

The role of research at the central bank

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It is a great pleasure to talk to you today about this important issue. In my short intervention, I would like to share my views with you about the role of research at the central bank and how the knowledge acquired from this research is transmitted (or fails to be transmitted) to one set of final recipients, the policymakers. My thoughts are a reflection of my short experience at the Bank of Greece (BoG) as chief economist and director of economic analysis and research for the past three years.

I would like to stress from the outset, that the role of research in a central bank depends on the role the central bank wants (or is allowed) to play in society. Whether the central bank wants to focus research on issues of monetary policy and bank supervision alone (in a narrow interpretation of its mandate) or whether it wants to also express its views about the economy in general and other areas of economic policy is a matter of strategic choice. Furthermore, monetary policy decision making in the Eurosystem is based on two pillars: the economic and the monetary analysis – thus research of central banks in the Eurosystem often focuses on both analytical approaches.

The BoG wants to be recognized as a knowledge-intensive institution which derives its influence (in and outside the Eurosystem) mainly from the quality of its arguments. This requires a strong research function. It also requires independence of research in order to improve the credibility of its findings and the resulting policy implications.

In my short remarks, I will try to answer the following six questions:

- i. Why do central banks conduct research?
- ii. What is necessary to produce good research at the central bank?
- iii. How does central bank research contribute to policy knowledge?
- iv. How is policy knowledge transferred to policymakers?
- v. How successful has the transfer of knowledge from the central bank to the government been so far?
- vi. How can we increase the influence of research on policymakers?

1. So, why do central banks conduct research in the first place?

The short answer to this question is because it allows policymakers (which includes central bankers and government officials) to do their job better. Good research lends credibility to the central bank and improves the quality of its policy, whether it is monetary policy or safeguarding financial stability. Good research also increases the potential impact of the central bank on society, the financial markets and the general government.

The main goal of economic research at the BoG is to provide a strong conceptual and empirical basis for policy-making. In particular our goals are:

- To increase our knowledge of the Greek and the global economy and the functioning of the financial system.
- To develop high-quality models, econometric tools and economic analyses that are relevant for the conduct of monetary policy and financial stability, thus informing decisions on monetary policy.
- To participate in research networks of the Eurosystem, such as the wage dynamics network, the household survey network, the macro-prudential research network and others. In this way, the bank profits from other central banks' research within the Eurosystem and the interaction of our researchers with those from other central banks.
- To provide credible advice to policymakers and communicate our views to market participants, foreign investors and the public at large.

2. What is necessary to produce good research at the central bank?

There is certainly no single formula for success. Some necessary conditions for doing good research are the following: (1) There must be support from the central bank governor. Without this support, any attempt to build a good research department will most likely fail; (2) There must be a highly trained research staff and a system of measuring quantity and quality of research output (point system); (3) There must be a fertile research environment. One way to ensure this is making the bank open to external researchers from academia, who visit the bank for a limited period of time to conduct research in-house. In order to stimulate research, the BoG invites leading scholars from universities and young PhD students to visit and conduct research at the bank. These programmes create a constant flow of academic researchers through the central bank which helps develop research ideas and provides valuable advice to the staff of the bank.

3. How does central bank research contribute to policy knowledge?

- a. There are many types of knowledge which can contribute to improving policy outcomes. Each of them has pros and cons. Let me focus on two broad types of knowledge: Research-based knowledge and experience.
- b. Research-based knowledge is the output of the research department of a central bank. Research is scientific in nature but the central bank is not interested in conducting basic research. That is the job of universities and research institutes.

The central bank promotes applied research which aims at providing answers to concrete policy related questions.

- c. Experience is the product of the institutional memory of the central bank. Bank staff participates in numerous committees and working groups of the Eurosystem as well as in international fora. The experience gathered over time is valuable for the governor of the bank but also for the government.

