

The Impact of the Independence of the Central Bank on the Effectiveness Monetary Policy in Iraq



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ABSTRACT:

The point of this paper is that demonstrates the relationship between the monetary policy and effectiveness of central banks for country Iraq. In this setting in econometrical part we utilize board OLS strategy with the reel GDP information of country and dummy variable which represent to independence of central bank of Iraq for investigation. We expect that effectiveness of central bank influences financial fiscal arrangement emphatically. This paper evaluates the relative adequacy of central bank effectiveness versus policy rules for the approach instruments in realizing great monetary policy. It analyzes recorded changes in (1) macroeconomic performance, (2) the adherence to rules based money policy, and (3) the level of central bank of Iraq effectiveness. Macroeconomic

performance is characterized regarding both financial stability and output stability. Both by right and accepted central bank effectiveness at the Federal Reserve are considered. The fundamental finding is that progressions in macroeconomic execution amid the past half century were nearly connected with changes in the adherence to rules-based fiscal arrangement and in the level of accepted money related autonomy at the Federal Reserve. In any case, changes in financial execution were not connected with changes in de jure central bank effectiveness. Formal central bank effectiveness alone has not created great money related approach results. A framework based structure is fundamental.

Keywords: Central Banks, Monetary Policy, Macroeconomic Performance, Policy Rules.

INTRODUCTION:

The central banks have existed for over a century but their purposes; functions and operations have evolved over time. Interest on the Central Bank Independence (CBI) intensified after models of monetary policy found the likelihood of an inflationary bias in monetary policy operated by democratic governments. The consensus is that, democratic governments generate a more pronounced inflation bias, requiring greater delegation of authority. The second is that democratic government is more open and pluralistic, involving more checks and balances, and therefore more amenable to delegation within the political system. As the economies tend towards democracy, the search began for how to establish monetary institutional policies that can be viewed as credible commitments. Delegation of monetary policy to an independent central bank was one strand of that exploration. Thus, since then, greater independence became the practice across all groups of countries, but has been particularly marked for developing and emerging market economies.

As central banks have become more independent, so the demand for transparency has increased, both for reasons of

accountability and legitimacy, and to guide the expectations of financial market participants (whose appetite for information has expanded as financial markets have become broader and deeper). Transparency became more necessary with the experience of the banking crises in Mexico in 1994 and the South East Asian. In 1997, official bodies, including the IMF and the Basel Committee on Banking Supervision, therefore, called for increased transparency of banking industry. Their suspicion is that the crises emanated from general lack of transparency in the affairs of both lender and borrowers and policies responsible for the depth of the crises which would not have been undertaken, had there been transparency. Also, monetary policy has become more information-intensive with the increasing popularity of inflation targeting (IT) over simpler policy anchors such as a fixed exchange rate or money aggregate rule. Hence both the supply of and demand for central bank transparency seem to have increased.

Monetary control and the central bank debates currently brought into agenda due to the increasing monetary policy implementations. Because, the basic source of inflation remains to be the disparity between the economic conjuncture and the

monetary growth. This is the reason why governments increase the budget deficits in order to finance the increased government spending instead of increasing the tax revenues due to the electional concerns. Free use of central bank resources causes the institution to be kept under the governmental coordination (pressures). This situation brings barriers to the efficient use of monetary policies. Monetary policy tools have an important place within the governments' economic interventions. The governments, with the hope of monetary adjustment accordingly with their output and employment targets, try to make policy implementations with the tools of open market operations and the reserve requirement ratios based on the general economic conditions.

The most important factor with the use of these tools is the existence of an independent monetary authority. Increasing the central bank autonomy debates are brought into agenda with the latest reforms in order to dispel the devastations caused by the inflation problem observed in many countries and also ameliorate the social structure in these countries. Debates reveal that there are four conditions required in the making of a sound monetary policy strategy. It is essential to examine these conditions

under the institutional framework. The discussions concerning the issues such as setting these conditions within an institutional framework, and justification of the need for these conditions are of special importance. Bringing the central banks into an independent position render the use of monetary policy tools more efficient in attaining the price stability target.

