Remarks for the Panel: “Transparency and Communications”[*]

At the Shadow Open Market Committee Conference – Current Monetary Policy: The Influence of Marvin Goodfriend

Loretta J. Mester
President and Chief Executive Officer
Federal Reserve Bank of Cleveland

Shadow Open Market Committee
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[*] The views expressed here are those of the author and not necessarily those of the Federal Reserve System or the Federal Open Market Committee.

A tradition at FOMC meetings is that the research directors go out for dinner the night before the meetings. Sometimes some of the Reserve Bank presidents join this group. Shortly after I had been appointed research director at the Philadelphia Fed in 2000, a group of us, which included my president and Marvin Goodfriend, were walking to dinner when an accident happened. In the midst of a robust conversation, the Philadelphia Fed president walked into a metal parking sign and cut his forehead. The prospect of losing the Bank's president to a bout of tetanus flashed through my mind: it was clear he had to go to the emergency room to get patched up. It took some convincing, but he and I headed over to George Washington University hospital where he was quickly taken to the back for triage. That was the last I saw of him for a very long time. If any of you have ever experienced the waiting area of a large urban emergency room you understand that it's not the most comfortable place to be. After a couple of hours, you can imagine my surprise when I saw Marvin Goodfriend walking through the emergency room door. Dinner was over and he had come back to check on me, knowing it was going to be a long night. I have never forgotten this act of kindness and caring for an individual. I tell you this story now to illustrate the kind of person Marvin was. He a great scholar who advanced knowledge in the field of monetary policy, not just out of intellectual curiosity but because he cared about people. He understood that if policymakers did things right they could improve how the economy works for real people. I feel very fortunate to be a part of this conference that honors Marvin Goodfriend and recognizes his many contributions to the theory and practice of monetary policy.

Our session discusses the contributions Marvin made to our understanding of the role of transparency and communication in monetary policymaking. I will frame my remarks around the two things Marvin indicated in his confirmation hearing statement that he would pursue if confirmed. First, Marvin planned to draw on his "academic and professional experience to promote policies that would further increase transparency and accountability at the Federal Reserve."[1] This is a worthy pursuit. Congress has given

[1] "Statement of Marvin Goodfriend, Nominee to be a Member of the Board of Governors of the Federal Reserve System" before the Committee on Banking, Housing, and Urban Affairs, United States Senate, January 23, 2018. (https://www.banking.senate.gov/imo/media/doc/01-23-18%20Goodfriend%20Testimony.pdf)

the Fed a mandate to promote price stability and maximum employment, and it has given the Fed independence in making monetary policy decisions in pursuit of those goals. This independence has been shown to yield better economic outcomes. But a central bank cannot expect to remain independent from the political process unless it is held accountable for its policy decisions and is transparent about the basis for these decisions.

Marvin was a strong advocate of transparency in monetary policymaking and clear communications about the strategy policymakers use to set policy. He was also a persuasive advocate: many of Marvin's suggestions that were contrary to how policy setting was being done at the time have become standard operating practice in central banking. Recall that it wasn't until 1994 that the FOMC began to explicitly announce changes in its fed funds rate target. At a time when the Federal Reserve was still quite secretive, Marvin argued that more transparency would confer social benefits by helping to align markets' and policymakers' expectations.[2] Well before the Fed adopted its explicit numerical inflation target in 2012, Marvin had been explaining the benefits such an explicit goal could play in anchoring inflation expectations. He argued further that the Fed's actions and its communications needed to be designed so as to make this goal a credible commitment on the part of the Fed. One way to do this is to ensure that policymakers are taking a systematic approach to setting policy, which can help align the public's policy expectations with policy decisions, thereby helping to transmit monetary policy to the broader economy. Policy rules are one way to foster systematic policymaking and Marvin suggested that the FOMC refer to a Taylor-type rule when explaining its policy decisions.[3]

[2] See, for example, Goodfriend, Marvin, "Monetary Mystique: Secrecy and Central Banking," *Journal of Monetary Economics*, 17 (January 1986), pp. 63-92. (https://doi.org/10.1016/0304-3932(86)90006-1)

