Monetary Credibility: a Post-Keynesian approach(*)

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Resumo:

Para Keynes e os pós-keynesianos, a política monetária é capaz de realizar uma importante tarefa: reduzir o desemprego. Faltam, contudo, ao arcabouço teórico pós-keynesiano de intervenção monetária desenvolvimentos a respeito das expectativas dos agentes em relação *especificamente* às políticas monetárias. Esse artigo apresenta uma série de situações em que tais expectativas alteram os resultados esperados das políticas monetárias ou, até mesmo, anulam sua eficácia. O que se pretende desenvolver são os conceitos de *reputação* e *credibilidade* cujos conteúdos tem sido elaborados pelo *mainstream* da ciência econômica representado pela teoria novo-clássica.

Introduction:

According to Keynes and the Post-Keynesians, monetary policy is able to perform a fundamental task: it reduces unemployment.[1] However, the success of monetary policy depends on several factors one of which, that is to say, the agents expectations regarding the monetary policy, is not an issue that has been widely addressed in non-conventional economics. Detailed and clear discussions of this do not exist in the writings of Keynes or his followers (Post-Keynesians, for example), despite the fact that the subject has been widely discussed in orthodox economics. Thus, non-conventional economics needs to develop studies concerning the agents expectations regarding the monetary policy. This subject has become known as *credibility of monetary policy*.

The orthodox concept on the issue affirms that lack of credibility in monetary policy may cause difficulties in achieving specific goal, or even preclude its achievement. The success of a monetary policy would depend in large part on the private agents belief in its effectiveness. In other words, agents expectations regarding monetary policy may determine its effects. Although this particular conclusion is very interesting (and compatible with Post-Keynesian theory), the orthodox concept of credibility cannot be incorporated in Post-Keynesian theory.

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1-By contrast, the Neo-classical Keynesians economists argue that monetary policy is not able to reduce unemployment. Empirical tests suggest that investment function has low interest elasticity. See Klein (1952),

In what follows, we demonstrate why this orthodox concept is incompatible with Post-Keynesian theory. Furthermore, the paper puts forward an alternative concept of credibility of monetary policy.

The article is divided into more four parts. The first describes the orthodox concept of credibility of monetary policy. The second develops a Post-Keynesian concept of credibility of monetary policy. The third demonstrates how this concept may be used when policy-makers strive to reduce the current rate of unemployment and also tries to make some initial links between credibility of policies and monetary authorities' reputation. The last summarises the main conclusions and recommendations of the article.

1)-The Credibility of monetary policy: the orthodox view

Until recently, orthodox economics has dealt with the identification of optimal monetary rules as the main question to monetary policy. Once the optimal monetary rule has been identified, the policy-maker would implement it and the private sector would adapt to it. However, orthodox economists have recognised that this approach is incomplete because policy-makers would have rational motives to break off the optimal rule. According to them, if the costs of deviating from a pre-announced policy were relatively small, policy-makers could have strong incentives to surprise the agents implementing unknown policies which would benefit the elected officials. Understanding monetary policy as a game of individual interests between agents and policy-makers, they have developed studies about the credibility of the rules of this game.

Credibility has a basic meaning for orthodoxy: a rule of monetary expansion which keeps inflation rate at level zero (according to the well-known Friedman's model) only would not be credible if there were incentives to policy-makers to break off the rule. However, according to Kydland & Prescott (1994), there would always be incentives to break off the rule. For example, any elected official needs to convert voters into government sympathisers, and to achieve this aim, policy-makers would try to manipulate monetary policy (by breaking off the monetary rule) in order to reduce unemployment. This is the policy-makers'

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for example. Although James Tobin is a Neo-Classical Keynesian economist, he has said that monetary policy is able to reduce unemployment. See, for instance, Tobin(1987).

continuous incentive to break off the monetary rule, and it clarifies the basis of the orthodox hypothesis that there is an inflationary bias present in an economy.

