Comments on
Re-Examining the Conduct of Monetary Policy: Towards the 2021 Framework Renewal

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Note: The views expressed here are solely those of the commentator and do not necessarily reflect the views of any other person or institution.

Mitigating the Risk of Political Interference

- The risk of political interference cannot be eliminated merely by granting statutory independence to the central bank, because politicians may ignore or override those laws.
- The operational independence of the MPC fundamentally rests on the degree of public confidence in the legitimacy of the institution.
- These considerations provide a crucial rationale for ensuring the transparency and public accountability of the MPC.

Mitigating the Risk of Group-Think

- Delegating monetary policy to a committee is now standard practice across the globe.
- However, the benefits of having a committee can be severely undermined by group-think:
  - homogeneity of committee members
  - consensus-based decisions
  - lack of external reviews
- In light of those considerations, the MPC should comprise a diverse group of experts who are individually accountable for their policy decisions.

Principle #1: Fully Public

The MPC should be a fully public institution whose members are accountable to elected officials and the general public.

- **Many central banks were originally conceived as private institutions, but the vast majority are now public.**
- **The Bank of Canada and Bank of England became public more than a half-century ago.**
- **The ECB and 16 of 19 NCBs are fully public.**
- **The Federal Reserve is the notable exception.**

Principle #2: Composition

The selection of MPC members should ensure diverse perspectives and forms of expertise.

- **Earlier studies of MPCs were mostly focused on hetereogeneous preferences (hawks/doves) or the hetereogeneity of anecdotal information.**
- **In contrast, this principle combats group-think by appointing experts with diverse educational backgrounds and professional experiences.**
- **Geographical diversity may also be crucial for fostering & maintaining public legitimacy.**

Principle #3: Selection Procedures

The process of selecting MPC members should be systematic, transparent, and consistent with democratic legitimacy.

- **The process should have “checks and balances”, i.e., multiple steps involving different sets of decision-makers.**
- **Transparency mitigates the risk of undue influence by special interests.**
- **The process should foster public confidence in the integrity of the institution.**

Principle #4: Size and Voting Rules

The MPC's size and voting rules should foster genuine engagement among members and diminish the influence of any single individual.

- **This principle mitigates the risks of autocracy, which has pitfalls like those of group-think.**
- **Previous analysis prescribed a fairly small size as optimal for engagement (e.g., 5 members), but a somewhat larger size may be needed to encompass sufficiently diverse perspectives.**

Principle #5: Terms of Office

Terms should be staggered, non-renewable, and last longer than the political cycle, with removal only in cases of malfeasance.

- **Staggered terms are fairly conventional but only effective if members serve out a full term.**
- **Foreclosing the possibility of reappointment mitigates risks of political interference and avoids the entrenchment of power bases.**
- **The heads of many MPCs serve terms of 7-10 years, whereas the Federal Reserve Chair has a renewable 4-year term.**

Principle #6: Individual Accountability

Each MPC member should be individually accountable to elected officials and the public.

- Individual accountability is crucial for mitigating the risk of group-think.
- Such accountability should occur through MPC communications, speeches & interviews, and hearings before elected officials.
- To avoid cacophony, the MPC must clearly explain the rationale for its decisions as well as elucidating the range of individual views.

Principle #7: External Reviews

The MPC should be subject to periodic external reviews of its strategy and operations, but not its specific policy decisions.

- **External reviews can be invaluable in identifying and mitigating group-think.**
- **Such reviews should occur on a regular schedule rather than triggered by political motives or idiosyncratic factors.**
- **These reviews should focus on assessing past & prospective performance, *not* on evaluating individual policy decisions.**

Principle #8: Legal Mandate

The MPC should have a legal mandate that sets forth its governance, goals, and tools.

- **Some previous analysts have advocated that the MPC's objectives & priorities should be clarified in its statutory mandate.**
- **With pervasive & persistent model uncertainty, the appropriate specification of those goals and priorities may be complex & time-varying.**
- **Thus, the mandate should set forth the MPC's responsibilities & tools in fairly broad terms to minimize the need to amend that statute.**

Principle #9: Medium-Term Framework

The MPC's medium-term policy framework should be approved or endorsed by elected officials roughly once every 5 years.

- **This framework should provide a quantitative description of the MPC's objectives, priorities, intermediate targets & operating procedures.**
- **The approval or endorsement of elected officials is crucial for the legitimacy and credibility of the policy framework.**

Principle #10: Near-Term Strategy

The MPC should formulate a systematic and transparent strategy that guides its specific policy decisions over the coming year or so.

- **This near-term strategy effectively clarifies the MPC's "policy reaction function."**
- **The strategy may be characterized using model-based forecasts, simple rules, scenario analysis, and contingency plans.**
- **Every central bank should engage in "stress testing for monetary policy."**

Principle #11: Policy Decisions

The MPC should regularly publish reports explaining the rationale for its specific decisions in terms of its policy framework and strategy.

