

BOOK REVIEW ESSAY

THE POLITICS OF INDEPENDENT CENTRAL BANKS

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Bankers, Bureaucrats, and Central Bank Politics: The Myth of Neutrality

Christopher Adolph

Cambridge University Press, 2016, 390 pp., £19.99 (pb), ISBN: 978-1107567092

The Power and Independence of the Federal Reserve

Peter Conti-Brown

Princeton University Press, 2016, 368 pp., £19.96 (hb), ISBN: 978-0691164007

Economy of Words: Communicative Imperatives in Central Banks

Douglas R. Holmes

University of Chicago Press, 2013, 278 pp., £19.50 (pb), ISBN: 978-0226087627

Central banks have long played a far larger role in policy-making than their legal mandates might imply. In recent years their power and influence have become even greater. Since the financial crisis, public banks around the world have taken on more direct responsibilities for financial supervision and regulation, and pushed monetary policy to new limits in order to stimulate the global economy. In the United States and Eurozone, in particular, political barriers have limited legislative responses to the crisis, forcing regulatory institutions to pick up the slack. As a result, central banking institutions today possess broader policy-making authority and discretion than they possessed a decade ago.

With greater power comes greater responsibility and, in the world of academia, greater scrutiny. In recent years, a number of books have challenged some of the *idées reçues* on central banks. Chief among the critical targets has been a set of theories, influential in policy-making circles since the inflation-ridden economic crises of the 1970s, extolling formally independent central banks as the best (if not only) way for governments to maintain price stability. Such theories argued that, since elected officials would always be incentivized to use monetary policy powers to gin up the economy preceding an election, leaving monetary policy to the discretion of elected officials would produce an inflationary bias. Only formally independent institutions, freed from the influence of the short-term election cycle, could make the 'credible commitments' necessary to maintain price stability. In the 1980s and 1990s, a number of studies found correlations between low inflation and independent central banks (e.g. Alesina and Summers 1993). In the same period, many states established formally independent banks, particularly in Europe. The EU even enshrined the principles of Central Bank Independence (CBI) and a commitment to low inflation in the 1992 Maastricht Treaty.

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But following the global financial crisis, some of the normative foundations and empirical claims of credible commitment theories have been called into question. As central banks engaged in more extensive public relations efforts to stabilize the economy, we have seen how even banks' most conservative function – maintaining price stability – depends crucially on their relationships with outside interests and external actors. With some institutions pursuing innovative expansionary policies and others remaining committed to low inflation even as economic output plummeted, beliefs that monetary policy management is an objective science free from the influence of ideology or interests, or that central banking independence effectively insulates decision-making from politics, have become more difficult to sustain. Indeed, as central banks have partially nationalized or backed private institutions, and bought trillions of dollars of private assets through quantitative easing programmes, the distributive effects of central bank interventions have become almost undeniable.

Inspired in part by these post-crisis monetary policy developments, several new works in recent years have taken aim at the two core theoretical premises of central bank independence (CBI): their technocratic and limited mandate; and the neutral, apolitical character of their policy-making. Peter Conti-Brown's *The Power and Independence of the Federal Reserve* (2016) presents a historically focused challenge to the empirical reality and normative desirability of neutral policy-making at the US Federal Reserve. Christopher Adolph's 2016 *Bankers, Bureaucrats, and Central Bank Politics: The Myth of Neutrality* uses data on central bankers across five decades and several dozen countries to make the deceptively simple point that personnel is policy. Central bankers, he argues, have predictable policy outlooks based on their past career socialization; moreover, elected officials make appointment decisions based on their anticipation of the distributive consequences of a prospective appointee's preferred policies. Finally, through careful ethnographies of several central banks, Doug Holmes' *Economy of Words: Communicative Imperatives in Central Banks* (2013) underscores the politically self-conscious and responsive constitution of central bankers. The author shows repeatedly how bankers learn and adapt their policies to new political and economic conditions, and how they even 'collaborate' with the public in the implementation of monetary policy itself.

Although these studies utilize divergent methods, and draw from the wide-ranging fields of economics, law, history, political science, and anthropology, they share an emphasis on the *political* function of central banks. Formal independence may have changed how politics works, but as sites of power within democratic-capitalist systems, politics persists: interests compete for influence, politicians make appointments based on distributive consequences, and bureaucrats depend on a wide range of political actors to achieve their goals.

