



UNIVERSIDADE CATÓLICA PORTUGUESA  
Faculdade de Direito

**FOR OR FROM DEMOCRACY?**

**THE PLURALISTIC INDEPENDENCE OF POLITICAL CENTRAL BANKS**

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by

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## FOR OR FROM DEMOCRACY?

### THE PLURALISTIC INDEPENDENCE OF POLITICAL CENTRAL BANKS

**Keywords:** Central banks, Central bank independence, Monetary policy, Macroeconomic policy, Democracy, Pluralism, Governance, Politicization, financial policy

**Palavras-Chave:** Banco central, Independência, Política monetária, Política macroeconómica, Democracia, Pluralismo, Governança, Politização, Política financeira

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## ABSTRACT

The global financial crisis heralded profound transformations in the economy and the governance of money and credit. The rise and politicization of central banks challenged the two-decade-old consensus on central bank independence (CBI), requiring the reconstruction of the concept, its normative justification and framework.

A new model of pluralistic CBI is proposed in which central banks are independent but also political and democratic. It preserves the essence of independence, the functional and institutional separation and delegation of the discretionary governance of monetary and financial policies to a non-majoritarian institution to protect the integrity of the specialized process. Yet, it debunks the traditional illusions of strict separation, absolute insulation, and narrow and clear delegation to central banks that would be apolitical and decide objectively and merely technical issues.

Instead, the separation of powers is balanced and limited, and external influences are prohibited, permitted, or even required, depending on their normative value.

Pluralistic CBI focuses on influences from the classic political actors and also from the public, courts, epistemic community, and affected private interests. All these Influencers may be "friends or foes" of the IBC. It constrains those influences to prevent domination or systematic biases (majoritarian or minoritarian) and adds a new Madisonian dimension by mobilizing and structuring a "competition of Influencers" that, through mutual checks and balances, protects independence.

Central banks are political because they make substantively political decisions, operate under conditions of public contestation, and are "inside" politics, in a bidirectional relationship with political actors.

They are democratic because they are subject to appropriate *ex ante* and *ex post* control by Democratic Representatives, they establish new channels of direct and bidirectional relationship with the public, and they help to correct some difficulties of contemporary democracies, namely by equalizing representation.

By comparative institutional analysis it is shown that the pluralistic model of CBI is superior to the classical political process and traditional CBI in terms of the core values of modern liberal democracies. It has the comparative advantages of specialized expertise, democratic credentials, and impartiality by mitigating domination or systematic majoritarian or minoritarian biases. Pluralistic CBI is a political technology of non-partisan politics and indirect democracy. It is also superior in terms of policy outcomes.

The normative reconstruction generates 18 lessons to improve and broaden the CBI framework, which is designed with 67 protections of institutional, personal, financial, and operational independence by combining defensive barriers and structured competition of Influencers.

## RESUMO

A crise financeira global desencadeou profundas transformações na economia e na governação das políticas monetárias e financeiras. A expansão e politização dos bancos centrais puseram em causa um consenso de duas décadas, exigindo a reconstrução do conceito, da justificação normativa e do regime de “Independência dos Bancos Centrais” (IBC).

Propõe-se um novo modelo de IBC pluralista em que os bancos centrais são independentes mas também políticos e democráticos.

Mantém-se o essencial da independência, com separação funcional e institucional e delegação de poderes discricionários de governação monetária e financeira a uma instituição não maioritária, para preservação da integridade do respetivo processo especializado.

Mas, rejeitam-se as tradicionais ilusões da separação estrita, isolamento absoluto e de uma delegação restrita e clara a bancos centrais que seriam apolíticos e decidiriam de modo puramente objetivo questões meramente técnicas.

A separação de poderes é limitada e equilibrada. As influências externas podem ser proibidas, permitidas ou até exigidas, consoante o seu valor normativo.

Relevam as influências do poder político, mas também as do público, tribunais, comunidade epistémica dos bancos centrais, e dos interesses privados especialmente afetados. Todos estes grupos podem ser “amigos ou adversários” da IBC. Todos devem ser ponderados e enquadrados para prevenir dominação ou enviesamento da decisão independente, mas também para mobilizar uma “concorrência de Influenciadores” que, controlando-se mutuamente, podem proteger a independência.

Os bancos centrais são políticos porque tomam decisões substantivamente políticas, operam em condições de contestação pública e estão “dentro” da política, numa relação bilateral com os atores políticos tradicionais.

São democráticos porque estão sujeitos a um controlo adequado, *ex ante* e *ex post*, dos representantes democráticos, estabelecem novos canais de relação direta e bidirecional com o público e ajudam a corrigir algumas dificuldades dos atuais regimes democráticos, designadamente equalizando a representação.

Por análise institucional comparativa demonstra-se que o modelo pluralista de IBC é superior ao clássico processo político e à IBC tradicional em termos dos valores essenciais das democracias liberais modernas. Este novo modelo apresenta vantagens comparativas de especialização, credenciais democráticas e imparcialidade por mitigação da dominação ou enviesamento sistemático em favor de maiorias ou minorias. É também superior em termos de resultados das políticas públicas.

Esta reconstrução normativa gera 18 lições que são incorporadas no aperfeiçoamento e alargamento do regime de IBC, para o qual são propostos 67 vetores de proteção da independência institucional, pessoal, financeira e operacional, combinando barreiras defensivas e a estruturação da “concorrência de Influenciadores”.

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# Declarations

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## List of Abbreviations and Acronyms

*Abbreviations and acronyms of institutions or concepts are also used in plural form by adding the suffix “s”.*

*Legal texts are referred as amended in their most updated versions, unless otherwise specified.*

|                       |                                                                                                                                                                                                                                                                                                                                                         |
|-----------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Aarhus Conv.98</b> | The Aarhus Convention of 1998 on Access to Information, Public Participation in Decision-Making, and Access to Justice in Environmental Matters                                                                                                                                                                                                         |
| <b>AG</b>             | Advocate General of the Court of Justice of the EU                                                                                                                                                                                                                                                                                                      |
| <b>APA</b>            | Administrative Procedure Act of 1946 of the USA                                                                                                                                                                                                                                                                                                         |
| <b>ANFA</b>           | Agreement on Net Financial Assets                                                                                                                                                                                                                                                                                                                       |
| <b>APP</b>            | The Asset Purchase Programs of the ECB which include the corporate sector purchase program (CSPP), the public sector purchase program (PSPP), the asset-backed securities purchase program (ABSPP), and the third covered bond purchase program (CBPP3)                                                                                                 |
| <b>Art.</b>           | article of the                                                                                                                                                                                                                                                                                                                                          |
| <b>BA2009</b>         | UK’s Banking Act of 2009                                                                                                                                                                                                                                                                                                                                |
| <b>BCBS</b>           | Basel Committee on Banking Supervision                                                                                                                                                                                                                                                                                                                  |
| <b>BIS</b>            | Bank of International Settlements                                                                                                                                                                                                                                                                                                                       |
| <b>BoCan</b>          | Bank of Canada (the central bank of Canada)                                                                                                                                                                                                                                                                                                             |
| <b>BoE</b>            | Bank of England (the central of the United Kingdom)                                                                                                                                                                                                                                                                                                     |
| <b>BoE Act</b>        | Bank of England Act of 1998, as amended                                                                                                                                                                                                                                                                                                                 |
| <b>BoE Act 1946</b>   | Bank of England Act of 1946                                                                                                                                                                                                                                                                                                                             |
| <b>BoFra</b>          | Banque de France (the central Bank of France)                                                                                                                                                                                                                                                                                                           |
| <b>Bolsr</b>          | Bank of Israel                                                                                                                                                                                                                                                                                                                                          |
| <b>Bolsr Law</b>      | the Bank of Israel Law, 5770-2010                                                                                                                                                                                                                                                                                                                       |
| <b>BolIta</b>         | Banca d’Italia (the central Bank of Italy)                                                                                                                                                                                                                                                                                                              |
| <b>BoJ</b>            | Bank of Japan                                                                                                                                                                                                                                                                                                                                           |
| <b>BoJ Law</b>        | Bank of Japan Law of 1997                                                                                                                                                                                                                                                                                                                               |
| <b>BoPrt</b>          | Banco de Portugal (the central Bank of Portugal)                                                                                                                                                                                                                                                                                                        |
| <b>BoSpa</b>          | Banca d’ España (the central Bank of Spain)                                                                                                                                                                                                                                                                                                             |
| <b>BRRD</b>           | Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and |

|                   |                                                                                                                                                                                                |
|-------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                   | Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council                                                                                              |
| <b>Buba</b>       | Bundesbank (the German Central Bank)                                                                                                                                                           |
| <b>CB</b>         | Central bank                                                                                                                                                                                   |
| <b>CBDC</b>       | Central Bank Digital Currency                                                                                                                                                                  |
| <b>CBI</b>        | Central Bank Independence                                                                                                                                                                      |
| <b>CBkers</b>     | Central bankers                                                                                                                                                                                |
| <b>Ch.</b>        | Chapter                                                                                                                                                                                        |
| <b>CJEU</b>       | Court of Justice of the European Union                                                                                                                                                         |
| <b>CRD</b>        | European Union's Capital Requirements Directive (2013/36/EU)                                                                                                                                   |
| <b>CRR</b>        | European Union's Capital Requirements Regulation (EU) (575/2013)                                                                                                                               |
| <b>DGSD</b>       | European Union's Deposit Guarantee Schemes Directive (2014/49/EU)                                                                                                                              |
| <b>DR</b>         | Democratic Representative                                                                                                                                                                      |
| <b>ECB</b>        | European Central Bank                                                                                                                                                                          |
| <b>ECB-EB</b>     | Executive Board of the European Central Bank                                                                                                                                                   |
| <b>ECB-GC</b>     | Governing Council of the European Central Bank                                                                                                                                                 |
| <b>ECHR</b>       | European Court of Human Rights                                                                                                                                                                 |
| <b>EFSSF</b>      | European Financial Stability Facility                                                                                                                                                          |
| <b>EFSM</b>       | European Financial Stabilisation Mechanism                                                                                                                                                     |
| <b>EIB</b>        | European Investment Bank                                                                                                                                                                       |
| <b>ELA</b>        | Emergency Lending Assistance                                                                                                                                                                   |
| <b>EMI</b>        | European Monetary Institute                                                                                                                                                                    |
| <b>EMU</b>        | European Monetary Union                                                                                                                                                                        |
| <b>ERM</b>        | Exchange Rate Mechanism                                                                                                                                                                        |
| <b>ESCB</b>       | European System of Central Banks of the European Union                                                                                                                                         |
| <b>ESCB-Stat</b>  | Statute of the European System of Central Banks and of the European Central Bank, as in the consolidated version of the Protocol (nº 4) of the Treaty on the Functioning of the European Union |
| <b>ESM</b>        | European Stability Mechanism                                                                                                                                                                   |
| <b>ESM Treaty</b> | Treaty Establishing the ESM, signed on 2 February 2012                                                                                                                                         |
| <b>ESRB</b>       | European Systemic Risk Board                                                                                                                                                                   |
| <b>EU</b>         | European Union                                                                                                                                                                                 |
| <b>EU COM</b>     | European Commission                                                                                                                                                                            |
| <b>EU Parl</b>    | European Parliament                                                                                                                                                                            |



|                   |                                                                                                                                                             |
|-------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Eurocrisis</b> | also known as the European Sovereign Debt Crisis that occurred in the European Union starting in 2009 (definitions of end vary from 2010 to 2015)           |
| <b>Fed</b>        | Federal Reserve System of the United States (the central bank of the USA). According to the context it may also stand for the Board of Governors of the Fed |
| <b>Fed BoG</b>    | Board of Governors of the Federal Reserve System                                                                                                            |
| <b>FOIA</b>       | The Freedom of Information Act of 1966 of the USA                                                                                                           |
| <b>FOMC</b>       | Federal Open Market Committee of the USA                                                                                                                    |
| <b>FPC</b>        | the Financial Policy Committee of the Bank of England                                                                                                       |
| <b>FRA</b>        | Federal Reserve Act of 1913 of the USA                                                                                                                      |
| <b>FSB</b>        | Financial Stability Board (international organization)                                                                                                      |
| <b>FSA2012</b>    | UK's Financial Services Act of 2012                                                                                                                         |
| <b>FSMA</b>       | UK's Financial Services and Markets Act of 2000                                                                                                             |
| <b>FSOC</b>       | Financial Stability Oversight Council of the USA                                                                                                            |
| <b>GCC</b>        | German Constitutional Court                                                                                                                                 |
| <b>GFC</b>        | Global Financial Crisis that erupted in 2007-2008                                                                                                           |
| <b>GSC</b>        | Global stable coins                                                                                                                                         |
| <b>ICB</b>        | Independent central bank                                                                                                                                    |
| <b>IFI</b>        | Independent fiscal institution, including independent fiscal councils                                                                                       |
| <b>IMF</b>        | International Monetary Fund                                                                                                                                 |
| <b>LOLR</b>       | Lender of last resort                                                                                                                                       |
| <b>MMLR</b>       | Market maker of last resort                                                                                                                                 |
| <b>MPC</b>        | Monetary Policy Committee of the Bank of England                                                                                                            |
| <b>MoU2017</b>    | Memorandum of Understanding on resolution planning and financial crisis management agreed upon by the HM Treasury and the Bank of England in October 2017   |
| <b>NCB</b>        | A national central bank of the European System of Central Banks                                                                                             |
| <b>NCA</b>        | A national competent authority in the context of the European Banking Union and its Single Supervisory Mechanism                                            |
| <b>NGO</b>        | Non-governmental Organization                                                                                                                               |
| <b>NRA</b>        | A national resolution agency in the context of the European Banking Union and its Single Resolution Mechanism                                               |
| <b>NZRB</b>       | New Zealand Reserve Bank (the central bank of New Zealand)                                                                                                  |
| <b>OMT</b>        | Outright Monetary Transactions program of the ECB                                                                                                           |
| <b>PEPP</b>       | Pandemic emergency purchase programme of the ECB                                                                                                            |

|                       |                                                                                                                                                                                                                                                                                                                                              |
|-----------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>PRC</b>            | Prudential Regulation Committee in the BoE                                                                                                                                                                                                                                                                                                   |
| <b>POTUS</b>          | President of the United States of America                                                                                                                                                                                                                                                                                                    |
| <b>PSD 2</b>          | European Union's Payment Services Directive 2 (2015/2366) on payment services.                                                                                                                                                                                                                                                               |
| <b>PSPP</b>           | Public Sector Purchase Programme of the ECB                                                                                                                                                                                                                                                                                                  |
| <b>QE</b>             | Quantitative Easing                                                                                                                                                                                                                                                                                                                          |
| <b>QT</b>             | Quantitative Tightening                                                                                                                                                                                                                                                                                                                      |
| <b>RB</b>             | Regional Federal Reserve Bank of the Federal Reserve System of the United States                                                                                                                                                                                                                                                             |
| <b>RBA</b>            | Reserve Bank of Australia (the central bank of Australia)                                                                                                                                                                                                                                                                                    |
| <b>Sect.</b>          | Section of a legal statute.                                                                                                                                                                                                                                                                                                                  |
| <b>SCOTUS</b>         | Supreme Court of the United States of America                                                                                                                                                                                                                                                                                                |
| <b>SIFI</b>           | Systemically important financial institution                                                                                                                                                                                                                                                                                                 |
| <b>SMP</b>            | Securities Markets Programme of the ECB                                                                                                                                                                                                                                                                                                      |
| <b>SNB</b>            | Swiss National Bank (the central bank of Switzerland)                                                                                                                                                                                                                                                                                        |
| <b>SRB</b>            | Single Resolution Board, the central resolution authority within the Banking Union of the EU                                                                                                                                                                                                                                                 |
| <b>SRM</b>            | Single Resolution Mechanism                                                                                                                                                                                                                                                                                                                  |
| <b>SRM Regulation</b> | Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 |
| <b>SSM</b>            | Single Supervisory Mechanism of the EU                                                                                                                                                                                                                                                                                                       |
| <b>SSM Regulation</b> | Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.                                                                                                                                                    |
| <b>SvB-Act</b>        | Sveriges Riksbank Act (1988:1385)                                                                                                                                                                                                                                                                                                            |
| <b>TEU</b>            | Treaty of the European Union                                                                                                                                                                                                                                                                                                                 |
| <b>TFEU</b>           | Treaty on the Functioning of the European Union                                                                                                                                                                                                                                                                                              |
| <b>TLTRO</b>          | Targeted Longer-Term Refinancing Operations                                                                                                                                                                                                                                                                                                  |
| <b>TPI</b>            | Transmission Protection Instrument announced by the ECB in 2022                                                                                                                                                                                                                                                                              |
| <b>TSCG</b>           | EU Treaty on Stability Coordination and Governance                                                                                                                                                                                                                                                                                           |
| <b>UK</b>             | United Kingdom                                                                                                                                                                                                                                                                                                                               |
| <b>USA</b>            | United States of America                                                                                                                                                                                                                                                                                                                     |

## PART I. INTRODUCTION

### 1. INTRODUCTION

#### 1.1. RETHINKING INDEPENDENCE IN A TRANSFORMED CENTRALVERSE

After thousands of writings on the subject<sup>1</sup>, what is the point of one more study on CB independence?

Central bank Independence (CBI) has spread gradually across the world since the 1980s<sup>2</sup> in a classic formulation as *strict* or *complete* separation or insulation from external control or influence<sup>3</sup>, *essentially from the political process* and the short-termism of politicians. This definition passed from academic writings to legal texts and jurisprudence<sup>4</sup>.

This traditional model was conceived for a specific, purportedly apolitical, and technical function at the service of a particular goal (internal monetary stability or inflation control) in each economic context (of inflationary pressures) and with a defined normative justification (alleged superiority in dealing with the time-inconsistency problem of monetary policy)<sup>5</sup>.

However, over the past two decades, the world economy and its “centralverse”<sup>6</sup> have significantly changed, with a series of crises and shocks leading to massive and materially different interventions of central banks (CBs), a perceived rise of their power and centrality, and some foreseeable challenges adding further complexity.

If the analytical and conceptual clarification of CBI was already necessary, it became indispensable with the seismic transformations in central banking and its external context. These exposed the analytical weaknesses, obsolescence, and how insufficient the traditional defense of CBI had become. However, the accommodating views and adaptations are also not entirely satisfactory.

The current post-pandemic inflation surge only reinforces the need for rethinking CBI’s existence, content, and limits.

---

<sup>1</sup> A Google Scholar search for keywords “Central Bank Independence”, “Independent Central Bank” and “Central Bank Autonomy” generated over two thousand results within titles-only (=2098+133+129) and over 56 thousand in all words. The search for the same three keywords in JSTOR, in all fields, generated almost five thousand results (2876+1664+355) – last checked on November 24, 2022.

<sup>2</sup> Most CB earned their independence in the 1990s, the Fed, Buba, and SNB in the mid-20th century.

<sup>3</sup> (EU COM Notice, 1991: 58), (BRENTFORD, 1998: 88), (ZILIOLI & SELMAYR, 2000: 603, 626), (AMTENBRINK & DE HAAN, 2002: 72), (LASTRA, 2015: 74), (CONTI-BROWN, 2016: 2).

<sup>4</sup> Article 130 TFEU, (CJEU caselaw on *Gauweiler* case, Case C-62/14, [2015], §40; *OLAF* case, Case C-11/00 *EU COM v ECB* [2003] §134; and *Rimšēvičs v Latvia* case [2019] §47). (AG JACOBS, Opinion in the *OLAF* case, §150), (AG CRUZ VILLALÓN, Opinion in the *Gauweiler* case, § 109), (ECB, 2017). (FRIEDMAN, 1968: 177-8), (GOODMAN, 1991: 329), (DEBELLE & FISCHER, 1994), (ALESINA & STELLA, 2010), (ZILIOLI, 2016), (BALLS ET AL., 2016), (ZILIOLI & RISO, 2018: 156), (ORPHANIDES, 2018), (IOANNIDIS, 2020).

<sup>5</sup> (LASTRA, 2015), (BLINDER, 2016: 9).

<sup>6</sup> (NYGAARD, 2016).

A realistic and coherently comprehensive inquiry and a reconstruction of CBI that can make positive and normative sense of such seismic transformations are necessary to offer new answers to the essential questions of *what CBI is, from whom, how, and why or what for*.

It will shed light on often (mis- or) disregarded aspects such as: (i) the politicization of central banking; (ii) the actual extension of democratic controls; (iii) the fundamental role of Influencers other than partisan political actors, such as the public, courts, the epistemic community, and specially affected interests, their rich bilateral interactions and how their complementary and competing influences can both curb and protect CBI; and (iv) *central banking in action*.

Such a thorough look will demonstrate that the traditional view is unfit for purpose, with its beliefs about: (i) a clear and complete democratic delegation leaving only resolved or low-salience value-questions; (ii) the possibility of optimal technical-only policymaking by entirely rational, objective, and neutral (disinterested) expert central bankers, whose preferences and interests, fallibility, biases and strategizing are disregarded; (iii) the purported homogeneity, conservatism and even higher-spiritedness of Independent Central Banks' (ICB)'s officials; and (iv) the strict separability of macroeconomic policies. Such assumptions rely on myths that fail under the closer scrutiny below.

In contrast with the traditional model, which was narrowly justified and suited for internal monetary policy in the limited context of high inflation, this comprehensive inquiry will lay the ground for a model of CBI for all seasons, i.e., that suits different economic contexts and various macroeconomic policy functions where CBs have specialized expertise.

It will show that the choice of CBI is not one between policy goals/objectives — namely price stability vs. others — but an option between alternative institutional models that may serve the same democratically decided objectives in different forms.

On the other hand, the comprehensive inquiry will also reveal that newer accommodative or remedial approaches are also unsatisfactory. They all view independence and democracy in opposition, suggesting that only more electoral and partisan intervention by the classic political branches can save the former, albeit at its own expense.

The original contribution of this comprehensive inquiry is to build a novel model and framework denominated *pluralistic CBI*, where central banking is democratic and yet independent. This model accounts for the external and internal transformations and rise of CBs over the past two decades and the abovementioned disregarded analytical aspects. It fits better with the normative demands of modern liberal democracies and the prevailing constitutional choice of a *balanced separation of macroeconomic powers*.

In this pluralistic CBI and *under conditions*, CBs are and should be *political, democratic, and independent*.

They are political in the double sense of inevitably making substantive political choices and operating under conditions of public contestation.

They are also democratic. ICBs are *of the People, by the People, and for the People*.

Firstly, they are democratic because they have adequate democratic credentials and legitimacy stemming from *good enough democratic control* and new relationship channels that ICBs have been developing with the public.

Second, such new channels create a connection and responsiveness to the public that differs from classic political branches. This new relation justifies the ICB's different type of democratic legitimacy while demonstrating the democratic possibility of *non-partisan politics* that ICBs and other independent agencies offer in modern liberal democracies in a time of increasing polarization, political dysfunctionality, and politically partisan conflicts.

Third, pluralistic CBI builds a triple institutional comparative advantage relative to the classic political process in the governance of monetary and financial policies and to other institutional alternatives.

Pluralistic ICBs have epistemic, democratic, and impartiality advantages. Their policymaking is not flawless, but the choice of institutions is one between imperfect alternatives<sup>7</sup>. The conditions of such advantages ought to be upheld to prevent the governance of monetary and financial policymaking from becoming a technocracy.

Fourth, based on such comparative advantages, democratic ICBs can have the positive externality of assisting in the current difficulties faced by liberal democracies, namely populism, polarization, and declining trust in both inputs and outputs of public governance.

CBs are and should be political and democratic, yet they are and should be *independent*. Such independence is a decisive element of those comparative advantages of pluralistic central banking.

Pluralism means that CBI is neither *absolute* insulation nor absence of politics, of interaction with other influential actors and the public, and of mechanisms of communication, accountability, and responsiveness.

Pluralistic CBI throws a new, critical look into the bidirectional interactions of ICBs with other potential Influencers and how influences can go in both directions. They are not necessarily undesirable from the point of view of preserving independence and the integrity of central banking as a unique model of policymaking.

It departs from an *all-influences-are-prohibited* approach to a framework that distinguishes amongst potentially effective influences of relevant Influencers, some of which should be prohibited, others tolerated, and others required.

---

<sup>7</sup> (KOMESAR, 1994).

Contrary to traditional suspicions against all external efforts to sway CBs, the pluralistic model argues that all relevant Influencers, be they political actors, the public, courts, epistemic community, or affected interests, can be friends or foes of CBI. Their interventions can protect CBI by imposing limits on or acting as countervailing forces against the interferences of other influencers. In this sense, they are to be welcomed. However, as described by traditionalists, external influences can also act as counter-powers, which limit the power and impair the integrity of the decision-making process of CBs.

Influences can individually or jointly threaten independence, but they may also control each other and thus guard CBs against impervious others. This dual relationship illustrates how pluralism can protect CBI.

Pluralistic CBI is not only about political insulation but also about a broader competition of influences that must unfold under conditions of equality, liberty, expertise, open participation and deliberation, and balance of influences rather than an unequal or systematically biased representation of interests.

Such competition of influences is both a *positive* assessment and a *normative* prescription under those conditions. Therefore, it must be acknowledged and structured.

Under this framework, the position and interactions of ICBs must be revisited. The traditional monochromatic framework of red lines against external influences is to be replaced by a pluralistic framework with a more complex yet more realistic and insightful “traffic-light” approach, with a regime of green, orange, and red lights or lines that are often crossed in both directions.

Permissible or green are those signals and interactions contributing to upholding CBI’s comparative epistemic, democratic, and impartiality advantages and achieving the optimal mix of macroeconomic policies.

Orange lines raise suspicions and risk impermissible actions. Yet, they should be dealt with flexibility considering the specific functions, context, and coherence with the overall constitutional-democratic regime and political culture in which the concrete ICB is embedded.

Red lines compromise independence and the integrity of central banking and should be staunchly repudiated.

The framework of pluralistic CBI offers a methodology and criteria to draw the boundaries of (in)admissibility of influences, accounting for the necessary adaptation to the political and institutional regime and culture of each economy, but without degenerating into relativism, where complex cases could be decided in any direction with the excuse of changing contexts and at the whim of dominant interests.

The current inflation burst offers an opportunity to test and apply this new model of pluralistic CBI.

## 1.2. (EXTERNAL) CHANGES IN CONTEXT

Traditional CBI triumphed in the macroeconomic context of the so-called Great Moderation that prevailed in many advanced economies between the mid-1980s and 2007. It was a period of low inflation and positive economic growth, stability, and reduction of economic shocks compared to the past's large boom and bust cycles. Public and global debt was on a steady rise, but interest payments as a share of government budgets remained stable or declined because real interest rates persisted below real growth rates ( $r < g$ ).

Economists have generally proposed three reasons for this context of macroeconomic stability: changes in the structure of the economy, sound policy, and good luck<sup>8</sup>.

The Global Financial Crisis (GFC) marked a break in this economic context. This transformation was deepened by the alternation between acute crises (Eurocrisis and the pandemic) and episodes of low-growth recoveries or contraction, with declining and even negative nominal and real interest rates, low inflation and even some periods of deflation<sup>9</sup>.

Since the 1980s, public debt stocks and ratios have been increasing significantly, reliant on the steady decline of long-term interest rates. However, public and global debt rose dramatically with a sudden spike after the financial crisis in 2008 and an even larger one during the beginning of the pandemic in 2020 due to extra public spending to support households and businesses in the two crises on top of an older trend of fiscal profligacy<sup>10</sup>. Private debt also increased to historical highs<sup>11</sup>.

Even though low-interest rate-growth differentials and high government debt ratios to GDP are not new, the post-GFC period registered a further decline in interest rates, with meager and even negative nominal interest rates and neutral real interest rates on a significant downward trend in many economies<sup>12</sup>.

Sluggish growth and subdued inflation persisted despite macroeconomic policy activism, continuing expansion of CBs' balance sheets, and interventions in financial markets, exposing macroeconomic policies' difficulties in stimulating the economy and achieving targets. This cast doubts on the continuing effectiveness or diminishing returns of monetary policy in the vicinity of the effective lower bound and over the limits of debt sustainability and budgetary constraint<sup>13</sup>.

---

<sup>8</sup> (BERNANKE, 2004), (HAKKIO, 2013).

<sup>9</sup> (GOODHART, 2015: v).

<sup>10</sup> (IMF, Historical Public Debt Database, 1800-2015), (IMF, Global Debt Database, 1950-2018), (MBAYE, MORENO-BADIA & CHAE, 2018), (LASTRA & GOODHART, 2018), (GASPAR, 2020), (REIS, 2022), (GASPAR & PAZARBASIOGLU, 2022).

<sup>11</sup> *Idem*.

<sup>12</sup> *Idem*.

<sup>13</sup> (BLANCHARD, 2019), (REIS, The Constraint, 2020).

The financial sector had gone through a profound transformation in terms of greater size, risk and interconnectedness, more lending, global expansion, an increase of dollar reliance, longer financial intermediation chains, shift from traditional funding by retail depositors to shadow banking and interbank wholesale short-term funding (through repos and borrowing in unsecured interbank markets), and deregulation.

Financial risks were amplified by the rise of the (much) less regulated shadow banking, massive CBs' interventions in financial markets that created hypersensitivity and silenced or distorted market-signaling and discipline mechanisms, and the emerging "critical macro-financial role" of sovereign bonds, which CBs purchased to anchor inflationary expectations and stabilize the inherently fragile market-based financial system. Their issuance became like a "collateral factory," creating the sovereign-bank diabolic loop risk<sup>14</sup>.

Consequently, the period since 2007 also witnessed the return of financial instability. After less than two decades of the 21<sup>st</sup> century, the world was ravaged by a series of crises and shocks: a financial crisis of a rarely-seen magnitude and a once-in-a-century pandemic that froze economies and markets followed by an inflation burst that generally raised prices at a pace unseen for over three decades.

Between these crises, European economies were shaken by a sovereign debt crisis (Eurocrisis) that almost destroyed their single currency and spilled over beyond that continent. CBs played a major role in not only responding to these crises but (at least in part) in causing them.

Massive state interventionism in response to the crises and particularly the pandemic, coupled with the feeling that price stability concerns had moved gradually to the back seat in the course of three decades (until mid-2021) and that fiscal constraint was relaxed by historically low-interest rates and a greater appetite for safer assets in the face of more significant financial instability, nurtured political and academic efforts to expand the boundaries of public intervention and the politicization of post-pandemic economy<sup>15</sup>.

On the other hand, greater state power and political intervention come with aggravated risks of interest-group capture of such state power and markets potentially more inefficient and afflicted by distortions and moral hazard from state interventions, zombie companies, and obsolete jobs. In currency areas with a single monetary policy, such as the Economic and Monetary Union (EMU), heterogenous economic and inflation conditions complicate the task.

The succession of multiple crises and shocks caused or accelerated significant political and economic consequences. Distress and distrust confronted quintessential Western value choices

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<sup>14</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016, 157-164), (GABOR, 2021).

<sup>15</sup> On the heterodox "Modern Monetary Theory" (KELTON, 2020).



such as liberal democracy, open societies, and globalization<sup>16</sup>; the Euro and the European Union trembled but did not fall, populists rose across the world, but they did not dominate (yet)<sup>17</sup>, and state interventionism in the economy and other dimensions of social life expanded, but (at least for now) market-based capitalism is still predominant. In addition, the balances of power in international relations seem to be changing; and digitalization has exploded bringing dramatic opportunities and risks.

### **1.3. CHANGES IN CENTRAL BANKING**

During these transformations, CBs emerged as leading actors in advanced economies and societies, with more powers, more influence, and more economic and political centrality<sup>18</sup>, while keeping their not-so-old independence credentials.

This combination of the two trends of rising *power* and *independence* in macroeconomic policies generated discomfort and the question of whether they could be reconciled.

Looking back, CBs became independent before becoming so powerful. In the first stage of their history, from the 17th century until World War I, CBs were significantly less powerful and most still privately held.

In the second phase (WWI-1970s), most were created as public institutions or nationalized under the government's dependence.

In the course of their histories, CBs pursued various missions, from monopolizing note issuance to being bankers of banks and governments, periodically managing crises and acting as lenders of last resort, financing government spending (on wars or for fiscal stimuli) or implementing controlled exchange rate regimes until the 1970s.

Even though claims and doctrines of independence had emerged as early as the 1920s<sup>19</sup>, and the Fed and German Bundesbank had earned significant autonomy since the mid-20th century, it was only during the third stage, 1970s-2007, that CBI spread globally and gradually.

CBI triumphed as a context- and mission-specific institutional device<sup>20</sup>, in a certain economic context (of inflationary pressures), conceived for a particular function (monetary policy), motivated by a specific goal (internal monetary stability or inflation control<sup>21</sup>) and a normative justification (alleged superiority in dealing with the time-inconsistency problem of monetary policy). CBI emerged as part of a larger policy experimentation with inflation targeting, free

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<sup>16</sup> (MOUNK, 2018), (LUCE, 2017), (LEVITSKY & ZIBLATT, 2018), (FERGUSON, 2020).

<sup>17</sup> (MULLER, 2016).

<sup>18</sup> (BERNANKE, 2015), (EL-ERIAN, 2016), (TUCKER, 2018).

<sup>19</sup> (CHERNOW, 1990), (VALE, 2021).

<sup>20</sup> (BLINDER, 2016: 9).

<sup>21</sup> (MILES ET AL., 2017: 75), (LASTRA, 2015).

capital movements between countries, a shift to fixed exchange rates within Europe, and financial and banking deregulation<sup>22</sup>.

Other functions and societal demands on CBs seemed forgotten, muted, or subordinated to the monetary stability primacy<sup>23</sup>.

Then came the 2007-08 GFC as a turning point, marking the beginning of the fourth historical stage of central banking.

With each crisis and transformation since the GFC, the role of CBs has grown and changed. Further societal demands have been pressed upon them, from the novel issues of climate change and inequality to ancient expectations that they may stabilize, stimulate, and even fine-tune the financial system and the real economy. Their policy responses to the GFC and the Eurocrisis were transformative. With the pandemic, they “cross[ed] a number of previous red lines to restore stability during this crisis”<sup>24</sup>.

The pandemic brought new levels of coordination between independent and fiscal, domestic, and foreign policymakers and further explosions in outstanding debt levels and CBs’ balance sheets. CBs challenged previous operational assumptions by deciding to “*go direct*” and *targeting* groups of companies and households (and certain Member States in the EMU or subnational governments in the USA) with large-scale purchases of various asset classes, including government securities and in some instances, bypassing the gatekeeping and transmitting roles of financial institutions<sup>25</sup>.

The transformations in the external context and the internal rules and practices of the “new style central banking”<sup>26</sup> entailed an “extraordinary exercise and accumulation of power by central banks”<sup>27</sup>.

They have risen along three dimensions: by the absolute expansion of powers, relative increase of power or centrality, and ascent and metamorphosis of their public standing (or *perceived* power position).

First, CBs grabbed and “have been handed greater responsibilities than before the [Global Financial] crisis”, when “central banking seemed rather simple” with essentially a “single objective – price stability – and a successful framework within to make decisions on interest

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<sup>22</sup> (KING, 2016: 22, 207-9), (MUNCHAU, 2020).

<sup>23</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016: 157).

<sup>24</sup> (BIS, 2020), (MARSH, 2020).

<sup>25</sup> (BARTSCH ET AL., 2020).

<sup>26</sup> (HALL & REIS, 2015).

<sup>27</sup> (TUCKER, 2018: 6-8). Differently, (SKIDELSKY, 2018: 219).

rates – inflation targeting”<sup>28</sup>. Since then, CBs have embraced more functions, objectives, and competences<sup>29</sup>, both in crisis and recovery times.

They took financial stability on their shoulders<sup>30</sup>, acting as banks’ lender of last resort (LOLR), dealer or market-maker of last resort<sup>31</sup>, LOLR to the non-financial sector and promoter of “favorable financial conditions” in credit markets<sup>32</sup>.

They took up roles of macro- and microprudential regulation and supervision, and banking resolution powers.

They (indirectly) supported governments’ funding conditions. By adding to demand and absorbing the supply of government bonds, CBs pushed up prices and so lowered interest rates. CBs were supporting both banks, many asset holders, and governments.

Not yielding to the prospect of diminishing returns of monetary tools and the proximity to the effective lower bound and committed to stabilizing markets or improving real economic variables (employment, growth), CBs innovated their toolkit. They implemented unconventional monetary policies of quantitative and credit easing, negative interest rates, long-term lending, and forward guidance, along with a drastic change in the communications strategy<sup>33</sup>.

Asset purchase programs and collateral management expanded to a broader range of securities, involving choices amongst agents and regions, with distributional consequences. Many believe CBs moved from monetary policy to credit policy and even to (quasi-) fiscal policy<sup>34</sup>. Insatiable insiders and outsiders have called upon CBs to pick up additional goals, such as fighting climate change, fostering the green transition, or reducing income, race, and gender inequalities.

The dramatic explosion of their balance sheets confirms the expansion of their interventions. Since the GFC, those balance sheets increased significantly in absolute terms, as a percentage of GDP, and in their positions relative to the sizes of markets for financial assets and their respective sovereign bonds<sup>35</sup>.

The balance sheet transformation was also qualitative because of shifts in the collateral management, taking up safe sovereign bonds but also a host of riskier assets, including subnational bonds and sovereign non-grade investments, mortgage-backed securities, corporate, ETFs and junk bonds, and even loans to “Main Street”.

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<sup>28</sup> (KING, 2016: 207-9).

<sup>29</sup> Goals and tools, in economists’ lexicon.

<sup>30</sup> (LASTRA, 2015: xv).

<sup>31</sup> (MEHRLING, 2011: 119-123), (BERNANKE & YELLEN, 2020).

<sup>32</sup> (LANE, 2021).

<sup>33</sup> (STRACCA, 2018).

<sup>34</sup> (GOODFRIEND, 2012), (BRUNNERMEIER, JAMES, LANDAU, 2016: 373), (BERNANKE & YELLEN, 2020).

<sup>35</sup> (MEHRLING, 2011: 2), (KUMHOFF ET AL., 2020), (REIS, 2017: 17).

The increasing share of financial assets, particularly government bonds, held by CBs due to their unconventional monetary policy actions demonstrated their centrality, which could become a source of both leverage and vulnerability.

Second, while CBs were amassing more power and deploying massive monetary support to the faltering economies, other political and macroeconomic institutions fell behind in the efforts of stabilization and recovery for most of the past decade up to the pandemic crisis.

The inertia of political authorities might be explained for reasons as different as conviction (fiscal conservatism in the USA, German ordoliberalism, and liability-focused economic philosophy<sup>36</sup>), lack of powers (in the EU, the lack of institutionalized coordination of fiscal policies and the incompleteness of the EMU), political, moral hazard<sup>37</sup>, blame-shifting, or dysfunctionality and partisan polarization amongst fiscal policymakers and in the political process.

Incapable or unwilling to resolve conflicts, political branches made a tacit decision to delegate macroeconomic stabilization and governance to CBs.

As a result, CBs gained an unprecedented centrality in the macroeconomic and political spheres that earned them the epithet of the “only game in town”<sup>38</sup>.

Central bankers were cautious about this new centrality, regularly exhorting political authorities to act decisively on fiscal policy and structural reforms and alerting on the insufficiency (due to diminishing effectiveness) or inadequacy of their monetary policy tools.

When Covid-19 struck, those calls resounded, and the severity and different nature of the crisis – a homogenous, external shock that weakened liability and moral-hazard arguments – prompted a more balanced macroeconomic response.

Fiscal authorities on both sides of the Atlantic acted more quickly, forcefully, and coordinated than before, as if they had learned the lesson. In the US, Biden’s Administration deployed successive rounds of fiscal support exceeding a quarter of the country’s GDP in less than two years<sup>39</sup>. In Europe, there was a combination of Member-States’ fiscal reliefs of very different relative sizes and compositions (e.g., immediate fiscal impulses, deferrals, and other liquidity or guarantee fiscal measures) and the EU Recovery Package of unprecedented size that deepened fiscal integration through the creation of an ad-hoc insurance and joint stabilization initiative to be partially financed by joint debt and the EU’s “own resources” (i.e., new European broad taxes and contributions).

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<sup>36</sup> (BRUNNERMEIER, JAMES, LANDAU, 2016).

<sup>37</sup> *Idem*, (ISSING, 2018: 337).

<sup>38</sup> (EL-ERIAN, 2016).

<sup>39</sup> (ALPERT, 2021).

The post-pandemic inflation burst confirmed the persistence of a world where both fiscal and monetary authorities are committed and active in policy interventions, but this time in opposite and possibly conflicting directions.

On the one hand, fiscal policymakers focused on minimizing social and economic pain from high inflation and protecting demand, at least for the most vulnerable groups. They often adopted broad-based fiscal support measures, including tax cuts, subsidies, and price rebates.

People and policymakers got used to such activism. Despite long-term risks and record levels of public debt accumulated over the past decade<sup>40</sup>, the surprising rise of prices generated an inflation tax that offered immediate relief from fiscal constraint and reduced the real value of governments' debt burden in the short term. The claim that price stabilization is a job for CBs justified the persistence of fiscal activism.

CBs, on the other hand, and now for different reasons, are again under the spotlight. This time their drive is to restrain aggregate demand and, thus, inflation.

After overcoming their initial inertia, they shifted language and actions, dropped earlier promises of a "soft landing" and "immaculate stabilization", and even expressly embraced the risk of overreacting and causing more economic contraction and pain than necessary. At different (belated) paces, all CBs of advanced economies but the Japanese have embarked on a quick succession of interest rate rises and, at least some, engaged in quantitative tightening. While the extent and consequences of such policy reversal are yet to be known, it is already threatening economic contraction and their financial results and equity. They are active, and their role in macroeconomic governance and societal life is undeniable.

The incongruence of concurring fiscal and monetary activism only confirms that the centrality of CBs is here to stay.

Third, over the past decades, CBs grew in power but also in their status in the eyes of the public, who became increasingly aware of their existence, power, and influence, and gave their leading figures celebrity-like status<sup>41</sup>. In a short period, they went through a dramatic metamorphosis "from mystery and mystique to transparency and openness"<sup>42</sup>.

True that by the end of the 20th century CBs' public standing had already risen to unprecedented levels<sup>43</sup>, as they were praised for taming the 1970s inflation and leading advanced economies out of stagflation into two decades of Great Moderation<sup>44</sup>.

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<sup>40</sup> (NEELY, 2022).

<sup>41</sup> (BAXTER JR., 2015: vii), (STRACCA, 2019: 1).

<sup>42</sup> (KING, 2016: 208), (BLINDER, 1998: 75).

<sup>43</sup> (BLINDER, 1998).

<sup>44</sup> (KING, 2016: 22).

True, also, that in the earlier years after the GFC, central bankers were blamed for a double fault: first, as accomplices in the build-up to the GFC for not curbing reckless lending and excessive financial risk-taking, and even facilitating the formation of the asset bubble through their easing monetary policy stance; next, as co-deciders of enormous unpopular bailouts to financial institutions affected by the crisis<sup>45</sup>. Their performance in the post-GFC recovery was also criticized, either for doing too much or too little<sup>46</sup>.

However, as a sequel to the Great Depression was avoided, and monetary authorities were left, for most of the time, alone fighting for the post-GFC recovery, their reputation and public trust gradually rebounded<sup>47</sup>. Anew “[a]fter the outbreak of Covid-19, CBs won acclaim for swift and significant action to stave off breakdown by providing much-needed liquidity at low or negative interest rates. Just as after the 2008 financial crisis, central bankers were heroes”<sup>48</sup>. The post-pandemic inflation burst is likely to open a new and intense chapter in the relationship between CBs and the public as they are brought even more to the forefront of economic, political, and public debates. They are being scrutinized, blamed, and scapegoated for their contribution to the rapid rise in inflation and their belated, weak, or excessive policy responses. History is still to pass the verdict on the path of this inflationary episode, its cyclical and structural determinants, and the relative contributions of the distinct policymakers.

It should be expected that the unpopular rise of interest rates will spark public contestation, which will increase with the severity of the economic contraction and the penalization of household mortgages and business credits.

Yet, the experience of VOLCKER’S Fed shows how dramatic medium-term unpopularity might eventually lead to long-lasting, deep admiration.

The metamorphosis of CBs into the open was promoted both from the inside and outside. Insiders understood the effectiveness and legitimacy gains from openness and turned transparency and communication from sources of anxiety into an essential monetary policy tool, with forward guidance as its apex.

Outsiders, elected officials, and civil society from various ideological corners and with different motivations pressured for more transparency and public accountability of CBs.

Public prominence adds a layer to monetary authorities’ absolute and relative power expansion. It is a source of power, particularly in money, finance, and economics, where confidence, trust, and expectations are fundamental parts of that machinery.

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<sup>45</sup> (BERNANKE, 2015, 90-91, 100), (KING, 2016).

<sup>46</sup> (EL-ERIAN, 2017: 94), (BUCHANAN & DORF, 2016).

<sup>47</sup> (EL-ERIAN, 2017: 31-58), (LAGARDE, 2013), (BRUNNERMEIER, JAMES, LANDAU, 2016: 314, 372).

<sup>48</sup> (DE LAROSIÈRE & MARSH, 2021).

But the *perception* of CBs' centrality is also a source of vulnerability that may degenerate into institutional overburdening that would weaken the effectiveness of monetary policy and the credibility of CBs<sup>49</sup>.

In DYSON's language, the power of CBs has grown in both individual dimensions concerning their most iconic leaders, relational and structural, namely in their impact on dominant economic policy beliefs and markets' performances and influences<sup>50</sup>.

The hypothesis of the rise of CBs is disputed in two accounts. Positively, their centrality is questioned, as their impact on *real* variables and visibility would still leave them with "second division status", with the (earlier stages of the) pandemic crisis demonstrating how other policymakers – healthcare and fiscal – have more prominence and visibility<sup>51</sup>.

Normatively, their accrual of power had opposition from different ideological corners as being undesirable<sup>52</sup>, leading to some frequently unsuccessful initiatives to curb their powers<sup>53</sup>.

Nonetheless, this expansionary trend seemed to garner political support. Despite the criticism of their alleged supervisory failure in the run-up to the GFC, elected politicians decided to grant them more financial supervision powers.

Aware of the delicacy of these novel times and positions, central bankers launched reviews of their monetary policy frameworks that ended as exercises of justification (and structuring) of their expanded roles.

CBs grew in power and influence over the past two decades but essentially maintained their independence.

There are no signs of deterioration of *de jure* independence. While assessments of *de facto* independence in advanced economies vary, there are solid claims that it might have strengthened or at least not weakened<sup>54</sup>.

Even though it is too early for a verdict, CBs' (belated) reaction to post-pandemic inflation shows some signs of enduring independence.

There are calls, in both directions, for the moderation of the other's policy stance.

This incongruence so far seems a good indicator of the solidity of *de facto* CBI. Only time will tell whether any side will change course or whether their coordination will improve, even if they agree to disagree.

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<sup>49</sup> (ISSING, 2018), (MUNCHAU, 2020).

<sup>50</sup> (DYSON, 2009: 16).

<sup>51</sup> (GILES, 2020).

<sup>52</sup> (BUCHANAN & DORF, 2016), (BRUNNERMEIER, JAMES & LANDAU, 2016: 372).

<sup>53</sup> RON PAUL's "End the Fed" (2009) and RAND PAUL's, "Audit the Fed". (DESAN & ORIAN PEER, 2020).

<sup>54</sup> (BLINDER, EHRLMANN, DE HAAN & JANSEN, 2017: 742), (BODEA & HICKS, 2015), (DE HAAN & EIJJFINGER, 2017). Suggesting *de facto* deterioration (MAS ET AL., ii, 2020), (LASTRA, 2015: 140), (MACCHIARELLI ET AL., 2020), (WACHTEL & BLEIJER, 2020: 106).

External and internal transformations and this new equilibrium of more powerful and independent central banking create, increase, or further expose complex cases for the institution of CBI. They swell unsettled disagreements about the trade-offs within and between some of the multiple mandates of CBs and evolving public preferences about the macroeconomic objectives. They intensify the distributive impacts, substantive political character, and public contestation of CBs' options. They expose the "macro-politicization" of modern central banking, in the sense of increased salience, decisiveness, or overall influence of unelected CBs in the direction or outcomes of public policy, and particularly of macroeconomic policy stance. In addition, they can expose its "micro-politicization," when CBs – more so in unconventional monetary policies, credit policy, and crisis management interventions – make value-choices, judgments with distributional impacts, and decisions on complex unsettled issues that would allegedly belong to the purview of elected decisionmakers. These transformations confirm that policymakers are under a broader competition of influences that include but go beyond electoral and partisan politics.

Crises and emergencies bring radical change to the world, extreme uncertainty about the outcomes, and threats to vital national interests and identity (by war, pandemics, or severe economic and social deterioration) that challenge the accepted (hierarchy of) objectives assigned to CBs and the distribution of powers amongst public authorities.

These complex cases may involve closer interdependence, interaction, and varying forms of coordination with political authorities and market agents, and they undoubtedly increase the politicization of ICBs.

The traditional view is that coordination entails subordination, and politicization overstretches and vests ICBs with roles of a different nature: improper political roles<sup>55</sup>. Both are incompatible with the traditional version of CBI and its tight conditions of democratic legitimacy.

The traditional model of CBI is not fit for this new equilibrium and complex cases<sup>56</sup>.

Alternative critiques propose exiting this equilibrium in very different directions. Some offer little more than resignation about the twilight of CBI<sup>57</sup>. Others want to abandon independence as a condition to maintain the increased powers and inherent possibilities of macroeconomic management (and stimulation) through CBs<sup>58</sup>.

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<sup>55</sup> (CALHOUN, 2002), (FERNÁNDEZ-ALBERTOS, 2015), (TUORI, 2015: 23-4), (TUCKER, 2018), (TORTOLA, 2020), (MARSH, 2020), (MACCHIARELLI ET AL., 2020).

<sup>56</sup> (TUORI, 2015: 195-6).

<sup>57</sup> (JAMES, 2012: 15), (MARSH, 2020, announcing "the end of ICBs"), (WACHTEL & BLEIJER, 2020: 106).

<sup>58</sup> (SKIDELSKY, 2018: 360), (JACKSON, 2020).



Contrariwise, others propose reversing the recent “over-expansion” of power to return to a model of “narrow central banking” and the purported “purity” of the classic case for CBI<sup>59</sup>.

Among those that acknowledge the cha(lle)nges but allegedly continue to support CBI, some propose unrealistic “two-track central banks”<sup>60</sup>. In contrast, others propose increasing accountability as a complement or a corrective to independence which is not entirely satisfactory<sup>61</sup>.

The solution is different: a new model of CBI for this new equilibrium where central banking is both independent and more powerful and political in the sense of making substantively political choices under conditions of public contestation.

In fact, such accumulation of power and centrality of authorities independent from political sovereigns is not new in modern states and even in liberal democracies. It occurred in realms of social life as important for collective control and sovereignty as religion, the judiciary, and to a lesser degree, the military. It also emerged in microeconomic or sectoral administrative regulation, and more recently, it is erupting in financial and fiscal policies<sup>62</sup>.

The challenge is to demonstrate that this pluralistic CBI is a superior institution for the governance of money and credit than the classic political process and other alternatives.

The foreseeable future seems to bring further cha(lle)nges that will test the robustness of the model and its framework.

#### **1.4. FURTHER CHANGES AHEAD**

“We are not at the end of history in central banking” and “central banks are bound to keep on changing in the future”<sup>63</sup>.

Three foreseeable trends promise further difficulties and disruptive impacts on the current equilibrium of powerful, political, and independent central banking: (i) the evolution of the macroeconomic context with the unfolding of the recent inflation burst; (ii) the digitalization of money; and (iii) a further rebalancing and deterioration of the international political and monetary orders.<sup>64</sup>

Post-pandemic inflation is at historically high levels, unseen for over three decades in advanced economies, but possibly past its peak. ICBs have moved into the anti-inflationary offense after their initial inertia, and there are signs that the economic contraction induced by the steepest and fastest interest rate rise on record might not be as deep as previously expected.

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<sup>59</sup> (TUCKER, 2018), (GOODFRIEND, 2001 and 2012), (BUIITER, 2014).

<sup>60</sup> (GOODHART, 2011), (ISSING, 2018: 338).

<sup>61</sup> (LASTRA, 2015), (CONTI-BROWN, 2016), (VAN’T KLOOSTER, 2020 ), (BALLS, 2020).

<sup>62</sup> (TUCKER, 2018: 2-4, 444).

<sup>63</sup> (STRACCA, 2019: 16), (LASTRA, 2015: 33).

<sup>64</sup> (LEITÃO AMARO, 2022a, for references and details).

Still, there might be distinct alternative futures, with different consequences for CBI.

In the short term, ICBs will face very hard choices with significant distributional impacts. As the interests of the distinct groups increasingly clash and economic and social pain grows, the public contestation and politicization of central banking will rise. Different alliances, for and against ICBs, will form.

The outcome of this anti-inflationary campaign will certainly be a litmus test on CBI.

Critics will see a vindication in worst-case scenarios (e.g., stagflation or persistent high inflation, economic depression, financial crisis), and there will be calls for institutional reform, either scaling-back central banking to a narrower role or for unitary and subordinated macroeconomic governance.

Relative success will reinforce ICBs' legitimacy and be described as the maturation of a new style of central banking.

In the long run, the post-inflation macroeconomic context might be challenging for CBI, even if inflation is tamed. It will depend on where the crucial variables, debt, growth, and interest rates, stand and the depth of the economic and financial scars left by the high inflation and the policy-induced contraction in terms of growth potential. ICBs will remain under conflicting pressures regarding their policy stances and interaction with other macroeconomic policies.

The digitalization of money is another trend that may have a seismic impact on the centralverse. Cryptocurrencies, normal or global stablecoins, and DeFi offer exciting opportunities but also serious risks and costs. They have the (disputable) potential to disrupt the existent model of provision and governance of money and credit.

ICBs understood the risks and are responding through a combination of defensive regulation of private initiatives and preparation for their own central bank digital currencies (CBDC).

The race between different technologies and designs is hot, and the outcome is uncertain, ranging from (a) *full* decentralized currency competition to (b) *centralized and foreign externally dominated systems* (with a few global stablecoins or foreign CBDCs), (c) a model of *centralized monetary sovereignty with a widespread domestic retail CBDC*, or (d) an *upgraded digitalized version of the current two-tier hybrid monetary system*.

Scenarios (a) and (b) would empty domestic ICBs and monetary sovereignty (and greatly empower the issuers of the dominant digital currencies), scenario (d) would preserve the existent equilibrium, and (c) would dramatically increase the power and politicization of central banking.

Direct retail CBDCs would allow more targeted monetary policy interventions, aggravating the potential distributive effects of the CB's decisions and the potential for public contestation. It would likely overburden ICBs, pushing them beyond their prototypical realm of expertise and

specialization and augmenting the temptation from external influences. It would certainly call for a more comprehensive framework of CBI.

A third troubling prospect is the rebalancing and deterioration of the international political and monetary orders towards a multipolar (or non-polar) world, with a possible dilution of the US dollar's "exorbitant privilege" and increasing financial fragmentation with restrictions on capital flows and exchange rate regimes.

Some reversal of globalization and international institutional cooperation may be underway, along with a weakening of the rules-based order, growing threats of currency wars, competitive devaluations, and financial sanctions.

The future is uncertain, but the system may reshape the conditions for and of monetary policy independence. Globalist dreams are more unlikely; the rise of autocratic potencies such as China, without CBI or liberal democracy more generally, will push the world towards politically dominated monetary and financial policymaking. The triumph of digital currencies may open the door to foreign dominations or alternatively to the preservation of monetary sovereignty through a network of CBDCs issued by highly interdependent CBs.

A solid framework of CBI that structures, legitimizes, and gives credibility to interactions, coordination and internalization of international macroeconomic spillovers and interdependencies might be able to contribute to avoiding the worst and assist in better outcomes for the international (re)order.

### **1.5. OUTLINE, THE DEFENSE OF A NEW MODEL OF PLURALISTIC CBI**

This dissertation tries to reconstruct the case for CBI considering the recent and foreseeable transformations in the external, societal and macroeconomic contexts and internally in central banking.

It evolves through the reanalysis of four fundamental questions: *What is CBI?*; *Independent from whom?* *How independent are CBs?*; *Why CBI?*; and finally, *How should CBI be protected?*.

Chapter 2 sets the stage for the reanalysis of CBI. First, it clarifies the fundamental constitutional option for a balanced separation of powers as a fundamental principle of the general structure of government and the distribution of macroeconomic powers, of which CBI is a manifestation. Second, it presents a realistic description of central banking in action, with incomplete mandates and real central bankers that are only humans with epistemic limitations, constrained and manipulatable utility functions of preferences and interests, beautiful heterogeneity, and willingness to strategize and compromise. It further discusses whether they exhibit systematic patterns of preferences.

Part II is dedicated to the questions of what CBI is, and from whom.

Chapter 3 critically re-examines both the traditional concept of CBI as strict insulation from politics, and alternative, remedial modifications such as the “operational independence”, “interdependence”, and “accountable independence” views. It concludes by redefining CBI as integrity of a specialized government process, which is the art and science of central banking, and by offering the new concept and model of pluralistic CBI, which is the main original contribution of this dissertation.

Chapter 4 explains that CBs ought to be independent, not only from partisan and electoral politics, but also from other relevant Influencers. Here the public, the judicial branch, the epistemic community of central banking, special affected interests, and particularly the leading financial actors are prime suspects. Leaving any of these Influencers unattended and unchecked would risk the substitution of biases or dominances.

It further explains that these Influencers engage in meaningful bidirectional interactions and interferences with ICBs that can either protect or limit the latter’s independence and powers. In this sense, they can be either friends or foes of CBI.

This more careful consideration of the influences and relations with a broader range of relevant Influencers offers the surprising revelation of a normatively valuable pluralistic *competition of Influencers* where their interferences check and balance out each other.

Part III analyses the position of ICBs in politics.

Chapter 5 detail the multiple channels of political control over central banking, directly by the People and indirectly through their Democratic Representatives (DRs) via the electoral-representative process. It analyses how the classic political branches exercise *ex-ante* guidance or signaling and *ex-post* accountability over ICBs, to conclude that there is a *good enough democratic control* overall, therefore rejecting the mutation into a technocracy.

Chapter 6 discusses the politicization of modern central banking. It concludes that CBs are independent and political, can and do make substantive political decisions, operate under conditions of public contestation, and are in bidirectional relation of mutual interferences with DRs and their electoral-representative process.

Part IV responds normatively to the questions of why CBI, and how should it be protected.

Chapter 7 presents the core normative justification of pluralistic CBI based on the comparative institutional analysis that demonstrates that it is superior to other institutional alternatives for the governance of money and credit, in particular the classic electoral-representative process and traditional strict CBI.

It recharacterizes the classic electoral-representative process in realistic terms, and explains the conception of liberal democracy that is assumed as background for the multi-level comparative analysis.

The superiority of pluralistic CBI is based on three comparative advantages: the first is epistemic, stemming from ICBs' specialized expertise and functionality; the second is their democratic advantage of balancing majoritarian control with stronger unpartisan democratic politicization; the third is their impartiality defined as non-domination, more balanced representation and mitigation of systematic majoritarian and minoritarian biases in macroeconomic policymaking. Output-based arguments reinforce the superiority of pluralistic CBI, described as a governance model of, by, and for the People, in all seasons.

Chapter 8 draws on 18 lessons that emerged from the normative analysis to broaden and upgrade the framework of pluralistic CBI through a combination of defensive protections of CBI and solutions that structure and mobilize the competition of Influencers that also has a protective effect. It presents 67 protections of CBs' institutional, personal, financial, and organizational independence.

Part V concludes.

## **1.6. A FEW METHODOLOGICAL CONSIDERATIONS**

A few methodological considerations are due before proceeding.

First, on the scope of the institutional analysis. Substantively, it focuses on macroeconomic governance, primarily monetary and financial policies whose governing processes have converged.

Chronologically, it concentrates on the period since the 1980s when CBI rose dramatically, particularly the transformations since the GFC of 2007-08.

Geo-politically it is circumscribed to advanced western economies with liberal democracies. Special comparative attention is dedicated to three of their ICBs with somehow different models of CBI and of systems of government: the Federal Reserve System of the United States of America (Fed), the European System of Central Banks (ESCB with its ECB), and the Bank of England (BoE). Emerging economies and different political regimes would entail different positive and normative conclusions.

Second, it assumes the main features of the political and macroeconomic regime of the chosen time and place: a model of liberal democracy, a resisting but fragile process of European integration, a monetary constitution with a two-tiered or hybrid money system with public outside and private inside money under public discipline<sup>65</sup>, an external regime of essentially free capital movements and flexible exchange rates with high levels of international financial integration, and in Europe an incomplete and minimal monetary union with a common currency<sup>66</sup>.

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<sup>65</sup> (BOCAN ET AL., 2020).

<sup>66</sup> (BRUNNERMEIER, JAMES & LANDAU: 210).

Third, the inquiry is methodologically interdisciplinary, building on insights from literature and academic debates in law, economics, political science, and political theory. As the problem and solutions are beyond the scope of any of those disciplines, the option is to integrate different information, data, techniques, tools, perspectives, concepts, and theories from various research areas. The advantages of integration weigh more than the benefits of disciplinary purity.

Fourth, the inquiry combines normative and positive analyses. Presenting an original institutional model on realistic grounds demands the integrated use of both approaches.

Fifth, the normative inquiry adopts the method of comparative institutional analysis that is explained and then implemented in Chapter 7, because institutions “should be evaluated not against some unspecified ideal of a perfect social order but against the feasible alternative systems of ordering social relations”<sup>67</sup>.

Even though the institutional “choice is always a choice among highly imperfect alternatives”<sup>68</sup>, there is a scientific and normative duty to improve the framework to mitigate such imperfections and constantly reinforce the comparative advantage over the alternatives.

Eight, positive institutional analyses and normative prescriptions are not made in a vacuum, with clean slates. They must ponder the positive conditions, contexts, path dependencies, political and legal regimes, and political culture the institution would inhabit<sup>69</sup>.

Yet, such context-dependence does not mean relativism.

Despite its regime adaptability, context-flexibility, and orange lines, pluralistic CBI is not a system of blurred, grey lines. A solid institutional model is discernible by defining traits, and it must offer a methodology and criteria to draw the boundaries of (in)admissibility.

That is the challenge for the ensuing chapters: to combine a realistic, positive analysis of modern central banking and its tensions and relations with an inquiry into the normative justification, conditions, and limits of that pluralistic CBI and, accordingly, with an outline of the upgraded framework of CBI.

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<sup>67</sup> (I. SHAPIRO, 1999: 16).

<sup>68</sup> (KOMESAR, 1994: 5, 2, 30).

<sup>69</sup> (LASTRA, 2015: 32).

## 2. SETTING THE STAGE

The inquiry into CBI requires two brief preliminary clarifications: on the model of distribution of (macroeconomic) powers, and on the realistic description of central banking in action.

### 2.1. CONSTITUTIONAL CHOICE FOR A BALANCED SEPARATION OF POWERS

CBI is an expression of the constitutional choice of modern liberal democracies for a *balanced separation of powers* as a fundamental principle of the general structure of government and the distribution of macroeconomic powers.<sup>70</sup>

The normative justification for such constitutional choice is that it serves the highest values of liberal democracy: liberty, efficiency, and, ultimately, democracy, combining the principles of limited government and functional specialization with the effective and democratic exercise of public power.

It is an intermediate alternative to a unified government with concentrated powers and a strict division of insulated functions.

This model of separation is neither complete nor strict but partial or balanced. It demands structural differentiation and protection of the functional core of each power from another's encroachment but allows mutual control and limited intervention in others' functional realms.

It creates a Madisonian system of checks and balances that accepts a degree of coordination without subordination between public policies, implying "continuous communication and incessant negotiation between the powers."<sup>71</sup>

It goes beyond the classic tripartite separation of legislative, executive, and judicial powers.

It requires functional, institutional, and personal separations materialized in: (i) the fragmentation of power per distinct institutional centers according to the respective functional specialization; (ii) the adoption of procedural or organic mechanisms to broaden and rationalize the inputs into decision-making; and (iii) the delegation of powers to independent agencies insulated from politics and other factual powers.

This fundamental principle of balanced, functional, and institutional separation of powers also applies to macroeconomic governance.

To warrant the separation, fiscal, monetary, and financial policies are divided functionally and institutionally, and an (increasing) choice for the delegation of discretion to independent institutions. CBI is well established in monetary policy and gaining ground in financial policies (alongside other independent supervisory agencies), and IFIs are timidly emerging in fiscal policy.

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<sup>70</sup> (LEITÃO AMARO, 2022b, for references and details on this section).

<sup>71</sup> (MORGADO, 2015: 86-7).

Fiscal policy is assigned to the Legislative and Executive in an eternal struggle for dominance, with the latter being supported by subordinated, professional bureaucracies.

Monetary policy has been entrusted to ICBs, which cumulate multiple functions, instruments, and objectives and often coordinate with political authorities.

Financial policies are spread through often distinct macroprudential, supervisory, resolution, and deposit-insurance functions and authorities. Their connection with individual rights and particular positions makes them the most prone to judicial intervention. Still, they are increasingly shared by political executives and ICBs, as in a “dance of two.”

The separation is balanced, first, by establishing some potential intervention of the three constitutional branches in all macroeconomic policies.

Second, by creating formal and informal channels of dialogue and coordination between policymakers to manage the pervasive domestic and cross-border interdependencies and spillovers between economic, monetary, and financial markets, flows, and policies.

The rise of international interdependencies and cooperation and supranational integration has shifted power abroad or above and affected the internal distribution of powers, hollowing some domestic powers but strengthening the relative role of domestic institutions with better seats at the leading international tables.

Those interdependences and spillovers between macroeconomic policies complexify their differentiation and the delimitation of boundaries the distinct legal competences.

Surprisingly, theoretical elaboration on how to differentiate macroeconomic policies is scarce. Should they be distinguished by who is the acting institution, the effects of the policy, or by the (objectives and tools of the) function?

In the past, the CJEU and the German Constitutional Court (GCC) engaged in a judicial dialogue about those criteria of differentiation.<sup>72</sup>

The GCC was leaning towards the effects of the policies. However, the CJEU imposed a functionalist view that differentiates policies (and legal competences to act) according to the *instruments employed and objectives pursued*, not the effects, actually discounting indirect effects that go beyond the statutory objectives of the policy.

In any case, a perfect clear-cut division of functions and their effects would be artificial, unrealistic, and undesirable because instruments evolve, and policies have multiple complex effects, interactions, and spillovers.

On the one hand, the essential is to preserve each function’s *core* assignment to the respective institution, its self-determination, and the integrity of its functionally specialized decision-making process.

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<sup>72</sup> In the *Pringle*, *Gauweiler*, and *Weiss* cases.



On the other hand, it is necessary to acknowledge that policymakers interact and have mutual interferences, ranging from (i) the ineluctable indirect spillovers and footprints and (ii) strategic interaction to the increasingly intrusive (iii) deontic interferences, (iv) imposition of conditionality, and (v) general policy dominance.

A balanced separation of powers does not reject all those interactions. Instead, it adopts a trivalent approach, where some are prohibited, but others are tolerated and even required, according to the normative values and the concrete checks and balances established in the positive framework. For the separation to be meaningful and the functional core to be preserved, there must be a red line banning monetary, fiscal, or financial dominance alike.