For orthodox economics, managers of monetary policy, contaminated by the inflationary bias, may circumstantially evaluate that immediate and provisional results regarding the product level are more valuable than credibility in the monetary rules. So, in the absence of *commitment technologies* (using Persson & Tabellini's words) [2] to avoid authorities' discretionary actions, the inflationary bias would be expressed through the implementation of monetary policies which are *dynamically inconsistent* with the natural rate of unemployment. Hence, every monetary rule would need credibility in economies which do not hold commitment technologies. An uncredible monetary policy, that is, one whose rules can be broken, would not be able to achieve the most important goal according to orthodox economics, i.e. the price stability. In other words, unfeasible and uncredible monetary policy cannot achieve its nominal target.

A credible monetary policy, in New-Classical macroeconomics, would be that defined by rules that the agents believe would be sustained. Credibility is thought to be the opposite of flexibility. Accordingly, the main task for orthodox macroeconomics would be to create tools which would have the capacity to: (i)-inhibit the inflationary bias and, simultaneously, (ii)-enhance the monetary rules credibility. In brief, a credible monetary policy rule would be one which agents believe in its inflexibility to achieve its unique goal, the price stability.

In the Post-Keynesian policy model, the discretionary use of monetary tools is not considered a policy mistake (such as Friedman, 1968) or a practical impossibility (such as Barro & Gordon, 1994). Monetary policy may indeed alter the current rate of unemployment via administration of the aggregate demand. Therefore, the Post-Keynesian thought must rebuke the orthodox correlation instituted between credibility and inflexibility of the monetary policy. However, it should be accepted that there is a real relation between the credibility of the monetary policy and its capacity to work - as will be shown later. It is, thus, essential for Post-Keynesian economics to establish credibility criteria for monetary policy.

[2]-See Persson & Tabellini (1994, p.4). These authors have proposed organisation of independent central banks as the principal commitment technology that a society could establish.

2)-A Post-Keynesian concept of monetary credibility: the criteria

To the Post-Keynesian view, a credible and, consequently, workable monetary policy would be that which: (i)- aims at unambiguous goal and creates the least space for contradictory use among its tools and the other policy tools, (ii)-makes use of suitable tools with respect to its goal, and (iii)-emits clear signals to the agents in order to stimulate them to act in the direction desired by the authorities. From these criteria, we may affirm that a monetary policy, understood by the agents as workable, has credibility. Thus, such a policy becomes *truly* feasible. An uncredible policy would face grave difficulties in approaching its goal because such a policy could be overlooked by agents. Agents expectations and reactions could transform a monetary policy into an useless initiative. These assertions as well as some examples will be discussed in the subsequent section.

The criteria towards a Post-Keynesian concept of credibility of monetary policy displayed below would only be sound in normal international and national conditions. Normal national circumstances would prevail when civil wars, radical constitutional transformations, chaotic electoral processes, high inflation, hyperinflation, sharp reduction of government expenses, deep changes in consumers preferences, and banking system deterioration are not expected to occur. Normal international conditions would be prevailing when world wars, serious diplomatic conflicts, notable changes in international trading, important changes in exchange market, and sudden movements of international financial assets are not expected to happen. The idea of normality is associated with the continuity that any economy can exhibit over an extended period of time. The normality is broken when fluctuations that are not consistent with regular capitalist economic life can take place.

2.1.Unambiguous goal and co-ordination of tools

Co-ordination in the tools utilisation becomes fundamental when an economic variable has more than one tool which can be put into action to alter it. Each monetary policy tool utilises different transmission channels acting in different timings and intensities, but all of them affect unique variable, aggregate demand. Co-ordination is necessary because, as Cairncross (1986, p.163) pointed out, all policy tools interact among themselves, and what occurs when a government uses any tool depends on the state of the other tools and on the prevailing conditions at the time. So, co-ordination of several policy tools is vital. The more co-ordinated monetary tools are among themselves and with other policy tools, the more workable monetary policy is expected to be. Authorities can incur co-ordination mistakes when they have ambiguous and contradictory goals. For instance, when authorities desire to cut inflation (with monetary contraction) and reduce the unemployment (with expansionist fiscal policy) at the same time.