First; the central bank autonomy definition, indicators and the relationship between the central bank independency and the economic performance issues are evaluated within this paper. Second, the effects of an independent central bank to the economies' growth are examined based on the cross – country applications.

MONETARY POLICY

In general, stabilisation policies can be implemented with the aid of either monetary or fiscal policy. As to the role of monetary stabilisation policy, let me take the example of the euro area. In the euro area the Maastricht Treaty assigns to monetary policy the responsibility for maintaining price stability. The clear assignment of price stability as the overriding objective of the Central Bank – specified by a quantitative definition – provides guidance to economic

agents as to what can be expected from monetary policy. Without doubt this enhances the credibility of monetary policy, contributing to the anchoring of medium and long-term inflation expectations in the euro area. Stable inflation expectations eliminate an important source of macroeconomic instability, namely the possibility that economic shocks affecting inflation in the short-term become amplified via a corresponding adjustment in inflation expectations. In turn, the stability of these expectations contributes to economic welfare via a reduction of inflation risk premia contained, for example in nominal bond yields. By insuring price stability, monetary policy can thus make an important contribution to macroeconomic stability.

In its monetary policy strategy the Eurosystem has adopted a medium-term orientation. The forward-looking nature of this strategy insures that timely action is taken to address any potential threats to price stability. Yet, the medium-term orientation also reflects the existence of economic shocks, the consequences of which monetary policy cannot control without inducing excessively high variability in real activity and interest rates. A medium-term orientation should

effectively guarantee that monetary policy itself does not become a source of economic fluctuations: it avoids misguided reactions to short-term developments, providing a safety net against overly ambitious economic fine-tuning. As is well-known, monetary history is full of examples where monetary policy activism – concerned too much with the short run – led to a sequence of decisions which had to be reversed within short periods of time. Such a policy is a source of instability and generates results opposite to the ones initially envisaged. Overall, the medium-term orientation of monetary policy – guided by the objective of price stability – helps policy concentrating on the relevant economic shocks, that is on shocks and economic developments that monetary policy can effectively address. The focus on the medium-term may in a certain sense be interpreted as a practicable and economically reasonable compromise between Friedman's idea on economic self-stabilisation, which focuses entirely on the long-run, and the Keynesian view on economic fine-tuning, focused on shorter-term developments.

THE ROLE OF FISCAL POLICY

Fiscal policy can promote macroeconomic stability by sustaining

aggregate demand and private sector incomes during an economic downturn and by moderating economic activity during periods of strong growth. An important stabilising function of fiscal policy operates through the so-called “automatic fiscal stabilisers”. These work through the impact of economic fluctuations on the government budget and do not require any short-term decisions by policy makers. The size of tax collections and transfer payments, for example, are directly linked to the cyclical position of the economy and adjust in a way that helps stabilising aggregate demand and private sector incomes. Automatic stabilisers have a number of desirable features. First, they respond in a timely and foreseeable manner. This helps economic agents to form correct expectations and enhances their confidence. Second, they react with an intensity that is adapted to the size of the deviation of economic conditions from what was expected when budget plans were approved. Third, automatic stabilisers operate symmetrically over the economic cycle, moderating overheating in periods of booms and supporting economic activity during economic downturns without affecting the underlying soundness of budgetary positions, as long as fluctuations remain balanced.

In principle, stabilisation can also result from discretionary fiscal policy-making, whereby governments actively decide to adjust spending or taxes in response to changes in economic activity. I shall argue, however, that discretionary fiscal policies are not normally suitable for demand management, as past attempts to manage aggregate demand through discretionary fiscal measures have often demonstrated. First, discretionary policies can undermine the healthiness of budgetary positions, as governments find it easier to decrease taxes and to increase spending in times of low growth than doing the opposite during economic upturns. This induces a tendency for continuous increases in public debt and the tax burden. In turn, this may have adverse effects on the economy’s long-run growth prospects as high taxes reduce the incentives to work, invest and innovate. Second, many of the desirable features of automatic stabilisers are almost impossible to replicate by discretionary reactions of policy makers. For instance, tax changes must usually be adopted by Parliament and their implementation typically follows the timing of budget-setting processes with a lag. Not surprisingly, therefore, discretionary fiscal policies aiming at aggregate demand management have tended

to be pro-cyclical in the past, often becoming effective after cyclical conditions have already reversed, thereby exacerbating macroeconomic fluctuations.

