

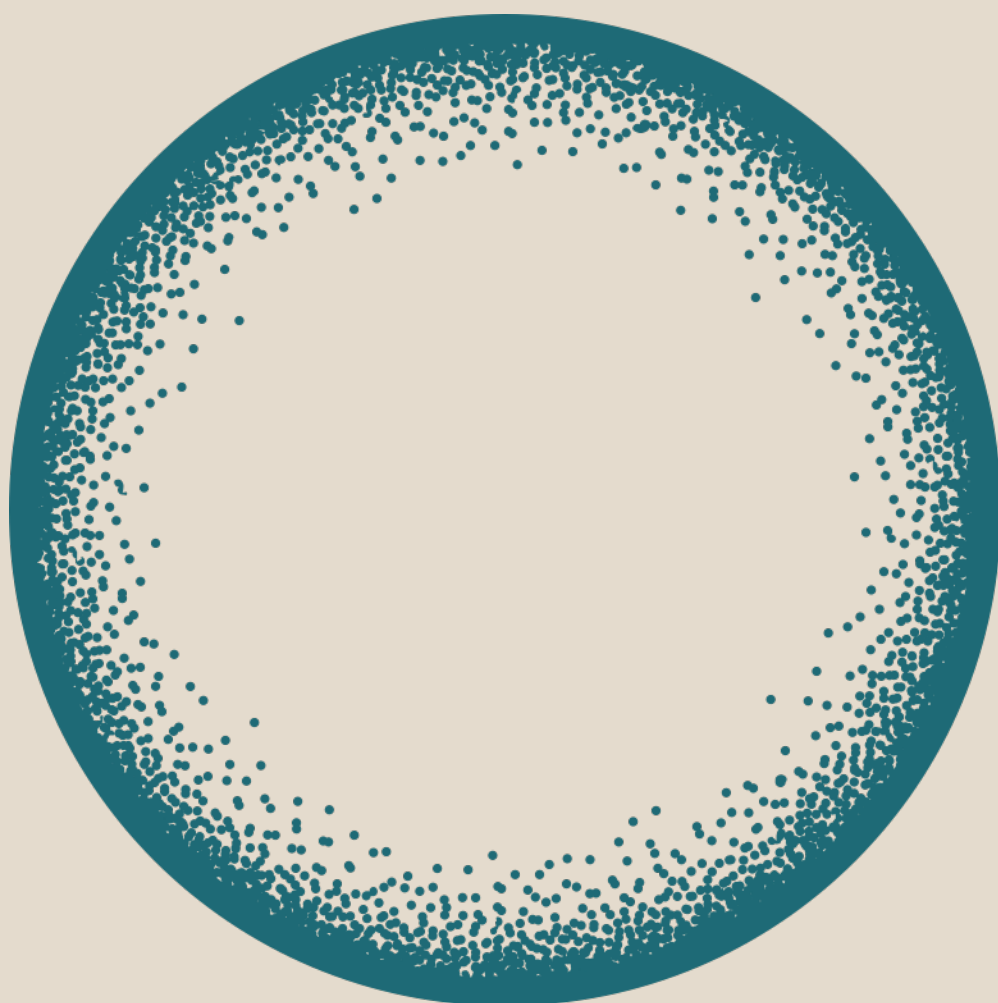
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Debating Central Bank Mandates

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DEBATING CENTRAL BANK MANDATES

Adam Tooze*, Columbia University

Abstract

Central banks are in the crosshairs of public debate about economic policy. Every minute of every day, interest rate decisions are debated and weighed in financial markets. The risks of inflation are assessed. Trillions of dollars hinge on correctly interpreting the next move by key central bankers. Central bank appointments are avidly discussed. Public campaigns are waged for and against particular candidates. This makes guardians of central bank independence nervous. Too much public scrutiny might put that independence at risk. But it should not be surprising that people want to debate the role of central banks. It is not because they are failing. It is because they have such massive effects. Furthermore, what is provocative is not just the scale of their interventions but the things that they are doing. Their role has visibly shifted. It is hard to claim that the status quo is set in tablets of stone, when the actual experience of recent decades is that what central banks do is very much a response to circumstances. Why then should we not go back to basics and ask fundamental questions about their mandate and their role?

JEL codes: E5, E58

Keywords: Central banks, new mandates, ECB, Fed

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I

One set of questions concerns the relationship between monetary and fiscal policy. The central bank independence paradigm was based on the idea that fiscal policy had an activist bias that needed to be restrained by central banks. In the long aftermath of the 2008 crisis and especially after the turn to austerity, that was reversed. Restrained by austerity, fiscal policy in Europe and the US was no longer a powerful partner of monetary policy. Central banks were “the only game in town”. So sluggish was fiscal action that there were even suggestions, from central bankers of note, that central banks should be equipped with their own fiscal capacity (Bartsch et al., 2019). Simply place central banks in charge of both monetary and fiscal policy. That would solve the problem of inadequate fiscal action without sliding into the realm of much-feared fiscal dominance. But then, when the call came in 2020 to respond to the COVID-crisis, the fiscal policy response was massive. And it was flanked by huge bond-buying by central banks. The question this inevitably posed, was whether central banks could openly acknowledge their role in underpinning fiscal policy, or whether that would amount to a surrender to fiscal dominance (Sargent & Wallace, 1981).

The role of central banks in relation to private finance has also been put in question. In 2008 and 2020 central banks were pivotal to maintaining the stability of the financial system. Effectively that means underwriting speculative, leveraged and profit-making activity. The chief beneficiaries are the small minority of the population who have large portfolios of financial assets. Given the urgency of the issue of inequality, central banks are now expected to consider the distributional implications of all their policies¹.

