role for the quantity of money in the macroeconomy. Also, those who advocated economic planning techniques saw no independent role for monetary policy. Milton Friedman and the other monetarists, who stressed the importance of the causal relationship running from money growth and inflation, challenged the Keynesian view, as well as the rationale for economic planning. Two landmarks in this literature were Bill Phillips' (1958) empirical work on the relationship between the rate of change in wages and the unemployment rate in the United Kingdom and the subsequent article by Paul Samuelson and Robert Solow (1960) on the cost of reducing inflation in terms of lower economic growth.

In 1958, Bill Phillips demonstrated the existence of a stable relationship between unemployment and the rate of change in wages in the United Kingdom over the past century, shown in Figure 1.1 (Phillips 1958, p. 288). He used this relationship to estimate the maximum level of aggregate demand and hence minimum level of unemployment consistent with price stability. He perceived that some combinations of lower unemployment rates and concomitant positive inflation rates fell inside a 'no-go zone' for macroeconomic policy and should therefore be avoided.

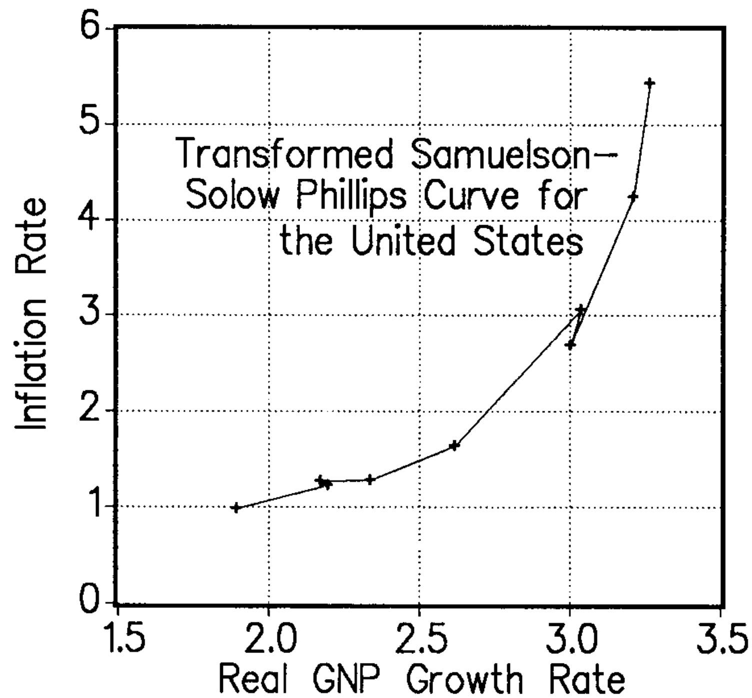
Figure 1.1 The Original Phillips curve



Within four years of its invention, Paul Samuelson and Robert Solow (1960) had inverted Phillips' analysis to suggest that a range of 3%–4% inflation was the necessary price of bringing unemployment down to 3% in the United States. Samuelson and Solow represented the Phillips curve as a relationship between price inflation and unemployment rather than between wage inflation and unemployment. This transformation was consistent with Phillips' own claim that low productivity growth in the United Kingdom permitted nominal wages to rise by only 2% for price stability to be maintained. In other words, it was reasonably safe to assume productivity growth of 2%. So the *y*-axis of the United Kingdom Phillips diagram was recalibrated at a price inflation rate two percentage points lower than the corresponding rate of wage inflation.

Combining assumptions of constant productivity growth and constant labour force growth enabled Arthur Okun (1962) to derive a monotonic relationship between growth and unemployment. In this way, the downward-sloping Phillips curve is transformed into an upward-sloping relationship between inflation and growth: higher growth can be achieved at a cost of higher inflation. Figure 1.2 illustrates this transformed Phillips curve for the United States between 1961 and 1969, starting with 1% inflation and less than 2% growth in 1961. For virtually all developing countries, Phillips curves can be represented only in this form, because there are no unemployment data.