Clearly, the short-term stabilising function of fiscal policy can become especially important for countries that are part of a monetary union, as nominal interest rates and exchange rates do not adapt to the situation of an individual country but rather to that of the union as a whole. Fiscal policy can then become a crucial instrument for stabilising domestic demand and output, which remains in the domain of individual governments. At the same time, however, the limitations of active fiscal policy may be greater when there is increased uncertainty about future income developments. This is the case today in many European countries where there is a growing concern about the difficulties faced by public pension and health care systems in view of demographic trends. Under such circumstances, cyclically-oriented tax cuts and expenditure increases today may simply translate into higher taxes or lower expenditure tomorrow. Aware of this, the public may increasingly react to fiscal expansions by raising precautionary savings rather than consumption. In the light of the previous

discussion, what is the scope for discretionary fiscal policies? Discretionary policies are needed to implement long-term structural changes in public finances and to deal with exceptional situations, particularly when the economy experiences extraordinary shocks. Discretionary policies in fact reflect the changing tastes about the desirable size of the public sector, about the priorities of public spending, and about the level and characteristics of taxation. These policies determine the structure of public finances and substantially affect the functioning of the economy but also the features of a country's automatic stabilisers. Discretionary fiscal policy decisions are also needed to preserve the sustainability of public finances in the medium-term. This is the precondition for automatic stabilisers to operate freely, as fiscal policy can only act as an effective stabilising tool when there is the necessary room for manoeuvre.

The experience of the industrialised countries in recent decades clearly shows that persistent fiscal imbalances limit the room for fiscal policy to stabilise the economy. Imbalances often necessitate tight fiscal policies during downturns to prevent unsustainable deficits and debt developments. Hence, when sustainability is

in doubt, expansionary measures and even automatic stabilisers may not have the desirable effect on output as people adjust their behaviour. Consolidation measures may then re-establish confidence and improve expectations about the long-term outlook of public finances. These so-called ‘non-Keynesian’ effects may have the result that fiscal consolidation even has an expansionary impact on the economy. Active fiscal consolidation with discretionary policies is therefore appropriate when budgetary positions are perceived as not being safe or when there are risks to fiscal sustainability due to high debt and future fiscal obligations. Finally, although automatic fiscal stabilisers are effective in dampening normal cyclical fluctuations, there may be situations where active policy decisions might be needed. For example, automatic stabilisers alone may not be sufficient to stabilise the economy when economic imbalances do not stem from normal cyclical conditions or are considered as irreversible. However, the benefits from expansionary policies in a recession must still be assessed against the risks to long-term sustainability or the persistent adverse effects on the structure of public finances, such as a permanently higher tax level, as

well as the economic costs of an eventual policy reversal.

DIFFERENT PATHS TOWARD AND AWAY FROM THE GREAT MODERATION

To measure changes over time in macroeconomic performance, I focus here on the size of the fluctuations in real output and inflation. A simple framework for evaluating the effect of monetary policy on such fluctuations is the tradeoff between variance of inflation and the variance of output which was developed in the years preceding the Great Moderation. This is the framework that Ben Bernanke used in his assessment of monetary policy and performance in his paper “The Great Moderation” first presented in 2004. The framework has also been used by other central bankers. While the tradeoff between the levels of inflation and output (or unemployment) is very short lived, the tradeoff between the fluctuations of these two variables is longer lasting and appropriate for comparing economic performance for more than two or three years. This framework naturally takes research beyond the question of why the financial crisis occurred and puts it in a

broader context of why the downturn was large and why the recovery so slow and, depending on the future, why the next downturn is large or small. We are considering fluctuations over longer periods of time.

Figure 1 replicates the tradeoff diagram as it appears. On the horizontal axis is the

variance of inflation; on the vertical axis is the variance of real output (deviations from potential GDP). Points more to the north or to the east represent more macroeconomic instability and thus poorer economic performance.