In their role as regulators and risk monitors, there are calls for central banks to widen the range of risks they consider². In the global race to net zero, could central banks help to clean up the economy and counteract biases towards fossil fuels? Upholding so-called “neutrality” in central bank interventions makes little sense if the markets themselves are underpricing climate risks³. Central banks should, some suggest, proactively support green development (Dikau & Volz, 2021).

In light of the importance of these issues, there are calls to make central banks more democratically accountable. “End the Fed” and “Audit the Fed” are just too slogans that express a mounting sense of impatience⁴. And these criticisms come not just from the left. Conservatives in Germany are indignant at the activism of the ECB. A devoted segment of public opinion on both sides of the

¹ Most recently, for instance, https://www.ecb.europa.eu/pub/economic-bulletin/articles/2021/html/ecb.ebart202102_01~1773181511.en.html. Do Central Banks Serve the People? Peter Dietsch, Francois Claveau and Clement Fontan. Polity Press, 2018.

² <https://www.ft.com/content/1cbbb6d5-1676-43dd-a1cb-232f92ebb876>.

³ https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210303_1~f3df48854e.en.html.

⁴ <https://store.mises.org/End-the-Fed-P619.aspx> <https://www.brookings.edu/blog/ben-bernanke/2016/01/11/audit-the-fed-is-not-about-auditing-the-fed/>.

Atlantic still mourns the passing of the gold standard. They are unreconciled to the idea of fiat money managed by central bankers. Advocates of non-discretionary Taylor-rule type policies couch their hostility to the current status quo in more technocratic terms. And then there are the advocates of cryptocurrency who are willing to stake tens of billions of dollars on a futuristic alternative to central-bank-money (Eich, 2019).

All of these proposals challenge the prevailing model of an independent central bank managing a free floating fiat currency with a mandate defined first and foremost in terms of price stability. But even the notion of price stability can no longer be taken for granted. In the last two years the Fed has moved to average inflation targeting and the ECB has made its objective symmetrical, requiring it to target 2 percent inflation, rather than inflation under 2 percent. Meanwhile, the dispersion in price inflation since the COVID shock has called into question the very idea of an “average price level” to which monetary policy can be directed. Research shows that monetary policy is actually effective in controlling only a diminishing fraction of prices (Borio et al., 2021).

All these questions are matters for economic argument. They are also highly political. Furthermore, in Europe they are tied up with a dense mesh of legal argument surrounding the Treaties that established the ECB. These debates themselves generate further controversy over the responsibility of courts at different levels. Nowhere else in the world is as much invested in the formality of the mandate. Nowhere else is the mandate defined so stringently or discussed in such legalistic terms (de Boer & van 't Klooster, 2020). But, defensiveness when it comes to the role of central banks is by no means a European peculiarity. In a turbulent and unpredictable world, an important part of what defines “normality” is at stake.

II

Central bankers in most places are cautious about the suggestion of widening their mandate. Many parts of the new agenda are a long way from any traditional conception of their role. This is in part a matter of professional sociology. The job of central banking attracts its fair share both of conservatives and strong-minded technocrats who set a high bar for outsiders meddling in their affairs (Adolph 2013, Cerulus 2013). Opacity and remoteness from the public fray were long celebrated as hallmarks of the job (Geraats, 2018). Until very recently, the all-male gender composition of senior central bank leadership indexed the degree to which they were sheltered against broader currents of cultural change. Not for nothing, central bankers are commonly described as belonging to a "club". It is hardly surprising that such a milieu is resistant to dramatic change, especially when it comes on the heels of external political pressure.

The current model of central bank independence was deliberately cast as one insulated from societal demands. Many central bankers would argue that what legitimates this independence is precisely a tightly circumscribed mandate delegated to them by the political authorities (Tucker, 2018). Expanding their activities without explicit delegation, risks undercutting the justification for their independence. Conversely, bringing the mandate into line with the current agenda of government with too much alacrity, though it would satisfy the principle of democratic delegation, risks hollowing out the true meaning of independence. For a central bank to "stick to its guns", those guns need to be fixed in place. In the limit, independence is tested by the ability of central banks, acting within their prescribed remit, to stand up to governments and to take a conflicting view (Cukierman et al., 1992).

There is a second, practical reason for being fussy about the mandate and its limits. The role of central banks is defined not just in relation to politics and society but in relation to the financial system – financial markets, banks, assets managers, funds etc. The financial system is both huge in size and exceptionally complicated, fast-moving and reflexive. The financial system continuously digests and interprets information about central bank policy. As a result, central bank communication is all-important. As Ben Bernanke famously said, central banking is 98 percent talk and 2 percent action⁵. The communication he was worried about was not with America's citizens, but with the trillion-dollar bond market.

Communication with the bond market is highly sensitive and can unleash huge financial flows. When faced with such a hyper-reactive system, the simpler the central bank's mandate the better (Bernanke & Mishkin, 1997). Whatever its mission may be, an agency charged with pursuing just one objective is more credible and easier to track than one with multiple objectives. If credibility is lost that has real costs. To achieve the same degree of inflation-control, a greater price will have to be paid in terms of lost output and employment, or at least so the argument used to go.

III

All of these points have merit in their own terms. If they no longer suffice to stifle debate about the role and independence of central banks, it is because they are vulnerable on several fronts.