Figure 1.2
Transformed Samuelson-Solow Phillips Curve for the United States



In the 1960s, the economics profession in general accepted the proposition that a stable trade-off existed between inflation and growth: higher growth could be achieved at the cost of higher inflation. But, as anticipated by Phillips himself (Phillips 1958), no sooner had policy-makers started to exploit the Phillips curve relationship than it disappeared. The generally accepted explanation is the expectations-augmented Phillips curves expounded by Milton Friedman (1968) and Edmund Phelps (1967). David Hume provided one of the clearest expositions of this relationship in 1752:

Accordingly we find, that in every kingdom, into which money begins to flow in greater abundance than formerly, every thing takes a new face; labour and industry gain life; the merchant becomes more enterprizing; the manufacturer more diligent and skillful; and even the farmer follows his plough with greater alacrity and attention. … To account, then, for this phænomenon, we must consider, that tho' the high price of commodities be a necessary consequence of the encrease of gold and silver, yet it follows not immediately upon that encrease; but some time is requir'd before the money circulate thro' the whole state, and make its effects be felt on all ranks of people. At first, no alteration is perceiv'd; by degrees, the price rises, first of one commodity, then of another; till the whole at last reaches a just proportion, with the new quantity of specie, which is in the kingdom. In my opinion, 'tis only in this interval or intermediate situation, betwixt the acquisition of money and rise of prices, that the encreasing quantity of gold and silver is favourable to industry. (Hume 1752, pp. 46–47)

So within a decade of its discovery, the Phillips curve had come under theoretical attack. Within two decades, the relationship had indeed disappeared. From an upward-sloping relationship between inflation and growth, the transformed Phillips curve had become vertical. No long-run trade-off between inflation and growth could be detected in the data collected after 1970.

Over the past two decades, the Phillips curve has rotated: simple bivariate regressions, cross-section and pooled time series, now detect negative relationships between inflation and growth for various country groups in both long and short runs. One study finds negative-sloping long-run expectations-augmented Phillips curve relationships between inflation and growth in developing countries (Fry 1995, Ch. 10).

Far from there being any exploitable trade-off in the medium and longer terms between inflation and higher output levels, the more widely accepted view today is that, in the longer term, this relationship is negative, i.e., more inflation is associated with lower growth (Barro 1995, De Gregorio 1994, Fischer 1994). While the deleterious effects of hyper-inflation on growth, with the dislocations caused to saving patterns and to the monetary and pricing mechanisms, are fairly obvious, it appears that inflation has a negative effect on growth even at low or moderate levels.

A wide variety of potential channels for both negative and positive effects running from inflation to growth, and vice versa, exist. In developing countries, fixed non-adjustable nominal interest and exchange rates may have been particularly harmful (Fry 1995, Ch. 8). As inflation rises, lower real interest rates resulting from fixed nominal rates reduce credit availability and distort resource allocation, while a fixed exchange rate prices exports out of world markets. Both effects are growth-reducing.

Another explanation for the negative relationship between inflation and growth lies in the fact that a higher level of inflation is generally associated with a greater variability of inflation and hence a greater riskiness of longer-term unindexed contracts. As John Locke (1695, p. 189) wrote:

I see no reason to think, that a little bigger or less size of the pieces coined is of any moment, one way or the other. … The harm comes by the change, which unreasonably and unjustly gives away and transfers men's properties, disorders trade, puzzles accounts, and needs a new arithmetic to cast up reckonings, and keep accounts in; besides a thousand other inconveniences.

The negative relationship between growth and inflation detected in recent years might also be attributable to the worldwide supply shocks of the 1970s and 1980s: a leftward shift in the supply curve lowers quantity and raises price. But the period 1988–1995 was not characterised by large supply shocks, and demand shocks affect price and quantity in the same direction, and yet the negative relationship appears to be even stronger over this more recent period. In any event, the available evidence from industrial, transitional, and developing economies does not support the belief that monetary policy can accelerate growth or reduce unemployment at the cost of a higher inflation rate. Hence, monetary policy frameworks should clearly not be based on the assumption that there is any such trade-off.