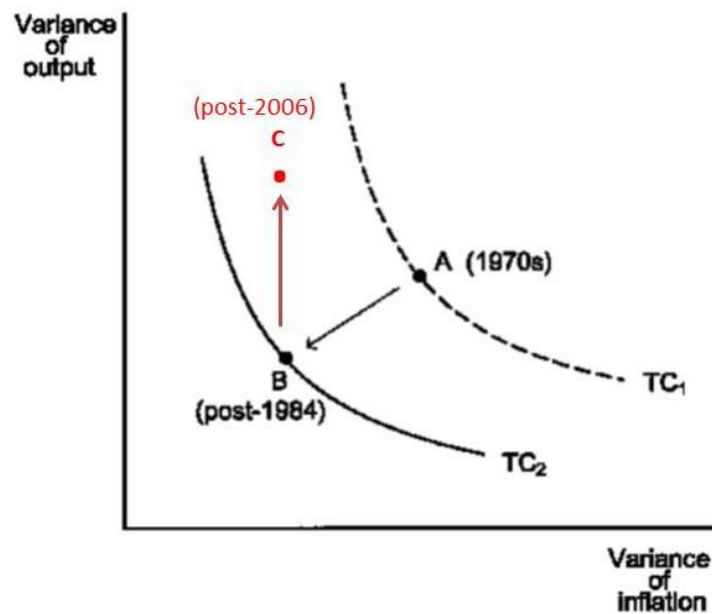


Figure 1: chart from bernanke (2004) "the great moderation"

The curve represents a tradeoff in the sense that along the curve monetary policy can achieve smaller inflation fluctuations only by generating larger output fluctuations. Points to the left or below this tradeoff curve are infeasible for a given structure of the economy. Points to the right and above are inefficient, in the sense that a better monetary policy would be on the curve. The

position and shape of the curve depend on the underlying structure of the economy and the size of the exogenous shocks to which it is subject. An economy with less rigid wage and price setting has a tradeoff curve closer to the origin than an economy with more rigid wages and prices. An economy with larger external shocks has a tradeoff curve

further away from the origin than an economy with smaller shocks.

Tradeoff curves can be derived quantitatively from a wide range of estimated or calibrated macroeconomic models, including DSGE models and New-Keynesian models of the type collected in monetary model data base. Of course the curve will differ somewhat from model to model because the economic structures of the models differ. The position of the economy on a given curve depends on how much emphasis the monetary authority places on inflation fluctuations versus output fluctuations. For example, a higher weight on inflation in the central bank's objective function implies a position on the curve more to the upper left.

Conceptualizing Central Bank Independence

There is no clear definition of Central Bank Independence (CBI) in the literature, as many authors give the definition in various ways. According to Friedman (1962), CBI relates to the relationship between the government and the Central Banks (CBs) as the government relates to the Judiciary. As the Judiciary can rule only on the basis of the laws provided by the legislation so also the CBs can only work on the policy of the government. Numerous episodes in the

world's economic history testify to a government's potential abuse of its power to create money. He gave an analogy of this as what happened around the third century AD in the Roman Empire, where the government collected silver coins as tax from the people melted and combined them with inferior metals, yielding many more coins to spend on the Caesar's priorities than the initial tax taken. With too much money chasing too few goods, the end result was hyper-inflation. Therefore, highlighted three major areas where the influence of government must either be excluded or radically reduced. These areas include; personnel, Financial and Policy sectors of the central bank.

Thus, there is the need for independence in the operations of the Central Banks in these three major areas. These are explained below; 1. Personnel Independence: This refers to the level of the influence of government in appointment of personnel in the Bank. 2. Financial Independence: This refers to the extent of power and type of access given to the government to handle Central Bank's Credits. If the government is given direct access, it means that the Central Bank is not financially independent. While indirect access like the power to have the Central Bank as the cashier of the

government or having the power to handle government debt management means independent of the Central Bank. 3. Policy Independence: This is given as the maneuvering room allowed for a central bank to formulate and implement monetary policy. This can be in respect of goal or instrument. In respect of goal, two important issues are raised. (1) the scope the Central Bank has to exercise its discretion and (2) the presence or absence of monetary policy as its central goal. A central bank is independent if it has the power to manipulate effective policy instruments and given the power by the law of the land to choose the means by which it will accomplish its goals. It is however not

independent if it will have to seek the endorsement of the government before it could use any instrument to attain its goal, then it is not independent with respect to instrument.