(1) The defenders of the status quo often present the current dispensation as though it were self-evidently and unquestionably optimal – the one best way. This idea is particularly prevalent in places where there is a tradition of independent central bank that goes back even before the 1970s, so that the costs of the adjustment to the current model are lost in the mists of time. In those places where the battle for central bank independence was fought out in the 1970s and 1980s, the memory is rather

⁵ <https://www.brookings.edu/blog/ben-bernanke/2015/03/30/inaugurating-a-new-blog/>.

fresher. The current form of words may be that central banks enjoy democratically delegated authority, but when the battle with inflation was still hot, figures like Rudiger Dornbusch at MIT spoke more bluntly. Delegation was a means to an end. The aim was to put an end to "democratic money"⁶.

The idea was not only that "democratic money", because unstable in value, was everywhere and always a second best, for everyone. As Joseph Stiglitz observed in 2013, "The notion of the desirability of an independent central bank was predicated on the belief that monetary policy was a technocratic matter, with no distributional consequences. There was a single policy that was best for all—a view to which the simplistic models that the central banks employed may have contributed, but which was not supported by more general models." As Stiglitz explained, this was a convenient illusion. "There does not, in general, exist a Pareto superior monetary policy."⁷ Any setting for monetary policy, including the choice of price stability, has significant distributional consequences. So putting monetary policy in the hands of unelected, independent central bankers involved placing a decision that had serious distributional consequences, beyond political argument. Central bank independence would certainly tend to mitigate any inflation bias in the political system. But, as Ken Rogoff pointed out in his classic paper of 1985, it came at a price. Independent and conservative central bankers backed by rigid rules would tend to ignore shocks to the economy, resulting in less stabilization and higher levels of unemployment.

It is telling that though the 1970s are the common reference point in discussions of central banks today, the notion of the independent central bank first originated in the 1920s (do Vale, 2021). At that time, the purpose of securing elite control over economic policy was unabashed. In the aftermath of World War I, the aim was to insulate monetary and financial policy from the emergence of mass democracy. The aim was to make monetary policy "knave-proof". The pressures of popular politics could be socialist or it could be nationalist. The Reichsbank of the Weimar Republic was an early example of an independent central bank, mandated by the reparations creditors (Eschweiler & Bordo, 1994). After 1945 it was again not by accident that it was West Germany's central bank whose independence was most powerfully defended. No one trusted German democracy, not even the Germans themselves.

Where states came better through the disasters of the early 20th century, where elites and popular politics arranged themselves with fewer traumas, there was less need for precautions. Following the collapse of the gold standard in the 1930s, the phase of rearmament and then total war ushered in a close cooperation between central banks and Treasuries. The aim was to achieve better mobilization than in World War I and to do so with less inflationary pressure (Tooze & Martin, 2015).

⁶ <http://web.mit.edu/15.018/attach/Dornbusch,%20R.%20Essays%201998-2001.pdf>.

⁷ <https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/PSS030113FL.pdf>.

Not surprisingly, in the victorious allied countries, close cooperation between central banks and treasuries continued after the war, as it did in France across the divide between Vichy and the Fourth Republic and as it, no doubt, would have done in Germany too, if Hitler had won. The venerable tradition of central bank independence in the Federal Republic of Germany is not just a legacy of two inflations, behind those inflations lurks the stark reality of humiliating defeat and comprehensive political failure.

Amongst the victors, continuity after 1945 did not preclude a sense of a new beginning. But in France, as in the UK, that meant not the independence but the nationalization of the central bank (Blancheton, 2014). In both France and Britain the motives were complex, but for the left, which had a loud voice in the postwar period, the aim was to lift the veil on financial power and ensure that the central bank did not act as a vehicle of the "mur d'argent" that in the 1920s and 1930s was seen as having crushed progressive politics⁸. Far from being self-evident, it took the disintegration of the postwar settlement, the collapse of Bretton Woods and the ensuing crisis of governability in the 1970s to resurrect and generalize the idea of central bank independence. As late as the 1990s, when the French central bank was shoehorned into the ECB project, it required a fundamental rethink of French constitutional principle to admit the possibility of a divided sovereignty when it came to money (Kurzmann, 1994).

Today's model of delegation has much to recommend it. But it should not be cloaked in euphemism. It is an abrogation of democratic sovereignty for pragmatic reasons, conditioned on the one hand by deeply entrenched and unflattering assumptions about electoral politics and, on the other, on an unquestioning acceptance of the private organization of credit markets and their lack of confidence in democratic control of economic policy. This may be an abrogation that we are willing to accept, but it should be recognized for what it is and the assumptions on which it is based should be subject to scrutiny and, if necessary, to revision. We should at least conceive of the possibility that we are, today, in a different political economy from that which prevailed in the so-called "short twentieth century" of 1914-1989.

(2) We should also recognize that the compromise that is central bank independence has been struck in different ways in different countries. The idea that there is a single central banking model and that debate about alternatives is heresy, is, itself, a myth.

The most important central bank in the world, the Fed, has never conformed to the Bundesbank model that provided the template for the ECB. The Fed's structure is hybrid. At the level of the member banks – the New York Fed etc – private interests are still directly involved in Fed business.

⁸ For the enduring resonance of this idea Duchaussoy, Vincent. "Les socialistes, la Banque de France et le «mur d'argent»(1981-1984)." *Vingtième siècle. Revue d'histoire* 2 (2011): 111-122.

