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Lars E.O. Svensson

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Centre for Economic Policy Research
33 Great Sutton Street, London EC1V 0DX, UK
Tel: +44 (0)20 7183 8801
www.cepr.org

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Abstract

Marvin Goodfriend's paper "Monetary Mystique: Secrecy and Central Banking" is a masterpiece: It is an extremely well-written, meticulous, and fair analysis and critique of the Federal Reserve's defense of its practice of secrecy in monetary policy and central banking. His critique was devastating, and he completely demolished the Federal Open Market Committee's (FOMC) arguments in the most precise and convincing way. Nevertheless, it took the Fed many years to reach the current standards of transparency and accountability in monetary policy.

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Lars E.O. Svensson - leosven@gmail.com
Stockholm School of Economics and CEPR

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Monetary Mystique and the Fed's Path Toward Increased Transparency[1]

Lars E.O. Svensson

Marvin Goodfriend's paper "Monetary Mystique: Secrecy and Central Banking"[2] is a masterpiece: It is an extremely well-written, meticulous, and fair analysis and critique of the Federal Reserve's defense of its practice of secrecy in monetary policy and central banking. His critique was devastating, and he completely demolished the Federal Open Market Committee's (FOMC) arguments in the most precise and convincing way. Nevertheless, it took the Fed many years to reach the current standards of transparency and accountability in monetary policy.

The paper and its background

When Marvin wrote and published his paper, central banking was generally cloaked in mystery. In a much-quoted paragraph, Karl Brunner had written in 1981:

> Central Banking [has been] traditionally surrounded by a peculiar and protective political mystique. . . The mystique thrives on a pervasive impression that Central Banking is an esoteric art. Access to this art and its proper execution is confined to the initiated elite. The esoteric nature of the art is moreover revealed by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences.[3]

A specific background to Marvin's paper was that in March 1975, the FOMC of the Federal Reserve System was sued under the Freedom of Information Act to make public, immediately following each FOMC meeting, the policy directive and minutes for that meeting. At the time, the policy directives were available to the public 90 days after their decision. In response to the suit, the FOMC did shorten the publication lag to 45 days, which was a few days after the *next* regularly scheduled meeting. But the Committee stated that it was not prepared to disclose policy actions and minutes immediately after an FOMC meeting.[4] The suit

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[2] Goodfriend (1986).

[3] Brunner (1981), p. 5; Goodfriend (1986) provides a longer quote.

[4] The FOMC also discontinued its Memoranda of Discussion, the detailed written minutes, removing them as an issue in the case (Goodfriend 1986, footnote 13).

went to court. After six years of court proceedings, including a hearing before the US Supreme Court, the case was decided in 1981 in favor of the FOMC.

Nevertheless, even though the FOMC won the legal case, it lost the intellectual case. The suit forced the Federal Reserve, for the first time, to provide a detailed written defense of its secrecy. The court records were made public. This allowed Marvin to summarize and evaluate the FOMC's arguments for continued secrecy. He collected the arguments found in the FOMC's affidavits into five categories:

1. *Unfair speculation*: Only the large speculator is in a position to benefit from disclosure of thecurrent policy directive.
2. *Inappropriate market reaction*: Current disclosure would cause the market to overreact or to react contrary to the intention of the FOMC; in general, market reaction would be more difficult to predict with current disclosure.
3. *Harm to the government's commercial interest*: Current disclosure would cause market reactions that would raise the cost of marketing US Treasury debt and make open market operations more costly.
4. *Undesirable precommitment*: The FOMC does not wish to precommit its future policy actions, and current disclosure of the policy directive would tend to precommit the FOMC.
5. *More difficult interest rate smoothing*: Current disclosure would make it more difficult for theFOMC to smooth interest rates.

The FOMC's arguments are laughable by today's standards. They were probably laughable to Marvin at the time, but he took them very seriously. He meticulously and fairly evaluated each category of arguments in the light of existing economic theory and "recent theoretical work related to the secrecy issue." And he ended up completely demolishing the arguments in the most precise and effective way.

