

PRINCETON UNIVERSITY
Woodrow Wilson School of Public & International Affairs

THE POLITICAL ECONOMY OF CENTRAL BANKING

WWS 593c
Fall 2004

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*“ There have been three great inventions since the beginning of time:
fire, the wheel, and central banking.” – Will Rogers*

This course is about the economics *and some of the politics*—both internal and external—of central banks as policymaking institutions. Since the focus is on monetary policy, the course presupposes a working knowledge of the relevant macroeconomic background—WWS 512c or the equivalent. (But Part 1 below is in some sense review.) The greatest emphasis will be on the Federal Reserve System, although some attention will be paid to other central banks.

A few questions—some positive and some normative—provide unifying themes for the course:

- What do central banks do? How do they make decisions?
- What *should* central banks do—that is, what sorts of decisions should be made by central bankers rather than by politicians?
- Do “political” considerations affect central bank decisions? Should they?
- To what extent is central banking “undemocratic”?

There are no textbooks for this course, but multiple references will be made to the following four books:

Alan S. Blinder, Central Banking in Theory and Practice (MIT Press), 1998.

Alan S. Blinder, The Quiet Revolution: Central Banking Goes Modern (Yale University Press), 2004.

Laurence H. Meyer, A Term at the Fed (Harper Business), 2004.

Steven Solomon, The Confidence Game: How Unelected Central Bankers are Governing the Changed Global Economy (Simon & Schuster), 1995.

The reading list also includes several speeches by Federal Reserve officials. These are available on line on the Fed’s website: www.federalreserve.gov. (Click on “News and Events,” then “Speeches by Federal Reserve Board members,” then chose the year.)

SYLLABUS AND READING LIST

(* connotes optional)

1. The Economics of Monetary Policy: Gaps, “Neutral” Rates, and Taylor Rules

Blinder (1998), Chapter 1, omitting Section 5; Chapter 2, Sections 1-3.

Stanley Fischer, “Modern Central Banking” in Forrest Capie *et al.*, The Future of Central Banking: The Tercentenary Symposium of the Bank of England (Cambridge University Press), 1994, Sects. 2.3, 2.4, 2.5.

Meyer, Chapters 2, 3, 4, 6

* John B. Taylor, “Monetary Policy Guidelines for Employment and Inflation Stability,” in R.M. Solow and J. B. Taylor, Inflation, Unemployment, and Monetary Policy (MIT Press), 1998, Chapter 2.

2. The Culture of Central Banking

Solomon, Chapter 9

Laurence H. Meyer, “Come with Me to the FOMC,” The Gillis Lecture, April 1998. (On Fed website.)

* William Greider, Secrets of the Temple: How the Federal Reserve Runs the Country (Simon and Schuster), 1987, Chapter 2.

3. Central Bank Independence—From Whom?

Blinder (1998), Chapter 3, pp. 53-66

Fischer, Sections 2.7-2.9

Solomon, Chapter 2

Adam S. Posen, “Why Central Bank Independence Does Not Cause Low Inflation: There is No Institutional Fix for Politics,” in Richard O’Brien, ed. Finance and the International Economy 7: The AMEX Bank Review Prize Essays in Memory of Robert Marjolin (Oxford University Press), 1993, pp. 41-54.

Blinder (2004), Chapter 3

* Henry W. Chappell, Jr. *et al.*, Committee Decisions on Monetary Policy, (MIT Press), forthcoming, Chapter 9, pages 1-16; Chapter 4. This book is not yet published, but is available online at <http://dmsweb.badm.sc.edu/chappell/Papers/Book/apage.htm>.)

4. Central Banking and Democracy

Blinder, Chapter 3, pp. 66-75.

Solomon, Chapter 26

Alan S. Blinder, "Is Government too Political?" Foreign Affairs, Nov./Dec. 1997, pp. 115-126.

Christopher J. Waller, "A Bargaining Model of Partisan Appointments to the Central Bank," Journal of Monetary Economics, 29 (1992), pp. 411-428. (Read for the ideas, not the details.)

Jon Faust, "Whom Can We Trust to Run the Fed? Theoretical Support for the Founder's Views," Journal of Monetary Economics, 37 (April 1996), pp. 267-283. (Read for the ideas, not the proofs.)

5. The Trend toward Transparency

Blinder (2004), Chapter 1

* Alan Blinder *et al.*, How Do Central Banks Talk?, Geneva Reports on the World Economy 3, 2001, Section 2.7, Chapter 4, Chapter 5

A synthetic "symposium" of current FOMC members:

Ben S. Bernanke, "Fedspeak," speech to the meetings of the American Economic Association, San Diego, January 3, 2004.

William Poole, "Fed Transparency: How, Not Whether," Federal Reserve Bank of St. Louis Review, Nov./Dec. 2003, pp. 1-8.

Roger W. Ferguson, Jr., "Why Central Banks Should Talk," speech to the Graduate Institute of International Studies, Geneva, January 8, 2002.

6. Decisionmaking by Committee

Blinder (2004), Chapter 2

Chappell et al., Chapters 6-8

7. Asset Bubbles and Monetary Policy

Meyer, Chapters 7-9

Alan Greenspan, "Opening Remarks," in Federal Reserve Bank of Kansas City, Rethinking Stabilization Policy, 2002.

Ben S. Bernanke, "Asset-Price 'Bubbles' and Monetary Policy," speech to National Association for Business Economics, New York, October 15, 2002.

Stephen Cecchetti *et al.*, Asset Prices and Central Bank Policy, Geneva Reports on the World Economy 2, 2000, Sections 2.1, 2.2, Chapter 3, Sections 4.1, 4.4, 4.5.

8. Inflation Targeting

Lars E.O. Svensson, "Monetary Policy and Real Stabilization," in Federal Reserve Bank of Kansas City, Rethinking Stabilization Policy, 2002, pp. 261-288 only.

*Lars E.O. Svensson, "Inflation Forecast Targeting: Implementing and Monitoring Inflation Targets," European Economic Review, 41, 1997, pp. 1111-1146.

Ben S. Bernanke, "A Perspective on Inflation Targeting," Speech to the National Association of Business Economists," Washington, March 25, 2003.

Laurence H. Meyer, "Practical Problems and Obstacles to Inflation Targeting," paper presented at Federal Reserve Bank of St. Louis conference, October 2003.