Specific policies, such as monetary policy, should never be elaborated in isolation from other policies - as well as particular monetary tools should never be chosen independently from the state of the other monetary tools. Every policy decision must be made as part of an overall strategy designed to face the economic problems. If policy-makers intervene to co-ordinate private plans, then each decision in their plan should be co-ordinated.[3] This conception of policy co-ordination is radically different from the orthodox conception. According to this thought, co-ordination among policies would be reached when government had a balanced budget and its central bank was autonomous.[4] That is to say, when a government has fiscal and monetary policy without a simultaneous dedication to real goals. By contrast, Tobin (1987, pp.9-10) has said that Keynesian policy has three principles. The first principle is the explicit dedication to real economic goal, in particular full employment. Second is Keynesian demand management policy is activist. Third is Keynesian policy have wished to put both fiscal and monetary in consistent and co-ordinated harness in the pursuit of economic objectives.

To the orthodox view, co-ordination is attained when the government possesses moderate capacity policies. This proposal is in conformity to the concept of the Smithian invisible hand which is the core of orthodox economics. As the Post-Keynesians rebuke such concept, they wish to implement a conscious macroeconomic management as an alternative to the passive observation of the movement of unregulated market forces. Therefore the co-ordination pursued by orthodoxy cannot be accepted by the Post-Keynesians. To them, co-ordination is self-evidently associated with flexibility and workability in order to steer market forces in the direction desired by policy-makers. A policy which has unambiguous goals and co-ordinates

[3]-Keynes' contribution to discussions of wartime finance began at the beginning of the II World War. His contribution was an interesting example of co-ordination among economic policies at those years. See details in Moggriedge (1993, p.129).

the use of its instruments would be possibly seen and understood by market forces as a potentially workable policy. A policy of this kind would therefore probably be supported by private decisions.

Co-ordination, however, in the Post-Keynesian view does not mean the subordination of any instrument to any other. In addition, we can say that past experience has taught agents that when the monetary administration is subordinated to the fiscal actions, monetary policy would not work suitably. Nowadays, a monetary-fiscal symbiotic relation, such as that of the 1950s and 1960s in Britain, would emit signals that would stimulate inflationary expectations. When environments of subordination emerge, the inflationary expectations become extremely sensitive because the agents have learnt that anti-unemployment policies were financed with mechanisms that caused inflation. The signals of inflation would increase the uncertainty about the future. So, private actions would be inhibited by this uncertainty. In the present time, the implementation of subordinated policies would probably result in inflation without reducing the current unemployment. In these contexts, monetary actions that search for a reduction in current unemployment would provoke pricing reactions and paralyse investment decisions due to the expectation of inflation. Consequently, these monetary policies would always be seen and understood as unworkable policies. Such policies would be considered monetary policies without credibility.

It should be clear that, in a Post-Keynesian view, co-ordination is necessary to avoid the subordination of monetary policy tools to other instruments. Certainly, monetary irresponsibility would disturb the financial and monetary arrangement. And as Carvalho has said: "the preservation of an orderly financial and monetary system defines limits and constraints on the use of monetary instruments, much in the same way as limits are also placed on the use of other instruments" (1995/6, p.172). The use of monetary policy tools has to be co-ordinated with (not subordinated to) other policy tools to increase its credibility and increase the probability of achieving their goals. Accordingly, institutional arrangements and rules must be settled to create a favourable environment for the implementation of flexible and credible policies at the same time.

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[4]-See, for instance, Goodhart (1995, chap.4).

Anti-unemployment policies, implemented in an environment subject to the subordination of monetary tools to fiscal policy, generate distrust and dissent among economic agents. In contrast, a favourable environment for flexible and credible anti-unemployment monetary policies would be one that possesses the required conditions (rules and institutional arrangements) for the creation of social co-operation and social consensus. Under different economic and social structures, different actors are better or less able to influence policy success through their behaviour. Thus, co-operation and consensus among them are very important. Any policy, in particular monetary policies, relies heavily on co-operation among government, firms, banks and households. As Arestis has suggested:

> …social co-operation and social consensus would have to be created by involving people in the process itself. There is, of course, the experience of some (…) countries which have been conspicuously successful with economic policies that relied on social consensus (Sweden, Norway, Australia and Austria are the best examples in this respect).(1997, p.437)

Thus, anti-unemployment monetary policies should never be subordinated to fiscal policies. Moreover, it should always be clear to the agents that there would be no threat of price instability resulting from the anti-unemployment monetary policy in progress because there would be no subordination. Both are necessary: (i)-to *implement* the proper economic policy and (ii)- to *inform* the agents what policy is being implemented. Trust, co-operation and consensus must be aimed for by a government that desires to execute a credible anti-unemployment monetary policy.

