Intermediate Commitment, Temptation, and Central Banks

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Abstract

Traditionally, models of central banks assume they either ignore past constraints (discretion) or completely integrate them (commitment) into today’s decision making. I show how the temptation to ignore the past can be taken seriously to produce intermediate behavior. I ground the analysis in micro-theoretic treatment of temptation for a two-period model. Then, I develop an extension of recursive contracts that accommodates a broad class of intermediate decision-making processes. Next I develop a particular example of “scaled commitment.” It can model central banks succumbing to stabilization bias after the zero lower bound, but resisting inflation bias. Finally, I provide a general derivation of the recursive approach for any problem with a forward-looking constraint.

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