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THE MYTH OF NEUTRALITY ...and the Twilight of the Technocrats?

Christopher Adolph

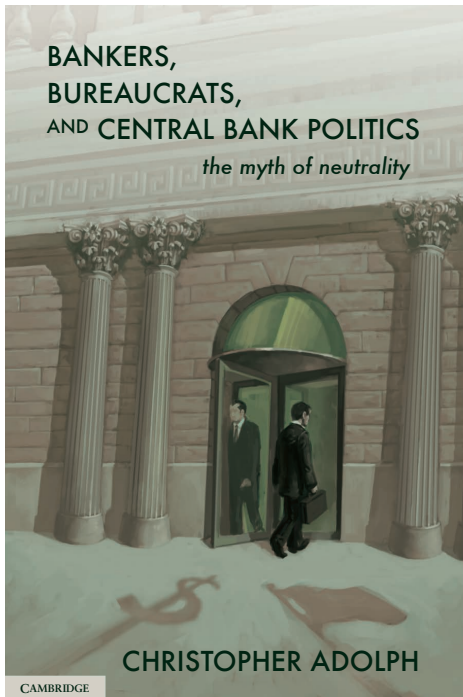
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PLAN OF TODAY'S TALK

Highlights from *Bankers,
Bureaucrats, and Central
Bank Politics*

6 thoughts on central
bank politics today



CAMBRIDGE

Monetary Policy Agents in Institutional Context

- Standard view.** Monetary policy is subject to a **time inconsistency** problem: myopic policymakers seeking to create real monetary stimulus may inflate “too much” for too little return
- Usual solution.** Delegate to a legally independent central banker agent who is either a **neutral technocrat** or **conservative former banker**
- Blind spot.** Agents **preferences are central** (CBI gives them great legal discretion) but are also **black-boxed** and assumed to vary little
- Paradox.** In some versions, central bankers are Weberian; in others, CBI lets them switch allegiance from government to private banks.

Shadow Principals & Central Bankers

Reality. Central bankers over many countries and decades tend to come from a handful of sectors and often return to them later.

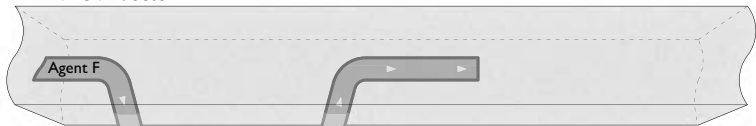
Key idea. Once and future employers may act as **shadow principals**, trading influence for prospect of elite/lucrative posts

Agents & Institutions. Adding multiple shadow principals to a principal-agent model:

1. Generates rich predictions of policy outcomes from preferences of principals and agents
2. Institutions (e.g., CBI) can have different effects for different agents
→ Agent-Centered Political Economy of Institutions

Socialization vs. Incentives Mechanisms of shadow principal influence may vary: career incentives and/or prior socialization/network ties

Financial Sector



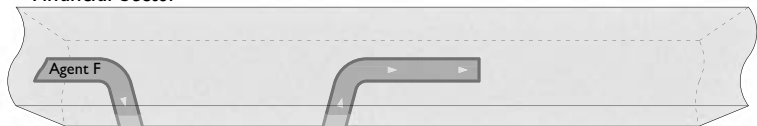
Central Bank



Government

Central banker backgrounds generate agent preferences, networks & expertise...

Financial Sector



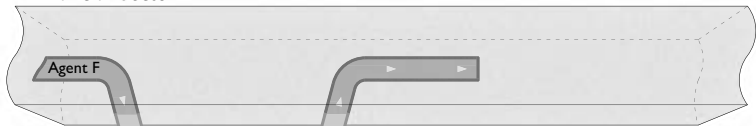
Central Bank



Government

which lead to their policy preferences as monetary policy makers...

Financial Sector



Central Bank



Government

which may entail a return trip to the shadow principal's sector

Questions in *Bankers, Bureaucrats, and Central Bank Politics*

1. How do career goals alter principal-agent models of monetary policy?
2. What careers do central bankers have & how do they transition between sectors?
3. How do career backgrounds shape monetary policy preferences & decisions?
4. Do the effects of central banker preferences vary across political economic contexts?
5. How do governments select (and retain) central bankers with shadow principals?

Career Theories of Monetary Policy: Socialization & Incentives

1. Past careers can **socialize** future central bankers to have differing preferences over monetary policy

Many years spent in private finance may inculcate anti-inflation attitudes

2. Central bankers not yet at retirement age also have **career incentives** to please *shadow principals* – future employers, typically financial firms and governments

One version of this argument holds central bankers signal loyalty by promoting shadow principals' interests: low inflation for banks; low unemployment for governments

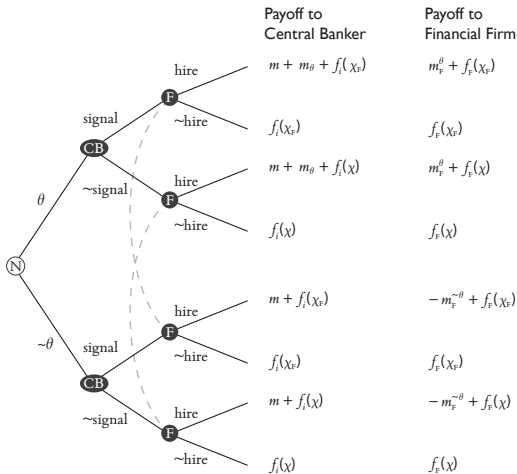
Another version models an implicit bargain – future jobs for monetary policy favors

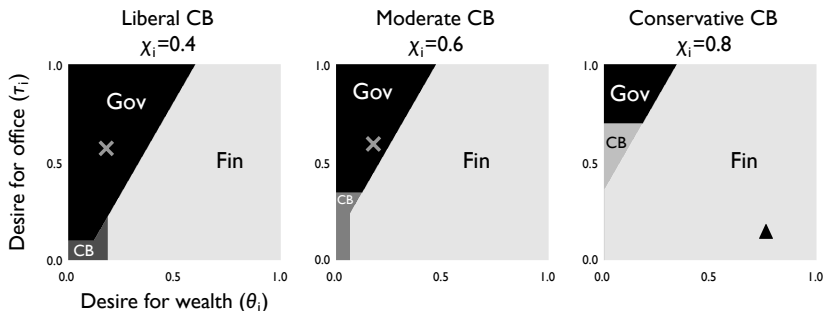
Both version argue human and network capital from past careers cement the identity of the shadow principal and make a “revolving door” likely

Career Theories of Monetary Policy

Chapter 2 of *Bankers, Bureaucrats, and Central Bank Politics* develops game theoretic models of the interaction between central banker agents and shadow principals in finance and government

One model is based on a signalling equilibrium – where central bankers who want future jobs send credible signals of type through policy choices...

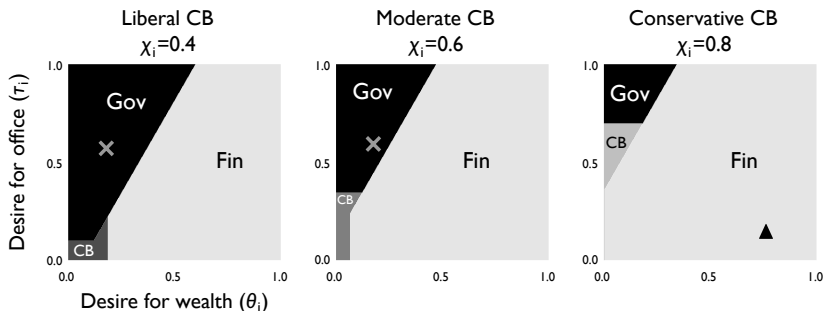




✕ Typical government type:
 dovish to slightly hawkish on inflation,
 prefers gov to fin jobs
 → adopts Gov monetary prefs

▲ Typical financial type:
 strong inflation hawk,
 prefers fin to gov jobs
 → adopts Fin monetary prefs

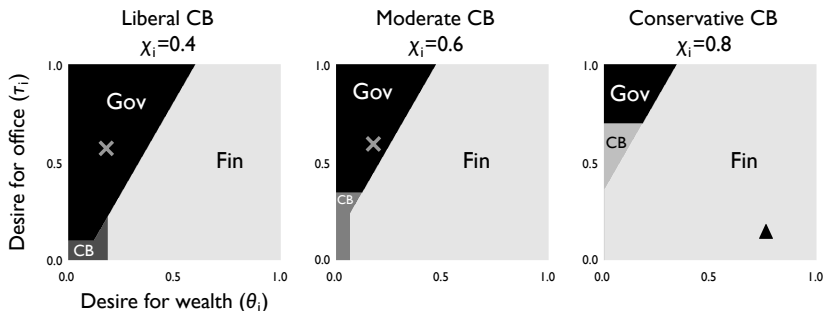
The second model involves bargains in which ambitious central bankers trade policy favors for (reputationally-enforced) future jobs



✕ Typical government type:
dovish to slightly hawkish on inflation,
prefers gov to fin jobs
→ adopts Gov monetary prefs

▲ Typical financial type:
strong inflation hawk,
prefers fin to gov jobs
→ adopts Fin monetary prefs

In both models,
unless central bankers care *much more* about policy than their own futures,
we expect different policy outcomes based on the types of futures central bankers seek



✕ Typical government type:
dovish to slightly hawkish on inflation,
prefers gov to fin jobs
→ adopts Gov monetary prefs

▲ Typical financial type:
strong inflation hawk,
prefers fin to gov jobs
→ adopts Fin monetary prefs

I argue (and show) that pre-central bank careers presage post-central bank careers

But to see the difference career backgrounds make, we need measures of career types

Career Experience: As Compositional Covariates

What careers do central bankers have, and how do they transition between sectors?