In Washington, the independence of the Fed board is politically negotiated (Binder & Spindel, 2019). And since the late 1970s it has had a dual mandate – both price stability and maximum employment. Of course, that mandate has often been honored in the breach, most spectacularly shortly after its introduction under the chairmanship of Paul Volcker. But, on other occasions, it has opened the door to a true balancing of priorities (Reis, 2013).

To give the Fed's dual mandate its proper weight, it is important to recognize its historic origins. It is more than merely a product of the Keynesian rearguard of the 1970s (Ginsburg, 2012). The dual mandate to consider maximum employment as well as price stability is not simply a macroeconomic guideline. It is a social justice mandate and, in a society of racialized inequality, it is a racial justice issue.

It is an acknowledged fact that minority workers are generally the last in and the first out of employment. This is true in Europe as it is in the US (Reyneri & Fullin 2011, Diop-Christensen & Pavlopoulos 2016). The dual mandate for the Fed is actually a watering down of the demand for an employment guarantee that was at the heart of the civil rights movement. The legendary demonstration in Washington in August 1963 - the march at which Dr Martin Luther King delivered his deathless “I Have a Dream”-speech - was a march for civil rights in the comprehensive sense. It demanded full employment, “Jobs”, and freedom. The two were intertwined. After MLK’s assassination, Coretta Scott King, his widow and herself a lifelong social justice activist, carried on the fight to ensure that racial discrimination in labour markets did not consign Black Americans to a life of precarity and unemployment⁹. The Humphrey-Hawkins Full Employment Act of 1978 is the legacy of her efforts and those of other activists (Andelic, 2019). It is the basis for the Fed’s dual mandate.

If you accept that monetary policy has a significant impact on economic activity and thus on employment and if employment is tied to other forms of social injustice, such as racial discrimination, choosing to ignore those facts and to focus in a one-eyed way on inflation implies a heavy social responsibility. Even if you believe that the influence of monetary policy is limited to the short-run, hysteresis and scarring mean that short-run shocks have long-run effects, and a sequence of shocks can add up to a structural problem.

There may be some hardline central bankers who are untroubled by the prospect of surging unemployment. There are others who convince themselves that price stability is, in the long-run, the best thing for an economy, regardless of the price paid in the short-run and that the price will be lower, the more narrowly they as central bankers focus on inflation. It is up to other policy-makers to ensure that labour markets perform as well as they might. But, in the horror of deflation shared by most central bankers, their efforts to stave off financial crises and their tireless quest to promote credit,

⁹ <https://socialeurope.eu/what-are-central-banks-for>.

it can hardly be denied that they, in fact, express an appreciation for the real costs of their policies and their policy mistakes.

Despite their one-eyed mandates, central bankers in recent decades have been far from oblivious to the fate of the real economy and society at large. There is an advantage to being able to acknowledge this openly, as the Fed's dual mandate enables it to do. Bernanke, Yellen and Powell have all ranked employment squarely alongside price stability as a top priority¹⁰. In the recovery from COVID it is clear that an expansive dashboard of labour market indicators has guided Fed policy-making. This dashboard includes the unemployment rate of black Americans¹¹.

In light of the model followed by the world's most important central bank, it is something of a puzzle that dual mandates for price stability and maximum employment are not the norm for independent central banks, certainly for those whose currencies otherwise enjoy robust credibility. The question is all the more pressing because in recent decades the question of inflation has seemed less pressing than it was in the 1970s and 1980s.

(3) Even if one accepts the historic validity of the rationale for highly restrictive central bank mandates that emerged from the 1970s, it can hardly be denied that since the world has changed. Globalization and an array of other changes have sapped the inflationary forces that destabilized the world economy after the end of Bretton Woods (Orphanides, 2020). Amongst other things, the monetarist shock therapy of the early 1980s, led by the Volcker shock of 1979, had dramatic effects. Crucially, the balance of power in labour markets was shifted. Wage-price dynamics were permanently changed (Stansbury & Summers, 2020). As trade union power dwindled, the wage-price spirals became less powerful.

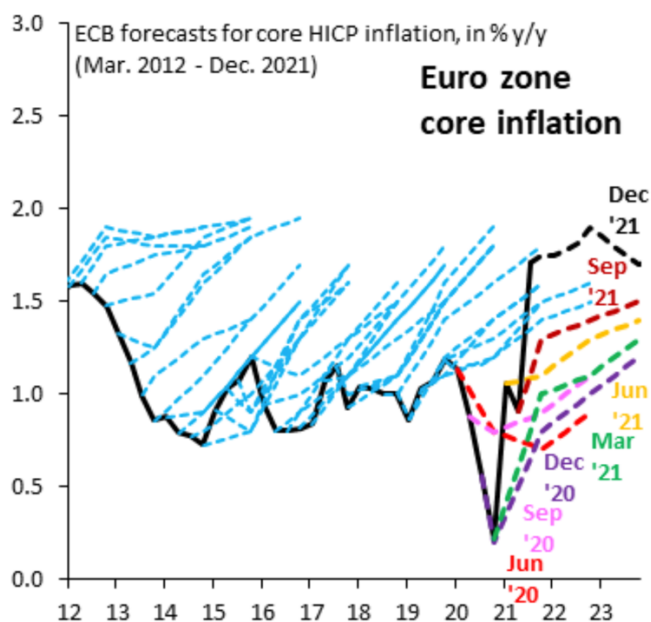
And yet, in this respect too, central banks find themselves in a state of cognitive dissonance. On the one hand they are charged with a mission to control inflation and that seems to require standing endlessly on lookout, anxiously scanning the horizon for risks, however slight. The ECB long outdid all other central banks in its repeated prediction of an acceleration of inflation despite the stubborn refusal of inflation to accelerate¹². The result is that it begins to appear like the boy who cried wolf.