[3] Goodfriend, Marvin, "The Fed Needs a Credible Commitment to Price Stability," testimony before the Subcommittee on Monetary Policy and Trade, Committee on Financial Services, U.S. House of Representatives, March 16, 2017. (https://financialservices.house.gov/uploadedfiles/03.16.2017_marvin_goodfriend_testimony.pdf)

The FOMC has been reluctant to relinquish policymaking to following a simple rule because no one rule works well enough across a variety of economic models and circumstances, and judgment will likely always need to be a part of policymaking. Nonetheless, rules provide useful benchmarks. The Board of Governors has begun to include a discussion of rules as benchmarks in the monetary policy report.[4] In some of my speeches I have referred to simple rules that have been shown to yield good economic outcomes as reference points to explain my own views of appropriate policy.[5] The Cleveland Fed's website regularly updates the outcomes of seven simple policy rules across several forecasts.[6]

Of course, one of the communications challenges for the FOMC continues to be how to convey to the public a good sense of how policy is likely to respond *conditional* on how the economy evolves without implying that policy is pre-committed to a particular policy path *regardless* of how the economy evolves. My own view is that if the Committee were willing to expand what it says in its post-meeting statement, it could give a better sense of its reaction function, its medium-run outlook, the risks around the outlook, and policy rationale. The statement could provide a summary of changes in a consistent set of indicators on inflation, inflation expectations, the unemployment rate, employment growth, output growth, and financial conditions that the Committee regularly assesses to formulate its outlook and view of appropriate policy. The statement would convey whether the accumulated changes in these indicators have materially changed the Committee's outlook. That outlook and the risks around the outlook would also be summarized. The statement would then describe the Committee's policy decision, tying that policy to the achievement of its policy goals, given the outlook and risks. The statement would articulate the considerations the Committee would take into account when determining future changes in policy to

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[4] See Board of Governors, "Monetary Policy Report," February 7, 2020, pp. 33-37. (https://www.federalreserve.gov/monetarypolicy/files/20200207_mprfullreport.pdf)

[5] See, for example, Mester, Loretta J., "The Outlook for the Economy and Monetary Policy in 2020," National Association for Business Economics, 36th Annual NABE Economic Policy Conference, Washington, DC, February 24, 2020. (https://www.clevelandfed.org/newsroom-and-events/speeches/sp-20200224-outlook-for-the-economy-and-monetary-policy-in-2020)

[6] See "Simple Monetary Policy Rules," Federal Reserve Bank of Cleveland. (https://www.clevelandfed.org/our-research/indicators-and-data/simple-monetary-policy-rules)

help the public anticipate how policy is likely to change in response to changes in economic developments that affect the economic outlook, without having to be prescient about how those conditions will actually evolve. Since the FOMC's assessment of risks is an important part of the policy discussion, for the four meetings a year in which the FOMC releases its Summary of Economic Projections (SEP), the Committee could release the balance of risk graphs that are part of the SEP with the other charts released at the time of the press conference, rather than waiting three weeks to release them with the minutes of the meeting. I believe enhancements like this would allow the FOMC to better control the narrative about its economic and policy views and they are consistent with Marvin's desire to increase FOMC transparency in a productive way.

A second thing Marvin said in his confirmation hearing statement was that his years at the Richmond Fed "gave him a deep appreciation of the role of the regional Reserve Banks in the Federal Reserve System," and that the regional structure encourages diverse perspectives and innovative thinking that he would consider in formulating monetary policy.[7] In 1998, Marvin was a presenter at a workshop on the structure of the newly formed European Central Bank and laid out some of the benefits of the decentralized structure of the Federal Reserve System.[8] The regional structure enhances credibility by making the institution less prone to political pressure. The diffusion of power across the 12 regional Reserve Banks helps build rapport with constituencies throughout the country. The regional structure also aids communication. It helps the institution collect information on economic and financial developments across the country. Reserve Banks have boards of directors drawn from the private sector and typically have multiple advisory councils; their presidents and staffs speak regularly with a large number of contacts representing business, labor, consumers, and banking. In a dynamic economy, anecdotal

[7] See "Statement of Marvin Goodfriend (2018).