4. How is policy knowledge transferred to policymakers?

- a. Knowledge generation is one thing; the transfer of knowledge to the policymakers is another. Transfer of knowledge is just as significant as its creation. Transfer may require first a translation of knowledge, i.e. repackaging, to make it more accessible to policymakers. Our capacity as researchers to translate research findings into clear messages and policy recommendations is crucial for the diffusion of knowledge to the policymakers.
- b. The official way to transfer knowledge from the central bank is its publications. The BoG publishes at least three policy reports a year, an economic bulletin (twice a year) and a series of working papers. In addition, BoG staff members present research results at academic conferences, seminars, professional events and presentations to investors. The governor and other senior staff members give talks and interviews, providing messages to investors, policymakers and the public at large. The bank issues a bi-weekly report on the Greek economy which is sent to policymakers and institutions. Finally, the bank publishes a monthly report which is sent to investors who meet regularly with the bank. The governor appears twice a year in parliament to present the Monetary Policy Report and answers the questions of MPs.

I now come to the crucial question:

5. How successful has the transfer of knowledge from the central bank to the government been so far?

- a. Well, a fair answer would be “Not much of a success”. Of course, there have been exceptions, but even in these cases the process is difficult and may take a long time. Often, it depends crucially on the personality of policymakers and their convictions.
- b. Political constraints also play a role. Governments care about their popularity. Proposals to the government which may be unpopular will be rejected for political reasons, despite their economic rationale. Furthermore, the horizon of policymakers is often constrained to the period until the next elections. This makes it hard to convince them to apply policies which lead to gains for the society in the long term but carry costs in the short term.
- c. A typical example is structural policies such as reforms in the labour and product markets. According to the OECD, these reforms can take up to five years to bear fruits in form of higher economic growth and job creation. In the short term, they

may lead to higher unemployment in the affected industries and sectors. This cost may be worth paying for the society as a whole, given the long term gains for everybody. But the short term cost is often prohibitive for politicians. Of course, the pain in the short term may be alleviated if the government designs policies to compensate the affected social groups. But often, the political pressure from vested interests is so large that governments resist to this kind of reforms. Eventually, even when the reforms are legislated, they are not (fully) implemented.

- d. Ideological differences are also present. It has to be recognized that not all economists agree on the optimal policy to address a particular issue. Thus, a central bank will be more successful in providing advice in areas where there is more consensus among economists.

6. Given all these constraints, what can we do to increase the influence of research on policymakers? I have four suggestions to make:

- a. Credibility and quality of research is crucial. Good evidence increases the likelihood that a policy proposal will eventually find its way to policymaking.
- b. Policy recommendations should be directly linked to the research findings. Often, research papers end up with more policy recommendations than justified by the empirical findings, while sometimes neglecting some caveats inherent in the analysis. This is wrong and should be avoided.
- c. Early engagement of research is crucial. Good policy today depends on good research yesterday. Research must be forward looking in nature in order to be available at a time when the issues it addresses are of active concern to policymakers.
- d. Understanding of the political context is crucial. As I explained above, part of our knowledge is a no go for policymakers due to their prior beliefs, ideological convictions and political constraints. Unfortunately, one cannot do much to get over this hurdle. Better communication of our policy proposals to the public may be the right response. Making the broad public understand our policy proposals can help challenge the pressure that vested interest groups exercise on policymakers.

7. Concluding, let me summarize my message in three main points:

- a. Central bank independence provides credibility to research findings.
- b. Central bank continuity provides institutional memory. A central bank accumulates knowledge both from research and experience. Governments change, ministers change more often, ministers come with advisors. There is no continuity. In contrast, central banks stay. They are one of the most important reservoirs of knowledge, available to consult governments.
- c. The transfer of knowledge to policymakers has not been particularly successful so far.

We are aware of the limitations and continue to work on the issues of research quality, credibility, timeliness and diffusion of knowledge. I am personally convinced that research-based knowledge is highly valuable in this country and this kind of knowledge is particularly important for evidence-based policy. The BoG has an important role to play both in the generation and in the dissemination of this knowledge to the policymakers and the public at large.