¹⁰ <https://www.federalreserve.gov/newsevents/speech/powell20210210a.htm>.

¹¹ <https://www.federalreserve.gov/newsevents/speech/powell20210210a.htm>.

¹² For rigorous evidence of systematic upward bias in ECB projections when inflation is below target see Granziera, Eleonora, Pirkka Jalasjoki, and Maritta Paloviita. "The bias and efficiency of the ECB inflation projections: a State dependent analysis." Bank of Finland Research Discussion Paper 7 (2021).

Fig. 1: ECB forecasts for core HICP inflation, in % y/y



Source: IIF

Meanwhile, until the recovery from the COVID crisis, the problem that dominated central banking policy was not so much inflation as the risk of deflation. Sagging inflationary expectations were the constant concern of central bankers. Again, the Fed has the advantage that the entire history of modern monetarism is built into its DNA. Anyone raised on Irving Fischer and the Friedman and Schwartz (2008) interpretation of the Great Depression knows to fear deflation at least as much as inflation.

But again, central bankers were not passive in accepting this contradiction between evidence and the mandate. Instead, they reinterpreted the price stability mandate to enable deflation-fighting as well as inflation-control¹³. In August 2020, the Fed adopted average inflation targeting¹⁴. And in 2021 the ECB followed suit by shifting its target to a symmetrical 2 percent. Not more. Not less. This, no doubt, makes "communicating policy" more complicated. But the central bankers are not making these changes on a whim. They are adjusting to realities and engaging in creative reinterpretation of their mandate to do so.

The sudden surge in prices in 2021 as the world economy began to recover from the COVID shock has challenged the central banks to make good on their new approach. This is clearly a moment for inflation-control. But to their credit the Bank of England, the ECB and the Fed have all followed through on the logic of their new stance. They have been relatively slow to react to rising prices. They have eventually moved to taper their support for the economy, but in so doing they have offered a compelling interpretation which stresses the transitory features of the price increases. They are not

¹³ <https://www.businessinsider.com/deflation-making-sure-it-doesnt-happen-here-2010-7>.

¹⁴ <https://www.kansascityfed.org/documents/7832/JH2020-Powell.pdf>.

trying to get ahead of the curve. The situation is no doubt fast-moving and opaque, but this relatively measured reaction undeniably reflects a new vision of their mandate. The risk of overreacting to inflation is being taken seriously.

(4) Even more dramatic has been the adjustment of central bank practice in response to financial crises. The unspoken precondition for all action by central banks is a functioning financial system. Finance is not just functionally necessary, it is also one of the most powerful backers of the quest for low inflation and thus an interest-group bulwark of the central bank's mission (Posen, 1995).

Tellingly, financial stability did not bulk large in the classic list of modern central bank mandates. But, faced with recent crises, central banks have responded with creativity and force. This is necessary. But the speed and scale of the interventions pose a further question. Independence of central banks was defined in relation to governments and the typical social interest groups of the corporatist era – trade unions and employers associations. But what about financial markets and their key actors?

How independent are central banks of the pressures of global finance? When it comes to financial crises their hands are forced. Central banks seem like hostages, or, eager collaborators of private finance.

No clear-eyed observer can fail to notice the spectacular overlap in careers between private finance and public central banking. The revolving door operates relentlessly. If independence was devised to guard against fiscal dominance, what it seems to have delivered in recent decades is financial dominance i.e. domination of central bank policy by financial markets¹⁵. And this applies not just nationally, but internationally as well. The majority of liquidity support provided by the Fed in the aftermath of the Lehman shock was to non-American banks. To ensure liquidity provision to banks and funds with large currency mismatches on their balance sheets, central banks have found themselves juggling complex networks of swap lines. This was done in the interests of national systemic stability and against collateral of unimpeachable quality. But where does it say in the familiar understanding of the Fed's mandate that when the chips are down it should act as the lender of last resort to European megabanks?

One can imagine structural reforms that would limit the too big to fail risks and might give central banks a true measure of independence vis a vis the financial system. It is not for nothing that central banks have since 2008 moved to the center of the regulatory game. But what is their scope for

¹⁵ <https://www.bis.org/speeches/sp120216.pdf>.
https://scholar.princeton.edu/sites/default/files/markus/files/2015a_bundesbankhistory_financialdominance_0.pdf.

action and how much support do they receive from wider policies in limiting the extent of the financial risks that they have to face? How long will Europe have to wait for a truly robust banking union?¹⁶

To sharpen this point, consider the way in which "inflation risk" was squeezed out of labour markets and collective bargaining in the advanced economies. It was in part due to tough policies delivered by the central banks themselves. But what freed central banks in the early 1980s, as someone like Paul Volcker was only too well aware, was the multifaceted shift in the balance of power. As he remarked, Ronald Reagan's action in breaking the power of the air traffic controllers union was "the single most important action of the administration in helping the anti-inflation fight."¹⁷

Dornbusch's fight against "democratic money" proceeded on a broad front. Where is the equivalent campaign that would ensure a true degree of autonomy for the state, including the central bank, from the entanglement with financial interests? Where is the powerful campaign to curb the excesses of "bank money" or "market money"? The questions are rhetorical. Even in the face of repeated systemic crises, the response has been incremental and reformist rather than radical. But without that fundamental restructuring to loosen the grip of financial pressure on central banks, brave talk of independence rings hollow.