The deontic interferences and conditionality are dependent on respecting, in concrete, conditions of independent decision-making by each of the policymakers.

A complete prohibition of interactions and coordination must also be rejected because the various policies contribute, in(ter)dependently and interconnectedly, to the *mix of macroeconomic policies* and the respective aggregate impact.

There is no one *a priori*, universally optimal policy mix. It depends on the circumstances, the economic theory of preference, the time horizon, and the type of shock if there is a crisis.

But the interdependences become more decisive when policies are closer to their limits of sustainability and effectiveness, even though such limits are dynamic over time, state-dependent, and susceptible to policy innovations.

Transformations such as the fall in real interest rates to the vicinity of monetary policy's effective lower bound, the explosion of debt stocks, and CBs' balance sheets, combined with conditions of low growth and high inflation, increase the challenges for the policy mix.

The contributions of each macroeconomic policy can be divergent or congruent, substitutes or complements, (de)stabilizing or neutral, and the result of independent decisions or explicit coordination.

Congruence is historically rare but still possible without formal coordination. Typically, macroeconomic policies act independently in a non-cooperative game.

However, in various circumstances, the best policy mix possible requires some coordination and explicit management of interdependences.

Even if the alternatives of complete concentration of macroeconomic powers in the hands of a centralized political planner or their strict functionalist separation could work temporarily and seem acceptable in certain states of the world, both would be positively and normatively untenable in the long run and would impose costs of efficiency, welfare, liberty, and democracy that societies are unwilling to bear.

The better alternative for multiple states of the world is the *balanced separation* of functions and authorities that combines the advantages of limited government and functional

specialization with the benefits of mutual checks and balances, structured coordination, and managed interdependencies that improve the macroeconomic policy mix.

## 2.2. CENTRAL BANKING IN ACTION

A rigorous analysis should be grounded in a realistic description of central banking in action. It is all the more important because the traditional defense of CBI relied on myths and fragile assumptions, namely about the completeness of ICBs' delegated mandates, the depoliticization or a-politicity of their functions, and their purported omniscient expertise, objectivity, neutrality, higher-spiritedness, and homogenous conservatism.<sup>73</sup>

On the contrary, real central bankers are only humans with epistemic limitations, constrained but manipulable utility functions of preferences and interests, beautiful heterogeneity, and willingness to strategize and compromise to comply with their incomplete mandates.

Chapter 6 demonstrates that they are political actors, and the following subsections briefly describe and debunk the other common erroneous assumptions about central bank(er)s.

When central bank(er)s exercise the delegated discretionary first-order policymaking – through their *judgment*, (strategic) *choice* of policy and its *implementation* – they are *determined* by competition or conjunction of *external* and *internal* “elements of reason and choice” that render policymakers more than a mechanical production function.

External determinants are the state(s) of the world under uncertainty, institutional constraints, other interferences from the relevant Influencers (political actors, public, courts, epistemic communities, and specially affected interests), and interactions with other macroeconomic policies.

*Internal* elements are the central bankers' ideas or values and interests (jointly, their preferences), and epistemic elements such as information, (specialized) expertise, and rationality with its biases and affective states.

Multiple studies discuss the relative impact of each of the external and internal elements in the policy judgment and choice of ICBs.

Attitudinal theories emphasize the role of individual preferences of central bankers, their ideology (hawks, doves), personal attitudes (swingers, pigeons), and characteristics (gender, stocks of knowledge, status, entrepreneurship).

Strategic theories identify as main determinants rational interests, such as ideological pragmatism, individual or institutional reputation management, power preservation, or effort aversion.

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<sup>73</sup> (LEITÃO AMARO, 2023a, for references and details on this section).

Institutionalist theories underline the role of exogenous rules and institutional constraints, as distinct as the formalistic application of mandate, path dependency, incentive schemes, or constructivist factors (socialization, group norms, and culture).

All theories have important contributions, they are complementary, and none is sufficient *per se*.

### **2.2.1. MYTHS**

This traditional account of CBI is based on a naïve view of the central banking process that: (i) expects too much from the legislated mandates (myths of social consensus and clarity of the mandate); (ii) assumes the possibility of optimal policy solutions through objective, technical expertise (myths of complete information, perfect expertise, and economic rationality of central bankers); (iii) overlooks the manipulability of their own ideas and interests (myth of neutrality), or instead believes in their conservatism – by nature, selection, or contract – or in their higher moral stature above politics; and (iv) oversimplifies their differences and thus disregards the need for internal and external strategizing (myth of homogeneity of central bankers).

However, real central bankers are human, fallible, limited, self-regarding, idealistic, heterogeneous, and strategic.

### **2.2.2. INCOMPLETE DELEGATION**

The assumption of “clear”, “narrow and boring” mandates is elusive. The incompleteness, uncertainty, and ambiguity of democratic mandates are inevitable in practice and under conditions may be normatively acceptable.

A fundamental premise of pluralistic CBI is that ICBs are not endowed with a complete delegation resolving all value choices, and that their delegated discretion involves substantive political decisions, value judgments, “trade-offs about the relative importance of their multiple goals”, and distributional choices. They have “to give tacit or explicit content to vague phrases” and broad concepts,

There are various reasons for ICBs’ receiving incomplete delegations and unresolved political choices: (a) lack of social consensus; (b) epistemic limitations of framers; (c) purposeful or functional abdication by the lawmakers; and (d) supervenient factors and changes, notably (e) crises that are often transformed into opportunities for institutional expansion.

### **2.2.3. EPISTEMIC LIMITATIONS**

Central bankers are neither flawlessly rational nor perfectly knowledgeable, and they do not have complete information, nor perfect expertise.

By disregarding the epistemic limitations of central banking, traditionalists fail to address performance problems, their potential as doors open for external manipulation, and their reputational and delegitimization consequences.

Bringing realism to the claim of the superior expertise of ICBs implies acknowledging their: (i) 'bounded rationality', subject to behavioral biases, namely, groupthink, hubris bias, confirmation bias, loss aversion, hindsight bias, preference bias, and myopia bias; (ii) limited information about the present and future, and (sometimes radical) uncertainty; (iii) imperfect and unsettled scientific tools, models and methods and unresolved technical disagreement about economic theories/methodology, information, interpretations of reality and the mandate, and consequently, on policy alternatives.

Epistemic limitations, uncertainty, and lack of conclusiveness of expert knowledge demonstrate that central banking is a mix of art and science.

The difficulty of the scientific method in policymaking, with its advances by "trial and error", is that in addition to the economic and social costs of the learning process in a field with such centrality and collective salience, it creates a problem of legitimation.

Citizens and specially affected groups are too impatient to stand the costs of transitioning through trial and error, and they are likely to use their agency in the public sphere in other participatory mechanisms.

ICBs will have a hard time using counterfactual reasoning in the public sphere to persuade audiences that their superior expertise has reduced the errors compared to what the political process would deliver.

Paradoxically, the transparency and promotion of the experts' processes and progress may reduce the error but increase public expectations about outcomes.

In any case, the response should not be to abdicate expertise, nor its scrutiny.

ICBs need humility about those epistemic limitations and must invest heavily in improving their specialized expertise and managing public perceptions and expectations about it.

They are institutionally designed for the purpose, and they do so more than any other public institution. They have shown adaptive capacity, learning through past experiences.

But they should better articulate policy alternatives, expose counter facts, organize uncertainty, and educate the public about their outputs, epistemic limitations, and uncertainty.

They should be aware that the epistemic limitations are manipulatable by outsiders.

The latter often seek to exploit asymmetric or otherwise incomplete information to equip ICBs with biased information and proposals or capture them epistemically (when they "listen to the markets", dialogue with large financial investors, fiscal authorities, foreign central bankers and other experts, or when they cater to noise from non-experts).

Influencers may also compromise expertise when they try to promote a selection of ICB officials and staff who are loyal to them, have a home bias or uniform homogenous economic or ideological views, or simply are non-experts or shirkers.

The external and internal socialization of central bankers might be another channel for instilling biased information or perpetuating groupthink and hubris.

#### **2.2.4. CONSTRAINED AND MANIPULATABLE UTILITY FUNCTIONS**

Central bankers are neither angels nor superhumans. They have their own preferences, interests, ideas, and plans that should not be hidden in a “black box”.

They have to be acknowledged and constrained because they can deviate ICBs from better policymaking, and they can be manipulated by external Influencers.

Despite the empirical measurement difficulties and individual diversity, it seems that the typical *constrained utility function* of central bankers is distinguishable, on the one hand, by controlling job security (protected), economic gain (at a limited level), and leisure as non-trivial, and on the other hand, by enabling the worth of recognition, power, and ideational (normative and political) preferences.

In order to avoid political manipulation of the strong job security preference, CBI frameworks establish long tenures, limited possibilities of anticipated removal (only for cause), prohibition or limitation of political reappointment of central bankers, and independent hiring and management of the bank’s human resources.

Economic gain has some importance (less than experts in the private financial sector). Thus, the preference has to be constrained by competitive salaries, prohibition of other forms of compensation, tight regulation of conflicts of interest, and post-employment limitations.

Recognition is typically the most activated preference. Professional reputation is the most regarded modality because it aligns decision-making with the mandate and expert-based processes. Popularity, political recognition, and shorter-cycled variants of social recognition are more suspicious but tend to gain ground when ICBs are more politicized.

The preference for power might explain some of ICBs’ activism but hardly differences in policies. Empirical studies on the existence of ideational preferences – either normative (e.g., hawks vs. doves), partisan or national – offer mixed results on their relative importance but challenge the view that such individual preferences are kept at the door of the committee.

One important conclusion is that central bankers may not be that different from politicians in allowing reputation, power and normative or political preferences to shape their behavior.

They seem more comfortable (and willing?) than expected to deal with growing salience amongst the wide public, heightened scrutiny from political actors, and centrality in making choices with significant economic and social impacts.

Coherently, the revolving doors between ICBs and political offices seem to be on a high. DON BRASH, YELLEN, and DRAGHI are not isolated cases. Seven out of 26 members of the ECB-GC, President and Vice-President included, held prior high-level political offices. This trend reinforces doubts over the distance between the prototypical utility functions of central bankers and politicians.

#### **2.2.5. BEAUTIFUL HETEROGENEITY**

Each group of Influencers uses the tools and channels it can to shape and manipulate the central bankers' preferences over policies.

It is part of a competitive interaction of endogenous and exogenous determinants that results in a heterogeneity of preferences and inevitably, disagreements.

Contrary to traditional ambitions of homogeneity, the paradigm for pluralistic ICBs is heterogeneity with diversity, materialized in: (i) the triumph of collegiality, plural committees with members with different positions (chair, others; federal, decentralized; internal, external), staggered tenures, and distinct backgrounds, knowledge, experiences, and views, but equal voting power; (ii) diversity in selection; (iii) culture of critical and free internal participation and deliberation; (iv) internal segmentation with multiple interlocking committees; (v) transparency and external review that broaden inputs and foster critical thinking; and (vi) internal procedures, including rotation of voting rights.

Such heterogeneity, with collegiality and diversity, has been empirically detected and is normatively desired.

*Heterogeneity is beautiful* because it: (1) prevents excessive concentration; (2) enhances the rationality of the deliberation by mitigating the impact of individual failures, the risks of individual hubris bias, collective blindness, and groupthink; (3) makes the capture of decision-makers more difficult and costly; (4) broadens the acquisition of information and ideas; and (5) multiplies skills and capacities to communicate decisions to a wider public.

However, it poses challenges by (a) increasing the complexity of the institutional design and incentive structure; (b) multiplying the entry points of influence; (c) fostering strategic behavior that might be suboptimal or lack logical cohesion; (d) increasing transaction costs to deal with disagreement; (e) potentially undermining policy clarity, credibility, and effectiveness when public dissent is noisier, and when larger boards create opportunities for shirking and coalition-forming; and (f) forgoing talent when diversity requirements are pushed too far.

Therefore, heterogeneity needs to be promoted but also managed because it increases complexity and disagreement.

ICBs develop various practices to manage dissent and promote some homogenization, from (i) institutional cultivation and socialization to (ii) filtered selection of central bankers; (iii)

permanent staff and institutional insiders that streamline procedures and frame discussions and alternatives; (iv) working rules on agenda-setting, information, internal and external expression of opinions and dissent, votes and the necessary majorities; (v) restrictions on transparency of committee discussions and deliberations and on individual accountability; and (vi) other informal practices such as chair dominance and cultures of compromise.

#### **2.2.6. SYSTEMATIC PREFERENCES?**

The question then is whether the constrained heterogeneity of central bankers results in some systematic patterns of preferences.

The Rogoffian defense of *CB conservatism* suggests that it *does* and it *should*.

But the institutionalization of conservatism or any other particular idea or preference via the profile of central bankers is normatively objectionable, especially in combination with CBI.

If the purpose of conservatism were to keep ICBs' policies within the limits of discretion, it is superfluous to the (rule of) law. If it were to operate within the limits of discretion, it would defeat the purpose of delegating discretion to an independent authority.

In both cases the result of conservatism would be to skew the exercise of the delegation and embed a systematic ideational bias. Conservatism should not seek to close what the legislator left open with the incomplete mandate.

In any case, empirical analyses do not confirm the dominance of conservatism amongst central bankers.

Neither do they find clear empirical support for the hypothesis of *partisanship* or political affiliation bias.

The strongest candidate, relevant for ICBs with federalist elements (ESCB, Fed, and SNB), is the home bias hypothesis that suggests that these central bankers may exhibit a pattern of preferences systematically biased towards their home country or region. They would weigh more strongly the specific economic conditions in their respective home country or region, or favor policy alternatives relatively more beneficial to, or favored at, home.

Institutional, social, and cultural forces pull central bankers both ways, to the federalist-aggregate interest or the decentralized-home biased preference.

Popular narratives suggest some individual predominance of the NY Fed in the USA and the Buba in the ESCB (twin-sister hypothesis). There can also be alliances of RBs or NCBs (e.g., coastal, peripherals, frugals).

The response to the predominance of an individual or alliance of home biases should combine the building of a supranational/federal ethos or pattern (*federalist strategy*) and the promotion of non-oligopolistic competition between diverse home biases (*competition strategy*). The ECB and Fed display elements of both strategies.

Empirical studies have found evidence of home bias in both the Fed and ESCB (stronger). Regarding the sub-hypothesis of systematic dominance by one country or an alliance, the ESCB might have gone through a period of “Europeanization as Germanization”, but since the existential Eurocrisis and the trauma of the ECB’s initial response to the GFC and the stewardship of DRAGHI (politically supported by MERKEL and SARKOZY), the situation changed, and perceptions of German dominance evolved into increasing German isolation.

### **2.2.7. STRATEGIC AND DYNAMIC DECISION-MAKING**

Another complexity in the translation of central bankers’ preferences into *choices* of policies is their *strategic behavior and dynamics*.

Challenging the “assumption of sincere voting”, central bankers *behave strategically*, internally within the policy committee and externally, considering the behavior and reaction of other macroeconomic policymakers, constitutional branches, other Influencers, and the addressees of their policies.

At the apex of the strategic behavior stands the *swingers* – board members without persistent preferences over time, yet they all strategize.

On the other hand, their sets of preferences vary with changes in the composition and leadership of policy boards, institutional constraints, and the incentive structure, and with the context.

Although ICBs are amongst the most cutting-edge, innovative public institutions, not all central bankers are dynamic.

The pigeons, who prefer to postpone policy decisions/changes, exhibit a bias towards the *status quo* due to a psychological trait of loss aversion.

This policy inertia is different from *information inertia*, rationally adopted to avoid tough stop-and-go policies and *governance inertia* caused by voting and procedural hurdles.

The succession of policy innovations between the GFC and the pandemic suggested that pigeons were a minority, and the majority were adaptive and dynamic.

In contrast, the initial period of the post-pandemic inflation burst revealed a predominantly inertial behavior of ICBs that was gradually abandoned during 2022. Only the future of this inflationary episode will shed light on this dimension of central banking in action.



## PART II. RETHINKING CENTRAL BANK INDEPENDENCE

### 3. REDEFINING CENTRAL BANK INDEPENDENCE

CBI is a political technology in the field of money and credit that defines and protects the integrity of central banking as a specialized process of government.

A few centuries of experience, some decades of independence, two decades of an unprecedented rise and testing through diverse states of the world, and countless failures and successes, have contributed to the development of a distinct process of government, also known as the “*art and science of central banking*”.<sup>74</sup>

Sometimes referred to as “central bank autonomy”<sup>75</sup>, CBI became an established notion, like *separation* became the established definition for religion-state relations, *autonomy* for civil-military relations, and *independence* is used for the judicial branch and administrative agencies. Different scopes convey similar ideas of insulation and protection of the integrity of a governance process from the interventions of other mighty powers and processes. Yet, none means absolute zero interference from the outside. Religions in regimes of separation from the state and individuals in liberal democracies are considered autonomous and self-standing but not above or immune from the law, its influences, and constraints. They are always subject to the vagaries of the world and embedded and interdependent on social relationships and institutions.<sup>76</sup>

Nonetheless, CBI grew with a *classic*, stylized formulation that spread consistently across the disciplines of economics, law, and political science.<sup>77</sup>

#### 3.1. FROM THE TRADITIONAL TO THE PLURALISTIC NOTIONS OF CBI

In this *traditional* view, CBI means *strict* or “*complete*” separation or insulation from external control or influence, *essentially from the classic political process* and the short-termism of politicians<sup>78</sup>

CBI is defined in consequentialist terms as *narrowly functional* and *teleologically* restricted to pursue an allegedly *settled goal through a purely technical function*. That is, CBI would exist “as

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<sup>74</sup> (BLINDER, 2008).

<sup>75</sup> Preferring the term “central bank autonomy” (FRIEDMAN, 1962), (ARNONE ET AL., 2007: 5). Yet, they are synonyms (Oxford Dictionary) and are used interchangeably (BRENTFORD, 1998: 82), (ZILIOLI, 2016: 128).

<sup>76</sup> (YUILLE, 2021).

<sup>77</sup> (LASTRA, 2017: 1279), (CONTI-BROWN, 2015).

<sup>78</sup> See notes 3 and 4 above.

an instrument” or “means” to control inflation or price stability through conventional internal monetary policy, neglecting other usual objectives and functions of CBs.<sup>79</sup>

This classic view assumed (or was associated with) the *neutrality, homogeneity, and/or conservatism of the central bankers* deciding and implementing such monetary policy<sup>80</sup>. It largely disregarded the roles of the legislative (particularly in the EMU) and judicial branches.

However, political, institutional, and economic transformations and evolution in academic research challenged and disavowed most of those assumptions and conclusions and exposed the simplifications, superficiality, and shortcomings of CBI’s classic definition and acceptability.

The GFC first, the pandemic next, followed by the inflation burst have led to a surge in academic studies, commentaries, and official speeches on CBI<sup>81</sup>. A few alternative conceptions were proposed, but they are also unsatisfactory.

The following task of debunking myths, simplifications, and mischaracterizations of traditional CBI literature paves the way to the presentation of a novel definition of CBI that is more comprehensive, rigorous, and truer to the positive conditions and normative demands.

A new *pluralistic* concept of CBI is offered. It is more relational and more democratic but no less (or even more) independent in the sense of integrity of an autonomous/self-determined process of policymaking in the fields of money and credit.

Instead of the traditionalist purpose of institutional loneliness or isolation, it sees ICBs as “*vulnerable*”<sup>82</sup>, *accountable*, but also *engaged with, constrained by, and responsive to* signals and (inter)actions regarding their decisions and conditions of decision-making, not only from the traditional political process and classic political branches but also from a host of other relevant domestic and international Influencers.

Pluralistic independence is relational. CBs are active nodes of a network of institutional and policy relations more populated and complex than the traditional and over-simplistic description of CBI as a duologue between CBs and political branches, and essentially the Executive.<sup>83</sup>

Instead of the traditional outright rejection of all interactions, coordination, and interferences (with the recent exceptional overture to channels of political accountability), this model presents a framework that treats signals, interdependencies, and interactions distinctively depending on their compatibility with the core normative justifications of CBI.

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<sup>79</sup> (ZILIOLI & SELMAYR, 2000: 629), (CHRISTODOULOU, 2005: 183), (LASTRA, 2015: 68), (ECB, 2017), (AG KOKOTT, *Rimšēvičs v Latvia* case, [2018], §101), (FROMAGE ET AL., 2019: 9).

<sup>80</sup> (GOODMAN, 1991).

<sup>81</sup> (BALLS ET AL., 2016: 12).

<sup>82</sup> (KEYOHANE & NYE: 2012, 10-11).

<sup>83</sup> (TUCKER, 2018).

For instance, developing new and direct channels between ICBs and the public becomes an essential democratizing element. One scholar even declared that the legitimacy of CBs “comes from productive and principled collaboration, not from autonomy”.<sup>84</sup>

Furthermore, this model accepts that the multiplication of relevant interactions, interdependencies, and Influencers increases threats, but it might, through “competitive influencing”, reinforce independence and its normative credentials and legitimacy. The efforts of each Influencer also check and balance those of other Influencers.

Pluralistic CBI seeks to structure, rather than ban, the game of competition of influences over ICBs. By accounting for such competition and complementarity, this novel approach reduces, rather than increases, the risk of certain influences skewing independence.

By challenging the myths of the apolitical character of CBs, the depoliticization of their policies, and the pure objectivity and homogeneous technicality of their process and decision-makers, this pluralistic concept deems that ICBs are not above or beyond politics. It assumes that ICBs are substantively political, just not in the narrow sense of partisan politics and that they operate under conditions of public contestation.

Consistently with the balanced separation of macroeconomic functions doctrine, it protects the integrity of an autonomous and specialized policymaking process – the “art and science of central banking”. This relational and democratic independence of political CBs is no less independence.

In the original classic *strict* view, independence would be absolute, meaning the freedom from or invulnerability to external control or influence.

In such absolutist formulation, there could be little room for dialogue, let alone cooperative coordination between CBs and political bodies.<sup>85</sup> Even the activity of constitutional branches in the fields of competence of ICBs would jeopardize their independence.

Legislative interventions to shape monetary policy, the CB’s mandate or structure, or the sheer announcement of intentions to legislate, would render independence a myth<sup>86</sup>.

Judicial review of CBs’ decisions would in itself deny CBI.<sup>87</sup>

The review of monetary policy operations by a public auditor (even if independent) would contradict independence<sup>88</sup>, or the mere possibility of an internal investigation by the European

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<sup>84</sup> (RILES, 2018: 21).

<sup>85</sup> (ECB, 2010: 74), (ECB, 2000: 52), (POWELL, 2014), (SOBEL, 2020).

<sup>86</sup> (BINDER & SPINDEL, 2018: 249).

<sup>87</sup> (WYPLOSZ, 2018), GCC, Order of the Second Senate of 14 January 2014 – 2 BvR 2728/13, parag. 60, finding that that CBI precludes judicial review of the exercise of actual powers.

<sup>88</sup> (AMTENBRINK, 1999: 58).

Anti-Fraud Office (OLAF) would put pressure on ECB's governors that would jeopardize the appearance of independence by undermining the confidence of financial markets in the ECB.<sup>89</sup> Interactions between macroeconomic policies and spillovers of central banking decisions into other policies (such as the economic effects of monetary policy challenged by the GCC in the *Weiss/PSPP* case), and in the opposite direction, the spillovers of fiscal, prudential, or exchange rate policies into monetary policy would violate a principle of strict separation of policies or amount to improper dominance.

In such absolute views, *ex-ante* constraints, accountability, inter-institutional coordination, and effective external influences on CBs' decision-making and operation would deny or compromise independence.

However, such an isolationist, absolute view is untenable.

The proper concept of CBI is not incompatible with interactions, interdependencies, and mutual influences between institutions and their policies, before, during, and after CBs' decisions and actions.

An interconnected and interdependent reality and the core tenets of liberal democracy, European integration, and the doctrine of balanced separation of powers reject isolated, self-sufficient, and autocratic CBs.

The rethinking of CBI should depart from these positive and normative indications, and take into account other legal and factual aspects which have not been sufficiently considered and incorporated in CBI literature, such as (i) the whole meaning and consequences of CBs' nature as institutions of and within the state, particularly their subjection to the rule of law and general norms of the respective legal order; (ii) the battery of functions of modern CBs, beyond the obvious internal monetary policy and, more recently, financial prudential supervision; (iii) the international cooperation between central bankers; (iv) the informal dialogue and engagement that central bankers maintain with political actors, foreign central bankers and significant market players; (v) the transformation of the relationship of CBs with the public; (vi) the political vocation of an increasing number of central bankers, exemplified by the icons DRAGHI, LAGARDE and YELLEN, and by the gradually increasing number of former politicians as central bankers, and notoriously as members of the ECB-GC<sup>90</sup>. Plus, the fact that the ECB-GC has a substantial majority of members that are NCB governors appointed by national authorities, defying the popular idea that the ECB is governed by a group of *techno-eurocrats*; or (vii) the institutionalized participation of EU Council and Commission representatives in ECB-GC meetings, and of ECB's

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<sup>89</sup> Position of the ECB in the Case C-11/00 *EU COM v ECB* [2003], the *OLAF* case (later rejected by the AG and the Court).

<sup>90</sup> (BICKERTON & ACETTI, 2021), (ALEMANNO & GRESSANI, 2021).

representatives in various committees and formations of the Council, European Council and Commission.

The following chapters further expose the shortcomings of the traditional case for CBI and defend the new pluralistic concept.

### **3.2. UNSATISFACTORY ALTERNATIVES**

Literature offers other conceptual alternatives that reduce the reach or strictness of the traditional view. The approaches focus on certain moments or dimensions of the policy process either to essentially accommodate the traditional view's basic tenets or to deny the essence of independence.

#### **3.2.1. OPERATIONAL INDEPENDENCE**

The first approach, popular in economic literature<sup>91</sup>, distinguishes *goal* and *operational* independence to defend only the latter.

It implies that CBs have autonomy in the selection of instruments and implementation. On the contrary, they are dependent on the goals, i.e., are constrained to pursue the mandate, which is the policy objectives defined by political authorities.

Such political determination may be *legislative*, namely by detailing the mandate in the CBs' statutes or other legal bases (as in the 1977 revision of the FRA defining the Fed's "double mandate"), or rely on the Executive to instruct the CB on the monetary objectives and targets to follow (e.g., the UK's BoE Act requiring the annual review of the remit for the Monetary Policy Committee whereby the Chancellor of the Exchequer specifies the definition of price stability and the government's economic policy objectives).

That operational independence would entail *ex-ante* inter-institutional coordination through hierarchy, subordinating the CB to strong external political influence at the level of the objectives and targets of monetary policy.

There are three versions of this operational independence view. A naïve version, labeled *formalism* or *agency instrumentalism*, suggests that "elected representatives must possess the power to define all policy ends" and the Legislature "should make all decisions about political ends, leaving the administrative state to make merely technical choices necessary for translating laws into policy"<sup>92</sup>.

It follows MAX WEBER's theory of legal-rationalistic bureaucracy based on purportedly neutral bureaucrats, professionalism, and impartial public administration<sup>93</sup>. Yet, inescapable

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<sup>91</sup> (FISHER, 1993).

<sup>92</sup> (DOWNEY, 2020: 4, critically), (FERNÁNDEZ-ALBERTOS, 2015), (ADOLPH, 2013).

<sup>93</sup> (WEBER, 2009: 329-341).

uncertainty, limits on cognition, and incomplete delegations are only some of the reasons that make such an approach delusional<sup>94</sup>.

An intermediate “broad social consensus” version suggests that delegation requires, and independence applies only within, “broadly settled preferences and a consensus that the policy regime will work”<sup>95</sup>.

In this perspective, CBs should not venture “into major choices on the distribution of wealth or society’s values”, remaining within matters of low political salience, not characterized by significant disagreement or weighty conflicting claims. In matters where the potential of politicization increases, the guiding intervention of legislatures and their regular revision of the mandate and terms of the delegation would be necessary<sup>96</sup>.

A looser version of “contingent independence” is based on the idea of *ultimate* legislative control, normally latent, of delegated policymaking. In this version, the Legislature retains complete control over the ends of policy-making even if it remains silent and allows the CB to make some decisions about the ends. That legislative silence is interpreted as assent to the CB’s decisions (seen as “advice”). The former “retains ultimate power because should the CB misstep, the legislature can always legislate to correct it”<sup>97</sup>.

This idea of latent, ultimate control has significant normative potential to be explored below, but in a pluralistic rather than legislative-monist formulation that encompasses, on the one hand, the proper, autonomous decision-making and discretion of CBs, and on the other hand, the influencing roles of other powerful actors.

These three versions emphasize the fundamental role of legislatures in *ex-ante* controlling and constraining the delegation’s terms and independence and settling the fundamental/contested substantive choices. They essentially correspond to “de-politicization strategies” as those used to justify the delegation of powers to technocratic supranational EU institutions, which were already critically analyzed and rejected above.<sup>98</sup>

These approaches were elaborated with the *goals* of internal monetary policy in mind, but the rationale is even more evident for other relevant functions of CBs. Treasuries have the primary role of guiding exchange rate policy and reserves’ management (external monetary policy). Financial legislation (dictated by political branches) on macro- and microprudential policies is more extensive than statutes on monetary policy. Above all, fiscal agency services provided by CBs to treasuries involve intensive guidance of the latter and operational coordination.

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<sup>94</sup> (TUCKER, 2018: 552), (SCOTUS Justice SCALIA, dissent in the *Mistretta* case).

<sup>95</sup> (TUCKER, 2018: 556), (VAN’T KLOOSTER, 2020), (DOWNEY, 2020: 5-6).

<sup>96</sup> *Idem*, (FERNÁNDEZ-ALBERTOS, 2015).

<sup>97</sup> (DOWNEY, 2020: 4, citing CHRISTIANO, 2005: 217).

<sup>98</sup> (MAJONE, 1996), (MORAVCSKI, 2002).

The notion of operational independence offers a valuable contribution by raising attention to *ex ante* political control of CBs through constraints, mandate, and guidance.

However, it is neither sufficient nor rigorous in its description of the map of relations and influences on ICBs.

It ignores other *ex ante* and *ex post* channels and actors and underestimates delegation of discretion. For the two largest CBs – Fed and ECB – it reads (or expects) too much into the short passages of the legal bases defining their mandates.

The comprehensive “goals of maximum employment, stable prices, and moderate long-term interest rates” (Section 2A FRA) and the objective of “price stability” (articles 119 (2) and 127 TFEU) left the Fed and ECB with ample room to define their meaning, which they have used to largely elaborate their own goals.

Even though proponents of these de-politicization strategies might find this assertion normatively problematic, the pluralistic CBI model fits within the updated normative justification of CBI.

### **3.2.2. INTERDEPENDENCE**

A second approach argues that CBs are *interdependent* rather than independent from the political branches. Political bodies depend on the CB “to manage monetary policy and provide political cover when the economy falters”. CBs and their autonomy depend on building and maintaining support from political branches and risk their retaliation through reforms that restrict CBI for the future or by adopting a counterproductive fiscal policy that undermines monetary policy.<sup>99</sup>

This approach also offers valuable insights. It rightly notes how influences and interdependences run both ways and that CBs have discursive tools, informational advantages, lobbying strategies, and policy options whose spillovers can also effectively condition the decision-making of the legislative and executive branches.

Expanding on the *operational independence* approach, it unveils a multiplicity of additional channels for political branches to influence, pressure, and potentially control the CB’s decision-making. These include the formal legislative power to eliminate the monetary authority, amend its mandate or structure, or create transparency or accountability mechanisms. But there are also informal and operational channels such as threats of legislative initiative, critical speeches, inquisitive hearing and written questions, behind-closed-doors meetings, and spillovers of their own fiscal and external monetary policies.

This approach shows that regardless of the extant legal guarantees, CBI is ultimately contingent on political and public support (and vulnerable to its swings). Such descriptive insight has great

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<sup>99</sup> (BINDER & SPINDEL, 2017: 236-7), (AMTENBRINK, 1999: 233-4).

normative importance as it indicates avenues for citizens and their political representatives to provide inputs and guidance to CBs.

At first sight, the interdependence tale may seem more appropriate to the USA and UK systems than the EU's. The constitutionalization of the ECB creates additional hurdles to political retaliation through legal reforms, and the asymmetric distribution of macroeconomic powers within the EMU complicates the mobilization of political and policy responses "against" the ECB. However, as described below, the Eurosystem is also subject to plenty of those mutual influences, *de jure* and *de facto*.

More importantly, this *interdependence* view goes too far in admitting "barely any independence at all"<sup>100</sup>, which is unsatisfactory on several accounts.

First, it practically denies CBI<sup>101</sup>. It prescinds from the normative and analytical concept of independence, which has substantive symbolic, historical, political, legal, economic, and operational worth.

While there is something valuable in its insight that CBI is "limited and contingent"<sup>102</sup>, it can be taken neither as a denial of a core of independent decision-making nor as a remission into a haze of interactions that escape any normatively grounded and coherent framework.

Second, in paradoxical similarity with the *absolute* view, it practically equates political moves with effective subordination and intention and attempts with results that might never occur. Political threats, criticisms, discursive pressure (by some), and non-cooperative fiscal or exchange rate policies are too quickly assumed as if dominance existed. Naturally, the rise of prominence and politicization of CBs tends to increase political contestation, disagreements, confrontational interactions, and uncoordinated policy choices – as observed with the most contested decisions of supreme and constitutional courts.

However, independence only succumbs to more pressure and greater stakes if CBs fail to increase their capacity to resist them and maintain the integrity and self-determination of their decision-making process.

Third, descriptively this approach does not suit the post-GFC paradox. Harsh criticism and diagnoses of CBs' failures in the buildup to the crisis led legislators in the USA, EU, and UK to increase those institutions' powers. Forces stronger than the blame and retaliation game seem to be supporting CBI.

Finally, it restricts the in(ter)dependence to a political game played between the Legislature, the Executive, and CBs – with the public playing a background role. It largely ignores other relevant

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<sup>100</sup> (BINDER & SPINDEL, 2017: 240), (JORDAN & LUTHER, 2020), (SALTER, 2020).

<sup>101</sup> (BINDER & SPINDEL, 2017).

<sup>102</sup> *Idem*.



Influencers such as the judicial branch, other CBs, their epistemic community, and special interests who also play a decisive role in a broader competition of influences.

### 3.2.3. ACCOUNTABLE INDEPENDENCE

A third conceptual alternative to the absolute view, increasingly mainstream amongst lawyers and political scientists, is the notion of “accountable independence”<sup>103</sup>.

It adds important aspects but is still an incomplete view of the proper and realistic position and relations of ICBs vis-à-vis other relevant actors.

They are accountable to, but also constrained by, engaged with, and sensitive, vulnerable, and responsive, in senses and terms beyond accountability and to actors beyond the three classic constitutional branches.

To rescue the notion of “accountable independence”, some scholars suggest a “twist” to accountability, a euphemism for (over)stretching its meaning to absorb the *ex ante* political control. They note how some mechanisms may play a double role of *ex ante* and *ex post* control, namely the powers to review the CB’s legal basis, appoint its leadership, or have a veto or mandatory consent on the CB’s decision.<sup>104</sup>

This elastic interpretation deviates from a settled definition of accountability as consisting of “a retrospective—*ex post*—activity” that involves the provision of information and justification, answering questions<sup>105</sup> and, essentially, a “meaningful and consequential *ex post* judgment”<sup>106</sup> on whether agents “have done what they should have”.<sup>107</sup>

When not chronologically (if it occurs during the decision-making), at least *logically*, accountability is exercised *ex post* to the decision or action, and it involves accepting a degree of autonomy of the power holder to decide or act within pre-established constraints, guidance, or “guardrails”<sup>108</sup>.

The difference between *ex ante* control or guidance – through institutional, procedural, and policy constraints or guardrails included in the act of delegation or elsewhere – and that *ex post* accountability has been fairly established<sup>109</sup> and has analytical and normative significance.

Values of liberal democracy demand more than the right to know and assess and even more than some ultimate power to correct policy choices and punish and replace representatives and other delegated decision-makers.

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<sup>103</sup> Coined by (LASTRA, 1992 and 2015: 88-93, 271-83), (AMTENBRINK, 1999), (CURTIN, 2017).

<sup>104</sup> (LASTRA, 2015: 90), (AMTENBRINK, 1999), (BOVENS, SCHILLEMANS & GOODIN, 2014: 7-8).

<sup>105</sup> (BOVENS, SCHILLEMANS & GOODIN, 2014).

<sup>106</sup> (WALLACH, 2015: 158).

<sup>107</sup> (MANIN, PRZEWORSKI & STOKES, 1999: 9).

<sup>108</sup> (DOWNEY, 2020).

<sup>109</sup> (MANIN, PRZEWORSKI & STOKES, 1999), (EPSTEIN & O’HALLORAN, 1999).

*Ex ante* inputs are often better than accountability mechanisms (with transparency, oversight, and sanction) at promoting values of deliberative democracy involving reflection and compromise, plural freedom, participation, and equal consideration of affected interests<sup>110</sup>.

The former calls CBs to be *responsive* to the signals from whoever is power-relevant (the public, elected and political officials, etc.), and the latter makes them *accountable* to the same or other power actors for their decisions or actions.

Whether they are or not responsive and both *ex ante* and *ex post* mechanisms are effective is a different, albeit related, story.

While guidance and accountability are relational concepts<sup>111</sup>, contrary to *independence as isolation*, the distinction between *ex ante* and *ex post* control is positively and normatively meaningful. It helps discern the different relations of ICBs with other powerful actors.

Accountability is only one of the qualifications and conditions of CBI, too circumscribed to be in its name tag.

### **3.3. CBI AS INTEGRITY OF A SPECIALIZED PROCESS**

#### **3.3.1. NEGATIVE AND POSITIVE DIMENSIONS OF CBI**

CBI is a political technology that combines a negative with a positive dimension<sup>112</sup>.

Negatively it is defined as a technique of protecting CB decision-making from the influences or interferences of other public and private actors to prevent distinct interests, institutional cultures, or processes (e.g., political, judicial, market) from controlling the CB's decisions and actions.

The purpose is to shield ICBs "from all influence which would derail them from rigorous and disinterested employment of their expertise."<sup>113</sup>

In this sense, the various powerful actors whose interferences and controlling influences have the potential to deviate the CB from its art and science should be of concern, regardless of their nature, including but not limited to politicians and the political process. CBI must thus be pluralistic.

Positively it means that within its field of competence – in the double sense of conferred legal power and of specialized expertise – the CB decides and acts per its own choice, self-determined within constraints, and according to its specialized process or method of government, the so-called *art and science of central banking*.

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<sup>110</sup> (BREYER ET AL., 2011: 48).

<sup>111</sup> (BOVENS, SCHILLEMANS & GOODIN, 2014: 6).

<sup>112</sup> (VAUCHEZ & FRANÇOIS, 2020), (TORTOLA 2020).

<sup>113</sup> (TUORI, 2015: 222-3), (TORTOLA, 2020).

CBI becomes the “place of birth of a distinct mode of governance exercised through independence”<sup>114</sup>.

In other words, *CBI is a political technology that preserves and asserts the integrity of central banking as a specialized decision-making and policymaking process in the fields of money and credit.*

CBI is the *integrity* of the choice to delegate to that distinct institution and process of central banking, with its institutional specialization<sup>115</sup> and comparative advantages<sup>116</sup>, its gradually matured structures, culture, knowledge, and policy resources, and its techno-legal method, objectives, and tools, which are the cause and object of independence.

The negative and positive dimensions offer two complementary strategies to preserve that independence as integrity: the negative by blocking or mitigating undue external interferences, the positive by strengthening the specialized process or mode of governing CBs and its pillars of specialized expertise and liberal democratic legitimation.

### **3.3.2. NON-ABSOLUTE INDEPENDENCE**

The negative protection is not complete, but limited insulation. The positive assertion of self-determined policymaking does not make it autarkic or unconstrained. CBI is not absolute.

“[I]ndependence as an all-or-nothing proposition rings false...Pure separation from the political process was never a possibility, whatever the law said or says”<sup>117</sup>.

A relative<sup>118</sup>, balanced or pluralistic independence, describes more appropriately the relation of CBs with other Influencers and the condition of integrity of central banking.

CBI *exists within* and is *constrained by* democratic choices; it also *accommodates* and *internalizes* in the central banking process other influences that are accepted or even required forms of *ex ante* guidance inputs and/or *ex post* accountability. Accountability is neither the only external counterpoint to independence nor the full story of influences and inputs to central banking.

*Factually, legally and normatively*, no CB enjoys complete decisional independence, absent of any constraint, exogenous or endogenous, actual or prospective.<sup>119</sup>

Influences and interdependencies exist *de facto* and are unavoidable<sup>120</sup>. CBs are vulnerable<sup>121</sup>, but they are also inescapably engaged. They interact, coordinate, and are interdependent with

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<sup>114</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>115</sup> (WALDRON, 2016).

<sup>116</sup> (KOMESAR, 1994).

<sup>117</sup> (CONTI-BROWN, 2016: 7).

<sup>118</sup> (LASTRA, 2015: 69, 73-5).

<sup>119</sup> (BURBANK & FRIEDMAN, 2002: 11-2).

<sup>120</sup> (LOHMANN, 1999: 401), (ZILIOLI & RISO, 2018: 169).

<sup>121</sup> (YUILLE, 2021).

other powerful actors. A proper CBI framework evaluates and manages (for the best) this multiplicity of relations and positions. It should structure them in a “competition of influences”, checking each other and upholding the normative credentials and comparative institutional advantages of the central banking process.

No social system can aspire to zero-influenced institutions, as these are animated by humans who have their preferences and values and live not in a vacuum but in contexts. They consist of organizations and procedures corresponding to embedded preferences, which are structured influences on decisions. They exist and hold power as long as they are tolerated by the polity, whose signals need to be responsive.<sup>122</sup>

Moreover, in constitutional systems with the rule of law and a doctrine of balanced separation of powers, each institution is only part of a larger and intertwined body of government in which each has a share of the whole of the power and mutually limits each other.

*Legally* no CB, including the most independent ECB<sup>123</sup>, is absolutely independent.

First, CBs exist and are “independent within” the state<sup>124</sup>. “Their” money is a creature of the state. They are legally constituted (or empowered) and delegated public powers over money and credit by the sovereign polity, acting through its DRs.

The Fed describes itself as “independent within the government, not independent of the government”. The ESCB has been described as independent within the EU structure.<sup>125</sup>

Second, independence exists only in the given sphere of legal competence, i.e., within the powers and mandate the ICB is conferred by democratic constitutional or legislative representatives. CBI “does not entail a Kompetenz-Kompetenz of any kind”<sup>126</sup>. There is no negative or positive protection of independence beyond the limits of such conferred powers.<sup>127</sup>

In this sense, independence is functional. But it is not confined to a single specific function (internal monetary policy) nor one particular legal objective (price stability)<sup>128</sup>. Its comparative superiority in the governance of money and credit extends to other objectives within the same monetary policy function and other functions within the same field of expertise.

Different countries chose this same political technology of CBI for various combinations of objectives such as price stability, maximum employment, financial stability, efficient payment systems, economic stabilization, support for government policies and different functions such as

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<sup>122</sup> (FRANKLIN, 2002: 150).

<sup>123</sup> (AMTENBRINK & DE HAAN, 2002: 72).

<sup>124</sup> (HUMPAGE, 2014).

<sup>125</sup> Art. 13 TEU, (LASTRA, 2017: 1278). Differently, (ZILIOLI & SELMAYR, 2000).

<sup>126</sup> (AMTENBRINK, 2019: 209), (CJEU, decision of the *Gauweiler* case §40).

<sup>127</sup> (LASTRA, 2017: 1279), (AMTENBRINK, 1999: 220), (POSNER & VERMEULE, 2010: 58).

<sup>128</sup> (LAVRANOS, 2004: 123), (LASTRA, 2015: 69-74).

monetary policy, prudential policies, crisis management in the financial sector, payments systems oversight.

The ECB's primary legal basis is clear: independence applies "[w]hen exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties". If the systematic location of art. 130 TFEU in a chapter of the Treaty dedicated to "monetary policy" could raise doubts on the scope of application, art. 282 (3) TFEU clarifies that independence applies to all "its powers and in the management of its finance" without functional limitation.

Third, CBs are not absolutely independent within the limits of the conferred powers. They are not fully isolated, invulnerable, nor protected against all interferences.

Chapters 4 and 5 identify a plethora of legal provisions establishing mechanisms of interaction with various Influencers and political *ex ante guidance* and *ex post accountability*.

Even the ECB's "independence provisions [in the EU Treaties], though very strictly formulated and written in stone, leave scope for a process of open influencing of the monetary authority"<sup>129</sup>. The combination of such overtures with the prohibitions (properly understood) and transparency and justiciability rules applicable to the ESCB constitute a definition of CBI in the EU Treaties that is robust, substantive, but not absolute.

Such non-absolute independence is also *normatively* accepted and even desired under conditions (of the influences furthering the normative tenets of CBI).

The most basic normative reason is that in liberal democracies and systems with a balanced separation of powers, there is no place for unchecked powers whatsoever. No process of government *should be* entirely concentrated, and "no institution can be absolutely independent and unconstrained"<sup>130</sup> or free from all control mechanisms.

"In a self-professed democracy, the idea of central bankers not being influenced by Community and State government members is absurd....the politicians can express their ideas about the correct approach to monetary policy and exchange rate policy, always respecting the independent decision-making of the [CB]"<sup>131</sup>.

The following chapters demonstrate the liberal, democratic, and welfarist advantages of allowing influences, interactions, and external checks that are not undue.

### **3.3.3. TWO-STEP TEST ON TRI-VALENT INFLUENCES**

Non-absolute independence means that some influences are forbidden, but others are permitted or required, according to a two-step test.

The first step tests the *relevance*, and the second the *appropriateness* of influences.

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<sup>129</sup> (SMITS, 2007: 1617).

<sup>130</sup> (LEINO-SANDBERG, 2019: 196).

<sup>131</sup> (SMITS, 2007: 1616-7), (BLINDER, 2016).

One commentator defined “independence as freedom from control of another, not freedom from influence of another”<sup>132</sup>.

#### a) THE RELEVANCE TEST

The *relevance test* filters the signals that *have* or *may have* a sensible impact on the CB’s decision or course of action, content, timing, or justification. Expressions of viewpoints and other efforts that are not likely to budge the CB can be ignored.

Only such efforts that have the potential to *effectively* or *apparently* move or shape the CBs’ course of action are relevant. Relevant Influencers are those with “the ability to influence the behavior of others to get the outcomes one wants”<sup>133</sup>, with power over the tasks of a CB but also over its legal, operational, or financial ability to fulfill its mandate<sup>134</sup>.

It does not require a demonstrated causality nor wait for real impacts. *Latent* powers, threats, and the *appearance* of undermining independence can also be relevant.

For the CJEU, the relevant “outside influences ... are those *likely to interfere* with the performance of the ‘tasks’ which the EC Treaty and the ESCB Statute assign to the ECB”. It followed AG JACOBS’s opinion that the test is whether a particular influence “is *liable to undermine* the ability of the ECB to carry out its tasks effectively”<sup>135</sup>.

This perspective that independence must be both effective and apparent is grounded on the CJEU’s established requirement that the “guarantees of independence and impartiality ...are such as to dispel *any reasonable doubt in the minds of individuals* as to the imperviousness of that body to external factors and its neutrality with respect to the interests before it”<sup>136</sup>.

This appearance criterion shall not be exaggerated, or it might have a detrimental chilling effect. It should not be the case that “in order not to create even the slightest impression of any outside influence on the monetary policy, the ECB may at times be inclined to rebuke certain policy decisions which are sensible in economic terms, i.e., lowering interest rates at a certain point of time in the economic cycle, simply because governments may have previously invited the bank to take such measures”<sup>137</sup>.

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<sup>132</sup> (BAXTER, cit by LASTRA, 2015: 66, fn 143).

<sup>133</sup> (NYE, 1990 and 2004), (DYSON, 2009: 2).

<sup>134</sup> (BINI SMAGHI, 2008: 452).

<sup>135</sup> Italics added (CJEU, Judgment *OLAF* case, §124), (AG *Jacobs*, Opinion *OLAF* case, § 155). Also (BINI SMAGHI, 2008: 451).

<sup>136</sup> CJEU, judgments on the cases: *EU COM v Poland (Independence of the Supreme Court)*, C-619/18 (2019): §74; *Wilson*, C-506/04 (2006): §53; *Republika*, C-896/19 (2021): §53.

<sup>137</sup> (AMTENBRINK & DE HAAN, 2002: 72-3).

On the other hand, power to influence may be effective without actually being used. Latent powers and credible threats to use it may be enough to influence the CB. That is the case of threats of legislators to table jurisdiction stripping and appropriation bills.

Finally, to have formal “power resources” does not mean to have effective influence, for instance, if dysfunctionality or the multiplication of veto points make it practically impossible for the principal to control the agent effectively. There is a long literature debating whether parliaments can effectively control unelected regulatory agencies to whom they delegate authority. Skeptical views vary from delegation as “legislative abdication” of the policymaking role to the suggestion that parliamentary control is restricted to a “control of excesses” through various means of oversight<sup>138</sup>. “[A]ll power depends on context – which relates to whom under what circumstances”<sup>139</sup>.

## **b) THE APPROPRIATENESS TEST**

In the second step, signals and influences are *prohibited, permitted, or required* depending on how they pass the appropriateness test. Such tri-valence<sup>140</sup> contrasts with the traditional view that CBs should be insulated from all influences.

But what are the criteria for assessing the appropriateness of influences?

The question emerged in the interpretation of article 130 TFEU that nominally forbids, without qualifications or restrictions, influences or instructions from “any ... body”.

The ECB interprets the provision as prohibiting only binding influences while permitting a “nonbinding dialogue”<sup>141</sup>. According to one commentator, the prohibition applies when the Influencer has “any formal mechanism at its disposal to ensure that its views influence the final decision”<sup>142</sup>.

However, these criteria on whether influences are *legally binding* or correspond to the exercise of *hard power* – in the sense of being supported by some *formal* sanctioning mechanism<sup>143</sup> – are not adequate. They would be both defective and excessive.

Prohibiting only legally binding influences would be too permissive. Using NYE’s taxonomy of power, Influencers might also be able to shape CBs’ policymaking through *non-formal hard powers* where sanctions and inducements are not the (il)legal(ity) sanction, but for instance, some material or effective reputational sanction or inducement; and through *soft powers* that

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<sup>138</sup> (EPSTEIN & O’HALLORAN, 1999: 9-10), (BREYER ET AL., 2011: 76-89).

<sup>139</sup> (NYE, 2004).

<sup>140</sup> (WALDRON, 2016: 33).

<sup>141</sup> (ECB, 2000).

<sup>142</sup> (AMTENBRINK, 1999: 216).

<sup>143</sup> (NYE, 2004).

consist of “the ability to affect others and obtain preferred outcomes by attraction and persuasion rather than coercion or payment”. The soft power to attract and co-opt operates through cultural resources, political values, and moral authority. It is different from rational “persuasion or the ability to move people by argument”<sup>144</sup>.

CBs’ *de facto* dependence often stems from non-binding and informal influences, as described below. Accounts of Fed history demonstrate how certain presidents managed to steer the Fed policymaking and its chair essentially through informal pressures. Fiscal and financial dominance might be created without any instruction from political or financial actors.

On the other hand, those criteria would be excessive to define the appropriateness of influences because several legally binding influences are expressly permitted or required by CB legal bases. For instance, information exchanges with political branches and market actors are permitted under conditions. Some examples of required influences are the political appointment of central bankers, the procedural participation of stakeholders in rulemaking procedures, the parliamentary hearings of central bankers, and the judicial reviewability of CBs’ acts and omissions. All these exercises exist to be somehow consequential, and yet they are both relevant and appropriate influences.

Such criteria would be simple, but the simplicity that traditionalists appreciate in the strict separation model is unsatisfactory.

### **c) FLEXIBILITY REQUIRED**

The defining line of appropriateness must be flexible as long as it preserves the core of CBI, which is the integrity of decision-making through the art and science of central banking.

“[I]ndependence is a continuous, not a dichotomous, variable. In other words, there are degrees of central bank independence”<sup>145</sup> that vary along an *in-dependence* continuum that goes from very low to very high (albeit never absolute) levels of insulation, which are inverse to the degree of appropriateness.

That degree of independence synthesizes the (relative tightness of the) criteria of appropriateness and the tri-valent matrix of prohibited, permitted, and required influences.

Those degrees and criteria cannot be rigid or fixed, as if independence were a transcendental ideal<sup>146</sup>. Descriptively and normatively, they vary across geographies, time/contexts, functions, and institutional aspects.

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<sup>144</sup> *Idem*.

<sup>145</sup> (GOODMAN, 1991: 330), (LASTRA, 2015), (TUCKER, 2018: 83-5).

<sup>146</sup> (FISS, 1933: 63, 67).



Firstly, they vary geographically in the sense that the polity's institutional choice is "regime-relative", contingent upon certain assumptions about the country's structure of government, political regime and culture, legal model, and historical path.<sup>147</sup>

Different models emerged, realizing the same concept of CBI<sup>148</sup>, as demonstrated below by contrasting the "living frameworks" of the Fed, ESCB, and BoE. There are variations even within the same CB system. The ECB is more independent than the national central banks (NCBs)<sup>149</sup>. In the US, the Board of Governors (Fed BoG) is less politically independent than the Reserve Banks (RBs), which are less independent from financial interests, particularly their stockholding banks. Secondly, degrees of independence and appropriateness criteria also change over time<sup>150</sup>. Both *de jure* and *de facto* independence wax and wane according to the state of the world and particularly in moments of crisis, to shifts in the prevailing political circumstances and political preferences.

There is a long literature on legal and institutional elasticity in periods of emergency and "states of exception".<sup>151</sup>

CBI regimes, too, have the flexibility to perform differently in moments of normalcy or crisis<sup>152</sup>. Cooperation and coordination of CBs with treasuries, foreign CBs, and leading financial institutions increase significantly in crises, flexing the boundaries of interaction. The GFC, the Euro sovereign debt crisis, and the pandemic crisis tested the argument that increased crisis-fighting cooperation does not structurally eliminate or weaken independence. At the same time, such crises may benefit the policy mix and strengthen independence if the integrity of the central banking process is maintained.<sup>153</sup>

The degree of independence also swings in case of serious changes in general political circumstances such as the power distribution, strategic action, and relation between branches of government, and according to cycles of political attention to, and public support for, independent central banking, notably those driven by perceptions of policy failures by economic downturns.<sup>154</sup>

Third, another source of variability is internal functional asymmetry. A one-size-fits-all approach to CBI is unsuitable in light of the different functions ICBs have assumed, with other features,

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<sup>147</sup> (FISS, 1933: 63, 67), (P. RUSSELL, 2001: 307), (MILLER & WHITFORD, 2016: 13), (SHAPIRO, 1988: 32), (FROMAGE ET AL., 2019: 8).

<sup>148</sup> (DALL'ORTO, 2020: 17).

<sup>149</sup> (ZILIOLI & RISO, 2018: 159-161).

<sup>150</sup> (COROADO, 2020: 117), (CARPENTER 2010).

<sup>151</sup> (POSNER & VERMEULE, 2010).

<sup>152</sup> (LASTRA, 2015: 76-8).

<sup>153</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016: 385).

<sup>154</sup> (BINDER & SPINDEL, 2017: 237). For judicial independence (RUSSEL, 2001: 307). (McNOLLGAST, 2006: 123).

particularly since the GFC<sup>155</sup>. The relevance and appropriateness of specific influences may vary across distinct functions and fields of competence.<sup>156</sup>

Similarly, degrees of judicial independence vary depending on the fields of law and the nature of the impacts of the decisions to be made. Criminal and economic investment cases would tolerate fewer interferences than major public policy litigation, where expressive signals and broader participation would be acceptable or convenient.<sup>157</sup>

To begin with, the functional variation of degrees of CBI depends on the distribution of stakes and the profile of biases involved. For instance, the demands for political independence tend to be stronger for the monetary policy function, which is more prone to majoritarian bias. Still, the need for independence from particular affected interests tends to be stronger in financial supervision, where the stakes of financial institutions are even more concentrated and higher per capita, thus tilting the scale of risks towards a minoritarian bias.

It also depends on the incidence of the comparative institutional advantages. Protections are more justified where central banking is more specialized and mature as a process, as in internal monetary policy, where more unique expertise has accumulated.

Contrariwise, the functions of LOLR to non-banks, MMLR, provider of selective credit support, and as backstop banker to government need a more democratically demanding and fiscally involved framework.<sup>158</sup>

The more the CBs share competences with other policymakers, the more tolerance to the latter's substantive interventions and necessary institutional coordination should be expected. While the internal monetary policy is more monopolized, prudential supervision is shared with other political or independent supervisors, and external monetary policy with the Executive.

Fourth, different institutional aspects – structure, mission, persons, finances, operation, and institutional relations – justify asymmetric levels of independence and constraint<sup>159</sup> to accommodate contrasting normative demands.

That begs for complex, positive frameworks of CBI, composed of many shades of independence. It entails a degree of variability on the protections of independence and on which influences are undue and prohibited.

#### **d) AGGREGATE AND CORE INDEPENDENCE**

The flexibility of the CBI framework means pluralism but not relativism, either legal or normative.

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<sup>155</sup> (FROMAGE ET AL., 2019: 14).

<sup>156</sup> (LASTRA, 2015).

<sup>157</sup> (RUBIN, 2002: 72-73), (GAROUPA & GINSBURG, 2008: 55).

<sup>158</sup> (CECHETTI & TUCKER, 2021).

<sup>159</sup> (LASTRA, 2017: 305).

Such flexibility and openness to a pluralism of positive frameworks must warrant an adequate overall level of independence and the protection of the core of CBI.

On the one hand, the pluralistic model accepts different compositions of protections and permissions, provided that they deliver appropriate balances of the normative justifications and demands of CBI (democraticity, expert specialization, and impartiality of central banking<sup>160</sup>).

On the other hand, such internal asymmetries and varying degrees of independence and constraint can only be limited.

A CB cannot be independent in the morning and submissive in the afternoon. It does not suffice to set interest rates autonomously if, the following week, it has to obey requests for incongruent foreign exchange market interventions or macroprudential measures.

It cannot have its officials protected from arbitrary dismissal yet hanged by the purse.

It cannot be insulated from partisan politics while captured by special interests.

As noted, EU Treaties clarified that independence applies to all functions and goals delegated to the ECB, without exception (art. 282 (3) TFEU).

If CBI is to subsist in any meaningful way, its core has to be preserved. Such core corresponds to the integrity of the specialized government process that is the art and science of central banking. Within delegated discretion, influences, interferences, or interdependences should not be allowed to the extent that central bank(er)s become *de jure* or *de facto* coerced or other-directed in their policy choices and implementation. The essence of CBI requires that such choices are self-determined, made through, and according to that specialized process of central banking.

Between that core (the minimum required) and the maximum of insulation stands a “twilight zone” where (potential) interferences with ICBs’ decision-making trigger serious scrutiny to be decided within the separation of powers framework through a proportionality test. This test weighs conflicting factors, pondering whether such challenged interference implicates the CB’s core function of independent policymaking and comparing the minuses of the threat to independence with the advantages of interventions of the Legislative, Executive or other relevant Influencers.<sup>161</sup>

The CJEU has applied a stringent version of that proportionality test in reviewing threats to judicial independence. For instance, it accepted exceptions to the principle of irremovability of judges if “they are warranted by legitimate and compelling grounds, subject to the principle of proportionality”. Moreover, such proportionality in light of a legitimate objective should not

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<sup>160</sup> Ch. 7.

<sup>161</sup> Adapting (KAUFMAN, 1980: 694-7).

raise reasonable doubt in the minds of individuals as to the imperviousness of the courts concerned with external factors and their neutrality concerning the interests before them.<sup>162</sup>

In a nutshell, undue are those *relevant influences* that *per se* deviate decision-makers from *the essence of independent central banking*, or which are excessive in the sense of the proportionality above described, or that in conjunction with other interferences in the context of a particular framework compromise the aggregate position of independence of the CB.

Required are the relevant influences that limit or control the *excesses of independence*. Permitted are those that stand in between.

### 3.4. THE CONCEPT OF PLURALISTIC CENTRAL BANK INDEPENDENCE

A better concept to define CBI is pluralism.

CBI is pluralistic in many senses.

It is neither monist, autarkic, nor absolute, and not excessive. Instead, it is relative, balanced, open to relations, and suited to manage interdependencies.

It is pluralistic in the sense of encompassing, acknowledging, and dealing with *various types of relations* of CBs with *multiple powerful actors* that may impact central banking, for good or worse, and then treating them accordingly.

A properly comprehensive notion and framework of CBI must care for insulation and distance but also vulnerability and responsiveness to constraints and inputs, accountability, engagement, and cooperation to manage interdependencies. No one of these relations alone conveys the reality and ideal of the position of modern ICBs.

ICBs must handle relations with multiple powerful actors, including (i) *political branches and officials* and other prominent actors of the electoral-representative process, but also (ii) the *public*, (iii) the *judicial branch* and other apolitical oversight bodies, (iv) the *epistemic community of central bankers*, and (v) mobilized *affected interests*, with financial institutions and labor representatives at the head.

These five groups are the relevant *Influencers* who take part in *ex ante* and *ex post* games of influence over central bank(er)s. They all intervene, actively or latently, with different degrees of legitimacy, officiality and formality, and effectiveness.

CBI is a plural rather than a dual dance.

Such a pluralistic notion is broader than the traditional view of mainstream academic literature that focuses merely on political (in)dependence and relegates attention to private and sectional pressures over ICBs in the context of financial supervision.<sup>163</sup>

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<sup>162</sup> CJEU, decision on *EU COM v. Poland I*: § 75-79, and *EU COM v. Poland II*: § 113-115.

<sup>163</sup> (ZILIOLI & SELMAYR, 2007), (LASTRA, 2015), (BALLS ET AL., 2016).

Denying or ignoring those other Influencers in the framework of CBI is not only myopic but dangerous and wasteful.

A broader perspective of CBI is necessary<sup>164</sup>. The narrow focus on the principal-agent relationship between elected representatives and CBs is an insufficient approach and an incomplete description of the reality of power and CB policymaking.<sup>165</sup>

The elusive benefit of a simple, more manageable, but incomplete framework would come at the higher cost of leaving free and unchecked other consequential processes and effects of influence, capture, or manipulation. It would be dangerous to disregard potentially determinant inputs to the central banking process.

In the EU, the CJEU has made clear that the protection of (judicial) independence has to be against “all external intervention or pressure”, “from any source whatsoever”.<sup>166</sup>

Pluralism also means attending to the distinct character of the multiple contributions and influences. It distinguishes those that are undue and should be forbidden and blocked because they breach the integrity of central banking from those with good potential because they strengthen the comparative advantages of CBI or block/out-compete and check undue influences from other powerful actors.

Pluralism also entails considering and extracting the best that other Influencers may bring to the process of central banking.

The role of a CBI framework is not to isolate central bankers in an ivory tower, and it is not exclusively about defending them against undue external interferences. It is, more broadly, about structuring and regulating a plurality of channels, interactions, signals, and interdependencies with relevant potential to influence central bankers.

CBI is also pluralistic in the strategies of protection and promotion of independence. Rather than relying exclusively on legal barriers to external inputs, it also counts on a “system of control by competition” of influence(r)s that mutually check one another in the spirit of Madisonian pluralism and of DAHL’s descriptions polyarchy.<sup>167</sup>

Finally, CBI is pluralistic in fitting within and supporting the concept of *pluralist democracy* (and potentially DAHL’s polyarchy) that acknowledges that the existence of relatively autonomous centers of power and political organizations is necessary to the practice of democracy on a large scale.

It is also coherent with a plural “agonistic theory of democracy” that stresses the importance of creating “multiple and multidirectional lines of authority and accountability” beyond elections,

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<sup>164</sup> (BLINDER, 1998: 59-60), (ADOLPH, 2013), (CONTI-BROWN, 2016: 6), (VAUCHEZ & FRANÇOIS, 2020).

<sup>165</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>166</sup> CJEU judgments on *EU COM v Poland* case: §75, and *ASJP* case: §44.

<sup>167</sup> (THE FEDERALIST PAPERS, 10 and 51), (DAHL, 1984).

at which actors within and outside government can be involved with agencies directly and engage in public “contestation and democratic mobilization”.<sup>168</sup>

#### **3.4.1. PLURALISTIC COMPETITION OF INFLUENCERS**

Contemporary CBs inhabit a profoundly interdependent world. The interdependence is functional and institutional, domestic and across borders, involving public(s) and private agents. And it is both a matter of fact and a choice of law.

Central bank(er)s coexist with(in) a web of actors with whom they interact through various channels, forms, and intensities: informal or formal; procedural, institutional, social, or cultural; across the multiple functions of CBs; in periods of crisis and normality; and both at leadership and staff levels.

Those interactions convey signals about policies going both ways. They influence central bankers through the law and institutions, the context and interdependencies, information, their utility function, and the incentives structure.

In modern liberal democracies, the classic electoral-representative political process and the traditional political branches, as embodiments of representation, are prime channels for the (democratic) legitimation, guidance, and accountability of CBs.

Yet, they have no *de jure* or *de facto* monopoly over the responsiveness and accountability of CBs. Central bankers are also “politically self-conscious” and have a broader “responsive constitution”.<sup>169</sup>

In this webbed context, ICBs are, in different ways and degrees, engaged with, constrained by, vulnerable, responsive, and accountable to all of the five groups of Influencers.

Ideally, the various Influencers would be aligned for the public interest, but such benign illusion is defeated by reality. In the worst cases, Influencers ally or complement one another, consciously or not, to favor a partisan or sectional interest contrary to the common good.

A resourceful and highly motivated Influencer might be able to mobilize and manipulate others and their processes in her favor. For instance, a special interest group can lobby both the central bankers and political actors (particularly those in related political positions such as the finance minister and the head of government, and the members of the parliamentary committee competent on central banking issues), promote friendly and even loyal appointees to the CB, invest in propaganda to persuade the public, and sponsor aligned academic and policy discussions and contributions. When displeased with a certain decision, the Influencer may bring judicial litigation against it.

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<sup>168</sup> (WALTERS, 2022).

<sup>169</sup> (HOLMES, 2013), (COROADO, 2020: 49).

In effect, Influencers can work their way through indirect manipulation or domination of other Influencers, including through DRs and the classic political process.

Politicians may act as proxies of businesses and interfere in the institutional design of agencies or their activities in exchange for political financing or similar benefits that allow them to increase their political gains<sup>170</sup>.

Such phenomenon of indirect capture through politicians may affect the attitude towards democratic control and create doubts about the claims for more of it.<sup>171</sup>

What is usually described as a defense against direct capture of CBs by sectional interests could become a dangerous ally of interest groups lobbying legislators so successfully that “politicians [come to] represent the narrow interests of the financial services industry over the broader public interest”.<sup>172</sup>

A comprehensive (pluralistic) framework of CBI guards against “iron triangles” formed by “symbiotic relationships between regulators, legislators, and private industry... with each group exchanging favors to remain entrenched at the expense of the general public, taxpayers, and consumers”<sup>173</sup>.

On the other hand, while leading global and domestic financial actors try to lobby politicians, so they pressure executives and the CB, many politicians understand and repel such efforts. In any case, a proper institutional comparison has to assume equally well-functioning institutions.<sup>174</sup>

There is, however, another story about the competition of Influencers to sway ICBs.

