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Review of Research Department Activities and Accomplishments
Federal Reserve Bank of Cleveland
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The principal objectives of the Research Department are (1) to provide research support for the monetary, financial and regulatory decisions taken by the Bank's president and directors, (2) to analyze international, national and regional economic issues so as to provide information to interested parties in the Fourth District and elsewhere, (3) to increase understanding of and support for Federal Reserve policy decisions and actions, and to enhance the reputation of the department and its members as professional economists. To accomplish these objectives, the department conducts research, holds conferences, prepares speeches for the bank's president, makes public presentations, briefs the president in advance of meetings of the Federal Open Market Committee and provides support for the president and other officers serving on system committees. The department publishes a monthly statistical bulletin with commentary, Economic Trends, a bi-weekly report on topics of interest to business, labor, and the educated public, Economic Commentary, and a quarterly known as Economic Review. In addition, most department members engage in many of the standard activities of a research professional such as giving lectures, participating in conferences, preparing working papers and publishing research results in scholarly journals.

There are tradeoffs in the time and effort allocated to the objectives above. The Research Department has not made an explicit decision about where the tradeoffs should be made. This issue deserves explicit consideration because it focuses attention of management and staff on the department's objectives. This is not a once-and-for-all decision. It should be revisited periodically and combined with review of how well the department's objectives are achieved.
The department has a structured method for setting individual goals and evaluating individual contributions. A competitive framework is encouraged through discussion by unit heads of promotions and performance of members of the other units. This is useful if not carried to the point at which individuals put subunit goals ahead of departmental goals.

We did not hear much about the process for setting and resetting of department goals or about comparison of department goals to achievements of subsections or units. This appears to be a missing or underdeveloped area. The department should have objectives that provide an additional dimension (or overall view); units should be evaluated on their contribution to departmental goals in addition to their effectiveness in reaching the unit's goals.

The department has made significant progress in improving along several dimensions in recent years. It is now at a point where it must consider the directions in which it wishes to move and the weights or values it places on various objectives. We return to this issue below.

**Organization**

The department had a professional staff of 21 at the end of 1990. It is managed by a director, an associate director, and 4 unit heads whose responsibility is to guide the work of the units.

The monetary-macro unit is the largest of the four. Its responsibilities for domestic and international monetary policy, for briefings prior to FOMC meetings, and the policy interests of the current president may explain its relative size.

The financial institutions and regulation unit concentrates on research concerned with bank structure, competition and regulation policy, deposit insurance and bank failures. It assists in the processing of supervisory casework.

Most (perhaps all) Federal Reserve Banks have one or more regional economists. At Cleveland, the regional economists are part of an applied microeconomics unit that has developed expertise in labor market issues but is concerned also with other factors affecting the Fourth District's economy.

Data analysis and discussion of current conditions is the principal assignment
of the Business Conditions Analysis unit. This group has principal responsibility for *Economic Trends* and for preparation of materials used in presentations on current conditions within and outside the bank. They assemble the data for the district’s contribution to the so-called beige book, and they brief the president in advance of FOMC meetings.

**Morale**

The committee interviewed approximately half of the professional staff. Although we did not select the people to be interviewed, the group we interviewed appears to be a broad-based sample of people from each of the units, representing a wide range of talents, interests and responsibilities.

Based on these interviews, morale appears to be high. Several of the staff spoke about the open atmosphere of the department, the availability of resources and the freedom to choose research topics. Most thought the incentives to do research and improve professionally were good. Some mentioned the existence of critical mass in an area as an important advantage of working at a Reserve Bank.

The strong impression left by the interviews is that the staff believes that there has been a significant change toward emphasis on quality research. They view the group as improved in quality and in collegiality. Those who spoke about incentives believed the incentives encouraged high quality research.

Two recurring complaints, offered in response to our questions, were the amount of resources devoted to preparation and publication of *Economic Trends* and the time required to complete articles for *Economic Review*. One or two staff members suggested that more resources could be used for in-house seminars. We discuss the *Review* below.