In the abstract of the paper, Marvin wrote (my emphasis): "The discussion highlights a number of potential benefits and costs of central bank secrecy, and identifies *some conditions under which secrecy could be socially beneficial*." In the summary at the end of the article, Marvin furthermore wrote (my emphasis):

> [My critique of the FOMC's defense], based heavily on rational expectations reasoning, *supported some FOMC contentions* and pointed out some theoretical weaknesses in others. In order to investigate the secrecy issue further, theoretical papers related to the secrecy issue were reviewed. The discussion highlighted a number of potential benefits and costs of central bank secrecy, and *identified some conditions under which secrecy could be socially desirable*. At best, however, given the inconclusiveness of the theoretical arguments and the presumption that government secrecy is inconsistent with the healthy functioning of a democracy, further work is required to demonstrate that central bank secrecy is socially beneficial. (p. 90.)

However, as far as I can see in Marvin's main text, he did not find *any reasonable* conditions under which secrecy would be socially beneficial and some FOMC contentions would be supported. The abstract and summary seems to have been written in order to somewhat hide the true force of the critique in the main text. If so, this is understandable. That Marvin wrote and published this paper must be seen as an act of considerable courage. Marvin was a vice president at the Richmond Fed at the time. That an insider of the Fed, a vice president of a Federal Reserve Bank, publicly criticized — even implicitly ridiculed — a major FOMC position was not a trivial thing.

As far as I know, Marvin had the full support of his boss, J. Alfred Broaddus, who had been appointed director of Research and senior vice president at the Richmond Fed in 1985. Broaddus presumably also had the support of *his* boss, President Robert P. Black. But the paper must have been very unpopular with the FOMC and the chairman of the Federal Reserve Board in 1986. It seems that one could easily have anticipated then that the paper could have negative consequences for Marvin's career in the Federal Reserve System.

Paul Volcker, who was chair until August 1987, was hardly a friend of transparency. He "liked to blow smoke — both literally and figuratively — in his congressional testimonies."[5] Neither was the new chair, Alan Greenspan. He boasted that he had learned to "mumble with great incoherence," and famously told an audience that "if you think what I said was clear and unmistakable, I can assure you you've probably misunderstood me."[6] More specifically, in 1989 — three years after the publication of Marvin's paper — an apparently unconvinced Greenspan vigorously argued in Congress against immediate announcements of changes in the federal funds target:

> The immediate disclosure of any changes in our operating targets would make this information available more quickly to all who were interested, but it would have costs. Simply put, this provision would take a valuable policy instrument away from us. It would reduce our flexibility to implement decisions quietly at times to achieve a desired effect while minimizing possible financial market disruptions. Currently, we can choose to make changes either quite publicly or more subtly, as conditions warrant. With an obligation to announce all changes as they occurred, this distinction would evaporate; all moves would be accompanied by announcement effects akin to those currently associated with discount rate changes.[7]

The Federal Reserve's path to increased transparency

It took quite a few years for the Fed to become more transparent and less secret, in what Yellen (2012) called a "recent revolution and continuous revolution" and Blinder (2020) called a "slow-motion revolution." In February 1994, immediately after the FOMC meeting, the committee surprised Fed watchers and media by issuing a statement under Greenspan's name[8]:

> Chairman Alan Greenspan announced today that the Federal Open Market Committee decided to increase slightly the degree of pressure on reserve positions. The action is expected to be associated with a small increase in short-term money market interest rates.
>
> The decision was taken to move toward a less accommodative stance in monetary policy in order to sustain and enhance the economic expansion.
>
> Chairman Greenspan decided to announce this action immediately so as to avoid any misunderstanding of the Committee's purposes, given the fact that this is the first firming of reserve market conditions by the Committee since early 1989.

After this, there were announcements immediately after the FOMC meetings at which the federal funds rate was changed.