Such competition might be for evil when it is not the most legitimate of the actors and channels that prevail.

But it can also be for the best.

The CBI framework must seek and extract the best that each of the relevant Influencers brings to the process of central banking. It should enable complementarities and competition amongst Influencers that are for the common good while insulating CBs from those that are not.

Since all Influencers (elected and partisan officials included) have their own problems, biases, and pathologies, such competition can be a good method of Madisonian mutual check.

In The Federalist Papers, MADISON argued that the multiplication and diversity of factions avoid the tyranny of any majority and that the localized danger of a specific faction is diffused in the aggregate by the existence of other factions.<sup>175</sup>

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<sup>170</sup> (PAGLIARI, 2012: 18-20), (MILLER & WHITFORD, 2016: 19), (TUCKER, 2018: 108).

<sup>171</sup> (MILLER & WHITFORD, 2016: 19).

<sup>172</sup> *Idem*.

<sup>173</sup> (CANOVA, 2011: 22).

<sup>174</sup> (WALDRON, 2016).

<sup>175</sup> (The FEDERALIST PAPERS nr 10 and 51, 1787), (RILES, 2018: 52).

KANT also described this competitive mobilization of “self-seeking propensities” as a path for perpetual peace through “a good organization of the state for their forces to be so pitted against one another, that the one may check the destructive activity of the other or neutralize its effect”.<sup>176</sup>

The competition of Influencers exposes CBs to a mosaic of diverse, potentially conflictual inputs that, even if problematic *per se*, on aggregate diffuses the relative threat of each and can enhance independence.

Therefore, competition is an alternative or complementary method to protect CBI.

Instead of, or in addition to, prohibiting certain signals from a partisan majority, political independence may be protected by institutionalizing interventions from other Influencers.

The development of other tools of social control of central bankers, such as professional discipline by the respective epistemic community, may weaken or interrupt the control of elected officials.<sup>177</sup>

This idea of a competition of influencers is akin to MAJONE’s suggestion that agency independence requires a “network of complementary and overlapping checking mechanisms”<sup>178</sup>. Or to GOODHART & LASTRA’s plea for the diversification and dispersion of accountability “through the three branches of the state, through institutions with differing obligations to the electorate... complemented by other forms of accountability, namely public support, disclosure and performance control”.<sup>179</sup>

The independence of CBs “from political majorities requires the continuous maintenance of support groups as well as audiences on the periphery of these institutions; the integrity of central banking depends on multiple and crossed games of competition and crossed accreditation”.<sup>180</sup>

The ICB’s “commitment to its approach is more credible when external actors support it and can be expected to resist if the agency tries to renege”.<sup>181</sup>

Furthermore, the five groups of Influencers and their competitive game are necessary to realize the potential epistemic and liberal democratic improvements of the art and science of central banking.

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<sup>176</sup> (KANT, 1795: 153-154).

<sup>177</sup> (MILLER & WHITFORD, 2016:141-3).

<sup>178</sup> (MAJONE, 1996: 5).

<sup>179</sup> (GOODHART & LASTRA, 2018).

<sup>180</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>181</sup> (CONTI-BROWN ET AL., 2021: 20).



Non-political Influencers make the democratic control of CBs less partisan, less majoritarian, and short-termist, and more pluralistic, unbiased, non-dominated, and republican in the sense of promoting quality of deliberation.

They can contribute to the objective of “an expert agency that is independent of partisan politics, but sensitive to the concerns of ordinary citizens and civil society groups”<sup>182</sup>. When they do, and when they cooperate and forge linkages and alliances with the CB that diversify information sources and empower and insulate the CB vis-à-vis undue interferences or interests<sup>183</sup>, they become *friends* of CBI.

Each Influencer can pose threats but also bring critical normative contributions to a more upright, professionally expert, unbiased, and democratically reflexive CB.

That risk of threats justifies the need to control them all, and their potential contributions demand that they may be permitted or even required, under conditions.

Depending on the situation, each Influencer can be either a *friend* or a *foe* of CBI and should be treated accordingly.

Therefore, inflexible lines of strict separation in the relations between ICBs and the Influencers would be artificial and self-defeating.

Instead, the CBI framework should rely on *flexible lines* and balanced separation for the CB to navigate all competing forces with the “autonomy of a tightrope walker” (*l'autonomie de l'équilibriste*) who has to learn the practical skills of holding the line between opposing forces and preserve the integrity of the art and science of central banking<sup>184</sup>.

Its independent political work lies precisely in its ability to maintain relationships while simultaneously keeping its distance from the various sectors involved.<sup>185</sup>

The ICB should *work proactively* to “harness these diverse pressures as commitment devices by inviting support and reliance from external actors, identifying external actors who benefit from the agency’s approach, notifying them about it, and helping them organize. It may be especially possible to build a coalition of diverse interests if the agency is adopting a process or an intellectual framework for choosing policies; groups of political actors have been known to stick by a common process even when each of them dislikes some of the particular outcomes that result from it”.<sup>186</sup>

CBs have increasingly assumed such responsibility to engage “in building a closer relationship with citizens, enhancing more relevant and active coordination with institutional players. This

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<sup>182</sup> (ROSE-ACKERMAN & LINDSETH, 2010).

<sup>183</sup> (CARPENTER & MOSS, 2014: 463).

<sup>184</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>185</sup> *Idem*.

<sup>186</sup> (CONTI-BROWN ET AL., 2021: 20).

includes national and international institutions, and also academia... [and] also deepening the exchange of information with market participants.”<sup>187</sup>

From the perspective of Influencers, the role of each group within the CBI framework is not arbitrary. The framework ought to be structured to enable and extract the best from each according to the respective institutional specialization in the Waldronian sense.

For instance, the epistemic community and mobilized affected interests may provide the information, expertise, and professional and expert-based discipline that public and elected and partisan actors are incapable of.

Courts do the remedial override of (extremely erroneous) concrete decisions that the political branch should not do.

Elected and partisan officials, the public, and potentially the epistemic community can prevent minoritarian biases and capture by special financial interests.

This competition is not a game of equals. Firstly, in the sense of having distinct institutional specializations, and thus capabilities to contribute. Second, because the competition is imperfect, it does not meet the assumptions of a perfectly competitive market.

A pluralistic framework takes into account and manages the heterogeneity and diversity of competitive forces that interact between actors of the same group of Influencers (internal competition) and between different groups (external).

### **3.4.2. CONTROLLING THE RISK OF SUBSTITUTION OF BIASES**

Understanding this competitive game of influences permits tackling a problem underlying one of the most fundamental criticisms of CBI: the risk of substitution of biases.

If CBI targeted only the relation with political institutions, it would open or leave unguarded the backdoor through which other forces could influence and capture ICB’s decision-making.<sup>188</sup>

Blocking influences merely from the classic political process does not leave the ICB in conditions of freedom from all hetero motivation, let alone neutrality in the sense of absence of self-motivation. Central bankers are subject to other external pressures. They are not angels but humans with preferences and utility functions who are involved in socialization.

The game of power and influence works like communicating vessels. The void left by banning political influences is likely to be filled by the influence of other actors. “[B]y granting an agency independence from above, it may become bound to the forces from below and thus beholden to the industry it is supposed to regulate”.<sup>189</sup>

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<sup>187</sup> (CENTENO, 2022: 13-14).

<sup>188</sup> (ADOLPH, 2013: 17).

<sup>189</sup> (HALBERSTAM, 2010: 191).

Thus, there is a risk that full legal independence from the political process “does not create political neutrality, but regulatory capture”.<sup>190</sup> Unless controlled, it propitiates an environment where the interests of financial players and central bankers might align.<sup>191</sup>

It has been argued that the broader the delegation, the larger the invitation to agency capture.<sup>192</sup> The process of insulating central bankers from political influence “removes an important check on their behavior, and thus allows the bank’s officers greater flexibility to ignore the goal of price stability in the service of other objectives”.<sup>193</sup> As political accountability creates a check on other deviating influences, the protection of political independence has to be accompanied by protection from other Influencers.

POSEN went further to declare that central bankers are not independent of the leaders of financial markets, that their political authority and independence from other branches of government rely on support from the financial sector, and that they cannot engage in policymaking without their support.<sup>194</sup>

This is one of the main arguments of the majoritarian and critical political economy critiques of CBI: that insulating monetary policymaking from democratic politics throws the ICB into the arms of minoritarian interests, privileged financiers, or wealthy classes. They emphasize the processes of financialization of economies and (markets’) financial dominance over CBs to criticize (and repudiate) CBI as an institutional device that would secure (“neoliberal”) ideological or special interests’ predominance and infrastructural power.<sup>195</sup>

Such purported substitution of a minoritarian bias for the majoritarian would put CBI in dire straits.

Firstly, it would jeopardize CBI’s democratic acceptability. The governance of important macroeconomic policies should not be delegated to an institutional mechanism beset by systematic minoritarian biases. To pass the test of comparative institutional analysis, CBI must avoid or mitigate both majoritarian and minoritarian biases. A pluralistic CBI controls both.

Second, such bias-substitution would be inconsistent with the evolution of CBs. They were transferred to the State in the first half of the 20th century also to insulate their functions from private banks and the business community.<sup>196</sup> The consideration of all relevant Influencers is part of the “long march” toward independence from economic and political interests.

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<sup>190</sup> (ADOLPH, 2013: 310, 413), (CANOVA, 2011: 20).

<sup>191</sup> (AKLIN & KERN, 2021).

<sup>192</sup> (CANOVA, 2011: 22).

<sup>193</sup> (LASTRA, 2015: 75).

<sup>194</sup> (POSEN, 2016).

<sup>195</sup> (POSEN, 1995), (MCNAMARA, 2002), (GABOR, 2016), (BRAUN, 2018), (RILES, 2018).

<sup>196</sup> (PADOA-SCHIOPPA, 2000), (VALE, 2021: 15).

Third, it could jeopardize the traditional claim that CBI creates credible commitment by avoiding the short-termism and time inconsistency of the political process. If a narrow, political-only independence facilitates financial dominance or leads the CB to “follow the markets”, the undesired short-termism and time-inconsistence could worsen. Financial markets are prone to cognitive biases such as irrational exuberance, herd behavior, overreaction, susceptibility to fads, and speculative bubbles that might generate short-termism that make the time horizons of electoral politics look long by comparison.<sup>197</sup>

Therefore, a pluralistic CBI framework must include the negative dimension of independence of protection from undue external influences that can substitute or complement political influences. It should deploy “[w]idespread vigilance and awareness of subtle but cumulative attempts to repoliticise central banking to serve sectional interests – what is cheered today might bring tears tomorrow”.<sup>198</sup>

### 3.5. MEASURING CBI

Mindful of variability across countries, multiple empirical studies since the 1970s have sought to measure and index degrees of CBI. Most gauge *de jure* CBI, while fewer focus on *de facto* CBI, and many use those indexes to assess the relationship between CBI and macroeconomic performance indicators.

Notwithstanding their valuable contributions, CBI measurements and their correlation with macroeconomic performance have methodological difficulties that recommend skepticism or caution about their empirical conclusions.<sup>199</sup>

In particular, the law in practice may differ from the “law in the books”. *De jure* CBI is necessary but is not sufficient for independent policymaking.<sup>200</sup>

To start with, laws are incomplete and leave room for interpretation, allowing tradition, informal practices, and the personalities of governors to shape the actual level of CBI.<sup>201</sup>

Even where the law of CBI is explicit, reality may deviate due to misinterpretation or non-compliance, which is more common in countries with a less established rule of law and weaker institutions. Many “[g]overnments will try to override CBI to meet their constituents’ demands” using the indirect and informal tools of democratic control, manipulating the utility function of central bankers, or “manipulating financial market outcomes”.<sup>202</sup>

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<sup>197</sup> (BLINDER, 1998: 61-2, and 2016: 10).

<sup>198</sup> (TUCKER, 2018).

<sup>199</sup> Identifying multiple methodological shortcomings of such empirical studies (EIJFFINGER AND DE HAAN, 1996), (JAMES, 2012: 271), (ADOLPH, 2013: 289-90), (GARRIGA, 2016).

<sup>200</sup> (OCDE, 2022: 168).

<sup>201</sup> (CUKIERMAN, WEBB & NEYAPTI, 1992: 361-3), (CONTI-BROWN, 2016), (BINDER, 2021), (BALLS ET AL., 2018).

<sup>202</sup> (AKLIN & KERN. 2021: 3).

Practices and conventions “have changed, strengthened, or undermined” the words of statutory law<sup>203</sup> and this “conventional character” of agency independence has been recognized by courts (particularly in Commonwealth countries and the USA).<sup>204</sup>

There are multiple notable examples of “the chasm between law on the books and law on the ground”. For instance, the Argentinian tradition in the 1950s-90s of central bankers tendering resignation whenever the government changes<sup>205</sup>. In the USA, “the Fed’s extraordinary budgetary autonomy... is not authorized by statute”, and “the fourteen-year non-renewable term of the Fed Governors (meant to enhance Fed independence) and the four-year renewable term for the Fed Chair (meant to enhance accountability) have become precisely the opposite: filling Governor vacancies has made the Fed more dependent on the President, filling Chair vacancies has made it less”<sup>206</sup>. In the EMU, the “constructive ambiguity” of the prohibition of monetary financing has been used to gradually dismantle previously asserted limitations on the purchase by the ESCB of sovereign debt of Member States.<sup>207</sup>

Because a “law-based approach to independence is insufficient” and CBI “is as much a function of politics as it is of law”<sup>208</sup>, scholars developed indexes to capture divergences between *de facto* and legal independence. They pondered the rate of turnover of CB governors (where more rapid turnover indicates less independence)<sup>209</sup>, the known conflicts between the Executive and CB, the informed perceptions through surveys of experts in each country<sup>210</sup>, and by examining the political and social setting within which CBs work that reflect a particular culture.

Four seminal indexes of CBI established the methodologies and coding that others followed: BADE & PARKIN (1977), ALESINA (1988), GRILLI, MASCIANDARO & TABELLINI (1991), and CUKIERMAN, WEBB & NEYAPTY (1992). More recently, LAURENS ET AL. (2009), BODEA & HICKS (2015), and CARRIGA (2016) reviewed preexistent studies and expanded the time-series and countries’ coverage.

Most of those studies found a few common trends: (i) a global spread and convergence towards *de jure* and *de facto* CBI since the 1970s; (ii) the fastest progress towards CBI occurred in the 1990s and early 2000s, and later in developing countries; and (iii) since the GFC, CBI has further

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<sup>203</sup> (CONTI-BROWN, 2015: 260), (CUKIERMAN, WEBB & NEYAPTY, 1992: 361-3), (BINI SMAGHI, 2008).

<sup>204</sup> (VERMEULE, 2011).

<sup>205</sup> (CUKIERMAN, WEBB & NEYAPTY, 1992: 363).

<sup>206</sup> (CONTI-BROWN, 2016).

<sup>207</sup> (VAN DER SLUIS, 2021).

<sup>208</sup> (CONTI-BROWN, 2016, 260, 272, 308-9).

<sup>209</sup> (CUKIERMAN ET AL., 1992: 364, warning that a low turnover does not necessarily imply a high level of CBI because a relatively subservient governor may stay in office for a long time).

<sup>210</sup> (BLINDER, 2000), (CUKIERMAN ET AL., 1992), (FRY, GOODHART, & ALMEIDA, 1996).

increased or at least not decreased for most countries, although some studies identify some reversal, particularly in non-OECD countries.<sup>211</sup>

Personal independence has been the most stable of the dimensions of CBI throughout the samples, while financial and policy or functional independence exhibit the most dramatic increases through time, particularly in higher-income countries.<sup>212</sup>

Regarding the major CBs in the world, the ESCB consistently exhibits the highest levels of CBI across studies. The Fed and BoE are found to have lower levels of CBI, but with different orders and levels depending on the studies and on whether the average results are weighted or not.

The Fed, like the SNB, has maintained a relatively stable level of independence across the past four decades. The NZRB, Riksbank, Norges Bank, and RBA tend to display the lowest levels of CBI amongst advanced economies. The BoJ, Borsr, and BoCan are mid-rangers.<sup>213</sup>

### 3.6. TAXONOMY OF CBI

CBI can be analyzed in different dimensions.

According to their *sources*, influences and dependences can be described as *political*, from DRs and partisan actors, *professional* from the epistemic community, *public* from the public opinion and media, *judicial* concerning courts, and *private* from special interest groups or individual affected parties. The professional can be either *external* or *internal* to the CB.<sup>214</sup> The analysis in the following chapter demonstrates that they might compete and check on each other or complement or even be instruments of one another.

In the *OLAF* case, the CJEU asserted that “the independence which the NCBs, and therefore the ECB too, must enjoy, must be such as to shield them from ‘all sources of external influence’”.<sup>215</sup>

From the perspective of the *target* of influences, independence can be *institutional* or *individual* (or decisional). The former protects from inputs directed at the CB or the body of central bankers in general, and the latter from interference when concrete central bankers make particular policy or adjudicatory decisions.<sup>216</sup>

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<sup>211</sup> Suggesting that most pro-CBI reforms occurred in the 1990s (FERNÁNDEZ- ALBERTOS 2015), (CUKIERMAN, 2008: 724), (BODEA & HICKS, 2015). Documenting a general increase in CBI in the current century, particularly in advanced countries, with some exceptions (GARRIGA, 2016), (DE HAAN & EIJJFINGER, 2017), (DE HAAN & EIJJFINGER, 2016). Finding a stable situation (BLINDER ET AL., 2017: 743, reporting that more than 90% of surveyed governors and academics believe that, since the GFC, CBI either did not change or was reduced only “a little”), (BODEA & HICKS, 2015).

Differently, (MASCIANDARO & ROMELLI, 2015, finding a reversal in the level of independence since the GFC, which they attribute to the assignment to CB of banking supervision in the GMT index they use).

<sup>212</sup> (CARRIGA, 2016), (CROWE & MEADE, 2008).

<sup>213</sup> (LAURENS ET AL., 2009), (BODEA & HICKS, 2015), (CARRIGA, 2016), (JORDAN & LUTHER, 2020).

<sup>214</sup> Adapting (RUSSELL, 2002: 11).

<sup>215</sup> CJEU, Judgment in the *OLAF* case, *EU COM vs ECB*, C-11/00, §115. (PADOA SCHIOPPA, 2000), (MERSCH, 2017).

<sup>216</sup> (ARDEN, 2007: 191), (RUSSEL, 2002: 11), (EUROPEAN COURT OF HUMAN RIGHTS, *Baturlova v Russia*, case No. 33 188/08, 19 April 2011, §28), (FEREJOHN & KRAMER, 2002: 965).

These two categories are interconnected because efforts directed at the institutional body are often motivated by decisions on specific cases, or a limited group of cases, or by the expectation that the abstract institutional pressure generates some systemic bias in the CB that shapes the direction of decisions on multiple particular policy processes.<sup>217</sup>

From the perspective of the *channels, factors, or levers of influence*, it is common to distinguish *institutional* (and/or *functional*), *personal*, *financial*, and *organizational* independence.<sup>218</sup>

This classification is used throughout the following chapters to analyze the channels of control and the framework of more than sixty protections of pluralistic independence.

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<sup>217</sup> (LASTRA, 2015: 69-70), (CONTI-BROWN, 2016: 34).

<sup>218</sup> (AG JACOBS, Opinion in the OLAF case, §151), (CUKIERMAN ET AL., 1992), (EMI, 1996), (EIJFFINGER & DE HAAN, 1996), (ARDA, 2006), (ZILIOLI, 2016), (DALL'ORTO, 2020: 17).

#### 4. INDEPENDENT FROM WHOM?

The concept of pluralistic CBI offers a novel, comprehensive answer to the question: from whom should CBs be independent?

It goes beyond the traditional view focused only on the insulation from the *classic political actors and process* and beyond the critical political economy approach that targets the capture by *special interests of private financial institutions*.

It innovates by demanding the consideration of other influential groups of actors, namely the public, the judicial branch, and the *epistemic community of central banking*.

However, the greatest originality of the pluralistic approach is the systemic treatment of the interactions with those five groups of Influencers.

It defines and analyses the position of ICBs as a collective game of competition of five groups of Influencers rather than a bundle of five pairs of bilateral interactions.

And it acknowledges that each Influencer can be either a *friend or a foe of independence*.

They all can protect CBI, limiting undue interferences of other Influencers, as they can be a counter-power that limits the power of ICBs.

The following sections explain why.

##### 4.1. POLITICAL ACTORS

In liberal democracies, ICBs are creatures of the political process. They do not emerge *sua sponte* and are not self-standing. They are created/acknowledged, structured, and delegated public functions and powers by political democratic institutions, whose kind of *kompetenz-kompetenz* generates some second-order policymaking. Political branches, with their arsenal of decisive *ex-ante* and *ex-post* controls of guidance and accountability, are the primary Influencers of CBs.

It is worth noting two complexities.

First, CBI literature traditionally treats Political Influencers as a homogenous ensemble, often referred to as the Executive<sup>219</sup>. The simplification is understandable but misses the dynamic of internal competition for influence over central banking among the various political actors.

Second, the stylized relationship between CBs and political actors describes them as *foes* of the former's independence. Yet, they can be *friends* of CBI.

The political process and its constellation of actors are much more complex than a simplistic duality of Legislative and Executive branches. There are more political actors, individual or composite, with distinct roles, relations, interests, and preferences over policies that vary across systems of government and parties.

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<sup>219</sup> (TUCKER, 2018).



Such distinctions lead to different positions and actions vis-à-vis the CB and its policymaking. They render illusory the idea of “one” political will. Political actors struggle for political deliberation and the approval of official signals to CBs. At the same time, they keep channels for issuing their own signals and influences.

The basic distinctions are between constitutional and infra-constitutional political powers and, for the latter, between Legislative and Executive bodies.

To start, neither the Legislature nor the Executive is necessarily cohesive and coherent. They act collectively, but some of their members have special roles and dedicated relations with the CB: the leaders vs. the others, and amongst them, the specialized members like the finance minister and the finance or banking parliamentary committee. Typically, these specialized members pivot the action of the respective political body regarding the CB and its policies. Still, sometimes they clash with their peers (other ministers and parliamentarians) and function as a defense of CBI. Political guidance or legislative oversight is often controlled by a few (the leadership or the specialized committee). In that case, the hypotheses of captive, concentrated, or elitist political representation raise questions about the preservation of the comparative advantages of the classic political process, namely in terms of number, variety, transparency, deliberation quality, and general representativeness.<sup>220</sup> If an individual legislator is clearly inferior to the whole legislature, she might not compare well with independent “technocrats”.

The struggle within and between Legislative and Executive varies with the degree of their political and policy distances and the type of political and party system.

The main conflict here tends to be between the government and the opposition, who are expected to assume contrary positions regarding the CB policies. The opposition tends to be friends with CBI if they see the CB under pressure by a majority seeking monetary financing or to sync monetary or macroprudential policies with the electoral cycle. However, a majority may increase the protections of CBI to deflect the blame to the CB over policy misgivings or to prevent a subsequent government of the opposition from manipulating the CB in its favor.

When the government is composed of coalitions rather than a single party, internal competition for influence can also be expected if the various parties have contrasting views on the macroeconomic agenda.

Presidential systems typically generate more significant division between the Legislative and Executive. Majoritarian political systems with Executive dominance, like the UK, are expected to create fewer conflicts between Legislative and Executive but more between government and opposition. In consensual democracies<sup>221</sup> with proportional systems and a leading party or

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<sup>220</sup> (BOVENS ET AL., 2014: 12), (EPSTEIN & O’HALLORAN, 1999).

<sup>221</sup> (LIPJHART, 1969).

coalition of parties without great distance, the conflict tends to be softer, compromise is privileged, and they accommodate non-majoritarian institutions better.

Furthermore, the multiple political actors have different degrees or natures of *substantive* democratic representativeness.

In every election, distinct forces gather different proportions of the popular vote. As time passes and conditions evolve, the perceived relative popular support changes.

Moreover, many Executives and some upper Legislative chambers are not even directly elected. At best, they closely reflect the outcomes of legislative elections. Still, often, their appointment results from intricate negotiations. In some cases, Executives are led by so-called technocrats to bridge a political stand-off (MONTI and DRAGHI's governments in Italy and PAPADEMOS in Greece).<sup>222</sup> Finally, the broad landscape of the political process encompasses the role of political parties and electoral competitors whose signals might be consequential even if they do not currently hold legislative or executive office.<sup>223</sup>

The complexity of CB-politics interactions is aggravated in the case of the ESCB, whose interactions multiply in number and nature.

Vertically the ESCB has to deal with a large number of national political authorities who hold the primary sovereign political power and are the masters of the Treaties, the members of the two Councils and Eurogroup, the fiscal authorities, and the owners and/or delegators to NCBs with whom they have a direct relationship.

The ESCB has to play two different games of political (in)dependence: one with directly partisan or electorally oriented politicians (ECB v. European Parliament and Commission; NCBs vs. respective national authorities); and another where political actors of national governments and politicians confront the ECB as representing an alleged national interest, even though they are oriented by similar domestic (partisan and electoral) politics.<sup>224</sup>

Moreover, the horizontal distribution of political power amongst EU institutions does not mimic the classic national distribution, forcing the ECB to navigate relations with the EU Council and the Council of the EU, the European Parliament, and the Commission, plus the Eurogroup and a host of supporting committees. Furthermore, each function conferred to the ECB has a distinct vertical and/or horizontal distribution of competences.

This complexity of the constellation of Political Influencers in internal competition reinforces the worth of a pluralistic notion of CBI.

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<sup>222</sup> (MACKENZIE & KYRIAKIDOU, 2012).

<sup>223</sup> (BLINDER, 1998: 59-60).

<sup>224</sup> (SHAPIRO, 2010), (IOANNIDIS, 2020: 374).

The traditional tale is that political competition is the main drive for political actors to manipulate central banking policies for their electoral advantage, thereby violating commitments and generating an inflation bias.

The internal political competition does pose difficulties for ICBs by exposing them to mixed and often conflicting signals and intensifying accountability. It increases politicization by heating public contestation with an impact on the CBs' credibility. If political competitors fail to deliberate or compromise on exercising the competences of *ex-ante* control, it may create political paralysis or suboptimal aggregation of wills in the democratic guidance of CBs. These difficulties are more likely in polarized political systems with multiple veto points.

However, free and open competition between the two political branches, or amongst government and opposition, within coalitions, between the finance minister and other cabinet members, amongst parliamentarians, or opposing national governments with different views or preferences over policies may protect political independence.

Such conflicts create mutual checks between political friends and foes of CBI that mitigate control and avoid domination à la Madison.

The mixed signals and paralysis may create opportunities for more autonomous CB action.

The plural debate might feed informative and argumentative material into the central banking process, enhancing the quality of deliberation and giving voice to otherwise ignored members of society, increasing participation.

Finally, when it brings the management of substantive conflicts back to the classic political process, it might relieve central bankers from some pressure from incomplete mandates.

The risks of partisan struggle over the CB's policies and control disavow the latter from actively inflaming such conflicts. It is not its place to tip the balance of the partisan-electoral game.

Nonetheless, in the face of a threat of political pressures, it may clinch the potential of mutual political checks.

The following behaviors seem compatible with the need to maintain partisan neutrality: first, ICBs should mitigate informational asymmetry between political competitors by being transparent and sharing information with all; second, they should privilege formalized institutional dialogue with parliaments whose process has better conditions of plurality and equality of arms; third, they should increase their caution in periods of heightened partisan or electoral tension, particularly in the vicinity of elections.

Finally, political actors can also be friends of CBI in the context of external competition of influences. Their representative credentials may help moderate populist mobs or defend against judicial challenges. This recently occurred when the German Government and Parliament supported the ECB's PEPP program (and its proportionality) in the face of the defiance of the GCC in the *Weiss* case and the Bundesbank's longstanding criticism.

## 4.2. PUBLIC(S)

One of the major transformations in the history of modern central banking concerns their relationship with the Public<sup>225</sup>. ICBs moved from strategic ignorance, monetary mystique, and secrecy to transparency and, subsequently, to bidirectional engagement.<sup>226</sup>

### a) TRANSFORMATION OF THE RELATION WITH THE PUBLIC

The transformation was pushed by democratic and policy efficiency concerns<sup>227</sup>, a favorable global environment promoted by peer effects among central bankers<sup>228</sup>, and by a wave of non-specific legal reforms on transparency and public participation in administrative law and policymaking<sup>229</sup>. Dramatic developments in communications technologies and social media accelerated it.

CBs made a transformative journey not required by the law in the books.<sup>230</sup>

Firstly, in an outward direction, embracing transparency and expanding communications, including disclosing projections, deliberations, and decisions, explaining them, and reporting their activity, and performance.

Subsequently, in an inward direction, consulting and listening to the views and appraisals of the Public without the intermediation of political actors.

In the process, they expanded broadened the communication focus from the community of experts to the non-expert public.<sup>231</sup>

The recent strategic framework reviews conducted by the Fed and ESCB mark the arrival of public consultation at the core of central banking: monetary policy. Until then, it was possible to say that “the ECB, like other central banks, has never formally consulted the public and stakeholders regarding monetary policy”.<sup>232</sup>

These reviews were probably the highest points of this new culture of CBs’ direct, bidirectional dialogue with the Public.

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<sup>225</sup> (HORVATH, 2020: 796).

<sup>226</sup> (ISSING, 2019), (BLINDER, 2004: 5-34), (DINCER & EICHENGREEN, 2014), (EIJFFINGER & MASCIANDARO, 2018).

<sup>227</sup> (ISSING, 2019), (BERNANKE, 2015), (SCHAUER, 2014: 820).

<sup>228</sup> (HORVATH, 2020).

<sup>229</sup> Rights of Information and consultation prior to an individualized decision had long been parts of due process fundamental rights. But in the context of policymaking and non-individualized decisions, they were US oddities (*e.g.*, FOIA and APA). In the EU, transparency became a general principle of law, and the duty to provide reasons is outlined in article 296 TFEU. But the CJEU has consistently resisted claims to procedural rights, except when explicit in primary or secondary law (CRAIG & DE BURCA, 2020: 577-582, 600-608). The Aarhus Conv.1998 led the transformation towards open and participative administration.

<sup>230</sup> (AMTENBRINK, 2019: 316).

<sup>231</sup> (EHREMAN & WABITSCH, 2022). Sceptically (BLINDER, 2018).

<sup>232</sup> (LETTANIE, 2019: 1). The ECB had organized over 20 public consultations on payments systems, and 30 on supervision.

They included dozens of “Fed Listens” and “ECB Listens” events and other mechanisms to collect written opinions and contributions from the general public and stakeholders. In the end, the ECB-GC promised “to make outreach events a structural feature of the Eurosystem’s interaction with the public”.<sup>233</sup>

Empirical studies have found that central bankers are indeed responsive to the Public. Notwithstanding their independence, they are “politically self-conscious”, and sensitive to the need to build and maintain their reputation with the Public.<sup>234</sup>

The increased centrality and substantive politicization of central banking intensify contestation and the Public’s motivation to influence CBs’ policymaking.

The Public’s relationship with the CB does not rely exclusively on the intermediation of DRs, who neither exhaust nor have a monopoly over political contestation<sup>235</sup>. Sometimes the government’s supporters do not feel fully represented in its actions or feel the need to complement or amplify its signals. Unsatisfied oppositions and discrete minorities often voice their divergent views.

The Public thinks, wills, and acts autonomously from its DRs. Liberal democracy requires more than regular, free, and competitive elections with a plurality of parties and representation by the elected.

Fundamental rights of freedom of opinion, press, and association engrave in the law the Public’s prerogatives to intervene and influence directly.

Liberal democracies recognize more factions than just the political parties and structure various non-representative channels of public participation in democratic deliberation. They are not “partitocracies”.

In a democracy, the Public is like a chorus in a Greek tragedy: it is both a spectator and participant that intermittently comments and acts.<sup>236</sup>

However, who is the Public?

## **b) PLURAL PUBLIC**

The answer must be a pluralistic notion of the Public rather than a Rousseauian idealization of a general will.

The Public’s discourse and contestation operate at multiple levels.

A comprehensive definition identifies the Public with the polity or citizenry in general, whose views and signals are conveyed through traditional opinion polls and online tracking of

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<sup>233</sup> (ECB, Monetary Policy Statement, 2021, §12).

<sup>234</sup> (HOLMES, 2013), (MOSCHELLA & PINTO, 2019).

<sup>235</sup> (BLINDER, 1998: 59-60).

<sup>236</sup> (VAN MIDDELAAR, 2012: 271-4).

behaviors. Other instruments extrapolate preferences and beliefs from mass behaviors. Participatory initiatives such as demonstrations, petitions, and civic activism offer insights. Novel technological tools provide additional possibilities for direct disintermediated dialogue between the CB and the general public.

Yet, the Public largely speaks through social intermediators of public opinion, generalist and specialized mass media, CB watchers, pundits, and other non-partisan voices who are not necessarily representative.

A critical group of intermediators comprises diverse stakeholders' organizations such as industry representatives, agencies, state and local governments, academics, or NGOs. They frame and filter public discussion with different degrees of expertise and bias (which are not mutually exclusive). They coexist with individual lay participation from either people who are genuinely unconnected to organized interests and that issue opinions and send comments on their own or people solicited to send form letters by advocacy groups.<sup>237</sup>

Public opinion is further fragmented in other senses.

Globally, public discourse is increasingly polarized in bubbles of like-minded people, often with discrete minoritarian and/or self-interested views, and sometimes mobilized by organized special interest groups. They create echo chambers that amplify each perspective and explain why people of different political views often cannot understand each other.<sup>238</sup>

For a supranational CB such as the ECB, the difficulty rises with the coexistence of multiple, discrete national publics, language and cultural barriers that block a collective dialogue, and a scant European public that is neither predominant nor fully formed.<sup>239</sup>

The ECB runs the risk of being perceived as too strict by Irish public opinion and, at the same time, too lenient in Germany. It operates in very different central banking cultures and perceptions of what the appropriate relationship between the CB and politics should be.<sup>240</sup>

Such plurality of publics creates various challenges for CBs trying to gauge public opinion, such as the difficulty of mutual understanding, cacophony, and risk of capture of public discourse by special interest groups and discrete, mobilized minorities with high per capita stakes, and therefore lack of rationality and representativeness.

### **c) RISKS OF ENGAGING WITH THE PUBLIC**

ICBs also have to deal with the fundamental limitations of the public and direct democracy as a mode of governance and with their own comparative inability to translate the popular will.

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<sup>237</sup> (CONTI-BROWN ET AL., 2021: 36).

<sup>238</sup> (SUNSTEIN, 2017).

<sup>239</sup> (VAN MIDDELAAR, 2012: 271-4).

<sup>240</sup> (BEUKERS, 2013: 1618-9).

The Public's limitations for the governance of monetary and financial policies tend to be even greater than those of the political process, which justified the delegation to independent, specialized experts.

The Public is expected to have (even greater) epistemic inferiority due to informational imperfections, lack of expertise or scarce allocation of time and attention, short-termism, lack of credible commitment, neglect of intertemporal and intergenerational impacts, and discrete minorities.

If CBs merely followed public opinion, they would fall prey to majoritarian bias, ignorance, and irrationality, and their policies could be governed by mob rule and the passions of instant majorities. All the evils that representation was meant to cure would be brought back by central bankers entirely concerned with their popularity.

Moreover, the fragmented structure of public opinions may also facilitate minoritarian biases if the predominant view of the CB becomes captured by discrete minorities with concentrated high stakes.

To increase the challenge, on average and on conditions of similar functionality, CBs are less specialized than the political process in aggregating and translating popular will into preferences over policies. The democratic process, with its free elections, competition of political parties, and representation through the classic legislative and executive branches, is the superior, less imperfect, most tested political technology to host and translate the Public's contestation into policy choices.

The political process is often dysfunctional, biased, and unresponsive, and it is insufficient to exhaust all public contestation and translate all valid and valuable public contributions.

ICBs shall not aspire to replace the political process as the primary technology for translating popular will. Still, they may have a role in providing new, additional, complementary, or remedial channels for democratic participation.

In those cases, they should not just accept and follow direct public pressures regardless of their form and content. Their openness to public signals should be accompanied by an effort to structure them better and protect against undue pressures.

#### **d) BENEFITS OF CONNECTING WITH THE PUBLIC**

Despite the difficulties and limitations of those direct relations, ICBs cannot give up on listening and engaging with the Public(s).

Firstly, the Public will speak and try to influence all policymakers. Thus, it is better to structure, manage and channel those efforts for the public interest so that the dialogue is more useful, informed, rational, unbiased, and representative.

The second reason is epistemic: it increases the quantity and diversity of incoming information on which to base decisions<sup>241</sup>.

Central bankers should remember that “because the voices of non-experts are rarely heard and are likely to convey different information than that available from experts, [policymakers] potentially stand to learn a lot...The judgments of experts can be improved materially by drawing on the views of non-experts.”<sup>242</sup>

However, “[t]he epistemic value of outside information depends largely on its diversity” that avoids minoritarian biases and on the nature of the public voices. “[T]he epistemic value of *individual lay comments* is mostly quite low. Mass form letters drummed up by advocacy organizations typically do little more than express value preferences, without providing new factual information”<sup>243</sup>

The third reason is that public participation increases the legitimacy of CB’s actions as a social fact. Participation makes such actions more acceptable to the Public (and the regulated industry)<sup>244</sup>. That possibility bridges the cultural chasm between expert central bankers and the broader citizenry<sup>245</sup>, solving public distrust and diffusing conspiracy theories that fuel populism.<sup>246</sup>

Central bankers must be legitimacy seekers, behaving like “unelected democrats” who continuously need to be in an ongoing conversation with society about what they are doing and why<sup>247</sup>. In this sense, “laypersons’ value-preference comments” might be relevant, even if they do not advance factual information and predictive judgments.

Still, central bankers should seek and manage public expectations correctly, and should avoid spam-participation.<sup>248</sup> Public participation cannot be an artificial, meaningless exercise. “[I]ndependence *requires* a CB to respond to the concerns of the public and to carefully evaluate whether and how it may be able, within its mandate, to respond to these concerns”. A failure to do so would risk nurturing populism and the so-called “undemocratic liberalism” – a system in which citizens feel that their political preferences are routinely ignored by unelected authorities.”<sup>249</sup>

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<sup>241</sup> (CONTI-BROWN ET AL., 2021: 21-22).

<sup>242</sup> (HALDANE, 2017).

<sup>243</sup> (CONTI-BROWN ET AL., 2021: 34, 36).

<sup>244</sup> *Idem*.

<sup>245</sup> (RILES, 2018: 63-89)

<sup>246</sup> (BERNANKE, 2015: 55-6, 239).

<sup>247</sup> (TUCKER, 2018: 563-4).

<sup>248</sup> (CONTI-BROWN ET AL., 2021: 36).

<sup>249</sup> (SCHNABEL, Societal Responsibility, 2021).



The fourth reason is that direct public participation can amplify and empower democracy. Usually, there are only two avenues to express collective political and social values about financialized welfare provision: individual investors' economic-financial valuations; and pure democratic representative action.

However, a new institutional arrangement or platform between CBs and the Public can offer additional possibilities for expanding democratic governance.<sup>250</sup>

Fifth, the Public can be a friend of CBI, competing against undue pressures from other Influencers and exposing and mitigating majoritarian or minoritarian biases.

Occasionally the Public can react to political errors and dissuade excessive partisanship and passions of the instant majority or interest group capture of democratic representation. Public support has been found to influence the ICBs' capability to resist pressure from democratically elected governments, including government deficit financing and inflation.<sup>251</sup>

There are reports that the Bundesbank emerged victorious from conflicts with the federal government partly through the support of public opinion<sup>252</sup>. It is comparable to cabinet members with political bases that guard them against removal, whatever irritation they cause to the Executive's leader.<sup>253</sup>

The Public's relevance increases when the incentives of political parties regarding the decision to delegate differ from those of the median voter.<sup>254</sup>

Provided that public contestation is not concentrated, and the financial industry does not have participatory dominance<sup>255</sup>, the Public may be a check on the excessive proximity between ICBs and leading financial institutions and market actors with more concentrated stakes. Broad and diverse public participation can mitigate risks of minoritarian bias and financial dominance.

Assuming that public participation mechanisms are functional, they facilitate the voicing of those with dispersed and low per-capita stakes whose interests could otherwise be ignored in the central banking process, e.g., the "ordinary citizens", the "other 99%", workers, and the middle class. In turn, they mitigate the purported influence of the "top 1%", the "financial elite", etc.

In conclusion, the question is not *if* but *how* the Public can be a relevant, direct Influencer of central banking.

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<sup>250</sup> (RILES, 2018: 79, 87-88).

<sup>251</sup> (BEUKERS, 2013: 1618 CIT MAIER, 2002).

<sup>252</sup> (BERGER & DE HAAN, 1997).

<sup>253</sup> (BREYER ET AL, 2011: 131 CIT BRUFF, 2010).

<sup>254</sup> (MUSCATELLI, 1998).

<sup>255</sup> (CONTI-BROWN ET AL., 2021: 34-35).

#### e) PRINCIPLES ON THE RELATIONSHIP WITH THE PUBLIC

Therefore, the CBI framework must include a few principles on (deepening) the relationship between ICBs and the Public.

First, CBs should remain independent from the Public, in the balanced sense of CBI. They should engage and dialogue with the Public and be open to contestation. Still, they cannot be mere followers contaminated by the Public's failures, passions, irrationalities, and biases. They should be independent in the sense of deliberating according to the integrity of the central banking specialized expert process. They must avoid “central banking by the mob” and artificial participation masking an industry-concentrated contribution.

Second, ICBs should structure the direct public input into their process rather than just exposing themselves to the Public's unmanaged interferences.

Public participation has to be managed to warrant access, quality, and diversity of inputs.

They need to mitigate the “pitfalls of public participation,” such as familiarity of sources, close-mindedness of the CB to diverse inputs, concentration of interests of the participants, and mass nonsubstantive input<sup>256</sup>. The ICB's engagement of *diverse stakeholders* is a defense against industry-concentrated participation and spurious individual lay comments.

Third, ICBs must be careful in being precursors of social changes in the borders of their mandates and in claiming direct access to and interpretation of the “will of the People”. They should better be “reflectors” of established social changes in their policy realms, like judges in common law systems frame their “innovations” as a revelation of established societal evolutions.

Despite the mumbles of traditionalists, ICBs have shown caution in the (still unsettled) definition of their role in the global fight against climate change. It was only after much public discussion and mobilization, a generalized scientific consensus, and various signals from DRs (including multiple international conventions and domestic laws) that they took part.

Fourth, the Public is not to become a *substitute* for, but rather a healthy *complement* and *check* of democratic representation and intermediation through the classic political process. The public citizenry is the ultimate principal of CBs. Still, in advanced liberal democracies, elected representatives are the intermediate principals and delegators with the primary role of *ex-ante* and *ex-post* control of the CB agent.

Fifth, CBs should amplify democracy by proactively creating “new forms of democratic connections” that provide indirect democratic legitimation, inclusive and diverse informational material, and a sense of societal preferences. Forms that enable non-partisan politicization and

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<sup>256</sup> (CONTI-BROWN ET AL., 2021: 29-37).

create an additional setting for public contestation and management of primary fundamental conflicts left unresolved by the political process.<sup>257</sup>

For ICBs to operate “under constraints and conditions of public contestation”,<sup>258</sup> they still have much work to do on their relationship with the public: to advance on the transparency front in a balanced way<sup>259</sup>, invest in developing financial citizenship, create more and better (diverse, rationalized) input channels, and perfect their own public relations skills.<sup>260</sup>

New communication technologies, social media, and big data analytics open the doors to novel forms and channels of citizen dialogue. The ECB has been very active on that front. It developed “[m]odern communications formats such as the ECB Blog and the ECB Podcast”, created “Twitter Q&As” with executive board members, launched “Ask us”, a new webpage where it proactively offers information on commonly asked questions, and organized many other educational and public engagement initiatives such as a hybrid online and virtual Visitor Center, online Explainers, and one annual Youth Dialogue.<sup>261</sup>

The BoE created and has been running a “Citizens’ Forum”, a Youth Forum, and a Community forums to converse with the public and to hear what they “have to say about jobs, pay and the cost of living,” their “experiences of the housing market and how easy [they] find it to borrow and save money”.<sup>262</sup>

In the future, ICBs may gradually conduct more democratically daring experiments, mobilizing participation through direct or deliberate democratic instruments supported by thorough epistemic preparation by the CBs’ experts.

#### **4.3. COURTS**

In liberal democracies, the rule of law principle demands that all public powers are subject to the laws of the land and that their actions and omissions are reviewable by independent courts. CBs, too, are not above the rule of law in *all* their functions, including the conduct of monetary policy<sup>263</sup>. Certain CBs’ legal bases, like the EU primary law, are explicit on that guarantee of judicial reviewability<sup>264</sup>.

Courts can be both friends and foes of CBI.

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<sup>257</sup> (VAUCHEZ, 2016).

<sup>258</sup> (PETTIT, 2004).

<sup>259</sup> (VAN’T KLOOSTER, 2022: 19), (HOLMES, 2013). On balanced transparency (SCHAUER, 2014: 819-823).

<sup>260</sup> (RILES, 2018: 44-48, 67-8).

<sup>261</sup> (ECB, Annual Report 2021).

<sup>262</sup> BoE website.

<sup>263</sup> (AG JACOBS, OLAF Case, §174), (AMTENBRINK, 2019: 177).

<sup>264</sup> Arts. 263, 265, 267 and 344 TFEU, art. 19 TEU and art. 35.1. ESCB Statute. In the *OLAF* Case, §135.

They are a counter-power to ICBs when they review and limit the latter's power. But they also protect CBI when reviewing and imposing limits on interferences of other Influencers.

This dual relationship illustrates how pluralism can protect CBI.

#### **a) JUDICIAL CHECK ON CBI**

Judicial accountability involves the scrutiny and, eventually, a binding decision on the validity and applicability of CBs' actions and omissions, contractual disputes, and non-contractual liability.

Courts, thus, have the power to give binding orders to CBs. Their interference in the central banking process varies in gravity and admissibility according to the scope and reach of those powers and the standard of review utilized by the court.

In abstract, a *full* review of the CB's discretionary choice that culminates in a judicial repeal, let alone an order for the adoption of a different policy choice, would correspond to an institutional transfer of the first-order policymaking power from the CB to the court. It would be a complete subordination of the former and a *de facto* surrender of CBI to a judicial *foe*.

However, per constitutional demand, CBI cannot have the consequence nor be the justification for exempting CBs from every rule of law and all judicial accountability<sup>265</sup>. Independence exists *within* the limits of the law, and Courts have a role in guarding such conferral, procedural and substantive legal limits.

Yet, the more intrusive and broader the exercises of judicial review are, the more pertinent the claim that judicial review threatens CBI. The German Constitutional Court judgment in the *Weiss* case (2020) sparked that kind of claim<sup>266</sup>.

Moreover, even a deferential and limited judicial review may allow the court to shape policymaking, for instance, when it makes "second-order policymaking decisions" in one of the three following categories<sup>267</sup>: (a) *jurisdictional*, to decide who decides the policy question; (b) *procedural*, to enforce and make the "rules of the game"; (c) *expression of constraints*, to enforce second-order principle- or rights-based constraints on first-order policy preferences that are likely, in the aggregate, to have a substantial effect on the policy itself.

In quantitative terms, courts intervene much less than other institutions, such as political actors, ICBs, and markets. However, the relevant indirect impact of their second-order policymaking, the mere possibility (not consensually accepted) of first-order policymaking by courts<sup>268</sup>, and the

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<sup>265</sup> CJEU, judgment *OLAF* Case, §135, (FELD & WIELAND, 2021).

<sup>266</sup> (BOFINGER ET AL., 2020), (TOOZE, 2020), (GOLDMANN, 2019, finding "a manifest threat to ECB Independence" in a *full* judicial review, but not in a *limited* review).

<sup>267</sup> (SCHAUER, 2006: 47-49).

<sup>268</sup> On the controversy about judicial policymaking (WALDRON, 2016), (HIRSCHL, 2008), (SCHAUER, 2006 45, fn 158), (CRAIG & DE BURCA, 3rd ed: 97).

finality of their constitutional judicial review put the judiciary in “a backstage role that makes it no less crucial to the substance of what is going on in front of the audience”.<sup>269</sup>

The question is not *if* courts can interfere and influence central banking but *how much*. It is ultimately a question of who has the last word on the reach and meaning of the limits of central banking law and on the exercise of discretion within those limits.

Who should resolve the incompleteness and ambiguities of the delegation – ICBs or courts?

## **b) COMPARING COURTS WITH ICBs**

KOMESAR indicates three structural elements that distinguish the judicial from the political and market processes: (i) higher threshold access cost stemming from its more formally defined process, with more formal requirements of participation; (ii) its limited scale in physical resources and personnel – which are “much smaller...than the political process” – and that it is far more difficult to increase in size; and (iii) judicial independence, which vis-à-vis the general population is greater than either political or market counterparts.<sup>270</sup>

Compared to CBs:

(a) Courts are even more *de jure* independent from politics, supported by more robust and developed legal protections and significantly less tolerant of *ex-ante* political guidance. There is no institutionalized political *ex-post* accountability of judicial decisions. Therefore, the judicial process has even stronger non-majoritarian character and counter-majoritarian effects of shielding decisions from majoritarian bias and political failures.

(b) They have a passive-reactive mode of intervention, which only occurs if and when some external party initiates formal proceedings. Therefore, they are structurally inapt to exercise systematic policymaking or control of CBs.

(c) They have highly specialized legal expertise but only generalist sectoral knowledge, with much less technical resources and expertise than ICBs, particularly in complex fields such as macroeconomics and policies. Countries sometimes create specialized courts to mitigate that problem. Still, even if specialization improves the epistemic credentials of the court of first instance, it will hardly reach central banks' expertise, experience, and epistemic resources.

Moreover, the decisions of specialized courts are typically appealable to higher courts. The latter tend to have more social authority and democratic legitimation (through the political appointment of their supreme and constitutional court judges and increased procedural transparency and visibility). They are expected to excel in specialized *legal expertise*, but they

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<sup>269</sup> (SCHAUER, 2006: 52-53).

<sup>270</sup> (KOMESAR, 1994: 123).

are as generalist as it gets in terms of sectoral policies and macroeconomic skills, thereby largely dissipating the technical specialization that first-instance courts could have offered<sup>271</sup>.

(d) Their process is more formalized, and participation is more burdensome than in the central banking process. In the judicial process, only the parties' claims and facts officially brought to the process can be considered in the adjudication. In most instances, to participate, litigants face more hurdles than whoever wants to convey signals to CBs. There are requirements of standing and justiciability, higher expenses to present the case – including hiring experts (lawyers and others) and funding the investigation – and risks of uncertainty about the law and facts.<sup>272</sup>

Although CBs still have a long way to go in the promotion and organization of systematic, diverse, and valuable public participation, they already receive informational and preferences-inputs from multiple channels, including public discourse, academic debates, and publications, spontaneous contributions from stakeholders, epistemic community and the Public. Notice-and-comment procedures are not the only way to participate in the central banking process.

Contrariwise, those with access to the court, with resources to raise the case, and more concentrated and higher per-capita stakes tend to be (relatively) unrepresentative groups.<sup>273</sup>

Consequently, the judicial process seems more prone to systematic minoritarian bias than the central banking process.<sup>274</sup>

This institutional comparison demonstrates that courts have some advantages but also severe relative limitations. They are more independent and specialized in interpreting the law, adjudicating the legislated boundaries of competence, checking procedural requirements and manifest errors in gathering facts, and applying substantive legal canons.

However, their relatively lower democratic exposure and accountability, lack of specialized expertise<sup>275</sup>, unfitness for systematic control, and greater susceptibility to systematic minoritarian bias compared to ICBs suggest that they should not second-guess evaluations made by CBs (particularly in decisions involving high degrees of uncertainty about the future). Nor should they make and substitute substantive policy judgments or provide democratic authorization for the latter to act when the law is silent or discretion was granted.<sup>276</sup>

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<sup>271</sup> Higher courts can only mitigate their limitation through qualified staff resources, openness to external expert submissions (*amicus briefs*), and deference to the factual and technical findings of lower specialized courts.

<sup>272</sup> (KOMESAR, 1994: 125-7).

<sup>273</sup> (KOMESAR, 1994), (BELLAMY, 2010: 13).

<sup>274</sup> (TOOZE, 2020, seeing a minority bias in the *Weiss* case proceedings before the GCC).

<sup>275</sup> (AG WATHELET, Opinion in the *Weiss* Case, §117), (GOLDMANN, 2019: 271-2).

<sup>276</sup> (LENAERTS, 2022), (GOLDMANN, 2019: 268), (DE BOER & VAN 'T KLOOSTER, 2020), (CJEU, *Poland v Parliament and Council*, C-128/17, 2019).

Otherwise, “instead of the hard decision being made by an accountable expert, it [would be] made by an unaccountable, life-tenured, generalist”.<sup>277</sup>

### c) DEFERENCE AND LIMITED REVIEW

What should then be the reach of judicial review of the decisions of ICBs?

Most courts on both sides of the Atlantic have been substantively deferential to CBs.

The GCC has been a notable exception in a field where it is hard to identify a monetary policy agenda on the judicial branch or a systematic jurisdictional control of any major CB. Its activism vis-à-vis ECB policies (and activism) gives force to the idea it sees itself as the “citizens’ court unafraid of upending the political agenda”.<sup>278</sup>

“[T]he scope of the review of legality incumbent on the Courts ... can vary according to the matters under consideration.”<sup>279</sup> Monetary policy typically involves exercising discretion and formulating complex, technical, and more general and abstract judgments.

Prudential supervision, resolution, macroprudential policy, and oversight of payment systems have dimensions of adjudication of individual rights that, in general, call for stringent standards of judicial review.

Still, even within financial supervision, some substantive deference is necessary. Judicial “oversight exists at the edges, with significant aspects of financial regulation committed to agency discretion under broad congressional delegations. Many financial regulatory decisions involve probabilistic judgments about risk, such as whether a bank’s failure might lead to financial panics, which are not readily subject to judicial second-guessing.”<sup>280</sup>

The conclusion based on the comparative institutional analysis is that courts should exercise a *limited* judicial review of CBs’ policymaking, similarly to other fields that also involve political, economic, and social choices, whose nature is highly technical and often substantively political, and which require complex forecasts.<sup>281</sup>

Courts must grant substantive deference to CBs’ broad discretion and, with a “considerable degree of caution,” exercise “limited” or “marginal” judicial review.<sup>282</sup>

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<sup>277</sup> (BREYER ET AL., 2011: 76).

<sup>278</sup> (TOOZE, 2020).

<sup>279</sup> CJEU, *Jose Maria Sison v Council of the European Union* case, C-266/05 (2007), §32.

<sup>280</sup> (BARR, 2015).

<sup>281</sup> (CRAIG & DE BURCA, 2020: 610-612), (BRENTFORD, 1998: 99), (GOLDMANN, 2019), (VILAÇA, 2020), (LENAERTS, 2022).

<sup>282</sup> CJEU, *Gauweiler* Judgment, §66-75; AG CRUZ-VILLALON, Opinion in *Gauweiler* case, §111: following the CJEU general case-law: *Jose Maria Sison v Council of the European Union*; *Arcelor Atlantique et Lorraine and Others* case, §57; *Vodafone and Others* case, C-58/08 (2010); AG Wathelet Opinion, *Weiss* Case, §114-117; (TRIDIMAS & XANTHOULIS, 2016: 31-2), (ZILIOLI, 2019), (AMTENBRINK, 2019: 169), (GOLDMANN, 2019), (BAY LARSEN, 2019), (LENAERTS, 2022).

“[T]he reach of judicial accountability in the field of the macroeconomic constitution is necessarily limited... courts have no choice but to leave a wide margin of appreciation to politicians and experts... [because] the rules they employ in their decision-making are not supposed to be so much legal as scientific by nature. Even when these bodies overstep their expert role and adopt the features of a politician, the value judgments they make within their mandate are often not judicially controllable.”<sup>283</sup>

The substantive deference allows for “a review of compliance with certain procedural guarantees” (including the duty to state reasons) and a (soft) proportionality review that may lead to judicial invalidation in case of “manifest error of assessment”, “a misuse of powers, or whether it manifestly exceeded the limits of its discretion”<sup>284</sup>. Courts “ensure that [ECB’s] decisions are subject to in-depth review, without substituting their own assessment”<sup>285</sup>.

So, what does that limited review mean? And who controls the respective boundaries?

Following the CJEU’s jurisprudence, judicial control and reviewability should cover (i) the *limits of the competences* conferred to the CB<sup>286</sup>; (ii) the infringement of *essential procedural requirements* applicable to the specific type of decision-making procedure, including the *duty to state reasons*; (iii) the *accurate statement of the facts* and the need to examine all the relevant facts and circumstances.

According to the CJEU, the substantive control of the exercise of discretion should be restricted to (iv) the verification of a *manifest error* of assessment by the CB, including in the application of the law, such as the proportionality test, and (v) the *misuse of powers*.<sup>287</sup>

Clashing with the CJEU in the *Weiss* saga, the GCC tried to impose a *full review* hidden behind the review of the limits of competences<sup>288</sup>, following the German tradition of a more pervasive judicial review of economic intervention and rights protection.<sup>289</sup>

In the USA and UK, courts adopt a broad deferential judicial review of CBs.<sup>290</sup>

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<sup>283</sup> (TUORI, 2015: 214-7).

<sup>284</sup> *Idem*.

<sup>285</sup> (ZILIOLI, 2019), (GOLDMANN, 2019).

<sup>286</sup> CJEU, Judgment *Gauweiler* case, §41.

<sup>287</sup> CJEU, *Jose Maria Sison v Council of the European Union*, §34; also *Vodafone and Others case*. (CRAIG 6 DE BURCA, 2020: 576-612), (VILAÇA, 2020), (BRENTFORD, 1998: 99).

<sup>288</sup> Judge GERTRUDE LÜBBE-WOLFF dissenting.

<sup>289</sup> (HALBERSTAM, 2019: 194-200).

<sup>290</sup> (POSNER & VERMEULE, 2010: 58), (ACKERMAN, 2010: 132, concluding that in the US the Chevron doctrine legitimates significant judicial deference to administrative legal determinations), (CONTI-BROWN, 2016: 100), (HALBERSTAM, 2019: 194-200).



It should be courts, and no other institution, that self-regulates those limits of judicial review and deference. Legislators are not suited for the task for which judicial self-restraint is more appropriate.<sup>291</sup>

If all forms of judicial review can influence CB policymaking, not all should be prohibited.

Only the *full* review compromises CBI and shall be deemed inadequate under the lenses of the comparative institutional analysis. “[A]pplying too high a standard of review might be just as harmful to the concept of democracy as exercising no review at all”. Courts do not have more (but less) democratic legitimacy than pluralistic ICBs to make significant policy decisions.<sup>292</sup>

On the contrary, CBI does not preclude a limited review since that independence relates only to the conferred powers and exists to protect their exercise within the legal limits of those powers. The influences of courts over central banking when reviewing those (conferral, procedural, mandate, and substantive) legal limits are permitted.

#### **d) COURTS AS FRIENDS OF CBI**

Such limited judicial review can be a friend of CBI.

Courts conducting and communicating proportionality assessments may strengthen the *de facto* independence of the ICB as long as they remain within that limited review and refrain from imposing or requiring the adoption of a specific alternative monetary policy<sup>293</sup>. For instance, the proportionality test can check whether fiscal concerns have dominated an ICB’s decision.

Or “the power of judicial review [can be exercised] to invalidate captured decisions after the fact”, with the advantage that “judges (as compared to regulators) may be less liable to being captured themselves, because of lifetime tenure and greater independence from political actors.”<sup>294</sup>

Judicial review can “help to level the playing field, allowing weak as well as strong to be heard, and is often effective in detecting cases in which the logical or evidentiary foundation for a particular regulatory action is weak.”<sup>295</sup>

Judicial actors can also help CBs enforce laws and their own regulations when regulated financial actors evade, and CBs are under-resourced to pursue enforcement.<sup>296</sup>

Moreover, effective judicial accountability reduces the pressure and even the incentive for political control. In the face of public or political accusations that the ICB is breaching legal

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<sup>291</sup> (AMTENBRINK, 2019: 169).

<sup>292</sup> (GOLDMANN, 2019: 266-8 and 2020), (DE BOER & VAN’T KLOOSTER, 2020), (FELD & WIELAND, 2021).

<sup>293</sup> (FELD & WIELAND, 2021: 227-8).

<sup>294</sup> (CARPENTER & MOSS, 2014: 463-4).

<sup>295</sup> *Idem*.

<sup>296</sup> (BARKOW, 2013: 24).

principles or the limits of its power (e.g., the limitation of monetary financing), independence may be preserved if the dispute finds an available independent forum to be adjudicated.

In this sense, judicial review of the actions or decisions of an independent agency can function as a non-partisan instrument of democratic accountability as a process that involves subjecting the accountable to the procedures and processes of a democratic society<sup>297</sup>.

Furthermore, Courts can be friends of CBI and uphold its legal protections when they scrutinize, adjudicate, and enforce conflicts between CBs and other Influencers.

In the *OLAF* case, the CJEU analyzed and accepted that an independent EU body could investigate (and thus interfere with) the ECB.

Still, in the same instance, the Court drew a protective line clarifying that it accepted the interference only because the OLAF agency was “completely independent”, and the scope and objective of its investigation were restricted to combat fraud, corruption, and any other illegal activity.

Thereby it made clear that similar investigative powers would not be admitted if assigned to a political institution or a subordinated body or if the investigator sought to review discretionary policy choices.<sup>298</sup>

Furthermore, in the *Rimšēvičs* case, the CJEU analyzed and directly annulled a decision from a national authority for violating a CBI-protection against the removal of a NCB’s governor. The Court was so eager to protect the independence of NCBs that it even devised an exceptional derogation to the general distribution of powers between European and national courts and EU and Member States’ spheres of more competence.

#### **e) JUDICIAL REVIEW OF THE ESCB**

The ESCB is in a uniquely complex position amongst ICBs in terms of the institutional architecture of their judicial review.

To understand who the Judicial Influencers of the ESCB are, it is necessary to navigate a sea of unresolved claims of legal pluralism and an institutional puzzle of four cells – the CJEU, national courts, ECB, and NCBs – that does not fit squarely with the general vertical distribution of judicial powers between the EU and national courts.

The predominant view and established case law is that the CJEU has a “monopoly over the review of the legality of acts of EU institutions and the final word on the interpretation of EU

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<sup>297</sup> (LASTRA, 2015: 95).

<sup>298</sup> CJEU, judgment *OLAF* case, §128, 144.

law”, and thus over the ECB’s acts and failures to act<sup>299</sup>. “The final word on EU law is always spoken in Luxembourg. Nowhere else.”<sup>300</sup>

The doctrine of constitutional pluralism developed as a remedy for constitutional conflicts of ultimate authority between EU law and national constitutional law. It could “embrace and regulate the nature of the European Union polity” and accommodate that monopolistic claim of the CJEU in a context of judicial dialogue and decentralized development of the EU legal order.<sup>301</sup> However, constitutional pluralism was recently abused by a few national constitutional courts, for example by the GCC in its final judgment of the *Weiss* case concerning the ECB<sup>302</sup>.

The GCC asserted an exceptional power to “review substantiated *ultra vires* challenges regarding acts of institutions” (ECB *in casu*) to conclude that when the “exceeding of competences [is] regarded as ‘manifest’” the CJEU’s said monopoly no longer applies.

The GCC found that the ECB’s PSPP “constitutes an *ultra vires* act, given the ECB’s failure to substantiate that the programme is proportionate”, and thus it “does not partake in the precedence of application of EU law” and “[a]s a result, the *ultra vires* act is not to be applied in Germany, and has no binding effect in relation to German constitutional organs, administrative authorities and courts”, Bundesbank included, who “may participate neither in the development nor in the implementation, execution or operationalization of *ultra vires* acts”.<sup>303</sup>

It has been noted that the GCC fell short of formally declaring the invalidity of the ECB’s decisions and instead “used instruments of an equivalent effect to reach the same result”<sup>304</sup>, but it still challenged the tenets of constitutional pluralism.

The EU Treaties establish two other derogations from the general distribution of judicial powers by entrusting the CJEU with exceptional prerogatives to review the acts of national authorities, *in casu* of the NCBs.

The first is the CJEU’s jurisdiction over disputes concerning the fulfillment by NCBs of obligations under the Treaties and the ESCB-Statute<sup>305</sup>. The mechanism differs from the actions for annulment (art. 263 TFEU) and for failure to act (art. 265) applicable to EU institutions (including the ECB)<sup>306</sup>. It differs from the regime applicable to all other national authorities whose infringements of EU law obligations are imputed to the respective Member State, against whom

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<sup>299</sup> CJEU judgments in the *OLAF* case, §135, *Gauweiler* case, § 41, *Weiss* case, § 49. (CRESPO & RUSCHE, 2022), (LENAERTS, 2022: 9), (KOKOTT & SOBOTTA, 2022: 168).

<sup>300</sup> (VON DER LEYEN, 2020).

<sup>301</sup> (MADURO, 2003, 2007, 2012).

<sup>302</sup> (MADURO, 2022, referring to the German and Polish Constitutional Courts).

<sup>303</sup> GCC, Judgment of the Second Senate of 5 May 2020 – 2 BvR 859/15, §111-118, 232-234.

<sup>304</sup> (VILAÇA, 2020).

<sup>305</sup> Art. 271 (f) TFEU.

<sup>306</sup> Contrast with art. 270 (b) TFEU on the European Investment Bank (EIB).

the Commission or the other Member States may bring judicial action before the CJEU (arts. 258-260 TFEU).

This construction is coherent with the NCBs' hybrid status of national authorities who act and participate within the framework of the ESCB.<sup>307</sup>

However, it is the protection of NCBs' independence that justifies the deviations that place the ECB-GC as law-enforcer in the structured dialogue, pre-litigation, and litigation, and the NCB as the defendant. Thus, it avoids interferences from the Commission and Executives of Member States who have such roles in general actions before the CJEU<sup>308</sup>.

Such deviations also express distrust of the adequacy of national courts to review the NCBs' fulfillment of their obligations while preserving their independence.

In this same line goes the other "anomaly", which is the "extravagant" direct recourse to the CJEU against a national measure of dismissal or impairment of the independent functioning of an NCB governor, which can be initiated by the governor concerned or the ECB-GC<sup>309</sup>.

In the *Rimšēvičs* case, the CJEU classified this direct recourse as "an action for annulment" of "an act rendered by an authority of a Member State". It gave "cassatory effect" to the annulment "and extricated [the national action] from the domestic legal order"<sup>310</sup>.

The CJEU admits that its assertion of the power to review and annul those national measures "derogates from the general distribution of powers between the national courts and the courts of the European Union"<sup>311</sup>.

Yet, the CJEU argued, the protection of CBI "would not have been fully respected if the judgment given under the second subparagraph of Article 14.2 of that statute were a declaratory judgment and the effects thereof were thus dependent on its enforcement by the national authorities"<sup>312</sup>. The CJEU assumed that this Treaty provision contains an exceptional remedy necessary to safeguard the principle of independence of the ECB<sup>313</sup>. Only time will tell whether this remains "a specific, central bank-related exception to the arrangements for judicial protection"<sup>314</sup> or a constitutional moment where "the Court has crossed ... a constitutional Rubicon that allows no turning back"<sup>315</sup>.

