For me, at least, it’s been a wonderful event to be here, and it’s made even better by the fact that at the end, I’m able to present my own ideas on a subject which, as you’ll find if you read this chapter, is dear to my heart. It has been for a long time. So, thank you very much. First of all, I want to—the outline of what I’m going to talk about, first of all, policy of normal times, which I mean by that the [inaudible 00:00:43] of the local financial crisis. I don’t doubt that there are other things that we call crises that occurred in this period, but I don’t think they were system-threatening.

We never thought that the period of the oil crisis was going to lead to the end of the Western civilization as we knew it. Well, there are people who argued that about the local financial crisis. Secondly, the need to adjust policies when confronting a crisis, and thirdly, the question of prolonging normality so that one doesn’t get into crises. Those are the three themes which, first of all, let me talk a little about monetary policy, about policies in normal times. First of all, monetary—we think of the two classic policies here are monetary policy and fiscal policy. Monetary policy has been—the conventional wisdom was that it was to be directed to inflations in civilization, and I don’t object to that on the grounds that one ought to have that in there as well, unemployment, because I think it implicitly takes unemployment.

If unemployment gets above a certain level, then prices tend to fall, or prices rise less rapidly than 2%, and therefore, one reflates. And so that’s already taken account of in having the inflation stabilization as objective. What I think it doesn’t take adequate account of is the danger of financial crisis, and it’s to—direct to that objective as well that I think one needs to have these two instruments in the Central Bank which are directed to two objectives of price and financial stability. So, that’s the first point I’d make.

The second point is that fiscal policy—I’m conventional in arguing that it should aim for stabilization of the debt to GDP ratio. That’s the wrong objective in fiscal policy. Where I do—I’m unconventional is, first of all, that I agree with Bill Cline in that I think one ought to be concentrating on net debt, and not on gross debt. Net debt takes on the negative side; one puts the things that are really worthwhile the government has invested in, and if the government has invested in those and thereby has acquired assets which are worth more (and this will tend to happen in recessions), I think the idea of cutting gross debt by cutting useful government expenditure in a recession is crazy. It makes no sense at all.

So, first of all, it should be net debt GDP and secondly, I would put it equal to zero rather than any arbitrary number. Why put the net debt equal to zero? Well, because that’s the rate at which there’s no either benefit or curse passed on to future generations. One does not pass anything on to future generations if one has a net debt of zero. One only invests what is worthwhile. So that’s a long one objective; it’s not a high-powered objective, but it should be an objective.
Secondly, with fiscal policy, I like to concentrate it on the built-in stabilizers rather than discretionary for various reasons, such as the ability to make sure—well, to begin with, one doesn't have to refight wars every time; they happen automatically. And secondly, the timing is much better; one gets injections when they're needed rather than a year or two later. And then third, as we had a discussion earlier this afternoon, I think I agree with Stan that it's half an instrument, exchange rate policy, but it is half an instrument. It's not redundant because the world isn't what I called here a “REEM,” meaning by that, rational-expectations-efficient-markets; that's a Paul De Grauwe phase. But it's been called here “DSGE,” and that's fine by me as well. But the point is that the world isn't organized that way and therefore one, there is scope to have an active exchange rate policy.

I would wish this to be conducted primarily, though not exclusively, by oil intervention, by having the Treasury Secretary say sensible things when that's what he's asked what thinks the exchange rate of the dollar ought to be, not that it ought to be, “I'm in favor of a strong dollar,” no matter what. That's just ridiculous, I'm sorry. But I think one can't be sure that there will be no occasions on which there will be no need for a real intervention. Let's just say an intervention in using actual money as well as oil intervention.

Then there's a discussion of crises and here I endorse basically the list which is given by Anders Åslund, which is in part based on a book that I edited once. But I'm not going to discuss the subject; I'm going to go on to how one could hope to perpetuate normality. And essentially, perpetuating normality is a case of removing the punchbowl just when the party gets going. It's exactly what [inaudible 00:06:53] or— said for the—wants to do to the Fed. The problem of course with that is that it's not a popular thing to do. When the party just gets going, is when people are enjoying themselves, when they want to have more drinks.

