

Comment

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I liked very much the paper by Almeida and Goodhart and I agree with its basic message. It is a very balanced paper with a lot of information. In fact I like it so much that I have used a previous version of it, in the past, to teach on these matters to my students.

The basic message that comes out of the paper is that the major difference between inflation targeting and other regimes is a difference in communication: there is much more transparency and accountability. On the other hand, we have not seen a major difference in credibility in these countries compared to the reference group. This is really the punch-line of the paper, which contains also a lot of information and a nice general discussion.

Given that I agree so much with the contents, I am not going to criticize it much. I am going to draw a distinction or maybe to put emphasis a little bit differently on one point and then I want to discuss a few other questions that are not dealt with in the paper nor in the literature. The first point that I want to raise, is how to go about and detect changes in behaviour.

We want to find out if inflation targeting made a difference. What are we going to look for? In the paper they look both for differences in outcomes and differences in the setting of policies instruments. In my opinion, looking for differences in the setting of policy instruments is difficult: it is not likely to yield a big insight, because we know that once monetary policy becomes more credible it also becomes more effective in influencing economic activity. With more credibility, smaller interventions are required. We are not going to find more aggressive behaviour simply because we do not need that aggressive behaviour if we are more credible. This is really the experi-

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ence that came out of some of these countries. So I am not surprised at all if the evidence on instrument setting does not indicate a break with the past or relative to other countries.

If we want to find evidence that inflation targeting made a difference, we have to look at *outcomes* rather than at instrument-setting. And here, even though I basically agree with everything that Almeida and Goodhart said, my emphasis would be a bit more generous in favour of inflation targeting. I think the evidence is encouraging, more encouraging perhaps than acknowledged in the paper.

It is true that there are no statistically significant differences with other countries. Nevertheless there is a break with the past. I remember, in one of the first conferences on which inflation targeting was discussed, now a few years ago, many economists of those central banks were saying at the time: "We have not really tested yet inflation targeting because we have not gone through a cyclical upturn". Well, now we have gone through a cyclical upturn and inflation targeting has resisted. It is the first time in these countries that inflation has not accelerated again.

I think this is an important success. Even if we will never know, it is possible that such a break would have not been feasible if different institutional frameworks have been put in place.

Also other studies by economists at the New York Fed (Posen and Mishkin for instance) indicate that there has been significant improvement in some dimensions, if you compare not across countries but over time. There has been an improvement in the trade-off between output and inflation in the inflation targeting countries, and there has been a structural break with the past.

So, I think that the evidence concerning outcomes is encouraging, perhaps a little bit more so than acknowledged in the paper.

Now I want to turn to other points that in the paper are not discussed, even though, in his presentation, Professor Goodhart mentioned one of them. The first point, perhaps the most important, is what role shall output stabilization have under inflation targeting. In the paper, Professor Goodhart and his co-author write: "The adoption of IT reflects the view that price stability should be the only (medium- and long-term) objective of monetary policy" (p. 37). Output stabilization is not discussed in the paper. It is not also discussed in the existing literature, at least not until very very recently, and I think this is a bit too extreme.

Let me read a sentence from the same lecture that was quoted by Professor Goodhart, a lecture given by Mervyn King on the same topic. He writes: "The overriding objective of monetary policy is to ensure that on average inflation is equal to the target, but such a target is not sufficient to define policy. There is a subordinate decision on how to respond to shocks as they occur. It is striking that Central Banks have been reluctant to acknowledge that monetary policy has two components: an inflation target and the response to shocks". In the context of the paper, Mervyn King makes it very clear that by response to shocks he really means choosing a trade-off between output stability and price stability.

So, as Professor Goodhart said in his oral remarks, there are important dimensions of the inflation targeting framework that bears on this precise issue of the trade-off between short-run output and price volatility; these are: the width of the band, the speed of transition once you are out of the band, how aggressive should monetary policy be on responding to specific supply shocks. All these important dimensions imply a choice in the trade-off between output stability versus price stability. Choices have to be made and have been made on these dimensions, but often without an explicit acknowledgment of the trade-offs involved. There is a large literature now on inflation targeting, which generally omits a discussion of these institutional aspects from the point of view of the choice between output and price stability. It would be welcome if the literature discussed this point a bit more, both with regard to the normative issue and also from a positive point of view, comparing how different countries have behaved on this front.

The second point which is absent from the literature and from this paper, is what I would like to call "the political economics of inflation targeting". Why have central banks chosen to reveal so much information? Why have these government agencies chosen to become so accountable and so vulnerable to criticism? I think we all understand, as economists, that secrecy is a source of rents. There may be arguments in favour of secrecy in monetary policy. But undoubtedly secrecy is also a source of rents, in the sense that it shields an agency from public criticism.

In this paper and in the literature, you find the view that inflation targeting comes about because other targeting arrangements were not feasible. There were shocks to many demands, there were shocks to exchange rates. This is the benevolent planner view. I think the

question of why these agencies have chosen to become so transparent is more puzzling than acknowledged by this benevolent planner view.

In the case of the United Kingdom, maybe an answer is not too difficult to find. The Bank of England was not an independent agency, so this transparent procedure was a way to acquire more prestige and independence. In other cases, New Zealand and Canada, the outcome was the result of an agreement between the government and the central bank. I think it would be interesting to discuss this question more extensively from a positive point of view.

The last point I want to discuss is: should the European Central Bank (ECB) adopt an inflation targeting framework? This is a very important question, but let me just say one thing. I agree with the message that would come out of the paper by Almeida and Goodhart in this regard. I think the issue with the optimal arrangement of the ECB is not one of credibility. The Treaty already provides sufficient safeguards in this respect. So, I do not think the ECB would gain a lot of additional credibility by having an inflation targeting framework. The ECB is likely to be credible anyway. But an inflation target would provide gains in communication and transparency.

The ECB is likely to face tough problems in this regard. There is a danger that the new Central Bank will lack democratic legitimacy, not for its own fault, but because Europe lacks adequate political institutions. There is some difficulty in predicting the ECB behaviour, since the new institution will not have a track record. Finally, it will be difficult to reach a consensus inside the ECB on what are the appropriate policy goals. The appropriate monetary policy in one country will not necessarily be the appropriate policy for other countries. Moreover, the national governors and the members of the Executive Committee come with different backgrounds, and are exposed to different external pressures. In these circumstances, agreement could be hard to find, and consistent decision-making could be difficult.

On all these fronts, inflation targeting would help. By increasing transparency and accountability, it would increase the legitimacy and the predictability of the ECB. And it would also provide a simplified and coherent framework for internal decision making. Inflation targeting is the appropriate framework for the conduct of monetary policy in Europe. And here, I expect Professor Goodhart to agree with me.