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<sup>307</sup> CJEU, Judgment on *Rimšēvičs* case, joined Cases C-202/18 and C-238/18 (2019), §70. (SMITS, 2020: 124), (HINAREJOS, 2019). Differently, (ATHANASSIOU, 2014: 38-39).

<sup>308</sup> Arts. 258 and 260 TFEU, and 35.6 ESCB-Stat.

<sup>309</sup> Art. 14.2 ESCB-Stat. (SMITS, 2020: 120-1), (SARMIENTO, 2019).

<sup>310</sup> CJEU, judgment on *Rimšēvičs* case, ruling against the AG KOLKOTT's defense of mere declaratory effect (BAST, 2019), (SMITS, 2020), (SARMIENTO, 2019), (HINAREJOS, 2019).

<sup>311</sup> CJEU, *Rimšēvičs* case, §69.

<sup>312</sup> *Idem*, §74.

<sup>313</sup> (HINAREJOS, 2019).

<sup>314</sup> (SMITS, 2020: 142).

<sup>315</sup> (SARMIENTO, 2019), (BAST, 2019).

Another signal of distrust of national courts as reviewers of the NCBs' acts is the CJEU's case law in the *Berlusconi* and *Fininvest* cases, where the CJEU that the NCBs' interventions in their supporting role to the Single Supervisory Mechanism (SSM) are "preparatory acts" to subsequent definitive external acts of the ESCB. As a consequence, only the latter can be reviewed by the CJEU, precluding national courts from reviewing such preparatory acts of NCBs<sup>316</sup>.

Those "anomalies" demonstrate that EU Treaties and the CJEU distrust national courts and EU political institutions to protect CBI, do justice, and confront national political authorities<sup>317</sup>.

But they also demonstrate that the framers of EU treaties and the CJEU understood how important independent courts, particularly the EU Court, are as friends that protect CBI.

#### **4.4. THE EPISTEMIC COMMUNITY OF CENTRAL BANKING**

Occasionally, "epistemic communities" emerge within and around certain institutions. They are *networks* of experts and professionals from various disciplines and backgrounds *connected and distinguished by that shared expertise*<sup>318</sup>.

##### **a) DEFINING EPISTEMIC COMMUNITIES**

To become epistemic communities, such networks of knowledge-based experts need to fulfill some conditions: (i) be composed of a specialized group of highly-developed professionals, (ii) who are like-minded in the sense of having a strong consensus on both theoretical and empirical knowledge of the fields of policy entrusted to the institution – *in casu* economic, monetary, banking – and sharing similar normative beliefs (worldviews and policy preferences), causal beliefs, and the same notions of validity of specific knowledge; (iii) their expert competences should be directed to a common policy enterprise; and (iv) they should apply that consensual knowledge to a policy enterprise as the basis for policy decisions. Finally, (v) they connect around some independent regulatory agency established to avoid political control.<sup>319</sup>

Entrenched unelected institutions tend to form communities and networks with specialized knowledge and information.<sup>320</sup>

The epistemic community of central banking is one such case that exists *within, between, and around* modern CBs.

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<sup>316</sup> (LENAERTS, 2022: 9).

<sup>317</sup> (SMITS, 2020: 138).

<sup>318</sup> (HAAS, 1992: 3).

<sup>319</sup> (HAAS, 1992: 3), (KAPSTEIN, 1992: 268), (MCNAMARA 1998), (VERDUN, 1999 and 2000), (JAMES, 2012: 266), (BASHAM & ROLAND, 2014), (LASTRA, 2015: 32).

<sup>320</sup> (VIBERT, 2007: 30-33).

Also called the “central bank fraternity”<sup>321</sup>, it developed during the 20th century<sup>322</sup> through and around the continual advancement and maturation of the “art and science of central banking”. The epistemic community is distinct from “bureaucratic bodies” that “operate largely to preserve their missions and budgets”, which are more limited and cannot easily work in a transformative way because they protect their interests rather than promote ideas<sup>323</sup>.

The professional epistemic community embodies a “socialized delegation” to “a collectivity that exists [inside and] outside the agency”<sup>324</sup>. This distinguishes ICBs from other independent administrative agencies lacking these communitarian and transnational profession dimensions.

## **b) A MULTI-LAYERED COMMUNITY**

It is a multi-layered community that exerts institutional and individual/decisional influences on the policies and actions of ICBs<sup>325</sup>.

It has the following layers around the members of the CB governing bodies and policymaking committees:

(a) The *internal institutional layer*, composed of the members of the CB’s bodies (e.g., advisory and oversight) and the staff of the bank, amongst which the group of the so-called “barons” or senior officers stands out for their influential role in providing and filtering information, analysis, forecasts and other materials for deliberation, and in framing the deliberation and policy alternatives. They are also involved in hiring decisions, planning and coordinating the internal production and contributions and external discussion of knowledge, and of legal interpretations and lawmaking<sup>326</sup>.

(b) The *system’s layer* in CBs with federalist structures like the Fed and the ESCB, where the decentralized units (RBs and NCBs) pool resources, cooperate, and ally, but also struggle with each other for influence<sup>327</sup>.

That creates one vertical and one horizontal tension within the system.

The first is between centralized efforts for homogenization and a decentralizing pull. In the ESCB, it is a clash between “communitarization” and the national bias of NCBs. In one direction, there is European supranational institutionalization and socialization, supported by claims that NCB governors intervene in a personal capacity<sup>328</sup>. In the opposite direction, NCBs are pulled by

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<sup>321</sup> (LASTRA, 2015: 32).

<sup>322</sup> (MCNAMARA 1998), (VERDUN, 1999 and 2000), (MARCUSSEN, 2009), (JAMES, 2012: 266).

<sup>323</sup> (JAMES, 2012: 266).

<sup>324</sup> (MILLER & WHITFORD, 2016: 154).

<sup>325</sup> (RILES, 2018: 22-34).

<sup>326</sup> (CONTI-BROWN, 2016), (LAGARDE, interview FT, 2021), (RILES, 2018).

<sup>327</sup> *Idem*. Art. 130 TFEU does not apply to the interactions between ECB and NCB.

<sup>328</sup> (ZILIOLI & SELMAYR, 2000: 603), (BINI SMAGHI, 2013).

national interests and socialization<sup>329</sup>. This tension gives NCBs more autonomy and control over policymaking in the ECB-GC than usually described<sup>330</sup>.

The second tension is amongst decentralized units (RBs and NCBs) competing for relative predominance. Occasionally, one succeeds, as did STRONG's NY Fed in the 1920s (and somehow less GEITHNER's during the GFC) and the German Bundesbank in the euro's first decade.<sup>331</sup>

Both vertical and horizontal competitions for influence are dynamic and often fierce, and while they exacerbate home biases, they tend to result in mutual checks and mitigation.

On the other hand, the CBs' decentralized structure allows for competing ideas about monetary and banking policy to develop within its system.<sup>332</sup>

(c) The *international layer encompasses the major central bank(er)s*, which form a kind of "executive transgovernmental network"<sup>333</sup>. "Central banks typically have much stronger ties among themselves on the international level than do other public institutions".<sup>334</sup>

CBs regularly meet, discuss and coordinate their actions and policies with other CBs (and with the community of financial regulators and supervisors domestically and abroad) and have jointly crafted the material content of legal frameworks and established soft-law standards.

In addition to financial assistance from those with dominant reserve currencies, many CBs formally transfer their know-how to their peers by offering so-called technical assistance<sup>335</sup>.

One distinctive feature of the post-GFC world has been the unprecedented and institutionalized cooperation between CBs worldwide.

For a long time, their interactions were intermittent, often based on personal complicity among leaders<sup>336</sup>. Their "contacts are usually informal or semi-formal in nature, avoiding conventional legal instruments like treaties in favor of purportedly sub-political 'administrative arrangements'"<sup>337</sup>.

Establishing a network of standing and temporary CB swap lines created a sort of international liquidity backstop of LOLR<sup>338</sup>, marking a permanent form of coordination.

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<sup>329</sup> Finding national culture and identity generally trump the effects of EU socialization on their policy views, even for ECB governors (DE JONG & VAN ESCH, 2013), (BRUNNERMEIER, JAMES & LANDAU, 2016), (VAN ESCH & DE JONG, 2017), (BENNANI AND NEUENKIRCH 2017).

<sup>330</sup> (BRENTFORD, 1998), (SINN, 2018: 20). Differently, (BUITER, 2019).

<sup>331</sup> (FATUM, 2006), (ESTELLA, 2018: 77, 84-7). Differently (HAYO & HOFMANN, 2005). Observing a minoritarian position of the Buba since the Euro Crisis (SMITS, 2015: 35).

<sup>332</sup> (BORDO & PRESCOTT, 2022).

<sup>333</sup> (SLAUGHTER, 2004), (KEHOANE & NYE, 1977), (MARCUSSEN, 2009), (JAMES, 2012: 14-5).

<sup>334</sup> (HORVATH, 2020: 765).

<sup>335</sup> (LASTRA, 2015), (HORVATH, 2020).

<sup>336</sup> In the interwar period (AHAMED, 2008).

<sup>337</sup> (LINDSETH, 1999: 688).

<sup>338</sup> (BAHAJ & REIS, 2017 and 2022).

The Bank of International Settlements (BIS) and its related Basel Committee have been privileged institutional settings for developing this international layer, the socialization of the CB elite, and their coordinated action. Other international bodies, such as the International Monetary Fund (IMF) and the Financial Stability Board (FSB), are also relevant actors of the international centralverse.

Such “horizontal cross-border contacts with their counterparts in other states bypass the coordination of national levels of government and the mediation of diplomatic channels and Foreign Offices”<sup>339</sup>.

Yet politicians have supported the direct international coordination between CBs, expressly<sup>340</sup> or implicitly, when joining them in international coordination *fora* such as G-20 and the FSB.

(d) The *external layer of professional outsiders* comprises CB watchers, academics, economists, lawyers specialized in central banking and related disciplines, and other regulators.

While the (a) to (c) layers are all insiders and central bankers *latu sensu*, in the fourth, they are outsiders. This difference is relevant and consequential: outsiders use different channels to influence, and their attitudes tend to differ.

Insiders have more skin in the game, some Niskanenian interest in institutional expansion and empire building, and a natural tendency to be more apologetic of past performance, whereas outsiders tend to be more critical. Such a different tendency has been documented when comparing the research produced by the two groups<sup>341</sup>.

Professional outsiders are likelier to contribute to the community’s epistemic diversity and critical thinking. While that recommends the openness of ICBs to the interaction, research, and review by those outsiders, there are also reasons for caution. Those outsiders can be biased or captured by the inside or external Influencers.

On the one hand, mindful of the competition of influences within the epistemic community, CBs proactively try to influence the research and debates in the external layer of professional outsiders – the influence circuit becomes bidirectional.

Compared to other academic or research institutions, ICBs make an unmatched investment in the supply of employment and quasi-employment opportunities for experts, in the organization of conferences and publications open to outsiders, and in the sponsorship of academic research in relevant fields to central banking, particularly in monetary economics<sup>342</sup>.

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<sup>339</sup> (LINDSETH, 1999: 688).

<sup>340</sup> (EU PARL Resolutions of 2001, §3, of 2007, §27, of 2020, §18, encouraging the ECB to strengthen the international coordination).

<sup>341</sup> (FABO ET AL., 2021), (ESCH & JONG, 2017: 14).

<sup>342</sup> (WHITE, 2005).



MILTON FRIEDMAN claimed that the Fed had a sort of oligopoly on monetary opinion in the USA<sup>343</sup>. CB sponsorship influences the aggregate output from outsiders through the direct, centralized allocation of research resources<sup>344</sup>, inducement of self-restraint due to past sponsorship by the CB or future career prospects, crowding-out research that would challenge the monetary regime *status quo* favored by the CB, and systemic influence on academic research that is subject to network effects that indirectly influence researchers outside the CB's direct sphere of influence<sup>345</sup>.

Therefore, a framework of pluralistic CBI demands that CB policies on internal research and sponsorship of external research promote inter- and intra-disciplinary diversity and critical inputs to avoid the prevalence within the epistemic community of *status quo* bias, groupthink, or inertia.

On the other hand, CBs should be cautious in reading the signals and contributions from that external layer of the epistemic community. Many of those professional outsiders belong to or have connections with special interest groups. Many are market insiders with vested interests or providers of services to them.

In their repeated interactions, CBs must be attentive to distinguish those double haters and the risk of their expertise being biased due to conflicting interests.

### **c) A PROFESSIONAL(IZED) EPISTEMIC COMMUNITY**

A fundamental "strategy" to avoid such biases and conflicts in epistemic communities is *professionalism*.

An epistemic community has institutional and cultural substrates built on organization, socialization, values, and "a body of knowledge and skill – however tentative or flawed"<sup>346</sup>.

Yet, it becomes a *profession* by developing a social code, a system of professional accountability through peer assessment and professional discipline. Professional standing and reputation are fundamental levers and standards to define and gauge belonging<sup>347</sup>.

Professionalism is a self-cultivated and self-enforced device of social control that creates its own incentives to motivate capable people and diminish the impact of hierarchical incentives,

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<sup>343</sup> (WHITE, 2005).

<sup>344</sup> (TOMA & TOMA, 1985).

<sup>345</sup> (WHITE, 2005).

<sup>346</sup> (RILES, 2018: 22-34), (ADLER & HAAS, 1992: 374), (MILLER & WHITFORD, 2016: 141-3).

<sup>347</sup> (MILLER & WHITFORD, 2016), (ALESINA & TABELLINI, 2007).

favoritism, and political variability.<sup>348</sup> It involves training and professional standing, practicing responsibility, and imposing expectations, norms, and pressure to abide.<sup>349</sup>

The “consanguinity” or belonging to the community, along with these aspects of professionalism, strengthens central bankers’ attachment to expertise, and knowledge-based and independent policymaking above any particular or sectional (conflicting) interests or direct influence of governmental sources of authority<sup>350</sup>.

In other words, professionalism and community advance two of the main comparative advantages of independent central banking: its specialized epistemic superiority and relative impartiality.

ICBs have developed an epistemic community that is also a profession. They are the institutional center and engine of their epistemic communities, “opening up their distinct knowledge networks to like-minded allies and closing off their relations to the uninitiated. Organizational boundaries are blurred, as are territorial and cultural boundaries. CBs are no longer building up or down; they are simply ‘building out’”. Their officials form “epistemic alliances” with other members of the professional community<sup>351</sup>.

ICBs are one of those few agencies that became a profession because professionals have a role/territory within and have a significant influence on their policies and because they assure a professional career and make decisions on personnel largely on professional grounds.<sup>352</sup>

They recruit according to shared educational background and professional experience<sup>353</sup>, offer training and promotions, and shape future career opportunities. They develop practices of exchanging information, collecting and distilling best practices, exporting particular regulatory forms, and strategically coordinating their policymaking and enforcement internally and internationally.

There is an effort of “rationalized streamlining” by (i) structuring collective decision-making in an “instrument rational” manner to filter out mere coincidence, prejudices, and arbitrariness; (ii) instituting transparency and communication procedures to minimize haphazard and random reactions to CB decision making (i.e., “irrational exuberance”); and (iii) implementing measurable performance based on a few and exact standards such as inflation targeting.<sup>354</sup>

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<sup>348</sup> (ADLER & HAAS, 1992: 374).

<sup>349</sup> (MILLER & WHITFORD, 2016: 141-3, 166).

<sup>350</sup> (BAXTER, 2012), (KWAK, 2014).

<sup>351</sup> (MARCUSSEN, 2009: 378-379).

<sup>352</sup> (MILLER & WHITFORD, 2016: 164).

<sup>353</sup> (RILES, 2018: 25), (VERDUN, 1999), (McNAMARA, 2002).

<sup>354</sup> (MARCUSSEN, 2009: 378).

Socialization amongst community members occurs in all the above actions, plus conferences, debates, books, articles and commentaries, and corporate and institutional events that develop ties, complicity, and ascendancy between members with often unequal positions.

Their shared functions in society, educational paths, socialization, methodologies, knowledge, and values put the members of the community of central bankers in a relative position regarding power, income, and prestige that makes them elite.<sup>355</sup>

Such “consanguinity” or feeling of belonging to a distinctive elite is a potent aggregator and community-builder.

#### **d) FRIEND AND FOE**

Central bankers, as other “regulators, are more likely to trust and to adopt positions advanced by people whom they perceive as being in their in-group,... people whom they perceive to be of higher status in social, economic, intellectual, or other terms,... and people who are in their social networks”.<sup>356</sup>

This is a complex and multi-faceted process of intellectual convergence between different but tendentially like-minded individuals, which involves socialization and, ultimately, “intellectual capture”.<sup>357</sup>

The epistemic community influences the policymakers’ visions and choices across the various stages of the policy process: (i) the framing of the policy problem and of the policy innovation possibilities (i.e., framing the range of controversy, defining public interests, and setting standards and the choice of appropriate norms and appropriate institutions that narrow the scope within which policy bargains can be struck); (ii) shaping the selection of policies; (iii) the policy diffusion domestically and abroad; and (iv) the policy persistence (pushing new ideas and policies, once institutionalized, to gain the status of orthodox).<sup>358</sup>

Yet, the impact of epistemic communities on policymaking depends on a variety of factors, including the information and knowledge of those that have the formal power to decide policies (“the degree to which those decision-makers are unfamiliar with and uncertain about the issues at hand”), the dimension encompassed by the network, whether other institutions already exist in which responses to a given problem can be pursued, domestic political factors, and contextual factors such as timing, circumstances, and societal views.<sup>359</sup>

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<sup>355</sup> (TUCKER, 2018: 549).

<sup>356</sup> (KWAK, 2014).

<sup>357</sup> (BAXTER, 2012).

<sup>358</sup> (ADLER & HAAS, 1992).

<sup>359</sup> *Idem*.

Professionalism does not turn the central banking community into a fully autonomous self-governed profession or “autonomous administration” like subnational governments and socio-professional associations/corporations<sup>360</sup>. CBs are, first and foremost, national or supranational public delegated agencies serving the public interest rather than bodies whose officials represent the professionals or the community experts.<sup>361</sup>

Moreover, while professional accountability may suffice for independent institutions such as fiscal councils that have less biting powers (primarily for transparency and correction of informational asymmetries), it cannot be enough for institutions such as CBs who have effective policymaking and enforcement powers, and thus cannot dispense with decisive democratic controls.<sup>362</sup>

It matters because the epistemic community can become a threatening foe of CBI. For instance, if central bankers turn into a self-effacing class that does not actively court the public limelight, a detached elite that steers decision-making in a self-serving direction, disconnected from the will of the People, leading to claims that they don’t care for the Public or politicians’ approval.<sup>363</sup> Some discrete minority might indirectly capture them.<sup>364</sup>

In that perspective, CBI has been reputed as a power grab by a few, excluding ordinary citizens and politicians and granting a share of public authority to professionals and sectoral experts.<sup>365</sup> The community can also become a foe of CBI when it enables one or a few of the decentralized units (RBs or NCBs) to dominate the system (Fed or ESCB), thus failing the promise of federal/supranational independence made to all other regions that would then live in a *de facto* foreign-dependent monetary system.

Or if the intellectual convergence becomes excessive and turns into sheep-like mimicry that violates the epistemic expectation that (also) justifies the independent delegation. If central bankers copy each other, or all do more or less the same at the same time, notwithstanding the jurisdictional differences in their mandates, tools, and instruments<sup>366</sup>, they suppress critical deliberation and diversity and generate self-congratulatory attitudes between insiders leading to groupthink and hubris bias.

However, overall, with its professionalism, the epistemic community of central banking seems to be (one of) the greatest friends of CBI among all Influencers.

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<sup>360</sup> (MOREIRA, 2003: 131-2, distinguishing “autonomous administration” (like socio-professional associations) from “independent administration”).

<sup>361</sup> (MOREIRA, 2003: 131-2).

<sup>362</sup> (VON HAGEN, 2012: 46).

<sup>363</sup> (VIBERT, 2007: 30-33), (VAUCHEZ & FRANÇOIS, 2020), (VALE, 2021: 12-14).

<sup>364</sup> (CARPENTER & THOMAS, 2014: 456).

<sup>365</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>366</sup> (GOODHART, 2021), (LASTRA, 2021).

Its institutional, professional, and sociological checks and influences are expected to fortify the epistemic superiority of CBs and be a virtuous defense against other inappropriate influences. Provided the community is captured, alongside the legal protections of CBI, it is the most potent check on majorities or minorities trying to control the CB<sup>367</sup>.

#### **4.5. AFFECTED INTERESTS**

Policies affect members of society disparately, who tend to cluster with others with similar interests to leverage their positions.

Certain discrete groups have concentrated, higher per capita stakes and, thus, greater incentives to mobilize to influence, contest, and contribute to the policy process.

Individuals and discrete groups have multiple forms to articulate and express their interests and intervene in public policy processes. Yet, each individual may have numerous and heterogenous affiliations to distinct forms and organizations.

Although political parties and social movements stand out as traditional channels, there are various alternatives with different degrees of institutionalization.<sup>368</sup>

Special Interest Groups are amongst the most organized non-partisan forms of articulation and representation of discrete groups in the public sphere. They correspond to (i) formal organizations usually based on voluntary membership, (ii) to influence public policies, (iii) without participating in elections or government, unlike political parties.

They can be organized according to different interests: causes, businesses, workers, professions, public or private institutions, or subnational governments<sup>369</sup>.

There are other less institutionalized forms of influence on behalf of identifiable sectional interests.

In the field of money and credit, the largest and most power-resourceful private financial institutions and their leaders interact closely with central bankers, seek to influence them, and on occasion, succeed in capturing them. When not in concert, they act individually or through implicit alliances.

Even more deinstitutionalized is the so-called “structural influence” from “financial interests” and financial markets in general, whose decentralized but congruent behavior puts collective pressure to influence CBs.

Even if ICBs may have contributed to financialization and benefited from it in terms of relative power vis-à-vis other public authorities, the growth of global financial markets’ structural power

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<sup>367</sup> (LINDSETH, 1999: 688), (HORVATH, 2020).

<sup>368</sup> (LISI ET AL., 2022: 16-17).

<sup>369</sup> *Idem*.

dwarfed the rise of their power. The claim is that it turned ICBs into spectators rather than independently active regulatory players of the structural power of financial interests<sup>370</sup>.

CB policies affect multiple, discrete sections of the community, some positively, others negatively, and often in conflicting directions. There are workers, non-financial businesses, and financial companies; lender-savers and borrower-spenders; pensioners; consumers; taxpayers; the wealthy, the middle class, and the poor; and individuals particularly concerned with other societal problems impacted by monetary and financial policies (e.g., climate change, fiscal prudence, and inequality).

These two tumultuous decades demonstrate how much the changing economic conditions, and the responding macroeconomic policies distinctively affected the situation of each of those groups and, consequently, their self-awareness and mobilization to influence ICBs' policy changes.

#### **a) LABOR UNIONS AND IMPERFECT COMPETITION OF INFLUENCES**

One of the most powerful Interest Groups in modern societies is labor unions. Still, for decades and until the post-pandemic inflation burst, they seemed to care little about CBs and their policies.

Contrariwise, environmental and civil rights groups have turned their attention to CBs seeking to press them to "green" monetary and prudential policies and to sustain monetary easing for the benefit of the least economically advantaged minorities.

Even though most eyes are on their interactions with "financial interests", major CBs have been opening and institutionalizing channels for dialogue with those (less suspicious) affected interests such as labor, consumer, and civil society groups and movements.

In the USA<sup>371</sup>:

(i) The Federal Reserve Beige Book, published ahead of each FOMC ordinary policy meeting, is based on a decentralized survey of the economic conditions in each district that includes questions to community organizations whose answers are aggregated with those of businesses, economists and other market experts.

(ii) The sectoral representation at the RBs' boards of directors are legally required to include "labor and consumers", albeit in a small minority. In the past five years, class B and C directors representing those two interests were 13 to 15 out of 72 directors (and of 108 when counting the class A directors representing stockholding banks).

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<sup>370</sup> (DYSON, 2009: 10), (JAMES, 2012: 363, 372).

<sup>371</sup> Fed's official website.

(iii) In 2015, the Fed BoG created a Community Advisory Council to complement the other industry-dominated advisory councils. It meets semi-annually with the members of the board and, according to published records, it has discussed credit access, conditions in housing and labor markets, and other matters affecting consumers and communities.

(iv) Fed BoG and RBs created and sponsor a collaborative project called “FedCommunities”, led by their officers, dedicated to advocacy and research on racial inequities and community development.

(v) The Fed organized multiple “Fed Listens” events in the context of its 2019-20 Strategy Review to engage “a wide range of organizations—employee groups and union members, small business owners, residents of low- and moderate-income communities, workforce development organizations and community colleges, retirees, and others—to hear about how monetary policy affects peoples’ daily lives and livelihoods”. Once the strategy review was concluded, it decided to continue this initiative and has organized 12 events since then.

In the EU:

(i) Since 1999, a bi-annual forum called Macroeconomic Dialogue gathers the ECB, the Council, the Commission, and the European social partners to discuss and contribute to monetary and budgetary policies as well as wage developments.

(ii) During the ECB Strategy Review, the ECB also organized various “ECB Listens” events that it promised to continue thereafter.

(iii) Since 2020, an ECB Civil Society Seminar Series has brought together ECB-EB members and senior staff and European-level civil society organizations to discuss topics related to the CB’s work<sup>372</sup>. Yet, as a manifestation of the relative relevance of different Influencers, in the same 20-month period when the ECB organized seven of these seminars with civil society, it (co-)organized over 30 with expert public, i.e., the epistemic community.

Not even where labor markets are more centralized and unions have more clout have labor Interest Groups ever achieved the proximity and interaction, let alone the influence over major CBs that could revert the effects of the decades-long decline in workers’ bargaining power.

Moreover, no institutional mitigation was sought. ICBs were not structured under whatever neo-corporatist model of Interest Group influence could secure a voice or a seat at the table for labor representatives.

Instead, they operate under a pluralistic model of open, dispersed, largely unstructured, and imperfect competition of influences amongst different interests<sup>373</sup>.

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<sup>372</sup> ECB website.

<sup>373</sup> (LISI ET AL., 2022: 18-22), (THOMAS, 2021).

This pluralistic model is not one of perfect competition. The various affected interests have differentiated competitive conditions, and labor unions and civil society groups are not among the most powerful Influencers.

## **b) FINANCIAL INTERESTS**

No other affected interest has a position, engagement with, and influence over CBs comparable to the financial industry.

Financial interests have an asymmetric role in the marketplace of private influences.

Sometimes they overlap or are in circumstantial coalitions with other affected interests. For instance, with “small savers and pensioners, importers, and mortgage holders” and workers against inflation surges or volatility<sup>374</sup>; or with borrowers and non-financial companies against liquidity squeezes and the increase of borrowing costs.

There is significant internal dispersion and heterogeneity amongst financial interests according to asset classes, net credit or borrowing positions, and short and long-run perspectives.

They include financial institutions, their directors, shareholders, and service providers, and those financial investors disproportionately invested in financial assets, typically those in the highest wealth and income brackets.

Their interactions with ICBs go beyond whatever formally organized Interest Groups, such as banking or financial services associations, exist.

Despite that heterogeneity, the various financial interests share concerns and demands with the CB: to stabilize, prop, and backstop financial assets’ markets, reduce regulatory costs for financial activities, and avoid deflation or too high or volatile inflation. They want it to mitigate risks while favoring their gains from financial activities.

On the other hand, the banking and financial industry is simultaneously interconnected and significantly concentrated, with big market shares of top financial institutions and common ownership at global and domestic levels<sup>375</sup>.

Consequently, a few huge and systemically important individual financial institutions have tremendous power and close direct relationships with and influence over CBs.

While a limited number of global financial intermediaries have consequential roles, the full impact and reaction of financial markets to the actions and omissions of CBs occurs through millions of decentralized operations involving so many agents.

The diversity and intensity of those forms and degrees of concentration and coordination should be noted.

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<sup>374</sup> (POSEN, 1995).

<sup>375</sup> (WORLD BANK, 2020: 64-65), (FURMAN, 2018, for the USA).



### c) THE CAPTURE OF ICBs

Financial interests, institutions and markets can exert “an influence that knocks the regulator off its original balance”.<sup>376</sup> Therefore, ICBs need to learn and be structured to “balance working with financial markets while trying to avoid being captured by them”.<sup>377</sup>

The theory of capture is a fundamental approach to understanding how financial interests can influence and eventually dominate central banking. Its comprehensive version encompasses what Marxist-based theories define as *structural power* to distinguish from “instrumental power” exercised in “microlevel interactions between public and private actors that impact upon the policymaking process and its outcomes”.<sup>378</sup>

Capture means the *undue influence* by certain sectional groups or entities that lead the agency (CB) to consider their interests in a *systematically biased or disproportionate* way relative to how it weighs the interest of the public or its mandate to maximize social welfare.<sup>379</sup>

It reveals something beyond persuasion through rational debate and indirect control by maneuvering the political process.

The capture of ICBs operates by manipulating central bank(er)s’ utility and preference functions, including material and reputational incentives, their ideas and beliefs, and their structural conditions and interdependencies, through multiple channels or dynamics that “develop together and coalesce and create cultures” of capture at CBs.<sup>380</sup>

(i) One basic channel is the exploitation of *informational asymmetry and knowledge-exchange channels* by private actors who hold important market information and data required by officials for more effective decision-making. They “have crucial technical knowledge concerning the functioning of esoteric markets, products, and financial procedures, and are thus well-suited to advise CB officials, and assist them in calculating the likely impact of policy choices”.<sup>381</sup>

This “informational lobby” occurs through private meetings and backroom informational exchanges with central bankers, regulatory reporting, surveys, conferences and events, and in their own produced or sponsored publications.

ICBs may reciprocate and pass non-disclosed information to a limited number of (large) financial actors, thus offering them unfair advantages. The Fed was denounced for “selectively disclos[ing] sensitive information about monetary policy to its favored clientele in the private

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<sup>376</sup> (PAGLIARI, 2012).

<sup>377</sup> (KALAITZAKE, 2018: 15).

<sup>378</sup> *Idem*.

<sup>379</sup> (STIGLER, 1971), (BARKOW, 2013).

<sup>380</sup> (BARKOW, 2013:20), (CARPENTER & MOSS, 2014), (KWAK, 2014), (MILLER & WHITFORD, 2016: 19).

<sup>381</sup> (KALAITZAKE, 2018: 7).

financial sector”<sup>382</sup>, and recently the ECB Chief Economist LANE was found to hold calls with a restricted number of large investment companies on the day of monetary policy meetings.<sup>383</sup>

(ii) Another channel of capture is the “*closed policy circles*” where certain outsiders can formally or informally participate in central banking decision-making procedures, in varying terms depending on the nature — generalist policymaking (for decisions on reserves, asset purchase programs, exchange rates, foreign exchange interventions), formal rulemaking (prudential and collateral policy regulations, but also the monetary framework), and in particularistic, adjudicatory decisions on supervisory processes, the status of counterparties, on emergency liquidity provision and resolution.

All these forms of participation create proximity and exclusive opportunities for dedicated persuasion and even the advancement of undue inducements.

Bolstered by an institutionalized culture of proximity and personal loyalties built through prior professional experiences, central bankers continue to give preferential access to financial industry groups and to interact with them in an often opaque and discretionary environment, with many discussions occurring behind closed doors.

(iii) The *asymmetrical capacity of the financial industry, compared to other stakeholders*, means that it can mobilize superior financial resources, expertise, attention, insistence, and repeated interactions to influence central bankers. Its stakes are concentrated and high per capita, particularly for regulated entities or potential beneficiaries of liquidity support from the CB.

In contrast, workers, deposit holders, and consumers of financial services, for instance, have special interests but relatively less engagement with the policy debates. They exhibit “collective action problems”, facing greater challenges to coordinate and mobilize the organizational and informational resources required to compete for influence with the financial industry. They are more numerous, but their stakes in the policy decisions tend to be more dispersed and lower per capita.

Furthermore, the central banking process involves high threshold costs for stakeholders’ participation due to its technicality, complexity, and distance, the procedural rules on information gathering, and the channels for dialogue with CBs, which are not that open.<sup>384</sup>

Even when both Interest Groups are organized, regulated entities exert permanent pressing efforts over the public regulator, while other stakeholders have only sporadic interventions.<sup>385</sup>

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<sup>382</sup> (CANOVA, 2011: 22).

<sup>383</sup> (LAGARDE, Letter, 2021).

<sup>384</sup> (KOMESAR, 1994).

<sup>385</sup> (TUSHNET, 2014: 2238-2239).

Moreover, regulated entities have a superior capability to lobby political branches to increase oversight, which incentivizes the regulator “to avoid being tied up with legal challenges and oversight”.<sup>386</sup>

The combination of that asymmetric distribution of stakes with the high threshold costs of access puts the financial industry in a unique relative position of force to influence ICBs, and it may systematically bias central banking toward this special affected interest.<sup>387</sup>

It creates unfair conditions of imperfect competition amongst stakeholders where certain organizations with more resources have a disproportionate voice.<sup>388</sup> Such imperfect competition goes against the normative ideals of democracy and impartiality in the sense of equal representation of different stakeholders.

Therefore, a fair pluralistic framework of CBI must combat systematic biases, prevent risks of asymmetric and unequal powers to influence, and guarantee the maximum equilibrium of representation possible.

(iv) There are also *Channels of personal capture* when the influence is directed at central bankers personally. The most famous is the “*revolving doors*” through which leaders and staff of the CB come from or go to work for the financial industry before or after their service at the CB.<sup>389</sup>

Prior professional experience working or servicing the financial industry tends to create affectional or intellectual loyalty to its views and interests. CBs typically have the autonomy to hire their staff which perpetuates the preference for experienced financial professionals. Even though leaders are politically appointed, the selection is usually constrained by legal eligibility requirements that also demand knowledge and professional experience in the banking and financial sectors.

The possibility of central bankers taking salaried positions or other compensated services in the financial industry<sup>390</sup> or making investments with hedge funds and private equity firms after leaving public office naturally impacts the central bankers’ utility function through promises or expectations of delayed gratification in exchange for more friendly policies. Even benevolent policymakers are likely to be affected by such a post-employment perspective of a revolving door.

The central bankers’ *accumulation of other paid positions or even unpaid affiliations* with private financial institutions, their representative interest groups, or service providers creates even more egregious conflicts of interest.

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<sup>386</sup> (BARKOW, 2013: 18-19).

<sup>387</sup> (KOMESAR, 1994), (PAGLIARI, 2012).

<sup>388</sup> (LISI ET AL., 2022).

<sup>389</sup> (JOHNSON & KWAK, 2010), (BARKOW, 2013: 18-19), (CARPENTER & MOSS, 2014), (ADOLPH, 2013: 351).

<sup>390</sup> (CANOVA, 2011: 22).

A milder but still problematic accumulation is with other non-public institutions that might not be directly affected by the CB's policies but that may pose reputational damages to the central banker in case some misdeed occurs at that entity, even if not attributed to her. For instance, the position of the Governor of the Bank of Finland, OLI REHN, in the FIFA Governance Committee is apt to create reputational damages considering FIFA's public exposure.

Material benefits and incentives can also shift central bankers' interest away from their mandated public interest and closer to the conflicting interests of financial actors. Private transactions with third parties, investments in financial assets, paid speeches<sup>391</sup>, and other remunerated services to private actors, gifts, or bribes might be used – sometimes even if outlawed – to manipulate central bankers' material interests and, consequently, their decisions. The 2021 scandal over stock trading by FOMC members exemplifies such risks, which in that case led to the resignation or early retirement of those involved.

One more explicit, albeit rarer, channel for capture is when financial industry representatives have a direct representation on the boards of CBs or their policy committees<sup>392</sup>.

Finally, financial markets more broadly play an important role in judging the reputation of central bankers, allowing them to manipulate one of their most decisive personal interests, which is the preference for professional reputation. Central bankers seek *high marks*, and “markets provide a kind of giant biofeedback machine that monitors and publicly evaluates the CB's performance in real-time. So central bankers naturally turn to the markets for instant evaluation – or, rather, they have that evaluation constantly thrown in their faces”.<sup>393</sup>

(iv) General *intellectual, cognitive, or cultural capture* occurs when the CB suffers “the cultural or social influence of repeated interaction with the regulated industry such that the regulator begins to think like the regulated and cannot easily conceive another way of approaching its problem”, and the repeated interaction shapes the assumptions, lenses, and vocabularies of policymakers<sup>394</sup>. The penetration of financial actors within the epistemic community gives them another channel to push central bankers in a congruent direction.

(v) One final channel of capture is *Markets' Structural Power* when their undue influence operates through interdependencies that create various forms of financial dominance or at least structural alignment with the interests of the central bank(er)s. Examples are: “Too Big To Fail” financial institutions; general conditions of financial dominance of monetary policy in case of high exposure to capital flight/disinvestment<sup>395</sup>; liquidity dry-outs; or a massive rise of private

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<sup>391</sup> (C. JONES, 2021).

<sup>392</sup> (CROWE & MEADE, 2007: 89).

<sup>393</sup> (BLINDER, 1998: 59-60).

<sup>394</sup> (CARPENTER & MOSS, 2014), (KWAK, 2014).

<sup>395</sup> (KALAITZAKE, 2018).

debt that creates a context in which “the financial sector can corner the CB and force it to run policy as to support the financial sector – the alternative would be financial crisis which would also impinge on price stability”<sup>396</sup>.

A critical political economy accusation is that CBI and certain governing technique such as inflation targeting, “regulatory neglect, and CBs’ pro-market attitudes and ‘bias towards excessive elasticity’ in the provision of money market liquidity, create deep-seated organizing alignments between, on the one hand mandates and policy programmes, and on the other hand, financial interests and rationalities and the structures and ecologies of the financial markets within which they are realized. CBs are then drawn into “a kind of ‘ontological complicity’ with the dynamics of financialized capitalism”.<sup>397</sup>

#### **d) FRAMING INEVITABLE INTERACTIONS**

Notwithstanding the risks of capture or structural dominance, it is inconceivable that all these channels should be closed and that all interactions must cease.

An absolute, strict separation from the financial markets is unattainable and undesirable. Monetary and financial policies work *through* markets, thus, *anticipated* and *actual* market reactions must be considered in the formulation of policies, their timing, and effects<sup>398</sup>.

ICBs gain from being close to those affected by their policy decisions to gather market intelligence and decrease information asymmetry, explain the policy to make it more effective, and even use forward guidance as a policy tool.

Furthermore, the involvement of stakeholders tends to increase the credibility and legitimation of policymakers and their decentralized accountability and facilitates consensus and the exchange of knowledge in policymaking.<sup>399</sup>

In the current system of hybrid money, financial institutions have exclusive access to the CB outside money and its balance sheet. Even if that exclusivity were relaxed and the CB moved to direct public distribution of money (e.g., retail CBDCs, “FedAccounts”<sup>400</sup> or a “People’s Ledger”<sup>401</sup>), the close interactions between ICBs and financial institutions and markets would remain necessary.

ICBs have a dual nature: a public authority with delegated functions, regulation and provision of money, credit and payment systems, and the bank to the banks.

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<sup>396</sup> (STRACCA, 2019: 87).

<sup>397</sup> (BRAUN, 2018), (WALTER & WANSLEBEN, 2019: 2), (AKLIN & KERN, 2021: 13), (DOWNEY, 2022).

<sup>398</sup> (BLINDER, 1998: 60).

<sup>399</sup> (LISI ET AL., 2022), (COROADO, 2020: 49).

<sup>400</sup> (RICKS, CRAWFORD & MENAND, 2020).

<sup>401</sup> (OMAROVA, 2021).

Moreover, financial crises demand even closer interaction and cooperation between public financial authorities and the most prominent private financiers.

Before modern central banking, private “bankers loomed so much larger than regulators in a crisis” (e.g., the spectacular rescues of the Barings Bank in 1890 or of financial companies, the New York City and Stock Exchange in 1907 under the leadership of the House of Morgan).<sup>402</sup>

More recently, private or hybrid rescues were cooked with four hands by the public authority and (consortia of) private rescuing banks.<sup>403</sup>

Crises increase the informational exchange between large financial institutions and CBs, and eventually the solicitation of emergency liquidity assistance that requires disclosure and negotiation of needs, conditions, and acceptable collateral.

If financial institutions are “failing or likely to fail”, ICBs act as maestros orchestrating either private solutions of bailout, assets purchase, or takeover by other financial mammoths, or some rescue with public funds through nationalization, partial capitalization, or emission of contingent convertible bonds.

Liquidity injections and bailouts ignite(d) popular discontent and populist attacks on CBs for working for the benefit of a private few, “privatizing gains, and socializing losses”.

Such safety nets often lead to excessive risk-taking and unfair capture of the burden-sharing.

On the other hand, they offer collective gains by protecting deposits and savings and avoiding financial tightening that would deteriorate investment, consumption, and employment.

The Great Depression of the 1930s showed that the aggregate welfare cost of public inaction, inadequate monetary tightening, and allowing market discipline to run its course was just too significant.

Public intervention and close cooperation with private financial interests become justified as lesser evils than the economic downturns, financial meltdowns, unemployment, bankruptcies, and foreclosures they intend to avoid.

Therefore, after the GFC, governments and CBs came up with reforms to prevent the accumulation of risks and reduce moral hazard, disincentivize reckless behaviors, and improve the burden sharing in a fairer direction, namely by requiring prior bail-ins and limiting exposure to bailouts.

Prior bail-in requirements, discouragingly high rates charged by the public lender, and limitation of bonuses, dividends distribution, and share buy-backs are some rules developed to improve public interest defense.

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<sup>402</sup> (CHERNOW, 1991: 122).

<sup>403</sup> During the GFC, in the USA - Merrill Lynch, Countrywide, Wachovia, Bear Sterns and Washington Mutual; in the Netherlands ABN AMRO. More recently Santander acquired the Portuguese BANIF (2015) and Spanish Banco Popular, and Intesa Sanpaolo the Banca Popolare di Vicenza and Veneto (2017).

CBs sought to play a challenging balancing game, to work with the markets without being captured by them, while maintaining independent professional judgment and system-wide perspective.<sup>404</sup>

In this sense, independence from affected interests means to hear but not “follow the markets”, and to interact and dialogue with financial actors but suspect the wisdom of the markets and financial experts.<sup>405</sup>

#### **e) FRIENDS AND FOES OF CBI**

The signals, interaction, and influences from the financial industry and markets might be friends of CBI to the extent that they bring epistemic benefits to CBs, adequately discipline ICBs’ reputation and behavior according to the mandate and expertise, and check on undue influences from other Influencers such as political actors.

One Fed governor recently confessed that private citizen enforcement is “another lever that can be pulled to force public decisionmaking back into the thicket of genuinely democratic politics...It is a powerful check on agency action and inaction from the toolkit...[it] empowers individual citizens to bring litigation against regulated parties or even the agency itself when the agency refuses to take a particular action”.<sup>406</sup>

However, interactions with affected interests can also degenerate into informational, institutional, personal, or intellectual capture or structural dominance capable of destroying *de facto* CBI.

They can promote cognitive biases, induce shorter-termism, and block legally permitted mechanisms of political control<sup>407</sup>. They can ultimately build a systematic minoritarian bias in central banking that would violate the fundamental normative foundations of CBI.

Particularly since the GFC, it has become popular (and maybe populist) to decry the capture of CBs by financial interests. The small group of the largest banks was denounced as “a dangerous oligarchy threatening public welfare, the economy, and democracy itself”.<sup>408</sup>

CBs have been described as “political oligarchic force[s], and key part of what looks and functions like a banking cartel” plagued by revolving doors and too close relationships between “officials and Wall Street executives”.<sup>409</sup>

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<sup>404</sup> (DYSON, 2009: 10).

<sup>405</sup> (BLINDER, 1998: 59-62 and 2016: 10).

<sup>406</sup> (WALLER, 2022).

<sup>407</sup> (ADOLPH, 2013).

<sup>408</sup> (JOHNSON & KWAK, 2010: 221).

<sup>409</sup> (PAUL & SPITZNAGEL, 2016), (ADOLPH, 2013).

Such capture and their “lobbying to further deregulate markets for financial derivatives” would explain CBs’ “failure to monitor and supervise the lending practices of banks”<sup>410</sup>, and why the ECB was purportedly more demanding with national governments than with financial interests during the Eurocrisis.<sup>411</sup>

#### **f) ASSESSING THE INFLUENCE OF FINANCIAL INTERESTS**

However, such critical diagnoses are disputed, and empirical findings on the effective influence of financial interests in central banking policymaking are mixed<sup>412</sup>.

Other authoritative studies have denounced a “tendency to overdiagnose capture”. They argue that “credible evidence of strong and/or pervasive capture is difficult to find, and we suspect that cases of both are quite rare.... The old Stiglerian notion of a fully captured regulator is most likely a rarity, if it exists at all...the extent and effects of special interest influence in the regulatory process are both less absolute and more preventable than is typically recognized – they come in degrees, in some cases having no discernible effects on regulation, and more commonly limiting a regulator’s efforts to serve the public interest, but not to the point of compromising the regulatory policy.”<sup>413</sup>

Claims of *hard capture* are described as empirically weak and “most often [as] ex-post rationalizations that attribute motive and meaning from outcomes”, even though soft capture is admitted on the edges.<sup>414</sup>

The coincidence between certain policy decisions and a signaled particular sectional interest does not entail causation. Undesired regulatory outcomes might be caused by a number of motives other than capture, including “regulators’ incompetence, inefficiency, or randomness”.<sup>415</sup>

In effect, the “discovery” of capture in the early 1970s did not represent the identification of a dangerous *new* ailment of western democracies waiting to be cured but rather the *rediscovery* of a chronic disease that was far from fatal but still required ongoing management to limit its adverse effects.<sup>416</sup>

Optimistic perspectives suggest CBs now have a much stronger hand in regulating private financial institutions, bringing these banks into more frequent conflict with private interests and

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<sup>410</sup> (CANOVA, 2011: 21).

<sup>411</sup> (FONTAN, 2018).

<sup>412</sup> (PAGLIARI, 2012: 8-9).

<sup>413</sup> (CARPENTER & MOSS, 2014: 451-8).

<sup>414</sup> (CARPENTER & MOSS, 2014), (ÖZGÖDE, Twitter, 2022).

<sup>415</sup> (PAGLIARI, 2012: 8), (BARKOW, 2013: 17).

<sup>416</sup> (NOVAK, 2014 cit by CARPENTER & MOSS, 2014: 455).



their political patrons<sup>417</sup>, and that an EU supranational supervisor reduces regulatory capture compared to national supervisors.<sup>418</sup>

The resolve eventually displayed by CBs in 2022 to fight the inflation burst as forcefully and prolonged as necessary, despite political criticism and complaints from many financial actors, may confirm their immunity to majoritarian or minoritarian biases.

#### **g) TWO REMEDIAL APPROACHES AGAINST PRIVATE CAPTURE**

Agency capture, can undermine the confidence, legitimacy and normative superiority of the central banking process if left unchecked.<sup>419</sup>

Still, be it a reality or an issue of “perception”, “[t]o a significant extent...capture appears to be a treatable condition”.<sup>420</sup>

As it is a systemic process, no single solution is likely to prevent distortions alone.

A *spectrum* of capture-prevention mechanisms exists and should be explored to reduce the scope of regulatory capture<sup>421</sup> and preserve CBI from undue disproportionate influences from financial interests.

The combination of solutions must be adaptive and specific to the sector.

With the benefit of hindsight, the 1990s strategy of combating capture by *dividing power* across multiple regulators seems unfit for “highly complex industries – with finance as the exemplar – [where] the problem is sometimes not that a monopoly on information leads self-interested regulators to collude, but that ambiguous information and a lack of expertise combine to prevent even the most benevolent regulator from creating policies that advance public welfare”.<sup>422</sup>

The traditional approach to prevent the capture of ICBs is disciplining and limiting their relationship with affected interests through a combination of legal reforms, internally adopted codes of conduct, guidance on external communications, and ethics of self-restraint in dealing with the private sector.

Some of the following apply to various Influencers and others are specific to private financial interests: constraining revolving doors, rules on conflicts of interests, prevention of corruption and coercion, rotation principles both for central bankers and their external analysts, limitation or transparency of privileged contacts between central bankers and financial market actors, and

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<sup>417</sup> (JONES & MATTHIJS, 2019).

<sup>418</sup> (SMITS, 2015: 53).

<sup>419</sup> (CARPENTER & MOSS, 2014: 454-8).

<sup>420</sup> *Idem*.

<sup>421</sup> (CARPENTER & MOSS, 2014: 453-60).

<sup>422</sup> *Idem*.

thresholds for maximum exposure of the ICBs' balance sheet to prevent structural power and financial dominance.<sup>423</sup>

However, this (mostly defensive) traditional approach does not exhaust all strategies.

The model of pluralistic CBI offers a *complementary* approach that prevents private capture through competition of Influence(r)s.

It suggests "measures promoting greater balance and diversity in the competition among different stakeholders" and opening up the central banking process to external or semi-internal checks and balances, perspectives, and ideas.<sup>424</sup>

In addition to the classic instruments of democratic control and judicial review, it may include (i) investments in the institution's capacity (financial, human, and informational), expertise and diversity; (ii) rules of administrative procedure on transparency, the duty to give reasons, and participatory mechanisms; (iii) opening banking to media coverage and journalistic scrutiny; (iv) the creation of semi-internal checks by institutionalizing "devil's advocates" within CBs; and (v) consumer empowerment programs.

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<sup>423</sup> (PAGLIARI, 2012: 21),(ADOLPH, 2013: 2), (BARKOW, 2013: 22-25), (CARPENTER & MOSS, 2014).

<sup>424</sup> *Idem*.

### PART III – CENTRAL BANKS IN POLITICS

#### 5. POLITICAL CONTROL OF CENTRAL BANKS' POLICY-MAKING

CBs are delegated public powers by the DRs of the People through the class political process.

This delegation is not a definitive transferal, the People remain the sovereign holder of those powers, and its DRs maintain the fundamental control over the continuance, conditions, and exercise of the delegation.

The delegation does not leave the ICB above or of-politics. It is the beginning of a multi-faceted and bidirectional relationship with the People and its DRs.

The following sections analyze the relationship between the People, DRs and the ICB departing from the basic intuition of the methodological framework of the Principal-Agent Theory, where the latter is the delegated agent, trustee or guardian<sup>425</sup>.

However, rather than remaining within such a methodological straightjacket<sup>426</sup>, it investigates the dynamics and (*de jure* and *de facto*) control of the delegation and implementation across the policymaking process, and particularly its segments of Democratic Representation, Political Delegation and Accountability.

The first two segments grant, and *ex ante* constrain, the delegated discretion and embed and signal some policymaking preferences. The latter segment is an *ex post* control method that operates and feedbacks into all previous input segments.

These segments cover the main possible methods of control *of* and *for representative* government and policymaking (in the best interests of citizens)<sup>427</sup>: (i) trying to select good-natured/public-spirited central bankers (but expecting the good nature of officials alone would be like trusting luck and risking “bad emperors”); (ii) the People and DRs pre-constrain central bankers’ policy choices through institutional constraints, procedures and prior signals about their preferences over policies (knowing that central bankers might not be responsive or that such constraints might be insufficient or defective, namely due to information limitations, uncertainty, incomplete mandates or, arguably, if citizens or representatives do not know what is best for the former); (iii) the People and DRs keep the right to be informed, and the power to review and sanction unresponsive and unrepresentative behavior of central bankers. They are aware of their own difficulties in delivering effective political accountability (namely information

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<sup>425</sup> (BARRO & GORDON, 1983), (SVENSSON, 1997), (AMTENBRINK & DE HAAN, 2002: 66), (ALESINA & TABELLINI, 2007), (TUCKER, 2018).

<sup>426</sup> (HUBER & SHIPAN, 2002: 26-43).

<sup>427</sup> (MANIN, PRZEWORSKI & STOKES, 1999).

asymmetries or inconsistency of time-preferences or myopia<sup>428</sup>); (iv) they also allow for further checks and signals on central bankers, and interferences with them by other actors, including the judiciary, in the spirit of pluralistic CBI and a balanced separation of powers.

This chapter challenges both the traditional view that basically equates CBI with insulation from DRs and their classic political process, and the progressive critique of CBI that the rise of CBs has left insufficient democratic control and (thus) legitimacy.

It makes a brief reference to the first segment, and thoroughly analyses the second segment of *ex ante* delegation and policy structuring and guidance (section 5.2), and then the fourth of *ex post* political accountability (section 5.3).

### **5.1. THE PEOPLE’S CONTROL**

The democratic representation segment mediates the relationship between the People and CBs through the (s)election of DRs and open mandates and other signals of policy preferences amongst alternatives presented by political parties, candidates, and policy platforms.

No significant specificities justify further elaboration on democratic representation, beyond noting that it neither monopolizes nor exhausts all political relations of the People/public with central bank(er)s nor its interferences in their policymaking<sup>429</sup>.

As explained above<sup>430</sup>, there are multiple existent and new potential channels for a direct public-CB relationship, with the last two decades witnessing a dramatic transformation and intensification of that politically disintermediated interaction from secrecy toward openness and bidirectional engagement.

### **5.2. EX ANTE CONTROL BY DEMOCRATIC REPRESENTATIVES**

In the second segment DRs delegate, but also structure, constrain, steer and nudge central bankers through choices of *institutional design* and of *substantive* signaling and intervention in policymaking.

Institutional design choices involve determining, first, whether to delegate policymaking and to which degree, and second, designing the institutional apparatus of the delegation<sup>431</sup>.

DRs also constrain and participate *substantively* in policymaking, the most obvious example being the definition of the CBs’ mandates.

Their “second-order role” in policymaking involves decisions that are *jurisdictional* on who will be making the first-order policy decisions, *procedural* (or *governance*) by establishing the

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<sup>428</sup> *Idem*.

<sup>429</sup> (MANIN, PRZEWORSKI & STOKES, 1999), (EPSTEIN & O’HALLORAN, 1999), (WALDRON, 2016).

<sup>430</sup> Chapter 3.2.

<sup>431</sup> (REIS, 2013), (IMFX, 2019), (LASTRA, 2015).

structural “rules of the game”<sup>432</sup>, and *substantive* when they signal preferences over the content of policies.

These distinctions are fluid, as the definition of mandate may be considered part of institutional design<sup>433</sup>, design choices also reflect *preferences over policies*, and “a large number of second-order procedural decisions about how policy will be made... have a large and lasting effect on the substance of policy itself”<sup>434</sup>.

From another methodological perspective, institutional design simultaneously embeds and structures a permanent power game. It expresses balances of competing interests, power struggles, and social constructs.

Institutional design establishes incentives structures, both institutional and individual, that generate potential entry points for external influences, but also barriers thereto. That is why institutional design is both a constraint on CBs’ discretion, and a protection of their independence.<sup>435</sup>

However, the role of DRs goes beyond general and abstract rule-like and institutional design decisions that draw the margins of CBs’ discretion. They have other channels to influence decisions of ICBs *within the margins* of the delegated discretion.

They establish limits (guardrails) on the delegated discretion, but they also influence and shape *ex ante* to how ICBs exercise such discretion.

This conclusion contrasts with traditional CBI literature’s defense of narrow and clear border-setting by political principals, and a “no-politician land” within such borders. The GCC summarized this (deluded) view when it declared that “Parliament’s, and therefore the electorate’s, opportunities for exercising influence on the implementation of sovereign rights by European governmental institutions are, however, almost eliminated to the extent that the European Central Bank is provided with independence from the European Community and the Member States”.<sup>436</sup>

Modern “accountable-independence” literature noted that the area of discretion is not as narrow as traditionalists claim but focused essentially on the *ex post* control accountability of its use.

Both views have largely disregarded institutionalized and informal incursions of DRs into that land of CBs’ discretion, before and during the decision-making, as they have mostly ignored the competing influencing efforts of powerful Influencers other than political actors.

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<sup>432</sup> (SCHAUER, 2006: 46-49), Differently (HALL, 1993: 278-280).

<sup>433</sup> (REIS, 2013).

<sup>434</sup> (SCHAUER, 2006: 48).

<sup>435</sup> (LASTRA, 2015), (BINI SMAGHI, 2008).

<sup>436</sup> GCC, 89, 155, October 12, 1993.

In effect, political decisions such as the selection of policymakers, the allocation of financial resources, binding instructions and vetoes on concrete decisions and actions, and a host of non-legally binding yet effective signals and informal behaviors and cooperative and non-cooperative interactions, operate *ex ante* within CB's discretion. They represent potentially effective sources of *de jure* or *de facto* second-order policymaking by DRs *within the margins of discretion*<sup>437</sup>. They exist, many are legally established, and they may be normatively justifiable under conditions.

They are essential pieces of the *good enough democratic control* of independent central banking. They offer democratic and utilitarian benefits: (i) enhanced political representation, participation, and deliberation; (ii) additional knowledge, expertise, and information; (iii) increased dialogue and cooperative coordination that is often crucial to improve the mix of macroeconomic policies; and (iv) prevention of failures or deviations that would require costlier reactions if revealed or solved only in *ex post* judgments.

On the other hand, *ex ante* political interference may jeopardize CBI and its comparative advantages.

Therefore, the admissibility of *ex ante* democratic influences is not a yes-no question. It depends on the conditions: the degree of interference, the circumstances, the framework, the robustness of the central banking process and institution to withstand and filter reproaches, and critically but independently ponder such democratic signals.

The following sections explore these political influences in two groups: the *ex ante* and *ex post*. DRs or "political actors" are normally referred to as a group, but their heterogeneity is significant. They include (i) constitutional and infra-constitutional powers; (ii) the Legislative and Executive, and parts of them; (iii) government and opposition; (iv) directly and indirectly elected and appointed representatives; (v) leaders and the others; (vi) single-party and coalition majorities; and (vii) supranational and national authorities.

They form puzzles of different compositions, with distinct roles, relations, interests, and preferences over policies, which vary across systems of government and of parties.

Political actors clash and compete for influence over the ICB and its policies, who needs to navigate such competition which, in turn, offers opportunities to maximize its power and autonomy.

DRs are part of a chain of delegation and policymaking: they know the People (in the singular) is expecting them to be responsive to the signals it sends them and for which it will hold them accountable; in turn, they expect central bank(er)s to be responsive to their second-order choices and signals and they also will hold them accountable for their exercise of such delegated discretion.

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<sup>437</sup> (TUCKER, 2018: 125).

### 5.2.1. DELEGATION OF AUTHORITY

The primary constitutional or statutory choice of DRs is whether to *establish and delegate public authority to a CB*.

Even when ICBs have a private legal nature and/or ownership<sup>438</sup>, the delegation of public functions and powers must be determined by a public law act enacted by DRs, that limits the rights of private shareholders.

The democratic decision to delegate must *determine the scope of the authority delegated*, i.e., the functions and powers.

DRs *legislate and assign the functions to each CB*, which have typically consisted of some or all of the following: (i) internal monetary policy; (ii) external monetary policy; (iii) macro- and micro-prudential financial policies, including regulation and supervision, and consumer protection; (iv) crisis management functions in case of illiquidity or insolvency of financial institutions (banks and nonbanks) and governments, including LOLR and MMLR, resolution authority and insurance of financial institutions; (v) operation and oversight of payment systems; (vi) truth-telling functions, namely the provision of statistics, economic forecasting, and policy advice based on their expertise; (vii) provision of banking services to banks and other financial institutions, to the state and other domestic and international government agencies (including other CBs), such as depository services, financing and liquidity provision and other “fiscal agency” services to the State related to debt management; and (viii) arguably credit policy.

“[T]he list of central bank functions is open-ended and dynamic” and “the definition of ‘central bank activity’ is likely to change over time”<sup>439</sup>. The original focus on “public debt management” and “financial stability” was abandoned in the late 20th century when ICBs were removed responsibilities that could conflict with price stability.<sup>440</sup> The post-GFC period marked some return to the origins.

Furthermore, DRs have to *determine and grant the powers or competences* for ICBs to perform their delegated functions.

ICBs are subject to the public law principle that public institutions can only act where allowed, instead of the opposing private law principle that individuals may act except where forbidden<sup>441</sup>. Contrary to the delimitation of functions, the determination of powers has not been an active constraint. The latter has, typically, been extremely broad, identifying general categories of acts available for various functions (regulations, decisions, recommendations, contracts, etc.).

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<sup>438</sup> A few ICBs are private law corporations, some with public ownership (e.g., Netherlands, UK) and others with private (e.g., Italy, US RBs, Turkey, Greece) or a combination (Switzerland and Belgium).

<sup>439</sup> (LASTRA, 2015: 2.12).

<sup>440</sup> (JAMES, 2022: 18-19).

<sup>441</sup> Art. 1 SwB-Act.

Such broad openness reduces the utility of that Japanese rarity which is a provision subjecting the extension of CB powers, within the mandate, to the Executive's approval<sup>442</sup>.

### **5.2.2. STRUCTURAL DESIGN**

DRs also design the governance structure of ICBs, whereby they establish the internal distribution of responsibilities and powers amongst the CB's officials and bodies, their organization, composition, and operation.

The extreme model of concentration in one individual governor has progressively given way to internal division of powers amongst committees, collective decision-making, and to mutual checks and balances, including internal oversight.

In the statutory basis lawmakers also establish procedural requirements that organize or constrain the policymaking process, from the aggregation and processing of information, to the discussion (including consultation and participation), the decision-making methods (namely the voting or consensus methods, the regime for dissents, an internal or external veto points), duties to give reasons, publication, and other transparency and accountability mechanisms.

The design of internal governance structures and procedures can embed substantive preferences over policies, but also create instances of internal competition of influences that might become a check on their own political control.

### **5.2.3. GENERAL PURPOSE LEGAL CONSTRAINTS**

Beyond the institution-specific constraints set in their statutory basis, ICBs are also subject to other general-purpose procedural and substantive provisions applicable to them as legal institutions, based on their legal nature, ownership, and public functions.

General principles of law such as the rule of law, human dignity or proportionality, fundamental rights, and procedural frameworks such as administrative procedure acts, (non-)delegation doctrines, freedom of information laws, business or company codes may be applicable to ICBs, often without an express legal provision for the purpose.

A substantial part of the "dialogue" between the CJEU and the GCC on the *Gauweiler* and *Weiss* cases revolved around the proportionality principle, which is laid down in Article 5 TEU (and Protocol No 2) and has been further elaborated in CJEU's case law.

Explicit references that the ESCB "shall act in accordance with the principle of an open market economy with free competition and favoring an efficient allocation of resources, and in compliance with the principles set out in Article 119"<sup>443</sup> ought to be interpreted as a non-exhaustive.

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<sup>442</sup> Art. 43 (1) BoJ Law.

<sup>443</sup> Art. 127 (1) TFEU.



General procedural and substantive legal norms do constrain CBs *ex ante*, imposing additional and relevant guardrails on their delegated discretion, some *positive* and others *negative*. The margins of discretion are apprehended in full only by looking beyond CBs' statutes and mandates. Society has other values and substantive demands that are enshrined in overarching norms on rule of law, fundamental rights, inequality and discrimination, environmental sustainability, and welfare, just to name a few, that have a role in signaling *ex ante* democratic preferences over policy that central bankers have to consider.

#### **5.2.4. SELECTING AND REGULATING CENTRAL BANKERS**

Who the decision-maker is matters when decisions are bound (as explained by non-formalist judicial philosophies), but it matters even more when decisions are discretionary. The more discretion central bankers have, the more important are their characteristics and incentives. Therefore, more meaningful is the political power to regulate the selection and appointment of individual central bankers, their status and the conditions of their tenure.

In the same vein, rules on the composition of the CB's bodies are important as they may impose requirements of diversity (sectoral, territorial, gender), expertise (education, experience), or a combination of internals and externals.

DRs can use the design of these rules to shape the characteristics, incentives, and constraints of central bankers, and consequently their policymaking. As described above, the latter's utility preferences are constrained and manipulatable.<sup>444</sup>

##### **a) APPOINTING THE LEADERS**

The appointment of central bankers is a second-order policy choice because it has potential to shape how first-order decisions are made.

When DRs select and appoint, from a diversified pool, those who are going to lead and make discretionary decisions on behalf of CBs, they are filtering profiles, shaping the probabilities of each policy outcome, and signaling policy preferences.

They are expected to choose those that are more likely to accommodate the politicians' views and/or interests, due to shared substantive policy preferences, loyalty, or for strategic alignment for reasons such as reputation management or interest in reappointment.

Still, the future policy choices of each appointee are neither mechanic nor deterministic, due to institutional acculturation, changes of context, or misalignment of incentives.

The appointment does not create a closed or clear mandate, and enforcement of whatever pre-appointment policy bargain is limited.

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<sup>444</sup> Ch. 2.2.

Traditionally, candidates avoid conveying explicitly their own policy preferences during the pre-appointment rituals, taking refuge in promises of strict adherence to the mandate and objective expertise.

However, things might be changing. The recent reappointment of Fed Chairman Powell was announced as if resulting from a negotiation of the policy agenda between the political appointer (the POTUS) and the candidate-appointee<sup>445</sup>.

US Senators, responsible for *advising and consenting* nominations, have used hearings and discussions during the process to link their vote with the policy preferences of the appointees, often inferred from past behavior (writings or statements) in whatever capacity.

That was perfectly illustrated by US Senator TOOMEY's statement that the "Senate's bipartisan rejection of Sarah Bloom Raskin's nomination sends a powerful message to the Fed . . . that it is not their job to allocate capital or stray from their mission to pursue extraneous or politically charged campaigns."<sup>446</sup>

The power to appoint central bankers is meaningful. Thus, in liberal democracies, DRs have decisive control over that appointment as crucial part of the democratic chain of delegation and *ex ante* political control of policymaking.

The option for a political appointment prevailed over alternatives, such as Mandarin-style knowledge examinations, cooptation by existing members, hierarchical or seniority promotions within the CB, ancient Greek-style lot, or direct election by the People. These could better suit other relevant values (e.g., expertise, neutrality, equality).

In both presidential and parliamentary systems, that power is predominantly assigned to the political Executives. In the EU, the appointment power belongs to the quintessentially political, intergovernmental and indirectly democratic European Council<sup>447</sup>.

Still, substantive and procedural requirements and power-sharing arrangements have been imposed to constrain that political power of appointment, and ultimately strengthen CBI, through one of the following strategies: the depoliticization or non-partisanship of the appointment, democratizing the politicization, and rationalization of the appointing decisions.

First, depoliticization of political appointments is pursued through: (i) requirements of specialized expertise and experience; (ii) long tenures as protection from political removal; (iii) assigning the power to select or short-list candidates to non-political actors such as the incumbent CB governor or governing body or special selection committees internal or external to the ICB; (iv) allowing the ICB to appoint the governor and/or deputy governors; (v) allowing

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<sup>445</sup> (TIMIRAOS & RESTUCCIA, 2021), (REDWOOD, 2021).

<sup>446</sup> (SENATOR TOOMEY, Twitter, March 15, 2022).

<sup>447</sup> Art. 283 (2) TFEU.

private outsiders to appoint some of the central bankers; and (vi) imposing institution's "insiders" in the policy committee<sup>448</sup>.