1.4 Who Determines the Monetary Policy Framework?

A crucial element of a country's monetary policy framework is how it is determined. Invariably, the basic legal framework is to be found in a country's central banking law. In some cases, the legislation is so outdated or unclear as to have been greatly augmented by convention and precedent. In several recent instances, monetary policy frameworks have been defined in new central bank legislation.

At one end of the spectrum, the framework may retain all policy decisions for the government, as was the case in the United Kingdom prior to 1997. In such a case, the government sets the goals of monetary policy and manages the instruments used to achieve them. Towards the other end of the spectrum the central bank may enjoy substantial, though not unlimited discretion to define the goals of monetary policy, as well as the autonomy to manage the instruments of monetary policy. The US Federal Reserve System provides an example of such independence. An increasingly widespread practice is for the government to be involved in setting the goals, while the central bank manages the instruments to achieve the goals, i.e., the central bank possesses instrument or operational independence but not goal independence.

1.5 Rules versus Discretion

An important issue related to who determines the monetary policy framework is whether the central bank is obliged to pursue fixed rules in its conduct of monetary policy or is free to use discretion. Milton Friedman (1960, p. 87) stresses that monetary policy takes effect with long and variable lags: " … there is much evidence that monetary changes have their effect only after a considerable lag and over a long period and that the lag is rather variable."

Since these lags are also unpredictable, it is impossible to achieve desired results by implementing monetary policy in a discretionary fashion. So, given imperfect knowledge about the way the economy works together with the danger that policy-makers might take inappropriate actions either out of ignorance or to further ends such as re-election that are unlikely to be in the general interest of the public, one can make a case in favour of adopting a monetary policy rule, such as annual growth in the money stock of *x* %. In this way, pro-cyclical monetary policy would be avoided. While not perfect, a rule may well deliver more stability than discretion will in practice.

The modern debate over rules versus discretion focuses on the time-inconsistency problem (Barro 1986, Kydland and Prescott 1977). The concept of time inconsistency can be illustrated in the case of patents. A patent encourages invention, which increases social welfare. Once the invention has taken place, however, social welfare can be increased by reneging on the patent right so that the patented good can be produced competitively. So too with monetary policy there is an incentive to renege on any commitment (the rule) to price stability and to generate unanticipated inflation in order to increase output, albeit only temporarily.

This dilemma also exists in monetary policy conduct. *Unexpected* increases in the price level increase real economic activity temporarily, i.e., an expectations-augmented Phillips curve exists. Economic expansions, even though temporary, provide utility, but inflation is costly.

The policy-maker has an incentive to generate unexpected inflation in order to achieve higher growth. However, individuals in the economy are rational and understand the policy-maker's incentives as well as the way the economy works. So people expect that the policy-maker will produce some inflation in order to raise output. In equilibrium, actual inflation is anticipated correctly on average. So to maximise social welfare, the policy-maker creates unanticipated inflation to the point where the marginal cost of inflation equals the marginal benefit of unanticipated inflation (Barro 1986, pages 16–19).

Under such circumstances the equilibrium inflation rate is relatively high, as of course is the cost of inflation. In this case, the policy-maker can improve social welfare by making a commitment to deliver low inflation. If such commitment is credible, individuals will anticipate low inflation and the equilibrium will be one of low and stable inflation but with the same amount of surprise inflation on average (zero) as before.

The ability to enforce of the commitment is all-important to ensure credibility. Without credibility of the commitment, individuals would understand the policy-maker's incentive to cheat and the low-inflation equilibrium would not be stable; the welfare-maximising policy-maker would return the economy to the previous high-inflation discretionary equilibrium.

Even with a model that incorporates the desire of policy-makers to create inflation surprises, Persson and Tabellini (1993, page 77) show that "the optimal central-bank contract, when feasible, does not entail any loss of welfare nor any sacrifice of stabilization policies … In general, the design of optimal monetary institutions does not seem to entail any tradeoff between credibility and flexibility."

As an alternative to securing a credible commitment from the policy-maker, various other enforcement devices have been proposed to counteract the perceived inflationary bias in monetary policy:

(i) Free banking that allows commercial banks to compete by issuing their own money. In conjunction with rational expectations and strong legal enforcement of contracts (both explicit and implicit), competition should ensure that the public accepts only commercial bank money that offers a competitive real return on deposits. In this model, there is no central bank and no official monetary policy.

