

THE **STRUCTURAL**
FOUNDATIONS OF
MONETARY POLICY



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WITH ADDITIONAL DISCUSSANTS

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Preface

Michael D. Bordo, John H. Cochrane, and Amit Seru

Each spring, the Hoover Institution hosts a monetary policy conference. The conference is an annual series started in 2014 by John Taylor, Michael Bordo, and Lee Ohanian.

This year's conference, titled "The Structural Foundations of Monetary Policy," examined the long-run monetary issues facing the world economy. The presentations and discussion were wide ranging, focusing on nearly everything *but* short-term issues, such as whether the Federal Reserve will or should raise interest rates another twenty-five basis points at the next meeting. Instead, participants focused on deep, unresolved structural questions. Their presentations and the discussions that followed are reproduced in this volume.

Chapter 1 addresses the Federal Reserve balance sheet. Should Fed officials keep lots of interest-paying reserves outstanding? Should they shrink the balance sheet, and if so, how fast? Should the Fed return to procedures with very small reserves and not pay interest? What kind of assets should the Fed buy or keep? Should it buy lots of assets and expand the balance sheet again in the next recession? Should the Fed periodically swap risky assets back to the Treasury?

Chapter 2 examines long-run interest rates. We seem to be facing globally lower long-run real interest rates. How should monetary policy adapt? Should we aim now for a 3 percent long-run nominal interest rate rather than 4 percent? Or should we keep

“headroom” over the zero bound and raise the inflation target so interest rates can still head toward 4 percent? Or perhaps further lower the inflation target?

Chapter 3 studies the puzzle of the last eight years in the United States and the last twenty in Japan: the long, quiet zero bound, the fact that the Fed’s forecasts have been wrong year after year, and what that means for monetary policy.

Chapter 4 explores the payment system. How will monetary policy adapt to blockchain and other innovations in payment systems? Will fintech take over from banks in providing transaction services? Will that eliminate or exacerbate worries about demand deposits? Should the Federal Reserve Wire Network clear transfers using blockchain, or should the Fed offer blockchain-cleared transactions directly? How will instant settlement of financial assets affect the monetary system? Should the Fed create its own digital currency?

In chapter 5, John Taylor explains how to make monetary policy decisions when there are wildly different views and models. The military will tell you it’s a bad idea to take one forecast and then count on it being true. Fog of war wisdom is probably appropriate in central banking.

Other chapters give Fed policy makers a chance to weigh in. Chapter 6 features Stanley Fischer, vice chair of the Federal Reserve System. Commenting on the central question of rules versus discretion, he comes out largely in favor of the latter.

In chapter 7, Markus Brunnermeier focuses on structural issues in the euro. He contrasts the economic policies of France and Germany to illustrate the power of ideology in driving states with congruent economic interests toward fundamentally different policies. In chapter 8, Kevin Warsh warns Federal Reserve decision makers that being prepared for future economic crises means avoiding a complacent climate of opinion.

Chapter 9 begins with a panel discussion moderated by John Cochrane with Federal Reserve Bank presidents James Bullard (St. Louis), Charles Evans (Chicago), and Eric Rosengren (Boston). The chapter engages a wide spectrum of big-picture questions, including monetary policy rules—a subject no Hoover monetary conference could ignore. What should rules look like? When should the Fed deviate from them? Panelists also address proposed structural reforms, such as the 2017 Financial CHOICE Act, and add a practical perspective to many of the academic questions raised in other sessions.

For inspiring the conference and this volume, we thank John Taylor. We also thank the *real* organizers of the conference, Marie-Christine Slakey, Denise Elson, and Eryn Witcher Tillman; Kristen Weiss for transcribing each session; Kyle Palermo for making a complete book manuscript out of a series of transcriptions; our summer intern Will Nagle for his excellent assistance; and Hoover's director, Tom Gilligan. We also extend special thanks to Hoover's donors for picking up the check—without them, we would not be here.