Generally, one—so the political resolve is the problem, but using “political” in a very broad sense to mean the public as well. Here, I think, one can refer to the value of fact-checking, and the fact is that this morning I read that Africa has set up its first fact-checking instrument just yesterday. So, I think that's also good, and the fact that they've—now there's an increasing recognition of the value of fact-checking and that's a step forward. But I don't think it goes far enough because essentially, fact-checking is looking up the factuality of particular statements. It's looking at whether a particular statement is true or not. It's not looking at whether the general sense of economic policy is consistent with the long run future, which I regard as the great need.

So, looking how one could do that—well, first of all, there's the idea of fiscal rules. The consultant to Germany has been urging on its partners in Europe in recent years. The problem with fiscal rules as I see them is that either they are cyclically destabilizing or else they're riddled by exceptions. One can draw up a list of—one can make exceptions for—as the Europeans have tried to do this last time round, but one doesn't know how effective these instruments are going to be in the future. Are they really going—are the Germans going to accept that they should be disciplined the next time around? They weren't last time as it affected them. So, one's not sure that they're really going to work.

So, I think the next step is to go on and look at fiscal councils. A number of countries have established fiscal councils: the office of budgetary responsibility here in the US; the CPB in the Netherlands; and a series of instruments—of councils that have been established for the purpose of saying, first of all, whether the government is being macro-economically responsible, and secondly, pointing to particular expenditures and doing cost-benefit analysis on them and saying whether they're worthwhile or not. I think that a fiscal council is a great thing and people who have them are likely to be thereby be better informed, but I don't think they're an answer, and if the—you see that by looking at the expenses in the United States.

I mean, who has—the United States has office budget—sorry? Office of Management and Budget and nobody can accuse it of being—Conventional Budget Office, yeah, sorry. It has—nobody can accuse
it of being ineffective and yet it has not solved the problem. The United States is in a problem as much as anywhere. So, therefore, I don’t think that they are the answer. How about the possibility of election watchdogs? Well, two countries presently have things that are called election—that qualify as election watchdogs. There’s in the Netherlands, that the CPB (that stands for Central Planning Bureau); it’s—doesn’t do any planning nowadays, I hasten to reassure you, but it—and the UK [inaudible 00:11:26] fiscal setters, also fulfills this populace.

First of all, let me talk a little bit about CPB. It’s part of the government, but it’s apparently trusted by the populace to act independently and to make a systematic comparison of the policy of the parties, which is done before each election. The costs—however, this process does not compare costs. Some people regard it as introducing a bias towards policies that are well-measured by the CPB’s central model. Against those benefits are not measured by the main model.

Now, it’s true that the CPB has developed supplemental models which try to say what the benefits of good education system are, but there is still a residual bias and it publishes the results of those comparisons as well, but they don’t attract the same degree of public attention simply because they don’t come out of the main model. The main model is what’s going to happen in the next four years. And so, it’s what’s happened to demand and other things in that four years, that’s—and so if your benefits (education is a good example), benefits are not well measured by that, then they’re undervalued by this approach.

How about the International Institute of Fiscal Studies? Well, it’s an NGO; it’s not a part of government. It probably made less impression on British electorate than the CPB has on the Dutch electorate. CPB publishes a report which is very widely read in Holland; not so much by the actual electorate as by the press, which then passes on to the electorate the main messages. One can understand that the IFS has not made that sort of impression on the British electorate. It publishes a series of briefing notes rather than a comprehensive report, which are—they draw on the work that C—IFS is doing when they can do, but they present the reports in verbal form rather than the outcome of a model.

I happen to be in favor of that, but I don’t think that at present the IFS makes that much impression on the British electorate. So, what could one think of for fortifying this role of election watchdogs? Well, first of all, I think that one needs to face the fact that there’s election watchdogs, at least in this role, they have to consist primarily for economists. The problems that we are seeking to address with them are economic problems, and therefore economists may be unpopular, but we nevertheless need to agree that—need to appeal to economists.

