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Discussion

The discussion began with Allan Meltzer questioning why Germany had lower inflation that the United States. First, as Issing pointed out, there was political support for attacking inflation rather than economic stabilization. President Richard Nixon used to say that no one ever lost an election because of inflation. Second, and very importantly, the Bundesbank had strategies that aimed specifically at sustaining a low inflation rate. The Federal Reserve was dominated by a Phillips curve that was not well estimated, and people that relied on it forgot that most of the points used to estimate it came from the time of the gold standard. Third, the Bundesbank made a commitment that the public believed that they and the Swiss National Bank were the dominant anti-inflationists. This is critical, and the political part is missing from most of our models of US policy. Optimal monetary policy is not possible unless the Congress and the Federal Reserve are willing to go along with it. The Congress had a mandate that it sent to the Federal Reserve to perform. The chairman of the Federal Reserve is aware of this and frightened of Congress.

Lars Svensson thought of the Bundesbank's legacy as its commitment to price stability, and not to monetary targeting as the authors suggest. There is conflict between achieving the inflation target and the money growth target. Issing and his colleagues chose an inflation target, and in the end Svensson believed that money is more of a smokescreen. The Bundesbank was thus just an early flexible inflation targeter. On a more technical note, Svensson referenced the model and how putting money growth into the central bank loss function is not very attractive; rather, one should use a lagged state variable. Nominal interest-rate smoothing does the same thing, and you do not need money in the loss functions to make the discretion equilibrium closer to the commitment equilibrium.

Athanasios Orphanides followed up on Svensson's comments in agreeing that money growth targeting proved a very successful framework for avoiding inflation. It avoided relying on utilization gaps and instead focused on stabilizing the growth rate of the economy. It is very close to nominal income targeting. The basic lesson that it provided was to not let policymakers perform gapist policy. The main question Orphanides posed was about the role of independence of the central bank in delivering different outcomes in Germany versus the United States at the time. In 1957, both central banks recognized that the objective of policy should be price stability because this would be how the central bank would achieve maximum sustainable growth in the economy. Starting from the same initial conditions, the story unfolds much differently.

Michael Woodford thought the chapter provided interesting evidence that the approach to policymaking that the Bundesbank was using had characteristics of what simple theoretical models would suggest as good policy. Yet, Woodford wondered if this proves that putting a stabilization objective for money growth in the loss functions for the central bank is the most practical way of achieving those benefits. Svensson had suggested using lagged interest rates, and another alternative is using a loss function that tries to stabilize the rate of change in the output gap. This makes discretionary policy look more like optimal policy and brings about results that are clearly a feature of Bundesbank policy. Woodford was not convinced that the only way to cure the suboptimal features of discretionary minimization of a New Keynesian loss function was to have discretionary minimization of some other loss function. One could simply design other procedures, most notably inflation targeting, and implement optimal policy with these.

John Crow did not believe money was important for the Bundesbank, and stressed it was mostly about the politics of the time. The central bank is in charge of money, and money does matter, which he stressed in reference to work at the Bank of Canada. The fact was that they needed to move to target prices straight away. Money demand responds faster to interest rates than to inflation. The path is the demand for money, then money, then the real economy, then inflation. Crow also questioned Issing about how the ambiguous response to inflation targeting of the Bundesbank and even the European Central Bank was not just political, but also technical.

Christina Romer asked why Germany opted into optimal policy rather than opting out like the United States? In the crucial period being looked at, German inflation went from 1 percent to 7 percent. It was at 5 percent even before the oil shock. So why did they make the mistakes in the late

1960s and seem to fix it in the 1970s? Is it in fact that they had bought into some of the same bad ideas of the United States but learned something the United States did not learn?

Issing began the rebuttal, claiming that the statements of Svensson were unfair. The Bundesbank was in conflict with strict monetarist ideas, and he thought the money had a crucial role. What they were doing might not be completely transparent, and it was probably inflation targeting in disguise. Issing agreed with Orphanides's story about avoiding the gapist policies. While stabilization gaps and real-time data were all instruments available to the bank, they did not rely on them. As a final point, to model monetary policy, which is neither strict money targeting, a Taylor rule, or inflation targeting, is a very ambitious approach. One can always improve on policy, but none of this says money does not matter. The political story is important, yet it is the job of the central bank to control money so that inflation does not get out of control.

Vitor Gaspar concluded with two points. First, in reference to McCallum, the authors will work on spelling out the argument that estimating instrument rules with money growth directly in them is not desirable. Lastly, there is confusion in this debate because there are many ways to explain inertia in a policy rule. The authors felt the beauty of their approach was that it was more compatible with the language of the Bundesbank at the time and was a description of what it actually did.