We asked each staff member we interviewed to indicate how he or she compared the Cleveland group to other research groups in the Federal Reserve System. There was no unanimity about which Bank had the best research department. Differences of opinion may reflect differences in interest. For example, Richmond was mentioned by several as a visible group of high quality, but Richmond’s efforts are relatively focussed and would not have the same appeal as a place to do
research for someone interested in banking structure or labor markets. Several staff members mentioned Minneapolis as a high quality group, but they criticized the Minneapolis group as too far removed from policy issues and Bank responsibilities. There does not appear to be a belief that Cleveland should emulate Minneapolis. Some dismissed the possibility as remote in any case, since Cleveland does not have a university economics department of the same quality as the University of Minnesota department.

The department has chosen to have a quality staff in several areas. Several economists commented on this favorably. They see advantages in diversity and report that diversity of staff interests helps to sharpen discussion and bring differing perspectives to the analysis of an issue. Organization into subunits gives new members a community that makes them become part of the organization. But, competition between subunits may restrict the ability of the department to adjust resources to achieve department goals. There is a risk of compartmentalization. Economists tend to interact mainly with members of their subunit.

Research Environment

The research environment seems to be very good. Many people we talked to thought it had improved significantly in the last two or three years. However, several people noted the need for interaction with the outside research world (noting that there is no university with a good economics department nearby, and so on). No one thought the opportunities for interaction were much too small. And most academic success stories -- in which a department significantly increases its strength -- occur along with significantly increased interaction with the outside research world. (The research department of the International Monetary Fund is an example. Causality is, as usual, hard to establish.)

The Research Department has in fact pursued this strategy with some success. It has had good outside visitors for varying periods of time in addition to its seminar series. It has held conferences with large outside participation. The conferences are particularly valuable for visibility. Large conferences, however, do not necessarily add significant value to specific individual research projects. For this reason, the Research
Department should consider increased use of short-term visitors and small “working-group” conferences. There is a wide range of possibilities here. One possibility is to have two seminars on similar topics on the same day, with each author attending and participating in the other seminar. Another is to have (say) five or so outside visitors for a week or two and infrequent formal presentations. The latter format has been successfully used many times by small groups meeting at the NBER and funded by the Economic Fluctuations program of the NBER.

Research Quality and Productivity

For several years, the Bank has sustained an effort to improve quality and productivity. This effort has taken two principal forms. New additions to the staff have increased the number and quality of journal articles submitted to outside publications. The change in emphasis has also been reflected, to a degree, in the efforts of some of those who have been at the Bank for a longer time to publish in non-Bank journals. This is a desirable change. Articles published in refereed journals are not a guarantee of quality, but they force staff to submit to external criticism, learn new techniques, keep up on current work in their fields of interest, and meet a market test.

An important reason for increased morale and productivity is external to the department. President Hoskins took national leadership in the effort to achieve price stability. This has given impetus to part of the research effort by giving direction to some of the work, by encouraging conferences, by imparting an element of uniqueness to the Bank and its research staff, by producing a significant impact on public discussion and public policy, and by building a high level of competence on the problem of inflation. As is often the case, the initial concentration on zero inflation spread to issues about the conduct of policy, the record of forecasters, the role of monetary targets, and other topics. President Hoskins’ interest in deposit insurance and financial deregulation had a similar effect on the bank structure group, though to a lesser degree.

Research that can be used to formulate policy positions and to back up arguments for them is very important for the Bank. The success of the Research Department in generating and disseminating research of this nature has been mixed.
The Bank has produced a small amount of research on the zero-inflation position taken by the Bank, although it has done research on related issues as noted in the previous paragraph. It held a conference devoted to issues associated with zero inflation. But little has appeared in Research Department publications or by Research Department staff in outside publications on zero inflation. From the published output of the Research Department, aside from speeches made by the President and perhaps by the staff, an outsider would not know that zero inflation was a major (perhaps the major) policy position taken by the Bank in recent years.

A similar situation arises with financial deregulation. While the Research Department held a conference devoted to this issue, it has not been a major source of published research papers on this topic. In this case as in the zero-inflation case, an outsider would not know that financial deregulation was a major policy position taken by the Bank on the basis of the research output of the Research Department. Finally, a similar situation arises regarding the role of international policy coordination.

