

MISSING REGIMES AND DELEGATED POWER

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MISSING INSTRUMENTS

Conference has revolved around instruments that have come into focus since GFC:

- Negative policy rate
- Supply of safe assets
- Long rates
- Capital controls
- Macro-prudential tools (whatever they are)

All reflecting view that pre-crisis monetary and prudential not enough

POLITICS OF MISSING REGIMES

Political economy of missing regimes:

- Incentives
- Values, less discussed but v important

Legitimacy matters to resilience of system of govt given inevitability of episodic policy failure

ADVANCED ECONOMIES

- *Problem*: internal runs
- *Missing regime*:
 - Resilience of core of financial system
 - Feedbacks with economy
 - 'Macro-prudential'
- *Debate*: can the central bank decently be the stability authority?

EMERGING MARKET ECONOMIES

- *Problem*: external runs
- *Missing regimes*:
 - Capital controls
 - ‘Macro-prudential’ policy (used here in a different sense)
 - Pigouvian taxes
 - Really about management of risks in *external national balance sheet*
- *Debate*: ?

TWO TYPES OF FAILURE

- Debates conducted as though challenges in positive economics: which instruments work best
- *Market failures*
- But what about *government failures*
- Little said about design of policy institutions
- Implicit assumption: if central banks are most capable policy body, they should be empowered with previously missing instruments

DELEGATION WITH INSULATION

- Standard justification: time inconsistency
- Too narrow: broader problem of credible commitment
- But now too broad given our values.
- Other conditions include:
 - No choices on big distributional issues or values
 - Minimize interference with liberal freedoms (proportionality)
 - Settled societal preferences
 - A clear objective that can be monitored

CONDITIONS BITE ON INTERNAL MACROPRU

- Problem re LTV and LTI caps for borrowers: not proportional as other options
- Problem of managing credit cycle: no monitorable objective proposed
- Solution: frame ‘finstab’ objective in terms of *resilience of system*
 - Politics shd decide/bless policy of degree of desired resilience given long-run trade-offs
 - Dynamic macropru policy directed to maintaining desired degree of resilience
- Not same as
 - ✓ mitigating every resource misallocation caused by fin system pathologies
 - ✓ leaning against real economy over-indebtedness that does *not* threaten system stability

MORE THAN ONE MISSING REGIME

A complete regime of regimes would cover:

- 1) Nominal stability and inter-temporal stabilization
- 2) Financial system resilience
- 3) Internal macro/financial imbalances (debt overhangs)
- 4) National balance-sheet management (vulnerabilities)
- 5) Global macroeconomic imbalances

WHAT ROLE(S) FOR CENTRAL BANKS?

- Stick to monopol, and rely on cooperation and information flows for everything else?
 - Great mistake of 1997 UK stability regime
 - Underlap v. Overlap
- So, can central banks decently lead on any of those missions?
- Need a framework for thinking about combined missions

INTEREST, INFLUENCE, INSULATION

- A clue: *inalienable interest* of LOLR in internal stability.
- But interest does not entail need for *influence*: eg monopol and labour mkt structures
- Where need influence, should be formalized
- But need for influence/powers does not entail *insulation* from day-to-day politics

BLURRING CBANK INDEPENDENCE

- Different degrees of independence for different regimes?
 - Bernanke description: do not agree
 - Fischer marriage metaphor: doesn't work
- Need criteria for combining missions

MULTIPLE-MISSION CRITERIA FOR IAs

Whether:

- 1) They are intrinsically connected,
- 2) Each mission faces a problem of credible commitment but does not entail making big distributional choices etc, and
- 3) Combination will deliver materially better results.

How: Separate policy committees (to mitigate salience-driven incentives problem)

WHAT ROLE IN *MISSING* MISSING REGIMES?

1) Internal macro/financial imbalances:

Advisory?

2) External national balance-sheet management

- *Intimate connection o/a FX intervention plus liquidity provision?*
- *Delegated powers, with insulation?*

3) Global macroeconomic imbalances

Advisory