(5) The astonishingly lopsided nature of our current situation is revealed by another unexpected development of the last twenty years. Back in the 1980s and 1990s a key pillar of new dispensation was the separation of national treasuries from central banks (Ryan-Collins & Van Lerven, 2018). Famously, the ECB is barred from buying government debt in primary markets. But since 2008 central banks have in fact bought debt – on secondary markets – on a giant scale. Why? Not to back up fiscal policy, central bankers hasten to insist, but to fight the fight against deflation (price stability) mandate, and, even more urgently and to prevent collapse of the financial system (financial stability mandate). Public debt is not just a means of financing public spending. It has in recent decades become the rocket fuel of market-based finance (Gabor, 2021). The truly epic purchase of Treasuries by the Fed in March 2020 is the most striking demonstration of this latter point¹⁸. In a matter of weeks the Fed bought 5 percent of the total stock outstanding of the world's most important safe asset.

The result is incongruous. Bond-buying is happening. It can hardly be denied that it helps to create easy credit conditions for all borrowers, including the issuers of sovereign debt. Sovereign debt, in an emergency like that of 2020, is issued to fund essential life-saving interventions. Some forward-thinking central bankers are willing to acknowledge, if not cooperation or partnership, then

¹⁶ <https://www.piie.com/events/will-euro-area-ever-complete-its-banking-union>.

¹⁷ <https://theweek.com/articles/883046/complicated-legacy-paul-volcker>.

¹⁸ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3545546.

at least complementarity between monetary and fiscal policy¹⁹. Others espouse yield-curve control²⁰. But going one step further to declare that central banks are helping to sustain a vital response to a national emergency by monetizing debt and ensuring that yields do not surge, remains taboo. And yet this has historically been one of the essential roles of central banks - to act as a stabilizing force in public debt markets. Of course, central banks and Treasuries working hand in glove can lead to fiscal dominance and runaway inflationary dynamics. But under current circumstances is that a realistic scenario or, merely, a scarecrow?

Close cooperation between Treasuries and central banks can also be used to implement a concerted policy of debt reduction and financial repression, as after 1945 in Britain and the US (Reinhart et al., 2021). For sure, the politics of such a regime are indeterminate and complicated, but so too is the current situation in which we pretend to a separation that is continuously subverted by the imperatives of the moment.

How long can we continue with a situation in which in moments of crisis, central banks are deprived of the most compelling justification for their action? Why is it so hard for central banks to say:

"Yes, we are acting as a cooperative partner in the collective societal effort to meet a shock of historic proportions. We are doing so by an expansion and reshuffling of the consolidated public balance sheet (offsetting private deleveraging by public expansion and reallocating government IOUs from private asset holders to the balance sheet of the central bank in exchange for reserve deposits). No, we will not stand by and allow a bond market panic to make a bad situation even worse. We will do whatever it takes ... and believe us it will be enough."

Why is something that was once obvious, now unspeakable and subject to collective amnesia (Braun & Downey, 2020)?

(6) The invocation of more distant historical vistas can appear antiquarian. But the intent is the reverse, it is future-orientated. The point is to put our current conceptions of what it is good and proper for central banks to do in their historical context. To show them to be recent and parochial. Expand your historical horizon beyond the half-century since the 1970s and it is clear that central bank mandates are shaped by history, history with a capital "H". They change in the face of large historical challenges, like the total wars of the early 20th century, or the great inflations of the early 1920s.

The most basic argument for questioning the current status quo, is that many people see the current moment as a moment of dramatic historic challenge (Klein, 2015). This time is different. The

¹⁹ <https://www.bis.org/review/r201012a.htm>.

²⁰ https://www.boj.or.jp/en/announcements/press/koen_2017/data/ko170111a1.pdf.

climate science, the inequality numbers, the demographic and development outlook at the global level, tell us as much. It is time, therefore, to put all our institutions under scrutiny and it is not unreasonable to expect central banks to play an active and creative role in this process. It is only in quiet times that powerful people can safely limit the scope of their action to tinkering with the levers of power to achieve well-defined objectives neatly formulated in decades-old mandates. That, after all, does not do justice to the role of central bankers even in the last half-century.

One must, of course, guard against simplistic hero narratives, but it can hardly be denied that figures like Paul Volcker and Mario Draghi were historical actors in a grand sense²¹. They responded to historic challenges with creative and efficacious action. In the process they did not simply follow mandate, for better and for worse they arrogated to themselves the role of history-makers. Of course, this is hedged with risks, as is any significant historical action. It can go right and it can go terribly wrong, as in the case of the cat and mouse game played between the ECB and European national governments in 2010-11. But, like it or not, central bank agency is a defining fact of recent history.

Faced with the urgent need to sustain the social conditions for flourishing democracies, to achieve sustainable global development and meet the immediate challenge of the climate crisis, to refuse to assume agency is, in fact, to take a stance. For central banks to dig in their heels and insist that their only conceivable role is that defined by mandates shaped as part of a conservative counter-revolution half a century ago is not just small-minded or cautious. It is either an abdication of responsibility, a self-imposed immaturity (*selbstverschuldete Unmündigkeit*), or, more ominously, a taking of sides with a dangerously unsustainable status quo.

Action and advocacy come with risks. You may get it wrong. You may provoke a backlash. But faced with the fierce urgency of now, inaction has consequences and it comes with its own burden of responsibility.

