Public Choice
DOI 10.1007/s11127-014-0157-3

BOOK REVIEW

Cheryl Schonhardt-Bailey, deliberating American monetary policy: a textual analysis

Cambridge, MA: The MIT Press, 2013. x+523 Pages. USD 50.00 (cloth)

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Deliberating American Monetary Policy explores how discussion among monetary policy makers, and those who oversee them in Congress, contributes to the formation of monetary policy decisions. Applying quantitative textual analysis[1] to transcripts from Federal Open Market Committee (FOMC) meetings and Congressional hearings on the Fed's Monetary Policy Report from 1976 to 2008 (with interviews of FOMC members and members of Congress and congressional staff serving as robustness checks), Cheryl Schonhardt-Bailey explores whether deliberation—"reasoned argument" (p. 5), in the case of monetary policy in a committee setting—matters, both in terms of process and outcome.

The introductory chapter provides a roadmap, outlining the scope of the inquiry and providing a basic argument as to the importance of deliberation for understanding monetary policy decisions. For Schonhardt-Bailey, deliberation matters because it helps us understand persuasion—a fuzzy topic in the social sciences, and economics especially—and because the inherent uncertainty in crafting monetary policy "should naturally lend itself to deliberation among the members of the decision-making body" (p. 23). A foundational assumption the author makes is that "what policy makers and politicians say is indicative of their intentions and preferences" (p. 5). Rather than focusing solely on outcomes, as in much of the literature which uses FOMC transcripts and other central bank data to construct backward-looking policy reaction functions, the author seeks "to analyze the *process* of conceptualizing, arguing, discussing, and *deliberating* on monetary policy by bankers and politicians" (p. 2, italics original). Schonhardt-Bailey also includes a short description of the FOMC committee structure, a description other structures of Congressional committees that oversee monetary policy, and a brief history of monetary policy in the U.S. since the passage of the Federal Reserve Act.

[1] This analysis is performed using a software package that analyzes verbatim FOMC transcripts from 1977 to 2008, measuring "systematically (and statistically) the characteristic words, phrases, and in some cases, the dimensionality of the discourse of committee members" (p. 6). The software is described in detail in Appendix I of the book.

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Published online: 24 January 2014

Chapter 2 provides further detail as to what deliberation entails, the study's focus, and the hypotheses to be tested. The definition of deliberation includes three requirements: reason-giving argument, argument over a public (rather than private) good, and the amenability of the arguers to persuasion (pp. 38–39). The author discusses the pros and cons of deliberation in democratic processes, asserting that, for good or ill, deliberation over the course of monetary policy is likely to be important due to inherent uncertainty, multiple views of how the economy works held by FOMC voters, and the possibility of implicit political influence (p. 44). Schonhardt-Bailey presents a list of seven central hypotheses (p. 55). Of particular interest to readers of *Public Choice* will be the emphasis the author places on the institutional context in shaping how deliberation matters for the FOMC, and the hypothesis that deliberation will be higher quality for the Senate Banking Committee than its corresponding committee in the House of Representatives.[2]

Chapter 3 begins the assessment of deliberation's importance, examining the change in policy comprising the Volcker revolution, as well as the 1999 tightening under Greenspan. Through examining FOMC meeting transcripts, Schonhardt-Bailey finds evidence that a shift occurred in decision making regarding monetary policy from Fed bank presidents to board governors. She also finds evidence of model-based thinking becoming more important at the margin. The most interesting portion is the in-depth analysis of the quest for credible commitment under Volcker. The author finds textual support for the hypothesis that Volcker himself was focused foremost on credibility, as opposed to adapting policy to a model-consistent view of the economy. Schonhardt-Bailey heavily emphasizes Volcker's ability to persuade other decision makers of the importance of credibility. This supports her hypothesis regarding the importance of deliberation as reason-giving argument in formulating monetary policy (pp. 140–142).

Chapter 4 analyzes the testimony of Fed chairmen during House and Senate oversight hearings. Unlike in the previous setting of committee decisions among monetary policy makers, Schonhardt-Bailey finds no evidence of persuasion, although there is substantial reason giving in public testimony. Interestingly, members of Congress seem to have very little interest in engaging Fed chairmen in issues of technical monetary economics and policy (with the exception of objections voiced to Volcker's attempt to tame inflation, due to the recession that followed). Members of Congress have become much more willing to defer to the modern consensus of low inflation as the proper goal of monetary policy. Instead of actively critiquing a chairman, members of Congress usually attempt to steer the discussion such that the chairman's answers could be seen as giving implicit support for members' own legislative agendas.