The Road Away from the Great Moderation

However, the Great Moderation has ended and it is time to move on to study the causes of this equally momentous change. In Table 1, I show the actual variability of the key variables. I report the variance as well as the standard deviation, which was the variability metric I originally focused on in where I drew the tradeoff curve in standard deviation space.

Table 1. Variability of Output and Inflation in Three Periods (%)

	Standard Deviation of		Variance of	
	Output	Inflation	Output	Inflation
1980 - 1998	3.6	2.4	13.0	5.8
1999 - 2010	1.5	0.8	2.3	0.6
2011 - 2016	5.4	0.8	29.2	0.6

The variability measures in Table 1 are computed for the three time periods indicated.

They represent the periods before, during, and after the Great Moderation. The

variance and the standard deviation of inflation are measured by the quarterly percentage change (at an annual rate) in the GDP price index. The variance and the standard deviation of output are measured

from the GDP gap, or the percentage deviation of real GDP from the Congressional Budget Office's (CBO) estimate of potential GDP. Note that the period since the end of the Great Moderation is only five years in length and shorter than the other periods. The recovery from the 2011-2013 recession does not appear to be over, and thus the change in the standard deviation may exaggerate the deterioration of performance in a post Great Moderation regime. It is very difficult to identify an emerging historical period in real time (and of course we hope the economy will go back to Great Moderation conditions soon). By way of comparison I first wrote about the post-1999 secular decline in volatility in—fourteen years after it began. By that time we had the strong recovery from the recession in the early 1980s, the small recession of the early 1990s, and the start of a long expansion in the 1990s. Nevertheless there is already plenty to study about this post Great Moderation period even though we will certainly learn more as time goes on. To represent this change I have updated, the variance tradeoff diagram used by adding a point C and an arrow from point B to point C.

Observe that the line from point B to point C does not simply retrace in reverse the path

from point A to point B. The movement from the 1970s toward the Great Moderation is much as in Bernanke's (2004) generic sketch. But the movement away from the Great Moderation, thus far, is much different. It is a nearly perfectly vertical move up from the in the diagram. Virtually all of the deterioration in performance is reflected in a major increase in output volatility due to the Great Recession and the very slow recovery. Inflation performance has remained steady, though that could change in the future. The end of the Great Moderation raises many of the same questions as have been raised about Great Moderation itself. Was the end due to a change in the structure of the economy traced, for example, to less aversion to risk as argued. In this case the tradeoff would have shifted back away from the origin. Or was there a change in monetary policy as I have argued in Taylor (2011, 2016), in which case the tradeoff curve did not simply move exogenously, but rather policy took the economy to point C. That virtually all of the deterioration in macroeconomic performance has been on the output dimension, not the inflation dimension, is an important fact that helps identify the reasons for the shift.

Monetary Policy Regime Change or Other Factors?

To answer the causation question it is helpful to address it within the broader context of why macroeconomic stability first increased and then decreased.

Exogenous Shocks and the Structure of the Economy

One of the structural explanations for the Great Moderation was that the U.S. economy became much more service-oriented than in the past. The production of services is not as cyclical as the production of goods. The problem with this explanation for the Great Moderation is that the transition to a service-oriented economy was very gradual. It could not explain the sudden shift toward greater economic stability. But it is an even less plausible explanation for the reversal of output volatility, because the move to services has not gone into reverse, even if it has slowed down. Another explanation for the Great Moderation was better control of inventories, such as the just-in-time approach to inventory management. During recessions and recoveries, inventory fluctuations accentuate the ups and downs in GDP. Firms cut inventories when sales weaken and rebuild inventories when sales strengthen. Better inventory control could thus explain the

improved stability. But this explanation also had problems. When one looked at final sales GDP less inventories—one saw the same amount of improvement in economic stability. And as an explanation of the higher volatility now the depth of the recession and the weak recovery this explanation is even less plausible because inventory management has not deteriorated.