The recent ruling by the German supreme court on climate policy has made the point with real force²². On the basis of Germany's rapidly waning carbon budget, the court mandated accelerated action by the German government. Central bankers of the current generation, like anyone else in a position of power at this moment, must ask themselves, how will I answer my grandchildren when they ask: what were you doing in the early 2020s? How did you respond to the Paris agreement of 2015 and the IPCC report of 2018? Do they really want to say that in the crucial period between 2020 and 2050 when the die was cast, their priority was upholding price stability or the no bail out clause of the Maastricht Treaties? That was all that the most powerful institution of economic policy could contribute?

²¹ <https://thecritic.co.uk/issues/may-2021/the-sphinx-who-reshaped-europe/>.

²² <https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/DE/2021/bvg21-031.html>.

(7) The one thing that we can be pretty certain about is that the status quo is not sustainable. And that goes for the standing of Western institutions in general, central banks amongst them.

Economic growth is protean. It operates by way of creative destruction. Periodically, that puts every institution of our society under stress. Right now, global economic growth is challenging the limits of environmental sustainability. And this demands a response. Economic growth is also shifting the global center of gravity from the 19th and 20th-century powers of the West, back to Asia.

The Asian economies though rapidly growing are, with the exception of Japan and South Korea, not at the same developmental stage as the economies of Europe and the United States. Their structure is different and so too is their mode of economic governance. China and Vietnam are ruled by one-party Communist regimes.

The paradigm of independent central banking that we take for granted today was largely a North Atlantic creation with important input from Anglosphere outliers like New Zealand. The Bank of Japan has always pursued a notably independent course, uninhibited by restrictive ideas about interest rates needing to be positive, or rules about asset purchases. It was the first to enter the topsy-turvy world of the zero-lower bound. The least one can say is that the BoJ has responded creatively.

In the last ten years, the PBoC has emerged as a key player in the global financial system. Though it takes inflation very seriously, it has never been able to confine itself to the price stability model (Girardin et al., 2017). The PBoC has always played a more active promotional role in development. It is not for nothing that the global monetary regime of the early 2000s was sometimes referred to as Bretton Woods 2.0 (Dooley et al., 2009). When it comes to policy tools like dual interest rates it is not by accident that Western pundits cite the example of the PBoC (He, 2011). In many ways China's central banking regime, enabled by a system of capital controls, resembles Western practices of the 1950s and 1960s. By the same token one might also ask whether China's rising importance in the world economy does not put in question the 1990s model of independence as the obvious endpoint of central banking history. What if, instead, we must view that model a historical episode, dated, for sake of argument, to the interval between 1992 and 2008?

This is not to suggest that the road points by way of Beijing back to some rewarmed mid-20th century future. The future may be more pluralistic. At the very least that will make the “one best way”, “there is no alternative” vision of Western economic policy harder to uphold. There will be an alternative.

Or, we may simply have misidentified the future. It is hardly a coincidence that the PBoC is leading the world in experiments in digital central bank currency (Hoffman et al., 2020). China's banking system in its current form is barely thirty years old. If fintech means that the system of financial intermediation will look very different in future, it may be China leads the way. Certainly, it

would be far easier for China to overturn the status quo than it would be to radically upend the entrenched financial institutions of the West. As with rapid abandonment of the internal combustion engine in the transition to EV, China's more recent economic development may mean that it is less burdened by the past.

Of course, the Chinese authorities face their own constraints. Critics both inside and outside China point to the distortions created by its compulsive growth model²³. Beijing and the ramified apparatus of the CCP regime seem compelled to deliver growth whatever the cost. But, as has also been demonstrated in recent months by the humbling of Jack Ma and his fintech empire and the deliberate puncturing of the real estate bubble, at least with regard to financial interests Beijing has degrees of freedom that Western states do not allow themselves. Unconstrained by legalistic concern for property rights, Beijing strikes ruthlessly at any conglomerations of private power it considers threatening to systemic stability. It is macroprudentialism with a vengeance. We may not sympathize with the nature of the CCP's authoritarian regime. To Western eyes it seems that such a system must undermine "incentives" and jeopardize long-term growth prospects. But one thing that Xi clearly is determined to defend is the "independence" of his regime's key agencies.

IV

The case for reexamining the familiar central bank model rests on one or other of this list of arguments. It is not so much a criticism of central bankers, who have responded creatively to the challenges facing them. It is a call to make explicit the changes that have already occurred and to recast out-of-date ideas and restrictive legal frameworks to match realities and to envision further changes that may be necessary. In the US this takes place largely by tacit adjustment and by exploiting the flexibility provided by the dual mandate. The Fed's intensely close relationship with financial markets and the financialization of the American upper class completes a system that has moved incrementally but radically towards a more accommodative and socially conscious stance. The truculence of the Republican Party and their willingness to call any institution into question that stands in their way, limits the scope for major institutional change. That may also limit the ability of the Fed to enter into areas like climate change that have become politicized in the US.

In the UK, a wave of the Downing Street wand can add climate to the Bank of England's mandate without much to do²⁴. In Europe things are more complicated. Given the scale of the climate challenge it is hard to accept that the one true mission for the ECB is to carry the flame of West Germany's Bundesbank into the 21st-century – a case of "Westalgie" writ at a continental scale²⁵.

²³ <https://www.ft.com/content/907740a4-854c-11ea-b6e9-a94cfd1d9bf>.

²⁴ <https://positivemoney.org/2021/03/big-win-new-green-mandate-for-the-bank-of-england/>.

²⁵ A play on the dismissive Ostalgie for those who hanker after the long-lost GDR.