Further, despite the fact that the Senate committee makes the substantial decision as to whether to reconfirm a Fed chairman, the author finds no evidence of the quality of debate being higher in Senate than in House hearings, although the content of the discussion differs. Unsurprisingly, the rhetoric in Senate reconfirmation hearings is more partisan than the actual voting. Ultimately, it seems the House and Senate oversight hearings have little to do with accountability—their originally intended purpose—and have evolved into a discussion on economic policy broadly conceived, the practical ramifications of which are unclear (pp. 318–320).

Chapter 5 contains the results of interviews with participants from FOMC meetings and Congressional oversight hearings. These interviews serve both as a robustness check on the author's quantitative textual analysis and offer an alternative perspective by which the

[2] While both House and Senate hold hearings on the conduct of monetary policy, only the Senate committee makes a substantial decision, namely overseeing appointments to the Fed's Board of Governors.

results might be interpreted. The most important findings are the confirmation of reasoned-giving argument and persuasion occurring in FOMC meetings, albeit in differing forms over time; the growing acceptance of a structural understanding of the economy in the policy formation process; and the lack of accountability of the FOMC, and even the chairman, to Congress due to Congressional ignorance of monetary theory and policy and a "culture" of leaving the Fed alone. Through the interviews Schonhardt-Bailey also learns that, in addition to the institutional environment in which the FOMC operates, deliberation is impacted by the clarity of the policy objective in question and the success, or lack thereof, of the policy in question. This last point is of obvious interests to students of public choice and monetary policy since it sheds light on policy makers' learning process in an environment where the link between deliberation and economic theory is merely implicit.

In the final chapter Schonhardt-Bailey summarizes her findings. She again stresses the importance of deliberation among FOMC members, but not members of Congress, since in discussions among the latter there is no evidence of persuasion; the importance of deliberation during Volcker's tenure in securing the consensus to curb inflation; and the disinterest of members of Congress in engaging technical aspects of monetary theory and policy, instead preferring a hands-off approach due to the perceived success of central banking as an institution during the Great Moderation. Interestingly, this latter point seems to have contributed to a *de facto* environment of weaker accountability and oversight, due to the previously mentioned norm among members of Congress regarding central bank independence (pp. 462–463). Schonhardt-Bailey concludes by reaffirming the importance of studies that shed light on deliberative processes, going beyond theories of well-defined preference aggregation and investigating the process by which these preferences are actually formed (pp. 467–468).

On the whole, *Deliberating American Monetary Policy* successfully increases our understanding of an important process that previously was little explored. The use of quantitative textual analysis on this scale and applied to a prominent aspect of non-market decision making is novel and appropriately handled. The author avoids the temptation to mine the data, instead carefully discussing the above results and avoiding over generalization. Even though the work represents a substantial novel contribution, it remains accessible to scholars with no familiarity with the deliberation literature, and only a minimal familiarity with microeconomics, macroeconomics, and political economy. Readers of *Public Choice* interested in aspects of non-market decision making applied to monetary policy, or non-market decision making in committee settings more generally, will find this study of great value.

There is one issue on which *Deliberating American Monetary Policy* is too hasty in pronouncing judgment. Early in the book Schonhardt-Bailey is dismissive towards public choice explanations of monetary policy. The author seems to equate public choice explanations of monetary policy with the theory of political business cycles. Since little evidence of the latter can be found in advanced economies, Schonhardt-Bailey concludes the inappropriateness of the former (pp. 29–30). Of course political business cycle theory does not exhaust the study of monetary policy from a public choice perspective. The public choice study of monetary policy can help us understand the institutions that shape the *incentives* non-market decision makers confront when deciding monetary policy issues. The author, in contrast, is primarily concerned with exploring non-market decision makers' *motivations* and how they find expression through deliberation in a committee setting.[3] In other words, the public choice study of monetary theory is properly viewed as a two-stage

[3] I am indebted to Peter Boettke for pointing out the differences between motivation and incentives.

process. The first stage includes studies such as Schonhardt-Bailey's, which explore the process and content of decision making within given institutions.[4] The second stage includes studies such as Boettke and Smith (2013a, b, c), which are concerned with the shape institutions themselves give to incentives. This is a nontrivial misunderstanding in theory, but in practice it does not affect her study. The most serious way it would impinge the analysis is by indicting the author's approach of taking FOMC and Congressional members at their word, but the nature of the study in which the author is engaged precludes her from doing otherwise. Since Schonhardt-Bailey is primarily interested in motivation rather than incentives per se, her strategy is both appropriate and useful.

References

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[4] Obviously there is feedback between decisions and institutions, especially informal institutions, in the FOMC and Congress. This does not diminish the usefulness of the two-stage approach.