Second, the improvement of the democratic credentials of political appointments is promoted through: (i) the participation of the Legislature or of democratic Heads of State in the process, namely in prior hearing of the appointees, opinion on and/or consent, or even making the appointment (which is rare); (ii) imposing selection criteria that foster territorial, sectoral or experience (and even theoretical, ideological, or partisan) diversity in the governing bodies; (iii) staggered terms that promote inter-temporal representativeness; (iv) combining elements of federal and decentralized representation in federal systems; (v) transparency of the appointment process enabling public debate and deliberation, and thus the public's input; and (vi) rules on conflicts of interests that prevent central bankers' loyalty from shifting away from the public interest towards some special Interests Groups, corporations or factions<sup>449</sup>.

These constraints elevate political appointments above a simple majoritarian conception of democracy, in order to expand the democratic legitimation, the representativeness and plurality, and the quality of public deliberation involved in choosing central bankers.

Third, many of the above, plus the long and multi-step appointment processes, the involvement of other veto players (such as the head of state in monarchies), and the low frequency of appointments, seek to rationalize the decision-making process.

Even if partially conflicting, this combination of principles is a manifestation of a pluralistic model of CBI that serves various values and seeks to mobilize a competition of Influencers.

All those constraints considered, DRs are still left with incalculable possibilities of choice and a vast discretion in choosing amongst profiles, policy preferences, and loyalties. Many individuals fit within the constraints, most legal concepts used are broad and courts are likely to use deference in scrutinizing the compliance.

Probably the most powerful limitations are those imposing long tenures and staggered terms that deprive each instant majority of the possibility to appoint the whole CB board with members of its liking.

However, such limitations of instant majoritarianism are for the sake of other liberal and democratic values, such as non-domination and inter-temporal representativeness. The composite will and wisdom of multiple successive democratic majorities is preferred over those of an instant majority.

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<sup>448</sup> (LEITÃO AMARO, 2022c, for references and details on this section).

<sup>449</sup> *Idem*.

## **b) REAPPOINTMENT**

The influence of the appointment channel rises significantly when reappointment is possible as it increases the central bankers' incentive to pay attention to the policy preferences signaled by political appointers<sup>450</sup>.

If incumbent politicians change, through elections or other democratic event, the loyalty and attention of central bankers tend to shift towards the new political appointer.

Reappointability may also shift the general balance of political control over ICBs from the Legislature (who sets mandates) towards the Executive (who appoints).

The reappointment allows the political appointer to give some forward-looking guidance on its preferences over policies. Yet, its most powerful role is as political sanction, the threat of a consequential backward-looking judgment on the performance of the central banker.

Thus, it is developed below as an instrument of *ex post* political accountability<sup>451</sup>.

## **c) REMUNERATION**

Another potential lever of political control over CBs is the definition of their remuneration.

If not blocked, the economic gain could be a potential determinant of central bankers' preferences and behavior and a channel for external manipulation<sup>452</sup>.

In theory, the power to determine the central bankers' remuneration can be conferred exclusively or combinedly to the political branches, to the CB governing body, or to some specialized body with expertise and some degree of independence from both politicians and the acting central bankers, such as an internal compensations committee or an external remunerations tribunal.

The more power they attribute to political actors, namely executives, to manipulate the remuneration, the more influence they will have.

In reality, different regimes exist, often combining different actors and processes. Politicians might intervene to set or "simply" to approve the remuneration and material benefits or the underlying contract, specifically for central bankers or as a general decision that aligns compensation of multiple categories of public officials. It is rare having central bankers setting their own salaries. The two main federal central banking systems, the Fed and ESCB, have complex remuneration systems that put its policymakers in disparate conditions of compensation and political influenceability.<sup>453</sup>

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<sup>450</sup> (FRATIANNI ET AL., 1997), (WALLER, 1992 and 1995).

<sup>451</sup> Ch. 5.3.4 b).

<sup>452</sup> Ch. 2.2.

<sup>453</sup> (LEITÃO AMARO, 2022C, for references and details on this section).

One final aspect to be considered is the use of performance-based elements of compensation. Allegedly, a well-designed, “optimal inflation contract” with a variable compensation component (or dismissal penalty) indexed to inflation targets could activate and align the economic gain factor in central bankers’ utility function with their mandate to control inflation.<sup>454</sup>

The BoE aligns material individual incentives with the institution’s goal by increasing salaries in line with the CB’s inflation target so that officials are disadvantaged if inflation is higher than the target. An alternative would be to fix salaries nominally<sup>455</sup>.

However, such devices are uncommon and, in some countries, explicitly prohibited.<sup>456</sup>

Such contracts have: (i) the risk of creating a perverse incentive for short-termist policy interventions in case of short-term economic fluctuations; (ii) difficulties in designing and implementing such performance-based compensation; (iii) meager financial incentives; and (iv) lack of indexation of compensation to broader economic performance.

Moreover, as the principal on such contracts would be politicians (with stronger inflationary bias) and renegotiation would be possible, the contract would maintain a risk of political intervention that would undermine the credibility of the commitment to counter inflation. Such a contract would not overcome the motivation for dynamic inconsistency, but merely relocate it.<sup>457</sup>

#### **d) REGULATING STAFF**

ICBs’ staff plays a fundamental role in policymaking, in framing and preparing decisions and executing the implementation.

DRs may regulate the human resources framework and its rules on staff hiring, selection, expertise, conflicts of interest (revolving doors) and compensation.

If political branches are given the power to approve or manipulate the content, time, or quality of the recruitment of staff by the CB, or to establish their conditions, including compensation, they can weaken the epistemic and operational capability of ICBs, and thus increase their dependency on future ad hoc approvals by the political branch.

#### **5.2.5. FINANCIAL RESOURCES FRAMEWORK AND ALLOCATIVE DECISIONS**

A fundamental channel of democratic control is the “power of the purse”.

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<sup>454</sup> (WALSH, 1993), (EIJFINGER & DE HAAN, 1996: 7), (SVENSSON, 1997).

<sup>455</sup> (BIS, 2009: 142).

<sup>456</sup> *Idem*, BoCan Act sect. 6 (3) c).

<sup>457</sup> (WALSH, 1995), (EIJFINGER & DE HAAN, 1996: 7), (BLINDER, 1998: 45-6).

Not even ICBs, who can “print money” on their own, are immune from various levers that political branches can push in their qualities of lawmakers and fiscal authorities to affect their financial autonomy.

DRs have power to regulate the framework of CB’s financial resources and may intervene in concrete decisions regarding the ICBs’ (a) budget, (b) audit and accounts; (c) profits, provisions, losses, and payment of dividends; and (d) initial capital subscription and fiscal backstop.

Political branches might utilize these powers, when available, as sources of second-order policymaking either by conditioning the funding to *specific* policy measures, or by affecting in general the financial resources of ICBs, and consequently their operating capabilities and even solvency, in terms that in practice enable or impair the implementation of certain policy strategies. Mere threats to “defund” the ICB might have impact.

All these mechanisms operate as financial (institutional) incentives of punishment or reward to shape central bankers’ policy choices.

Political branches might also *indirectly* affect CBs’ financial independence, balance sheets, monetary burden, and policy choices through spillovers and interdependencies from their fiscal or macroprudential policies, the impact of fiscal indiscipline on inflation, and in the extreme, fiscal dominance. However, such indirect manipulation falls in the distinct form of *ex ante* democratic control which is *uncooperative coordination*.<sup>458</sup>

#### **a) APPROVAL OF BUDGET**

In general independent “central banks finance themselves through their own operations”<sup>459</sup>, approve their own budgets and are excluded from the public sector budgetary process typically dominated by Legislatures<sup>460</sup>.

The Executive or Legislative appreciation, unilateral approval, or funding agreement over the CB’s budget or operating expenses are exceptional<sup>461</sup>.

From the perspective of independence, government’s control over the CB’s budgeting “opens the possibility of political influence on central bank operations”,<sup>462</sup> and an annual conditional approval of budgets that sets out what the agency may or not do would amount to redrawing the terms of the mandate<sup>463</sup>.

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<sup>458</sup> See Ch. 5.2.11.

<sup>459</sup> (AMTENBRINK, 1999: 324).

<sup>460</sup> (LASTRA, 2015: 72), (CONTI-BROWN, 2015: 274), (AMTENBRINK, 1999: 324-330).

<sup>461</sup> (LEITÃO AMARO, 2022C, for references and details on this section).

<sup>462</sup> (AMTENBRINK, 2005: 6-7).

<sup>463</sup> (TUCKER, 2018: 125).

From the democratic accountability point of view, because the “central bank is essentially managing public funds”, the complete freedom of the ICB to establish its budget (or a mere informational obligation to submit an estimate of expenditures) “is problematic” .<sup>464</sup>

## **b) APPROVAL OF THE ACCOUNTS**

The budgetary cycle ends with the preparation, audit and approval of annual accounts and financial statements, that frequently need to be reported to Parliament, the Executive, or both. In a few cases, they need to be discussed or approved by one of the political branches.

Audits and the discussion and approval of financial accounts are essentially backward-looking, accountability exercises, but they may contain forward-looking elements.

Audits frequently include concrete reservations and recommendations on the accounts and reported practices, but nowhere are they political exercises led by DRs.

The approval or rejection of accounts is a holistic verdict, it involves public or private discussion and feedback to the CB leadership, which might include signals on policy preferences.

The European Parliament’s resolution on the ECB annual report includes an appreciation on the accounts and recommendations to the ECB, who then responds publicly and in writing. It includes explicit policy signals, that are non-binding and have no juridical effect on the direct allocation of resources.

## **c) PROFITS AND DIVIDENDS**

The determination and distribution of CBs’ profits and dividends is a potential channel to influence their condition and independence. To the extent that DRs are allowed to decide the distribution of profits and the amount to which the government is entitled, they may impact the CB’s financial strength and consequently their capability and policy room to pursue their otherwise preferred policy strategies<sup>465</sup>.

Also problematic are provisions giving government the right to partial payments before the end of the fiscal year based on an estimate for that year or when the profit calculation includes unrealized gains.

If the general/institutional influence of these interferences is potentially significant, the fact that they concern the ICB’s aggregate bottom line makes them blunt tools to convey signals about specific policy decisions.

In abstract, profits might be retained and/or distributed to the Treasury and to the CB’s public or private shareholders. Such distribution “may follow established rules and/or be based on

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<sup>464</sup> (AMTENBRINK, 2005: 6-7).

<sup>465</sup> (AMTENBRINK, 2005: 10).

discretionary decisions made by the CB, the government and/or shareholders, or jointly by the two parties”<sup>466</sup>.

When existent<sup>467</sup>, private shareholders are entitled to some remuneration corresponding to a (small) share of the profits.

There are various positive regimes on political intervention in the determination of CBs’ profits and payment of dividends to the Treasury, ranging from discretionary order or authorization by the Executive or Legislative; agreement between the Executive and the CB which has a defensive veto; legislated or CB-enacted rules that eliminate governmental discretion; and absence of political intervention whatsoever<sup>468</sup>.

Those rules must strike a balance between two potentially conflicting concerns: to preserve the CB’s financial strength and solvency (including by requiring the constitution of general or specific provisions or reserves) and thus their financial independence, and, on the other hand, to transfer to the Treasury the maximum amount possible of profits generated by the public functions delegated by the People to the ICBs.

Governments know the trade-off between their short-term interest in maximizing the fiscal revenue from larger transfers of profits and dividends from CBs, and their concern with the financial strength of CBs and the economy-wide consequences of some induced fragility.

BUNEA ET AL. surveyed 57 CBs worldwide to find that “governments have tried to influence the amount of distributable profits by changing the profit distribution rules, by attempting to change the amount of profit distributed under the existing rules, and even by attempting to force the CB to transfer accumulated reserves from past undistributed profits when its risk exposures did not necessarily justify the diminution in its capital resulting from such transfers”<sup>469</sup>.

CBs are not profit-maximizing institutions, and their statutory objectives are not profits but rather of macroeconomic nature. Nonetheless, they are expected to seek profits for the sake of remunerating taxpayers’/shareholders’ invested resources and delegated functions, as an indicator of the quality of their pursued policies, and to strengthen their own balance sheets and thus the room, credibility, and effectiveness of their policies.<sup>470</sup>

Moreover, as their profits essentially constitute public funds, it should not be at the discretion of the CB itself to freely decide on the amounts of net profits withheld.<sup>471</sup>

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<sup>466</sup> (BUNEA ET AL., 2016: 31).

<sup>467</sup> (BUNEA ET AL., 2016), (LEITÃO AMARO, 2022c).

<sup>468</sup> (LEITÃO AMARO, 2022c).

<sup>469</sup> (BUNEA ET AL., 2016), (GONCHAROV, IOANNIDOU & SCHMALZ, 2018).

<sup>470</sup> (GONCHAROV, IOANNIDOU & SCHMALZ, 2018), (IMF LEGAL DEPARTMENT, 2007), (CHIAICCHIO, CLAEYS & PAPADIA, 2018). Disagreeing on the profit motive (AMTENBRINK, 2005: 9), (VAN RIET, 2019: 19).

<sup>471</sup> (AMTENBRINK, 2005: 10-12).



The CBs' historical success in generating profits, even after the GFC and Eurocrisis<sup>472</sup>, is now deeply at risk as interest rate rises and the unwinding of their massive bond purchases in response to the post-pandemic inflation burst meet gigantic CB balances filled with assets paying yields much lower than the rising remuneration of the liabilities that they have to pay to commercial banks.

Since mid-2022 most major CBs have been warning of, or reporting, financial losses, and they are stopping payments of profits to the treasuries.<sup>473</sup>

Another distinct, but materially related power of DRs is that of taxing or exempting CBs' profits<sup>474</sup>. Even if normatively disputable, taxing practices vary considerably across countries<sup>475</sup>. Taxing powers are quintessential democratic powers, and they affect the operational profits that may be retained or distributed as dividends.

#### **d) FISCAL BACKSTOP**

If ICBs generate losses there are three major strategies to cover them, all of which have impacts on the treasury and some intervention from DRs.

First, through present and/or future reduction of profits and using reserves, whose level politicians may affect by altering rules or concrete decisions on provisions, transfers to reserves and distribution of profits. But, when deeper losses get the ICB into negative comprehensive net worth – insufficient profitability over the entire future to offset deficit – the use of reserves and carrying losses forward would no longer be enough.

Second, through (re)capitalization of the ICB through the transfer of funds or (government) securities, or some conversion of anticipatedly retained profits<sup>476</sup>. DRs control such capitalization as owners or shareholders of (most) CBs, as legislator of their legal basis, and as fiscal authority that needs to approve the use of taxpayers' resources in the capitalization.

Finally, by providing a specific fiscal backstop, indemnity or guarantee to losses on certain fiscal operations.

In all three strategies the “long-term deep pockets” of the Treasury complement the “short-term deep pockets” of the CB<sup>477</sup>.

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<sup>472</sup> (GONCHAROV, IOANNIDOU & SCHMALZ, 2018), (CHIAICCHIO, CLAEYS & PAPADIA, 2018), (ARNOLD, 2022).

<sup>473</sup> (ARNOLD, 2022), (TREECK, 2022), (<https://fred.stlouisfed.org/series/WLAD>, December 26, 2022).

<sup>474</sup> (BUIER, 2007: 49).

<sup>475</sup> (IMF LEGAL DEPARTMENT, 2007, recommending the exemption of CB from income taxation).

<sup>476</sup> (STELLA, 2008: 20-21), (STELLA & LONNBERG, 2008: 18).

<sup>477</sup> (BUIER, 2007: 52).

Even if ICBs can avoid technical insolvency (through seigniorage) and are protected from legal insolvency or bankruptcy proceedings<sup>478</sup>, the problem is “whether the central bank can meet its policy commitments given its financial situation”<sup>479</sup>.

CB financial strength is positively associated with good policy performance<sup>480</sup>, and losses below the level of capital and reserves deteriorate its ability to discharge the respective functions<sup>481</sup>, undermine the credibility of its policies, and may raise political and communication concerns<sup>482</sup>. On the other hand, “public finances may not be in good enough shape for governments to forgo the chance to dip into inflation taxes”<sup>483</sup>.

The political power to provide or withhold such fiscal support, indemnity, or backstop to specific operations or to the solvency of CBs in general, then becomes essential for central banking and a potent channel of democratic control.

In abstract there are four possible regimes on the provision of a fiscal backstop to CBs: (a) explicit prohibition; (b) explicit recognition of an open-ended, general fiscal backstop; (c) *ex ante* regulated and limited backstop, and (d) *ex ante* ambiguity, that interpretation and practice may take either way<sup>484</sup>.

The solution involves a delicate balance. With an uncertain and discretionary fiscal backstop, CBs might become politically dependent, but without any they might become operationally and “financially weakened (abandoned rather than independent)”<sup>485</sup>.

(a) *The prohibition regime* is inspired by the ideas of monetary dominance, strict separation between monetary and fiscal policies and market discipline. Yet, it can hardly be seen as *entirely* credible, as in extreme circumstances, the legal interdiction becomes a “parchment barrier”. It should, at least, try to be *sufficiently* credible *ex ante* to prevent moral hazard and fiscal dominance.

(b) The *explicit general backstop regime* is unknown in advanced economies with solid CBI frameworks, but it is common elsewhere.<sup>486</sup> They tend to create the worst of both worlds: an open-ended promise of fiscal support that triggers moral hazard, with vagueness, uncertainty and discretion that create political dependence.

The intermediate regimes (c) and (d) try to strike a better balance.

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<sup>478</sup> (HALL & REIS, 2015), (ADLER, CASTRO & TOVAR, 2015).

<sup>479</sup> (STELLA & LONNBERG, 2008: 10-11).

<sup>480</sup> (STELLA, 2008). Differently (ARCHER & MOSER-BOEHM, 2013: 17).

<sup>481</sup> (STELLA & LONNBERG, 2008), (ADLER, CASTRO & TOVAR, 2015).

<sup>482</sup> (VAN RIET, 2015), (BERNANKE, 2015: 542).

<sup>483</sup> (ARCHER & MOSER-BOEHM, 2013: 18).

<sup>484</sup> (STELLA & LONNBERG, 2008, reviewing 135 CB laws), (BUNEA ET AL., 2016).

<sup>485</sup> *Idem*.

<sup>486</sup> *Idem*.

(c) The *regime of an ex ante regulated and limited backstop* might support either specific CB operations, or the (re)capitalization of the balance sheet in general, and be either *permitted* or a *commitment* that is automatic or dependent on further political decisions.

The automatic commitment reduces uncertainty and political dominance, may promote moral hazard amongst central bankers, but it mitigate the risk of them losing control of inflation.<sup>487</sup>

A discretionary political power creates a potent channel for DRs to signal and impose their preference on the CB policy initiatives at stake. The uncertainty may cool off the CB's reaction function, but also create political dependence.<sup>488</sup>

To mitigate dependence, the law should regulate the procedure for approval, the order in which losses have to be offset, and whether the consent of both political branches is required (which would create a check on instant impulses, but increase the risk of paralyzing the support in case of a political divide).

*Ex ante* clear and coherent democratically legislated financial support seems to better preserve financial and operational independence than political discretion and ambiguity about *ex post* support<sup>489</sup>.

Of the three most paradigmatic CBs, the BoE falls neatly within the regime of regulated limited backstop, the Eurosystem within the regime of ambiguity, and the Federal Reserve System has a combination of both.<sup>490</sup>

#### **5.2.6. MANDATE AND OTHER GENERAL POLITICAL GUIDANCE**

One of the most essential powers of DRs over a delegated agency is the determination of the objectives that it must pursue and other substantive limits it ought to observe.

The delegation has to be purposeful. For every public function ICBs ought to have mandates assigned more or less explicitly.

There is a bare minimum of *ex ante* democratic substantive guidance over CBs' policymaking, and even lenient courts require the political branches to at least give the agencies an "intelligible principle" on which to base their policymaking and regulations – e.g., the SCOTUS' non-delegation doctrine and Chevron deference.<sup>491</sup>

This power-duty to frame the CB's mandate gives DRs a channel of second-order substantive policymaking to frame and guide the exercise of the delegated discretion.

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<sup>487</sup> (VAN RIET, 2017: 17), (REIS, 2017), (BARTSCH ET AL., 2020: 14), (BUIER, 2006: 49), (GONCHAROV, IOANNIDOU & SCHMALZ, 2018: 5).

<sup>488</sup> (AMTENBRINK, 2005: 3).

<sup>489</sup> (AMTENBRINK, 2005: 15), (BUIER, 2009), (SALIB & SKINNER, 2020).

<sup>490</sup> (LEITÃO AMARO, 2022C, for detailed analysis on the three regimes).

<sup>491</sup> (BREYER ET AL., 2011).

## a) A CERTAIN LEGISLATIVE RESTRAINT

However, often legal texts muddle functions and objectives, fail to explicitly ascribe objectives for every function or to clarify the relations, hierarchies, and conflicts between various objectives within or across functions, use broad and vague concepts, and legislated mandates are inevitably incomplete.

Reality demonstrates how CBs' legal bases fall short of the traditionalist assumption of *narrow and clear mandates*.

The mandate for monetary policy has consumed most discussions and legal provisions, with a widespread prevalence of various stability objectives – internal and external monetary, financial, and economic stabilities – whose articulation is challenging.<sup>492</sup>

Legislated mandates may include long- and short-term goals, aiming for nominal or real aspects, or even support for the government's economic and other policies, or broad references to general welfare and prosperity.

In advanced economies, the objectives for the monetary policy function range from a single price-stability mandate, to multiple ranked mandates typically with price stability topping the hierarchy (e.g., in the EU, UK, Israel, and Switzerland), or multiple mandates putting “on an equal footing” nominal and real activity objectives, as in the USA, Australia, and New Zealand<sup>493</sup>.

After the GFC, democratic lawmakers and governments assigned (more) macro- and microprudential financial policy functions and a financial stability objective to ICBs, typically as shared or supporting responsibility, rather than an exclusive competence.

This mandate expansion was not accompanied by a legislative clarification of its articulation with the preexistent price stability mandate. They seemed to be formally parallel mandates. The option to internally segregate the CB structures accordingly (e.g., BoE, ECB, and RBA)<sup>494</sup>, does not eliminate the conflicts and interdependencies, which lawmakers left unresolved.

Despite differences in structure and wording, legislated mandates in general are broad, using vague concepts (e.g., “price stability”, “full” or “maximum employment”, “stability of the financial system”, “growth and employment”, “welfare of the People”, “economic prosperity”), without specifying targets and orientations to measure and assess them.

The picture became only fuzzier after the GFC when societal demands emerged and activist CBs marched towards new missions to preserve stable conditions in financial markets and combat climate change, inequality, and rising housing prices, sometimes without waiting for explicit democratic authorization.

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<sup>492</sup> (LASTRA, 2015), (LEITÃO AMARO, 2022c).

<sup>493</sup> (LEITÃO AMARO, 2022c).

<sup>494</sup> SSM Regulation, Recital 65, anchored on art. 127 (5) and (6) TFEU.

This legislative self-restraint stands far from the myth of complete mandates and “goal dependence” dreamt by traditionalists and progressives alike.

However, it cannot be confused with democratic abdication or definitive transfer of power in favor of technocratic central bankers.

First, it is a deliberate, thus legitimate, choice.

Second, the mandate, in whatever terms, is always reviewable by the democratic principals, even if under conditions. DRs never lose, or abdicate from, the ultimate power to amend the delegation, its mandate and legal basis. Even if latent, their democratic control of the mandate is effective.

Legal burdens, namely from the constitutionalization of the mandate, or *de facto* difficulties stemming from political dysfunctionality and partisan polarization will not stand in the way of determined politics and broad societal consensus.

Third, DRs have various other ways to provide ICBs “with targeted democratic guidance” and “enhanced democratic authorization”.<sup>495</sup>

## **b) STRATEGIES TO REMEDY INCOMPLETE MANDATES**

Legislative self-restraint is an implicit deference for others to complete the mandates, specify its objectives and resolve the trade-offs. In abstract, courts, the Executive branch, and CBs may take on that role.

Courts have been deferential to agencies and CBs’ choices, and they largely abdicate from intervening substantively in monetary and financial policymaking.<sup>496</sup>

Two main strategies have been adopted: (i) the British model of mandate specification by the Executive, which is closer to the doctrine of operational independence only<sup>497</sup>; and (ii) the American and EMU’s model of granting broad discretion to the ICB to detail its mandate and substantive standards, thereby shattering the myths of mere operational independence and no politicization of central banking.

In the British model, it is up to the political institutions and process to specify the mandate. The democratic Legislature broadly defines the delegation’s objectives, and then the democratic Executive specifies them, detailing concepts and defining policy targets and how to measure them, thus defining the so-called policy framework.

Such specification, or remit, is conducted on a recurring basis or in case of disagreement with the CB.

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<sup>495</sup> (DE BOER & VAN’T KLOOSTER, 2020).

<sup>496</sup> Ch. 4.3.

<sup>497</sup> (SALIB & SKINNER, 2020, 931-932).

CBs under this model – BoE, RBNZ, BolSr, BoCan and RBA – have to be consulted before the government issues its specifying directive or remit.<sup>498</sup> Despite this unilateral power, some Executives have the custom of negotiating and agreeing with their CBs the monetary policy framework (e.g., Canada and Australia).

In the UK and New Zealand, the Executive has an additional power to introduce temporary deviations from the mandate or remit. In the UK, in “extreme economic circumstances” the Executive may give directions to the BoE with respect to monetary policy that *ope legis* suspend the Bank’s monetary policy statutory objectives. Such Executive orders are temporary, ought to be made by statutory instrument and satisfy conditions and procedural requirements, including prior consultation of the Governor of the BoE and being laid before parliament in the 28 days after being made.<sup>499</sup>

In New Zealand the Executive may order the RBNZ to temporarily pursue economic objective(s) that depart from its normal remit.<sup>500</sup>

The alternative, predominant model relies on the ICB to specify the legislative mandate and define its own policy targets. The Fed, ECB, BoJ, SNB and Riksbank set the respective policy frameworks with a degree of informality.<sup>501</sup>

More recently, though, the Fed and ECB reviewed their monetary policy framework with procedural rituals, open participation, and communication efforts that surpassed many legislative and administrative rulemaking procedures.

### **c) POLITICAL GUIDANCE BEYOND MANDATE**

All CBs, including the majority under this model of self-specification, are subject to other channels of *ex-ante* democratic guidance of general and abstract character.

In addition to the mandate enactment, and British-style executive specification (when applicable), political institutions can also: (i) specify the objectives of economic policies when CBs have a secondary mandate to support them; (ii) approve other legislative or executive rulemaking; (iii) enact or sanction other legal instruments to which ICBs should somehow defer. (i) Some CBs like the ECB and the BoE have secondary mandates to support the general economic policies of the EU and UK Government, respectively<sup>502</sup>.

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<sup>498</sup> Sect. 12 (1) (a) BoE Act, Sects. 10 to 15 and 17 RBNZ Act, Sect. 14 BoCan Act, and Art. 3 (b) BolSr Law, Sect. 12 RBA Act.

<sup>499</sup> Sect. 19 BoE Act.

<sup>500</sup> Sects. 12 to 15A of the RBNZ Act.

<sup>501</sup> (WADSWORTH, 2017: 6).

<sup>502</sup> Arts. 119 (2) and 127 (1) TFEU, Sects. 9C (1) (b) and 11 (b) BoE Act.

Admitting that ICBs have some substantive role in discerning what such objectives mean and entail<sup>503</sup>, the prevailing authority to formulate and elucidate such economic policies must lie with the government.

The UK law requires the Treasury to annually specify “what the economic policy of H[is] Majesty’s Government is to be taken to be”<sup>504</sup>.

The EU Treaties are silent on how the EU political institutions may orient the ECB on that matter, but they empower the Council to adopt a recommendation setting out the broad guidelines of the economic policies of the Union<sup>505</sup>. On the other hand, excerpts of EU Parliament resolutions on the ECB Annual Report seem to go in the same direction.<sup>506</sup>

While those acts of the Council and EU Parliament are non-binding, and the primary addressees of the Council recommendation seem to be Member States in the context of the coordination of their economic policies, it would hardly be acceptable for the ECB to claim a standalone authority to articulate the economic policies of the Union, let alone to depart from the official guidelines legitimately adopted by the political institutions.

It has been suggested that, on the basis of the same Treaty provision, the Council could set out Economic Policy Guidelines specifically addressing the ECB’s role in realizing the secondary mandate, and how it should deal with the economic policy effects of its operation.<sup>507</sup>

The challenge of this proposal is to identify the line that divides the clarification of the economic policies, including for the purpose of monetary policies, from the interference on the formulation of the latter in terms that affect primary objectives (which political institutions are, in general, barred from).

(ii) Another path for further democratic guidance is the democratic enactment of secondary legislative or administrative rulemaking or international agreements that complement or tweak the primary legislative definition of the mandate or that involve guardrails or guidance on the CB’s exercise of discretion.

In monetary policy, that would be the case of rules on convertibility or anchoring, legal tender, limitations or prohibition of monetary financing to the State,<sup>508</sup> and on the instruments of monetary policy clarifying their permissibility and the conditions under which they can be activated.<sup>509</sup>

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<sup>503</sup> Ch. 6.3.

<sup>504</sup> Sects. 12 (b) and 9D BoE Act.

<sup>505</sup> Art. 121 (2) TFEU.

<sup>506</sup> (EU PARL, Resolution of 10 February 2021 on the ECB – annual report 2020).

<sup>507</sup> (DE BOER & VAN’T KLOOSTER, 2020).

<sup>508</sup> Art. 34 BoJ Law.

<sup>509</sup> (DE BOER & VAN’T KLOOSTER, 2020).

In financial policy, the legislative intervention is much more extensive, as exemplified by the mammoth US Dodd-Frank Act and the vast EU financial services legislation<sup>510</sup>. That difference in favor of more intervention in financial policies has multiple reasons: (i) path dependence, as historically CBs were more supervisors than regulators; (ii) greater political interest and concern with the vagaries of banks and financial institutions; and (iii) the nature of the issues as financial policymaking involves relatively more concrete and direct individual effects and thus limitations of rights, which recommend legislative intervention.

Other examples of Executive rulemaking exist in external monetary policy. Even the very independent ECB is subject to Council of the EU's powers to conclude formal agreements on an exchange-rate system for the euro in relation to the currencies of third States, or to "formulate general orientations for exchange-rate policy in relation to these currencies" in the absence of those exchange-rate systems<sup>511</sup>. Still, it has been argued that "politicians imposed upon themselves restraint in the external area. They do not give clear guidance on the precise demarcation line between what belongs to the ECB and what to the politicians when it comes to deciding on exchange rate influencing measures"<sup>512</sup>.

In the EU, the admission of European or national *political* rulemaking powers in the fields of monetary policy raises eyebrows in face of the traditional assumption that the ECB has vertically and horizontally exclusive competence in monetary policy.<sup>513</sup>

Yet, the Treaties have provisions<sup>514</sup> empowering the EU lawmakers to adopt rules within which the ECB is to operate (autonomously) in the field of monetary policy.

Such powers expand the channels for *ex ante* democratic control<sup>515</sup>, and the Council has used them to enact Regulations and Decisions on the ECB's application of the prohibitions of monetary financing<sup>516</sup> and sanctions<sup>517</sup>, imposition of reserve requirements<sup>518</sup>, consultation by other institutions<sup>519</sup>, and collection of statistical information.<sup>520</sup>

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<sup>510</sup> Namely the CRD, CRR, SSM Regulation, BRRD, DGSD, PSD 2.

<sup>511</sup> Art. 219 (1) and (2) TFEU.

<sup>512</sup> (SMITS, 2007: 1628).

<sup>513</sup> Art. 12.1. ESCB-Stat declaring that the ECB-GC "shall formulate *the* monetary policy of the Union" (*italic added*); (MERSCH, 2020), (WAIBEL, 2020, arguing that "monetary policy is an exclusive competence ... in name only").

<sup>514</sup> Arts. 125(2), 129 (4) TFEU and arts. 5.4., 19.2, 20, 34.3, and 41 ESCB-Stat.

<sup>515</sup> (SMITS, 2007: 1626), (DE BOER & VAN'T KLOOSTER, 2020).

<sup>516</sup> Council Regulation No. 3603/93.

<sup>517</sup> Council Regulation No. 2532/98.

<sup>518</sup> Council Regulation No. 2531/98.

<sup>519</sup> Council Decision No. 98/415/EC.

<sup>520</sup> Council Regulation No. 2533/98.



The Treaties also allow the Council and European Parliament to amend the legal basis that specifies the instruments of monetary policy and other operational methods of monetary control.<sup>521</sup>

Additionally, the simplified revision procedure of Article 48 (6) TEU could be used to revise TFEU provisions that govern the ECB's mandate.<sup>522</sup>

(iii) One other channel for general and abstract guidance are those legal instruments adopted or sanctioned by political branches to which the ICBs should somehow defer or “could draw more proactively on”.<sup>523</sup>

Two examples in the EU context are: the conditionality of ECB programs, such as the OMT or the TPI, that rely on assessments and legal deliberations of EU political institutions (particularly the Council), which the ECB commits to respect; and the Regulation that approves the EU Green Taxonomy clarifying the economic activities compatible with the EU's environmental objectives<sup>524</sup>, which the ECB may use on its “climate agenda” and respective adjustment of its monetary and financial supervision instruments.<sup>525</sup>

#### **5.2.7. INSTRUCTIONS – DIRECTIVES, VETOES, AND OVERRIDES**

DRs may also shape and interfere with specific and concrete CBs decisions, *within the limits of their discretion*, by means of instructions, directives, administrative orders and vetoes or override mechanisms with constraining force stemming from legal binding effects or other forms of command imposed through punishing or rewarding incentives.

##### **a) POLITICAL INSTRUCTIONS *LATU SENSU***

DRs might issue *political instructions latu sensu* at various stages of the CB's decision-making process:

- (i) As *directives or instructions stricto sensu* issued before or during the discretionary decision-making;
- (ii) As a *veto*, when some form of political authorization or ratification is required – e.g. provisional veto, resolution of disapproval, ratification, or formal enactment as legislative statute or executive regulation;
- (iii) As an *override stricto sensu* in the form of repeal, annulment, substitution, or suspension of a concrete CB decision that is finalized and is under implementation.

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<sup>521</sup> Arts. 129 (3) and (4) TFEU, and arts. 18, 20, 41 ESCB-Stat.

<sup>522</sup> The amendment has to be adopted by unanimity in the European Council and by Member States. (DE BOER & VAN'T KLOOSTER, 2020).

<sup>523</sup> (DE BOER & VAN'T KLOOSTER, 2020).

<sup>524</sup> Regulation (EU) 2020/852.

<sup>525</sup> (DE BOER & VAN'T KLOOSTER, 2020).

Certain forms of vetoes and the overrides entail a backward-looking judgment and political sanction on CBs, and thus are also exercises of *ex post* accountability.

However, all those instructions *latu sensu* are forms of *ex ante* control in the sense that they affect and thus potentially integrate the CB policy decision, and they are applicable to ongoing and future situations. In other words, they offer political forward-looking guidance to CBs.

While “legislative vetoes” are proper overrides, the so-called “legislative overrides” in the form of reactive *amendments* to the CB legal basis do not fit this particular category of political instructions. Even when they are adopted reactively with specific policy decisions in mind, statutory amendments only affect CBs mediately. They reverse or adjust preexistent legislative constraints and narrow discretion through statutory precision with impact on ongoing or future decision-making. These “legislative overrides” fit better the previous section, or the accountability exercises labelled below as the “R-bomb”.<sup>526</sup>

Instructions are *negative* when they cease temporarily or permanently the existence or effects of a concrete decision.

In positive instructions, DRs impose or formulate policy content or preferences, and thus they are usually perceived as enabling stricter democratic control over CBs.

However, this distinction is rather fluid.

First, because a veto or override determines the maintenance or return to the status quo, which is itself a policy condition, and thus entails a policy choice.

Second, because the veto and override are outcomes of an interaction and negotiation, formal or informal, between the political branch and the CB. For instance, in the UK it involves an exchange of letters or statements.

During such interaction the CB may be willing to adjust its decisions to satisfy the political institution preferences and thus avoid being vetoed or overridden. These negative powers become like “a stick behind the back” providing both sides with the incentive to bargain the policy output and avoid their application, as both stand to lose: the CB by being overridden, and both institutions due to the costs from the instability and adverse reaction from financial markets and the public to the clash and explicit disagreement between policymakers.

In this sense, the mere availability of both positive and negative powers may be effective and sufficient to make their application superfluous<sup>527</sup>.

Similar strategic dynamics occur between policymakers and courts doing judicial review when the latter have only the negative power to annul (or not) policy decisions. The non-trivial difference is that political-judiciary dialogue is structured in a sequence of separate and

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<sup>526</sup> Ch. 5.3.5., (AMTENBRINK, 1999), (BREYER ET AL., 2011: 76-89), (SALIB & SKINNER, 2020).

<sup>527</sup> (AMTENBRINK, 1999: 357).

formalized processes<sup>528</sup>, while the CB-political interaction is quicker, more intimate, and informal.

## **b) POLITICAL INSTRUCTIONS AND CBI**

These instructions differ from other channels of *ex ante control* below is their constraining force. Concrete instructions *latu sensu* are said to attack the heart of CBI, as they dictate concrete CB decisions, render their discretion meaningless. They turn government into first-order policymaker and compromise CBI operational independence.

That is why EU Treaties banned all instructions to the ECB and NCBs from political authorities, European and national alike<sup>529</sup>. A few other CB laws (of Euro Area countries<sup>530</sup>, Switzerland and Sweden) include similar prohibitions<sup>531</sup>.

However, such literal prohibition is neither as absolute for the ECB as the words of TFEU suggest, nor generalized across ICBs of advanced economies.

In fact, there are various examples where DRs are legally entitled to direct, veto, or override CBs, in direct confrontation with the traditional view of CBI.

## **c) CROSS-FUNCTIONAL POLITICAL INSTRUCTIONS**

One often overlooked challenge to decisional independence is when political instructions directed at one policy function succeed to condition and affect the ICB's policy room in its other functions where it was supposed to be more independent.

To avoid confronting this risk of cross-functional political influence, CBI literature offered two strategies: the purist/reductionist, and the asymmetric independence.<sup>532</sup>

The purist strategy advanced by traditional defenders of strict independence consists of rejecting the accumulation of other functions beyond internal monetary policy and defending that within such single function all political instructions must be prohibited. Their remedy, then, is to relieve CBs of all other functions where political instructions are inevitable.

The asymmetric independence strategy is advanced by those who accept that modern CBs necessarily multitask but reject any political instruction in the field of internal monetary policy. They distinguish subordinated functions from fully independent functions like internal monetary

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<sup>528</sup> The off-the-court informal interactions, albeit existent, are rarer and generally seen as more suspicious.

<sup>529</sup> Art. 130 TFEU and art. 7 ESCB-Stat.

<sup>530</sup> Arts. 12 Buba Act, 1 (2) Bolta Law, 7 (4) of the Spanish Law 13/1994, art. 27 (7) BoPrt organic law, article L. 141-1 BoF-Stat, and Ch. II Sect. 3 Nederlandsche Bank Act and art. 6 (3) of its Articles of Association.

<sup>531</sup> Art. 5 SNB Law, and Ch. 2, art. 2 SwB-Act.

<sup>532</sup> (LASTRA, 2015), (ALEXANDER, 2015), (TUCKER, 2018: 215), (SALIB & SKINNER, 2020). Defending independence on supervision (BCBS, 2012, principle 2, §1), (DE BELLIS, 2015: 80-82), and on the resolution function (FINANCIAL STABILITY BOARD, 2014: 2.5).

policy (and possibly microprudential policy) where political instructions would be fully prohibited, and naively assume the possibility of preventing cross-contamination between the two groups of functions, as if CBs had internal dividing walls and could frictionlessly live submissive to instructions in the morning but be independent in the afternoon.<sup>533</sup>

However, both strategies fail by assuming too much (absolute) independence in the so-called independent functions, by overlooking the inevitability of cross-functional contamination, and by dismissing the ambition of an independence for all seasons and delegated functions that is normatively sensible and positively demanded by the EU Treaties.<sup>534</sup>

On the one hand, all CBI positive frameworks are porous and allow and regulate political instructions even within those “independent functions”, internal monetary policy included.

On the other hand, political instructions given on subordinated policies inevitably generate spillovers into independent functions that compromise the latter’s independence. The purported non-contamination and coexistence of two different relational conditions of CBs vis-à-vis the political power is not very robust.

The law might try to solve the conflict between the policies, through rules that prioritize the objectives within and across multiple functions. However, such abstract rules are not sufficient to solve all trade-offs in all circumstances.

The RBNZ Act created a rare mechanism to explicitly deal with such conflicts when they actually materialize.<sup>535</sup> Despite its virtue of creating procedural certainty, the practical result is to make clear that the final word belongs to the political Executive.

DRs might, through political instructions that are permitted in the context of other functions and locus, end up indirectly affecting the independent exercise of internal monetary policy.

The following areas offer such opportunities for cross-functional instructions: (i) external monetary policy; (ii) fiscal agency function; (iii) macroprudential function; (iv) ICBs’ international activities; (v) and decentralized units of federal central banking systems.

(i) As CBs participate in external monetary policy in general subordination to the Executive<sup>536</sup>, they risk facing political instructions regarding the exchange rate regime or concrete policy orientations and foreign exchange operations in conflict with the internal monetary policy goals where they are independent. The risk for independence exists even where ICBs have some (minor) room for autonomous foreign exchange operations.

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<sup>533</sup> (LASTRA, 2010 and 2015).

<sup>534</sup> Art. 282 (3) TFEU and 7 ESCB-Stat.

<sup>535</sup> Art. 20 RBNZ Act.

<sup>536</sup> (FOMC, Foreign Currency Directive, amended 2020), (FOMC, Authorization for Foreign Currency Operations, amended 2020), (SALIB & SKINNER, 2020: 975), (AMTENBRINK, 1999: 234). Differently (CONTI-BROWN & ZARING, 2018). Also Art. 40 (3) BoJ Law, arts. 17 and 18 RBNZ Act.

In the USA, until 1992 the Treasury's requests for the Fed to "warehouse" foreign exchange transactions through swaps of foreign-currency holdings between the two threatened *de facto* CBI because the practice resembled "a loan from the Fed to the Treasury, undertaken at the latter's behest and outside of the congressional appropriations process".<sup>537</sup>

In the EU, the Treaties give the Council the responsibility either to establish external agreements in a Bretton Woods-like world, or to "formulate general orientations for exchange-rate policy in relation to non-Member States" in a global system with floating currencies.

The Council, though, has so far exercised self-restraint<sup>538</sup>.

(ii) When ICBs act as fiscal agents to the State they have to take instructions from the Executive, acting as principal in that relationship. This may impact the (independent) conduct of monetary policy if it leads to some form of monetary financing, or to significant changes in the supply of government securities or in the composition and risks of the CB balance sheet.

See, for instance, the Treasury's overdraft at the BoE, or the US Treasury's power to "direct" RBs to act as its fiscal agent<sup>539</sup>, namely in the execution of foreign exchange transactions using funds from the Treasury Exchange Stabilization Fund, in the maintenance of the government's bank account at the regional banks, and purchases of treasuries<sup>540</sup>. The ESCB Statute authorizes both ECB and NCBs to act as fiscal agents but prohibits overdrafts or any other type of credit facility to EU, national or local public authorities.<sup>541</sup>

(iii) Conflicts might also arise where CBs are assigned macroprudential functions<sup>542</sup> under some Executive's coordination or direction whose specific political decisions may require CBs' observation and implementation.<sup>543</sup>

The significant interactions and potential conflicts between macroprudential policies and monetary policy confirm how first moves in the former might indirectly constrain the latter.<sup>544</sup>

The BoE Act expressly allows the government to direct macroprudential measures to the BoE, provided that it consults with the Bank's FPC, and its Executive order is laid before and approved by resolution of each House of Parliament.<sup>545</sup>

One indirect possibility for Executive sway over CBs' macroprudential policies occurs when there is a multi-agency financial stability committee, with direct constraining powers over the

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<sup>537</sup> (HUMPAGE, 2017), (SALIB & SKINNER, 2020: 975, fn 74), (FOMC 2017, 5-7).

<sup>538</sup> (SMITS, 2007: 1628).

<sup>539</sup> Sect. 15 FRA.

<sup>540</sup> (SALIB & SKINNER, 2020), (HUMPAGE, 2017).

<sup>541</sup> Art. 21 ESCB-Stat.

<sup>542</sup> (EDGE & LIANG, 2017).

<sup>543</sup> *Idem*.

<sup>544</sup> Ch. 2.1., (LEITÃO AMARO, 2022b).

<sup>545</sup> Sects. 9L and 9N BoE Act.

participating agencies, including the CB (less common<sup>546</sup>), and the committee is chaired by a finance minister with substantial leadership (much more likely than the CB chairing, which often has a formal leadership role).<sup>547</sup>

The US Treasury Secretary's chairmanship of the Financial Stability Oversight Council (FSOC) might give her a decisive role in consequential decisions, such as the designation of nonbank financial institutions as systemically important (SIFIs), that affect (the perimeter of the) Fed's regulatory and supervisory role and have distributive impacts in the market, choosing regulatory "winners" and "losers"<sup>548</sup>.

To mitigate such political predominance, the FSOC operates collegially and includes members from independent agencies, and its nudging and mediation authority relies on non-binding recommendations, which they either implement or explain publicly and report to Congress.<sup>549</sup>

(iv) Another opportunity for Executives to set the tone for others to follow, CBs included, is the coordination of positions of the domestic authorities in international financial institutions and conferences and in the compliance with international obligations.

In the EMU, the Council has the legal power to "adopt a decision establishing common positions on matters of particular interest for economic and monetary union within" such international *fora*<sup>550</sup>.

In the UK the Treasury was granted a power of direction over UK financial regulators, including the BoE as microprudential regulator of individual financial institutions and as regulator of financial market infrastructure, to secure compliance with international obligations<sup>551</sup>. More recently, a new legal provision clarified the powers of UK's financial regulators (BoE included) after Brexit and determined that any technical standards they make will need to be *approved* by the Treasury, subject to publication and report to Parliament.<sup>552</sup>

(v) Finally, federal CB systems may create further avenues for subordinated relations between political authorities and the decentralized CBs of such systems.

For instance, the ESCB Statute expressly authorizes NCBs to perform functions outside the ESCB functions, under conditions set by national lawmakers.<sup>553</sup>

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<sup>546</sup> (EDGE & LIANG, 2017).

<sup>547</sup> *Idem*.

<sup>548</sup> (SALIB & SKINNER, 2020).

<sup>549</sup> (BARR, 2015: 123-5).

<sup>550</sup> Art. 138 (1) TFEU.

<sup>551</sup> Sect. 410 FSMA, (SALIB & SKINNER, 2020: 932-3).

<sup>552</sup> Section 138R FSMA.

<sup>553</sup> Art. 14.4 ESCB-Stat.

To protect the ESCB's independent exercise of monetary policy, the Treaties allow the ECB-GC to prohibit interfering domestic functions by a two-thirds majority, and it requires national legislation to be compatible with the EU Treaties and ESCB Statute<sup>554</sup>.

The Fed System tried to prevent such risk in the design of the 12 RBs districts and structures, whose number is smaller, and boundaries are very different from the now 50 States of the Union. Furthermore, RBs are held by private commercial banks and the States' governing bodies have no powers over those covering their territories.

Nevertheless, the absence of such formal connection between RBs and States does not prevent the development of proximity and interactions between RB leaders and the most prominent politicians of those States, such as governors and federal and state legislators, which might propitiate *informal* efforts to influence RBs' choices.<sup>555</sup>

#### **d) POLITICAL AUTHORIZATION OF RISKIER CENTRAL BANK OPERATIONS**

Another fertile ground for political instructions are the CB's riskier operations such as (a) unconventional monetary policies involving the acquisition of riskier assets<sup>556</sup>, (b) emergency lending and liquidity provision in the context of LOLR and MMLR functions, or (c) financing insolvent financial institutions in the context of recapitalization or resolution.

The rationale for demanding prior political consent to those risky operations is that CBs manage public funds and losses on those operations would have fiscal impacts in the form of diminished remittances to the Treasury or fiscal backstop, and thus distributional effects inherent to the socialization of those losses.

Even without losses, those decisions on which private assets are eligible for purchase and collateral, who gets access to emergency lending, recapitalization or resolution financing, involve picking winners and losers by the CB's "strike of the pen".

The traditional view is that distributional choices belong to the electoral-representative process, which would demand a political veto power on those operations,<sup>557</sup> thus creating opportunities for DRs to negotiate or impose the content of those specific CB policies.

The problem is that it is difficult to draw clear lines between such interventions (subject to political instruction) and the operation of internal monetary policy.

Asset purchase programs initiated in the midst of the GFC as crisis management policies were later maintained and expanded for accommodating monetary policy purposes<sup>558</sup>. The

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<sup>554</sup> *Idem*.

<sup>555</sup> (BINDER & SPINDEL, 2017), (CONTI-BROWN, 2016).

<sup>556</sup> (BUIER, 2009).

<sup>557</sup> (TUCKER, 2018: 453).

<sup>558</sup> (BENFORD ET AL., 2009: 94).

stabilization of financial and credit markets began as a crisis management function, to later be explicitly recognized as an intermediate objective of internal monetary policy<sup>559</sup>.

Moreover, only with the benefit of hindsight is it possible to firmly discern (i) liquidity and (in)solvency, which complicates the *ex ante* separability of the three categories of operations: (i) CB liquidity provision to *liquid* institutions through monetary policy mechanisms<sup>560</sup>; (ii) emergency lending to *illiquid but solvent* institutions; and (iii) financing of *illiquid and insolvent* institutions in contexts of recapitalization or resolution.

#### **e) A CONTINUUM OF (IM)PERMISSIBILITY**

Positive regimes generally spread across a continuum of increasing government intervention. Monetary policy conduct by independent CBs tends to be freer from direct governmental instructions and override except in a limited number of countries. Emergency liquidity provision may or not be subject to some political decision, and financing to insolvent institutions is typically considered a government task that only some CBs are allowed to perform but in the dependent role of administering agent<sup>561</sup>.

The four major ICBs of advanced economies represent distinct points in that continuum.<sup>562</sup>

The BoJ is the most permissive to discretionary instructions of the Executive of various sorts (including a provisional veto on ordinary monetary policy).

The BoE has the most comprehensive and regulated scheme, with the British Executive being allowed six types of political instructions: (i) broad power to give directions, excluding monetary policy, (ii) a reserve power to “give the Bank directions with respect to monetary policy” in extreme economic circumstances, (iii) powers of veto and direction over the BoE’s crisis management functions; (iv) power to order the BoE to implement macroprudential measures, (v) narrow powers to direct the BoE on financial regulation and (vi) to impose information obligations and regulation of cash deposit ratios.

Only microprudential functions rest excluded from this comprehensive and regulated scheme of powers, which involve stringent substantive and procedural requirements, including transparency and often Parliamentary consent or ratification.

The Fed is, like all agencies, subject to a general power of congressional review and override of its *rulemaking*. While monetary policy is explicitly exempted from this disapproval power, other Fed functions, including financial microprudential rules and supervisory guidance, are not.

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<sup>559</sup> (LANE, 2021).

<sup>560</sup> On the ECB (PAPADIA & CADAMURO, 2021), on the BoE (INDEPENDENT EVALUATION OFFICE, BoE, 2018), (WINTERS, 2012).

<sup>561</sup> (MERSCH, 2018).

<sup>562</sup> (LEITÃO AMARO, 2022C, on the four regimes).



Specifically, the FRA grants three explicit provisions granting the Treasury Secretary power: (i) to direct Reserve Banks to act as fiscal agents, (ii) to exercise “control and supervision” over overlapping jurisdiction or powers of the Fed, and (iii) to veto on emergency lending to illiquid but solvent non-banks.

Apparently these three Treasury powers are not of great concern.

The first two authorize neither *direct* relevant interference in internal monetary policy nor encroachment in Fed’s independent decisions. However, the broad language of its provisions may be weaponized by an intrusive Treasury willing to rein in the Fed’s policies.

The third is narrow, as it applies neither to liquidity provision to liquid financial institutions, nor to LOLR to illiquid banks. Moreover, it is restricted to “unusual and exigent circumstances”, to broad-based eligibility rather than individual loans, and requirements on acceptable collateral. But, when compared to the British regime, this power is less regulated.

Second, as detailed above, a few primary law provisions allow for certain political instructions in other ECB and NCB functions that might contaminate monetary policy.

Third, secondary law provisions assign functions to the ECB and NCBs in microprudential supervision and resolution that may open backdoors to political instructions, particularly when the latter are designated as NCAs and NRAs.

The SSM prohibition of instructions does not apply to the decision-making bodies of NCAs, and the SRM’s prohibition of instructions applies neither to the NRAs, nor to their representatives in the SRB. Moreover, the SRB decisions are subject to decisions and veto of the Council and the Commission, and NRAs to political veto of the respective national Executive.

Finally, the ambiguity surrounding the LOLR function in the EMU might open a crack for abusive attempts of political instructions. ELA is left to NCBs, but not explicitly legislated. A written Agreement and the institutional culture suggest that ELA shall be conducted with “independence from the political instruction of government”, and subject to control and possible prohibition from the ECB.

In a nutshell, ICBs from all advanced economies may legally face instructions from political institutions, a few of which directly concern the conduct of internal monetary policy, while others may indirectly spill over into such policy.

This plethora of permissions and partial prohibitions may be seen as vindicating the view of an asymmetric independence, that would be weaker in functions other than internal monetary policy.

Yet, it can also confirm a more comprehensive concept of pluralistic CBI, that requires that the *core* of independence as integrity of ICBs’ specialized decision-making is always and everywhere preserved, but has flexibility to accommodate varied implementations of the *principle* of independence which, under conditions, may or not include prohibition of political instructions.

There seems to exist “coherence in difference”, consistent with different CBI models: the BoE maintains a more permissive but tightly regulated model, whereas the Fed is left in ambiguity, and the ESCB has a nominally bold prohibitionist regime with some exits and a practice of more permissive reinterpretation.

It might be the case that – similarly to the provision of a fiscal backstop – those regimes with formal structured permission for political instructions within an established, transparent, and scrutiny-prone legal framework might be more respectful of CBI than regimes of ambiguity or of prohibition, i.e., regimes that open the backdoor to a practice of ad hoc and informal powers and conventions of political control of CBs, discrepant from the law.<sup>563</sup> Only an empirical inquiry can it be assessed whether less regulated channels of *de jure* control cause and/or are associated with more *de facto* political control.

#### **5.2.8. RECOMMENDATIONS**

DRs may also use formal or institutionalized channels to *persuade* the ICB through recommendations that differ from instructions because they lack legal force, and their acceptance is “voluntary”.

As long as the force of those recommendations stands on the strength of the arguments, their acceptance is an exercise of autonomy, and they should raise no objections.

However, to understand their effective force and impact on *de facto* CBI independence it is necessary to observe the *real* dynamics of political control and whether political actors are using other sources of *hard* and *soft power* to leverage the persuasion over the CB, including informal channels and the manipulation of the incentives system.

There are three main forms for political branches to issue formal recommendations to ICBs: (a) the cross-participation in governing bodies; (b) spontaneous or solicited opinions; and (c) parliamentary resolutions.

##### **a) CROSS-PARTICIPATION IN GOVERNING BODIES**

The most peculiar, institutionalized venue for recommendations consists of the participation of DRs (or their representatives) in the meetings of CBs’ governing bodies.

The legal bases of those major CBs intentionally institutionalize a cross-pollination between CBs and political branches, in terms unthinkable for the independent judiciary. This was experimented in the creation of the Fed but abandoned two decades after with the argument that seating the Treasury Secretary and the Comptroller of the Currency in the Fed BoG menaced its independence. The Buba and BoFra also had government representatives in their monetary policymaking bodies, without voting rights, until they joined the ESCB.

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<sup>563</sup> (SALIB & SKINNER, 2020).

Currently, several CBs such as the ECB, BoE, BoJ, BoCan, RBA, and BoSpa, have inscribed in their legal bases the participation of representatives of political institutions in their governing bodies.<sup>564</sup>

Such cross-participation mechanism provides political institutions with “not only the right to state their opinions, but also to try to convince the [CB] Governing Council of their views”.<sup>565</sup>

The purpose of this device is enabling *ex ante* political contribution to CB decision-making and some coordination, at least informative. It is much more forward- than backward-looking.

In the EU participation rights are reciprocal. The ECB President participates in EU Council meetings “discussing matters relating to the objectives and tasks of the ESCB” (since the GFC on a recurring basis).<sup>566</sup> ECB and NCBs’ representatives also participate in the Economic and Financial Committee (EFC).<sup>567</sup>

These cross-pollinations create a two-way dialogue. Central bankers participating in those meetings of political bodies are allowed to express opinions on the ongoing political deliberations, but they also face a much larger group of politicians who might try to persuade them of their political recommendations.

Empirical studies are needed to gauge into which extent this cross-participation results in effective influence. Minutes of the ECB-GC are mute on the the participation of the EU Commissioner (more regular), the President of the Council (occasional) or the President of the Eurogroup on her place.<sup>568</sup>

Behind this opacity, it seems that EU political institutions have not explored the possibilities of their participation rights at fullest, allegedly due to a culture of strong independence.

## **b) SPONTANEOUS OR SOLICITED OPINIONS**

Another modality are the formal opinions issued by political bodies on policy decisions in preparation at the ICB.

In the context of the ESCB, restrictive voices have suggested that national legal provisions requiring prior information to or consultation with the Government before the NCB makes decisions would violate the EU Treaties’ protection of independence, even if the consultation is not binding<sup>569</sup>.

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<sup>564</sup> Sect. 13, Schedule 3, sect. 9B, and sect. 11 (7), Schedule 2A BoE Act; art. 19 (1) and (2) BoJ Law; sect. 5 (2) BoCan Act; sect. 14 RBA Act; art. 20 of the Spanish Law 13/1994. Art. 284 (1) TFEU.

<sup>565</sup> (AMTENBRINK, 1999: 216, 222, 230).

<sup>566</sup> Art. 284 (2) TFEU, (ECB, 2010).

<sup>567</sup> Council Decision (2003/476/EC) of June 18, 2003 on a revision of the Statutes of the EFC.

<sup>568</sup> (ECB, 2010: 78, 81).

<sup>569</sup> (BINI SMAGHI, 2008: 450), (LANGNER, 2020: 419).

That would entail an inconsistency between EU and national regimes, as the prior information to and consultation with EU political institutions is permitted and institutionalized at the ECB level in the form of the cross-participation described above.

If, by law, the President of the Council has the right to table proposals for deliberation at ECB-GC meetings and both she and the EU Commissioner have the right to vocalize opinions in those same meetings<sup>570</sup>, it makes no sense that the Council or the Commission as a whole are prohibited from issuing a written opinion separately and sending it to the ECB.

There are differences between the political institution separately issuing an opinion and having its own representative participating and opinionating inside the CB's decision-making body. Yet, those differences hardly justify rejecting the former while accepting the latter. It not at all clear which of the two better preserve CBI.

The written opinion is detached, more transparent and circumscribed to what is written in the governmental opinion, allowing more external scrutiny, and possibly inducing some self-restraint and giving central bankers distance and time to reflect on, and deflect the government's arguments.

Transparency of that advice might be considered democratically necessary – otherwise the parliament and public cannot hold executive's accountable for what they recommend – and better at preventing self- or special-interested manipulation of the advice.

On the other hand, publicity might push the governmental advice and its public debate into partisan and populist arguments and concerns, reducing its rationality and deliberative quality. The seat-at-the-table form of advice has the advantage of occurring on the CB's home turf, in a group setting where politicians are in the minority, and where the discussion tends to unfold under the methods, language, and ethics of CBs.

On the other hand, the lack of transparency of the meetings reduces the self-restraint on what politicians may say (and threaten). The possibility of repeated and live exchanges may increase the effectiveness of the political input.

In any case, both forms of governmental advice conceal efforts to ultimately influence the outcome of the CB's decisions.

In the British model of CBI, if the Executive is allowed to issue binding instructions, under conditions, they are not forbidden to offer opinions.

In the USA, presidents are not barred from issuing recommendations, and they actually do so. In a recent Executive Order on Digital Assets, President BIDEN the Fed "is encouraged to ...research and report ..., assess..., and to develop a strategic plan for Federal Reserve and broader

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<sup>570</sup> Art. 284 (1) TFEU.

United States Government action... for the potential implementation and launch of a United States CBDC”.<sup>571</sup>

In the ESCB, solicited and spontaneous political advice collide with a literal and extensive interpretation of article 130 TFEU, implying that the cross-participation in meetings would be an exception to a strict prohibition.

Contrariwise, that institutionalized participation may be seen as a manifestation of a narrower or systematic construction of the prohibition of influences, one that only bans *binding* influences, while accepting or encouraging cross-pollination and non-binding dialogue and cooperation between CBs and other policymakers.

### c) PARLIAMENTARY NON-BINDING RESOLUTIONS

Parliaments worldwide approve political non-binding resolutions and motions to express substantive views on issues they see as of People’s concern.

Policies under the purview of ICBs are not excluded.

These resolutions differ from parliamentary questions, debates, and speeches in the sense that while the latter express the opinions of the intervening parliamentarians and parties, the former, when approved, convey the will of (a majority) of a democratic branch.

In the USA, the Congress can issue non-binding resolutions. A few times between 1980 and 2000, Congress Resolutions were introduced (albeit never agreed) with recommendations to the Fed “to defer increases” or “to reduce interest rates to reasonable levels”, “to reduce inflation, and facilitate economic growth”, or favoring the coordination and compatibility of monetary and fiscal policies.<sup>572</sup>

In the EU, a major *praeter legem* custom developed with the European Parliament passing non-binding resolutions that included substantive recommendations to the ECB in the context of the yearly discussion of its Annual Report, and the latter responding with detailed written feedback. The EU Treaties only impose the presentation of the report, followed by a hearing, but the two bodies turned the extended *monetary dialogue* into a custom,<sup>573</sup> and the ECB has expressly acknowledged that the parliamentary “recommendations” bore fruit<sup>574</sup>.

These European Parliament resolutions have, across the years<sup>575</sup>, consistently combined backward-looking (accountability) assessments of the ECB performance (introduced by

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<sup>571</sup> Sect. 4 (c) of POTUS Executive Order, 2020.

<sup>572</sup> H.Con.Res.299 and S.Con.Res.106 – 96th Congress (1979-80), S.Con.Res.8 and S.Con.Res.71 – 97th Congress (1981-1982), S.Con.Res.13, S.Con.Res.54 and S.Con.Res.73 – 98th Congress (1983-1984), H.Res.54 and S.Res.80 – 104th Congress (1995-1996), and H.Res.536 – 106th Congress (1999-2000).

<sup>573</sup> Art. 284 (3) TFEU and 15 ESCB-Stat.

<sup>574</sup> (ECB Statement in the presentation of the conclusions of the Strategy Review, 2021), (ECB, 2010: 77).

<sup>575</sup> Since EU PARL Resolution on the 1997 annual report of the EMI (C4-0313/98).

expressions such as “welcomes”, “takes note”, “regrets”, “agrees with”, “notes”, “shares the view”), with explicit forward-looking recommendations both substantive and procedural for ECB’s future action (using expressions such as “urges the ECB”, “calls on”, “asks”, “encourages”, “suggests”, “advises”)<sup>576</sup>.

In the same spirit, with the Banking Union, EU secondary law established a *supervisory dialogue*, that is further regulated by an interinstitutional agreement between the two EU institutions<sup>577</sup> which creates a channel for *ex ante*, non-binding, parliamentary inputs on ECB’s draft acts<sup>578</sup>.

These tales about various channels for DRs to issue recommendations officially conveying signals of their policy preferences into CBs’ decision-making confirm that ICBs, the ECB included, were never expected and are not supposed to be institutionally lonely.

These channels for formal or institutionalized political recommendations, albeit non-binding, demonstrate a positive legal choice for a model of independence which is not strict, but engaged, and open to a plurality of political influences.

It is a model that accepts risks to the *perception* of independence when it allows both behind-closed-doors cross-participation and transparent executive opinions and parliamentary recommendations.

#### **5.2.9. FURTHER *EX ANTE* COORDINATION: FROM DIALOGUE TO COOPERATION**

Many of the signaling channels above involve some form of “dialogue” with the CB.

Legislating on central banking issues often requires a proposal from or prior consultation with the CB, and the appointment of central bankers frequently starts with pre-selection of potential candidates by the CB.

Financial decisions on budgets, allocation of profits and backstops logically demand some proposal from or negotiation with the CB.

Executive specification of mandate, when existent, typically involves a prior exchange of views or letters, vetoes and overrides presuppose prior action by the CB and most likely entail negotiation, and recommendations are part of an institutionalized or procedural dialogue.

However, the powers described in the previous sections do not exhaust all channels for *ex ante* interaction, influence and *ex ante* signalling of policy preferences from DRs to CBs.

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<sup>576</sup> (EU PARL resolution of 10 February 2021 on the ECB annual report 2020 (2020/2123(INI)). Some of the previous EU PARL resolutions (C5-0195/2000 – 2000/2118(COS)), (C5-0196/2002 – 2002/2092(COS)), (2017/2124(INI)), (2018/2101(INI)), (2019/2129(INI)).

<sup>577</sup> Art. 20 (9) SSM Regulation.

<sup>578</sup> Article V third indent of the Interinstitutional Agreement (2013/694/EU).

## a) FROM DIALOGUE TO NEGOTIATED INFLUENCE

There are also formal and informal instances of *dialogue* that may lead to *cooperative coordination*, and *uncooperative* signaling and coordination channels.<sup>579</sup>

“Cooperative coordination”, or cooperation, here means in concert, a contributory and engaged mode of ordering interactions and conflicts between institutions with varied but somehow overlapping interests and values. Coordination is uncooperative when that ordering occurs as a combination of parallel, self-driven and disengaged conducts.<sup>580</sup>

On the basis of cooperative coordination there is a *dialogue* between the institutions on issues of common interest through which they share information, discuss policy choices and enhance the mutual understanding of each other’s policy.<sup>581</sup>

Yet, in cooperation there is something more than that dialogue. There are two main levels of increasing engagement between the CB and political policymakers:

First, the *implicit* cooperative coordination or *adaptive exchange* when the institutions share and then take the “other’s planned actions into account when deciding in the use of their own monetary or regulatory power”.<sup>582</sup> That regular exchange of views provides knowledge of the reasoning behind and the predictable course of each institution’s policy decisions which then becomes “an essential input into the decisions of other policy-makers”<sup>583</sup>.

Coordination between monetary and fiscal policy can be achieved without close contact or interaction “if relations are governed by clear roles and responsibilities”. One macroeconomic policymaker knows the other’s policy-reaction function, and it can then anticipate the monetary policy response to a planned fiscal action and adjust accordingly.<sup>584</sup>

Second, the *explicit* cooperative coordination or *negotiated influence*, when macroeconomic policymakers strategically bargain policy choices and negotiate and potentially agree on aspects of content, timing, and terms for their mutually interdependent policies.

This dialogue and cooperative coordination can be either voluntary or mandatory in their existence and either binding or non-committal regarding the policy courses, decisions, and results.

It is deeply contested whether any of these modalities of cooperative interaction are prohibited, permitted, or required for the sake of CBI.

CBI is not absolute and does not mean lack of interaction between ICBs and political institutions.

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<sup>579</sup> Ch. 5.2.10 and 5.2.11 on the uncooperative channels.

<sup>580</sup> (HARDIN, 2011: 96).