Thus, eight years after the publication of Marvin's paper, the Fed gave up its strong resistance toward

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5 Blinder (2020).

6 Blinder et al. (2001).

7 Greenspan (1989), pp. 14–15.

8 FOMC (1994).

disclosing its policy decisions immediately after each meeting. The Fed thereby implicitly acknowledged that Marvin had been right. Marvin had completely won the case.[9]

However, this was not the end of the Fed's steps toward increased transparency. As noted by Blinder (2020, p. 43), in August 1994, the Fed offered its first bit of forward guidance — although that term would not appear until years later: In announcing that it was raising both the discount rate and the federal funds rate by 50 basis points, rather than the expected 25, the committee added that "these actions are expected to be sufficient, at least for a time, to meet the objective of sustained, noninflationary growth," where "at least for some time" was a new phrase.

More importantly, in 1999, the FOMC started to issue a short explanatory statement also when the interest rate was *not* changed. The FOMC also started to reveal whether there was a "bias" toward future tightening, easing, or neither in its thinking about the near-term future of interest rates, that is, effectively a near-term forward guidance.[10] During Greenspan's time, a more specific much-noted forward guidance appeared in the in the August 2003 statement and subsequently:

> The Committee judges that, on balance, the risk of inflation becoming undesirably low is likely to be the predominant concern for the foreseeable future. In these circumstances, the Committee believes that policy accommodation can be maintained *for a considerable period*.[11] [12]

There were several further steps toward more information and transparency with Ben Bernanke as chairman (see Blinder, 2020, and Yellen, 2012, for details). In November 2007, the first "Summary of Economic Projections" (SEP) — a summary of FOMC participants' individual projections of GDP, unemployment, and inflation produced four times a year — was included in the minutes published three weeks after the October 2007 FOMC meeting. Any individual projections of the federal funds rate were not included at this time. After the federal funds rate hit its perceived effective lower bound (0–25 basis points) in December 2008, the statement was amended in 2009 to include decisions on asset purchases and more explicit forward guidance for the interest rate, first in the form of initial qualitative language similar to the 2003 language: "for some time," then "for an extended period," which remained until August 2011, when a specific date was first mentioned. This "calendar-based" forward guidance was later changed to be "data-based." In April 2011, the first press conference after a meeting was held. Then an advance version of the SEP table on the ranges and central tendencies of the participants' projections was released.

In January 2012, there were two major steps. First, the "Statement on Longer-Run Goals and Monetary Policy Strategy" was issued. It was an extremely well-written and concise summary of the Federal Reserve's goals and strategy. It has since been reaffirmed by the FOMC every year in January.[13] The statement was the result of a subcommittee chaired by then Vice Chair Janet Yellen (see Yellen, 2012, for details and the case for transparency). Second, the SEP was amended to also include the individual FOMC participants' projections of the federal funds rate, the "dot plot" of individual participants' assessment of the appropriate

[9] Broaddus would be appointed president of the Richmond Fed in 1993, and Marvin was the same year promoted to senior vice president and director of Research. Ex post, neither Marvin's nor Broaddus's career seems to have suffered.
[10] Blinder (2020).
[11] FOMC (2003a), my emphasis.
[12] The expression "for a considerable period" had first appeared in Greenspan's July 2003 testimony before Congress (Greenspan 2003). There is some interesting, lively, and perhaps even tense discussion in the August 2003 FOMC meeting about whether or not to include that sentence in the FOMC statement (FOMC 2003b, pp. 86–95). (I am grateful to Alexander Wolman for alerting me to this.)
[13] FOMC (2012b).

policy-rate settings over the next three years and the long run.[14]

With these two steps, the Federal Reserve had arguably become a full-fledged flexible inflation targeter, including doing "forecast-targeting" (see Svensson, 2020b, for details). The Fed's loss function was well understood, and the "balanced approach" indicated equal weight on stabilizing inflation around the inflation target and employment around its estimate of full employment.[15] It was publishing projections of its target variables, inflation and employment (unemployment), and of its main instrument, the federal funds rate.