- **This principle presumes that the MPC promptly announces each policy decision.**
- **The MPC's reports should be published on a fixed schedule, roughly once per quarter.**
- **These reports should explain the rationale for the majority's decision along with concurring and dissenting opinions that clearly convey the range of individual views.**

Central Bank Digital Currency

- In contrast to virtual currencies, the central bank can issue a digital currency that is fixed in nominal terms and that serves as legal tender (like paper currency).
- Many central banks are actively exploring the launch of their own digital currencies, and some have begun experimenting with prototypical designs.
- Recent studies about CBDC have generally focused on technical & logistical issues regarding payments.
- Central banks should consider how CBDC can enhance the effectiveness of the monetary policy framework.

Design Principles for CBDC

- Drawing on a long strand of literature in monetary economics, Bordo & Levin (2017) analyze the basic specifications of CBDC, with the aim of formulating design principles rather than a technical blueprint.
- We conclude that CBDC can transform all aspects of the monetary system:
  - Medium of exchange: practically costless
  - Store of value: secure & interest-bearing
  - Unit of account: true price stability
  - Monetary policy framework: systematic & transparent

Basic Properties of CBDC

- **Medium of Exchange**
  - ***Universally Accessible*** **(like paper currency)**
  - ***Account-Based*** **(like debit cards),** ***not*** **token-based (unlike paper currency or bitcoin).**
- **Store of Value. CBDC should be** ***interest-bearing*** **at essentially the same nominal interest rate as short-term government securities; cf. Friedman (1960).**
- **Unit of Account. CBDC should be the nominal anchor, and hence its real value should remain stable over time in terms of a general index of consumer prices.**

Alternative Forms of CBDC Accounts

- **Direct Accounts.** **Anyone can hold funds in a CBDC account at the central bank itself.**
  - ***This approach is reminiscent of an earlier era when some private individuals had accounts at the central bank (e.g., Bank of England, Riksbank).***
- **Public-Private Partnership.** **CBDC can be intermediated by depository institutions, which must hold those funds in segregated accounts at the central bank.**
  - ***This approach is similar to the Federal Reserve's recent move to establish such accounts to protect customers' funds at key financial market utilities.***

Private Networks and Virtual Currencies

- **Complementarity.** Individuals & firms can continue to hold funds at private financial institutions and make payments via private networks.
- **Privacy.** Individuals and firms should remain free to engage in *relatively anonymous* transactions using virtual currencies or other private forms of payment.
- **Obsolescence of Cash.** Once CBDC is widely used for payments, the demand for paper currency will quickly diminish, especially if cash deposits & withdrawals are associated with graduated fees.

Unit of Account

- **Economic Efficiency.** A stable unit of account facilitates the decisions of households and firms and the determination of nominal wages & prices.
- **No Need for Inflation Buffer.** Because the CBDC interest rate can be adjusted downward as needed, there will no longer be a compelling rationale for the central bank to target a positive average inflation rate.
- **True Price Stability.** Therefore, the monetary policy framework should ensure that the real value of CBDC remains stable over time, as measured in terms of a general index of consumer prices.

Fostering Price Stability

- **Specification. The price level target should be specified in terms of a broad measure of consumer prices, using publicly-posted prices and chain-weighting, and this specification should not be modified except for compelling technical reasons.**
- **The Nominal Anchor. The price level will inevitably fluctuate in response to exogenous shocks, but monetary policy should ensure that the price level returns to its target over time, thereby anchoring the expectations of households & firms.**

The Central Bank’s Balance Sheet

- **Simplicity.** Under this framework, the central bank will be able to respond to a severe adverse shock without resorting to QE or other measures aimed at modifying the size or composition of its balance sheet.
- **Transparency.** The central bank’s balance sheet will be highly transparent, with assets of short-term government securities matching its liabilities of CBDC.
- **Operating Procedures.** The central bank will engage in purchases and sales of short-term government securities to equate the supply and demand for CBDC.

Interactions with Fiscal Policy

- There will generally be a negligible interest rate spread between CBDC and short-term government securities, and hence the size of the central bank's balance sheet will have no direct fiscal consequences.
- With obsolescence of paper currency, the central bank will no longer generate substantial seignorage and will simply cover its expenses via miniscule fees on payment transactions.
- The maturity composition of government securities held by the public will be determined by the fiscal authority, not the central bank; cf. Greenwood et al. (2014).

Lender of Last Resort

- During a financial crisis, the central bank should be able to expand the stock of CBDC as needed to provide emergency liquidity to supervised financial institutions.
- Alternatively, the central bank could extend such emergency liquidity to another public agency, such as the bank regulator or deposit insurance fund.
- Appropriate legal safeguards will be crucial to ensure that LOLR actions do not undermine the central bank's ability to carry out its commitment to price stability.

Economic Benefits of CBDC

- **Productivity.** By eliminating payment transaction costs, the CBDC significantly raises the productivity of the macroeconomy; cf. Barrdear & Kumhof (2016).
- **Progressivity.** The current payment system is costly for consumers and small businesses. Moving to CBDC can be viewed as similar to removing a regressive tax.
- **Macroeconomic Stability.** A large number of analytical studies have concluded that transparent & credible price-level targeting enhances macro stability.