Conti-Brown examines the historical development of the US Federal Reserve, drawing from research in law, economics, history, and political science. The author mobilizes this synthesis of disciplines towards understanding a range of contemporary political problems at the institution today. By exposing the gap between independence theory and Fed practice, Conti-Brown shows the limits of credible commitment theories. He demonstrates that the design and function of the Fed has changed tremendously over time, that central bankers bring their personal ideology to the job, that they are influenced by a variety of external interests, and that the institutions themselves are engaged in a wide range of activities that go beyond maintaining price stability. In its early days, the Fed was far more concerned with financial stability and fighting deflation than with insulating decision-making from the force of popular politics; and even in recent years, the Fed has pursued a range of

activities and policies from bank supervision to consumer protection that are not related to price stability.

Ultimately, Conti-Brown argues that independence has been a 'sleight of hand' (p. 7) that has allowed the Fed to have more power and autonomy than can be normatively justified. The author claims that the American central bank is not merely a technocratic body, since nearly all of its decisions have political and distributional implications. Therefore, the Fed must be made more accountable to the public. Conti-Brown proposes to centralize the Fed's decision-making authority and increase congressional oversight over the institution's appointments and budgetary decisions. The contemporary confirmation hearings for US Supreme Court nominations serve as his recommended model. '[P]ublic vetting is the best opportunity for allowing democratic participation without subverting the benefits of separating monetary policy from the floor of the House of Representatives', he concludes (p. 240).

Although there is much to admire in Conti-Brown's reform agenda – particularly his call to rein in the budgetary autonomy of the Fed – his argument for more congressional scrutiny is insufficiently justified. Even if we agree that the Federal Reserve's structure is 'complicated, confused, and opaque' (p. 266), the contention that the best way to achieve more democratic accountability is to subject Fed appointees to politicized and partisan-driven nomination battles is based on limited theoretical and empirical support. In fact, recent works of democratic theory caution against assuming that additional sunlight always improves democratic legitimacy (e.g. Warren and Mansbridge 2013) and recent political experiences underscore the limits of adversarial legislative hearings as a tool of democratic accountability (Binder and Lee 2013). The current refusal of US Senate leaders to even consider a nominee for the Supreme Court's vacant seat is a case in point. Entangling Fed appointment processes in additional partisan politicization and legislative scrutiny could wreak real havoc on the global economy without providing additional public confidence in government.

Christopher Adolph approaches accountability in central banking from a different standpoint in *Bankers, Bureaucrats and Central Bank Politics*. The political scientist identifies similar major gaps between credible commitment theories and the actual practices of central banks, but comes to different conclusions. Leveraging an impressive amount of data covering dozens of developed and developing countries over 50 years (1950–2000), Adolph argues that the prior career experiences and future career expectations of central bankers predict their policy choices. Specifically, appointees with previous work experience in finance care more about maintaining low inflation, while those coming from the public sector care more about full employment. Introducing the concept of 'shadow principals', defined as the 'patrons who set implicit contracts with bureaucratic agents to implement policies that the shadow principal desires' (p. 17), Adolph encourages us to think about the structural interests that lie behind any central banking decision, from personnel appointments to inflation rates.

Yet, the presence of differing interests and political choices is a source of democratic potential for Adolph rather than a red flag. 'Contrary to the mission and conclusions of the central bank independence literature', he concludes, 'monetary policy has not become a purely technocratic exercise but remains, at least at key moments, a political and even democratic process, in which partisan governments get to choose central bankers according to partisan preferences and may later deny re-appointment on partisan criteria' (p. 302). To be sure, the mechanism of accountability has a time lag and is indirect, working through tools more akin to 'salad tongs' than 'tweezers' (p. 264); moreover, central banks

in some places tend to enact more anti-inflation policies than desired by the public in recent years (p. 307). Still, he sees tremendous potential for change to occur within the existing structure of central banks. Rather than suggest adversarial legislative hearings that could be counterproductive in polarized and paralyzed systems such as the United States, he urges governments to address central banks' conservative bias by appointing more central bankers who care about employment – something that in recent years has occurred at both the US Federal Reserve and European Central Bank. One of the major benefits of Adolph's assessment is that his analysis is based on a broader understanding of central bank behaviour, avoiding some of the narrower preoccupations of internal policy-making at the US Federal Reserve that take up dozens of pages of Conti-Brown's account.