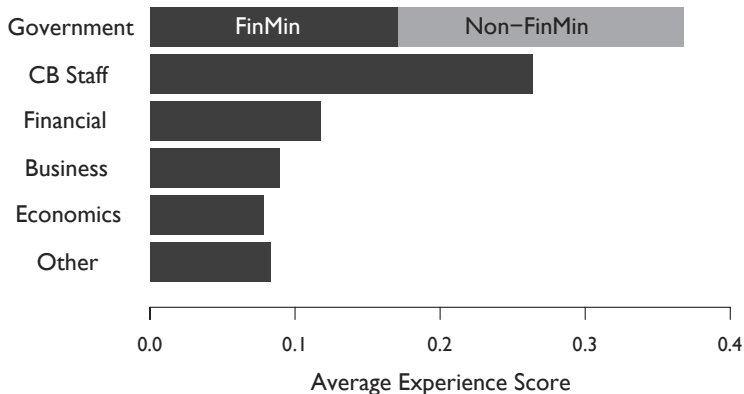
I measure career background as **compositional** data:

fractions of a career (up to a certain time) spent in each of 7 categories:

| | |
|------------------------------|--------|
| Financial Sector | FinExp |
| Finance Ministries | FMEExp |
| Central Bank Staff | CBExp |
| Other Government Bureaucrats | GovExp |
| Academic Economics | EcoExp |
| Private Business | BusExp |
| Other Experience | OthExp |

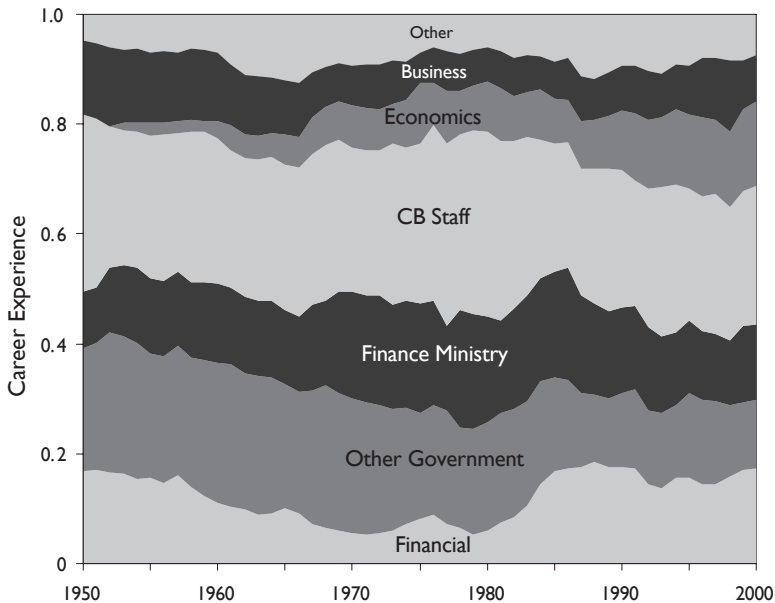
The categories must sum to 1 for

- (a) any (piece of) an individual career and
- (b) the average or median experience of a monetary policy making body

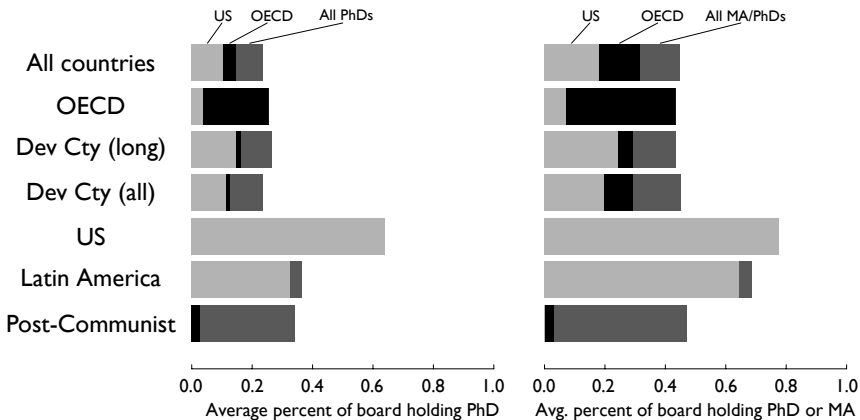


Average career composition of central bankers with monetary policy making authority in 20 developed country central banks, averaged over 1973-2001

Careers come in remarkably few varieties, with less private finance than one might expect and more bureaucrats (today, we'd see more economists)



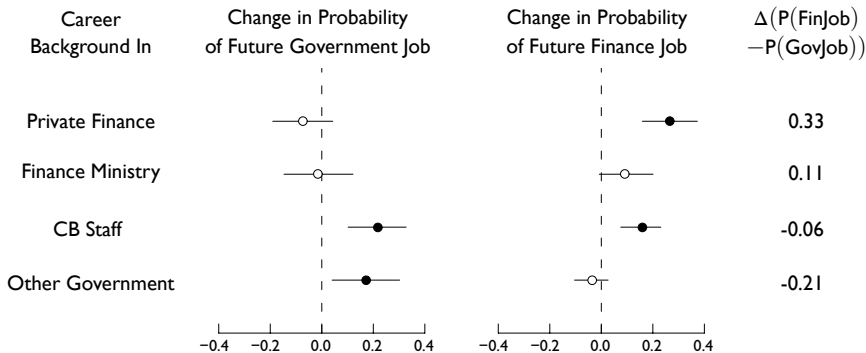
Rows indicate sample countries; shading indicates degree origin



On economics training:

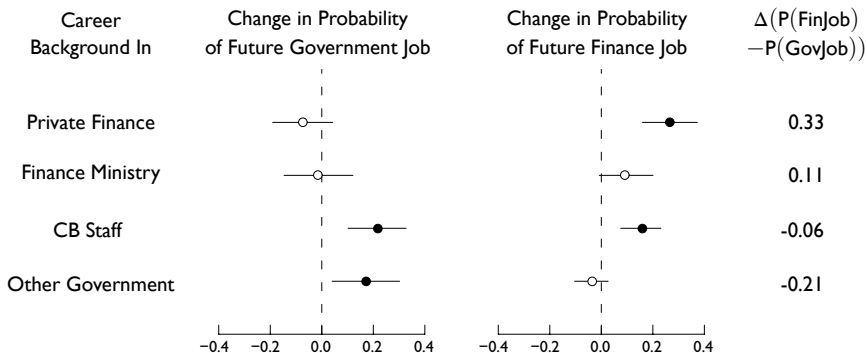
In the historical data, it's not as universal – or as US dominated – as one might expect

A great diversity of schools, with the exception of Latin America



A probit model of post-monetary policymaking careers on prior career experience shows a tradeoff:

1. Former private bankers and finance ministry officials are more likely to end up back in private banks
2. Former generalist bureaucrats and central bank staff tend to end up in further government posts



Why not show a table of coefficients (aside from the usual ugliness of probit coeffs)?

Subtle, important difficulty with compositional covariates:

Because of the compositional constraint, to consider the effects of a change in one category, we must adjust the other categories simultaneously

Career Experience: As Compositional Covariates

| | Initial Composition | | Hypothetical New Composition |
|--------|------------------------|-----------------|---------------------------------|
| FinExp | 0.1 | Δ FinExp | 0.250 |
| GovExp | 0.3 | +0.15 | |
| FMEExp | 0.1 | | |
| CBExp | 0.2 | → | |
| EcoExp | 0.3 | | |
| Sum | 1.0 | | 1.000 |

What happens if I increase FinExp by 0.15, but keep all other components the same?

Note – this is close to what I assume when I interpret the β for a component as the “effect” of raising that component

Career Experience: As Compositional Covariates

| | Initial Composition | | Hypothetical New Composition |
|--------|------------------------|-----------------|---------------------------------|
| FinExp | 0.1 | Δ FinExp | 0.250 |
| GovExp | 0.3 | +0.15 | 0.300 |
| FMEExp | 0.1 | | 0.100 |
| CBExp | 0.2 | → | 0.200 |
| EcoExp | 0.3 | | 0.300 |
| Sum | 1.0 | | 1.150 |

Increasing one component without lowering the combined total of the other components by the same amount leads to a logical fallacy
– a career that has 115% total experience!

Career Experience: As Compositional Covariates

| | Initial Composition | | Hypothetical New Composition |
|--------|------------------------|-----------------|---------------------------------|
| FinExp | 0.1 | Δ FinExp | 0.250 |
| GovExp | 0.3 | +0.15 | 0.300 |
| FMEExp | 0.1 | | 0.100 |
| CBExp | 0.2 | → | 0.200 |
| EcoExp | 0.3 | | 0.150 |
| Sum | 1.0 | | 1.000 |

Alternatively, if we left out a category (say, EcoExp) as a “reference,” we would implicitly assume that category *alone* shrinks to accommodate the increase in FinExp

But that blends the effects of FinExp and EcoExp –
so that in our model, the choice of reference category is no longer harmless!

Career Experience: As Compositional Covariates

| | Initial Composition | | Hypothetical New Composition |
|--------|------------------------|-----------------|---------------------------------|
| FinExp | 0.1 | Δ FinExp | 0.250 |
| GovExp | 0.3 | +0.15 | 0.300 |
| FMEExp | 0.1 | | 0.100 |
| CBExp | 0.4 | → | 0.400 |
| EcoExp | 0.1 | | -0.050 |
| Sum | 1.0 | | 1.000 |

And what if EcoExp (still the reference category) starts out smaller than 0.15?

Then our counterfactual would create negative career components!