2.2.Use of suitable tools

In the Post-Keynesian view, monetary authorities can use basically two tools: required reserve ratios and open-market operations.[5] The first instrument affects the capacity of the banking system to concede short-term credit to satisfy the needs of firms to maintain their regular production. Short-term credit is conceded because firms have to validate their liabilities with other firms and because they have to pay their workers. Consequently, the capacity of conceding short-term credit by the banking system can restrict the capacity of

[5]-The instruments available to central banks vary from country to country, depending on institutional structure, political system and so on. In most developed capitalist economies, central banks use as main instruments the two cited.

production of firms. Using this instrument, the monetary authorities can mainly manage private decision-making concerning production.

The second instrument can regulate *the* interest rate that is used by capitalists as the discount rate of expected monetary returns of investment. This rate determines the marginal efficiency of capital - according to Chapter 11 of *The General Theory*. In Keynes' words: "…the value of capital goods depends on the rate of interest at which the prospective income from them is capitalised" (CWJMK:5, p.139) and yet "a fall in the rate of interest stimulates the production of capital goods not because decreases their cost of production but because it increases their demand price" (CWJMK:5, p.189). Hence, when this second instrument is implemented, reducing or raising the interest rate, the decision making of the monetary authorities essentially affects private decision-making in investment.

In Keynes' view, the reduction of required reserve ratio aiming to stimulate decision- making in investment could be a mistake. This reduction could only increase banking reserves which could be used by bankers to buy any assets (and not necessarily debts from potential borrower entrepreneurs). In doing so, bankers would impede any real change in an economy. In addition, private agents would not have motives to change their portfolios acquiring capital assets. In comparison, financial assets, equipment of capital, rental of flats, and possession of gold, for example, would not have their expected returns altered - according to Chapter 17 of *The General Theory*. So, if monetary authorities desire to stimulate investment decisions, an appropriate monetary policy would be the one that would stimulate a more illiquid composition of portfolios (but, more profitable) and, simultaneously, would provide reserves for the banking system. Thus, decision-makings of investment could be stimulated by the reduction of interest rate which remunerates financial assets and these decision-makings of investment should be supported financially by increasing in banking reserves.

The workability of a monetary policy depends on the instrument put in action. Economic agents are guided by signals received from market and government. When government signals or even provokes a reduction of the monetary returns of some liquid financial assets, agents are stimulated to recompose their portfolios. Thus, an anti-unemployment monetary policy must be basically operated via open-market. And monetary authorities can also reduce required reserve ratios at the same time. These policies would be possibly understood and seen by agents as a workable monetary policy. Such policies would gain credibility and agents would recompose their portfolios, acquiring those assets desired by policy-makers. Agents would acquire profitable capital assets and be reducing unemployment accordingly.

To orthodox economics, the use of any monetary instrument to reduce current unemployment would be ill-advised. Any instrument in action could only cause provisional real changes and would disturb an economy for a significant time. The orthodox criticism of the utilisation of specific monetary tools and its possible results is well-represented by Friedmanian *helicopter*. Using this metaphor, Friedman stressed that open-market operations, required reserve ratios or even a helicopter throwing money onto beaches on sunny bank-holidays cannot alter unemployment for any significant time. Plagiarising Friedman, for him *monetary tools do not matter*! On the contrary, according to the Post-Keynesians, *the use of specific monetary tools does matter*.

2.3.Emission of clear signals and reputation of authorities

One reason for the lack of success of monetary policy is that it is conducted in an environment of individuals whose expectations are themselves functions of the past successes and failures of these monetary policies. Agents remember the consequences (sometimes good, sometimes bad) of past policies, and use these experiences to form expectations of the results of these same policies in the present. In doing so, they might adopt a peculiar behaviour that could instantaneously nullify monetary policies. That is why government should always reveal its intentions and emit clear policy signals.

