

Should central banks be involved in historical research?*



By Ivo Maes (Robert Triffin Chair, University of Louvain and ICHEC Brussels Management School)

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With central banks becoming monetary authorities, research departments have become a core element of a modern central bank. Crucial functions of a central bank research department are contributing to monetary policymaking and sustaining a dialogue with the academic community. The importance of historical research varies a lot. The historical curiosity of influential central bankers and the commemoration of anniversaries are important factors hereby. Historical research can allow central banks to focus more on identifying regime shifts and avoid a “this time is different” view.

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Introduction

Modern central banks, with fully fledged economics and research departments, are the outcome of an evolutionary process (Maes 2010). The growth of research departments in central banks is closely related to their transformation from issuing banks, with more commercial tasks mainly relating to discount credit, into modern monetary authorities. It is also related to the need for the management of the monetary system, especially after the demise of the Gold Standard. Moreover, the growth of research departments, not only in central banks, is an expression of the growing importance of a more systematic and scientific approach in modern society. At the end of the 20th century, the start of the economic and monetary union also implied some significant changes for the central banks of the euro area. From the outset, Professor Otmar Issing, responsible for the ECB's Directorates General Economics and Research, was at pains to stress the importance of academic research for monetary policymaking. A crucial reason for this was that EMU presented an unprecedented challenge, or, from an economic analysis perspective, a "regime shift". For an analysis of such fundamental changes, Issing referred to the work of Nobel Memorial laureate Robert Lucas (1976), "His core finding is that individual economic agents' adjustment to policy changes can be associated with sizeable changes in macroeconomic variables ... As a result, models based on historical data using empirical parameters become unreliable or simply useless. If policy ignores the influence of the regime shift and continues to rely on existing models or parameters, mistakes will inevitably result" (Issing 2008: 79).

In this paper we will go into question of the importance of historical research central banks, in a broad sense, comprising not only economic history but also history of economic thought. This paper has both a descriptive and a normative component. As for the actual practice, one can note a great variation in the importance of historical research between central banks. As for the "normative" issue, the argument here is that historical research can allow central banks to take more distance and contribute to identify regime changes. It can so help to avoid a "this time is different" view (Maes 2022).

Central banks and historical research: trying to avoid a "this time is different" view

As for the importance of historical research at central banks, one can observe a wide variety of practices. In certain central banks, like the Bank of Italy, there is a Historical Research Division, while in other central banks historical research is nearly absent, with a wide variety of situations in between. In general, historical research, like in the academic community at large, is rather losing ground. There are two main factors which can account for this wide variety of experiences: the importance of personalities and anniversaries. In many central banks historical research is dependent on personalities, both the personal interest (and demands) of high level officials in historical questions and the curiosity of researchers who are investing in historical research. Anniversaries are often occasions for remembrance and reflections on one's history and moments when central banks typically pay attention to their origins and growth (see Maes 2018 for an overview of recent histories of central banking).

The crucial question, however, is what historical research can contribute to monetary policymaking. Here the argument is that a pluralist approach to policymaking can have significant advantages. Typically, central banks give a lot of attention to the history of the last year. Indeed, the annual economic report is for many central banks one of their flagship publications. But it is important to look at different time spans. This can be intra-day analysis, especially important to understand the functioning of financial markets, but why not also take a longer perspective, of several years or decades? It is crucial not only to look at times when things go well, but also at crisis periods.

In the light of the Great Financial Crisis of the first decade of the 21st century, there is a tendency to perceive the history of central banking as one of an institution whose predominant concern varied between "normal" times and "extraordinary" times. In a contribution on the history of the financial stability mandate (FSM) of central

banks, Gianni Toniolo and Eugene N. White, conclude that central banks performed quite well in “normal” times, but had difficulties during “extraordinary” times, also because of financial innovations: “most supervisory regimes successfully managed financial systems in ordinary times, sometimes preventing a troubled institution from generating a systemic crisis, but were less capable of dealing with extraordinary macro-systemic shocks, which they were not designed to confront. When macro-systemic shocks overwhelmed supervisors’ capacity to meet the FSM, the shocks led to regulatory/supervisory regime shifts that primarily addressed past deficiencies, rather than focusing on reforms to ensure the stability of a continually innovating financial system.” (Toniolo and White 2016: 485).