Career Experience: As Compositional Covariates

| | Initial Composition | | Hypothetical New Composition |
|--------|------------------------|-----------------|---------------------------------|
| FinExp | 0.1 | Δ FinExp | 0.250 |
| GovExp | 0.3 | +0.15 | |
| FMEExp | 0.1 | | |
| CBExp | 0.2 | → | |
| EcoExp | 0.3 | | |
| Sum | 1.0 | | 1.000 |

When covariates form a composition, we have two problems:

1. to avoid blending effects across components
2. to avoid impossible counterfactuals

I recommend *ratio-preserving counterfactuals*, which uniquely solve both problems

Career Experience: As Compositional Covariates

| | Initial Composition | | Hypothetical New Composition |
|--------|------------------------|-----------------|---------------------------------|
| FinExp | 0.1 | Δ FinExp | 0.250 |
| GovExp | 0.3 | +0.15 | 0.250 |
| FMEExp | 0.1 | | 0.083 |
| CBExp | 0.2 | → | 0.167 |
| EcoExp | 0.3 | | 0.250 |
| Sum | 1.0 | | 1.000 |

The transformations above uniquely preserve the ratios among all categories (except FinExp, of course)

Note that now,
the effect of a change in one category works through *all* the β s for the composition

Careers and Monetary Policy Preferences

In Chapter 4, I consider the link between careers and policy preferences by looking at policy votes (US), expressed policy preferences (US, limited data), and interest rates (cross-national)

Federal Reserve Open Market
Committee (FOMC) sets interest rates
 8% /year

Members of the FOMC vote on the
Chair's proposed interest rate

Dissenting voters signal whether they
would like a higher or lower rate

Dissents are rare but may be
symptomatic of how the actual rate gets
chosen

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Many factors could influence
interest rate votes:

- Individual** Career background
Appointing party
Interactions of above
- Economy** Expected inflation
Expected unemployment
- Politics** Election cycles

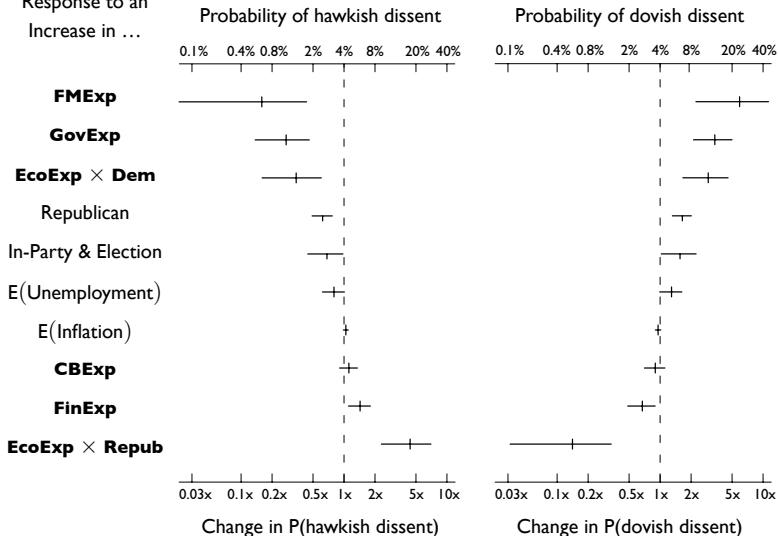
Compositional constraint makes these ordered probits (especially) opaque: effects mix across coefficients as one component substitutes for another

(Misinterpreted compositional covariates are everywhere: budget shares, demographics, trade flows, etc.)

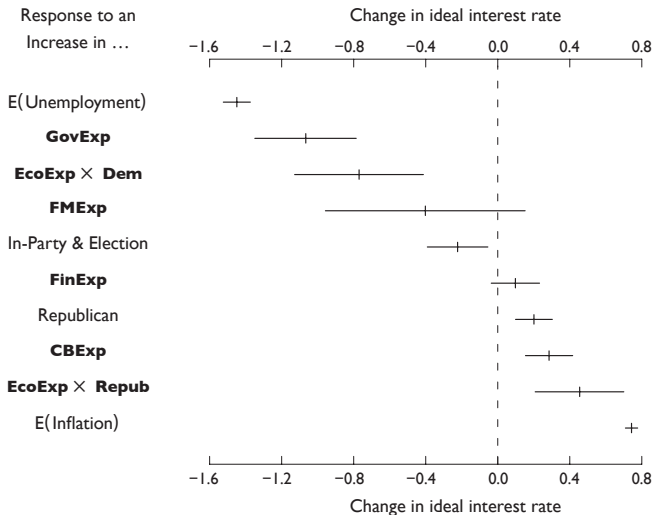
Solution: the usual simulation techniques, but applied to ratio-preserving counterfactuals (RPCFs)

| Covariates | FOMC Votes (1 = ease, 2 = accept 3 = tighten) | Revealed Fed Funds Target |
|-------------------------|--|------------------------------------|
| FinExp | -0.021 (0.146) | 0.105 (0.194) |
| GovExp | -0.753 (0.188) | -1.059 (0.254) |
| FMEExp | -1.039 (0.324) | -0.393 (0.399) |
| CBExp | -0.142 (0.141) | 0.292 (0.202) |
| EcoExp × Repub | 0.934 (0.281) | 0.299 (0.224) |
| EcoExp × Dem | -0.826 (0.202) | -0.622 (0.287) |
| E(Inflation) | 0.019 (0.015) | 0.743 (0.02) |
| E(Unemployment) | -0.035 (0.022) | -1.449 (0.045) |
| In-Party, election year | -0.182 (0.103) | -0.223 (0.102) |
| Republican | -0.485 (0.102) | 0.305 (0.126) |
| Constant | 2.49 (0.148) | 11.776 (0.303) |
| Cutpoint | 3.745 (0.067) | |

Response to an
Increase in ...



Careers drive policy in expected ways – and more than other variables;
Economists are reliable partisans (easier to id preferences per-appointment?)



Revealed ideal interest rates from Chappell et al for 1970-1978 & 1987-1996 show similar patterns: career backgrounds predict agent preferences

Table 3.7. Log inflation regressed on central banker characteristics, twenty countries, 1973 to 2000, quarterly.

| Variable | Expected Sign | DV: ln(Inflation) | | | |
|---|---------------|-------------------|-----------------|-----------------|-----------------|
| | | 1 | 2 | 3 | 4 |
| FinExp _{<i>j,t-2</i>} | — | -0.14 (0.08) | | | -0.09 (0.07) |
| FMEExp _{<i>j,t-2</i>} | -/+ | -0.08 (0.06) | | | -0.13 (0.06) |
| CBExp _{<i>j,t-2</i>} | +/- | 0.12 (0.05) | | | 0.12 (0.05) |
| GovExp _{<i>j,t-2</i>} | + | 0.23 (0.08) | | | 0.19 (0.08) |
| CBI _{<i>j,t-2</i>} | — | -0.91 (0.30) | -0.92 (0.29) | -0.90 (0.29) | -0.94 (0.30) |
| CBCC ^{med} _{<i>j,t-2</i>} | — | | -0.09 (0.03) | -0.03 (0.07) | |
| CBI _{<i>j,t-2</i>} × CBCC ^{med} _{<i>j,t-2</i>} | — | | | -0.12 (0.15) | |
| (Imports/GDP) _{<i>j,t-2</i>} | — | -0.02 (0.26) | 0.02 (0.25) | 0.05 (0.26) | -0.25 (0.26) |
| %EcDegree _{<i>j,t-2</i>} | — | | | | 0.04 (0.06) |
| ln π _{<i>j,t-1</i>} | | 0.97 (0.04) | 0.97 (0.04) | 0.97 (0.04) | 0.96 (0.04) |
| ln π _{<i>j,t-2</i>} | | -0.03 (0.04) | -0.03 (0.04) | -0.03 (0.04) | -0.01 (0.04) |

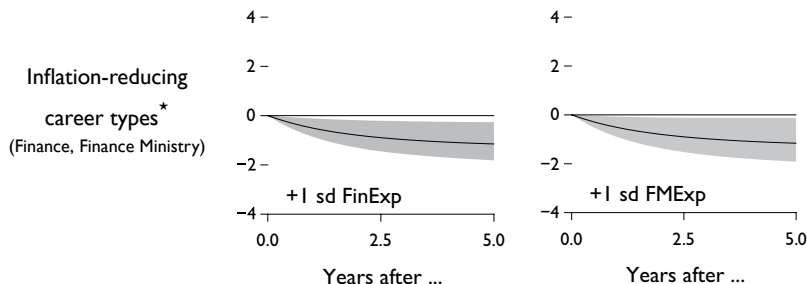
Turning to outcomes in the comparative context, we want to know how the mix of careers present on a monetary policy board shapes inflation outcomes

At left, several linear panel models, but compositional constraints complicate interpretation

Simulation of RPCFs to the rescue again

Comparative Inflation Performance

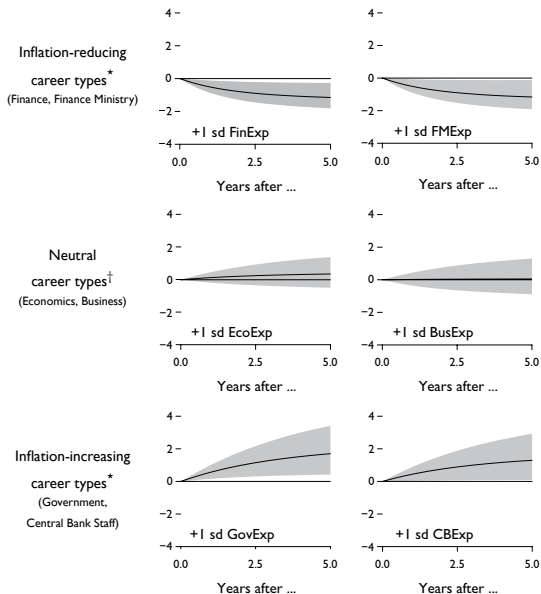
Change in inflation, over time, from changing career composition of the central bank



We imagine a central bank that initially has central bankers with typical career experience (i.e., the global average in each category)

Then, we imagine raising experience in one category (say finance, or FinExp), and use the model to predict how inflation will change over the next 5 years

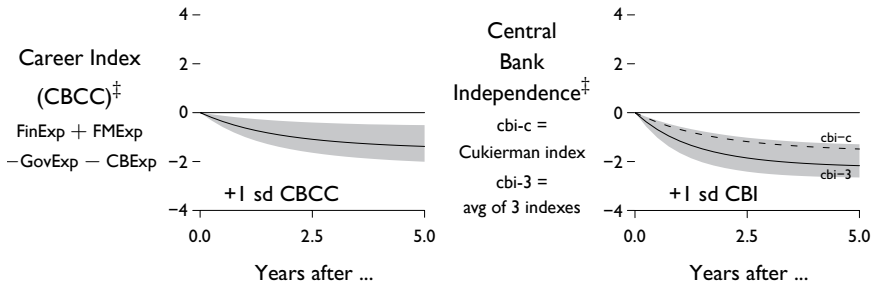
Change in inflation, over time, from changing career composition of the central bank