If government has adopted the two criteria already discussed and the conditions are favourable, agents could evaluate that the direction desired by government would be right. But they need to receive information about the intentions of government. The clearer the policy signals, the more confident the agents would be in making their decisions. Thus, private impulses toward the direction of government's policy would be encouraged, and the intensity and time of utilisation of monetary tools would be minimised. For a monetary policy to be feasible, it needs to emit clear signals to the agents in order to stimulate them to act in the direction desired by policy-makers. Each agent is an individual economic policy unit that cannot alone face and destroy government policy, but all agents (or a significant part of them) together could. Therefore, a policy will only be truly feasible when such a policy is trusted by the majority of agents. A feasible policy is based on trust.

Thus monetary policies should be reinforced by real signals. Clear and real signals improve the understanding of economic agents and, consequently, stimulate them to act and lessen the monetary policy timing. Keynes' words are illustrative:

> I think … that greater publicity of all kinds will lead to better understanding by the market of what the Bank's intentions are, and will facilitate those intentions being carried into effect quicker and with more certainty. It nearly always pays the market to adapt itself to the real intentions of the Bank. So that the easier it is to interpret those, the quicker in effect will be the methods of control which the Bank uses. (CWJMK: 20, p.262-3)

The criterion of the necessity of the emission of clear signals is rigorously within Keynes' conception of *economic planning*. For him, the phase *economic planning* has a greater meaning than the phase *economic policy*. The former, beyond involving the second one, refers to the accomplishment of considerable economic transformations, for instance, institutional reforms. Economic planning and, consequently, policies are not, according to Keynes, the kinds of intervention that mean economic control, the end of the liberty principle or the imposition of individual decisions (CWJMK:12, p.238). On the contrary, economic planning must be designed in order to orient society and induce private decisions. As Tobin pointed out: "perhaps Jean Monnet's post-war 'indicative planning' in France, where government sponsored a co-ordinated raising of sights to overcome pessimism and lift investment, is an example of what Keynes had in mind" (1987, p.8).

The comprehension of monetary policy by society is vital in Post-Keynesian thought. In contrary, according to New-Classical orthodoxy, a monetary policy-maker who tries to reduce unemployment should indispensably keep his (or her) intention as a secret - it could only be shared among other policy-makers. According to Sargent and Wallace (1981), if agents know that policy-makers desire to implement an expansionist monetary policy, such a policy would have its effects cancelled out in terms of real variables. Therefore, any monetary policy aiming to reduce unemployment should inevitably be a policy designed to cheat agents - surprise is the key-word. For that reason, this conception of intervention is far from Post-Keynesian thought, which does not accept this idea that policy-makers could (or should) operate their anti-unemployment monetary policies using the deception of agents as a means.

In Post-Keynesian policy theory, policy-makers and private agents are involved in repeated action-and-reaction movements. These movements build a solid connection between the current action of monetary authorities and expectations regarding future monetary policies. Agents analyse the past patterns of behaviour of monetary authorities and form their own opinion of them. Thus, mistakes made by monetary authorities in the past could modify the state of expectations regarding new policies in the future. Consequently, an incorrect monetary policy implemented by authorities in the past might make it harder to implement even dissimilar policies in the future. In fact, this minute examination made by agents of the past behaviour of authorities is a measure of the *reputation* of authorities. Monetary authorities without reputation will face serious difficulties in developing their tasks inclusively when they desire to implement policies which have unambiguous goals and suitable tools - such as will be seen in the next section.[6]

In the Keynesian view, a high degree of reputation would help to increase the credibility of monetary policies. Reputation is related to the prior-behaviour of monetary authorities. Reputation is a *backward-looking* variable. Credibility is a *forward-looking* variable that depends on the evaluation made by private agents about the workability of a policy that is to be implemented. Credibility depends on reputation. However, credibility is not exclusively determined by the prior-behaviour of monetary authority. Any policy considered unworkable by agents would have low credibility, even though it could have been implemented by authorities with high reputation. Nonetheless, the implementation of an unworkable monetary policy would reduce the degree of reputation of monetary authorities when acting in the future.