The Bank needs to confront the issue of the extent to which it wants to impose research topics from above, based on the policy interests of the bank's management and the Federal Reserve System. Greater attempts to impose topics from above may reduce the overall quality of work done by some members of the research department judged from a purely academic standpoint. But some may find direction helpful if it is not heavy handed and leaves room for choice. President Hoskins indicated that it is useful for the Bank President to have an academically respectable staff, and that such a staff imparts credibility to his arguments. But it is also important to devote research resources toward the goals of the institution.

There are several ways to affect the substantive direction of research. The most direct way is to require that people generate research plans directed toward a certain set of issues. While direct, this method is likely not to produce research that is as high in quality as research that comes out of an academic institution (where people can work on whatever they want). While this direct method has some role, there are other more subtle ways to affect the substantive direction of research. These involve creating a research environment in which the issues surrounding Bank policy positions are perceived as exciting topics of research.
There are many ways to proceed in this direction. One way, for example, would be for the Research Department to hold formal policy debates among its staff. It might also invite short-term visitors (say, for one to three days) for policy debates. The debates should be kept small so that people interact rather than present public speeches. The goal of these debates should be to determine what research that bears on these policy issues has already been done, what criticisms can be levied on that research, and what extensions of that research ought to be done (and how). The debates should also focus on what questions need to be answered that have not received attention in previous research, and on ideas for specific projects to answer those questions. Ideally, these would lead to new papers written by the staff, perhaps jointly with the outside visitors. They should also lead to new ideas about whom to invite to give seminar presentations or as short-term visitors, and so on. There are many possible formats for these debates and research discussions.

One way to encourage research related to Bank policy positions is to create an outlet devoted to that research. In fact, the Research Department has no current outlet devoted to policy debates. (A debate on the merits of zero inflation appeared in the Federal Reserve Bank of Minneapolis Quarterly Review rather than in a Cleveland publication.) Several staff members indicated that the Research Department has a reluctance to turn the Review into a policy-debate publication, but this should not preclude publication of such debates from time to time. The Research Department should consider this role for the Review, if it continues to publish the Review.

The Research Department needs to develop internal procedures that focus attention on how research is related to policy objectives. We doubt that this will be done well if the choice is imposed. But the choice will not be well made if it emerges as a by-product of unconstrained individual research interests.

Rating the Research Department

We have decided not to rank or rate the Research Department at Cleveland relative to other research departments at Federal Reserve Banks. One reason is that we do not have comparative information about other Reserve Banks. And it would require a considerable commitment of time to assemble materials on each of the other
banks and the Board’s staff. Little in the way of useful information would be gained by doing so.

The individual Reserve Banks make different investments in research. Departments differ in size and breadth, and they have different objectives. Rating the departments would make sense only if there are common objectives.

The Cleveland department has improved its performance relative to the criteria it has chosen. There now appears to be a stronger theoretical core to the work while the relevance to policy issues remains high or has increased. Several new staff have been recruited and have contributed significantly to the department’s goals. The work has a sharper focus, reflecting President Hoskins’ interests in monetary policy, international coordination, zero inflation, and deregulation of financial institutions. The research department more clearly supports the policymaking function both because the quality of the work has improved and because the policy objectives are more clearly defined.

The department appears to have high morale and commitment to its professional tasks. It is, properly, not satisfied with its progress and seeks to improve further. Instead of attempting to give a comparative rating to the department, we will suggest some possible problems and propose some improvements.

**Problems and Proposals**

We have stressed that President Hoskins’ interest in the work of the department, his involvement in that work, and the interaction between the president and the department have helped to focus efforts and improve quality. Some of the changes were underway before he came to the bank. No doubt some improvements were independent of his leadership.

The choice of a new president is important for the entire bank, but particularly for the research department owing to the close relation President Hoskins established with the department and particular individuals. Some of our recommendations depend on the choices a new president makes and the goals or objectives he or she chooses to pursue. But others do not.

The role of the *Economic Review* in furthering the department’s objectives
should be reexamined and clearly articulated. Our discussions suggest that some in the department question its value or worth. Others see it as a useful place to put exploratory or survey material on a problem that they are beginning to study. These are conflicting insider views.

We know very little, and we believe that the Bank knows very little, about the attitude of two relevant outside groups: readers of the Economic Review and potential readers of the Review. The Bank should decide on the audience it wants to reach, learn who it currently reaches, and determine whether the two match.