Douglas Holmes' rich ethnography of central banks in the US, Sweden, the EU, the UK, New Zealand, and Australia, is perhaps the most intriguing among recent studies of the politics of central banks. Holmes not only argues that external interests influence central banks' decisions, but also that central bankers depend on external actors to implement their own policies. Whether seeking to generate confidence in investment or achieve an inflation target of 2 per cent, the defining feature of monetary policy today (p. 4) is the need to tell persuasive 'promissory visions' to the public that comport with the views of external experts, and the public's own lived experiences. Such a process, in Holmes' view, is democratically empowering: 'provid[ing] us with the intellectual material – data and analysis – by which we, the public, can make decisions, by which we as protagonists can sustain the totality of promises of a distinctive order' (p. 218).

Similar to the other authors, Holmes rejects the caricature of the staid, conservative central banker with a single-minded and mostly uniform commitment to maintaining low inflation. Neither does he agree with the characterization of out-of-touch, and mostly unaccountable actors in Conti-Brown's portrayal, or Adolph's suggestion that central bankers' decisions are products of career socialization and distributive politics. In fact, Holmes' depiction is more in the spirit of Hugh Hecló (1974) – of 'puzzling' bureaucrats, always 'collectively wondering what to do' (p. 305). Central banks are engaged in 'continuous experimentation and learning' (p. 20); his actors are agile and self-reflexive, seeing their jobs as 'inevitably works in progress' and their own ideas and practices as 'open to continual refinement and revision' (p. 3). Far from being unaccountable actors, central bankers are deeply aware of public reactions to their own policies. They engage in 'collaborative relationships' (p. 3) with the public, which hold them accountable for the economic consequences of their actions, and make central bankers highly dependent on external actors to achieve their own policy goals.

At a time of increasing cynicism about the motives of government officials, such a view of central banking institutions is quite comforting. Yet based on Holmes' account alone, it is difficult to rule out the possibility that the observed behaviour is not mostly strategic – designed to enhance the power of public bankers, or to maintain a particular set of policy consequences in response to a rapidly changing environment. Interfacing with the public, justifying policy choices using the best available evidence, and learning from new economic and political conditions certainly have value in a democracy – but the presence of such practices does not preclude actors from still systematically serving the interests of themselves or other favoured groups. Holmes would probably not dispute the presence of power relations and economic interests. But a more sceptical interpretation of his central bankers' 'collaboration' and 'learning' would reflect the world of unaccountable

bureaucrats or distributive politics described by Conti-Brown and Adolph, respectively, rather than the contingent and uncertain one described by Holmes.

Although the authors effectively historicize (Conti-Brown), debunk (Adolph) and complicate (Holmes) theories of CBI, they do not provide a clear sense of where these theories stand today, especially in the aftermath of the global financial crisis. Outside of a few pages here and there, we receive little information about how proponents of independent central banks reconcile their theories with recent developments. This can be explained by a lack of serious engagement with intellectual history; in particular, how those positing credible commitment theories of central bank independence have responded to the financial crisis. This leaves the reader wondering why and how this set of theories retains such power, despite the gaps between theory and practice made evident during the crisis, and even with the increasing number of academic critiques.

Even with this limitation, these works make important contributions to the understanding of the politics of independent central banking institutions within contemporary democratic capitalist societies. Put together, they provide what could be considered a collective takedown of the conventional credible commitment view of the function of central banks. After reading these books, it is difficult to heed central banks' austerity policies without considering the interests underpinning them. Likewise, we are forced not only to consider the relative autonomy of central banks, but also their dependence on the public and outside experts for power and legitimacy.

Even more important, these three books push us to think about how politics within independent central banks might work better. Avoiding the Scylla of complete central bank insulation and the Charybdis of total popular control, the authors push for reforms that would improve the democratic accountability of central banks without losing the advantages of independent structures. Central banks, we are reminded, can be made to care more about employment (Adolph), or to creatively respond to economic or political crises (Holmes), without having to be subject directly to the political cycle. Likewise, we can rationalize their decision-making processes and increase their budgetary accountability, without undermining their institutional capacity (Conti-Brown).

Central banks, in their tremendous autonomy, in their ability to manage the politics of distributional conflict, and in their agility and learning, possess outsized power that will likely continue for some time to come. It is therefore important to continually reconsider the implications of such developments, and to be willing to reform such institutions when they no longer align with democratic values or economic goals. By employing a wide array of methodological and disciplinary approaches, these three works go a long way toward helping us understand the most important political questions and interests at stake, as well as the normative strengths and limits, of the considerable authority conferred to central banks in the contemporary moment.

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