The Change in Monetary Policy

It was through such considerations that others were led to consider changes in monetary policy as a major reason for the improved economic performance in the 1980s and 1990s. And in fact there were clearly identifiable changes in policy during this period, including the more rule like focus on price stability and the closer adherence to simple predictable policy rules starting with Paul Volker and continuing for much of Alan Greenspan's term. In my view, the same monetary policy considerations working in reverse are relevant for explaining the recent deterioration of performance. Monetary policy became much less rule like, starting in my view in the period from 2003 to 2005 when the policy interest rate was held far below levels that would have pertained in the 1980s and 1990s under similar conditions.

Many empirical researchers have uncovered evidence of such deviations from policy rules, but one can also simply compare the settings of the federal funds rate at different times and come to the same conclusion. In addition, policy became much more discretionary with the interventions into particular markets such as the mortgage backed securities market, with the expansion of the Fed's balance sheet, and with the commitment to hold the interest rate to zero after traditional rules would call for higher rates. In his comprehensive history of the documents this change toward discretion flowing the more rule like policy in the 1983-2003 period. Of course, as with onset of the Great Moderation, one can point to exogenous shocks, other than these monetary policy shocks, as another factor. In examining the period up to the crisis argue that there was a shock to preferences in the form reduced risk aversion. Indeed, King (2012) argues explicitly that this structural change shifted the tradeoff curve in Figure 2 back up and out as investors took on greater risk which led to the boom and the bust. He argues that the very stability of the Great Moderation caused this shift in preferences as people got complacent in a Minsky-like "stability breeds instability" line of argument. Of course, as discussed below,

monetary policy may have caused this shift as the low interest rates led to a search for yield and risk taking.

To be sure, other government policies largely unrelated to monetary policy may also have contributed to these financial market shocks.

The Impact of the Change in Monetary Policy

While there is already much evidence that there was a change in monetary policy regime starting around 2003, there is growing empirical and theoretical research showing that this change was largely responsible for the deterioration of performance. The study consider this evidence briefly here. Much of the research has focused on the impact of the Fed holding interest rate below what was suggested by policy rules that were effective during the Great Moderation. More recently showed that housing booms are closely associated with deviations from simple monetary policy rules over time and across countries. As they put it, "our evidence for close to a century, for many countries, and for three types of asset booms, that expansionary monetary policy is a significant trigger, makes the case that central banks should follow stable monetary policies.

These should be based on well understood and credible monetary rules.” Another effect of extra low policy rates is on risk aversion. Using time series techniques Bekaert, Hoerova, and Duca (2012) found that this effect is empirically significant. They decompose the VIX into a risk aversion component and an uncertainty component. They then look at the cross autocorrelations between policy rates and these two components. Their empirical results show that “Lax monetary policy [below policy rule rates] increases risk appetite (decreases risk aversion) in the future, with the effect lasting for about two years and starting to be significant after five months.” These results provide a reason why a change in monetary policy might actually shift the tradeoff curve back up a channel to poor economic performance which is quite different than the risk aversion channel or with much different policy implications.

Bekaert et al. (2012) also find that increased uncertainty leads the Fed to lower rates, a policy reaction that explains deviations from conventional policy rules in recent years. A similar response has been uncovered by Steil (2012) who uses a completely different measure of risk aversion and uncertainty. The impact of the recent discretionary policy interventions is uncertain and not fully

understood by either the policy makers or economists. A particular source of uncertainty is the Fed’s enlarged and growing balance sheet which will have to be drawn down in the future. The risk is two sided: if the balance sheet is drawn down too quickly it will cause a downturn and if it is drawn down too slowly it will lead to inflation.

Deviations from conventional monetary policy also create a number of distortions which could push the economy in a suboptimal direction. In my view these distortions are akin to price controls which interfere with the functioning of markets and are known to have negative effects, though they are frequently hard to measure in practice. For example, the short term interest rate has been driven down to zero by the exploded balance sheet, and the money market is no longer providing its usual allocation and price discovery function. The Fed has effectively replaced the money market and the longer term treasury market with itself. The commitment to hold rates at zero and the large purchases of long term Treasury securities for several years into the future reduces the usefulness of longer term treasuries as benchmarks as Pringle (2012) has emphasized.