The relationship of central bankers' prior careers to inflation *exactly fits* with what we'd expect if policy were tilted to the shadow principals holding the revolving door each type of central banker prefers

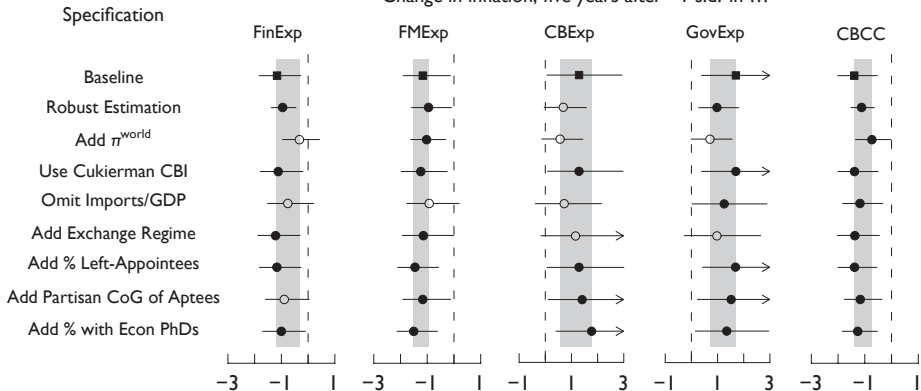
Note: in the comparative context, can't interact economic experience with party in a helpful way - likely similar (but unmeasured) diversity as in US

Change in inflation, over time, from changing career composition of the central bank

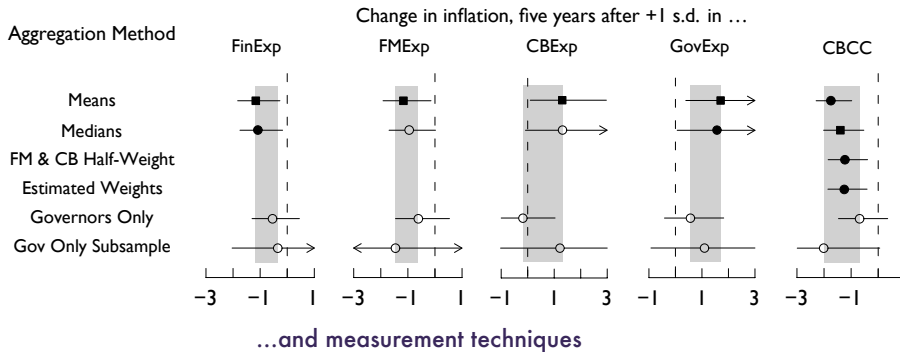


Aggregating career backgrounds into an index (CBCC), we find strong effects of career conservatism on par with the main variable in the literature (independence, CBI)

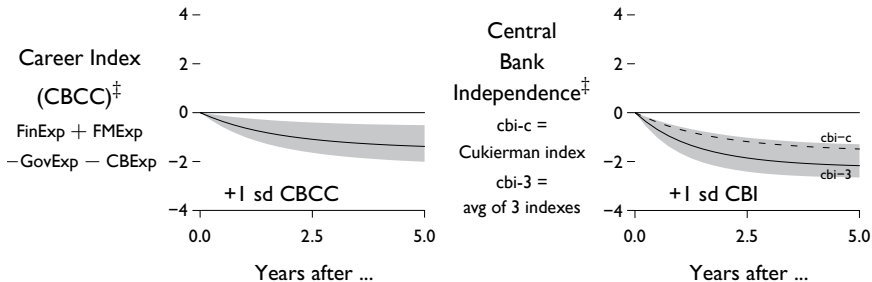
Change in inflation, five years after +1 s.d. in ...



These results are robust to a variety of alternative specifications...

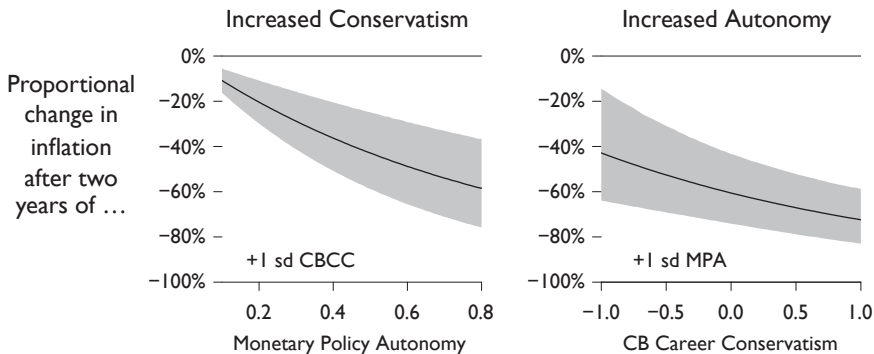


Change in inflation, over time, from changing career composition of the central bank



Aggregating career backgrounds into an index (CBCC), we find strong effects of career conservatism on par with the main variable in the literature (independence, CBI)

But surely, independence has different effects on different agents;
 and surely, *preferences matter most when agents are autonomous?*



Interactive models show monetary policy autonomy augments the effects of career conservatism – and vice versa

(MPA is a reduced set of CBI measured focused on autonomy; the usual measures mix in tangential components to try to capture “behavioral” independence, or “agent-less” preferences)

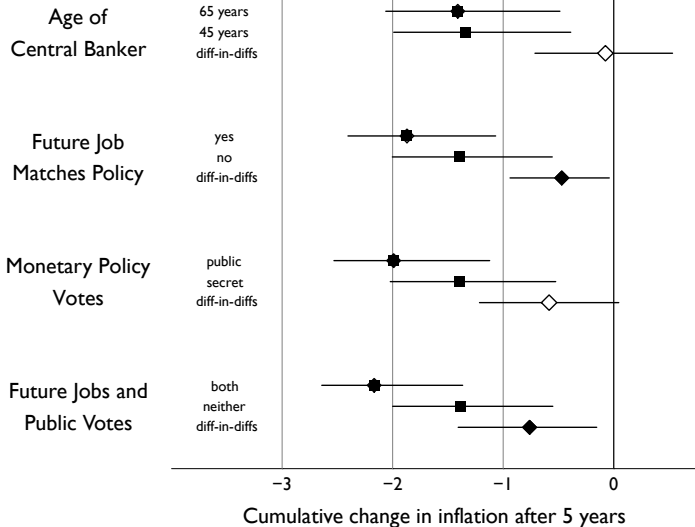
By what
mechanism do
career histories
shape agent
preferences?
Incentives for
the future?
Socialization
into networks &
norms?

Comparing
effect sizes
under
conditions
weakening or
strengthening
incentives
might help

Cumulative change in inflation after 5 years

-3 -2 -1 0

Increase CBCC by +1 sd, given...



By what mechanism do career histories shape agent preferences? Incentives for the future? Socialization into networks & norms?

Comparing effect sizes under conditions weakening or strengthening incentives might help

Cumulative change in inflation after 5 years

-3 -2 -1 0

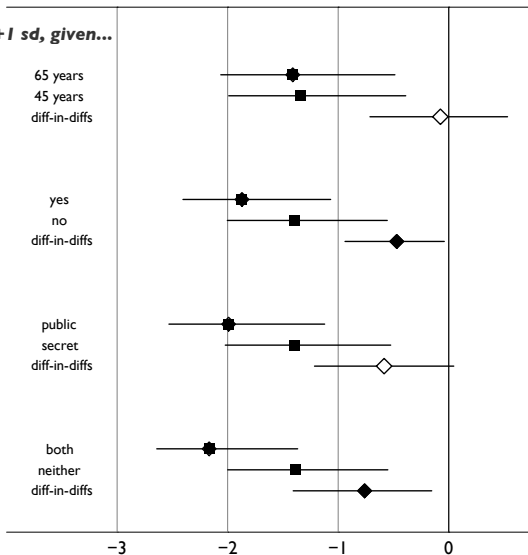
Increase CBCC by +1 sd, given...

Age of
Central Banker
65 years
45 years
diff-in-diffs

Future Job
Matches Policy
yes
no
diff-in-diffs

Monetary Policy
Votes
public
secret
diff-in-diffs

Future Jobs and
Public Votes
both
neither
diff-in-diffs



Cumulative change in inflation after 5 years

To manipulate the probable strength of career incentives, I interact "conservative" careers with:

Age

Future Job Awarded

Public Voting

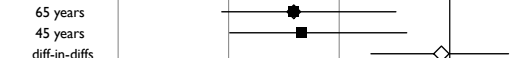
Cumulative change in inflation after 5 years

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Increase CBCC by +1 sd, given...