An interesting issue is further the question, who was aware of the Great Financial Crisis (GFC)? Among the few persons who are considered as a Cassandra who was warning for the crisis, one might single out Nouriel Roubini, Alexandre Lamfalussy and Bill White. Typical for them was a wider historical perspective. Roubini and Lamfalussy were marked by the Latin American debt crisis of the 1980s. White was very much under the impression of the Japanese experience, with an asset price bubble in the 1980s followed by a “lost decade”. For these three, this broader historical approach was of crucial importance to let them take distance. The three were marked by experiences whereby bust had followed on boom. It made them reticent to an approach of “this time it is different”. Furthermore, Ben Bernanke, who served as the Chair of the Federal Reserve Board during the GFC, was marked by his studies of bank runs during the Great Depression, for which he was honored with the 2022 Nobel Memorial Prize. It helped him to steer monetary policy during the GFC. As is well known, history does not repeat itself. However, it can contribute to a broader perspective. This can help to see parallels and differences and help identify structural changes.

From a policy perspective, it would even be better to prevent crises. For this, a more robust, or, at least, less fragile, economic policy framework is important. After the Great Financial Crisis, actions in different areas were undertaken, like strengthening corporate governance and increases in capital and liquidity buffers. There remains however the issue, why was this not done earlier? Different elements can be advanced: (1) banks were happy, as they were making big profits; (2) central banks were happy as their objective of price stability was, more or less, achieved; (3) like in other booms, there was the opinion of “this time it is different”; and (4) economic theory was based on analytical frameworks where history was absent, and crises did not happen. This all shows that the political economy of economic and financial reform would merit a high place on the future research agenda of historians and historians of economic thought.

Conclusion

Economic research has become a core activity of a modern central bank. As part of a pluralist approach towards research, historical research can have important benefits. Firstly, a historical perspective can offer insights into the relative strengths and weaknesses of economic theories. Theories are techniques of thinking and remain partial. So, it is important to select theories which highlight the relevant features of reality. The great Austrian economist, Joseph Schumpeter (1954: 15), approvingly referred to Jules Henri Poincaré’s observation, “tailors can cut suits as they please; but of course they try to cut them to fit their customers”. Secondly, for policy-makers, the policy regime is of crucial importance. Sometimes, one tends to take the policy regime as given, rather ignoring that a change in regime will affect economic events and policy outcomes. At other moments, on the contrary, there are heated discussions about the policy framework. In both cases, thorough economic research can help central bankers to build a more robust economic policy framework. A broad historical approach, which can offer distance and a wider variety of experiences, has a role to play here. As observed by John Steinbeck, “The study of history, while it does not endow with prophecy, may indicate lines of probability” (as quoted in Triffin 1960: 17). ■

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About the author

Ivo Maes is a Professor, Robert Triffin Chair, at the Université catholique de Louvain, as well as at ICHEC Brussels Management School. He was a Senior Advisor at the Economics and Research Department of the National Bank of Belgium. In 2003, he was a member of the Committee for Institutional Reform of the West African Monetary Union and from May 2015 to June 2018, he served as the President of the Council of the European Society for the History of Economic Thought. Recent books include *Architects of the Euro. Intellectuals in the Making of European Monetary Union* (editor, with Kenneth Dyson, Oxford University Press, August 2016) and *Robert Triffin : A Life* (with Ilaria Pasotti, Oxford University Press, January 2021), which received the 2022 Best Book Award of the Italian Society for the History of Economic Thought (AISPE). In May 2018, he was awarded the Camille Gutt Prize for his scientific publications on money and finance, especially the making of European monetary union.

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SUERF Secretariat
c/o OeNB
Otto-Wagner-Platz 3
A-1090 Vienna, Austria
Phone: +43-1-40420-7206
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