To be precise, the SEP includes the FOMC participants' *individual* projections *before* the meeting; it is not the result of a joint decision about a *joint* projection *at* the meeting. In particular, the projections are not linked together: the SEP shows the distributions for each variable but not the joint distribution (no table with numbered rows for participants and columns for variables, even unnamed). For that, one has to wait five years until the minutes and SEPs amended with such unnamed tables are released. Nevertheless, the SEPs are quite informative: they provide forward guidance about the participants' appropriate policy paths, reveal the participants' long-run forecasts (including the neutral unemployment and policy rates), and help to hold the FOMC accountable for achieving its goals.[16] Perhaps the median projections are not so different from what a vote on the projections would result in?[17]

The new monetary policy strategy

In August 2020, the Federal Reserve announced a revision of its monetary policy strategy and released a new "Statement on Longer-Run Goals and Monetary Policy Strategy,"[18] a result of the strategy review that it had initiated in 2019.[19] With regard to the *maximum employment mandate*, the FOMC now seeks over time to mitigate "shortfalls" of employment from its maximum level, not "deviations." This means that a low unemployment rate by itself, unless accompanied by signs of unwanted increases in inflation, will not justify a policy tightening. Focusing on shortfalls of employment instead of deviations introduces an asymmetry in the maximum-employment mandate, and the statement drops previous language about "a balanced approach."

With regard to the *price stability mandate*, the FOMC now "seeks to achieve inflation that averages 2 percent over time." This implies that if inflation has been running persistently below 2 percent, the FOMC would likely aim to achieve inflation "moderately above 2 percent for some time." The Federal Reserve has thus adopted an explicit "makeup" strategy. As explained by Powell (2020), Clarida (2020), and Brainard (2020), this introduces a strategy of "flexible average inflation targeting."[20] It is also made clear that it would not be

[14] FOMC (2012a).
[15] Yellen (2020).
[16] Svensson (2020a,b).
[17] A decision-making process whereby the FOMC arrives at an explicitly joint policy-rate path and corresponding inflation and unemployment forecasts would be more consistent with forecast targeting. As discussed in Svensson (2020b, pp. 81–82), the FOMC has undertaken some experiments in constructing a consensus policy-rate path and forecasts of inflation and unemployment. They are discussed in some detail under the heading "Experimental Consensus Forecast" in the October 2012 transcripts, FOMC (2012c, pp. 201–79). There were several difficulties noted about constructing consensus forecasts, including that the policymaking environment was unusually complex with both unconventional portfolio actions and forward guidance being important policy tools. In view of these difficulties, the FOMC abandoned the consensus forecast exercise at the time — perhaps not permanently — and instead focused on improvements to the SEP. This resulted in the first dot plot, in FOMC (2012a).
[18] FOMC (2020).
[19] Powell (2020).
[20] Svensson (2020a) discussed the strategies of flexible price-level targeting, temporary price-level targeting when the

appropriate to implement this strategy by using a mechanical Taylor-type instrument rule.[21]

Although the Fed has announced that it seeks to achieve inflation that "averages 2 percent over time," it has left itself with some flexibility by not announcing an explicit period over which average inflation is calculated. Dropping the language about a balanced approach leaves some ambiguity about the relative weights on the maximum-employment and price-stability mandates. It is understandable if the Fed prefers some flexibility in adapting the new framework, but eventually a high level of transparency and accountability will most likely require the Fed to become more explicit on these points.

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effective lower bound for the policy rate binds, flexible average-inflation targeting, and nominal-GDP targeting for the Fed and, in conclusion, recommended flexible average-inflation targeting.

[21] Clarida (2020); Brainard (2020). Such reservations were also expressed by FOMC participants in the discussion of average-inflation targeting at the September 2019 FOMC meeting (FOMC 2019).

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