Age of
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65 years
45 years
diff-in-diffs



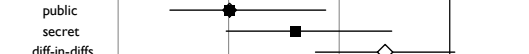
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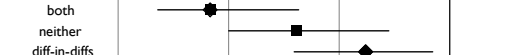
Monetary Policy
Votes

public
secret
diff-in-diffs



Future Jobs and
Public Votes

both
neither
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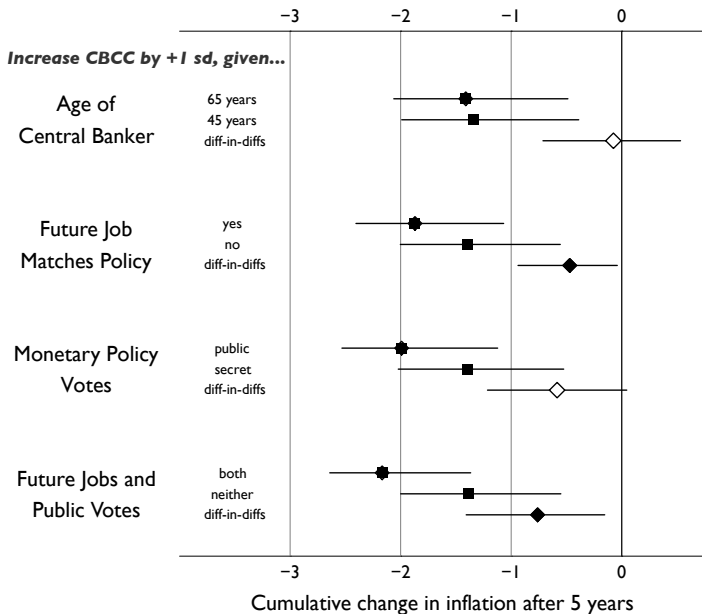
Cumulative change in inflation after 5 years

Conservatism has bigger inflation-fighting effects when central bankers end up taking jobs in the financial sector

May be more powerful when votes are public, but this is not quite significant

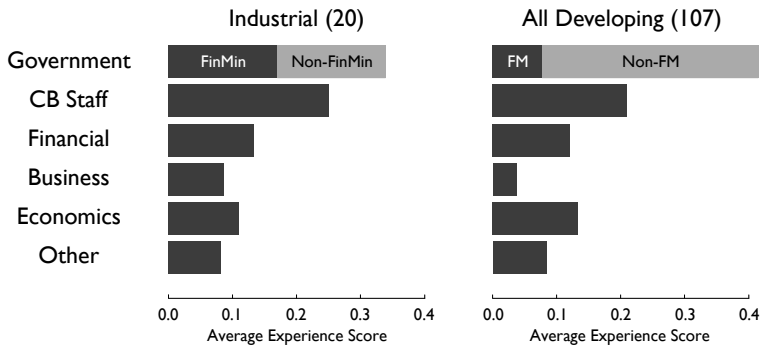
Age is a wash

Cumulative change in inflation after 5 years

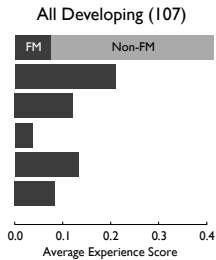
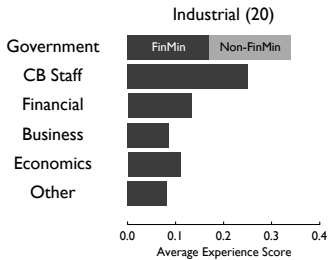


Career backgrounds arguably work through both incentives and socialization in this case

Careful work on specific cases shows these mechanisms can be interwoven (Tod Van Gunten, AJS)

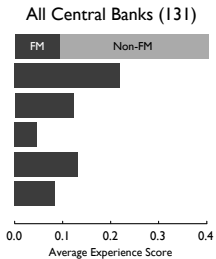
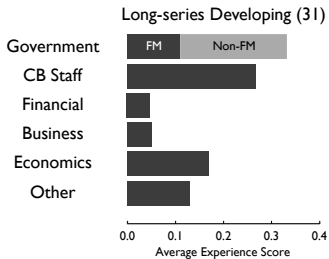


Chapter 5 of *Bankers, Bureaucrats, and Central Bank Politics* turns to developing countries, whose central bankers have surprisingly similar career backgrounds in this period



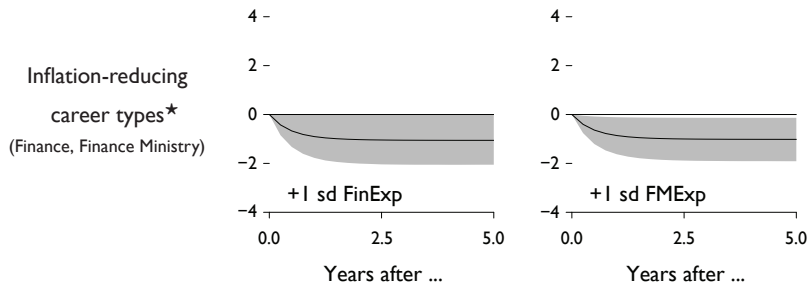
Unfortunately, I could only gather short time series for most countries

But for 31 developing countries, I gathered sufficient data to test similar career hypotheses



Comparative Inflation Performance: Developing Countries

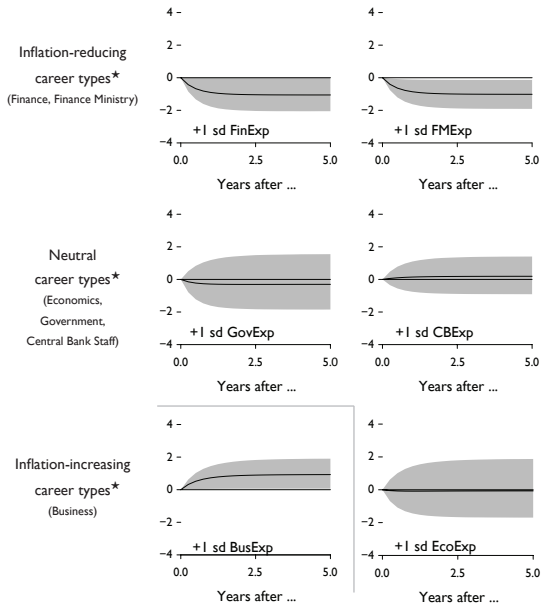
Change in inflation, over time, from changing career composition of the central bank



We imagine a central bank that initially has central bankers with typical career experience (i.e., the global average in each category)

Then, we imagine raising experience in one category (say finance, or FinExp), and use the model to predict how inflation will change over the next 5 years

Change in inflation, over time, from changing career composition of the central bank

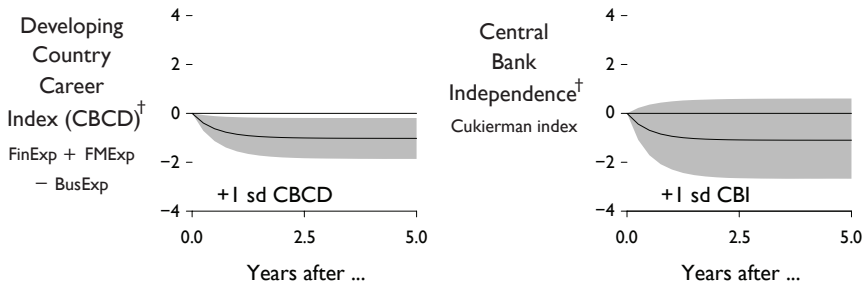


As in developed countries, central bankers with prior financial sector experience tend to produce lower inflation

Now, government is a middling category

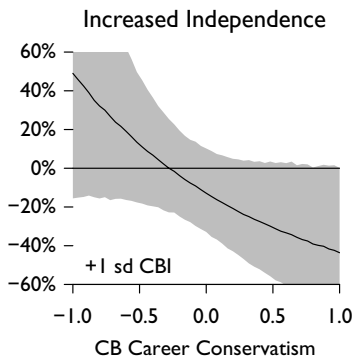
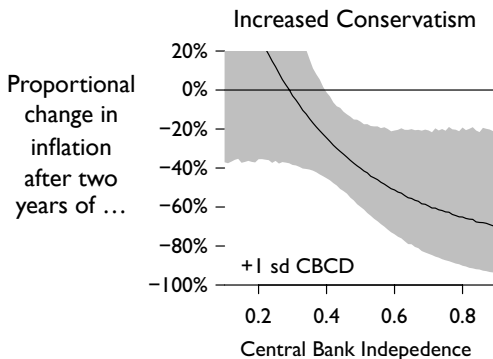
While businessmen produce discernably higher inflation rates

Change in inflation, over time, from changing career composition of the central bank



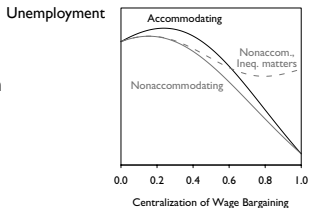
Aggregating career backgrounds into an index (CBCD), we find strong effects of career conservatism, while as in other work in developing countries, CBI has no significant effect

But if some central bankers lower inflation, and others raise inflation, perhaps what matters is the interaction?

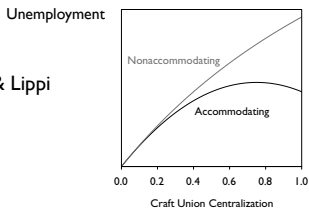


As in developed countries, interactive models show independence might augment the effects of career conservatism – and vice versa – though the results are not quite significant

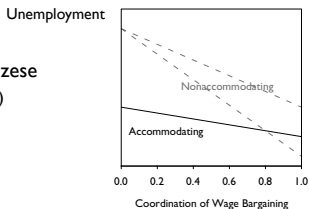
Iversen



Cukierman & Lippi



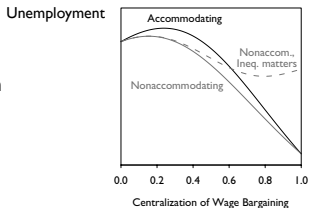
Hall & Franzese
(Stylized)



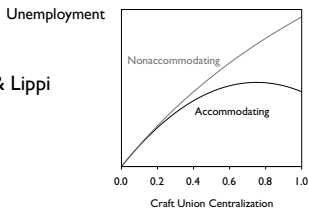
In Chapter 6 of *Bankers, Bureaucrats, and Central Bank Politics*, I consider the interactive effects of central bank “nonaccommodation” (autonomous conservatism) and wage bargaining centralization on unemployment

I build on and test a complex literature positing interactive, nonlinear effects

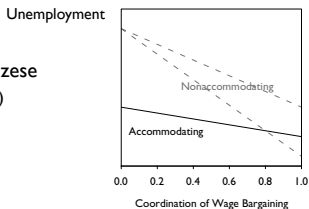
Iversen



Cukierman & Lippi



Hall & Franzese
(Stylized)



Theoretical and empirical work is divided, but generally claims monetary policy can have real effects under particular wage-bargaining schemes

Non-accommodation may help restrain powerful unions from making inflationary demands (Iversen)

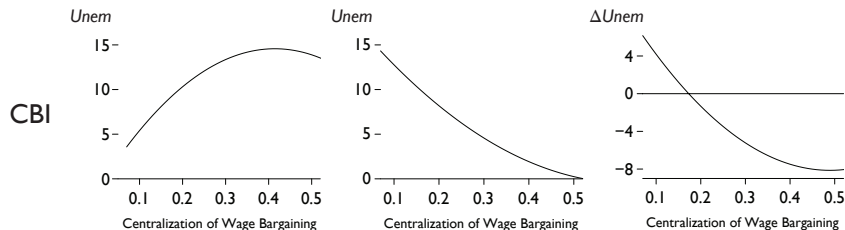
Non-accommodation may hurt in mostly decentralized labor markets if unions can't coordinate enough to stave off rate increases (Hall/Franzese)