In an economy where money is not neutral, as defined by Davidson (1994), monetary policy-makers can only keep its their reputation if they implement credible policies. If

[6] -From an orthodox perspective, the reputation problem was analysed by Barro & Gordon (1994) - firstly published in 1983. These authors tried to explain that policy-makers have to face a complex situation: implementation of discretionary monetary policy, i.e. surprising policies, can obtain benefits in terms of real variables (which are provisional), but this implementation would provoke inflationary expectation formation in a economy. Consequently, this economy would reach its equilibrium with higher inflation rates in agreement with the prior-behaviour of monetary authorities. Thus, there is a future cost which is counterpart of current benefit. Such cost would be transformed into an inhibited force of the authorities' discretionary capacity, called reputational force. This force can inclusively be, according to Barro & Gordon, a perfect substitute for commitment technologies; the inflationary bias would be reduced by reputational forces.

policy-makers during a long time keep their reputation and implement credible policies, possibly, they would then reach the situation that Keynes considered desirable:

> Publicity will also help to educate the public and the world bring much nearer the day, which I am sure we should all welcome, when the principles of central banking will be utterly removed from popular controversy and will be regarded as a kind of beneficent technique of scientific control such as electricity or other branches of science are. At present the feeling of all of us towards banking problems represents, I think, a very primitive stage of knowledge, and if we could get into a more advanced stage of knowledge a great many of what are at present legitimate fears of wrong pressures being brought to bear, and so forth, will graduate disappear. (CWJMK: 20, p.263)

In the Post-Keynesian view, thereby, a credible monetary policy would have to prepare an appropriate environment in order to enable individual decision-making to be favourable to the desired goals. Such policy does not create final results, but creates the conditions for them. Finally, the explicit inclusion of credibility criteria (such as the use of suitable tools, the adoption of unambiguous goals, the co-ordination of tools, and the emission of clear signals) in the design and implementation of monetary policy is not only imperative for its theoretical and academic relevance, but also for its real world implications. Policy-makers who do not explicitly account for the credibility problem may incur mistakes and run grave risks of retarding economic growth - as will be discussed in the next section.

3)-Monetary credibility and the goal of unemployment reduction

In Keynes and the Post-Keynesians' models, monetary policy is capable of reducing unemployment, but it must operate via the open-market. In Keynes' words, "…it is by playing on the speculative-motive that monetary management … is brought to bear on the economic system" (CWJMK: 7, p.196). A mere operation of bonds purchasing by monetary authorities, *ceteris paribus*, increases the quantity of money in the speculation-motive and reduces the interest rate. However, when agents make decisions based on monetary authorities' reputation and the credibility of their policies, results become much more complex. That is why the liquidity preference of the agents can change when monetary authorities' intentions are announced. Keynes' insights concerning monetary policy operation are compatible with the dynamic of expectations described by the non-conventional concepts of credibility and reputation. As Keynes pointed out:

> In dealing with the speculative-motive it is, however, important to distinguish between the changes in the rate of interest which are due to changes in the supply of money available to satisfy the speculative-motive, without there having been any change in the liquidity function, and those which are primarily due to changes in expectation affecting the liquidity function itself. Open market operations may, indeed, influence the rate of interest through both channels; since they may not only change the volume of money, but may also give rise to changed expectations concerning the future policy of the Central Bank or of the Government.(CWJMK: 7, 197-8).

The stability of the liquidity preference function depends on the stability of the set of opinions about the interest rate that agents consider normal. Normality is a subjective concept related to individual experience. But if, for some reason, a change in the central bank monetary policy was announced and such a change was interpreted by the agents as *permanent*, a significant number of agents would change their view of what they consider the normal interest rate and the liquidity function would be altered. Thereby, the set of opinions of what would be considered the normal interest rate would be a function of the reputation and credibility of monetary authorities (as it will be shown shortly). Accordingly, the interest rate, as Keynes suggested, is a highly psychological phenomenon. (CWJMK: 7, p. 202).