With rates held this low there is disequilibrium in the money market. While borrowers might like the near zero rate, there is little incentive for lenders to extend business or consumer loans at that rate. It is much like the effect of a price ceiling in an agricultural market, and it can be illustrated with a standard supply and demand diagram. The supply curve of loans is upward sloping with the interest rate on the horizontal axis. The demand curve is downward sloping and also dependent on the interest rate. Firms will not supply more than what the supply curve implies at that ceiling rate, even though consumers would be willing to borrow at the low rate. The result is excess demand and lower volume than in the case of an equilibrium interest rate. As Fisher (2012) put it: “as they approach zero, lower rates will not automatically create more credit and more economic activity but, rather, run the significant risk of perversely discouraging the lending and investment we need.” There are many other potential negative effects of the low rates and the unconventional policies. Low rates are a drag on consumption for many people whose income is significantly negatively affected by the low rates. This effect may be larger than any offsetting substitution effect which would tend to encourage consumption

by households and investment by business firms. And then there is effect on pension fund solvency. In addition the low rates make it possible to roll over rather than write off bad loans at banks, and they reduce fiscal discipline on the congress and the administration. As McKinnon (2011) describes it, the bond vigilantes have been replaced by the central bank.

Recent research on the overall macro effects of the change in policy regime includes the economy wide regime switching model of Baele, Bekaert, Cho, Inghelbrecht, Moreno (2012). They find that monetary policy regime changes are responsible for both the improved economic performance in the Great Moderation and the recent deterioration in performance. Their work thus extends the economy wide empirical work of Stock to recent events.

Changes in Central Bank Independence?

So there clearly have been large shifts during these three periods in the degree to which monetary policy has been rules-based in the United States. But have there been comparably large shifts in the underlying legal basis for Federal Reserve independence? To be sure, there have been several notable changes in the Federal Reserve Act during this period. The so-

called dual mandate was added to the Federal Reserve Act in 1977 and the requirement to report on the monetary aggregates was removed in 2000. But when you look at the conventional indices of de jure. There have been shifts, of course, in de facto independence. Allan Meltzer (2009) showed in his comprehensive history how the Fed sacrificed its independence in the late 1960s and 1970s, regained it in the 1980s and 1990s, and has since sacrificed its independence again by cooperating with the Treasury and engaging in fiscal policy. Marvin Goodfriend (2012) and Otmar Issing (2012) come to similar conclusions about central bank independence in recent years. Note that these changes in de facto independence can be driven either by the executive branch or the central bank, or both. Meltzer explains how the loss of de facto independence in the late 1960s was originally driven by the U.S. Administration, while the loss of de facto independence more recently was driven by the Fed itself. In any case there is a very close correlation between the ups and downs in de facto independence and the adherence to rules based policy in the United States during this period. In other words within a given legal framework, policy makers in the United States have been able to engage in varying

degrees of de facto independence and adherence to rules-based policy. For these reasons we have seen major shifts in the efficiency of monetary policy within the same framework of central bank independence.

CONCLUSION:

The study concludes that changes in macroeconomic performance during the past half century were closely associated with changes the adherence to rules-based monetary policy and in the degree of de facto monetary independence. But performance was not associated with de jure central bank independence. In the absence of a rules-based framework it appears that formal Federal Reserve independence does not generate good monetary policy outcomes. These conclusions are very similar to those of Friedman (1962) who argued fifty years ago that in reality we have never had a de facto independent central bank that does not take account of the preferences of the government or does not work together with the government to encourage various interventions. He argued that the attractiveness of independent central banks at that time came from those interested in limiting the scope of government. Central bankers, being “sound money men,” as Friedman put it then, have

“tended to oppose many of the proposals for extending the scope of government.” But in recent years some central bankers have been the main advocates of extending the scope of government interventions, so that attractiveness has vanished.

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