Real effects of monetary nonaccommodation

CBNA
Measure

Long-run Unemployment Under ...
Low CBNA High CBNA

5 Year Difference,
Low → High CBNA



Nonaccommodation (CBNA) implies a central bank is conservative *and* independent

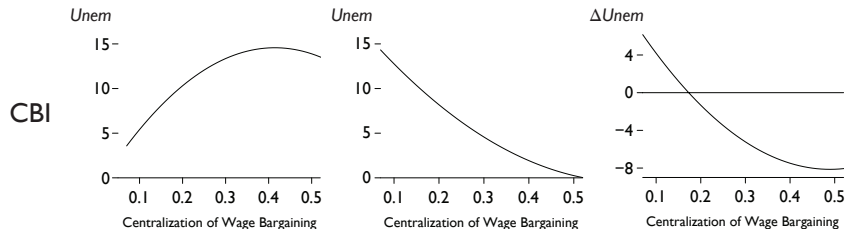
I investigate how different measures of nonaccommodation affect the results,
starting with a crude “independence only” measure

Real effects of monetary nonaccommodation

CBNA
Measure

Long-run Unemployment Under ...
Low CBNA High CBNA

5 Year Difference,
Low \rightarrow High CBNA



The left and middle show expected unemployment across the continuum of CWB for two different levels of CBNA

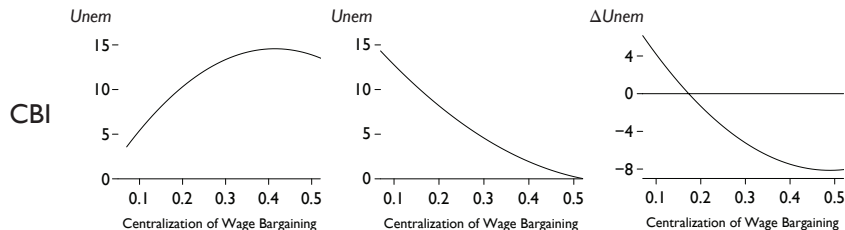
The right plot shows the first difference in unemployment given a change in CBNA at each level of CWB

Real effects of monetary nonaccommodation

CBNA
Measure

Long-run Unemployment Under ...
Low CBNA High CBNA

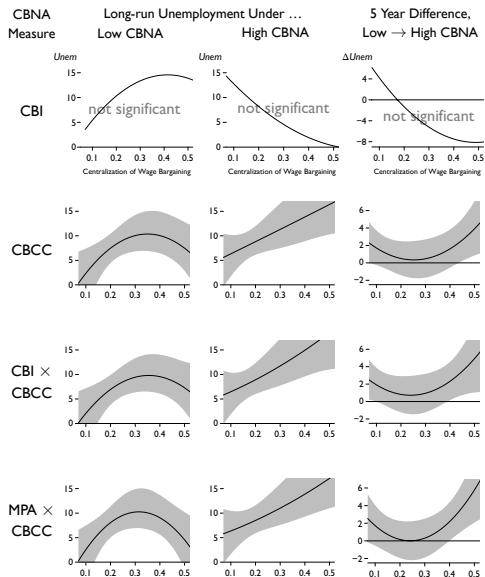
5 Year Difference,
Low → High CBNA



This is an intuitive measure of the wage-bargaining-conditional effect of nonaccommodation

Unfortunately, the result is not remotely significant using measures that ignore agent preferences

Real effects of monetary nonaccommodation



Measures of CBNA incorporating career conservatism produce similar and generally more precise results, alone or in combination with different measures of autonomy

The results suggest Iversen and Hall-Franzese are both partly right about real effects of monetary policy

From Agent's Policy Choices to the Choice of Agent

Central banker careers not only affect inflation, but also – depending on labor market institutions – unemployment

Given this, we expect political principals to select monetary agents with care:

More conservative governments should prefer to appoint more conservative central bankers, e.g., those with financial sector backgrounds

More liberal governments should prefer to appoint more liberal central bankers, e.g., those with bureaucratic backgrounds

In both cases, formal principals recognize shadow principals can circumvent CBI, and select the relevant shadow principal through their choice of an agent

Choosing a Monetary Policy Agent

I test this claim using data on central bankers setting monetary policy in 20 countries over 30 years

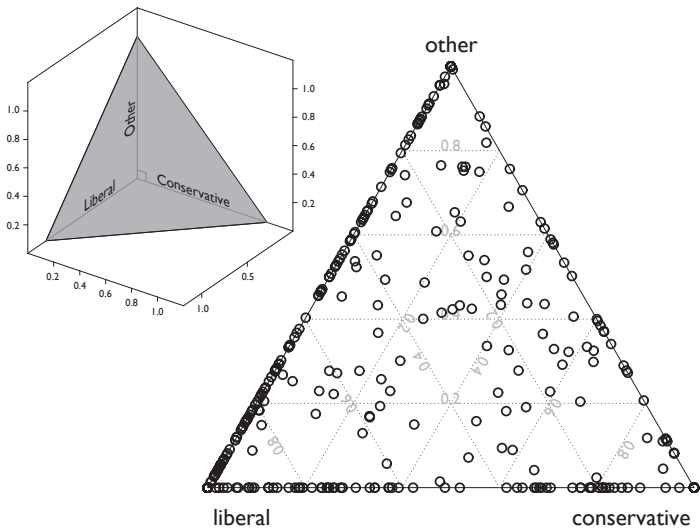
Conservatism of central bankers is measured by percentage share in “conservative,” “liberal,” and “other” careers

Partisanship of government is measured by PCoG:
higher values = more conservative Partisan “Center of Gravity”

Model:

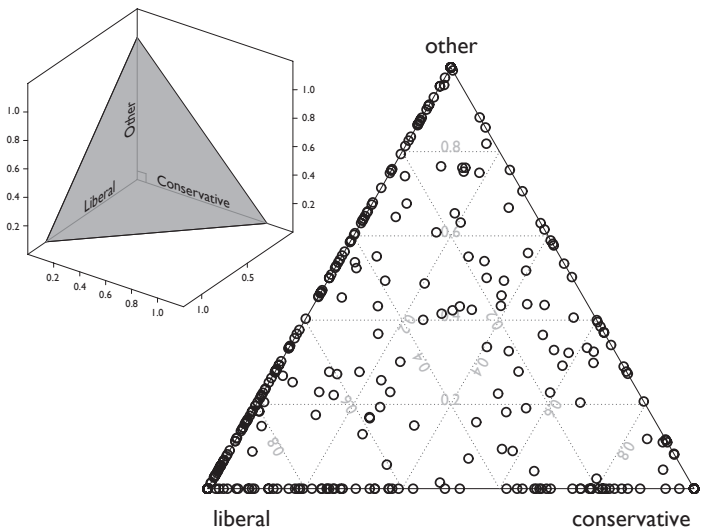
Effect of parties (covariate) on appointed central banker's career composition

Estimation is tricky...



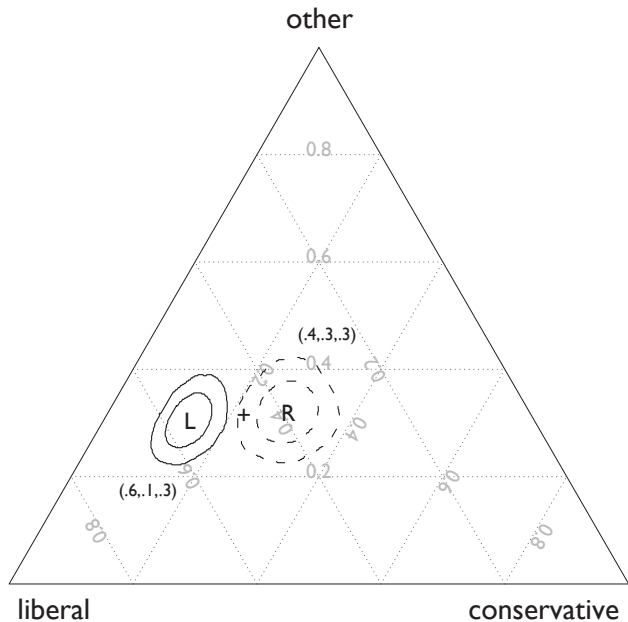
Compositions
lie on the
simplex

Usual solution
is a seemingly-
unrelated
regression of
components
after applying
Aitchison's
additive
logratio
transformation



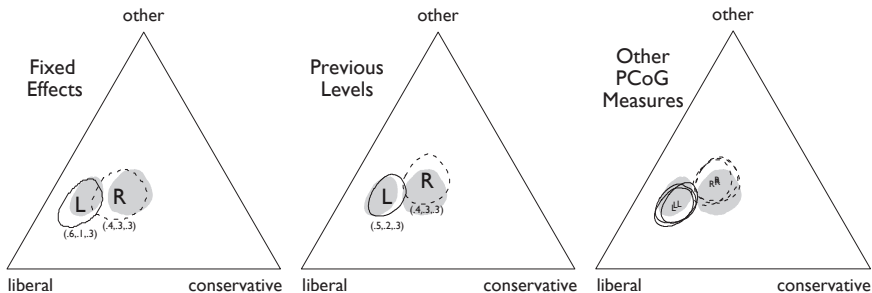
Added twist:
 need three
 zero-inflation
 equations to
 deal with
 zero-value
 components

Visual
 interpretation
 easiest (5
 equations total)



Expected
result: partisan
selection on
career types

Effects are
quite strong in
terms of
implied policy
outcomes
($L \rightarrow R$:
-0.9 pts
inflation,
+0.5 pts
unemployment
in liberal labor
markets)



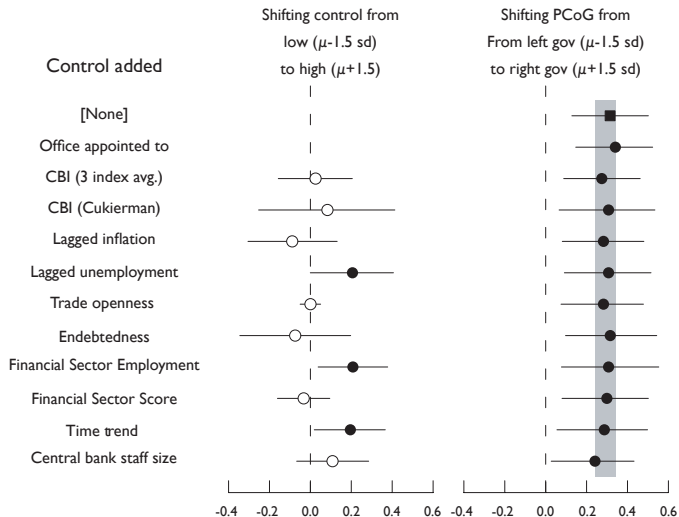
Results are highly robust

We could include country fixed effects, lags, alternative party measures ...

and many other things ...