In the following figure, three cases are analysed: authorities with reputation implementing policies with credibility, authorities with reputation implementing policies without credibility and authorities without reputation implementing policies without credibility. Authorities without reputation implementing policies with credibility would be a contradiction in terms.

Monetary authorities and their policies	Authorities with reputation	Authorities without reputation
Policy with credibility	Case 1	Impossible
Policy without credibility	Case 2	Case 3

3.1.Case 1: authorities with reputation and policy with credibility

If a monetary authority with reputation announces that it is striving for a reduction in unemployment and its monetary policy is considered credible by agents, its declaration would probably affect the liquidity preference function of agents. The interest rate considered normal by each agent would probably be reduced. Agents would re-evaluate their conventions to a lower position regarding the original situation. Because of the firm and credible announcement that there would be a permanent fall in the interest rate, each of the agents would revise his/her conventions thus reducing his/her own normal interest rate. Therefore, it would be possible that such an economy would reach a lower long term interest rate. In addition, speculators' actions trying to obtain capital gain (and consequently increasing their demand for bonds) would provoke a faster decline in the interest rate. Thus, all of these decisions would accelerate the effects of the monetary policy and would reduce the quantity of bonds the central bank would have to purchase to achieve its target.

3.2.Case 2: authorities with reputation and policy without credibility

Monetary authorities with reputation may try to implement monetary policies of interest rate reduction considered uncredible by the agents. As was seen earlier, policies which do not follow the credibility criteria will be unfeasible. A monetary policy with ambiguous goals is considered by agents to be an unworkable policy. In general, we can see this ambiguity in stabilisation contexts of sharp inflationary processes. Monetary authorities sometimes announce measures aimed to combat unemployment (resulting from anti-inflationary policies) by implementing interest rate reduction policies. Simultaneously, they stress that they would avoid at any cost the return of the inflationary process. Economic agents have already learnt that, in stabilisation contexts, it is impossible to swell domestic demand without activating the inflationary process. Therefore, this monetary policy would not have credibility and it would be unworkable.

In these (goal ambiguity and stabilisation) contexts, agents would maintain their prior evaluations regarding what they consider a normal interest rate in these periods. They know that lower interest rates are incompatible with the stabilisation goal. As a result, they would know that in a short time the central bank would have to return to the open-market in order to reduce the quantity of money to avoid the return of the inflationary process. Furthermore, such policies are not credible because they do not emit signals that have the capacity to stimulate agents to act in the desired direction by authorities.[7]

Monetary authorities with reputation may also implement anti-unemployment policies that would not be co-ordinated with fiscal policy instruments. Nevertheless, there is no record in history of events of this nature in relevant economies. We have knowledge only of Arthur Burns' intention (secretary of American Treasury) during the second presidential electoral campaign in the 1950's. He intended to pressure the Federal Reserve System to make an expansionist monetary policy to favour Nixon's republican candidature. At the same time, the republican president, Eisenhower, promoted a fiscal contraction policy to balance the budget. However, Eisenhower stopped Burns' attempt. If Burns had succeeded, there would be a real example of fiscal contraction and monetary expansionism for Economics to analyse.

3.3.Case 3: authorities without reputation

When a monetary policy of interest rate reduction is announced by an authority without reputation, such a policy would always be considered by agents as unworkable. It would have no credibility - authorities without reputation do not accomplish what they promise. Thus, the liquidity preference curve would not be shifted. There would not be changes in conventions. Despite such a context where expectations are unfavourable, if such monetary policy was effectively implemented, authorities could obtain some result. The interest rate would be provisionally reduced. This is why, as Keynes explained, "the short-term rate of interest is easily controlled by the monetary authority, .. because it is not difficult to produce a conviction that its policy will not greatly change in the very near future…" (CWJMK:7, p.203). However, the anti-unemployment monetary policy is intended to reduce the long term interest rate. This rate is the one that stimulates investment. And, as Keynes stressed "…the long-term rate may be more recalcitrant when once it has fallen to a level which, on the basis