<sup>581</sup> (ECB, 2010: 75).

<sup>582</sup> (TUCKER, 2018: 520).

<sup>583</sup> Differently (ECB, 2010: 53).

<sup>584</sup> (BIS, 2009: 91).

Still, cooperative coordination enables “negotiated influence”. It is a real *de facto* channel to steer and shape ICBs’ decision-making within their margin of discretion.

ICBs may be trying to maximize their preferences over policy, yet for whatever rationalized, strategic or “incentivized” pressure they might end up accommodating the politicians’ preference. The mere dialogue and negotiation might be influential if politicians leverage their positions with legally binding prerogatives or manipulation of individual or institutional incentives, thereby leading central bankers to self-restraint and policy adjustments.

In a pluralistic model, for CBI to be preserved, it must be “coordination without subordination”, where the CB “remains autonomous for those decisions delegated to it by the legislature”.<sup>585</sup> It can be a “policy leader” or “autonomous policy coordinator”, but not a “policy-taker”.<sup>586</sup>

## **b) RESTRICTIVE VIEWS ON COOPERATIVE COORDINATION**

The classic view of CBI suspicious of cooperation and even dialogue between central bankers and DRs, according to one of the following four restrictive views: (i) the radical rejection of dialogue; (ii) acceptance of non-binding dialogue; (iii) admission of voluntary dialogue; (ii) and an exceptional acceptance of cooperation strictly limited to periods of crisis.

(i) The strictest views of CBI and, in the EU, a literal interpretation of the legal prohibition of influences, reject dialogue, let alone cooperation. Dialogues, so they argue, offer opportunities to influence and may jeopardize the *appearance* of independence and the credibility of the commitment to the mandate<sup>587</sup>. It resembles the standards of judicial independence that distrust dialogues between political and judicial bodies on policy choices and oppose any interaction regarding concrete decisions outside the heavily regulated and structured rituals of the judicial process.

(ii) The ECB has taken the view that dialogue is permitted but cannot result in commitment to certain policy courses or decisions, even if both the interaction and the result are voluntary. “Non-binding dialogue” would be the limit for the ECB’s relations with other policy-making bodies, where “there cannot be any *ex ante* coordination of monetary policy with economic policy, as this would blur the allocation of responsibilities between policymakers, which in turn would dilute accountability”<sup>588</sup>.

(iii) A less strict view suggests that the ECB may engage in *ex ante* policy co-ordination by its own volition, but not if it is imposed.<sup>589</sup>

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<sup>585</sup> (GABOR, 2021), (TUCKER, 2018: 520).

<sup>586</sup> (ECB, 2010: 53).

<sup>587</sup> (AMTENBRINK, 1999: 224).

<sup>588</sup> (ECB, 2000: 52), (ECB, 2010: 74), (BEUKERS, 2013: 1582).

<sup>589</sup> (ARDA, 2006: 8).



(iv) Even amongst traditionalists there is a widespread, yet strictly exceptional, acceptance that macroeconomic policymakers may cooperate in periods of crisis such as wars, natural disasters, pandemics, or financial meltdowns.

Acceptability grows with the severity of the crisis. The graver economic and social costs of a prolonged and unmanaged crisis and adjustment to a new equilibrium, and the possibility of economies getting stuck in an inferior one, justify urgency, coherence, and congruent coordination of the mix of policy responses.

There is a general tendency, in moments of crisis and across policy domains, for Executives to gain relative institutional prominence due to their agility and swifter and broader arsenals of tools. Legislative and judicial branches, whose processes are designed to cool off instant impetus and rationalize deliberation, become more deferential and flex their checks.<sup>590</sup>

However, in response to a crisis with macroeconomic dimensions, unlike parliaments and courts, ICBs can be *partners in crisis* rather than mere *followers*. They can and should actively engage in cooperative coordination with political branches to deliver a coherent and swift macroeconomic policy mix.

Firstly, if they don't, they will be left with the worst position in terms of independence, which would be to become another follower of the Executive's *de facto* guidance.

Second, CBs have tools, structure and procedural specificities, and private and international connections that allow them to react to crises with similar effectiveness and concreteness, but with even more promptness than Executives and fiscal authorities in general, which are relatively more constrained by procedural and transparency demands and the need to build political support.

It is an insightful paradox that the greater protection of judicial independence and stricter barriers against judicial-executive dialogue and concert might leave judges – with their passive *ex post*-intervention – with only the option of acquiescing (or not). Without channels to bargain and shape crisis-response policies (*in due time*), and subject to the contextual pressure to defer, they are more likely to be followers than the less independent CBs.

On the contrary, CBs may negotiate and shape the content and boundaries of that cooperation, contributing to superior policy mixes and outcomes, while preserving more of their decision-making autonomy.

In this sense, cooperative coordination in times of crisis may be both welfare- and independence-enhancing.

There are plenty of historical accounts narrating how in periods of crisis ICBs engage in very close information-sharing, dialogue, and concert of actions with fiscal authorities, especially treasuries

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<sup>590</sup> (POSNER & VERMEULE, 2011).

and (some) legislators, with foreign CBs, other domestic financial regulatory agencies, and with the most relevant private financial institutions in their respective financial markets.

Multiple daily calls, co-drafting of legislative and administrative decisions, joint press releases, discussion of mutually accepted boundaries, mutual support and back-stop, resources' mobilization, and burden-sharing are parts of the crisis-mode interaction between CBs and fiscal authorities.

Often, ICBs and finance ministries work side-by-side in the same room, and a small number of legislators is kept in the loop to be informed and occasionally to negotiate legislative proposals needed to accommodate endeavoring emergency measures.<sup>591</sup>

After the GFC, a "financial crisis cell" integrating central bankers and political institutions was created in the EMU to enable the EU to take rapid and effective crisis response measures<sup>592</sup>.

Top central bankers have abundantly acknowledged how crises are times for cooperative behavior.<sup>593</sup>

A tentative lesson might be that heightened cooperative coordination has avoided the GFC's Great Recession from turning into a Great Depression, the Eurocrisis from culminating in the collapse of the euro, and the Covid pandemic from degenerating into a severe, prolonged crisis. The pandemic crisis response seems to have benefited from learning policy errors and discoordination in the early stages of the prior two crises<sup>594</sup>.

However, the widespread acceptance of cooperation in moments of crisis does not extend to normal times. For traditionalists, cooperation is a crisis-only exception.

### **c) COOPERATION POSSIBILITIES IN NORMAL TIMES**

These restrictive accounts are untenable on both *normative* and descriptive grounds, at odds with the legal regimes and the *reality* of inter-personal and policy interactions of CBs and with multiples *choices of positive law*.

A pluralistic view assumes both the serious risks that dialogue and cooperative coordination pose to independence, and the possibility of non-subordinated coordination.

Instead of simply caving to those risks and prohibiting cooperation, the pluralistic solution is balanced and proportional, offering a framework to preserve the conditions of self-determination when the cooperation is beneficial on aggregate. It seeks to mitigate those risks without wasting the potential of cooperation.

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<sup>591</sup> (BERNANKE, 2015), (CHERNOW, 1990), (FERGUSON, 2003), (AHAMED, 2008), (JAMES, 2012), (KING, 2015).

<sup>592</sup> (ECB, 2010).

<sup>593</sup> (WALLER, 2021), (WEIDMANN, 2021), (LAGARDE, April 2020).

<sup>594</sup> (WALLER, 2021).

Pluralistic CBI admits both voluntary and mandatory, non-binding and binding dialogue and cooperative coordination, *under conditions*.

The interactions should be *non-subordinated* (i.e., *self-determined* through the specialized central banking process), preferably *structured*, and *net-beneficial* (delivering greater benefits, namely in efficiency and effectiveness of the policy mix).

Many traditionalists fall into *conceptual oversimplification*, confusing interaction, cooperation, influence, and dominance/control. Yet, cooperative coordination does not necessarily entail subordination.

Self-determined cooperative coordination amongst actors with unequal power resources is verified reality. It exists amongst independent states, between private individuals, and even in public-private partnerships.

The political channels described in the sections above empower DRs with “unequal authority”, but *de jure* and *de facto* protections of CBI enable CBs to preserve self-determination to the maximum extent possible in democratic societies. The competition of influences might come in friendly support of ICBs.

Preserving (the conditions for) self-determination, “independent monetary policy is fully compatible with coordinated and cooperative monetary and fiscal policy”<sup>595</sup>.

Mature ICBs are likelier than infant institutions to go through close interactions and maintain independent decision-making, and the appearance thereof. They might even “reverse control”, becoming policy leaders rather than policy takers. They can do this by leveraging the informational and expertise superiority they accrued in their specific fields in comparison to other policymakers (Treasuries included), the support of external pressures from foreign or supranational institutions and domestic coalitions, or their towering authority in macroeconomic issues, institutional credibility, or even (less often) their stellar popularity, to attract strategic-minded or comparatively less authoritative political leaders to cater to their will.<sup>596</sup>

Structuring interactions can balance gains of cooperation over risks to independence and help maturing ICBs.

For instance, such a framework should impose procedural requirements to elucidate the allocation and exercise of responsibilities by each participant, in terms that enable accountability.

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<sup>595</sup> (BUIER, 2006: 71).

<sup>596</sup> (CONTI-BROWN, 2016: 195-7, on the reverse control of GREENSPAN over CLINTON).

Written records or some documentation of interactions between central bankers and political officials<sup>597</sup>, duties to give reasons on coordinated decisions, including with reference to the CB's mandate and methodologies, a burden of identifying every party's contribution to the cooperation, and eventually transparency of all that<sup>598</sup>, would be important.

Cooperative coordination is net-beneficial in various contexts beyond crisis. Certainly, in low key tasks such as back-office operations and collection of statistics, and where competences are shared. Also, where a forceful policy mix is required to drag the economy out of deflation or a suboptimal new normal, and monetary policy is closer to its effective lower bound.<sup>599</sup>

The need for cooperation has grown with the expansion of central banking. The breadth of the mandate of CBs and their degree of coordination with other actors are two variables that, historically, have been positively correlated.<sup>600</sup>

What justifies triggering cooperation is not the imminence or existence of a crisis but relevant interdependencies between macroeconomic policies that a crisis circumstantially exposes but that exist elsewhere.

A crisis is not the only factor tilting the scale towards accepting cooperative coordination and even binding dialogues.

#### **d) ADVANTAGES OF COOPERATIVE COORDINATION**

There are various good reasons to allow dialogue and cooperation between macroeconomic policymakers. They improve the exchange of information, enabling knowledgeable decision-making, creating mutual understanding and trust, and reporting and facilitating accountability that promotes political legitimacy and leads to better policy outcomes<sup>601</sup>. They aid in better managing policy interdependencies and spillovers and promote an optimal macroeconomic policy mix.<sup>602</sup>

The option of structuring and cooperatively managing interdependencies and spillovers amongst macroeconomic policies in both periods of crisis and normality tends to deliver superior policy mixes compared to non-cooperative conduct. Therefore, refusing the former would leave the

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<sup>597</sup> The practice of recording and documenting conversations of the United States President is an interesting example.

<sup>598</sup> Even if deferred for some time in case of sensitive information, with different degrees of access to agents of accountability.

<sup>599</sup> (BUIJTER, 2006: 66-71), (PANETTA, 2021).

<sup>600</sup> (DIETSCH ET AL., 2018: 8).

<sup>601</sup> (BEUKERS, 2013: 1581-2).

<sup>602</sup> (BIS, 2009: 91).

latter as the only, yet inferior and welfare-detrimental, way to deal with the inevitable interdependencies between macroeconomic policies.<sup>603</sup>

“Cooperation and coordination between independent agents is often welfare-enhancing. When cooperation and coordination extend to all parties (to all players in the game), and when all parties are capable of credible commitment to future actions, welfare will be higher than in any non-cooperative equilibrium.”<sup>604</sup>.

#### e) COOPERATION AS A DUTY

There are differences in practice and legal approach across CBs.

In general, paucity of formal mechanisms tends to be associated with an increase of informal practices, rather than absence of dialogue and cooperation.

There are legal provisions, with varying degrees of detail and actual use, creating *procedural* and *institutional* permissions or duties of *ex ante* dialogue and cooperation.

The ECB, BoE, BoJ, BoCan, RBA, SNB and Buba are subject to *explicit* duties of interinstitutional cooperation.<sup>605</sup>

They impose obligations of means (or best efforts), not of results, consistently with preserving self-determination. If the cooperation is mandatory, its result are not. ICBs must engage *bone fide*, but they should not compromise or yield at all costs.

Contrary to the traditional views, the general principle of macroeconomic constitutions of advanced economies seems to be *for* and not *against* dialogue and cooperative coordination between CBs and other policymakers. *For* admitting negotiated *self-determined* commitments, and *for* preferring engaged, rather than isolated, CBs.

This duty of interinstitutional cooperation is more natural to the American constitutional system where the Madisonian separation of powers, with mutual checks and balances is more established.

A Fed Governor recently acknowledged that Fed and Treasury “*should* work together at key times and along certain dimensions”.<sup>606</sup>

A *constitutional duty of cooperation* between the ECB and other EU institutions might seem stranger in the EU, whose primary law has been interpreted as establishing a complete prohibition of influences over the ESCB, and the institutional loneliness of the ECB.

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<sup>603</sup> (REICHLIN ET AL, 2021), (PANICO & PURIFICATO, 2013), (HENNIG, 2015).

<sup>604</sup> (BUIER, 2006: 71), (RILES, 2018: 21).

<sup>605</sup> (LEITÃO AMARO, 2022c).

<sup>606</sup> (WALLER, 2021, italic added).

Literature rightly emphasizes the singularity of the EU's choice to constitutionalize the ECB's independence<sup>607</sup> and accountability (political and judicial)<sup>608</sup>.

Less noted but no less worthy of considering is the constitutionalization of the dialogue, the cooperative coordination, and the institutional engagement between the CBs of the Eurosystem and EU and national political institutions.

It adds something to the constitutionalization of independence and of accountability, as none expresses the idea of "equal dialogue" and cooperative coordination.

This constitutionalized *engagement* is fully consistent with the model of balanced separation of macroeconomic powers that protects a core of autonomous decision-making, enables both powers to check and interfere in the other's decision-making, but also accepts (and favors) efficiency-enhancing cooperation contributory to an optimal macroeconomic policy mix.

Traditionalists would argue that the "strict interpretation of th[e Maastricht Treaty] arrangement denies the need of active coordination between monetary and fiscal policy".<sup>609</sup>

However, "such a rigid interpretation...was not possible under all circumstances. It worked for the first decade of the euro, but events soon showed it was not sustainable for longer periods". "In the last decade, with interest rates nearing the lower bound, monetary policy has become less effective and the opportunity for fiscal policy to play a larger stabilization role than that envisaged in the treaty has increased"<sup>610</sup>.

In fact, EU primary law constitutionalizes and formalizes that dialogue and some degree of cooperative coordination. Article 13 (2) TEU establishes a duty of mutual sincere cooperation between all Union institutions, including the ECB. The TFEU provides for "inter-institutional dialogue ...and seeks to ensure that the work of all the institutions involved in a given policy area is coordinated, or at least compatible, so as to achieve the overriding goals of society"<sup>611</sup>.

The Treaty establishes mandatory cross-participation and extensive consultation within the areas falling within the ECB responsibilities, formalizing a bidirectional system of interinstitutional cooperative coordination.

The ECB itself acknowledges that Treaties require its cooperation with other EU institutions or bodies in those tasks where they share competences<sup>612</sup>.

Furthermore, *implicitly*, the conferral of the various specific powers of *ex ante* democratic control described in the previous sections legitimates and/or implicates some high-level policy

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<sup>607</sup> Arts. 130 and 282 (3) TFEU, and 7 ESCB-Stat.

<sup>608</sup> For political accountability, art. 284 (3) TFEU and 15 ESCB-Stat, and for judicial accountability arts. 263, 265, 267 and 271 (d) TFEU and art. 35 ESCB-Stat.

<sup>609</sup> (REICHLIN ET AL., 2021: 4, 53).

<sup>610</sup> *Idem*.

<sup>611</sup> (ZILIOLI, 2016: 131).

<sup>612</sup> (ECB, 2010: 75), (BRENTFORD, 1998: 93).

bargaining in advance of their exercise (or not) by DRs, and/or staff level operational collaboration in their implementation.

There are also *institutional* entanglements, including the non-binding participation in one another's governing bodies and the joint participation in international organizations or in other domestic bodies with implicit or explicit coordination roles where none has a dominant position.<sup>613</sup>

Spontaneously or by legal imposition, CBs also enter into interinstitutional agreements with political policymakers where both commit beyond what is statutorily prescribed to being coordinated institutionally thereafter. Notable examples are the several MoUs between the BoE and HM Treasury<sup>614</sup>, the Interinstitutional Agreements between the ECB and the Council of the EU or the European Parliament<sup>615</sup>, and the Fed-Treasury Accord of 1951.

#### **f) PRACTICES OF COOPERATIVE COORDINATION**

Finally, there is a significant practice of informal interactions and cooperative coordination. Even the most independent CBs “do not operate in a political vacuum”. They work closely with politicians but in the end, each takes its own decisions.<sup>616</sup>

For instance, in the USA, there is a longstanding practice of regular, informal meetings, often weekly, over breakfast or lunch, between the Fed Chair and the US Treasury Secretary, and monetary policy issues are on the table<sup>617</sup>.

POTUS meet Fed Chairs, albeit less regularly, including to seek the latter's advice on issues relating to economic and monetary policy<sup>618</sup>.

There are also strong links between the Fed BoG and the President's Council of Economic Advisers<sup>619</sup>.

Fed and Treasury cooperate voluntarily “in a spirit of collegiality”<sup>620</sup>, both at leadership and staff levels, also in periods of normality, and across various Fed functions.

Sometimes they have cooperated on more equal footing as in the F.D. ROOSEVELT – ECCLES and OBAMA-BERNANKE years, but at other times with informal ascendancy of one or the other side –

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<sup>613</sup> Sect. 4.2.8.

<sup>614</sup> In the UK, the MoU2017, and the MoUs on their financial relationship (June 2018) and on the coordination of UK's participation in international organizations, and regarding Brexit (October 2019).

<sup>615</sup> MoU Council-ECB and the Interinstitutional Agreement EU Parl-ECB on democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the SSM (2013/694/EU).

<sup>616</sup> (DE HAAN & EIJJINGER, 2016), (FERNÁNDEZ-ALBERTOS, 2015), (MOSER-BOEHM, 2006).

<sup>617</sup> (BERNANKE, 2015), (AMTENBRINK, 1999: 233-4), (CONTI-BROWN, 2016).

<sup>618</sup> *Idem*.

<sup>619</sup> (AMTENBRINK, 1999: 233).

<sup>620</sup> (SALIB & SKINNER, 2020: 951), (HUMPAGE, 2017).

President NIXON personally dominated Fed Chair ARTHUR BURNS, whilst GREENSPAN'S Fed worked hand in glove with the CLINTON Administration "to determine domestic fiscal policy"<sup>621</sup>.

In ordinary times the coordination of fiscal and monetary policy tends to be tacit, "informal and not based on statutory authority", and happen more at a working level, while in times of emergency or crisis it is more likely to be formal and intentional.<sup>622</sup>

They work "together on certain macroeconomic policy issues" and in "back office operations", including the Treasury's cash and debt management, the Fed's decisions on market operations, collateral, and balance sheet management, and the (less regular) decisions on CB remittances<sup>623</sup>. Where direct CB financing to the government is permitted, it requires negotiation and cooperation. Yet "in most advanced countries, central banks do not finance government expenditure"<sup>624</sup>. Government overdrafts with the CB ceased in the USA in 1979<sup>625</sup>, are constitutionally forbidden in the EU (article 123 TFEU) and limited in the UK<sup>626</sup>.

External monetary policy, too, involves "close and continuous cooperation and consultation"<sup>627</sup>, because the CB holds and manages Treasury's foreign exchange reserves, or they intervene in foreign exchange markets "jointly, with the Fed conducting operations on Treasury's and its own behalf"<sup>628</sup>.

In the EU, the scene is also of intense interinstitutional interactions, but even more complex. First, due to the asymmetry and incompleteness of the EMU, the ECB is in interaction with a multitude of European and national macroeconomic authorities with different interests, voices, and coalitions.

Second, the specific decentralized structure of the Eurosystem creates multiple arenas of *political* interaction.

Beyond the two obvious horizontal levels — EU institutions-ECB, national actors-NCBs — the ECB has also interacted with national governments, including in the design choices of asset purchase programs and its participation in financial assistance programs to various Member-States.

The ECB also has an intense practice of informal interactions which has grown with time.<sup>629</sup> From meetings and telephone calls at leadership level, to gatherings of leaders of the main EU

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<sup>621</sup> (CONTI-BROWN, 2016: 180-198).

<sup>622</sup> (SALIB & SKINNER, 2020: 951, 977-8).

<sup>623</sup> (WALLER, 2021), (TYMOIGNE, 2016).

<sup>624</sup> (JACOME ET AL., 2012).

<sup>625</sup> (TYMOIGNE, 2016).

<sup>626</sup> (BoE, 2020), (JACOME ET AL., 2012: 11).

<sup>627</sup> (FOMC, Authorization for Foreign Currency Operations, 2021).

<sup>628</sup> (SALIB & SKINNER, 2020: 951-2), (HUMPAGE, 2017).

<sup>629</sup> (ECB, 2000), (ECB, 2010).



institutions (“Euro-Principals meetings”<sup>630</sup>), joint press conferences after Eurogroup meetings that occasionally include the ECB President<sup>631</sup>, and the “Macroeconomic Dialogue” amongst European institutions and social partners.<sup>632</sup>

The ECB staff also engages in cooperation and technical support with the other EU institutions.<sup>633</sup> In a nutshell, all major ICBs are deeply engaged with political institutions, formally and informally, to dialogue and also to cooperatively coordinate. As long as such interactions and cooperation are non-subordinated and preserve the self-determination of the CB, they are consistent with the law, practice and values of pluralistic CBI.

#### **5.2.10. DISCURSIVE SIGNALS AND CONFLICTS**

Not all dialogues, public or private, result in cooperative coordination.

DRs use formal and informal conversations with central bankers and unilateral public remarks to express critical backward-looking judgments, but also to convey forward-looking preferences over policies with the purpose of influencing the CB’s decision-making.

The “informal expression of opinion” by public office holders is a real political power<sup>634</sup>.

They can potentially affect and steer central banking, either by compromising its appearance of independence and credibility, or by effectively shaping the choices of ICBs who are either rationally persuaded, or strategically decide to adjust their otherwise preferred policy course due to some combination of incentives.

Their interests or preferences may coincide, as a result of purposeful selection or loyalty of the central bankers, opportunistic interest, or concurrence in specific circumstances<sup>635</sup>.

But they may not.

Central bankers also emancipate from preferences and interests of the political official appointing them. They are institutionalized and socialized by the epistemic community. They change loyalties to new political incumbents, as they can simply maintain the commitment to optimal policies without yielding to deviations of opportunistic governments.<sup>636</sup>

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<sup>630</sup> (DURÃO BARROSO, 2022, privately).

<sup>631</sup> (ECB, 2010: 79).

<sup>632</sup> *Idem*.

<sup>633</sup> (ECB, 2010: 77-78).

<sup>634</sup> (OTERO, 2010, II: 144-147).

<sup>635</sup> (CONTI-BROWN, 2016: 181).

<sup>636</sup> (CONTI-BROWN, 2016: 191), (ADOLPH, 2013).

## a) CONFLICTS

Political and discursive signals sometimes escalate into tension and even outright conflict between central bankers and politicians in office.<sup>637</sup>

There are uncountable episodes of such conflicts on both sides of the Atlantic<sup>638</sup>. These may occur through instrumentalization of the statutory powers above, and/or through various informal channels, such as contacts behind closed doors, public remarks made in speeches, appearances and statements to traditional media or comments on social media, or still as political actions like the presentation of policy documents, party programs, proposals for parliamentary resolutions and threatening or tabling legislative initiatives.

In fact, disagreements and conflicts between central bankers and DRs are inevitable, and some entered the history books, such as the dispute between the BoE Governor MONTAGU NORMAN and then Chancellor of the Exchequer CHURCHILL over the UK's participation in the gold standard, the clashes between German Reichsbank President SCHACHT and the Nazi Government over excessive rearmament expenditure, the conflicts between Fed and the POTUS over continuing government bonds-buying programs, the pressure of POTUS LBJ and NIXON over Fed Chairs MCCHESENEY MARTIN and ARTHUR BURNS, the "spectacular conflicts" between German Chancellors and leaders of the Buba over the German reunification, the European public quarrel of "the two Jean-Claudes", SARKOZY's ranting against Trichet's ECB, TRUMP's Twitter-bashing of Fed Chair POWELL over FOMC's interest rate decisions.<sup>639</sup>

Sometimes central bankers withstand political pressure, e.g., SCHACHT in 1923-24 Germany, VOLCKER in his politically unpopular anti-inflationary war in the early 1980s, DRAGHI's pivoting the change of ECB stance against German-led monetary conservatism.

Their resistance can "be destabilizing for the political party in power", and political incumbents may even "owe their downfall directly or indirectly to the actions of the [central]bank". Allegedly, three German chancellors – ERHARD in 1966, KIESINGER in 1969, and HELMUT SCHMIDT in 1982 – were ousted rather than defeated in general elections as a consequence of shifts in coalitions sparked off by controversies over monetary policy".<sup>640</sup>

Other times central bankers resigned to avoid yielding to that pressure or taking responsibility for it.<sup>641</sup>

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<sup>637</sup> (MAIER & DE HAAN, 2000: 13).

<sup>638</sup> For the USA (CONTI-BROWN, 2016), (BINDER & SPINDEL, 2017), (SALIB & SKINNER, 2020). For the UK (KING, 2015) and (KYNASTON, 2017). For Europe (DE HAAN, 2000), (JAMES, 2012), (BRUNNERMEIER, JAMES & LANDAU, 2016). For the interwar period (AHAMED, 2009), (JONES & MATTHIJS, 2019: 129), (SIKLOS, 2002).

<sup>639</sup> *Idem*, (SMITS, 2007: 1629-34), (BEUKERS, 2013: 1580).

<sup>640</sup> (LASTRA, 2015: 79, 82, citing MARSH).

<sup>641</sup> Buba Presidents OTTO POHL and WEBER resigned, as did ECB-EB member SABINE LAUTENSCHLÄGER in 2019.

And sometimes CBs have adjusted their policy course, ranging from “skilled management of these conflicts” through strategic compromises and partial accommodation of opposing policy stances<sup>642</sup>, to full capitulation that grants politicians “informal direction over monetary policy”<sup>643</sup>.

One extreme example of this latter outcome is the NIXON-BURNS “close personal and emotional proximity” and the latter’s “acquiescence to NIXON’s domination”. “BURNS attended cabinet meetings; had his speeches vetted by NIXON’s staff; cleared his talking points with the president ahead of meeting with other central bankers in Basel...; advised NIXON on tax, wage, and other fiscal policy; and made pledges to remain the president’s “true friend” on economic policies before the public”. Moreover, BURNS “coordinated monetary policy for NIXON’s electoral ends”<sup>644</sup>. Even for the very insulated ECB “[t]here is no lack of public utterances by economic policymakers on their desired outcome of monetary policy decisions. Sometimes, a state’s minister of economic affairs or finance will publicly call for a lowering of the ECB’s interest rates. At other times, presidential candidates openly state that the ECB’s rule book should be rewritten if it does not heed popular pressure for economic stimulation”<sup>645</sup>.

Occurrence of political pressures and conflicts vary, as does the likelihood of central bankers succumbing to them.

Empirical studies show disparate findings, in part due to methodological differences<sup>646</sup>.

BINDER recently found that 10% of CBs reportedly face political pressure in an average year. Even CBs with high legal independence frequently face pressure – nearly always for looser monetary policy.

And in terms of impact, political pressure is associated with higher inflation and inflation persistence.<sup>647</sup>

Political pressures are more likely to exist and be stronger in periods of election where stakes are higher for politicians<sup>648</sup>, and in periods of economic and social instability where electorates tend to be more attentive and response-seekers.<sup>649</sup>

Pressure is more likely to come from governments with left-wing or nationalist executives, few checks and balances, or weak electoral competition.<sup>650</sup>

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<sup>642</sup> (BERGER & SCHNEIDER, 2000: 61).

<sup>643</sup> (SALIB & SKINNER, 2020).

<sup>644</sup> (CONTI-BROWN, 2016: 193).

<sup>645</sup> (SMITS, 2007: 1614, 1629-34).

<sup>646</sup> (HAVRILESKI, 1993), (LOHMANN, 1998), (MAIER & BEZOEN, 2004), (BINDER, 2021).

<sup>647</sup> (BINDER, 2021).

<sup>648</sup> (MAIER & DE HAAN, 2000).

<sup>649</sup> (MAIER & BEZOEN, 2004).

<sup>650</sup> (BINDER, 2021).

It is more likely that political pressures degenerate into conflicts if the government and CB hold divergent preferences or views over the policy stance, when clashes of personalities exist<sup>651</sup>, or whenever central bankers are partisan but distant from the government.

On the contrary, where central bankers can be reappointed, they might be less likely to escalate or stand a conflict in periods closer to the reappointment decision.

The informal channels might be forcefully leveraged through manipulation of the central bank(er)'s institutional or individual incentives. Not rarely, DRs threaten, publicly or in private, to use some of the formal powers above to nudge it into a certain policy action. Such political threats include amending, curtailing or terminating the CB's existence, mandate, powers, funding, or its leadership terms, or increasing oversight, transparency, and auditing<sup>652</sup>.

Therefore, the outcome of such conflicts will depend on the availability of and barriers to the use of such formal powers, on the intensity of the political pressure, and on the strength of the pressing-politicians, namely in terms of their popularity and size and the outlook of their political majority.

It also depends on the profile of the central bankers (partisan vs. technocratic), the distance of their policy views from the political majority, the internal cohesiveness of the CB's governing body – as governments may try to exploit internal divisions and even try to form a coalition with their closest faction within the CB – and the existence and characteristics of alliances and competition of Influencers.

Central bankers that explore (often tacit) alliances and garner support from rival political actors, media, their epistemic community, and vocal constituencies that share their views, will strengthen their defense against governmental pressure.

Only too often commentators see visible conflicts between politicians and central bankers as evidence of the demise of CBI.

However, conflicts may actually demonstrate CBI-in-action. The more visible can be displays of institutional force and independence of CBs.

Only the complete subordination of a CB would avoid them all.

In a liberal democracy CBI protections have the ultimate role of increasing procedural burdens and audience costs for democratic majorities willing to control the public functions delegated to CBs.

Existence and public awareness of such conflicts indicate that central bankers are resisting, and those legal protections have some role.

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<sup>651</sup> (CONTI-BROWN, 2016).

<sup>652</sup> (CONTI-BROWN, 2016: 180-217), (BINDER & SPINDEL, 2017).

This is not to say that political pressures, conflicts, and their cognition are desirable. Public escalation may dent the appearance of CBI and its credibility value. Thus, advanced economies seek to mitigate both informal pressures and conflict.

## **b) REGULATING INFORMAL SIGNALS**

One legal approach is to curtail the leverage that the unequal authority provides to the informal pressures. For that purpose, legal protections of CBI regulate and constrain those formal channels and mitigate the manipulability of incentives. Constraining formal authority may *indirectly* weaken (the leverage over) informal channels.

The other approach is to act directly upon the informal practices. In general, most legal regimes leave informal channels as they are: informal; and rely on a culture of independence and an ethics of mutual restraint.

A possible exception is article 130 TFEU that explicitly requires EU institutions and national governments “not to seek to influence the members of the decision-making bodies of the” ECB and NCBs and not “seek or take instructions from” Union institutions and national governments. The distinct reference to “instructions” and “influence” indicates that the latter includes formal and informal efforts alike.

Yet, an outright prohibition of all informal meetings, speeches, public remarks, and policy proposals in which DRs convey views on policies remitted to the CB would be excessive and untenable. It would surely clash with the fundamental freedom of expression of political actors, the constitutional values of pluralism in democracy and it would compromise the exercise of the *ex ante* control and *ex post* accountability powers that are also legally granted to DRs.

In liberal democracy, with rule of law, no institution with public powers is insulated from public scrutiny and debate, not even courts. It would be rather fictional and illustrative of a limited vision of democracy to suggest that such debates are merely backward-looking and that all forward-looking signals of policy preferences have to be conveyed through elections of representatives who would then translate them in formal legislative acts. The participatory and deliberative dimensions of democracy demand an open debate of contrasting views, including through informal practices of DRs and the Public.

It would make no sense to suggest that the Legislative body retains the power to amend the CB’s legal basis and delegation, but none of its individual members could deliver a speech about it in advance, publicly present a draft proposal or use the media to justify the initiative with her different view of what (or how) a CB ought to do. No doubt that such informal acts of the elected

politician seek to influence the CB's decision-making, and on occasions CBs react strategically by adjusting their policy stances long before the legislative measures are approved<sup>653</sup>.

Article 130 TFEU's prohibition is a principle rather than an all-or-nothing rule. It has to be interpreted restrictively in what concerns informal inputs, seeking a balance with those other constitutionally protected values<sup>654</sup>.

The literal element also suggests a further restriction: the prohibition is only addressed to institutions and other legal entities, but it does not mention or specify their members or other individuals<sup>655</sup>. It would mean that the prohibition would apply to acts of institutions, but not to words and deeds of individuals, including the members of the bodies of those same institutions. Yet, this distinction is somehow formalistic and diabolic to hold in the case of unipersonal institutions and offices such as executive presidents.

### **c) STRUCTURING CONFLICT MANAGEMENT**

In complement to efforts to minimize political pressures, legal regimes have also to consider alternatives to deal with conflicts that eventually materialize.

Constitutional or legislative lawmakers will always have the ultimate prerogative to settle conflicts, which is to amend the delegation or even eliminate the CB.

As this lawmaking "R-Bomb"<sup>656</sup> is subject to the liberal constraints typical of legislative and constitutional processes (in the EU), it is burdensome, politically costly, and is rarely used. This latent power is a credible or viable exit for only the most extreme conflicts.

There are basically two strategies for exits *within* existent legal frameworks: structured conflict management or ambiguity.

*Structured conflict management* entails a framework that recognizes the possibility of conflict and offers mechanism(s) to resolve them, which can be unilateral, negotiated or mediated.

Examples of unilateral devices include the Executive powers to remove or change the central banker(s) ahead of their terms, or to concretely instruct them the policy be followed. By offering the upper hand to the political branch, such devices are likely to encroach on CBI and are rejected or highly restricted in many countries.

An alternative would be to create some coordination body or third-party umpire to resolve or mediate a solution to certain conflicts.

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<sup>653</sup> (CONTI-BROWN, 2016), (BINDER & SPINDEL, 2017).

<sup>654</sup> (SMITS, 2007: 1626).

<sup>655</sup> Whereas the prohibition of instructions (art. 130 first part) specifies "any member of their decision-making bodies".

<sup>656</sup> Ch. 5.3.5.

REICHLIN ET AL. recently proposed the establishment of “a new board for euro area joint fiscal-monetary oversight”, including representatives of both monetary and fiscal authorities with powers of analysis, oversight, and issue of occasional warnings, but no binding authority.<sup>657</sup>

If these coordination bodies or third-party umpires were to have binding powers, their institutional design would have to solve the same normative difficulties and power struggles that weigh on the design of the current separation of powers arrangements.

That is why existent coordination bodies, most of them created after the GFC (e.g., FSOC in the US, ESRB in the EMU, and similar national bodies), have essentially roles of information and cooperative coordination, a few softer competences, but no power to override any of the democratic or CB decision-makers.

Ambiguity is when the legal framework makes no recognition of the (possibility of) conflict and gives no side the formal upper hand. In ambiguous frameworks, DRs have no power to dismiss central bankers before the end of their tenure (maybe except for serious misconduct unrelated to the policy content of their discretionary choices), and the latter have long and staggered terms that delay the pace of their substitution. Moreover, the former have no power to specify the mandate, issue instructions or override CB decisions.

Ambiguity regimes oblige DRs to work, out in the open, through the checks and institutionalized burdens, which raises their time-, operational- and audience costs. Still, that apparent deterrence protective of CBI has to be thought through. Without a solid ethic of restraint, such a high bar might increase the use and importance of informal channels, less noticed by the public and harder to scrutinize. On the other hand, it might result in the disproportionate use of a (legislative) nuke to solve a small, concentrated conflict.

When existent, explicit mechanisms of removal, instructions, and override powers belong to the Executive. That entails a fundamental power shift in comparison to the ultimate solution of changing the legal basis, which belongs to the Legislature.

In the ambiguity approach, executives may fight CBs through informal channels, but conflicts can only be settled by the Legislature, with its slower, burdensome, and more transparent, plural, and participated procedures. In the recognition-cum-exit approach, executives are allowed to take and solve the conflict with their own hands.

It could be argued that the power shift is not that relevant because those same countries with such executive powers tend to have majoritarian parliamentary systems, where the executive (leader) already dominates the parliament.

However, firstly it ignores those valuable differences between executive and parliamentary decision-making procedures; second, it says nothing about other systems of government and

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<sup>657</sup> (REICHLIN ET AL., 2021).

parties where power is effectively divided, e.g., presidential, proportional parliamentary, and consensual systems.

As demonstrated above, the Fed and the ESCB are closer to the ambiguity approach, while the BoE and its Commonwealth peers are more toward the opposite pole.

The legal bases of the BoCan, RBA and NZRB explicitly establish mechanisms to resolve policy conflicts, all giving the Executives the final word.<sup>658</sup>

Only the law in action will allow a verdict on the performance of each conflict management strategy.

Nonetheless, some framework and constraints on informal interactions may help prevent a “black market” of informal pressures.

In any case, a safe conclusion is that ICBs are subject and potentially *vulnerable* to a host of informal political practices that try to influence their decision-making. The heterogeneity of DRs may foster internal and external competition of Influencers that change the outlook for CBI.

#### **5.2.11. NON-COOPERATIVE COORDINATION AND STRATEGIC BEHAVIOR**

DRs use the channels above to exert influence through signals and actions aimed at the CB’s own functions and decision-making. However, they may also influence central banking without engaging in any informal dialogue or cooperation, without speaking of, or exercising any formal power over the CB.

The sheer exercise of the politicians’ own macroeconomic policy functions and the respective effects may be enough to change and restrain the effective margin of discretion of the CB, as a *de facto* source of discipline or laxity.

Democratic fiscal, prudential, or foreign exchange policymakers adopt policy stances that affect the monetary policy constraint, that counter or amplify its impact, and thus shape *de facto* the array of decisions that CBs may take. In the extreme they may create fiscal or financial dominance, severely compromising the CBs’ room for decision-making and, thus, their self-determination.<sup>659</sup>

The interdependencies and spillovers between the various macroeconomic policies are significant, and “[w]ith a large CB’s balance sheet and a high level of government debt, these interactions are more sizeable”<sup>660</sup>.

They exist regardless of any dialogue or articulation amongst their policymakers, and then coordination *latu sensu* will be uncooperative and each policymaker is expected to act strategically to preserve its autonomy and policy preferences. For instance, it will seek first-

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<sup>658</sup> Ch. 55.2.7. **Error! Reference source not found..**

<sup>659</sup> (WYPLOSZ, 2018).

<sup>660</sup> Ch. 2, (LEITÃO AMARO, 2022b), (REICHLIN ET AL., 2021: 63).



mover advantage and avoiding being dominated or will learn and exploit the other's constraint and policy-reaction function, including to gain more policy room of its own.

Fiscal-monetary interaction is more likely to be a non-cooperative game, in comparison to interactions with macroprudential policy that have led to the creation of joint "coordination" bodies or the integration of (some) of its tasks within the Executive or CBs' purview.

Strict or balanced, any model of separation of macroeconomic powers accepts a degree of uncooperative coordination. The common essence is that each policymaker determines the policies under its purview, according to its own mandate and framework, methods, expertise, information, and preferences.

Interactions and incongruences (and conflicts) are inevitable, are expected, and many are left without hierarchical or cooperative resolution.

However, in certain states of the world and in certain forms and conditions, uncooperative interactions are hazardous or suboptimal.

Thus, legal regimes have adopted two basic approaches to deal with them: by creating post-legislative mechanisms as described in the subsections above, or by establishing substantive limits that "anticipate" some degree of coordination at the legislative level.

Such legislative limits are rules constraining each policymaker in the exercise of her own function, with the purpose of preserving hers and/or other policymaker's policy room.

One paradigmatic example is the legislative balancing or hierarchization of macroeconomic objectives (e.g., price stability, financial stability, real variables such as employment and others). Another is the prohibition or limitations to monetary financing.

In such cases, Legislatures take it into their own hands to draw boundaries to that post-legislative uncooperative interaction. However, their efforts to anticipate some degree of coordination at the legislative level are limited.

First, because fixing legislative limits means transferring out to another actor, the courts, the responsibility to eventually adjudicate conflicts, i.e., some post-legislative coordination remains. Second, because those limits tend to be extremely vague and subject to contentious interpretations.

Definition and hierarchization of the multiple macroeconomic objectives is all but clear, and the restrictions on monetary financing have left ample room for constructive ambiguity – even in the EMU, where the primacy of price stability and prohibition of monetary financing are purportedly starker.

In turn, courts tend to be more deferential to the policymakers *sub judice*, governments or CBs, thus re-passing them the responsibility of dealing with the conflict and weakening the purported legislative-level coordination.

It only confirms the importance of uncooperative coordination, its strategic interactions and struggles for dominance, as potential sources of *ex ante* democratic influence.

Decisions of DRs in their macroeconomic policymaking roles may have consequential impacts in constraining the policy space of CBs, *de facto* limiting their discretion and their independence. That impact is magnified if they get first-mover advantage, let alone dominance.

CBs may be *engaged* institutions, but they are also *vulnerable* in many *de jure* and *de facto* ways.

### **5.3. POLITICAL ACCOUNTABILITY: EX POST CONTROL BY DEMOCRATIC REPRESENTATIVES**

Democratic Principals are not discharged of their responsibilities just by delegating and structuring the mandate *ex ante* through institutional design, constraints, and further signals of their preferences over policies. They cannot then wash their hands and trust on luck to have a good execution of the delegation.

Courts may help them through the judicial control of the legality of the execution of the mandate, but judicial review cannot go so deep within the domain of delegated discretion.

DRs cannot dispense with the *ex post* control of the performance and output of the delegation. “Accountability is [such] *ex post* mechanism of control”<sup>661</sup> of CBs.

Accountability is “a relationship between an actor and a forum, in which the actor has an obligation to explain and to justify his or her conduct, the forum can pose questions and pass judgment, and the actor may face consequences”.<sup>662</sup>

Accountability is about being answerable towards others with a legitimate claim to demand an account, i.e., to *be informed*, *evaluate* and *sanction* the performance of the delegated functions.<sup>663</sup>

Accountability is but a portion of the policy-making process, its fourth segment, that requires the accountable decision-maker to: (i) disclose its decisions or actions; (ii) explain and justify them; (iii) be subject to questioning and review by the “accountee”; and (iv) where error or harm is found, to own responsibility and face a variety of potential, formal and informal, institutional or personal sanctions.

#### **a) ACCOUNTABILITY AS EX POST CONTROL**

Some voluntarists suggest expanding the concept of accountability to encompass both *ex ante* and *ex post* mechanisms of (political) control, but the distinction has analytical worth that should not be wasted<sup>664</sup>.

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<sup>661</sup> (ELSTER, 1999:254).

<sup>662</sup> (BOVENS, 2010: 948), (LEINO-SANBERG, 2019: 196).

<sup>663</sup> (BOVENS ET AL., 2014), (MANIN, PRZEWORSKI & STOKES, 1999), (LASTRA, 2015: 89).

<sup>664</sup> (LASTRA, 2015), (AMTENBRINK, 1999: 38), (FROMAGE ET AL., 2019: 10).

It is true that often the exercises of accountability convey not only backward judgments and sanctions, but also forward-looking signals about the democratic principals' preferences over CB policies.

Central channels and powers can have this dual role and perspective: the review of CB's legal basis and mandate, overrides and decisions to re-appoint or remove its leaders whenever possible, deliberations on its accounts and allocation of its profits, informal meetings, and public hearings.<sup>665</sup>

A paramount example is the iteration between European Parliament and ECB on the latter's Annual Report.

It begins with the report, information and explanation by the CB to the legislative body, followed by the plenary debate of the EU Parliament with the presence of the ECB President, and subsequently the preparation, internal negotiation and approval of a resolution by the European lawmakers that combines backward evaluation, a reputational sanction (which has been mixed-to-positive) and several forward-looking recommendations on the ECB policy priorities and choices, and its institutional behavior and interaction. Finally, the ECB created the tradition of reporting back in writing to the Parliament on how it is following up on such recommendations. Oversight shapes how policy is made<sup>666</sup>. The possibility of *ex post* control "can make...an agency sensitive to the shifting preferences of politicians and political parties"<sup>667</sup>. It provides the CB with an incentive for behaving in a manner that may prevent it from being sanctioned.

The sheer availability of sanctions can make their application superfluous and maintain the political-CB relation in balance because both sides may only lose by their application<sup>668</sup>.

Decision-makers anticipate the retrospective judgments from those they are accountable to, and the latter's judgments and sanctions provide signals to guide present and future members of the institution held accountable.<sup>669</sup>

On the other hand, the politicians' passivity, favorable judgment, or decision not to apply sanctions may be read as tacit or express acceptance and signal support for the continuation of the policy choices and implementation by the ICB.<sup>670</sup>

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<sup>665</sup> (MANIN, PRZEWORSKI & STOKES, 1999), (AMTENBRINK, 1999: 48).

<sup>666</sup> (HUBER & SHIPAN, 2002: 227).

<sup>667</sup> (TUCKER, 2018: 125).

<sup>668</sup> (AMTENBRINK, 1999: 357).

<sup>669</sup> (MANIN, PRZEWORSKI & STOKES, 1999: 10, 29).

<sup>670</sup> (AMTENBRINK, 1999: 357).

Nevertheless, conceptually and analytically, the design and enactment of the mandate, institutional constraints and incentives, and in general, the *ex ante* guidance through signals of preferences over policies are different from the power and mechanism of accountability<sup>671</sup>.

*Responsiveness* is how CBs relate and react to the *ex ante* guardrails and signals, and *accountability* how they relate and answer to *ex post* control mechanisms<sup>672</sup>.

Moreover, it may be suboptimal to use a mechanism for both purposes of prospective mandate and retrospective judgment. It “weakens the power of incentives for the incumbent” central bankers and may introduce distortions on the democratic deliberation about the mandate and its exercise.<sup>673</sup>

Chapter 7 demonstrates the normative importance of political accountability, including for democratic legitimation of independent central banking, and the efficiency and effectiveness of the delegated policies<sup>674</sup>.

Notwithstanding the difficulties and perils, it also raises, e.g., informational asymmetry and manipulability, and myopia (short-term bias), inconsistency of time-preferences and risk of capture of the political actors – the advantages clearly exceed those of “the doctrine of central bank infallibility” that justified the latter’s resistance to more transparency and accountability<sup>675</sup>. The more substantively political are the role and interventions of CBs, the more important becomes their effective democratic scrutiny. For instance, the distributional effects of monetary policy, the new missions and fulfilment of secondary objectives that support government policies, and the international roles and cooperation of CBs justify renewed appeals for strengthening CBs’ political accountability<sup>676</sup>.

## **b) DEVELOPMENTS OF ACCOUNTABILITY**

Descriptively, the dramatic increase of accountability is one of the main trends of the centralverse in the current millennium. There has been a multiplication of mechanisms, and “an increased frequency of interaction; a broadening of the topics discussed”<sup>677</sup>.

CBs no longer operate “in the relative shadow of obscurity”, but there is a common perception that existent democratic accountability is not the panacea, it “is helpful but limited and insufficient”<sup>678</sup>.

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<sup>671</sup> (MANIN, PRZEWORSKI & STOKES, 1999), (ELSTER, 1999: 255-6).

<sup>672</sup> *Idem*.

<sup>673</sup> *Idem*.

<sup>674</sup> (OECD, 2022), (BLINDER, 1998: 68-75), (MERSCH, 2019), (ADLER & MOSER-BOHEM, 2013: 47).

<sup>675</sup> (BLINDER, 1998: 75), (MANIN, PRZEWORSKI & STOKES, 1999).

<sup>676</sup> (BRAUN, 2017), (TRICHET, 2020), (LASTRA, 2020).

<sup>677</sup> (ECB, 2010).

<sup>678</sup> (RILES, 2018: 87-88), (AMTENBRINK, 2019: 316), (LASTRA, 2015), (CURTIN, 2017), (FROMAGE ET AL., 2019: 10).

Opinions differ on how to describe and respond to such insufficiency.

A more radical view believes that *ex post* accountability will always fall short of the democratic demands and thus more political *ex ante* control is needed, at least for the new missions and centrality that CBs have acquired since the GFC<sup>679</sup>.

One perspective suggests that political accountability is still essentially explanatory and thus (more) sanctions are needed<sup>680</sup>.

Others observe that developments need to be complemented. For instance, with (stricter) judicial accountability to ensure that the independent CB acts within the confines of its democratically authorized mandate<sup>681</sup>.

Or with “technical accountability” before “forums of technical expertise” that allow the CB to learn and legitimate “best practices”<sup>682</sup>.

In addition, with accountability before the public, because legislative oversight “cannot in itself absolve central bankers of the responsibility for engaging with the public” and new channels with the public have to be developed<sup>683</sup>. The CB is a “disinterested” trustee for a specific public interest”<sup>684</sup>.

An interesting approach is the proposal for the creation of “a new venue for democratic debate and deliberation on EU economic governance”, named the “Great Macroeconomic Dialogue” and consisting of a “yearly conference to outline the grand economic strategies for the coming year. This could be a space in which the ECB engages with other EU level actors responsible for economic policymaking – not just ministers of finance and relevant Commission officials – but also representatives of industry, labor, and civil society from across Europe.”<sup>685</sup>

If combined, those appeals recommend a pluralistic accountability, complementary but also competitive<sup>686</sup>.

### **c) MODALITIES OF ACCOUNTABILITY**

There are various modalities of accountability.

They vary with the *subject* to whom the CB is accountable: *political accountability* toward the Legislative or the Executive (and other political actors), and the European or national authorities

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<sup>679</sup> (VAN’T KLOOSTER, 2020), (SCHMIDT, 2020), (DOWNEY, 2021).

<sup>680</sup> (AMTENBRINK, 2019), (SCHMIDT, 2020).

<sup>681</sup> (DE BOER & VAN’T KLOOSTER, 2020).

<sup>682</sup> (SCHMIDT, 2020).

<sup>683</sup> (RILES, 2018: 87-88).

<sup>684</sup> (DYSON, 2009).

<sup>685</sup> (SCHMIDT, 2020).

<sup>686</sup> (GOODHART & LASTRA, 2018).

in the case of the ESCB; to *the public*; *judicial* accountability; *professional* accountability; and to the stakeholders with affected rights or interests<sup>687</sup>.

And they vary with the *object* that is controlled: *proceduralist* accountability that judges the CB action against procedural norms; and *substantive* or *performance* accountability where the action “is based on the assessment of the results achieved”, and which can in turn be *normative* or *non-normative*. In the former, the outcome is assessed in relation to the specified constitutional or statutory objectives and standards, and in the latter the performance is evaluated regardless of any established norms<sup>688</sup>.

However, when combining “multiple accountability mechanisms” in the CBI framework, attention should be paid to the risk that “[i]nstead of creating ‘tailor-made’ accountability where one forum compensates for the failure of another, in the end no channel addresses the substance of [the ICB] decisions.” The multiplication of channels that are “promises of procedural accountability” should be balanced with the concern of (also) making it more substantive<sup>689</sup>.

Political accountability can be mandatory or voluntary<sup>690</sup>, formal or informal<sup>691</sup>.

The *real* picture can only be discerned if both the formal and informal channels are considered<sup>692</sup>.

Even when CBs are only *formally* accountable to the Legislature – as is the case of the Fed and ECB (except for banking supervision)<sup>693</sup> – they end up being informally accountable to both political branches and the political process in general. The judgments and reactions of the US President and the members of the Council of the EU effectively matter and sometimes are consequential.

The BoE is formally accountable to both branches of government, in general to the Parliament, and with respect to the Bank’s inflation target set in the remit letter, also to the Chancellor of the Exchequer in a structured process of exchange of letters.

One final comment needs to be made on the structure of political accountability of the ESCB where two levels of central banking – supranational ECB and NCBs – coexist with two levels of political authorities, European institutions and national governments and parliaments.

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<sup>687</sup> (BUIER, 2006), (DYSON, 2009), (BOVENS ET AL., 2014: 4-5).

<sup>688</sup> (LASTRA, 2015), (DAWSON ET AL., 2019: 93), (BUIER, 2006).

<sup>689</sup> (DAWSON ET AL., 2019).

<sup>690</sup> (BOVENS ET AL., 2014: 12).

<sup>691</sup> (BUSUIOC, 2013).

<sup>692</sup> (SCHUBERTH, 2020).

<sup>693</sup> (BIS, 2009: 139), (BRAUN, 2018: 39).

Such complexity, and the concern of promoting Europeanization of the Eurosystem in general and the NCBs in particular (while combating their home biases) has created some strange elements.

For instance, NCBs are national hybrid institutions in general “accountable, first and foremost, to their national constituency.” Yet, NCB governors are not accountable to their national parliament for the performance of their ESCB tasks, whilst “the ECB and its decision-making bodies are also accountable to a European audience, which includes the European citizens’ elected representatives at the European Parliament”<sup>694</sup>.

Furthermore, the accountability of the ECB before national parliaments is still very rudimentary. The Supervisory Dialogue created with the Banking Union includes national parliaments, but it is purely consultative<sup>695</sup>.

On the monetary front, the ECB is engaged in the traditional Monetary Dialogue with the EU Parliament (also consultative) and it decides selectively and voluntarily how to deal with national parliaments. While in 2012 ECB President DRAGHI decided to visit the German Bundestag to explain the OMT<sup>696</sup>, in 2020 in response to the GCC decision in the *Weiss* case, the ECB adopted the position that it dialogued only with European Parliament and the Bundesbank. To the former, it responded through a written reply to an MEP and several committee hearings. To the latter, it provided various documents and assessments, including on proportionality.

That said, both European and national parliaments have the power to scrutinize and debate ESCB policies publicly, even when they have limited formal and mandatory channels of interaction.

The following sections provide detail on the main types of interaction in political accountability: (1) transparency (2) reporting and explaining decisions; (3) answering questions; (4) sanctions, including (5) the ultimate legal revocation or amendment of the CB legal basis.

### **5.3.1. TRANSPARENCY**

Transparency concerning the CB’s actions, omissions and situation is the first segment and a condition of accountability<sup>697</sup>.

#### **a) THE QUIET REVOLUTION**

Since the 1980s central banking has undergone a “quiet revolution” of which one of the main aspects is a transformational journey of its transparency and communications.<sup>698</sup>

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<sup>694</sup> (ATHANASSIOU, 2014: 34-38).

<sup>695</sup> (AMTENBRINK & VAN DUIN, 2009), (FROMAGE & IBRIDO, 2018).

<sup>696</sup> (HÖGENAUER, 2019).

<sup>697</sup> (IMF, 2020: 13).

<sup>698</sup> (BLINDER, 2004: 5-33), (HORVATH, 2020: 796).

CBs moved from strategic ignorance, monetary mystique and secrecy to openness and transparency.<sup>699</sup>

Slowly but steadily over the past four decades, CBs embraced transparency.

“Central banks used to ask, ‘Do we communicate this?’ Now, as a rule, they ask ‘Why wouldn’t we communicate this?’”<sup>700</sup>.

Many CBs announce their monetary policy strategies and their clear definition and quantification of the respective monetary policy objective. They make public their decisions, the minutes, or some accounts of their policy meetings and sometimes the individual voting records. Various explain their policy decisions in dedicated press conferences.

They publish macroeconomic projections, regular bulletins and preparatory documents, analyses supporting decision-making, and reports and working papers analyzing past options and performance and discussing policy alternatives.

They make multiple speeches informing, explaining, and reflecting on policy choices and even other topics.

## **b) TRANSPARENCY AS A POLICY TOOL**

Communication became a policy tool in itself through the so-called “forward guidance” by which CBs try to steer and anchor the expectations and thus the behavior of economic agents “just” by indicating the policy directions in which they will be leaning in the medium-term future<sup>701</sup>.

“In central banking, speeches aren’t just about policy, they are policy tools”. There are empirical findings that “public trust is essential for the successful conduct and implementation of monetary policy” and impacts inflation expectations.<sup>702</sup>

Fed Chair JANET YELLEN declared that “the explanation is the policy” (2013), and Irish Central Bank Governor GABRIEL MAKHLOUF echoed that “forward guidance communication has shifted from being the medium by which monetary policy decisions are explained to the public, to being a monetary policy instrument in itself” (2020).

DRAGHI’s promise to do “whatever it takes” is probably the most famous case of “policymaking by words”, extremely effective before any policy decision or change was actually made, let alone implemented.

CBs inhabit an “economy of words”<sup>703</sup> and the backbone of fiat money is trust, as long as the monetary authority remains credible. Often effective policy actions are needed to sustain such

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<sup>699</sup> Ch. 4.2.

<sup>700</sup> (HALDANE ET AL, 2020, cit SKINGSLEY, 2019).

<sup>701</sup> (BERNANKE, 2015).

<sup>702</sup> (SCHNABEL, Societal Responsibility, 2021).

<sup>703</sup> (HOLMES, 2013).



credibility, and sometimes endorsements from political actors are helpful, e.g., MERKEL and SARKOZY's 2010 statements of support to the ECB in Deauville<sup>704</sup>, or BIDEN's public commitment to respect Fed independence in June 2022.<sup>705</sup>

### **c) WHY TRANSPARENCY?**

Transparency has multiple advantages starting with the enhancement of monetary and financial policy effectiveness by accurately transmitting policy signals and molding public expectations through the so-called "open mouth operations".

It increases policy credibility by staking the reputations of CBs and their officials, forcing regulated parties to do realistic contingency planning, and building a coalition of external interests<sup>706</sup>.

In line with the famous BRANDEIS' observation that "sunlight is said to be the best of disinfectants"<sup>707</sup>, transparency has a self-disciplining effect on policymakers and ensures that their public policy decisions and explanations are consistent over time.

It is more about preventing the bad than fostering optimal behavior. "Transparency makes malfeasance more difficult, exposes error, and in general is useful in guarding against disaster and mistake"<sup>708</sup>.

Transparency enables the various types of accountability, including political and public<sup>709</sup>. It corrects the information asymmetry between the ICB and the political authority that is scrutinizing its behavior, thereby reducing the risk of informational manipulation.

Furthermore, making public the behavior empowers the People to press its DRs to act and make the CB accountable.

In a global age of transparency and networked politics, the old mystique and secrecy of CBs would be unbearable and undermine their trust and legitimacy. In contemporaneous societies, transparency is a condition to build public support.

As citizens and economic agents are more likely to accept and implement accordingly the decisions that they understand, and whose motives and procedures they can see, transparency tends to increase the public's willingness to accept the CBs' decisions (and the policy effectiveness), and thus reinforces the legitimacy and strength of CBI.

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<sup>704</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016: 1).

<sup>705</sup> (POLITICO, 2022).

<sup>706</sup> (CONTI-BROWN ET AL., 2021), (ECB, 2010: 74).

<sup>707</sup> (BRANDEIS, 1914).

<sup>708</sup> (SCHAUER, 2014: 821).

<sup>709</sup> (TRICHET, 2020).

However, transparency is a “mixed blessing” that generates its own problems<sup>710</sup>.

The rationales for the old mystique were the theory of ambiguity, credibility and inflation under discretion and asymmetric information, and the belief that secrecy increases the appearance of all-knowledgeable central bankers, could temporarily increase trust of outsiders, and increase short-term policy flexibility.<sup>711</sup>

Transparency might render it “more difficult for competent and well-intentioned decision makers to make optimal decisions”. It may increase biases in decision-making. If the CB policy makes financial (re)distributions and lets their existence and amount be known by Congress, the press, and the public, that will likely increase pressures and render such distributions influenced by the vagaries and irrationalities of politics and political opportunism<sup>712</sup>.

Transparency on the opinion-formation and decision-making process in the policymaking body tends to increase the difficulty of bargaining and compromise. It might facilitate both external pressures and internal disagreement, thus making compromises more difficult.

It increases the incentive for each member of the committee to posture more and parade its loyalty to the external publics, aggravating home biases. “[T]he ECB has for a long time maintained that the publication of any details of the deliberations could result in pressure on NCB governors by national governments”. Therefore, it publishes only “monetary policy accounts” of the meetings of the governing board in which monetary policy decisions are taken<sup>713</sup>.

Consensus (and the absence of “dissonance in public communication” amongst members of the policymaking body) increases the effectiveness of monetary policy<sup>714</sup>, thus central bankers should sincerely strive to achieve this, with the precious pivotal role of their leaders.

When such consensus is not possible, disagreements should not be hidden<sup>715</sup>, in spite of the risk that a perception of a divided CB could confuse the public, wrong-foot markets, and undermine its credibility and so affect its ability to influence financial conditions – and by extension the economy – if markets do not believe it will follow a consistent policy path.

Transparency might also decrease the quality and innovation of the deliberative process. A leading central banker acknowledged that announced and public meetings are “not a great venue for blue-sky thinking and strategizing”.<sup>716</sup>

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<sup>710</sup> (SCHAUER, 2014).

<sup>711</sup> (EIJFFINGER & MASCIANDARO, 2018), (BERNANKE, 2015).

<sup>712</sup> (SCHAUER, 2014: 822-3).

<sup>713</sup> (AMTENBRINK, 2019: 316-8), (LASTRA, 2020).

<sup>714</sup> (PRAET, 2020).

<sup>715</sup> (KNOT, 2020).

<sup>716</sup> (BERNANKE, 2015: 172).

Transparency may also aggravate financial risks and generate contagions. In financial prudential policies transparency enhances market discipline, but it makes sense mostly for publicly traded securities. Outside the securities markets, transparency is more problematic. For the banking sector, transparency can be an inefficient discipline if it leads to bank runs.<sup>717</sup>

For instance, when it comes to CBs' decisions on access to the discount window and the LOLR function, the trade-off is evident and widely discussed. The risks that such interventions pose for the CB balance sheet and to a level playing field between financial institutions militate in favor of transparency. However, publicity may result in a deterioration of trust in the financial institution involved and lead to a bank run which would transform a liquidity problem into one of solvency or even generate some systemic contagion.

Furthermore, there are many CB activities where there might be legitimate needs for confidentiality, such as the contexts of market-sensitive information, financial stability considerations, and personal data<sup>718</sup>.

#### **d) REGULATING A BALANCED TRANSPARENCY**

Thus, one should “think of transparency not as the panacea for all sorts of objectionable policies and decisions, but instead as a specialized tool that can do great good when it is used appropriately, but which may be counterproductive when it is used for the wrong job or when its costs go unappreciated,” namely in terms of sacrificing privacy, confidentiality, and independence/not politically biased decisions<sup>719</sup>.

Transparency involves trade-offs. Its application in a CB context cannot be indiscriminate or excessive<sup>720</sup>.

The way forward then should not be an effusive demand for total, unrestricted transparency of all CB held information, opinion-formation, decision-making processes, and actions.

Transparency is the correct principle, but its implementation must be balanced.

Each CB strikes a specific balance.

Comparing the transparency of the monetary policy decision-making of the US FOMC, ECB-GC and BoE MPC there are various commonalities and a few differences in terms of specificities<sup>721</sup>.

All three publish a monetary policy statement after the meeting reporting the decisions made. The FOMC and ECB also deliver a press conference open to Q&A from accredited journalists where their leaders transmit and explain the decisions, but the BoE only delivers a press

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<sup>717</sup> (MERRICK, 2020).

<sup>718</sup> (IMF, 2020: 6).

<sup>719</sup> (SCHAUER, 2014: 819-823).

<sup>720</sup> *Idem*, (IMF, 2020: 6).

<sup>721</sup> See Fed, ECB and BoE websites.

conference after those meetings where a monetary policy report is also adopted (every two months, thus every other meeting).

All three CBs publish minutes or some written account of the meeting's discussion and policy deliberation, with distinct delays. All three accounts do not attribute the different views to individual members, with the partial exception in the ECB for the introductions (including views and proposals) of two members of the executive board, the chief economist and the responsible for market operations.

The FOMC and MPC publish in the minutes the voting records of their individual members, but the ECB keeps them confidential. Article 10.4 of the ESCB Statute prescribes that only the outcome can be published but not the minutes.<sup>722</sup>

This option is certainly related to the "consensus culture" that the ECB tried to cultivate since its foundation that started cracking with the post-GFC measures. It is also aligned with the "civil law tradition of not publishing dissenting opinions to reinforce collegiality"<sup>723</sup>.

Yet, the divergences are becoming increasingly known through leaked news or open expressions of disagreement by individual NCB Governors that find themselves in the minority<sup>724</sup>.

Regarding supporting materials prepared (by the staff) in advance of the policy meetings, only the Fed "Beige Book" is made public. FOMC members also receive another report called "Tealbook" (the "Report to the FOMC on Economic Conditions and Monetary Policy") that is not published.

With a six years' delay the FOMC publishes all historical materials for its meetings that were kept secret until then, including a full transcript attributing each individual intervention, agenda, staff presentation materials and memos<sup>725</sup>.

Differences are also encountered on transparency about other aspects of CBs, namely their balance sheets, institutional and individual activities, and interactions with external institutions and relevant Influencers, composition of their staff and aspects related to their leaders.

In 2020, the IMF published a Central Bank Transparency Code with a five-pillar framework covering transparency in every area of central banking. The Code "recognizes the diversity of transparency practices across jurisdictions reflecting different legal, and structural backgrounds"<sup>726</sup>.

These variable limitations of transparency across CBs confirm that transparency requires a trade-off.

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<sup>722</sup> (LASTRA, 2020).

<sup>723</sup> *Idem*.

<sup>724</sup> (AMTENBRINK, 2019: 171).

<sup>725</sup> Fed website.

<sup>726</sup> (IMF, 2020).

It is, however, important to clearly distinguish between general transparency towards the public, and specifically toward political branches to whom the CB is accountable.

Most downsides of public transparency can be avoided if cabinet members and legislators preserve the confidentiality of information they receive from the CB.

On both sides of the Atlantic there are established practices of privileged transmission of sensitive information by the CB leaders to a limited number of elected officials, including information on individual banks undergoing liquidity stresses, or even that are likely to fail in advance of resolution measures that might need some injection of taxpayers' resources.

The FRA requires the Fed BoG to provide certain sensitive information to Congressional Committees, part of which must remain confidential.<sup>727</sup>

The EU SSM Regulation establishes that “[u]pon request the Chair of the Supervisory Board of the ECB shall hold confidential oral discussions behind closed doors with the Chair and Vice-Chairs of the competent committee of the European Parliament concerning its supervisory tasks where such discussions are required for the exercise of the European Parliament’s powers under the TFEU”.<sup>728</sup>

The 2013 EU PARL ECB Interinstitutional Agreement regulates the Supervisory Dialogue and the MEPs’ access to confidential information and discussions under obligations of confidentiality equivalent to the supervisors.