Choosing a Monetary Policy Agent

Estimated increase in Central Bank Conservatism (CBCC) resulting from ...



From Choosing an Agent to Keeping Them

Correlates of central banker tenure in 20 industrialized countries using a Cox proportional hazards model on the covariates...

Age

Career types

Economic performance

Change in government

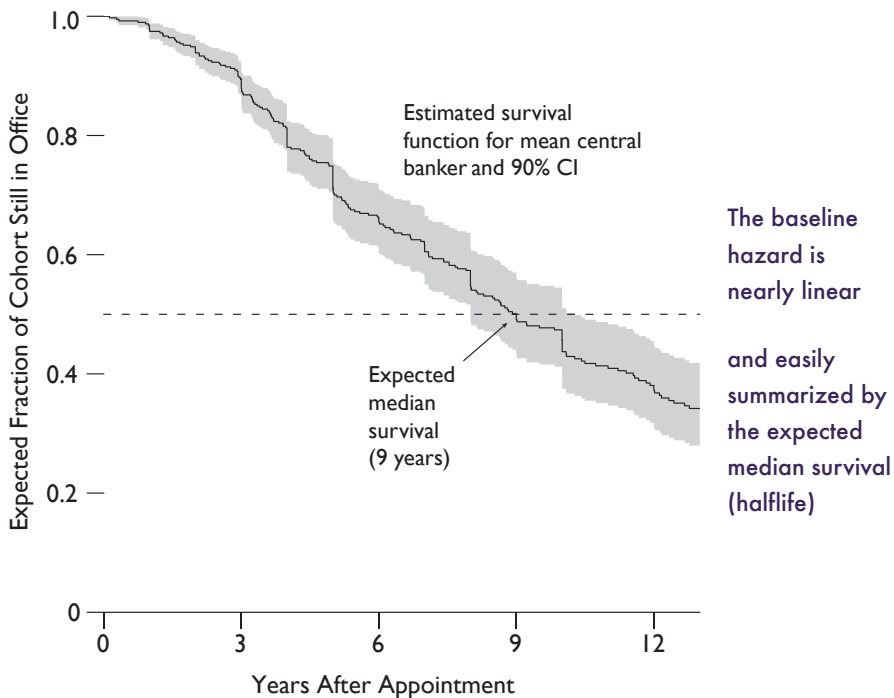
Performance \times Party

Last is most interesting: are central bankers graded on a partisan curve, with the Left penalizing unemployment and the Right inflation?

Table 9.1. Cox proportional hazards estimates of central banker tenure.

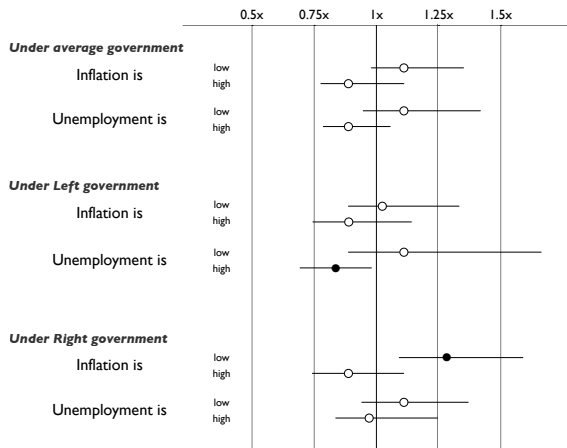
| Covariate | Hazard ratio | 95% CI | |
|---|--------------|-----------------------|-------|
| | | lower | upper |
| Age > 75 | 5.78 | 2.28 | 14.68 |
| 70 < Age \leq 75 | 3.48 | 2.32 | 5.22 |
| 65 < Age \leq 70 | 2.01 | 1.24 | 3.27 |
| Other Government Experience | 1.86 | 0.82 | 4.23 |
| Abs diff in PCoG, appt party vs. current | 1.67 | 1.24 | 2.25 |
| Financial Experience | 1.40 | 0.83 | 2.38 |
| Finance Ministry Experience | 1.34 | 0.71 | 2.52 |
| Current PCoG \times Inflation | 1.05 | 1.00 | 1.11 |
| Unemployment | 1.04 | 1.00 | 1.08 |
| Inflation | 1.04 | 1.01 | 1.07 |
| Current PCoG \times Unemployment | 0.95 | 0.89 | 1.02 |
| Central Bank Staff Experience | 0.90 | 0.62 | 1.30 |
| Economics Experience | 0.87 | 0.52 | 1.43 |
| Current Partisan Center of Gravity (PCoG) | 0.86 | 0.41 | 1.82 |
| N | 10,863 | 349 individuals | |
| log likelihood | -1229.4 | LR test $p < 10^{-9}$ | |

Entries are hazard ratios (exponentiated coefficients) and their associated 95 percent confidence intervals. Hazard ratios greater than one indicate factors making retirement/dismissal *more* likely. Confidence intervals are calculated using standard errors clustered by country; significant results are those with lower and upper bounds on the same side of 1.00.



Conditional Retention of Monetary Policy Agents

Conditional median central banker tenure, relative to baseline



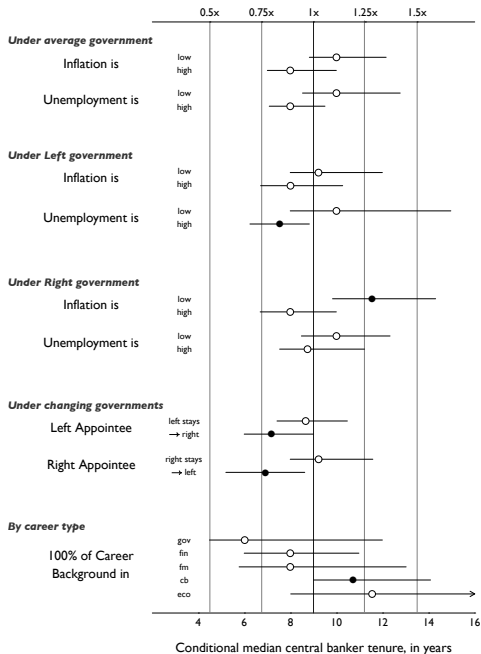
Gov'ts hire on prospects (career background) but retain on performance

Left-wing appointees last longer when they avoid high unemployment

Right-wing appointees last longer when they produce low inflation

But not vice versa

Conditional median central banker tenure, relative to baseline



Transitions from left to right (and vice versa) tend to reduce tenures of holdovers appointed by the opposition

No clear evidence on career backgrounds, but tentatively tenures may be shorter for agents with shadow principals (theory ambiguous in any case)

Stepping Back: Implications for Study of Delegation

Can a legal principal have it all: neutral, loyal, and effective agents?

CBI literature (“low inflation at no cost”) says yes

But evidence here suggests no: agents’ careers are often subject to either exit or informal rewards, which undermine neutrality

Institutional design often seeks “embedded autonomy” – that is, to lift agents from the private sector to gain their skills/networks, yet insulate them from gov’t and private sector influence

Central banks shows that it’s hard to create autonomy from the state and the private sector *at the same time*:

nature abhors an agent without a principal

The Twilight of the Technocrats?

Bankers, Bureaucrats, and Central Bank Politics re-evaluates the late 20th century, which the monetary policy literature sees as a great success justifying present institutions

I'm less certain about these institutions and their future

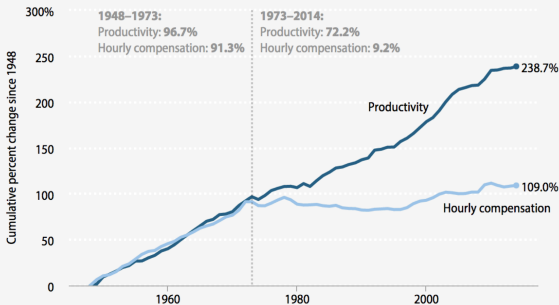
Will the Fed stay independent? Will the ECB survive or fragment?
What sorts of agents will run these agencies?

These institutions will probably muddle through –
but I also thought Brexit and Trump would fail

I still see six reasons to think the future could be rocky

1. Central banks' effect on inequality is overlooked & growing

Disconnect between productivity and a typical worker's compensation, 1948–2014



Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

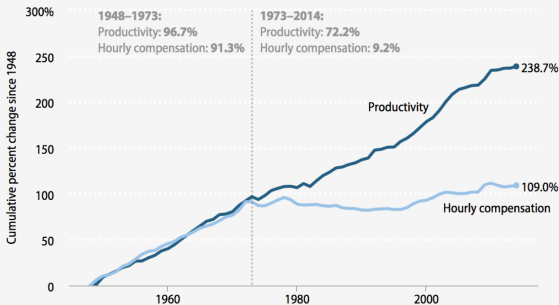
Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

ECONOMIC POLICY INSTITUTE

Economic inequality is arguably the driving political economic problem of our era

1. Central banks' effect on inequality is overlooked & growing

Disconnect between productivity and a typical worker's compensation, 1948–2014



Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

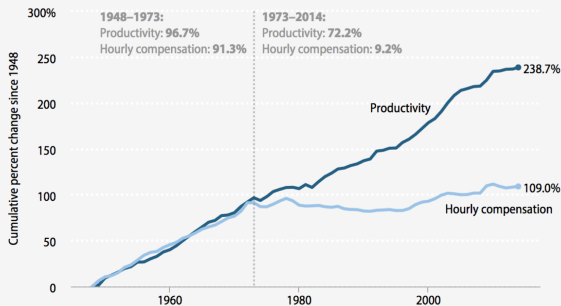
Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

ECONOMIC POLICY INSTITUTE

2 components: huge rises at the very top; stagnation for the majority

1. Central banks' effect on inequality is overlooked & growing

Disconnect between productivity and a typical worker's compensation, 1948–2014



Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

ECONOMIC POLICY INSTITUTE

Overdetermined: returns to skills, declining unions, globalization, automation...