[7] -In countries, such as Brazil, which have utilised foreign exchange anchor to halt sharp inflationary processes, when the government reduces the interest rate during the stabilisation period, agents expect the interest rate rises in the near future. If anecdotal evidence is to be believed, after the upheaval in the world financial markets (October, 1997 and September, 1998) led to increased fears that Brazil (which had an overvalued currency and large fiscal and current account deficits) would be forced into a devaluation. Consequently, Brazilian Government was obligated to double interest rate in order to defend the currency, which helped to bring stability to the foreign exchange market. In January, Brazilian Government was obligated to devaluate its currency.

of past experience and present expectations of *future* monetary policy, is considered ‘unsafe’ by representative opinion” (CWJMK:7, p.203 - italicised by the author).

The lack of credibility in this monetary policy eventually implemented as a consequence of the lack of reputation of the policy-makers would not provoke changes in conventions - the normality concept would be maintained. After interest rate has fallen to a level considered too risky, agents would expect that in near future the monetary policy would be reversed. Thus, given the expected monetary policy, speculators would sell their bonds to avoid capital losses. Consequently, the interest rate would probably rise. This is the motive that inspired Keynes to affirm “it might be more accurate, perhaps, to say that the rate of interest is a highly conventional, rather than a highly psychological, phenomenon. For its actual value is largely governed by the prevailing view as to what its value is expected to be” (CWJMK:7,p.203). And he concluded “*any* level of interest which is accepted with sufficient conviction as *likely* to be durable *will* be durable; subject, of course, in a changing society to fluctuations for all kinds of reasons round the expected normal” (CWJMK:7, p.203 - italicised by the author).

An authority without reputation would always implement policies that are seen and understood by agents to be provisional and according to Keynes “…a monetary policy which strikes public opinion as being experimental in character or easily liable to change may fail in its objectives of greatly reducing the long-term rate of interest…” (CWJMK: 7, p.203). Then, Keynes concluded, “the same policy, on the other hand, may prove easily successful if it appeals to public opinion as being reasonable and practicable and in the public interest, rooted in strong conviction, and promoted by an authority unlikely to be superseded” (CWJMK:7, p.203). In short, authorities with reputation may implement monetary policy with credibility which reduces the long term interest rate. Contrariwise, authorities without reputation always implement policies without credibility which can only reduce short term interest rate.

To summarise this subsection, a workable monetary policy must emit clear signals to stimulate agents to act in the desired direction by government - the reduction of unemployment. Policy-makers who have high reputation may indicate their intentions to the agents clearly. These policy-makers would be able to emit signals that would induce private reactions which would be consistent with the goal of reducing unemployment. On the other hand, authorities without reputation would not cope to implement policies which emit clear signals. That is why their policies would need credibility. Although they can implement a policy with unambiguous goals and suitable tools, they could never emit clear and stimulating signals. Even though, authorities without reputation can reveal their true intentions, they are constantly under suspicion of occulting actual information and their intentions.

Summary and Conclusions

The conclusions and recommendations of the article are supported by Keynes and Post-Keynesian theory. In particular, we have assumed that monetary policy can reach real goals. Our starting-point has been that the success of monetary policy depends on credibility of monetary policy and reputation of policy-makers. However, Post-Keynesian economics does not have detailed and clear discussions on this subject. The aim of this article was to define an alternative concept of monetary credibility - very different from the orthodox concept - which is compatible with Post-Keynesian theory of monetary policy.

A workable and credible monetary policy would be that aims at unambiguous goals, makes use of suitable tools with respect to its goal, and emits clear signals to the agents in order to stimulate them to act in the direction desired by the authorities. The article revealed some situations where the state of expectations can alter or even nullify the expected result of a certain monetary policy. For instance, an anti-unemployment monetary policy performed by an authority without reputation will not approach its goal.

In conclusion, the Post Keynesian theory would suggest that monetary policy should always be performed by authorities with reputation and subject to criteria of credibility of policy. Thus, it is possible that this performance helps to educate the public and the world bring much nearer the day, which Keynes considered welcome, when the policies of central banking will be utterly removed from popular controversy and will be regarded as only beneficent technique of scientific control such as electricity or other branches of science are.

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