In part B of section IV of the course, we look more closely at the formulation and implementation of monetary policy. First, we look at the instruments and final goals of monetary policy. Second, we address the problems associated with a monetary policy response. Third, we investigate the rules versus discretion debate.

The required readings in this section are chapters 14 and 18 (pgs. 486-494) of Mankiw and “What Should Central Banks Do?” by Frederic Mishkin (which is posted at the website). While you read the material, keep in mind the following questions:

1. How does the central bank formulate and implement monetary policy? What are the instruments of monetary policy? What are the final goals?
2. What are some of the problems associated with the formulation and implementation of a monetary policy response?
3. How do the “Guiding Principles” of Mishkin address the problems in question 2?
4. How can a discretionary policy lead to a political business cycle?
5. What is the time inconsistency of discretionary policy? How does the time inconsistency of discretionary policy introduce an inflationary bias?
6. What are some rules of monetary policy?
7. What does Mishkin conclude central banks should be?