1. Central banks' effect on inequality is overlooked & growing

Monetary policy run by independent central banks might play a role:

Mechanism 1. Monetary policy can have real economic effects depending on labor market structures

Mechanism 2. As a substitute fiscal policy, QE has large distributive effects

As Fontan asks, what if the Fed/ECB used helicopter drops or funded education or climate change programs?

Moreover, preferential treatment of banks through QE enhances banks political power: a *political* multiplier effect

1. Central banks' effect on inequality is overlooked & growing

Mechanism 3. Inequality-enhancing side effects of central bank saviors

During the global financial crisis, divided and conservative governments abdicated demand management to CBs

Would they have done so if CBs couldn't be relied on to step in?

Or would gov'ts lacking independent CBs have pursued more traditional fiscal stimulus?

Does the existence of a political-separate central bank savior crowd out more redistributive fiscal alternatives? Does it foreclose public debates on the role of government?

Relevant fact: most significant US laws now passed under threat of catastrophic "sunset clauses" (Wilkerson & Adler, 2013)

Are central banks sparing elected governments from facing critical moments in which new redistribution is possible?

2. Overgeneralizing from brief economic eras

Much of comparative political economy has been driven by the conditions of the decades from which we have rich data

We treated the 1950s – 1960s as a “baseline” for too long

Monetary policy literature still heavily influenced by the 1970s:
perpetually looking for rising inflation and Nixonian political business cycles

Eichengreen’s take on the financial crisis is helpful:
if need a reference decade to understand the Euro, should be the 1930s

Going forward, we need two things:

- (1) the emerging broader perspective of historical studies in political economy
- (2) humility re: the temporal scope & historical episodes bounding data-driven political economy

3. Fine-tuning complex systems can backfire

Imagine you have an economy running at 5% unemployment and 3% inflation

Is it risky to try to push inflation lower still?

Increasingly convinced human systems need some “friction” to function well

You can have too much transparency (Kramf), too much Taylorite management, and probably too much monetary fine-tuning

Examples:

(1) A little inflation helps hide real wage adjustments –
it's psychologically and socially easier to fire workers than to impose nominal cuts

(2) If central banks take away the punch bowl just as the party is getting started,
what if the same people always miss out on drinks?

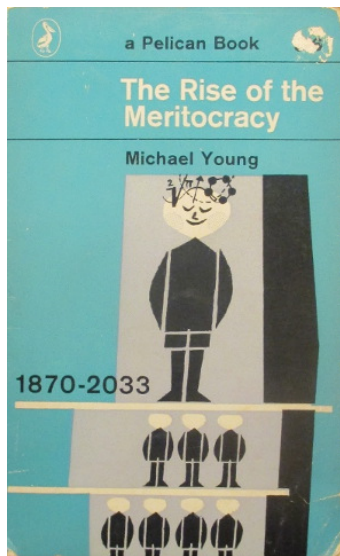
Upshot: Monetary-policy-led inequality again,
from central banks killing growth just as it leads to broad real wage increases

4. Beware the fall of the meritocracy

Michael Young coined
"meritocracy" in a 1958
satire about a brittle
dystopia

His view: a
comprehensive
meritocracy would ossify,
breeding *greater*
resentment among those
rank at the bottom

This prescient warning
has been oddly forgotten



4. Beware the fall of the meritocracy

If any part of the political world identifies itself as a merit-based technocracy, it's independent central banks

Message pre-2007:
central banks are here to stop inflation and save the world

But what happens when you can't?



4. Beware the fall of the meritocracy

Recent echoes of Young speak to the precarious state of the Western political elite:

Colin Crouch (2004, *Post-democracy*): modern democracy delegates everything complex and important to elites and their corporate backers, leaving publics disconnected, dissatisfied & uninformed

Christopher Hayes (2013, *Twilight of the elites*): meritocracy is time inconsistent – the best are working to preserve their power over generations at the expense the public good, causing broad institutional failure and distrust of elites

If your legitimacy comes from being a technocratic wizard of high finance, the fall could be swift after years of failure to deliver sink in with the public

The flip side of claiming (too much) credit for low inflation boom years of the 1990s is getting lots of blame after a decade lost to secular stagnation

5. The downside of epistemic communities

As
indispensible
actors in an era
of gridlock,
central banks
gained power
through the
financial crisis
and aftermath

5. The downside of epistemic communities

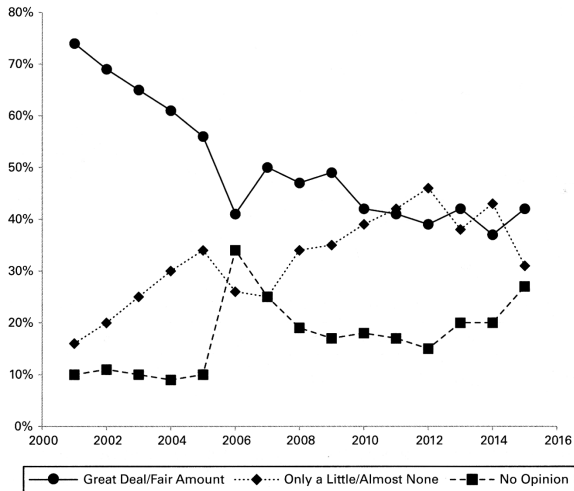


Figure 4.2. Damaged Confidence in the Fed Chair²⁰

Source: Jacobs & King, *Fed Power*

As indispensable actors in an era of gridlock, central banks gained power through the financial crisis and aftermath

But they also gained detractors, on the left and right

5. The downside of epistemic communities

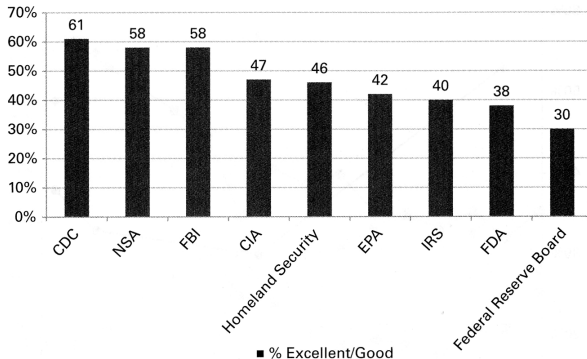


Figure 4.4. Fed Ranked Last among Government Agencies for Job Performance²⁵

Source: Jacobs & King, *Fed Power*

Publics are losing faith in all institutions, but central banks are faring worse than most...

5. The downside of epistemic communities

Monetary policy justifications are geared to a monocultural epistemic community could prove vulnerable if CBs need to justify independence to the public

(Something conservative parties just learned about their ideological foundations)

Goes beyond the usual problems of explaining non- or counter-intuitive economic concepts like nominal illusion

Consider core concepts undergirding elite consensus around central banks' current role

Set aside whether "time inconsistency" or "quantitative easing" are sound theories: do these theories sound good to a broad audience?

And a harder sell after the "great financial crisis" than after the "great inflation"

6. Broader scrutiny means it's time for a broader perspective

With greater public scrutiny of monetary policy and central banks likely, it's time for fresh questions and perspectives

Welcome new interdisciplinary efforts

text analysis of central bank documents and communication
(Schonhardt-Bailey 2013, Diessner & Lisi, Warin)

ethnographic treatments of Wall Street culture (Ho, 2009)

But it's also time for closer connections to comparative politics

Example: with rise of populist leaders, how will pressures on central banks change?

Will these leaders respect independence?

What sorts of agents will they appoint? Who will their shadow principals be?



Sally Q. Yates

Deputy Attorney General

January 10, 2015 – January 20, 2017

Acting Attorney General

January 20 – January 30, 2017

Sen. Jeff Sessions (R-GA): “But if the views the President wants to execute are unlawful, should the attorney general or the deputy attorney general say no?”

Sally Q. Yates: “Senator, I believe the attorney general or the deputy attorney general has an obligation to follow the law and the Constitution and to give their **independent** legal advice to the President.”

from US Deputy Attorney General Sally Q. Yates’ confirmation hearing, 2015



Sally Q. Yates

Deputy Attorney General

January 10, 2015 - January 20, 2017

Acting Attorney General

January 20 - January 30, 2017

My responsibility is to ensure that the position of the Department of Justice is not only legally defensible, but is informed by our best view of what the law is after consideration of all the facts...I am not convinced that the defense of the Executive Order is consistent with these responsibilities nor am I convinced that the Executive Order is lawful.

from Acting AG Yates' January 30, 2017 letter on Pres. Trump's immigration ban executive order



"...as long as I am the Acting Attorney General, the Department of Justice will not present arguments in defense of the Executive Order, unless and until I become convinced that it is appropriate to do so."



White House Response: "Sally Yates has **betrayed** the Department of Justice by refusing to enforce a legal order designed to protect the citizens of the United States...Tonight, President Trump relieved Ms. Yates of her duties"



Term up in 2018
Two current vacancies on Fed Board



Yellen "should be ashamed of herself"
Promises Republican replacement
Wants to gut Dodd-Frank
Economic goals (!):
high interest rates, growth, \$, exports

Will Trump appointees be:

Monetary policy experts?

Financial sector agents?

Independent in any sense?



Yellen “should be ashamed of herself”

Promises Republican replacement

Wants to gut Dodd-Frank

Economic goals (!):

high interest rates, growth, \$, exports