The idea of balanced transparency should be implemented through a layered regime where most of the limitations to public transparency should not be applicable to the disclosure to elected officials, provided they are subject to conditions that avoid detrimental uses.

Naturally elected officials, who are themselves accountable to the public, will have an incentive to make public use of the information in their political activity.

Thus, the terms and conditions for the political access and use of such information must strike a proportional balance between the advantages of transparency and the potential costs to individuals or the system that a public disclosure might entail.

The limitations to transparency and this asymmetry between access of the public and of selected elected officials has to pass the proportionality scrutiny.

It seems acceptable to limit broader access to a limited number of elected officials and to regulate the procedures of access in order to preserve the necessary secrecy. However, such regime of transparency to elected officials cannot distort political competition and its level playing field, nor disrespect the equality of treatment and access to information by government and opposition.

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<sup>727</sup> Art. 13 (3) (C)-(D).

<sup>728</sup> Art. 20 (8).

Whenever CBs are to share sensitive information they should share it with the Executive, but also *directly* with a politically plural group of elected lawmakers, ideally those participating in the specialized committees responsible for the accountability of the CB.

In other words, the layered regime should allow for much less restrictions on transparency toward a selected group of elected officials, as long as informational asymmetry between political competitors is prevented, and it enables equality and diversity in the competition of political influences over CBs.

### **5.3.2. EXPLAINING TO ALL AUDIENCES**

Transparent *disclosure* has to be complemented with *adequate explanation of decisions*, actions, omissions, and the situation of ICBs.

#### **a) DUTY TO GIVE REASONS**

Prompted by a wave of general administrative law reforms it became increasingly clear for CBs that in addition to communicating, they also had to *explain* their actions and policy decisions.<sup>729</sup> Long gone is the age of secrecy and opaque mystique when a BoE Governor could adopt a philosophy of “never explain, never excuse”<sup>730</sup>, and a deputy governor dared to respond in parliament that “it is a dangerous thing to start to give reasons”<sup>731</sup>. Or when a Fed chair (GREENSPAN) could say to a Senate Committee: “[i]f I seem unduly clear to you, you must have misunderstood what I said.”<sup>732</sup>

CBs, like other public agencies, have a *legal duty to give reasons* for their actions and omissions<sup>733</sup>.

Duties to provide reasons have multiple advantages<sup>734</sup>: they are a form of internal improvement for central bankers who rationalize the decision-making procedure and prevent arbitrariness, capricious decisions, and abuses of discretion. Decision-makers become more likely to think through the rationale for the action and to weigh pros and cons carefully before reaching a decision.

They allow the affected parties and general and expert publics to understand why a certain measure has been adopted, to respect or react against it, and – if it is eventually upheld – to act and plan future action accordingly.

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<sup>729</sup> See footnote 229 above.

<sup>730</sup> (BERNANKE, 2015: 55, on MONTAGU NORMAN).

<sup>731</sup> (KING, 2004, citing an episode in 1930).

<sup>732</sup> (GREENSPAN, 1987).

<sup>733</sup> Art. 296 TFEU for the ESCB, section §706 (2) (A) of APA.

<sup>734</sup> (SHAPIRO, 1992: 180-1), (CRAIG & DE BURCA, 2020: 580-2).

Furthermore, such requirements enable external controls. They facilitate judicial review of whether the CB acted fairly, rationally, proportionally and for proper law objectives; and enhance democratic influences on the CB by making it more transparent.

Moreover, “[t]he reason-giving administrator is likely to make more reasonable decisions than he or she otherwise might and is more subject to general public surveillance”<sup>735</sup>.

Legal regimes vary in the extension and the type of procedural or substantive demands to give reasons. They can “just” demand the existence of a record of the grounding facts and reasons or also include a duty to respond to all issues and objections brought to the CB by interested parties. In the extreme, they can require the CB to ponder and respond to all issues.

What began as “You can adopt any rule you please as long as you give reasons” became “You must adopt the best-reasoned rule.”<sup>736</sup>

DRs are expected to question and press central bankers to give facts, reasons, and responses to their objections.

Courts have binding legal powers to react to a failure of CBs to give reasons, namely by legally invalidating the decision, ordering some action or a compensation.

One well-structured example is the British Executive’s demand, in its monetary policy remit, that the BoE MPC *reports* and *justifies* in writing whenever a significant deviation from the inflation target occurs. Thereafter the Executive may respond and ask the BoE to adjust its policy stance<sup>737</sup>.

## **b) LAYERED COMMUNICATIONS**

Disclosure and explanations are important but need to have a broad reach. To enable serious evaluation and potential sanctions a second wave of the revolution of CB communication was needed.

In the first wave central bankers became comfortable opening up and conversing with other experts whom they trusted to share the “secrets” of the “esoteric art” and science of central banking. They then relied upon those experts – watchers, market participants, specialized journalists – to intermediate, filter and translate the messages to the world beyond the walls of the epistemic community of central banking.

The general public and most political actors, with the exception of a few, e.g., ministers of finance and lawmakers at banking and finance committees, stood outside those walls, in the wilderness of an “understanding deficit”.

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<sup>735</sup> (SHAPIRO, 1992: 180-1).

<sup>736</sup> (SHAPIRO, 1992), (BREYER ET AL., 2011), (CRAIG & DE BURCA, 2020).

<sup>737</sup> (CHANCELLOR OF THE EXCHEQUER, Remit, 2021).

In highly complex and technical fields such as economics and central banking, there is dramatic asymmetry of knowledge and capabilities to understand amongst audiences. What expert CB watchers find intelligible can be gibberish for wider publics.

Studies found that the “minutes and Inflation Report published regularly by the B[oE]’s Monetary Policy Committee are pitched at a linguistic level which means they are readily accessible to only around 5% and 12%, respectively, of the UK population. Minutes of the meetings of the United States FOMC are pitched at a level which makes them accessible to only around 2-3% of the US population”<sup>738</sup>.

The rise of CBs’ independence, centrality and public contestation made those walls unbearable. Central bankers understood they need to reach out to the broader public.

They learned that legitimation, effectiveness, and efficacy of their policies required them to address the understanding deficit and the “inaccessibility problem” that affect all technical disciplines, but economics more acutely. Central banking transparency needs to reach beyond the epistemic community<sup>739</sup>.

The questions of *whether* and to *whom* should CBs communicate had been answered. The new question became: *how* to do it?

Expert-level communication did not reach the general public and plenty of political actors. The opposite extreme of uniformly simplifying communication in the minimum common denominator would reach everyone, but at the price of wasting precious informative materials for more sophisticated audiences, and compromising professional, judicial, and market accountability.

The best option for CBs is *layered communication*, with adaptations in the forms, channels, and content to the different audiences and their asymmetries of information, knowledge, and interest (or per capita stakes) in the central banking process.

Each layer should adjust the *complexity* and *relatability* of the communication to deal with the interconnected problems of understanding and attention/interest, respectively.

What suits expert audiences (members of the epistemic community), is different from what is adequate for fairly interested but not so expert audiences such as parliamentary committees and other market participants<sup>740</sup>, which is also different from what is needed for little informed and generally uninterested public and most political actors.

On the *complexity* dimension, communication and explanations for unspecialized politicians and public communication must be simplified. However, if they are “too simplified then people may

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<sup>738</sup> (HALDANE, 2017).

<sup>739</sup> *Idem*.

<sup>740</sup> (R.KING, 2021).



develop a false sense of certainty about the CBs' views about the economy...[and] be disappointed if the central bank doesn't deliver on its communicated forecasts"<sup>741</sup>.

There are signals that ICBs are improving and moving in the right direction of engaging with a wider public.<sup>742</sup>

The BoE launched a layered inflation report with three layers based on the same underlying analysis but pitched differently to distinct audiences.

The ECB has been revamping its digital and social media tools to make itself understood and attractive to the wider public.

It cannot be overstated how layered, transparent, regular, simple, and relatable communication with the public also matter for political actors and democratic accountability.

### **5.3.3. ANSWERABILITY: QUESTIONS, DIALOGUE, AND REVIEWS**

For political accountability to actually mean answerability, political actors cannot be restricted to passively receiving reports, explanations and communications from central bankers. They need to be able to question them, conduct reviews and engage in a meaningful dialogue.

The paradigmatic exercise of *ex post* democratic control is the parliamentary hearing of central bankers, but there are various other types of interactions, informal and formal.

CBs have regular meetings and consultations with members of both the Executive and the Legislature, specially the finance minister and members of the specialized parliamentary committee.<sup>743</sup>

The ECB has to interactions with the two Councils, Eurogroup and Commission, in addition to the institutionalized cross-participation in official meetings.

The formal interactions with the parliament involve: regular and on-request hearings, presentation and discussion of reports (particularly the annual report), written questions, parliamentary reviews and inquiries, and political debates. Even when such dialogues are based on informal rules, they are sufficiently institutionalized to be considered customary obligations.<sup>744</sup>

The BoE's parliamentary accountability has one peculiarity which is the individual accountability of its policymakers before parliament, in addition to the institutional accountability of the bank (and its policy committees).<sup>745</sup>

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<sup>741</sup> (HALDANE ET AL., 2020: 2).

<sup>742</sup> (BLINDER, 2018), (BHOLAT ET AL., 2018), (HALDANE ET AL., 2020).

<sup>743</sup> (BERNANKE, 2015), (CONTI-BROWN, 2016), (BINDER & SPINDEL, 2018).

<sup>744</sup> (ECB, 2010: 78), (ECB's Convergence Report to the ECOFIN Council), (BRAUN, 2017: 39).

<sup>745</sup> (LEITÃO AMARO, 2022c, for references and details on this section), (BIS, 2009: 140).

Whilst the Fed and ECB are typically represented in hearings by only one leading official, the BoE is represented by various, part of them rotating, and they all participate in responding to MPs in relatively equivalent positions, with the Governor appearing as *primus inter pares*.

Finally, and foremost, each member of the policy committee is also required to annually submit to the Treasury Committee his or her own individual report detailing expressed views, voting record and the speeches delivered over the prior year.

The ESCB has an increasingly developed regime of collegial accountability before the the European Parliament that includes (a) the presentation and debate of the ECB's annual report, followed by a resolution, to which the ECB responds publicly and in writing; (b) the Monetary Dialogue, with four annual hearings at the ECON Committee, (c) on-request appearances of the ECB President and other ECB-EB members appear before the ECON Committee; (d) regular meetings behind closed doors between ECB-EB members and MEPs to exchange views; (e) a practice of replying in writing to questions from all MEPs, which is voluntary except for SSM issues where the ECB is obliged to respond to MEPs and members of national parliaments; (f) the newer Supervisory Dialogue in which the ECB responds before both the European and national parliaments, creating a rate case of mandatory decentralized political accountability of the federal body; (g) Voluntary meetings of the ECB with national parliaments, that the ECB resisted for long, President DRAGHI organized irregularly (albeit not all were public); and (h) national parliaments exercise of political accountability over NCBs, according to different national regimes and practices.<sup>746</sup>

The overall political accountability of the ESCB has increased, but there are multiple appeals for its improvement, namely to cover the ECB contributions to global regulatory bodies and its involvement in the definition of economic conditionality in the context of financial assistance programs, and by ameliorating the operation of the committee hearings.<sup>747</sup>

Finally, two further instances of discursive, parliamentary accountability worth mentioning: official reviews and political debates.

Reviews of the activities or policies of CBs may be regularly scheduled reviews, extraordinary, or parliamentary inquiries. Inquiries are the most intrusive, giving parliaments special, sometimes quasi-judicial investigative powers.

CBs are required, often by law,<sup>748</sup> to cooperate. According to a BIS survey, a vote based on the outcome of the official review is uncommon, and generally no formal sanctions are imposed.<sup>749</sup>

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<sup>746</sup> Art. 284 (3) TFEU and 15.3. ESCB-Stat, Arts. 20 and 21 SSM Regulation, BIS, 2009), (AMTENBRINK & DE HAAN, 2002: 74-6), (BRAUN, 2017: 38), (SCHUBERTH, 2020), (TRICHET, 2020).

<sup>747</sup> (FROMAGE ET AL., 2019: 14), (BRAUN, 2017: 44).

<sup>748</sup> Art. 20 (9) SSM Regulation.

<sup>749</sup> (BIS; 2009: 140-2).

Politicians may also raise questions and assess the ICB in parliamentary debates and other public remarks without the presence of central bankers, who are then under pressure to respond in public speeches or provoked to comment by the media.

#### 5.3.4. EVALUATION AND SANCTIONS

The channels above consist essentially of *discursive accountability*, or *answerability*, where CBs report, explain, respond, and justify their actions and omissions.

However, full accountability requires the possibility of extracting consequences from the political evaluation and imposing rewards and punishment accordingly.

The ECB's political accountability, in particular, has been described as "limited to the dimension of answerability", a kind of toothless *ex post* control where elected politicians do not have any instruments to sanction the ECB, and "consequences are indirect"<sup>750</sup>. They purportedly lack powers to remove European central bankers, to override decisions or give concrete policy instructions.

According to the BIS, only "[a]bout 20% of CBs are subject to formal procedures when targets are missed" and "[t]ypically this involves additional reporting requirements to explain the reasons for missing the target as well as the measures and time frame needed to meet the target"<sup>751</sup>.

In abstract, sanctions can be either formal or substantive. The formal include institutional sanctions such as override mechanisms, budgetary or resource penalties, and amendments to the CB legal basis, and personal sanctions such as dismissal, refusal of reappointment when possible, and financial penalties or bonuses based on performance.

Substantive sanctions are essentially reputational when DRs transmit the conclusions of their evaluation of CBs' performance, either in the form of public criticism or some explicit judgment that might include a resolution or vote on the central bank's performance.

All such potential sanctions or rewards suppose a political evaluation of central bankers' behavior and performance. It is reasonable and consistent with the rule of law to demand that political authorities make such connection (and causality) explicit. They too should have a duty to give reasons for the sanctions they impose upon central bankers.

However, not all political evaluations result necessarily in some sanction or reward.

*Silence* and *tacit endorsement* may or may not have some meaning in terms of democracy, legitimacy, policy effectiveness and credibility, depending on the circumstances.

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<sup>750</sup> (BRAUN, 2017: 38), (AMTENBRINK, 2019: 319), (LEINO-SANDBERG, 2019: 197), (SCHMIDT, 2020).

<sup>751</sup> (BIS, 2009: 142).

Political actors might remain unconsciously silent for various reasons. Perhaps they did not notice the CB's behavior which is expectable in lower salience issues or because they were not duly informed and CBs exploited informational asymmetry.

They can also be dissatisfied but consciously silent due to some dysfunctionality of the political process that prevented their collegial and plural political branch from adopting some judgmental or punitive deliberation or because the use of major sanctioning powers carries such a high cost that they do not object sufficiently to justify the hassle and costs of reacting.<sup>752</sup>

It has been argued that the endorsement value of those silences is negligible<sup>753</sup>. Others suggest that "informal and tacit consent from politicians is a weak substitute for democratic authorization via the legislative process"<sup>754</sup>.

Yet, the hypotheses of rational inattention and selective ignorance<sup>755</sup> approximate the two apparently distinct positions of political actors, except in the case of hidden information. The low relative importance of the CB action or of its negative consequences may explain why political actors rationally ignored them, and so the selective ignorance may indicate a lighter form of tacit political acquiescence of CB behavior.

Several factors contribute to reduce the likelihood that political silence is due to real lack of consciousness: (i) certain types of political sanctions, such as critical or supportive declarations, have low costs; (ii) since the GCF, the centrality and public contestation of CBs rose significantly; (iii) the digital revolution has made the supply of political information virtually unlimited and almost free<sup>756</sup>; and (iv) other Influencers with higher stakes, and thus more attention to central banking (e.g. affected stakeholders and the epistemic community) are expected to raise awareness and wake politicians up from their torpor about CB's behavior. It is increasingly unlikely that political branches, and particularly those more specialized elected officials, let CBs' performance go unnoticed.

In other words, it seems reasonable to conclude that the absence of political sanctions conveys a certain degree of tacit acceptance of what CBs do and do not, particularly about their more fundamental, innovative, and politicized choices in the various senses of politicization explored below.

In the following sections, the main political sanctions are explored.

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<sup>752</sup> *Idem.*

<sup>753</sup> *Idem.*

<sup>754</sup> (DE BOER & VAN 'T KLOOSTER, 2020).

<sup>755</sup> "Rational inattention" is when actors allocate their scarce and costly attention in a flexible way to choose which pieces of information to process based on what is most important to them. (MATEJKA & TABELLINI, 2021), (MAĆKOWIAK, MATĚJKA & WIEDERHOLT 2021).

<sup>756</sup> (MATEJKA & TABELLINI, 2021).

## a) REMOVAL

The political power to remove the heads of administrative agencies is often described as the most decisive tool of *ex post* political control, and it has been described as the essential test or the crux of CBI<sup>757</sup>.

Even though some scholars claim that the condition of removal *only for cause* “is neither necessary nor sufficient for operational independence”<sup>758</sup>, *ceteris paribus*, a free and unrestricted political power to remove central bankers puts their necks in the hands of the politicians who hold such power.

The risk of arbitrary dismissal reverberates intensely in central bankers’ strong preferences for job security and professional reputation. “The threat of dismissal then affects the conduct of policy”<sup>759</sup>. If the integrity of independent central banking is to be preserved, central bankers’ seats cannot be at the whim of political actors, partisan mobs, or instant majorities.

Still, the opposite extreme of central bankers’ *absolute* irremovability is also inadmissible.

Even judges, who benefit from the strongest protection of personal independence, can be removed in the gravest cases of loss of capability to discharge functions and of serious misconduct.

Moreover, while flawed judicial decisions are subject to an appeal regime that provides a safety valve, there is no similar possibility of systematic reviewability of CBs’ policy decisions<sup>760</sup>. Therefore, the absolute impossibility of removing pathological central bankers would be excessive, and amount to an intolerable accumulation of powers in the absence of an easy mechanism of override of specific CB policy decisions.

The solution thus has to fall between the two extremes: permit removal under conditions but *prohibit arbitrary or free dismissal*. In other words, the removal power has to be significantly limited, or prohibited with limited exceptions. But, protections against removal can be “neither immunity nor impunity for central bankers who seriously misbehave”.<sup>761</sup>

Two legal techniques concur in constraining the free political removal of independent central bankers: tenures with terms of years, and conditions on removal.<sup>762</sup>

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<sup>757</sup> (CONTI-BROWN, 2015: 292).

<sup>758</sup> (VERMEULE, 2011), (BARKOW, 2013: 22).

<sup>759</sup> (WALSH, 2002: 2).

<sup>760</sup> CB boards and policy committees generally decide as last instance, without hierarchical appeal to external entities.

<sup>761</sup> (SMITS, 2020: 138), CJEU *Rimšēvičs v Latvia* case (2019) §38.

<sup>762</sup> *Idem*, § 48,.

Two scholars took the view that “[w]hen officers are appointed for a ‘term of years’ with the stipulation that the President may remove them for [cause], the language that protects them from removal at pleasure is not [the cause]—it is the term of years”.<sup>763</sup>

The protection of CBI would then stem from the long-termed tenures, and the provisions setting the causes create permissions for removal where it would otherwise be prohibited by an officer’s term of years.<sup>764</sup>

The regime of the removal power must admit it “only for cause” and regulate the *what*, the *who*, the *how*, and the *why*.

In terms of the *what*, the protection of CBI must cover the formal dismissal and other formal legal penalties with equivalent consequences, including the temporary prohibition on performing the central banker’s duties.<sup>765</sup> The confirmed that even a temporary suspension or prohibition “is likely to constitute a form of pressure on that person”.<sup>766</sup>

In terms of *who* has the power to remove, the options are between a pluralistic or a concentrated model, with decisions internal or external to the CB, or a combination of the two, and political, apolitical, or mixed.

Pluralistic interventions distribute the various roles: proposal of removal, approval, non-binding opinion, and veto in the form of non-objection or required approval (or consent).

The concentrated, apolitical, internal removal by the CB governing body appears to be the most CBI-protective, but it would cut out any democratic or external control, which are essential to keep central bankers in check and augment the comparative institutional advantages (epistemic, impartiality and unpartisan democraticity). Such an autarkic solution would hardly be compatible with the prevailing model of non-absolute independence.

A pluralistic hybrid model, requiring the double concurrence of wills, including some democratic element, is preferable. When the Executive has the power to dismiss, an approval would be required from Parliament (by qualified majority in majoritarian political systems, at least), the Head of State, an external independent committee of specialized experts, or a Court.

The conferral to the CB’s bodies or to an external committee of experts with some decisive role in proposing or approving the removal – as in the ECB-EB, the BoE, Riksbank and SNB – empowers the professional/epistemic community’s influence. Its combination with some political intervention in the removal creates a mutual check of distinct influences. This double veto increases the central banker insulation by demanding concurrence of influences, rather than prohibiting removal at all.

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<sup>763</sup> (MANNERS & MENAND, 2021: 5-6).

<sup>764</sup> *Idem*.

<sup>765</sup> CJEU, judgment on *Rimšēvičs* case, § 51-55, (SMITS, 2020: 133-134), (BAST, 2019).

<sup>766</sup> (SMITS, 2020: 133, 138).

In the laws of major central bankers there seems to be no symmetry between the powers to appoint and remove. In the United States, the SCOTUS adopted the view that in general “Congress cannot make the removal of an executive officer subject to its own advice and consent”, as it would reserve in Congress the control of the execution of the laws<sup>767</sup>. For the BoE and the ECB-EB, the initiative of removal belongs to their own governing bodies, not the government.

The ECB-EB stands as an (excessive) exception where the removal of its members has no involvement from any classic political institution: the CJEU may, on application by the ECB-GC or the EB, compulsorily retire them<sup>768</sup>.

The definition of who has the power to remove governors of NCBs is left to national laws<sup>769</sup>. The only institutional demand in EU primary law is that relief of the central banker from office is directly reviewable by the CJEU.

Contrary to the Federal Reserve System, in the ESCB there is no centralized control/power of removal over the governors of NCBs.

The ECB tried to extend to NCB governors the a-politicization of removal that was designed for its Executive Board. In the *Rimšēvičs* case, it unsuccessfully tried to persuade the CJEU that the conditions for legal dismissal must be verified/established by an independent court or tribunal, and not by a government agency, neither a public prosecution service, nor even an investigating magistrate<sup>770</sup>. However, the CJEU accepted “a preliminary decision taken by a government agency, rather than a national court.”<sup>771</sup>

In the BoE, all officials are removable by the Bank with the consent of the chancellor of the exchequer<sup>772</sup>. This lack of a political power to initiate or propose the removal is more democratically restrictive and CBI-protective than in most other countries.

This reveals an interesting internal coherence within the British BoE’s CBI-framework, confirm that such frameworks have to be interpreted systemically, and that political branches may live well without removal, as long as they have other controlling powers such as the specification of the policy objectives, override powers, or shorter and renewable tenures for the majority of policymakers.

The American framework is the most complex and open amongst major CBs. It includes a Congressional path through the process of impeachment, and an Executive path of removal.

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<sup>767</sup> (CONTI-BROWN, 2015: 294), (STRAUSS ET AL., 2003: 177-8).

<sup>768</sup> Art. 11.4. ESCB-Stat.

<sup>769</sup> Art. 14.2. ESCB-Stat.

<sup>770</sup> CJEU, judgment on *Rimšēvičs* case, § 84.

<sup>771</sup> (BAST, 2019).

<sup>772</sup> Sects.7 to 9 of Schedules 1, 2A and 3 BoE Act.

The House of Representatives has power to approve, and the Senate the power to trial the “impeachment for, and Conviction of, Treason, Bribery, or other high Crimes and Misdemeanors”, which is applicable to all FOMC members where they stand as “civil Officers of the United States”<sup>773</sup>. It is as “a unique political process largely unchecked by the judiciary. Whether a certain practice qualifies is determined by, among other things, competing political interests, changing institutional relationships among the branches of government, and legislators’ interaction with and accountability to the public”<sup>774</sup>. Impeachment processes against FOMC members were (unsuccessfully) initiated at least in 1917 and 1935<sup>775</sup>.

Regarding the removal by the Executive, the constitutional bedrock of the POTUS power is the Take Care Clause.<sup>776</sup>

However, the SCOTUS made clear that Congress may limit the removal power of the president, and those acting for her, by imposition of a good cause standard, subject to a balancing<sup>777</sup>.

Congress apparently chose three different regimes of removability for each of the categories of FOMC members. Members of the Fed BoG in general are removable by the president acting alone and only for cause<sup>778</sup>.

“The statute, however, is silent as to Chair [and Vice Chairmen] removability”, which is remarkable considering that “the Fed Chair wields such prominence within the System, government, and public imagination”<sup>779</sup>.

Three distinct interpretations emerge on the removability of the Fed Chair: (a) the SCOTUS interpretation that Congress meant to give removability protection even when it did not do so explicitly<sup>780</sup>; (b) VERMEULE’s suggestion that despite the absence of explicit formal recognition, there is a “hoary convention” that rises to the level of a law-like rule that would prevent the president from dismissing a Fed Chair prior to the end of her four-year term<sup>781</sup>; and (c) CONTI-BROWN’s claim that “the forces protecting the Fed Chair from arbitrary dismissal do not come from law or even law-like conventions, but from the ebb and flow of political calculations made in the moment”<sup>782</sup>. The fact is that “no President has ever formally discharged the Fed Chair”<sup>783</sup>.

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<sup>773</sup> Art. I sect. 2 and 3, and art. II sect. 4 of the Constitution.

<sup>774</sup> (CONGRESSIONAL RESEARCH SERVICE: ART II.S4.1 and Art.II.S4.2).

<sup>775</sup> (NYGAARD, 2021).

<sup>776</sup> Art. II, Sect. 3 of US Constitution, (MANNERS & MENAND, 2021: 71).

<sup>777</sup> (CONGRESSIONAL RESEARCH SERVICE: ARTII.S3.1.3.1 TAKE CARE CLAUSE: OVERVIEW).

<sup>778</sup> Sect. 10 (2) FRA.

<sup>779</sup> (CONTI-BROWN, 2015: 292).

<sup>780</sup> *Free Enterprise Fund v. Public Company Accounting Oversight Bd*, 561 U.S. 477 (2010) (inferring removability protection for the SEC Commissioners).

<sup>781</sup> (VERMEULE, 2011).

<sup>782</sup> (CONTI-BROWN, 2015: 296).

<sup>783</sup> (VERMEULE, 2011: 1198).



As to the RB presidents, the law allow for their dismissal centrally by the Fed BoG for cause<sup>784</sup>, or regionally by the board of directors of the respective RB at pleasure<sup>785</sup>.

However, this institutional design might be unconstitutional because it puts RBs' presidents out of direct reach of appointment and removal by the POTUS. While the latter can exercise control over the Fed BoG through the appointment process, she gets no such authority over RBs. Thus, "the President must reach through two (maybe three, and perhaps even four) layers of bureaucracy before removing them", which would offend the constitution according to the SCOTUS in *Free Enterprise Fund v. PCAOB*<sup>786</sup>.

Turning to *how* central bankers may be removed, CBI demands that some due process is followed in order to mitigate the risk of arbitrariness<sup>787</sup>. That requires, at least that: the dismissing authority states the reasons and demonstrates the fulfillment of the legal conditions; the central banker is heard prior to the dismissal; process is transparent; and judicial review of the dismissal by an independent court of law is possible.

The ECB tried to further rigidify the removal process by suggesting even more procedural guarantees proper of criminal proceedings (e.g., right to a fair trial and the presumption of innocence), but fell short of demanding a final judicial decision. Yet, the CJEU offered no solace to the ECB's more protective intentions, and tried to find some balance in the scope of its review of national measures.<sup>788</sup>

On the least protective side falls the American dismissal through congressional impeachment. The applicability of the Due Process Clause of the Fifth Amendment to federal impeachments is unclear, and "impeachment is essentially a political process that is largely unreviewable by the judicial branch"<sup>789</sup>.

In terms of *why* (i.e., the admissible justifications), the dismissal cannot be arbitrary, nor be based on vague conditions that give governments too much leeway for manipulation. Ideally the law should require a "good cause" that is grave/serious, specific, and clearly defined.

The following causes have been admitted: (i) if the central banker no longer fulfils the legal conditions required for the performance of her duties, including due to permanent incapacity, unfitness, insolvency, prolonged absence or some supervenient and unremedied ineligibility or incompatibility; in case of (ii) "serious misconduct" or "malfeasance in office", including but not

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<sup>784</sup> Sect. 11 (f) FRA.

<sup>785</sup> Sect. 4 (4) §fifth FRA.

<sup>786</sup> (CONTI-BROWN, 2015: 303).

<sup>787</sup> (ARDA, 2006).

<sup>788</sup> CJEU, judgment on *Rimšēvičs* case, § 91-96.

<sup>789</sup> (CONGRESSIONAL RESEARCH SERVICE: ARTII.S4.1.2).

limited to being found guilty of a criminal offence<sup>790</sup>; (iii) “neglect of duty” or failure to faithfully execute official duties; and (iv) “inefficiency” that relates to government waste and ineptitude. The first group (i) of causes seems more concrete and with less room for post-legislative discretion. The others are vague concepts, creating discretion that courts should substantively review in order to prevent excesses.

“Neglect of duty” and “inefficiency” tend to be more problematic from a CBI point of view, as they may more easily be distorted to justify a dismissal for divergences over policy preferences. That is why they are not frequently admitted as sufficient legal conditions in many countries. Certainly not in the ESCB, BoE, BolSr, Norges Bank, RBA, Riksbank, SNB, and apparently not in the BoJ.<sup>791</sup>

EU primary law admits the removal of ECB-EB Members and governors of NCB only if the central banker no longer fulfils the conditions required for the performance of her duties or if she has been guilty of serious misconduct<sup>792</sup>, which means “, unlawful conduct adopted by the holder of an office, which is sufficiently serious to justify the person responsible being relieved from office.”<sup>793</sup>

What the Treaties seem to reject is that a member of the ECB-GC can be dismissed on the grounds of bad performance, such as the failure to achieve policy targets.<sup>794</sup>

In the BoE, are causes for removal: the prolonged absence, insolvency, supervenient legal incompatibility, and inability or unfitness to discharge functions as a member of the policy committee<sup>795</sup>.

The Fed and NZRB<sup>796</sup> have the broadest permissions.

The FRA permits removal only “for cause”, which the literature defines as one of three possible conditions: malfeasance in office, neglect of duty and inefficiency. Yet, neither Congress nor the Supreme Court have ever defined them.<sup>797</sup>

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<sup>790</sup> It is debatable whether “petty crimes” of lower gravity and unrelated to the exercise of public functions or to financial or management issues may be disregarded.

<sup>791</sup> Sect. 13 BolSr Law, sect. 2.12 Norges Bank Act, sect. 18 RBA Act, sect. 13 ch. 9 of the Swedish Instrument of Government, art. 41 (3) SNB Law, art. 25 BoJ Law.

<sup>792</sup> Arts. 11.4. and 14.2. ESCB-Stat.

<sup>793</sup> AG KOKOTT Opinion on CJEU’s *Rimšēvičs v Latvia* case, §104.

<sup>794</sup> Art. 11.4. ESCB-Stat, (AMTENBRINK & DE HAAN, 2002: 74-6), (BRENTFORD, 1998: 95).

<sup>795</sup> Sects. 7 to 9 of Schedules 1, 2A and 3 BoE Act.

<sup>796</sup> The NZRB Act permits the removal of a Governor that *inter alia* “has not adequately discharged the responsibilities of office” or has contributed for the MPC to “breach a collective duty”, or if the “Bank is not adequately carrying out its [non-MPC] functions”, or its resources “have not been properly or effectively managed” – arts. 49, 50 and 53, and art. 19 of Schedule 2.

<sup>797</sup> (MANNERS & MENAND, 2021), (BREYER ET AL, 2011), (STRAUSS ET AL, 2003), (CONGRESSIONAL RESEARCH SERVICE: ARTII.S3.1.3.1.) elaborating on the most important cases *Myers v United States*, 272 U.S. 52 (1926), *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), *Wiener vs United States*, 357 US 349 (1958), *Bowsher v. Synar*, 478 U.S. 714 (1986), *Morrison v. Olson*, 487 U.S. 654 (1988), *Free Enterprise Fund v. Public Company Accounting*

Justice KAGAN's opinion in *Seila Law* concludes that such provisions permit the president to remove for "incompetence" or a "failure to faithfully execute the law",<sup>798</sup> which would include failure to perform their statutory duties in an inexperienced or wasteful manner that they impair the public welfare<sup>799</sup>.

Where all the frameworks seem to agree is in rejecting the admissibility of removal for policy divergence between the central bankers and the political authorities, or if they do not follow executive's policy directives or agenda<sup>800</sup>.

In the same vein, unsatisfactory performance or policy outcomes are not permitted causes for removal if the central banker delivered poor results but complied with her duties and employed diligence.

All removal frameworks of major CBs prohibit arbitrary removals and constrain the dismissal. They agree in allowing removal in egregious cases of pathological central bankers, and in denying that political or policy disagreements are acceptable causes.

Their main divergences concern the institutional design, namely the degree of plurality and of political intervention, and on whether incompetence and inefficiency can legally justify the removal.

In any case, in major CBs in advanced economies, the discrepancies between regimes have not made such a difference because the power has remained largely dormant.

Contrary to developing countries,<sup>801</sup> in advanced economies the cases of *formal removal* of independent central bankers are extremely rare, with none in both the Fed and the ECB-EB, and one case brought to the CJEU against the removal of a governor of an NCB of the ESCB.

Moreover, "in the real world the presence or absence of the power to remove does not [necessarily] equate with substantive authority"<sup>802</sup>.

There are various aspects weighing on the "politics of removal", namely, the public stature of the official, the strength of her political base, the proximity to the political authority, the degree of outrage over a specific scandal or a general policy choice or failure of the central banker, the politicians' interest in deflecting blaming or in avoiding that the removal process backfires due to difficulty in finding replacement, or because the dismissal of an official they appointed may

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*Oversight Bd*, 561 U.S. 477 (2010), and *Seila Law LLC v. Consumer Financial Protection Bureau*, 140 S. Ct. 2183, 2192 (2020).

<sup>798</sup> *Seila Law LLC v. Consumer Financial Protection Bureau*, 591 U.S. \_\_\_\_ (2020)

<sup>799</sup> (MANNERS & MENAND, 2021).

<sup>800</sup> *Idem*, (STRAUSS ET AL., 2003: 172)

<sup>801</sup> (VULETIN & ZHU, 2011).

<sup>802</sup> (BREYER ET AL., 2011: 130).

invite criticism of their own judgment. “[T]he politics of removal suggest that within limits, Presidents are more likely to tolerate than to remove” central bankers<sup>803</sup>.

Political authorities have other ways to affect policies of ICBs, and they are likely to prefer them to the constrained and politically complex removal.

## **b) RE-APPOINTMENT**

Where DRs are allowed to re-appoint incumbent central bankers, they can sanction past performance.

Moreover, “the threat of non-reappointment introduces an additional risk of political influence to which the [CB] governors might be exposed (through the exercise, by the appointing authorities, of their power to withhold their reappointment)”<sup>804</sup>. “[R]eappointment procedures for central bankers significantly affect the conduct of policy”. There are some empirical findings of a positive inflation bias arising from the desire of the central banker to please the government and thereby gain reappointment<sup>805</sup>.

There is also evidence that “central bankers are more likely to stay in office when they produce the economic outcomes sought by the party in power”, although the “financial sector’s role as a shadow principal offering outside employment may limit government’s ability to hold central bankers to account through reappointment rewards”<sup>806</sup>.

Anecdotally, it has been argued that Fed Chair Powell dragged his feet in the fight against the post-pandemic inflation surge “until after President Joe Biden reappointed him”<sup>807</sup>.

Those concerned with maximizing democratic control also charge against the merits of non-renewable terms, suggesting they “provide lame-duck officials with potential to go their way”<sup>808</sup>, and that they are not optimal because the central banker tends to inflate in the initial period of office<sup>809</sup>.

In rigor, only the incumbent political actor who is likely to be in office when the central banker’s tenure expires has some political leverage. A central banker whose tenure spans several majorities/electoral cycles is expected to be less sensitive to the pressures of the political majority of the moment, even if she can be reappointed. In countries with strong electoral

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<sup>803</sup> (BRUFF, 2010 cit. by BREYER ET AL., 2011: 130).

<sup>804</sup> (ATHANASSIOU, 2014: 41).

<sup>805</sup> (WALSH, 2002: 4-5, citing also FRATIANNI, VON HAGEN & WALLER, 1997).

<sup>806</sup> (ADOLPH, 2013).

<sup>807</sup> (LUCE, 2022, suggesting that Powell did not acknowledge that inflation was non-transitory until the reappointment was secure).

<sup>808</sup> (AMTENBRINK, 1999: 49).

<sup>809</sup> (O’FLAHERTY, 1990).

competition and frequent turnovers, the possibility of reappointment may lead to bipartisanship.

To analyze the effective impact of renewability of terms, it is also important to verify the potency of the Thomas-à-la-Beckett effect, i.e., to what extent the institutional cultivation of the central banker is so great that it dissipates the loyalty to the political appointer. If CBs have a monopoly of selecting and proposing candidates or a short-list, such cultivation effect is expected to increase.

On the other hand, it might be that the most accomplished CB leaders build up so much authority and supportive financial and political constituencies that political authorities feel *de facto* constrained to decide for the reappointment. That might be the case of the USA where out of the ten Fed Chairs since the position was created in 1935, seven were (re)appointed by a successive Administration, and five of these seven were reappointed by a successor president of a different party (MCCHESNEY MARTIN, VOLCKER, GREENSPAN, BERNANKE, and POWELL)<sup>810</sup>.

Liberal democracies vary significantly regarding the *legal possibility* and the *practice* of reappointments. There are three types of legal regime: unlimited reappointments, limited number of reappointments, and no reappointment possible but longer terms.<sup>811</sup>

The three main models of central banking have mixed regimes on reappointability.

In the ESCB, the terms of the members of the ECB-EB are not renewable<sup>812</sup>, but there is no such limit for NCBs (who are the voting majority in the ECB-GC), leaving the choice for national legislators.

In the BoE, the Governor cannot be reappointed, but the other officials of the Court of Directors and policy committees may be reappointed, albeit only once.

In the USA, members of the Fed BoG cannot be reappointed after they have served a full term of 14 years. Yet, the chairperson and vice-chairpersons may be reappointed for those leadership positions (whose terms are of four years) within the broader limit of their tenure as Fed BoG members. These tenures may in practice extend beyond the nominal 14 years as each Governor is allowed to serve the “unexpired term of his predecessor”. The “myth of the chair’s four-year term” was disproved by MCCHESNEY MARTIN and GREENSPAN’s 18-year tenures each and VOLCKER and BERNANKE’s 8-year tenures each<sup>813</sup>.

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<sup>810</sup> Updating (CONTI-BROWN, 2015: 291).

<sup>811</sup> (LEITÃO AMARO, 2022C, for references and details on this section).

<sup>812</sup> Art. 11.2. ESCB-Stat.

<sup>813</sup> (CONTI-BROWN, 2015: 290).

Presidents of Regional RBs may be reappointed, only subject to the age limit of 65 – unless appointed after turning 55, in which case they can serve for a maximum of 10 years or until they are 75, whichever comes first<sup>814</sup>.

### **c) FINANCIAL SANCTIONS**

DRs may use financial sanctions as forms of *ex post* control of CBs' *policy performance and outcomes* or their *use of resources* in terms of profitability, efficiency in the CB's operations and cost effectiveness.

The accountability on the use of resources is based on accounting, auditing, and reporting exercises, both internal and external, potentially with the intervention of external auditors or independent courts of auditors and public audit offices.<sup>815</sup>

Financial sanctions can be either institutional or personal.

Institutional sanctions are imposed by political branches on ICBs as a whole, and they include Executive and/or Parliamentary decisions, namely on (i) the approval of the central bank's profit and loss statements<sup>816</sup>; (ii) allocation of profit and remittances to the Treasury; (iii) capitalization of the CB; and (iv) provision of a fiscal backstop to the CB.

Personal sanctions would include financial penalties or bonuses to central bankers based on the institution's performance, with the benevolent purpose of aligning the material incentives of the individual policymakers with the institutional goals established democratically.

In abstract they could be defined *a priori* in the contract offered to the central banker or be left to the *ex post* discretion of the political branch that reviews the recent performance.

As explained above, these remuneration-related mechanisms are problematic both conceptually and practically, and they are rare.<sup>817</sup>

### **d) VETOES AND OVERRIDES**

One particularly effective *ex post* political control would be the power to veto (when decisions are conditioned to political review and possible reproof or approval) or to defer, suspend, annul, repeal, or substitute a policy decision, action, or omission of a CB.

Section 5.2.7 analyzed those sanctioning powers that, when existent, combine *ex post* accountability and *ex ante* guidance. They involve a critical backward-looking judgment of some prior conduct of the CB, and a sanction over the decision or action that is also a forward-looking

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<sup>814</sup> (WESSEL, 2022).

<sup>815</sup> (BIS, 2009: 139-140).

<sup>816</sup> (BIS, 2009, rarely the political rejection of the ICB financial statements determines the dismissal *ope legis* of central bankers).

<sup>817</sup> Ch. 5.2.4 c), and also 8.4.2.

choice over policy or some other aspect of central banking to the extent that it would be applicable and affect future and present ongoing situations.

This survey of positive solutions showed some “coherence in difference”, consistent with different CBI models.

#### **e)NON-BINDING POLITICAL JUDGMENTS**

When political authorities are displeased with the CB’s conduct or performance but are not allowed to veto or override, with legal force, its actions and policies, they have a less biting alternative: to issue a non-binding political judgment that imposes institutional and personal reputational costs.

As described in the previous chapter, reputational penalties and rewards can be effective in steering central bankers’ behavior, working through their utility function, where the individual concern with general and professional reputation is one of the most decisive incentives and motivational factors.

A healthy liberal democracy cannot prohibit DRs from publicly criticizing the CB’s choices, performance, and results. No public institution can be above public contestation, and all merits of political accountability reinforce the importance of allowing such public criticism of CBs<sup>818</sup>.

A robust CBI framework does not oppose such possibility, but it would prefer that such public contestation occurs in coherence with the normative tenets of CBI. That means, for instance, that (i) such judgment should be informed, facts-based, and normative in the sense of evaluating the performance against prior or at least reasonable standards (e.g., legal and intermediate objectives, policy targets, regulated procedures); (ii) the justifications of the CB should be considered and the reasons for the political conclusions should be offered; (iii) political deliberation of such judgment should be open, free and plural, taking the public interest and various viewpoints into consideration.

One tricky question concerns the transparency of that political judgment.

Traditionalists see a politician criticizing the CB and immediately conclude that CBI is under threat. Their rationale is that increasing public contestation suggests a greater likelihood that the CB will bend to political pressure, thereby importing the inflation biases, short-termism, partisanship, and intertemporal inconsistency of the political process, thus eroding the credibility of the CB and the effectiveness of its policies.

Even if such risk is never reducible to zero, it tends to fade as the maturity and institutionalization of the CB grows, as it did over the past decades.

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<sup>818</sup> (BIS, 2009: 142).

The insulation of ICBs from external accountability and criticism, political or other, is descriptively and normatively untenable.

On the contrary, CBs will perform better and have legitimacy only if they operate under constraints and conditions of public contestation.

The “reputational sanctions” may be merely informal – conveyed in public and political speeches and debates, or in statements or comments to the traditional or social media<sup>819</sup> – or formal non-legally binding resolutions and censures voted by parliaments or Executives to express support or dissatisfaction with CBs’ performance.

The EU offers the most consolidated and regular example of such practice. Every year since the ECB creation and after receiving and publicly debating the ECB Annual Report, the European Parliament drafts, discusses, and votes a (non-binding) resolution on the Report. The practice follows the tradition that existed with the antecedent EMI, and it includes both backward-looking judgments of the ECB’s past conduct, and recommendations for the future.

The adopted texts of the resolutions result from negotiation between very diverse MEPs, and the rapporteur usually makes an effort to incorporate heterogeneous inputs.

Over two decades these resolutions were never predominantly negative. Many of their considerations express support for policies and actions of the ECB, but there are also multiple critical rebukes and appeals for future improvement.

The US Congress also has an instrument to formally announce its disapproval of the Fed, which is the adoption of a resolution censuring, condemning, or expressing a lack of confidence in the CB or one of its officials.

No constitutional provision expressly authorizes or prohibits such actions, and the propriety of using resolutions to condemn practices (which some describe as censure) has been debated.

Such censures, that Congress has not yet used on the Fed, would impose no formal legal penalties or consequences for any party. Their primary function is to express congressional judgment on some matter and signal disagreement with the actions of the institution or a named individual<sup>820</sup>.

### **5.3.5. R-BOMB, REVERSIBILITY OF DELEGATION AS THE MOTHER OF ALL DEMOCRATIC SANCTIONS**

The ultimate controlling mechanism for DRs that are dissatisfied with the choices or performance of their CB is the power to change, reverse, or revise the delegation<sup>821</sup>.

CBs’ powers exist within and while the delegation endures.

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<sup>819</sup> Ch. 5.2.10.

<sup>820</sup> (CONGRESSIONAL RESEARCH SERVICE: ArtI.S2.C5.1.4.1).

<sup>821</sup> (AMTENBRINK, 1999:41).



The delegation is never definitive nor irrevocable. On the contrary, it perdures as long as the People and its DRs maintain sufficient support to the CB or until they succeed in mobilizing enough votes to amend the delegation.

The US and UK Legislatures and the national authorities of the EU Member States retain the prerogative to withdraw the powers from their respective CBs, dismantle or subject them to controls.<sup>822</sup>

Such power to *Reverse, Revoke, or Revise* the delegation and the laws of the CB is like an atomic bomb – the *R-bomb* – the mother of all democratic sanctions that can be dropped at the “end of a long opinion-forming process” in which politicians evaluate policies and performances and review legal arrangements, institutional constraints, and incentives.

The deliberation to revoke or amend the delegation, its mandate, powers, governance, leadership, or financial framework should be in part a reaction to past actions or omissions of the CB, and in that sense the R-bomb belongs to the arsenal of *ex post* accountability. However, it also entails an *ex ante*, forward-looking signal effort to guide and reorient central banking<sup>823</sup>. Normally the power to amend belongs to the same political institution that originally issued the delegation. However, exceptions exist to this parallelism of competences.

It occurs in the EU where the ESCB’s legal basis is “constitutionalized” in primary EU law, but the TFEU and the ESCB Statute expressly de-constitutionalize parts of that legal basis. Those provisions allow for post-constitutional, legislative or executive changes or deviations to the primary rules<sup>824</sup>.

Other exceptions are legislated escape clauses<sup>825</sup>, and powers granted to the Executive to temporarily set policy objectives or procedures that deviate from those established in the CB’s legal basis.<sup>826</sup> In these exceptional cases the original democratic lawmakers authorized a distinct, but also democratic body to modify or suspend, permanently or temporarily, its own rules.

These democratic powers to revoke or revise the delegation bear resemblances to an atomic bomb in various senses.

The first is the great destructive potential to the target, the CB.

The second is the risk of mutual destruction. A political branch that drops the R-Bomb purportedly to improve the performance of the ICB is actually creating a serious risk of jeopardizing its own credibility, thereby frustrating its own objectives. Moreover, where strong constituencies support the ICB, the political branch risks serious political backlash. Therefore, it

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<sup>822</sup> (POSNER & VERMEULE, 2010: 58).

<sup>823</sup> (AMTENBRINK, 1999: 41, 51), (TUCKER, 2018: 241, 277).

<sup>824</sup> Ch. 5.2.6.

<sup>825</sup> (AMTENBRINK, 1999:41), (BRENTFORD, 1998: 108).

<sup>826</sup> Sect. 19 BoE Act and sect. 12 RBNZ Act.

will only occur when the political evaluation of the CB is so negative that it incentivizes the legislator to bear the high costs of altering the existent legal framework.

The third resemblance is the deterrence effect. The latent existence of such powers, and the credible threats of deploying them, are capable of shaping and influencing, by themselves, the behavior of the ICB. They offer certain control without ever being used.

The simple announcement of legislative proposals or the threat of tabling them in the Legislature is sometimes sufficient to make central bankers adjust their behavior (at least partially) to accommodate the lawmaker's preference<sup>827</sup>.

The revocation or significant revision of the delegation should be deployed with a difficulty and rarity proportional to the gravity of the circumstances that might lead to them, and of the consequences of the use.

Meanwhile they remind CBs that they need support of political branches and the public to maintain their authority.

The R-Bomb is also a reminder that CBs are ultimately, albeit indirectly, subordinate to the electorate<sup>828</sup>.

One way to avoid doubts about whether it is possible to infer political endorsement and legitimation out of the silence and absence of legislative reaction is to impose sunset clauses on the delegation in order to force political branches to come to the fore and make their judgments explicit.

Recently the requirement of periodic renovation or enactment of CBs' mandates, functions, or objectives was suggested<sup>829</sup>. That would mean that if by the period's end the legal provisions were not legislatively renewed, the delegation would expire.

Sunset clauses invert the meaning of silence. Instead of tacit endorsement, it would mean a tacit rejection and termination of the CB and its delegation.

The most famous historical sunset clauses were those attached to the American First and Second (central) Banks. The political failure to renew their charters brought an end to the delegation of their monetary authority and left the USA without a CB.

These historical examples do not inspire great expectations about sunset clauses. In particular, the extinction of the Second Bank was problematic in its results and process. The subsequent period was turbulent and plagued by financial instability, and the deliberation that eventually led to the failure to renew the charter was dominated by President ANDREW JACKSON's populism.

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<sup>827</sup> (BINDER & SPINDEL, 2017), (CONTI-BROWN, 2016).

<sup>828</sup> (AMTENBRINK & DE HAAN, 2002: 76).

<sup>829</sup> (BINDER ET AL., 2020, suggesting an automatic 10-year sunset clause for the ECB mandate), (CLAEYS ET AL., 2020), (DOWNEY, 2021).

Nowadays, the political process on both sides of the Atlantic is plagued by unprecedented levels of political polarization, a rise in populism, political dysfunctionalities and difficulties in generating political consensus over important institutional and policy reforms. Moreover, public trust of CBs swings with the economic and financial cycle.

These conditions suggest that the need for an express political deliberation of renewal may have more difficulties and generate consequences that would be worse than the general public sentiment towards the CB. Or the generation of a political consensus for the renewal might implicate suboptimal partisan bargains whose cost is the addition of irrational or incoherent provisions that degrade the future performance of the CB.

### **5.3.6. ACCOUNTABILITY AND INDEPENDENCE: MORE THAN A TRADE-OFF**

The relationship between independence and accountability has figured prominently in the literature on CBI over the past decade.

Numerous texts debate it in distinct terms. They have been described as opposites demanding a trade-off<sup>830</sup>, as two sides of the same coin<sup>831</sup>, as symbiotic rather than conflicting<sup>832</sup>, as complements, etc.

For traditionalists defending a strict separation and (quasi-)absolute independence, accountability, even its lightest form of *ex post* discursive answerability looks contrary and incompatible with a fully insulated CB.

The full picture, though, goes beyond the trade-off and tension between two opposites.

A pluralistic and balanced definition of CBI as political technology integrates accountability as a constitutive element to the framework<sup>833</sup>.

It reckons that political accountability can be both a threat to the integrity of central banking beyond a certain degree and a support and lever for stronger independence by offering democratic and epistemic contributions and legitimacy and assisting in the prevention of certain biases.

Pluralistic independence is *balanced* also because of the equilibrium that accountability brings to insulation, both of which express fundamental values of liberal democracies and the proper framework of CBI.<sup>834</sup>

Yet, political accountability does not tell the full story of influences, inputs, control, and legitimation of modern central banking.

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<sup>830</sup> (BRENTFORD, 1998: 108), (ZILIOLI & RISO, 2018), (JONES & MATTHIJS, 2019: 139).

<sup>831</sup> (BRAUN, 2017).

<sup>832</sup> (BLINDER, 1998: 68-9).

<sup>833</sup> (GOODHART & LASTRA, 2018).

<sup>834</sup> (GOODHART & LASTRA, 2018), (ZILIOLI & RISO, 2018: 158).

There are other non-political forms of accountability, including professional, judicial, and affected interests' accountability. Despite running outside the political process, they also have (liberal) democratic and epistemic contributions, but in a non-partisan and non-majoritarian way.

And there are other political forms of democratic control of central banking, that operate as *ex ante* guidance, rather than (or simultaneously with) accountability's *ex post* control.

This chapter demonstrated that while it is settled that ICBs are and should be accountable to DRs, there are various possible equilibria or compromises between independence and accountability.

#### 5.4. GENERAL ASSESSMENT OF POLITICAL CONTROL

Classic political branches and modern CBs are not in a relation of hierarchy.

ICBs are not subordinated to the direction of the instant, partisan majority. They were delegated discretion to govern various aspects of money and credit, within which the instant majority is left at a certain distance.

Yet, they are not absolutely independent, neither isolated, nor all-powerful, nor unbound<sup>835</sup>. Their democratic control goes well beyond (thin) answerability<sup>836</sup> or discursive accountability<sup>837</sup>. Even their monetary policy is subject to more than *ex post* accountability<sup>838</sup>.

CBs are subject, *de jure* and *de facto*, to multiple channels of political constraint, guidance, and accountability. As detailed above, DRs have some combination of (i) *statutory controls* over the delegation and its terms, including structure, functions, powers, objectives, organization and independence protections; (ii) *personal controls* through the appointment and limited removal and manipulation of certain material and reputational incentives of central bankers; (iii) *financial controls* over the allocation of resources through appropriations, provisions and profits, capitalization and backstop, and demands of monetary financing<sup>839</sup>; (iv) *signaling of concrete preferences over policy* through mandate specification, instructions, recommendations and informal dialogues; (v) *manipulation of the interdependencies and spillovers* from the macroeconomic policies under their direction; (vi) *political vetoes or override* of concrete policies or actions; (vii) *reputational judgments and sanctions*, both formal and informal; and (viii) ultimately, and returning back to the beginning, the *R-bomb* that threatens the existence and terms of the delegation.

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<sup>835</sup> (POSNER & VERMEULE, 2010: 61).

<sup>836</sup> (BRAUN, 2018: 38).

<sup>837</sup> (SCHMIDT, 2020).

<sup>838</sup> (WYPLOSZ, 2003: 14).

<sup>839</sup> (BARR, 2015).

These are *ex ante* forward-looking or *ex post* backward-judging controls, or a combination of both. Some of them adjust the constraints and limits of delegated discretion, others seek to influence within the limits of discretion.

They are unevenly distributed by the actors of the political process, chiefly the Legislative and Executive bodies, but also their sections or individual members (especially finance ministers and parliamentary committees), and even political leaders and their parties. Such distribution is regime-specific, and there is a limited parallelism between *ex ante* and *ex post* controls.

Every country's central banking framework has a distinctive arsenal of mechanisms, with a specific combination of possibilities, limitations, and relative weights for each tool of political control.

The Fed, ECB and BoE seem to constitute distinguishable models.

Ultimately, though, what matters is whether those arsenals give DRs effective or potential control over the CB and its outputs; and, If so, how much?

The mere, latent existence of sanctioning powers, and of the R-bomb above all, might be sufficient to influence the CBs' behavior, especially when the possibility or threat of using them is credible.

On the other hand, the passivity and silence of politicians might be interpreted as tacit endorsement of the CBs' performance, or at least as lack of disagreement strong enough to justify the costs of political reaction, sanction, or reform of the CB.

The degree of *de facto* democratic control can only be identified empirically and in concrete as it ebbs and flows with multiple factors.

As full hierarchical control is excluded by the very idea of CBI, three other broad hypotheses should be considered: political abdication, weak proceduralist control, and good enough control of excesses.

The first hypothesis views democratic delegation of authority to an ICB as equivalent to an abdication of politicians' sovereign or constitutionally assigned policymaking roles. Allegedly, what legislators or governments representing member states would have done was to surrender their legislative and other policymaking powers to unelected CBs<sup>840</sup>, without keeping the powers and will<sup>841</sup> to effectively scrutinize and mend them, even if they would later want to.<sup>842</sup>

The second hypothesis admits that political branches maintained certain powers to render the CB procedurally accountable, in a "weak form of formal accountability"<sup>843</sup>. Allegedly, "central bank operational independence precludes substantive accountability", which "does not mean

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<sup>840</sup> (LOWI, 1969, cit by EPSTEIN & O'HALLORAN, 1999: 9).

<sup>841</sup> (TUCKER, 2018: 40-1).

<sup>842</sup> (SCHMIDT, 2020).

<sup>843</sup> (BUIER, 2006).

control over them or power to revoke their decisions”<sup>844</sup>. Monetary dialogue and similar devices would be “a fig leaf for the democratic deficit of the” ICB<sup>845</sup>.

The third hypothesis, though, concedes that DRs have not full, but sufficient, non-trivial ability to control ICBs, including the lonelier ECB. Such control is less than full, to respect the integrity of the specialized process of central banking.

The vast arsenals of *ex ante* and *ex post* devices suggest that the degree of democratic partisan control is greater than traditionalists like to admit.

ICBs operate under conditions of political and public contestation. They are independent, but limitedly<sup>846</sup>, and they are also politically empowered, sustained, and legitimated. They are subject to the law and further political commands and review, and they are vulnerable and responsive. Even if their delegation conveys a “low level of policy detail [it] does not imply that the legislative majorities do not obtain desired policy outcomes”. Vague statutes, with low levels of policy detail, translate an unwilling abdication of legislative majorities to the agency only when three conditions are simultaneously met: the legislative capacity of the politicians who propose policy must be low; there must be a high level of policy conflict between the legislature and the bureaucrats; and the legislative majority cannot rely on statutory means – such as friendly judges – to help ensure the outcomes it favors.<sup>847</sup>

The People and its DRs have powers to convey guidance and substantive accountability.

As they delegate areas in which the political process is least efficient, one should not expect oversight to be either perfect or desirable. Legislators lacking the time, expertise, and/or political will to make hard policy choices themselves in an area, will not magically find these resources when it comes time to oversee the CB. Nor should we necessarily want them to try if this would decrease agencies’ incentives to invest in policy expertise<sup>848</sup>.

The arsenal of *ex ante* and *ex post* channels offer good enough control, that can and should be able to *curtail CB excesses*<sup>849</sup>.

It is good enough because the combination of so many different *ex ante* and *ex post* controls (with varied limitations and strength) permit DRs to signal their preferences over policies easily and regularly, and to leverage their persuasiveness or influence with distinct but cumulative sanctions and rewards involving aspects that are cherished by central bank(er)s.

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<sup>844</sup> (LASTRA, 2015: 131, fn 19).

<sup>845</sup> (VAN DER SLUIS, 2014: 116)

<sup>846</sup> (LAVRANOS, 2004: 121).

<sup>847</sup> (HUBER & SHIPAN: 222-225).

<sup>848</sup> (EPSTEIN & O’HALLORAN, 1999: 9-10).

<sup>849</sup> *Idem*.

It is also good enough because DRs keep the ultimate control over CBs, the R-Bomb, which they can and will use if they feel that too deleterious excesses have been committed.

That ultimate control of the American and British legislatures is clearer. But even in the EU, there exists “the possibility to change the legal basis of the ECB and thus also its independent status through a Treaty amendment procedure...After all, the electorate (or their representatives) should decide on (changes in) the objectives of monetary policy. In other words, in principle the ECB is ultimately, albeit indirectly, subordinate to the electorate in the EU.”<sup>850</sup>

Whether this degree of “good enough political control” with multiple channels of democratic guidance and control of excesses, including the ultimate power to revoke or revise the delegation, is normatively adequate is a question for Chapter 7.

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<sup>850</sup> (AMTENBRINK & DE HAAN, 2002: 76).

## 6. CENTRAL BANKS AS POLITICAL ACTORS

Another fundamental premise of the pluralistic concept of CBI is that modern CBs are political actors that make substantive political choices in conditions of public contestation.

### 6.1. TRADITIONAL DENIAL OF THE POLITICIZATION OF CENTRAL BANKING

Opposingly, the traditional view of CBI rejects, in both normative and descriptive terms, the politicization of central banking<sup>851</sup>.

ICBs, they argue, do not, cannot and ought not to make political choices.

They would need “to be protected from politics, should also ...refrain from engaging in politics, and in political trade-offs”<sup>852</sup>. Their independence should be a “place empty” or “field off” politics<sup>853</sup>.

Central banking should be apolitical and entail no conflicts of values and redistributive consequences, or at least none that are sufficiently relevant. It should be “primarily a technocratic activity that is purposely separated from the political process”<sup>854</sup>, as a result of the depoliticization or apoliticization of certain macroeconomic policy functions, through a process of scientization to put them above politics.<sup>855</sup>

Mimicking the official discourse of judges and technocrats, central bankers self-demote their role and, convincingly or strategically, feed that myth and “tend to portray their decisions as purely technical and devoid of any value judgment”<sup>856</sup>.

More sophisticated versions admit some politicization but downplay its relevance, accepting that the discussion should not be about *if* but about the *degree* to which such decisions entail *relevant* political, distributive, or value-laden choices.<sup>857</sup>

Those suggest that politicization could be overlooked because technical expertise would be relatively more important than value judgments in central banking<sup>858</sup>, and the distributional consequences of monetary policy would be “minor, unsystematic and inevitable”<sup>859</sup>, or would be temporary and even out over time<sup>860</sup>.

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<sup>851</sup> (TUCKER, 2018), critically (McNAMARA, 2002: 67), (DIETSCH ET AL., 2018), (RILES, 2018).

<sup>852</sup> (BEUKERS, 2013).

<sup>853</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>854</sup> (RILES, 2018).

<sup>855</sup> (MARCUSSEN, 2009: 375-7).

<sup>856</sup> (CONTESSA, 2020), (BLINDER, 1997: 118-9), (RILES, 2018: 40), (VAUCHEZ & FRANÇOIS, 2020)

<sup>857</sup> (SHAPIRO, 2010: 301).

<sup>858</sup> (BLINDER, 1997: 118-9).

<sup>859</sup> (DIETSCH ET AL., 2018).

<sup>860</sup> (CŒURE, 2013).



In the background loom economic theories such as the quantity theory of money and the defense of neutrality of money at least in the long run<sup>861</sup>, and the empirical “line of argument [that] denies trade-offs between price stability and employment”<sup>862</sup>, as if sensible short-term, real effects could be ignored by CBs.

In such theories, ICBs have been delegated only secondary conflict management and low-salience discretion, and value-choices are only be by-products of “broadly settled preferences and a consensus” reached by the society and/or by democratic principals reflecting on society’s preferences and passed into legislated mandates or other democratic signals including the Executive’s mandate specification.<sup>863</sup>

When the transformations of post-GFC new style central banking further exposed the inevitability and significance of the existent politicization, the traditionalists’ reactions were that it was illegal and normatively objectionable.

Illegal because ICBs were allegedly engaging in *ultra vires* activism, breaching the limits of their delegation. And, even if their actions had redistributive consequences as a side effect or by-product, they would still lack a mandate to redistribute, as they would be legally forbidden to care for other values and goals not included in their mandates.<sup>864</sup>

This approach was based on a distinction of fiscal and monetary policy, where only the former could “legitimately handle primarily distributive matters, essentially by organizing deliberate transfers between different groups of agents” and “effectively and legitimately target specific (groups of) firms and households”. On the contrary, monetary policy could not purposely do so. Whatever practical transfers it caused – e.g., from creditor to debtors, or from its shareholders (governments) to the banks<sup>865</sup> – would have to be dealt with and eventually compensated through fiscal policy.<sup>866</sup>

The politicization of central banking is also normatively rejected using democratic, separation of powers and utilitarian arguments.

The basic democratic argument is that (above a certain degree) political choices of “the appropriate balance ...between competing priorities” ought to be made by DRs and the classic electoral-representative process.<sup>867</sup>

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<sup>861</sup> (DORN, 2022).

<sup>862</sup> (DEUTSCH ET AL., 2018: 43, critically extrapolating from ALESINA & SUMMERS, 1993).

<sup>863</sup> (TUCKER, 2018: 105, 556).

<sup>864</sup> (REIS, 2017: 37-8, claiming that “unlike fiscal authorities, CB have no redistribution mandate”), (TORTOLA, 2020: 505), (CŒURÉ, 2013), (SKINNER, 2021). More flexibly, (DEUTSCH ET AL., 2018: 103, arguing that ICBs can only be “sensitive” to distributive concerns as “tie-braker criterion”).

<sup>865</sup> (BARTSCH ET AL. 2020).

<sup>866</sup> (GOODHART, 2021).

<sup>867</sup> (GOODHART, 2002: 192), (TUCKER, 2018: 101, 556), (DEUTSCH ET AL, 2018), (JONES & MATTHIJS, 2019: 130).

A “democracy that leaves too many important policy-relevant value judgments to unelected, unaccountable, and unrepresentative experts runs the risk of turning into a technocracy”<sup>868</sup>.

ICBs would be (comparatively) unrepresentative due to a lack of equal voice and consideration of affected interests (and the risk that their officials’ value system might not represent society’s values at large). In addition, they are seen as reducing (democratic) opportunities for political partisan competition and contestation and perpetuating the interest of a class or group (the capital owners or financial elite) or some neoliberal creed. Thus, they make distributional choices in a systematically biased way.<sup>869</sup>

The separation of powers argument was that the politicization of central banking was undercutting the fiscal prerogatives of democratic parliaments, the unity of the representative Executive, and the idealized division of (macroeconomic) roles where CBs lack the power to make compensating side payments to the losers. This power typically belongs to (elected) fiscal policymakers through tax or social security measures, taking monetary policy as given and optimizing accordingly.<sup>870</sup>

The utilitarian argument is that it would be suboptimal or less effective for monetary policy to be concerned with other objectives beyond strict price stability, namely distributional considerations or the pursuit of other societal values. This would generate detrimental inflationary biases due to intertemporal inconsistency or disturbance from some political business cycle.

Therefore, politicization “is broadly seen as a threat to CBI”.<sup>871</sup>

First, it would deviate central banking away from the ideal of specialized-expertise decision-making towards other partisan or sectional interests, or at the service of preferences other than those ingrained in the allegedly objective legislated mandate.<sup>872</sup>

Second, the increased public contestation would make it increasingly difficult for the ICB to produce effective policies because of conflicting preferences, or even to agree on the benefits of the outcomes.<sup>873</sup>

Third, the public contestation and criticism of CB policies by political institutions and the public would raise disagreement on the goodness of their policies’ outcomes, thus eroding the credibility, and consequently the policy effectiveness and output legitimacy of CBs.<sup>874</sup>

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<sup>868</sup> (CONTESSA, 2020).

<sup>869</sup> (MCNAMARA, 2002), (CONTESSA, 2020).

<sup>870</sup> (GOODFRIEND, 2001: 27), (KING, 2004: 5), (TUCKER, 2018), (SKINNER, 2021).

<sup>871</sup> (DIETSCH ET AL, 2018: 17).

<sup>872</sup> (TORTOLA, 2020).

<sup>873</sup> (SCHMIDT, 2019).

<sup>874</sup> (HÖGENAUER, 2019: 294), (TORTOLA, 2020), (SCHMIDT, 2019).

Chapter 7 demonstrates the normative compatibility of politicization of central banking with CBI under conditions of specialized professionalism, impartiality and good enough democratic control.

The pluralistic framework of independence, including the role of the competition of Influencers, ensures the compatibility of politicization with independence.