I think there are three problems; first of all, how to achieve a useful measure of professional agreement because if you put six economists in a room, the popular opinion is seven arguments will be agreed—will be put forward. So, achieving a useful measure of professional agreement is not a trivial matter. And secondly, there’s having the prognostication to take it seriously by the electorate, and thirdly, the problem of getting politicians to accept—to take some notice of what’s said. So, what does one—how to achieve a useful measure of professional agreement?

First of all, I think that one needs to restrict the questions that are asked to the economic. For example, it is no use asking a bunch of economists how to solve the problem of the budget deficit because you won’t get an answer. There is—basically, it’s a political judgment as to what mix of expenditure cuts and tax increases one needs to have, and you won’t get an agreement on that. What you could get—conceivably get an agreement on is if you pose them a purely economic question, such as “Does a particular programmed—electoral program agree—does it achieve the objective? Does it hit the objective?” Or else, “How much is left over to be done in the future?” That is a purely objective question.
Sure, there's a large margin of uncertainty, but it is an objective question that one is confronting the economist with, that I think that should be … that's a first key to achieving useful measure of professional agreement. Secondly, I think it comes down to the panel of economists that is chosen. First of all, I would suggest that one needs a pool of economists who are approved by all the parties, all the relevant parties. I have suggested a definition of relevant parties; it's not a question in the US where there are two relevant parties, but it is a question in many other countries where there are more than two parties. One—therefore, if one assumes that—but all parties would need to—would have to approve members of the pool; that's the first thing.

Economists—first of all, one is assuming that there is a sufficient degree of bipartisanship to in fact accomplish this first step of having a pool of economists who are generally acceptable as they would be willing to give an independent advice, and if somebody says—one party says that they are not willing to approve anybody who doesn't act to their particular line—doesn't tow their particular line, then that's their problem. Secondly, the parties would pick the candidates from the pool. Again, one would have a formula for that, but if they're given that candidates are in the pool, that one has—that one knows one can rely on these individuals to in fact put an objective—to put the objective of achieving truth above the interests of party. Third, they should be able to—the parties should pick candidates from the pool.

So that's my suggestion of how to achieve a useful measure of professional agreement. Then the process of how to have the prognostications taken seriously by the electorate, I think that to begin with, one needs to recognize that it's going to be a gradual process. That one can't hope for—to start off by having a televised debate. One might hope to get there in ten, twenty, thirty years' time after the process has been in operation for—in operation for a long time, but initially, the people would have to—if they agree to be in the pool and be on the panel, then they'll have to labor long and hard out of the limelight to start off with.

But the basic assumption is that the many electors who are tired of half-truths, they want therefore to see objective truth approached, and they would like to hear the results. So, there would be some who would take them seriously in the first instance, and then hopefully, they'll work up from there. Well, now, then the third question is whether one could hope for the politicians to accept a type of election watchdog. Now, it's true that the IFS can do something [inaudible 00:20:10] to have no ability to veto the type of proposal that is public—that is pushed there. But on the other hand, if this type of proposal, I think, is very vulnerable to—it needs political buy-in.

It needs political buy-in for two reasons. First of all, the parties who are organizing—the parties who are going to be responsible for approving people who go in the pool, they will need to therefore be prepared to support this idea. They will need to pick the candidates from the pool. So, once again, this proposal for giving an enhanced role to election watchdogs assumes that the politicians are willing to accept them, and unless they're willing to accept them, there's no point in this proposal. The second thing is that political buy-in is essential, is that there's no point in having the election results simply on the basis of the ability to persuade the electorate, if in fact the politicians proceed to take no notice. But the assumption is that in a democracy, then if politicians don't take notice the first time, well, they're punished the second time. So, in due course, the politicians also will see the virtue in this type of proposal.

So, that's the idea that I want to propose this afternoon. I think that the excess would remove the danger of the conflict which many have pointed between democracy and far-seeing economic reforms. At least, that's the intention of the proposal, is to remove that objective—remove that potential conflict, and to in fact move to a situation which the democracy would be more likely to reach the—reach a good outcome. Thank you very much.