But, for all one's impatience with legalistic argument over the ECB's mandate, the treaties and their carefully worded clauses cannot simply be waived aside. What is at stake, is the legal frame of the EU and the ongoing argument about who gets to shape, interpret and enforce it. The rule of law and the demand for explicit, democratic delegation and legitimation are values that Europe rightly upholds. They are also a precondition for securing legitimacy across the diverse national polities of Europe. If history calls for visionary leadership, it also teaches us that for want of a nail, battles are lost. European politics is all about ticking all the boxes, every last one.

Rather than viewing this as tiresome we should instead view it as a creative dialogue driven by the Treaties, a dialogue that is constitutive of a European public and of European politics. Around the ECB, once an Arcanum, a vibrant pan-European conversation has developed. Of course, not every debate is productive. Some challenges are in bad faith, corrosive of legitimacy and are intended to be such. Some of the recent litigation entertained by the German Verfassungsgericht falls squarely into that category²⁶. But this makes it all the more important to grasp the nettle of consolidating a clearer and more solidly grounded legitimacy for the expansive course that the ECB must, willy nilly, pursue.

Rather than making specific proposals, the aim of this paper is to insist that the door to debate and change must be opened and must be held open. But it would be remiss if it did not end with at least some concrete suggestions. All the more so since in a memo for the Transformative Responses project of the NGO Finanzwende and the Henrich-Böll Foundation Jens van't Klooster (2021) has recently delivered an excellent list of constructive and practical proposals.

As van't Kloosters puts it: "The ECB's conundrum is clear. For issue after issue, its mandate simply does not say what the ECB should do. That is not surprising, since it was written decades ago and has remained unchanged since then. The absence of explicit democratic authorisation for its policies undermines the ECB's ability to contribute effectively to the EU's broader economic, environmental, and social policy objectives. But if the ECB's conundrum is the result of insufficient democratic authorisation, then the solution is straightforward: Revisit the democratic basis for ECB operations. This is possible without limiting the ECB's independence."

How to fill the authorization gaps that seem to surround the ECB and the efforts by its current leadership to respond to the urgencies of the moment?

Within the statutes of the ECB itself there is room to adjust provisions for collateral and the treatment of deposits to bring them into conformity with Europe's green agenda and to facilitate a green TLTRO program.

²⁶ <https://twitter.com/lucasgutenberg/status/1394576769949310977?s=20>.

The ECB's so-called secondary mandate to support the economic policy objectives of the EU, is open-ended. This flexibility is convenient, but it also diminishes the weight of the secondary mandate by comparison with the compelling specificity of price-stability. Both the Council and Parliament could add to the weight of that secondary mandate by rank-ordering the long list of priorities. They could, for instance, give priority to the joint objective of carbon neutrality by 2050 and the vision of Social Europe recently outlined at the Porto summit. Both involve specific numerical targets for rates of employment, levels of poverty and carbon emissions. Such rank-ordering need not be set in stone. A review could become a regular event.

The ECB can proactively seek guidance from the European institutions on how to navigate authorization gaps. The more closely it can link its policies to already agreed programs the smaller those gaps become. Linking OMT to the EMS system was a maneuver along these lines. Given how restrictive that linkage proved to be in 2020 – no one wanted to pay the political price of applying for an ESM Program - it also suggests the significance of the multi-level game in which arguments at one level condition possibilities at another. For example, the specification of the EU's green mandate matters because of what it potentially does or does not authorize the ECB to do.

Finally, Europe should not shrink from broaching the issue of Treaty change. It may be laborious but to avoid it for that reason is to declare the game lost in advance. Would it not be better if the ECB had more a clearly spelled out mission to defend the integrity of the euro area, if necessary by intervening in bond markets? Would it not be better if the ECB, like the Fed, had a dual mandate? Would it not be better if the ECB was explicitly enjoined to promote the pursuit of net zero in positive terms, by all means necessary? That may be unrealistic to hope for, but is it not better to state out loud what would be desirable?

All such steps involve Europe's political organs reviewing, updating and addressing the European central bank and its mandate. According to conservative skeptics, that in itself could be seen as an encroachment on independence. It should, instead, be seen as filling crucial legitimation gaps and thus providing the central bank with the political backing it needs.

But the change cannot simply be on the side of the bank and the European institutions. The question bears repeating: independent from what? So long as the financial system retains its current structure, central banks are the hostage of crisis-situations that force their hand. Not just financial regulation, but structural change to the financial system should be seen as integral to the project of creating a more democratically accountable, truly independent central bank²⁷.

²⁷ S. Eich, "Independence from What?", Just Money, draft essay.

The fragility of Europe's banking system, the continued exposure to doom-loop risk, the incomplete and partial banking union, the lack of a large pool of Europewide safe assets, all these remain sources of serious politico-economic risk. It was particularly pleasing to see a recent research report by the ECB on the stability risks revealed by the turmoil of March 2020 in the ecosystem of investment funds²⁸. They are a ticking time bomb of open-ended run risk. Structural reform should be a top priority. It is not only in debates of grand historical scale about democracy, money and the climate crisis, but also in such technical points of regulation that the argument for a truly independent, publicly-accountable central bank will be won and lost.

²⁸ https://www.ecb.europa.eu/pub/financial-stability/macprudential-bulletin/html/ecb.mpbu202104_2~a205b46756.en.html and https://www.ecb.europa.eu/pub/financial-stability/fsr/focus/2021/html/ecb.fsrbox202105_06~36685631fa.en.html

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