[8] See Goodfriend, Marvin, "The Role of a Regional Bank in a System of Central Banks," *Carnegie-Rochester Conference Series on Public Policy*, 51, 1999, pp. 51-71. (https://doi.org/10.1016/S0167-2231(00)00004-X) and reprinted in *Economic Quarterly*, Federal Reserve Bank of Richmond, 86, Winter 2000, pp. 7-25. (https://www.richmondfed.org/publications/research/economic_quarterly/2000/winter/goodfriend). The workshop was "Monetary Policy of the ESCB: Strategic Implementation Issues," sponsored by the Bank of Italy, IGIER, and Bocconi University, July 6-7, 1998, in Milan, Italy.

information from the regional Reserve Banks can provide early indications of changing sentiment or developing trends well before they show up in the data. Because the dispersion of activity across the country is not even, the regional structure also allows for some specialization in expertise about particular industries relevant to each region, expertise that can be called on when needed.

A further benefit of the regional presence is that it helps the Fed disseminate its policy messages via speeches and presentations made by Reserve Bank officials. In addition, it provides a way to collect information about the impact of its policy in the community. An example of the power of the regional structure in action was the program of Fed Listens events that the System held as part of its ongoing review of its monetary policy framework. These events were held across the country to gain the perspectives of people with diverse backgrounds and in different economic circumstances about how our dual mandate goals of maximum employment and stable prices affect them.[9]

As has been documented, the regional Reserve Banks have also been able to provide thought leadership within the Federal Reserve System.[10] Reserve Bank economists regularly interact with academic economists and have provided a way for diverse analytical methods and innovative thinking to enter into the process of monetary policymaking, helping the institution to guard against group think and leading to better policy outcomes. Ideas such as rational expectations, time consistency, the important roles of credibility and commitment, and inflation targeting first came into the System via a Reserve Bank.[11] The

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[9] A summary of the Cleveland Fed's Fed Listens event is available at https://www.clevelandfed.org/newsroom-and-events/events/2019/policy-summit/fed-listens.aspx. A full list of Fed Listens events is available at https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-fed-listens-events.htm.

[10] See Bordo, Michael D., and Edward S. Prescott, "Federal Reserve Structure, Economic Ideas, and Monetary and Financial Policy," NBER Working Paper No. 26098, July 2019 and Federal Reserve Bank of Cleveland Working Paper No. 19-13, June 2019. (https://www.clevelandfed.org/en/newsroom-and-events/publications/working-papers/2019-working-papers/wp-1913-federal-reserve-structure-economic-ideas-and-monetary-and-financial-policy.aspx), and Wheelock, David C., "National Monetary Policy by Regional Design: The Evolving Role of Federal Reserve Banks in Federal Reserve System Policy," in *Regional Aspects of Monetary Policy in Europe*, eds. Jurgen von Hagen and Christopher J. Waller, Kluwer Academic Publishers, 2000, pp. 241-274. (https://doi.org/10.1007/978-1-4757-6390-4_9)

[11] See Bordo and Prescott (2019).

Federal Reserve has been criticized at times for offering a cacophony of views that can be detrimental to clear communication. However, the reality is that the economy is complex and so is monetary policymaking. Different models, techniques, and measurements need to be brought to bear in order to assess appropriate monetary policy. Participants on the FOMC bring their perspectives to the table and these perspectives are inputs into the consensus-building process. While the FOMC works hard to get to a consensus, there will inevitably be times when individual policymakers hold different views. These diverse views are shared with the public and ultimately result in better policymaking as sound ideas gain traction. Indeed, the contributions that Marvin Goodfriend made while he was an economist and policy advisor at the Richmond Fed prove this point. His arguments on the value of transparency and good communication in monetary policymaking began in the 1980s and ultimately gained traction within the System. The FOMC can thank Marvin Goodfriend for starting us on our journey toward better policy communications in support of more effective monetary policy, a journey that continues to this day.