

## MACROECONOMICS AT WORK EXERCISE

### CENTRAL BANKING

**REFERENCE:** ‘The future of the Fed’ (by Rich Miller), *Business Week*, December 16, 2002, pp.95-104.

**CHAPTERS RELEVANT TO THIS EXERCISE:** Chapters 10, 16, 18.

### OVERVIEW

The Federal Reserve System (the Fed) is the United States’ central bank, the equivalent of the Reserve Bank of Australia. This article is about the operation and policies of the Fed over the last fifteen years and Alan Greenspan the Chairman of the Federal Reserve over that time. (The analysis is relevant to Australia, although there are some differences in the economic circumstances of the two countries. Moreover, in the US the Chairman is a somewhat higher profile and more influential figure than his Australian counterpart, the Governor of the RBA.) Greenspan is widely considered to have been a highly competent and successful Chairman, having been the principal architect of a monetary policy which allowed a high and sustained level of economic growth and prosperity accompanied by only a low level of inflation. The events of the early 2000s (particularly the dramatic fall in technology stocks, the more general fall in the stock market, subdued economic conditions and continuing unemployment, and the threat of deflation for the first time in 70 years) have raised questions as to Greenspan’s ability (and perhaps even the ability of *anyone*) to address the economic circumstances of the times, to which has to be added the unique circumstances of the unsettled international political situation. For this reason there is great concern about future Fed policy and the question of who will be Chairman after Greenspan retires in 2004. There is a range of views over the appropriate emphasis that should be given to measures affecting growth and inflation, and the manifestation of economic activity in asset prices (i.e. the share market). Contenders for the position – which include John Taylor, author of the *Macroeconomics* textbook – are considered to base their policy prescriptions on different economic theories.

### QUESTIONS

1. What are considered to be the major achievements, and shortfalls, of the Greenspan era (1987 to the present)?
2. What is the essence of the ‘new economy’ policy attributed to Greenspan? What are the dangers in adopting this policy stance?
3. How does the ‘inflation-targeting’ school of thought differ from that identified with Greenspan? What is the key principle of adherents to this school?
4. Explain the key principles underlying the ‘anti-bubble’ school of thought and what emphases they would give to policy.

5. John B. Taylor has been described as a 'monetarist'. What does this mean and how might it be expected to influence his policies?
6. How real is the prospect of deflation? What are the macroeconomic policy implications in a deflation scenario?