(ii) A monetary constitution, "a regime prescribed by constitutional law and changeable in its main lines only by constitutional amendment" (Yeager 1992, page 731). The idea here is that the obstacles to changing the constitution will reinforce adherence to a monetary constitution that presumably incorporates price stability as its main or sole goal.

(iii) Ensuring that central bankers benefit, perhaps financially, from maintaining a reputation for establishing and sustaining price stability.

(iv) Appointment of conservative central bankers (Rogoff, 1985).

(v) Use of principal-agent contracts to make central bankers' remuneration decline as inflation rises (Walsh 1995). Under this approach, the legislature creates an independent central bank and assigns it, by law, the objective of price stability (Persson and Tabellini 1993).

(vi) Assuming that central bankers are not motivated by financial incentives, use of inflation targeting as constrained discretion. Ben Bernanke, Thomas Laubach, Frederic Mishkin and Adam Posen (1999, pages 4–6) argue that inflation targeting is a framework, not a rule:

"By imposing a conceptual structure and its inherent discipline on the central bank, but without eliminating all flexibility, inflation targeting combines some of the advantages traditionally ascribed to rules with those ascribed to discretion." (Bernanke, Laubach, Mishkin and Posen 1999, page 6)

Blinder (1998, pages 36–48) attacks the case for monetary policy rules in various ways. One simple device is to ask the question: If there is an inherent inflationary bias in discretionary monetary policy, why has inflation been reduced in so many countries since 1980? He then demolishes two of the three proposed solutions to this inflationary bias—reputation, principal-agent contracts, and the deliberate appointment of conservative central bankers. While reputation is undoubtedly important in practice, Blinder objects to the on-off way it is introduced in Barro's model. Contracts between the government and the central bank that imposed financial penalties for inflationary bias do not address the fact that most central bank policy-makers would be far better off financially in alternative employment. If financial incentive was not the overriding consideration in accepting the job, why would financial incentive affect behaviour in the job? While more tolerant to Rogoff's suggested solution in the form of appointing conservative central bankers, Blinder (1998, pages 47–48) points out that there is a danger in appointing central bankers who are too conservative.

Blinder (1998, pages 50–51) concludes that academic research has assisted practitioners in choosing an appropriate monetary policy instrument (interest rates), but has provided, in the main, misleading answers in the debate revolving around time-inconsistency and rules versus discretion, and has left the issue of defining a neutral monetary policy unresolved.

1.6 Central Bank Independence

An important objection to central bank independence in democracies is based on the fact that central bankers are not elected to office and are not therefore directly accountable to the electorate for their actions. One solution to this so-called 'democratic deficit' is to ensure that the central bank is accountable to the electorate and that its affairs are transparent.

Blinder (1998, Chapter 3) accepts the proposition that in a democratic society the central bank should have instrument but not goal independence. Because monetary policy-making necessitates a long time horizon and often requires an initial cost before the benefit is reaped, impatient politicians would be tempted to seek short-term gain at the expense of longer-term benefits. But to pursue the goals set by government central bankers need independence not only from government itself but also from financial markets. When extracting information for monetary policy purposes from financial markets, Blinder believes that it is all too easy to fall into the trap of 'following the market'.

While advocating central bank independence, Blinder (1998, pages 62–66) claims that there is no evidence that such independence increases credibility of monetary policy announcements and so improves the short-run trade-off between inflation and unemployment in OECD countries. Perhaps, however, a wider search for credible macroeconomic policy announcements is warranted. In 1975, for example, Taiwan launched a stabilisation plan. That year its inflation fell from 47% to 5%, while the economic growth rate increased from 1% to 5%. In 1976 inflation fell further to 2.5%, while growth accelerated to 13.9%. Just sometimes, useful additional data points are available outside the OECD countries.

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[2] This view was presented forcefully by Kenneth Clarke, the former UK Chancellor of the Exchequer, to the House of Lords Treasury Select Committee on 18 March 1999. He maintains that economic policy should be aimed at steady, sustainable growth and that "everything else is subordinate."