We raise this issue because the purpose and audience is not clear. The articles are not written at a uniform level or aimed at a well-defined audience.

The Review could make a larger contribution to the department's goals as a policy journal, with policy debates, analyses of alternative policies, and critical surveys of issues that are important to such analyses. (For example, articles in the Review might critically survey work on the effects of disinflation in various countries, or theoretical literature on financial intermediaries and effects of bank regulations. Surveys of this kind could provide academic and system respectability as well as support for Bank policy positions. People writing these articles would presumably do so to sort out issues for themselves in conjunction with doing more original academic work on these subjects.) There may be other ways for the Review to contribute to the goals of the Research Department. The Research Department should determine what the role of the Review is or if the department's resources could be better used in pursuing its goals.

Assuming the Research Department chooses to continue publishing a Review, it should reassess the publication requirements it places on its staff. How much time should people devote to it, in comparison with outside publications? Would it be better for staff to submit their papers to outside journals? How should Review articles count relative to outside publications in evaluations (and therefore in incentives)? (Two people we talked to thought that the Bank did not fully appreciate the amount of work involved in outside publications relative to the work involved in Bank publications. They allege that outside publications involve considerably more work, in revising papers and so on.)
Economic Commentary is aimed at a general audience. It appears to be an effective means of communicating general economic principles and helps the educated public to understand monetary policy and Federal Reserve actions. No one that we talked to questioned the value of Commentary.

Economic Trends aims at economists, analysts and possibly students. It presents data but also attempts at times to do more than describe what the series show. We believe more effort should be made to use economic theory in the data analysis. Also, more attention could be given to discussion of the quality of data, the degree to which series are revised, the large random element in most monthly observations, the difficulties and pitfalls of seasonal adjustment, the number of observations required to say with reasonable confidence that a particular series has changed direction, etc. Most of the data in Trends is available from other sources. Consideration should be given to the publication's value added.

As the U.S. economy becomes more open to trade, research in open economy issues, communication of research results to the public, and the policy implications of trade, capital movements and exchange rate changes become more important. This research area should receive more attention.

Service sector productivity has become more important as the size of the service sector has increased. The principal problem is to measure output. Research aimed at developing measures for particular service output would be very valuable.

Most empirical research in economics takes the data as given. Theory could be used to guide data collection and to refine the concepts or definitions. This would reduce the gap between theoretical and empirical work.

The Bank has taken the position that policy should be guided by rules or medium term strategies. Research on alternative rules or strategies, particularly fiscal rules, is underdeveloped. This should be part of increased emphasis on analyzing long-run consequences of policy and other changes. What are the long-run consequences of international differences in saving rates? in educational attainments? in productivity growth? in net investment? in domestic energy production? These issues are important to the U.S. economy.

Administrators of the research department should encourage more interaction
between units. The most obvious connection is between micro and macro units, and the administration is aware of these opportunities. Other opportunities include (1) closer relation between the fact gatherers and analysts of business conditions and the theory groups, (2) the theory of finance with its emphasis on risk and uncertainty and monetary theory where uncertainty has a more limited role.

One advantage of increased interaction would be to reduce subgroup identification and promote departmental unity. Another would be to strengthen smaller subunits that have 3 or 4 members. These units, particularly the micro unit, could be hurt if one of its leading members, or its head, left the bank.

These suggestions should not be taken as criticisms of existing practices. The bank’s research department has made impressive strides. There is a danger, however, that the staff will be divided into those who mainly publish in scholarly journals and those who do most of the daily or monthly work. Some of that appears to have happened.

Daily or monthly work supports Bank policy positions and must continue. Scholarly research should play a supporting role for this work, strengthening the final product. In addition, scholarly work keeps the staff abreast of current developments and issues and helps to achieve credibility and respect for the policy views of the Bank’s officers. Efforts must be made to get the two groups to work together to combine the theoretical power of the mostly younger, newer appointees with the experience, institutional knowledge and policy orientation of the older staff. This is a challenge in any research organization, and particularly in a research organization where assignments are not made from above. A successful outcome to this problem will do much to raise the productivity and relevance of both groups.

Finally, some attention should be given to the retention and promotion of senior researchers. Some Reserve Banks have appointed Research Officers whose duties are research, not primarily administration. We recommend this step be taken at the Cleveland Bank.