## 6.2. DEFINING POLITICIZATION AND POLITICAL CHARACTER

The concept of politicization is popular yet polysemic across literature on central banking, military autonomy, judicial independence, and European integration.<sup>875</sup>

Politicization of *outputs* of independent institutions exists when they enter the traditional turf of politics to (a) decide *questions that are substantively political* or (b) *encroach on the classic political process* beyond a “non-controlling” advisory role in their area of expertise, namely by interfering in contested political debates or electoral competition, or even taking political offices.

In the opposite direction, politicization of inputs occurs when political actors interfere with or encroach on the independent process.

In another overlapping approach, politicization means the increase of *political or public contestation* of the authority and decision-making of non-majoritarian institutions.

It materializes in three dimensions: (i) *public salience* of decision-making and issues that were assumed to be under the radar for being too technical or non-distributional; (ii) *polarization* of issues that were expected to be fundamentally settled by the polity; and (iii) *expanded access and participation of the public* in the debates and choices that were thought of as being delegated away to independent institutions.

Such intensified political contestation may unfold amongst elected representatives, political parties, public opinion, and Special Interest Groups.

Technical and stakeholders’ criticism is only public contestation when it becomes a general political conflict through relevant public resonance and confrontation of societal demands.

Politicization does not necessarily weaken CBI. It is problematic only when disagreements, power politics, and interbranch struggles (are likely to) succeed in deviating institutions from the integrity of their independent, specialized, and expert decision-making process, even if indirectly and with a time lag. Influences should be dealt with in the trivalent approach described above.<sup>876</sup>

The independent institutions’ capacity to withstand pressures and political contestation is a key justification for their independence that exists *because of* and *to stand* (certain degrees of) politicization.

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<sup>875</sup> (LEITÃO AMARO, 2022d, for references and details on this section).

<sup>876</sup> Ch. 3.3.3

The consequence of politicization is an expansion of the space of *substantive* politics and a dislocation of the locus of political contestation.

The *formalist* – organic and procedural – definition of the political is rejected. In this definition, political *issues* are (only) those *decided* by the two traditional political *branches* (Legislative and Executive) through the electoral-representative political *process*.

The electoral-representative political process has a continuing and predominant, but not exclusive role, in the overall functioning of government and in making substantive political choices.

However, modern constitutions are polycentric or pluralist, implicating a *substantive* conception of the political, and thus the amplification of the institutions with the power to manage *fundamental* conflicts and disagreements in terms that are enforced continually within a given territory.

Neither all public powers and authorities, nor most public discretionary decision-making are substantively political. The “distinction is mainly one of degree”<sup>877</sup>.

Political issues and choices are *fundamental* and *conflictual*, addressed by *decisions* on fundamental trade-offs, that make a *primary* determination and specification of objectives/ends and (arguably) the means to pursue them and choose the objective criteria that legitimate (re)distributive effects and risks.

Under conditions, some political choices are better delegated to independent institutions and their independent, specialized, and expert processes.

The *political processes* include but are not limited to the electoral-representative/partisan/majoritarian processes.

The *political character* of the choice is not eliminated simply by the (re)assignment of the decision-making power to different, independent institutions or processes.

One illustration of this substantive notion of politics, where independent institutions have a decisional role, was the multilateral and multidirectional dialogue between the GCC, CJEU, Bundesbank, and ECB in the *Weiss* and *Gauweiler* cases. Four independent institutions clashed about the validity of two unconventional monetary policy initiatives (PSPP and OMT, respectively). These cases were of seismic importance to the European polity (ies) in all the senses of political importance: fundamental substantive choices were hanging in conflicts with intense salience, polarization, and public participation.

Mature ICBs are a paradigmatic example of such non-majoritarian institutions that make political decisions through a process that is also political, albeit different from the classic partisan political processes.

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<sup>877</sup> (SÉRVULO CORREIA, 1982: 29-30).

Liberal democracy is pluralist or polyarchic<sup>878</sup>.

It seeks the multiplication of locations and differentiated forms of public contestation. The claim that *politics is necessarily partisan*<sup>879</sup> only holds if partisan means *factional* in the Madisonian sense, as different sides in some political conflict.

There are *political actions, contestation, and decisions* outside and beyond elections, the Legislature and Executive, and political parties. Politics may be non-partisan and non-electoral-representative.

Pluralistic CBI materializes the existence of this form of non-partisan politics.

### **6.3. POLITICAL CENTRAL BANKING**

Chapter 7 demonstrates that ICBs matured and developed democratic and contestation-suitable characteristics and devices while preserving their independence and advantages of specialized expertise and impartiality that warrant them the normative conditions to legitimately make substantive political decisions under conditions of public contestation. In particular, they built democratic credentials, indirectly through a “good enough”, *ex ante* and *ex post*, democratic control-cum-independence, and directly through “new forms of democratic connections” with the public.<sup>880</sup>

The rest of this chapter demonstrates, on *descriptive* grounds, that CBs (i) *de facto* decide political issues; (ii) have *de jure* been trusted to make substantive political decisions on money and credit; and (iii) interfere in the electoral-representative process in a two-way dynamic with classic political actors.

The politicization of ICBs is, in all senses of outputs and inputs, including public contestation, both a fact and a choice.<sup>881</sup>

ICBs are political actors<sup>882</sup>, and CBI “might be better understood as a social process that is highly political in both its sources and effects”.<sup>883</sup>

Central banking, monetary policy included, “is inherently political, with important distributional and power-political consequences”<sup>884</sup>. It involves “trade-offs among competing goods and will benefit some constituencies more than others”. It is not just a technocratic but also a value-laden activity”.<sup>885</sup>

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<sup>878</sup> (DAHL, 2000).

<sup>879</sup> (McNAMARA, 2002: 53-4).

<sup>880</sup> (VAUCHEZ, 2016).

<sup>881</sup> (DIETSCH ET AL., 2018: 21).

<sup>882</sup> (JONES & MATTHIJS, 2019: 128), (VAN’T KLOOSTER, 2021), (RILES, 2018: 7).

<sup>883</sup> (McNAMARA, 2013: 68),

<sup>884</sup> (BINDER ET AL., 2020), (TRICHET, 2020: 5).

<sup>885</sup> (McNAMARA, 2002), (RILES, 2018: 7), (VAN’T KLOOSTER, 2020: 7-10).

In its 1993 Maastricht judgment, the German Constitutional Court acknowledged monetary policy as “[a] substantial political sphere”, while accepting that “most of the functions of monetary policy have been rendered independent and assigned to an independent central bank”<sup>886</sup>.

“It is practically impossible not to entrust experts with making value judgments on our behalf”<sup>887</sup>. The illusory clarity of the distinction between technical and political does not hold for policymaking in general<sup>888</sup>, but even less for policies such as the macroeconomic that involve “some mix of both...highly technical questions and highly political” issues and of value and distributional questions with complexity and technicality.<sup>889</sup>

(Superior) expertise does not equate with certainty, omniscience or incontestability, and central bankers themselves are heterogenous, with differences of knowledge and preferences that impact their substantive (political) choices. They differ in their interests and are motivated by various potential sources, including institutional constraints, cultural contexts, substantive preferences, but possibly also direct partisanship or sectional favoritism, and they often strategize away from what they would prefer as the optimal policy choice.

### **6.3.1. CENTRAL BANKS MAKE SUBSTANTIVELY POLITICAL CHOICES**

The historical conditions of the decades of the Great Moderation contributed to the illusions of the political lowness of conventional monetary policy and the possibility of a narrow focus on price stability, shielding ICBs from the various senses of politicization.

The relative macroeconomic stability and muted inflation concerns during that period dispensed with painful or contentious countercyclical policy actions and cultivated a fantasy of “end of history”. The illusion was that societies had found the definitive macroeconomic institutional arrangement, business cycles had been tamed, preferences over macroeconomic policies had been settled, and ICBs had the knowledge, clear democratic mandates, and appropriate tools to successfully stabilize prices and the economy,<sup>890</sup> without generating primary fundamental, i.e., political, conflicts.

Episodes of volatility, and mild and short crises, were dealt with by minor policy adjustments, small changes in interest rates, and (coordinated) interventions in foreign exchange markets that triggered not very pronounced side effects or public contestation.

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<sup>886</sup> (BVerfG, 89, 155, 12 October 1992).

<sup>887</sup> (CONTESSA, 2020).

<sup>888</sup> (LINDSETH, 2010).

<sup>889</sup> (BLINDER, 1997: 118-9), (RILES, 2018: 53).

<sup>890</sup> (US COUNCIL OF ECONOMIC ADVISERS, 2000: 74-77), (WEBER, 1997).

The “extraordinary exercise and accumulation of power by central banks” and the rise of their centrality since the GFC (Chapter 1) made their politicization more explicit and contested<sup>891</sup>. Therefore, it became common to associate politicization with the recent evolution of CBs, with the multiplication of their mandates, the expansion of their toolkits and balance sheets, their closer policy coordination with the respective treasuries, and the increased macroeconomic reliance on CBs.

With inflation subdued during the rollercoaster period of 2007-2021, all eyes were on other societal concerns and disputes, starting with financial stability, and then moving to short-run economic stimulation, sovereign solvency, and later climate change and mounting inequality. The uncertainty and disagreement surrounding these innovations captured (and fueled) the debate on the limits and nature of CBs’ interventions.

Traditionalists kept calling for the retreat of ICBs back to that mythological place where narrow price stability was a politically settled and technically solved problem. Many seemed to have forgotten the Great Inflation, which was publicly contentious and salient, technically debated, and intensely conflictual in terms of values and interests.

If in the past 35 years, CBs had faced a 1970s-like inflation shock and the need for a VOLCKER-like policy response, or the German 1920s hyperinflation and SCHACHT’s tough stabilization policy<sup>892</sup>, the myth of “low politics” monetary policy might have never spread.

With the current inflation burst across Western advanced economies, the same traditionalists are claiming vindication, concluding that the inflation surge is to blame for the politicization and the “mission creep” that has distracted CBs from the fundamentals of monetary economics and narrow mandates.

Some will respond that greater politicization was occurring for more than a decade, but the spectacular rise in broad monetary aggregates materialized only in 2020 (and inflation in 2021)<sup>893</sup>, therefore the explanation for the inflationary episode is be due to politicization, but other factors, such as epistemic limitations under uncertainty, policy errors or inertia, or a reflection of changes in economic thought or in the societal balance of preferences and interests when combating a crisis like the pandemic.<sup>894</sup>

If the jury is still out on the causes, policy reactions, and evolution of this post-pandemic inflationary episode, it certainly comes as a reminder of how politically charged – substantively conflictual, technically contentious, and publicly contested – the traditional CB function of fighting inflation might be.

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<sup>891</sup> (AMTENBRINK, 2019: 178).

<sup>892</sup> (CHERNOW, 1990).

<sup>893</sup> (WOLF, 2022, noting that broad monetary aggregates did not expand in the GFC when the monetary base did).

<sup>894</sup> (LEITÃO AMARO, 2023b, on the application of the model of pluralistic CBI to the current inflationary burst).

## a) POLITICAL CHOICES IN CONVENTIONAL MONETARY POLICY

Since mid-2021 the inflation problem and the CBs' choices of remedial actions have been front and center in political and popular debates. Different policy alternatives involve significant impacts on various cherished societal objectives and interests, such as the purchasing power of millions, the financial burden for indebted sovereigns and privates, jobs, and the real value of savings and incomes.

Heated technical debates and disagreement have flared, even amongst mainstream academics and expert policymakers, over the cause, nature, and expectations of inflation – supply-sided and/or demand-sided; permanent or temporary; high or moderate – and about the appropriate policy decisions – if, when and how much to change interest rates and reduce the balance sheet; and on the optimal trade-offs and impacts on price stability, financial stability, and economic stabilization, growth, and employment.

The outbreak of a war in Europe with the Russian invasion of Ukraine left CBs with even tougher choices on how to cope with high inflation, the risks of a recession and the spillover effects from the war on the financial system<sup>895</sup>. Politicians and so many other factions took the podium to express conflicting preferences and defend interests over what the monetary and financial policy stances should be.

Scientific certainty blurred and the choice and calibration of policy tools involved fundamental decisions about the balance of conflicting values/preferences and interests that were contested, technically and politically.

Multiple mandates, unconventional policies and financial crises may increase complexity, but the potential for technical uncertainty, subjective and contested judgments exists even without them.

The post-pandemic inflationary pressure highlighted that the political character is congenital to central banking, it existed before the GFC, even in CBs with narrow price stability mandates closer to the traditional Tinbergenian ideal (which never existed in its purity). GOODHART acknowledged that monetary policy cannot “be totally innocent of trade-offs, despite its one objective, one instrument format. In particular there is a short-run trade-off between inflation and output”<sup>896</sup>.

No CB got a price stability objective sufficiently specified in its legislative mandate, nor does the legal primacy (or uniqueness) of the price stability objective entail a legislative authorization for the CB to disregard all *short-term* trade-offs with real variables and side effects<sup>897</sup>.

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<sup>895</sup> (FINANCIAL TIMES EDITORIAL BOARD, March 15, 2022).

<sup>896</sup> (GOODHART, 2003: 100-101).

<sup>897</sup> (PADOA-SCHIOPPA, 2000).



ICBs substantively contribute to or specify the definition of price stability, in which they also have to ponder side effects in their policy choices.

The BoE has the Executive regularly specifying its stability objectives, but the CB itself is deeply involved through substantive contributions and dialogue with the Executive.

Most ICBs, however, take it upon themselves to specify their mandates, to determine what price stability legally is, and how it is balanced with real variables and goals (at least) in the short term. In their review of the monetary policy frameworks, they redefine how price stability is specified, quantified and measured, based both on technical knowledge and balancing of values and priorities.

These *ex ante* self-commitments have evident political character, and their amendments amount to substantial shifts in policy and the balance of values, highly consequential for the subsequent concrete policy decisions and their nominal and real effects.

Both the Fed's and ECB's recent strategy reviews were highly political in various senses. They adjusted the definition of price stability considering new knowledge, changed contexts, and evolved societal consensus on the balancing of substantive priorities (on employment, financial stability, access to housing, economic inequalities, and climate change). They pondered the distributional impacts in terms of sociodemographic groups and territories.

Those were notorious and contested exercises that got more public attention than most legislative initiatives in the period.

Finally, and because central bankers grasped the political relevance of such exercises, they were conducted with a fundamental contribution, direct and indirect, from the public. Both the Fed and ESCB promoted broad public debate and input in various forms, including events with the academic community, civil society organizations and the public at large, exchanges with Parliaments, and thousands of direct responses and written contributions submitted online<sup>898</sup>.

When CBs move from this second-order policymaking involved in reviewing monetary framework, to concrete first-order monetary policy decisions such as changing the (outside) money supply, altering reserve requirements, setting interest rates or the collateral policy, they still have to balance priorities and consider distributional impacts. Their complexity and technicality does not eliminate the underlying fundamental conflicts and, thus the political character.

It is worth exploring BLINDER's approximation of monetary policy with tax policy. BLINDER identifies similarities between the two macroeconomic policies in terms of "a long time horizon", "constant temptation to reach for short term gains that can have negative long-run

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<sup>898</sup> (ECB, An overview of the ECB's monetary policy strategy, 2021), (FED BoG, Fed Listens: Perspectives from the Public, 2020).

consequences”, need for “considerable technical expertise”, and “susceptib[ility] to interest-group politics”, to conclude that in the “overall...the similarities seem far greater than the differences”, and “the reasons for removing the monetary policy from the political thicket...apply just as well to many other aspects of economy policy”, namely tax policy. BLINDER goes from there to suggest “similarly turning tax policy over to an independent agency”.<sup>899</sup>

However, the identification of these and other similarities can be turned on its head, not to entertain this possibility of independentizing tax or fiscal policy, but to confirm that even the very conventional monetary policy may involve substantively political choices, i.e., fundamental innovations to manage fundamental conflicts.

Both policies materialize in changes in policy stances (expansionary to contractionary, and vice-versa) or in percentages in rates (of interest or tax) that affect both *generally* the economy as whole, and *distinctively* certain sectors and individual positions, rights, and wealth.

The fact that tax policy is more explicitly particularistic (it operates directly on the individual agents’ wealth or income), and conventional monetary policy is more generalist on its face (it operates directly on the monetary base and the inside money provision by financial institutions, and only indirectly on the access to money and credit by individual agents in general), or even that the latter’s distributional effects tend to even out over time, are not reasons to turn a blind eye to the significant particular and discrete effects of monetary policy.

In fact, “changes in interest rates can create redistributions in income that may be just as large as those that result from changes in taxes”<sup>900</sup>. They generate redistributive impacts outside the budget, but which entail implicit or explicit taxation or subsidization of particular groups or activities. In fact, monetary policy redistributes not only current wealth, but also risk-contingent future wealth<sup>901</sup>. “Any institution that can affect the purchasing power of the currency is perceived as potentially affecting the level and distribution of wealth among the participants of that society, hardly an inconsequential issue”<sup>902</sup>.

Empirical analyses have confirmed beyond doubt that monetary policy has consequential and asymmetric effects on particular sectors and individuals, i.e., it has a significant distributional footprint<sup>903</sup>. “Redistributive struggle over monetary policy is endemic to what central banks do”.<sup>904</sup>

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<sup>899</sup> (BLINDER, 1997: 122 and 1998: 59), (GOODHART, 2003: 96-99).

<sup>900</sup> (WREN-LEWIS, 2012: 67).

<sup>901</sup> (BRUNNERMEIER & SANNIKOV, 2013), (ZILIOLI, 2016: 175-6).

<sup>902</sup> (GREENSPAN, 1996), (MCNAMARA, 2002: 47-48).

<sup>903</sup> (BIS, 2021), (TUORI, 2016), (DEUTSCHE BUNDESBANK, 2016).

<sup>904</sup> (RILES, 2018: 60, 58), (MCNAMARA, 2002: 53), (SKIDELSKY, 2018: 32).

Both the underlying phenomena of price dislocations and of financial instability (liquidity and solvency conditions), and the policies to manage them, entail serious distributional impacts. A refusal to act with an argument about the distributional consequences of whatever policy measures has to be confronted with the distributional consequences of inaction, i.e., of tolerating the effects that price dislocations and financial instability would generate if left to themselves.<sup>905</sup>

#### **b) IN UNCONVENTIONAL POLICIES AND OTHER FUNCTIONS**

The succession of institutional and policy innovations in response to a succession of three major crises – GFC, Eurocrisis and the pandemic – only made clearer that CBs make direct, value-choices and decisions with discrete distributional effects<sup>906</sup>.

Financial stability and unconventional monetary policies have much stronger distributional consequences than conventional monetary policies<sup>907</sup>.

Collateral policies, programs of *selective* purchase of public and private financial assets, and *targeted* long-term lending facilities have immediate distributional implications. Their selection of certain eligible financial assets and sectors for privileged lending corresponds to the preferential treatment of the respective issuers and borrowers who benefit from their conditions of financing and investment<sup>908</sup>.

It creates winners and losers amongst market competitors for financing, both amongst borrowers (depending on whether their assets are selected or not) and amongst lenders (depending on which financial products they invest in), and between socio-economic groups of stakeholders.<sup>909</sup>

When the monetary authority converts into money only some of the outstanding obligations, the practical effect is to decide that some, but not other industries, banks and governments deserve to be supported for the general good, and so their debts are monetized. It naturally leaves the unprivileged others on the losing side resentful.

After starting to buy corporate bonds and make certain target lending, ICBs have been accused of getting into the business of credit allocation, of developing a “kind of hidden industrial policy with distributive impact”<sup>910</sup> and of departing from “the core central bank task [that] is to steer

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<sup>905</sup> (KEYNES, 1923, Ch. 1), (DORN, 2022).

<sup>906</sup> (FERNÁNDEZ-ALBERTOS, 2015), (JONES & MATTHIJS, 2019: 137).

<sup>907</sup> (DE HAAN & EIJJFINGER, 2016: 7).

<sup>908</sup> (FOSTER, 2017), (BUIITER, 2014: 270).

<sup>909</sup> (JONES & MATTHIJS, 2019: 136), (RILES, 2018: 58-60), (DORN, 2022).

<sup>910</sup> (DIETSCH ET AL., 2018: 32).

aggregate demand in a neutral way without favoring a particular sector or actor over another”<sup>911</sup>.

Central bankers try to deflect such criticism, arguing that their collateral policy regulating the selection of assets and counterparties is guided by the principle of market neutrality. Thereby they would just *follow the markets’* assessment, discipline, and allocations, purportedly abstaining from introducing their own valuations and allocative judgments.

However, this argument is questionable: (i) it downplays the substantive importance of the criteria defined by the CB (eligibility, limits, capital keys, etc); (ii) it disregards, protracts, and potentially amplifies the market failures, its shortcomings as a price signalling mechanism, and the biases that result from extraordinary market concentration (e.g., credit-rating agencies, market power of a few securities’ intermediaries, and market-makers); and it underplays how CBs’ intervention distorts the market’s playing field and deforms or mutes its signalling ability. Furthermore, the new prudential functions threw CBs further into particularistic and distributional decision-making. Macroprudential measures constraining lending conditions, such as ratio caps like Loan-to-Value, Loan-to-Income, and Debt-Service-to-Income, and microprudential supervisory measures that require banks to raise capital and shed assets or that limit particular or sectoral exposures of individual financial institutions have a particular and direct impact on groups or sectors of economic agents. They require “political, as well as technical, assessments”<sup>912</sup>.

Banking supervision and the complacency thereof have distributional consequences<sup>913</sup>. The BIS recently stated that “[c]entral banks can also help mitigate economic inequality wearing their “non-monetary hats”, notably as prudential authorities, promoters of financial development and inclusion, and guardians of payment systems.”<sup>914</sup>

One traditional function that is going through a profound transformation that requires the ICB to make fundamental value choices is the issuance of money. The digitalization of money presents such seismic threats and opportunities for sovereign money, that almost all major CBs are exploring or testing the creation of CBDCs.<sup>915</sup> CBDCs may have great disruption potential, depending on the design choices the CB makes.

The more ambitious forms, the tokenized or account-based retail CBDCs, increase the powers and possibilities of the CB to program and manage each unit of money. They would open doors to hyperparticularistic micromanagement of sovereign money that could enhance the monetary

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<sup>911</sup> (STRACCA, 2018: 62-66).

<sup>912</sup> (EUROPEAN UNION CENTER OF NORTH CAROLINA, 2013).

<sup>913</sup> (BERNANKE, 2015: 102).

<sup>914</sup> (BIS, 2021).

<sup>915</sup> (LEITÃO AMARO, 2022a).

policy transmission and be programable to support many other goals. The development of CBDCs involves choices of architecture and design, which have a fundamental political character and are entirely in the hands of ICBs as exclusive monetary policymakers.

### c) IN CRISES

The value-laden and distributional decisions of ICBs are even clearer in moments of crisis, where they exercise the discretionary roles of LOLR and MMLR for countries, banks, and even non-banks. They choose which banks and countries are cut off from access to liquidity and external finance, and which are saved and which are left to fail. These are, truly, live-or-let-die decisions. Even “technical parameters such as haircuts became vehicles for extremely important policy decisions”.<sup>916</sup>

ICBs decide who bears the brunt or the heightened risk in liquidity squeezes – shareholders, creditors, depositors, or taxpayers – and to what extent<sup>917</sup>.

That is immediate and at least temporary redistribution.

The THORNTON/BAGEHOT prudence required in the LOLR function – lend only *to solvent firms, against good collateral, and at penalty rates* – is expected to minimize the risks of losses and of permanent redistribution. But the risk remains, and the CB has ample discretion.

To mitigate moral hazard, the availability and conditions of the LOLR have remained largely implicit and in the statutory penumbra. Still, lawmakers in the UK, and more recently in the USA, have required the CB to get prior approval from elected officials, namely the Executive branch through the Treasury, to engage in especially risky emergency lending.

When problems deteriorate from illiquidity to insolvency, decisions venture further into distributional territory.

Post-GFC and the pandemic, major CBs adopted “go-direct and targeted” strategies, for instance when they become MMLR or when the BoE launched its direct lending facility to the UK Treasury, or the US Fed’s highly targeted facilities to provide funding to financial institutions originating loans to specific entities, including the novel Mainstreet Lending Program for small and medium-sized companies considered financially sound, and the Municipal Lending Facility for selected subnational governments. So far, the ECB’s TLTRO has been “targeted” but not “direct”.<sup>918</sup>

CBs that are resolution authorities (or intervening supervisory authorities) have to make very particularistic decisions, some more technical – on whether the bank is failing or likely to fail or its liquidation poses a threat to financial stability, but others that decide terminal distributional conflicts by allocating losses (and subsisting assets) amongst various categories of agents. The

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<sup>916</sup> (BRUNNERMEIER, JAMES & LANDAU: 322).

<sup>917</sup> (JONES & MATTHIJS, 2019: 136).

<sup>918</sup> (BARTSCH ET AL., 2020).

distributional intensity is so great that legislators go into more detail to reduce their discretion, establish the primary orientations and even require authorization of political branches for the injection of public resources to capitalize the failing institution or temporarily acquire public ownership.

#### **d) MULTIPLE HATS AND OBJECTIVES**

The multiplication of hats (macroeconomic functions) and of the objectives (including for the same function) assigned to CBs only increases coordination difficulties, the need for choices and compatibilization, and the potential conflicts of preferences and interests they have to manage. There are conflicts between the objectives of the different functions and also the various statutory objectives for the same function<sup>919</sup>: price stability and maximum employment or other real variables to be stabilized in the short term, price stability and financial stability (even if “financial stability is a pre-condition for price stability”<sup>920</sup>), or price stability and the support of government or Union goals.

The macro trends of the past decade and a half seemed to call for a rethinking of those balances. With such vague legislative mandates and a reality that does not wait to take its course and impact people’s lives, CBs have no alternative but to manage those conflicts of functions, objectives, underlying preferences and interests.

Solutions can rarely be all-or-nothing, proportionality is demanded, and thus trade-offs are needed. The vagueness of legislated mandates, even of those that hierarchize objectives, is such that many of the choices are really primary: fundamental conflicts in need of innovative solutions. They are substantively political decisions.

ICBs have been gradually assigned and proactively accumulated functions and objectives, and as a consequence, there is a growing need for internal management of value conflicts.

To structure substantive conflicts, lawmakers have relied on some legislative hierarchization of mandates, but also on the internal segregation of functions: the BoE with its three policy committees (MPC, FPC and PRA), the Fed with the FOMC for monetary policy and a vertical division of the functions between the Fed BoG and RBs, and the Eurosystem with the internally segregated SSM for banking supervision and a vertical distribution of functions and risk, including the assignment of emergency liquidity assistance to NCBs.

Notwithstanding the internal segregation, the institution, external perception, and the ecosystem are one and the same. The most powerful members tend to have some say (or even seat) across the segregated spheres, and there are implicit or explicit coordination mechanisms.

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<sup>919</sup> (BAILEY, 2021).

<sup>920</sup> (LANE, 2022).

In other words, the multiple hats of CBs sit on the same head.

From an external point of view, despite the internal segregation, the institution is held accountable as whole, for the entire and each outcome of the balances of objectives, values, and interests that were found (explicitly or not).

Even if the CB presents a separate face to speak for a segregated function or committee – for instance, the ECB’s head of the Single Supervisory Board, or the Fed Vice Chair for Supervision, or the BoE’s Deputy Governor for Financial Stability or the CEO of the PRA – the CB leader responds for the sum of the parts.

### **6.3.2. CENTRAL BANKS’ INTERVENTIONS /IN POLITICS**

Beyond that politicization in the sense of making substantive political decisions, there are other dimensions in which CBs’ outputs enter the politicians’ turf, interfering in their decisions. It is part of their dynamic, bidirectional relationship with the classic political actors, with mutual efforts to influence.

ICBs need to navigate multiple layers of domestic and supranational politics. They engage in activities associated with the classic political process, including the strategic and tactic dimensions of power politics. This involves negotiating and coordinating their policy room and course with the constitutional branches and communicating, listening, and bargaining the policies’ implementation and effectiveness with distinct players (markets, the public, fiscal policymakers, epistemic community), and ultimately shaping the policies’ content and outcomes.<sup>921</sup>

“[A]ll of this is political activity. The Fed is in and of Washington, not above it”<sup>922</sup>. CBs can but do not have to stay out of politics<sup>923</sup>.

They are also proactive and on the offensive, going beyond cooperative coordination, and seeking to materially shape the political decisions of the classic political branches and to influence their decision-making process. Such outward interferences can be described according to increasing degrees of impact.

#### **a) EXPRESSING VIEWS ON DEMOCRATIC POLICIES: ADVICE, ADVOCACY, AND MUSCLED PERSUASION**

In the softest version, CBs *express* views on issues under the purview of the Executive or Legislative.

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<sup>921</sup> (RILES, 2018: 13-4).

<sup>922</sup> (GREELY & SCRAGGS, 2018).

<sup>923</sup> (CONTI-BROWN, 2016: 51), (GREIDER, 1987: 117).

## Advice in the field of competence

Often that is done as part of the quintessential central banking function of providing advice, *within the field of competence*, to a government planning to act.

As unique centers of macroeconomic expertise and forecasting capabilities and as depositors of rare stocks of statistics and other information, their epistemic collaboration with legislators and executives is meritorious and *per se* needs not to disrespect the autonomy of any side.

All major CBs do provide such advice, as a matter of custom or legal obligation (to consult the ICB), solicited or as spontaneous recommendation, in their fields of competence, through informal channels (meetings, calls and other private interactions) or through formal devices such as written and public opinions and participation in the meetings of political branches.<sup>924</sup>

This advisory role is part of what some have defined as a collaborative relation between CBs and government<sup>925</sup>.

There is often a mutual obligation of political authorities to consult the CB, and of the latter to provide advice. The EU has constitutionalized and institutionalized this advisory function of the ECB to the EU institutions and national authorities<sup>926</sup>, and the BoE and other CBs have it in their statutory bases.<sup>927</sup>

## Views on other macroeconomic policies

On other occasions, central bankers express views about policies and issues not immediately under their responsibility. More frequent have been positions on the policy stance of fiscal or other macroeconomic policies which are interrelated and could benefit from some coordination. For about a decade since the GFC, central bankers have repeated, over and over, appeals for fiscal policymakers to take the appropriate fiscal stance, and for legislators and executives in general to promote supply-side “structural reforms” aimed at stimulating growth and employment. Frustrated with the proximity of the effective lower bound, they begged fiscal policymakers “to do their part”.

Recently Fed Chair POWELL refused to comment on “specific” fiscal options when questioned about the possible excessive scale of the new 2021 fiscal package<sup>928</sup>. It could be that the Fed was adjusting its approach on the tails of the also non-partisan Congressional Budget Office with its

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<sup>924</sup> (BERNANKE, 2015), (CONTI-BROWN, 2015), (KING, 2015), (JAMES, 2012).

<sup>925</sup> (MANETTI, 1994).

<sup>926</sup> Arts. 127 (4) and 282 (5) TFEU establishing obligations to consult the ECB. Also art. 132 (1) 3rd indent TFEU, and art. 4 ESCB-Stat.

<sup>927</sup> For the BoE, sects. 9L (2) and 9P BoE Act in financial policies, and sects. 17 (3) and 19 (4) in monetary policy. Also art. 13 Buba Act, sect. 14 (1) BoCan Act, art. 11 RBA Act, arts. 12 (2) (e) and 16-A (2) BoPrt law, ch. 2.art. 4 and ch.4.art. 1 SvB Act, and NRB Act.

<sup>928</sup> (POLITI, 2021).



self-restraint in not making recommendations on policy matters, i.e., not suggesting which option to choose<sup>929</sup>. Or it may just be that after years calling for more fiscal stimuli, faced with a serious divide – political, partisan, and also academic – on the possible impact of the proposals for a fiscal package, the Fed refused to participate in that specific polarized discussion and used neutrality as a convenient excuse.

However, advocacy is institutionally accepted at the Fed, whose Board expressly ruled that the System’s “directors are not restricted by the Board’s policy from contacting and lobbying legislators and others regarding legislation or legislative policy. Thus, directors may express their views, whether personal or on behalf of their employer or others, regarding any legislative matter, including the need for legislation and proposals to revise existing laws or pending legislation”<sup>930</sup>.

In the EU, although “the powers of the ECB do not include giving formal opinions in the framework of the multilateral surveillance procedure of budgetary positions and the surveillance and coordination of economic policies, the macroeconomic imbalances procedure, or the excessive deficit procedure... this has never prevented the ECB from actively contributing to the discussion on the economic policy guidelines of the EU, or the budgetary policies of the Member States, either before or during the crisis”<sup>931</sup>.

The ECB-GC members spent years calling for action from national authorities, often in different directions depending on the position of the respective economy. President TRICHET led “increases in fiscal communication from 2010” and he “came to be seen as one of the principal spokespeople for austerity in the Eurozone”<sup>932</sup> and DRAGHI, LAGARDE, and their peers tried to combine a general message for the complementarity and coherence of macroeconomic policies and the need to correct various macroeconomic imbalances with distinct tailored messages for Member-States<sup>933</sup>.

Probably, the most dramatic of the ECB’s *expressive* initiatives were the (in)famous 2010-2011 confidential letters co-sent by the President of the ECB TRICHET and the Governors of the NCBs of Ireland, Italy, and Spain to the respective governments setting out precise courses of action focused on measures to promote growth (“a comprehensive, far-reaching and credible reform strategy” on labor and product market aspects) and approve separate legislation to balance the

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<sup>929</sup> (RIVLIN, 2012), (JOYCE, 2015).

<sup>930</sup> (FED BOG, Policies Governing Directors: Political Activity).

<sup>931</sup> (BEUKERS, 2013: 1588).

<sup>932</sup> (DIESSNER & LISI, 2019: 11-12), (BEUKERS, 2013).

<sup>933</sup> (DRAGHI, 2015, 2017 and 2019), (LAGARDE, 2019), ECB, Opinion of 5 December 2011 on fiscal responsibility (CON/2011/96).

budget<sup>934</sup>. The detailed prescriptions in the letters, their timely coincidence with the roll out of the ECB's new Securities Markets Program (SMP) crafted to assist the peripheral countries under financial stress, the dramatic swings in the respective sovereign bonds markets around the date of the letter, and the political controversy generated by the letter publication<sup>935</sup> came to be interpreted as crossing a fault line. It goes beyond the issuance of expert opinion, and becomes institutional pressure in the form of *de facto* conditionality to access ESCB's unconventional monetary policy facilities.

At some point, these expressions on macroeconomic policies and their mix go beyond efforts of cooperative coordination as equals and become efforts to dominate.

### Opinions beyond macro policies

While in the expressive interferences above central bankers could claim to be constructively contributing to an "optimal overall policy mix" or complying with the full extent of their legal obligations<sup>936</sup>, other times they went beyond the fields of macroeconomic policies to comment or take political stances in some contested areas.

Central bankers across the world have been criticised for overstepping their brief, having opined about broader issues", per politicians or media request or their own initiative<sup>937</sup>. "GREENSPAN'S inclination to speak out on issues that are formally beyond the authority of the Fed was legendary, and he possibly inspired central bankers elsewhere to do the same".<sup>938</sup>

More recent contentious examples were the pronouncements of the Reserve Bank of India Governor RAGHURAM RAJAN on religious tolerance, the BoE Governor MARK CARNEY on climate change<sup>939</sup>, the Fed Chair YELLEN on inequality in income and wealth<sup>940</sup>, and the RB of Minneapolis President NEEL KASHKARI participated and enlisted the RB in a campaign for the amendment to the Minnesota Constitution that would create the "fundamental right to a quality education"<sup>941</sup>. Despite their effort to frame their observations in connection with macroeconomic aspects related to their remit, their expressions were still seen as political, even if not partisan<sup>942</sup>.

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<sup>934</sup> For the Irish Letters: <https://www.ecb.europa.eu/press/html/irish-letters.en.html>; The Italian letter: [https://www.ecb.europa.eu/ecb/access\\_to\\_documents/document/pa\\_document/shared/data/ecb.dr.par2021\\_0001lettertoItalianPrimeMinister.en.pdf](https://www.ecb.europa.eu/ecb/access_to_documents/document/pa_document/shared/data/ecb.dr.par2021_0001lettertoItalianPrimeMinister.en.pdf); and the Spanish letter: <https://www.ecb.europa.eu/pub/pdf/other/2011-08-05-letter-from-trichet-and-fernandez-ordonez-to-zapateroen.pdf>. (DIESSNER & LISI, 2019: 11-12), (TORTOLA, 2020).

<sup>935</sup> (DINMORE & ATKIN, 2011), (TORTOLA, 2020).

<sup>936</sup> Arts. 119 and 127 TFEU oblige the ESCB to support the general economic policies of the Union and contribute to sound public finances within the EMU.

<sup>937</sup> (THE ECONOMIST, 2017).

<sup>938</sup> (MARCUSSEN, 2009: 377, 388).

<sup>939</sup> (RAJAN, 2015), (FINANCIAL TIMES, 2015), (CARNEY, 2015).

<sup>940</sup> (YELLEN, 2014).

<sup>941</sup> (FEDERAL RESERVE BANK OF MINNEAPOLIS, 2020), (WILL, 2022).

<sup>942</sup> (WILL, 2022).

## Regulating opinions

There is an evident tension between the individual freedom of expression of central bankers and the restraint and containment within the scope of the institutions' responsibilities and a concern to neither damage the institutional reputation of non-partisanship, nor perturb its policy effectiveness.

Such tension is visible in the US Fed's voluntary Code of Conduct for Senior Officials, which states that "[t]hey should feel free to express their personal views concerning questions of System or public interest, but they should carefully consider whether their remarks might create public misunderstanding of the System's actions, or impair the effective formulation and implementation of System policies or lessen the prestige of the System". And elsewhere the Fed declares that the "Board's policy does not restrict the right of any director to express his or her personal political views in an individual capacity"<sup>943</sup>.

Furthermore, to prevent *expressions* at the service of particular interests or that tilt public debates to their favor, central bankers are generally prohibited from accepting compensation for paid speeches or writings on a subject that relates to their duties and responsibilities, and even unpaid speeches at meetings sponsored by profit-making organizations should be carefully pondered<sup>944</sup>.

The BoE and the ESCB also have limitations on their Codes of Conduct and other soft law sources, the former stricter than the latter<sup>945</sup>.

TUCKER suggests that central bankers follow an ethic of self-restraint, underpinned by informal conventions and norms established in a Code of Ethics on public relations<sup>946</sup>.

Central bankers' words are powerful, but they may step up their interferences from the *expressive* to the *constraining* level.

They can take *de facto* control of the policy course through their supposedly secondary or ancillary functions of advice and implementation. There is the risk that they provide manipulative/*controlling* rather than *supporting* advice, taking advantage of their informational and expertise asymmetries and their framing advantages vis-à-vis elected officials, which allow them to filter the possibilities and alternatives for legislative or executive choice<sup>947</sup>.

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<sup>943</sup> (FED BOG, Voluntary Guide to Conduct for Senior Officials, as revised November 2017: par. 6, 8), (FED BOG, Policies Governing Directors: Political Activity).

<sup>944</sup> *Idem*, (RBs' Codes of Conduct, dated between 2016 and 2018, sect. 7.2) .

<sup>945</sup> Art. 9 ECB, Code of Conduct, (ECB, Guiding principles for external communication for high-level officials of the ECB, 2019).

<sup>946</sup> (TUCKER, 2018: 564-7).

<sup>947</sup> (DIESSNER & LISI, 2019: 2).

CBs' forecasts on the economy, the calculation of their profits transferrable to the Treasury, statistics on external accounts balances, and information on the financial sector are amongst the information that political branches make use of in their fiscal and financial regulation powers.

## **b) PARTISAN AND POLITICAL ACTIVITY OF CENTRAL BANKERS**

One other path for central bankers to condition the classic political process is to become, themselves, politicians or engage in some partisan or electoral activity, including running for office or somehow leading, integrating or collaborating with a party.

TUCKER provides one of the rare insights into the political activity of central bankers, but a quite radical one. He states that central bankers should not be allowed to vote nor to participate in party politics, even in the private recesses of their minds. That "absolute bar on outside activities with any public policy content, other than those ex officio roles entailed by their service" means that "central bankers lose their right to participate in many other and broader issues confronting our society". He justifies that the price they pay for gaining an extraordinary public platform is to surrender some of the ordinary's citizen's rights of participation<sup>948</sup>.

The discussion on the limits of the participation of independent officials in partisan and electoral activity has been more thorough regarding judges and the military. It identifies a trade-off between the unelected officials' individual political rights of speech, association and to take public office, and on the other hand, the preservation of autonomy and independence of their institutions vis-à-vis the partisan and electoral processes<sup>949</sup>.

The conclusion is that the solutions ought to be balanced, pondering the nature of the participation and contribution and the degree of contestation of the debate or election. The more partisan and contested they are, the more such political participation threatens independence, creating a risk perception of jeopardizing the impartiality that society and affected interests expect from the independent officials and their institutions as a whole<sup>950</sup>.

CBs vary in their approaches to the problem, either relying on an ethics of self-restraint as the ESCB does and TUCKER suggests, or opting to issue internal codes and other soft law rules of conduct to establish limitations, incompatibilities, and prohibitions on political participation by central bankers that may cover both board members and top-managing staff.

For instance, the Fed prohibits its directors, officers, and employees from running for partisan political office, and its officers from participating in political campaigns and from organizing or

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<sup>948</sup> (TUCKER, 2018: 543, 564-7).

<sup>949</sup> (KOMMERS, 2001: 137-9), (MIRANDA, 2012), (CONSULTATIVE COUNCIL OF EUROPEAN JUDGES, Opinion (2002) nr. 3, §27-36, 49). Germany is exceptional in allowing judges to run or be appointed to political offices. (German Judiciary Act, sect. 36).

<sup>950</sup> According to the ECHR it should be employed an objective standard of the reasonable impartial observer.

leading partisan activities or bodies. But it allows all of them to exercise individual political rights of voting, expressing a private opinion, contributing with funds and indicating preference for a political candidate for public office<sup>951</sup>.

The BoE allows its officials, governors and policy committee members included, to stand for local or national elected office, subject to prior consent from the Bank and to the candidate taking unpaid leave while running and resigning from the Bank if elected<sup>952</sup>. Other political activity that is likely to include involvement in a party organization, fundraising or campaigning ought to be notified to the Bank.

Both banks are more open and even encouraging of non-partisan public services and community or charity roles<sup>953</sup>.

It is common to find legal norms forbidding central bankers to hold elected public offices in the Legislature and/or Executive as in the Fed, BoE, BoCan, BoFra, Bolsr, RBNZ, SNB, BoSpa<sup>954</sup>.

Rarer, though, are the explicit legal prohibitions on leaders to “hold positions of a political nature” (Bolta), to “be employed by the central administration of a political party” (Riksbank), to become a candidate to “any elected public office” or “an officer of any political body” (BoJ), and to “join a political party” and be involved “In political movements” (Bank of Korea).<sup>955</sup>

### **c) POLITICIZED FOOTPRINT AND QUASI-FISCAL POLICIES**

The interdependence and spillovers between central banking policies and other macroeconomic policies and the CB’s role as banker to the State – including services from fiscal agency to LOLR to sovereign governments – enable it to materially constraint the policy *room* and *choices* of DRs, not only in the obvious cases of fiscal policy, external monetary policy and financial regulation but also in areas such as foreign policy.

In general, the relative increase in the power or centrality of ICBs, supported by the absolute expansion of their powers and the ascent of their public standing, means that they weigh relatively more in the determination of the country’s mix of policies. This gives them structural power in (macro)economic governance and the capability to effectively condition the policy programs of the political branches.<sup>956</sup>

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<sup>951</sup> (FED BOG, Policies Governing Directors: Political Activity), (RBs Code of Conduct: section 7.3.), (FED BOG, Roles and Responsibilities of Fed Directors, 2019: 43).

<sup>952</sup> (BoE, Our Code, 2021: 15).

<sup>953</sup> Sects 7.3. RBs Codes of Conduct; BoE, Our Code, 2021: 12.

<sup>954</sup> Sect. 4 (13) FRA Act, Sect. (1) of Schedule 1, Sect. 6 of Schedule 2A and 5 (a) of Schedule 3 BoE Act; sect 6 (4) and 10 (4) b) BoCan Act; art. L. 142-3 (I) 5<sup>o</sup> BoFra Statutes; art. 11 (a) Bolsr Act; sects. 11 (2) and 46 (1) RBNZ Act; art. 44 (2) SNB Act; art. 26 of BoSpa Law on the Autonomy.

<sup>955</sup> Art. 16 (2) c) Bolta Law, Ch. 3, art. 1 (4) SvB Act, art. 26 of BoJ Law, art. 19 Bank of Korea Act.

<sup>956</sup> See Chapter 1, (DIETSCH ET AL., 2018: 16), (McPHILEMY & MOSCHELLA, 2019: 490), (FROMAGE & IBRIDO, 2018, p. 295).

In response to the GFC and the pandemic, CBs dramatically expanded their balance sheets and deployed policy instruments that may have a significant fiscal footprint. They might impact fiscal revenue through variation of seigniorage flows, balance sheet absorption of significant parts of sovereign bond issuance and even offering a financial backstop to governments of a regional monetary union. They may directly force additional fiscal expenditure if they come to need substantial capital injection or a fiscal backstop.<sup>957</sup>

This constraint operates in a negative and in a positive way, as a form of uncooperative coordination, but this time led by the independent authority.

The negative constraints reduce, in *aggregate*, the policy room or *stances* available for the Legislative or Executive to choose.

ICBs steal policy discretion from the classic political authorities, through their footprint or indirect effects and spillovers of their own policies into others. In this form of uncooperative coordination, they might influence without expressing any view on the policy options under the purview of the elected branches.

The ideal of *monetary dominance* reflects the traditionalist desirability and acceptance of this sort of constraint on the political process by CBs. It demands more than the rejection of fiscal dominance as it seeks to preserve CBs' first-mover advantage in the game of mutual interdependence.

ICBs may also impose a positive constraint when their actions press their own preferences on specific policy choices within the policy room that politicians were left with, nudging decisions through their quasi-fiscal policies.<sup>958</sup>

The CJEU tested and accepted that the ESCB may frame and shape its monetary policy programs in terms that generate *indirect economic effects* (i.e., as quasi-fiscal policies), as long as the measures were to pursue objectives assigned to the ESCB.<sup>959</sup>

The measure "will be compatible with the ECB's mandate only as long as it serves to 'support' economic policy measures and is subordinate to the ECB's overriding objective" of maintaining price stability<sup>960</sup>. On the other hand, in designing such measures "the ESCB is obliged, under Article 127(1) TFEU, read in conjunction with Article 119(3) TFEU, to comply with the guiding principle that public finances must be sound"<sup>961</sup>.

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<sup>957</sup> (REIS, 2017 and 2020), (MARSH & LAROSIERE, 2021), (SIMS, 2016: 13).

<sup>958</sup> (BEUKERS, 2013: 1602).

<sup>959</sup> CJEU, *Gauweiler case*, C-62/14: §51-52, 61.

<sup>960</sup> *Ibidem*, §132.

<sup>961</sup> CJEU, *Gauweiler case*, C-62/14: §61.

In other words, the ESCB is constitutionally mandated to deploy monetary policy instruments to serve fiscal policy aims (fiscal are amongst the economic policies) within two legal bounds, as long as it does not deteriorate price stability or the Member State's fiscal discipline.<sup>962</sup>

It has been argued that the CJEU's *Gauweiler* "judgment grants to the ECB much more than merely a supporting role. Given that the concept of the 'general economic policies in the Union' is very vague, the Court of Justice interprets that vagueness in favour of the ECB by allowing it not only a supportive but also a proactive role"<sup>963</sup>.

Such *functional view* provides the cover for CBs to launch policies using their legal instruments and subordinated to their constitutional mandate, but whose materiality overlaps with policies assigned to the elected branches.

The so-called *quasi-fiscal policies*, and the relevant *quasi-foreign policies* are paradigmatic examples of how blurred the line is that divides indirect spillover/negative constraint and substantive encroachment on classic political policies.

Quasi-fiscal policies of CBs "may entail implicit or explicit taxation or subsidization of particular groups or activities, but they all fall outside the budget"<sup>964</sup>. Salient examples are the post-GFC and pandemic "go-direct and targeted" strategies referred above.<sup>965</sup>

With its TLTRO, the ECB went "targeted" but, so far, not "direct". Still, it "entered fiscal territory with an intervention spiral of unprecedented dimensions" through "quasi-fiscal activities [that] can be seen as a combination of debt mutualization and outright public international credit provision undercutting the conditions that competitive capital markets would have required"<sup>966</sup>.

Other examples have been offered: local money creation from three sources (NCB issuance of ELAs, non-monetary policy assets within limits fixed in ANFA, and more importantly, overdraft of Target balances in consequence of collateral policy); and the sovereign-issued asset purchase programs that enable public credit without overloading the market (SMP, OMT, PSPP) and provide a sort of free-of-charge insurance (OMT)<sup>967</sup>.

Beyond the indirect economic effects, ICBs' policies may have political consequences in the sense of impacting the balance of forces in the partisan-electoral competition. They "may contribute to changes in the public mood and the emergence of particular political coalitions", trigger reactions and shape cultural and political attitudes and preferences of the public. Both

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<sup>962</sup> (TRIDIMAS & XANTHOULIS, 2016: 25).

<sup>963</sup> *Idem*, 33.

<sup>964</sup> (MACKENZIE AND STELLA, 1998).

<sup>965</sup> Ch. 6.3.1 c)

<sup>966</sup> (SINN, 2019).

<sup>967</sup> *Idem*.

the anti-experts and anti-elite populist, and the nationalist anti-globalization waves fed on the actions and omissions of CBs.<sup>968</sup>

To the extent that ICBs adjust their playbook – tools, transparency, explanations – to counter populism with trust and nationalism with cosmopolitanism and promotion of supranational cultures<sup>969</sup>, they are not only passive political takers but also political actors.

#### **d) QUASI-FOREIGN POLICIES**

In a world of financial globalization and complex interdependencies, CBs' policies and actions have relevant external dimensions, with impacts on and from other countries.<sup>970</sup>

Yet, the deployment of public authority and resources in support of or in conflict with foreign interests is a typical remit of foreign policy, which is a quintessential function of the classic political branches, traditionally under the leadership of the Executive<sup>971</sup>.

In that vein and because “the idea that the [CB] might have an independent diplomatic policy” poses a threat to “the traditionally executive role in foreign policy”<sup>972</sup>, external monetary policy, with its exchange arrangements, rates' policies and capital controls, is traditionally left under the direction of classic political branches.<sup>973</sup>

Nonetheless, CBs of advanced economies are trusted with significant discretion in the implementation (and even definition) of that external monetary policy and the management of foreign exchange reserves, with the potential to make foreign relations-sensitive choices. Moreover, CBs participate and interact in international organizations and institutional settings, including the BIS, IMF, G7 and G20, OECD, and FSB, where their positions and involvement in multilateral initiatives express and sometimes commit public authority and resources across borders<sup>974</sup>.

As a subset of such international relations, the *direct* relations and coordination between CBs assume extraordinary importance and have evolved significantly in the past century. “In this complex and interdependent world there is, and will continue to be, a clear need for structured, institutionalised central bank cooperation”, in general and especially in the periods of crises,

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<sup>968</sup> (RILES, 2018: 57), (SLAUGHTER, 2004: 37).

<sup>969</sup> (RILES, 2018: 37-42, 61).

<sup>970</sup> (CHOI ET AL., 2021).

<sup>971</sup> (HARRIS, 2015, recalling that in *Zivotofsky v. Kerry*, 135 S. Ct. 2076 (2015), the SCOTUS confirmed the US President's unitary and unequivocal conduct of foreign affairs).

<sup>972</sup> (CONTI-BROWN & ZARING, 2019).

<sup>973</sup> (LASTRA, 2015: 67, fn 145).

<sup>974</sup> (KAHN & MEADE, 2016), (SLAUGHTER, 2004: 37-64), (LASTRA, 2015: 407-427). (CONTI-BROWN & ZARING, 2019).



as the stabilizing success of the Plaza Accord (1985), and responses to the Asian financial crisis (1987), the GFC and the pandemic crisis clearly demonstrate<sup>975</sup>.

Central bankers meet and form a “transnational elite”<sup>976</sup>, leading an “executive transgovernmental network” that cooperatively coordinates actions and policy<sup>977</sup>. They go beyond relationship-building, information sharing, exchange of views and best practices, and cooperation in enforcement. They harmonize and standardize concepts and collectively originate, export, and mimic policies, overcoming differences in mandates, legal bases and even in national sovereigns, peculiarities, and specific interests<sup>978</sup>. That collective international policymaking is akin to diplomatic negotiations and rulemaking, albeit conducted outside the classic distribution of foreign policy powers to the political branches.

Such networks “may well be seeking to circumvent their own legislatures and the governments of countries with whom they did not think they could reach agreement, but less for the purposes of exclusion than of speed and effectiveness”<sup>979</sup>.

Furthermore, the current international financial system is asymmetric, with many peripheral or dependent countries *de facto* devoid of independent monetary policies, and a few “center countries” with reserve currencies, one of which (the USA) still enjoys the exorbitant privilege of issuing and controlling the dominant currency in financial and trade flows. The internal monetary policies of those CBs with dominant currencies have even more significant spillovers and impacts on foreign economies (and some potential spillbacks).

In effect, monetary or financial stability goals may collide with foreign policy goals. For instance, the negative spillovers in friendly or antagonistic foreign countries from ICBs’ domestic policies may counter the diplomatic efforts of the political branches.

Another friction could exist if politically decided financial sanctions against foreign aggressors encounter CBs’ resistance. The BoE misalignment with the UK Government’s sanctions on Germany in 1939,<sup>980</sup> and the ICBs’ action coordinated with Western governments’ response to the Russian invasion of Ukraine in 2022 offer contrasting tales.

Acknowledging the global financial interconnectedness, major CBs have developed instruments of coordination and of mutual liquidity support that have been decisive to preserve both the collective and individual interests of various countries.

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<sup>975</sup> (KAHN & MEADE, 2016, cit. CARUANA), (VALE, 2021: 12-14).

<sup>976</sup> (TUCKER, 2018: 549).

<sup>977</sup> (SLAUGHTER, 2004), (KAHN & MEADE, 2016).

<sup>978</sup> (GOODHART, 2021), (LASTRA, 2021), (KHAN & MEADE, 2016), (SLAUGHTER, 2004: 51-61).

<sup>979</sup> (SLAUGHTER, 2004: 49).

<sup>980</sup> (HARRIS, 2015: 413-4).

In the 1960s, Western CBs established swap agreements mostly to fund interventions in foreign exchange markets, but after decades of sparse use, they have gained a new dimension since the GFC, renovated during the pandemic. The institutional coordination between major Western CBs evolved from temporary swap lines, mostly in USD, into a network of standing swap lines between six of CBs – Fed, ECB, BoE, BoJ, BoCan and SNB, whose usage peaked in the GFC and again during the pandemic.<sup>981</sup>

In Europe, the ESCB established its own web of euro liquidity lines with non-euro CBs (beyond that network of six). Decisions on granting such liquidity lines are “based on a positive case-by-case assessment by the Governing Council” under a main framework with criteria.

The decisions on the establishment of those lines for foreign liquidity provision, and particularly the “selection of who gets favourable borrowing terms has indeed become more political”<sup>982</sup>.

Transcripts of US FOMC meetings confirm the complex hybrid nature of these decisions of extending or not cooperation and financial support to foreign CBs. These decisions that define whether to extend support, what levels of support to extend, and the type of restrictions that should be placed on each nation’s CB are technical but also substantively political. The lack of *ex ante* criteria leads to ad hoc decisions without public discussion.<sup>983</sup>

As Chair BERNANKE reportedly acknowledged, such decisions involve both “an economic perspective and a diplomatic perspective”<sup>984</sup>. Non-economic factors such as shared policy preferences and the reinforcement of economic alliances<sup>985</sup>, “[n]ational security, geopolitical concerns, historical experience, and past negotiations” also inform the decisions<sup>986</sup>.

The establishment of such swap lines amounts to a selective policy of foreign financial assistance of enormous quantitative significance to certain allies<sup>987</sup>. Moreover, while “[n]ormally the [US] President, subject to parameters established in law by Congress, is in charge of determining which allies get which benefits..., here supporting U.S. allies’ financial systems ...was left to the Fed alone to determine”<sup>988</sup>.

Additionally, and also combining monetary and non-economic reasons and weighing the international dimensions of their joint decision, CBs launched internationally coordinated interest rate cuts to fight both GFC and the pandemic crisis<sup>989</sup>.

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<sup>981</sup> (CHOI ET AL., 2021).

<sup>982</sup> (SPIELBERGER, 2022).

<sup>983</sup> (SAHASRABUDDHE, 2019), (SPIELBERGER, private exchange, 2021).

<sup>984</sup> (FED BOG, Transcript of the FOMC Meeting of October 28-29, 2008, 2014: 16).

<sup>985</sup> (SAHASRABUDDHE, 2019).

<sup>986</sup> (HARRIS, 2015: 404), (FED BOG, Transcript of the FOMC Meeting of October 28-29, 2008, (2014)).

<sup>987</sup> (CONTI-BROWN & ZARING, 2019).

<sup>988</sup> *Idem*.

<sup>989</sup> (FED BOG, Press Release Joint Statement by CB, October 8, 2008), (HARRIS, 2015: 405-7).

There is evidence that central bankers “understood and carefully considered” the “substantial foreign policy implications” of their policy decisions<sup>990</sup>, although they often decided against the interest of affected foreign countries<sup>991</sup>.

Through this discretionary implementation of external monetary policy, internal monetary policy spillovers, and internationally coordinated swap lines and facilities, CBs engage in quasi-foreign policies. They are not “explicit exercises in foreign policymaking beyond [their] statutory mandate”, but “monetary policy choices with secondary, albeit substantial, implications for foreign policy”<sup>992</sup>.

What is more complex, though, is that the CB’s approach may diverge from the preference of the democratic branches constitutionally entrusted with foreign policy. It has been argued that the “U.S. Federal Reserve System sometimes has imposed a globalist, cosmopolitan approach to international economic relations at loggerheads with the political preferences of the executive and legislative branches; at other times it pursues a form of rank nationalism at the expense of our allies”<sup>993</sup>.

Beyond external monetary policy and liquidity assistance, CBs also engage in relevant quasi-foreign policymaking in the context of international bank supervision and regulation. Through the Basel Committee on Banking Supervision (BCBS) created under the auspices of the BIS, “central banks negotiated an international regulatory framework of enormous, decisive importance”. The BCBS was created by and for CBs, without legislative authorizations, great information to or involvement of the political branches<sup>994</sup>. The GFC led the BCBS to overhaul the international regulatory framework for banks in Basel III.

That CBs have taken it upon themselves to collectively and internationally agree upon banking regulation and supervision harmonization is all the more puzzling because bank supervision and regulation are not now and have almost never been the exclusive purview of CBs<sup>995</sup>.

Democratic legislators, who always had a decisive say, in particular in terms of regulation, see their role *de facto* affected.<sup>996</sup>

Laws may constrain such quasi-foreign policies and regulate the external role of CBs, as they do regarding external monetary policy and participation within the international financial institutions.

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<sup>990</sup> (HARRIS, 2015: 400).

<sup>991</sup> (RAJAN, 2013).

<sup>992</sup> (HARRIS, 2015: 407, FN 85).

<sup>993</sup> (CONTI-BROWN & ZARING, 2019).

<sup>994</sup> *Idem*.

<sup>995</sup> *Idem*.

<sup>996</sup> *Idem*.

Yet, laws are generally silent on the cross-border spillovers of internal monetary policy and on the international coordination between CBs.

Regarding the Fed, it has been noted that no “legal authorities, conventions, or guidelines govern Federal Reserve Board decisions with implications for foreign affairs”, and the Fed made policy decisions such as swap lines and coordinated interest rates “without any *formal requirements* to consult or notify the political branches”<sup>997</sup>.

Whatever reforms should balance the need for democratic sovereignty and the risk of undermining the Fed’s independence and efficacy as a monetary policymaker.

One solution is a “more surgical mandate of greater disclosure of its international activities”, while rejecting “both the Fed’s historical positions, which would exempt most kinds of disclosures of its diplomacy, and the more searching congressional interventions that have been mooted in proposed legislation, such as requiring congressional pre-approval of the Fed’s regulatory diplomacy, or prohibiting the CB from participating in the forums where it concludes its international arrangements without going through notice and comment rulemaking before doing so”<sup>998</sup>.

Nevertheless, *informally* an ICB should closely interact with the political branches to ensure its monetary choices would not undermine the country’s foreign policy objectives, and work with domestic agencies and international entities like the IMF to understand the foreign affairs implications of their proposals.<sup>999</sup>

Concerning the ESCB, despite Treaties foreseeing a political predominance by entrusting the Council with establishing international agreements or issuing general orientation, the practice has been different. The Council opted for “fair measure of self-restraint from the outset”, not giving clear guidance and leaving the ECB with “quite some room for maneuver”<sup>1000</sup>.

When ICBs’ mandated functions have indirect effects on foreign affairs, it creates tension between CBI and the constitutional option for classic political control of foreign policy. The solution is not surrendering full control of the autonomous policies to elected branches and shutting down CBs from their international networks, reducing the formalized coordination between CBs and political foreign policy authorities, nor giving free rein but limited transparency and accountability to CBs on their international cooperation.

Direct multilateral cooperation between CBs is indispensable, but it should be better structured, institutionalized, and made open and transparent to prevent the central banking community

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<sup>997</sup> (HARRIS, 2015: 393-4), (CONTI-BROWN & ZARING, 2019).

<sup>998</sup> (CONTI-BROWN & ZARING, 2019).

<sup>999</sup> (HARRIS, 2015: 400), (FED BOG, Transcript of the FOMC Meeting of October 28-29, 2008, (2014): 16), (FED BOG & US DEPARTMENT OF TREASURY, 2009).

<sup>1000</sup> (SMITS, 2007: 1627-8).

from falling into cognitive biases such as groupthink and minoritarian biases such as financial dominance and capture by special interests, and to increase the democratic legitimization of such cooperation.

In that vein, the ESCB published in 2018 a brief document with “best practices” on international CB cooperation,<sup>1001</sup> that fall short of the abovementioned normative needs. They lack, for instance, promotion of transparency, diversity, and engagement with public contestation.<sup>1002</sup>

#### **e) IMPOSING CONDITIONALITY FOR A SPECIFIC COURSE OF ACTION**

Another way for the CB to interfere in the political process is by imposing conditionality (on their own policy tools) so that political branches adopt a specific course of action.<sup>1003</sup> This strategy was borrowed from a supranational financial institution, the IMF, which has long imposed a “link between the approval or continuation of the Fund’s financing and the implementation of specified elements of economic policy by the country receiving the financing”<sup>1004</sup>.

This conditionality strategy is unique to the ECB amongst major Western CBs, and it is only made possible by the idiosyncratic structure of the EMU with its institutional asymmetry, one single supranational and sturdily independent monetary authority and a multiplicity of national (political) authorities on economic policies.

The strategy unfolded after the GFC in face of the individual and collective inaction of political policymakers<sup>1005</sup>, of the limited fiscal and economic coordination within the EMU, and the emergence of the ESCB “as the ultimate manager of financial stability in the euro area...the referee on individual countries’ financial viability.”<sup>1006</sup>

It involves two dimensions: the CB (1) making its own policy tools conditional on the adoption by political policymakers of certain policies or reforms; and (2) intervening in the specific design of such (political) policies and reforms.

On the one hand, the CB puts pressure on the national government(s) to accept an economic adjustment programme or economic policy reform (leveraging such pressure) by making the access to its policy tools conditional on such acceptance. The ECB has applied such conditionality both on ordinary and emergency liquidity provision to banks – leveraging its collateral policy/risk control framework and its veto over Emergency Liquid Assistance by NCBs – and on the implementation of its sovereign asset purchase programs.

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<sup>1001</sup> (ECB, 2018).

<sup>1002</sup> See also (HARRIS, 2015: 415-6), (KHAN & MEADE, 2016).

<sup>1003</sup> (BEUKERS, 2013), (BRUNNERMEIER, JAMES & LANDAU, 2016: 343), (AMTENBRINK, 2019: 171-2).

<sup>1004</sup> (LASTRA, 2014: 468-483), (IMF, 2002).

<sup>1005</sup> (BEUKERS, 2013: 1608).

<sup>1006</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016: 336-7).

On the other hand, the CB has a role in designing, negotiating and directly co-supervising that conditionality whose content is not monetary policy-price stability driven, but concerns political economic policies and is aimed at macroeconomic stability more generally<sup>1007</sup>. The ECB gets involved in defining specific policy measures, either through a detailed message, as in the case of the infamous Italian, Irish and Spanish letters, or in its role of negotiating a Memorandum of Understanding in the Troika of the ECB, Commission, and IMF. In both cases, the CBs goes beyond the mere expressive signals explored above.

These CB interventions may be unsolicited, solicited, or mandated, and aimed at individual or collective reforms by Member States<sup>1008</sup>.

The two dimensions of conditionality are often but not necessarily cumulative.

The ECB could and does engage in the first dimension of conditionality only, for instance, when it rejects the eligibility of certain Member States' bonds for its monetary policy facilities based on the credit assessment by (private) credit rating agencies (CRAs)<sup>1009</sup>.

Such collateral policy action entails an implicit demand for some economic adjustment by the national authorities, but it relies on the private sector to "negotiate" with the national governments what an adequate economic adjustment would be<sup>1010</sup>.

The CRAs' "negotiation" involves various signals about the government's economic policy course and necessary adjustments in the publicized forms of actual changes of credit rating, outlook and watch, but also through substantive private discussions with government officials<sup>1011</sup>. The CRAs' downgrade of sovereign credit rating into a level of ineligibility triggers other indirect negative consequences for sovereign bond issuers<sup>1012</sup>, but the exclusion from a CB lending facility is undoubtedly potent per se, even if the CB does not get involved in detailing specific policy reforms. A recent confirmation of such importance is the ECB's Spring 2020 decision to keep utilizing pre-pandemic sovereign credit ratings, thus muting the fiscal and economic consequences of the pandemic and the policy responses thereto, and self-committing not to use that type of disciplining conditionality this turn.

Theoretically, the ECB could engage only in the second dimension of conditionality in the case where it did not leverage its position in the negotiation with and/or the monitoring of Member States' economic adjustment programs or reforms. But it seems unlikely that the ECB does not bring into the conversation the access to its monetary facilities and the exercise of its financial

<sup>1007</sup> AG CRUZ-VILLALÓN Opinion in *Gauweiler case*, §146.

<sup>1008</sup> (BEUKERS, 2013: 1601-3).

<sup>1009</sup> On the Eurosystem Credit Assessment Framework, <https://www.ecb.europa.eu/paym/coll/risk/ecaf/html/index.en.html>.

<sup>1010</sup> Critically (EIJFFINGER, 2012), (PAUDYN, 2013).

<sup>1011</sup> (AP GWILYM E ALSAKKA, 2011).

<sup>1012</sup> (DE SANTIS, 2012: 3).

supervisory powers, or that the outcomes of such negotiation and monitoring do not spill over into its lending, collateral, and supervisory practices.

It is when the two dimensions of conditionality are cumulated that they are most problematic. There are six channels for such bi-dimensional conditionality worth exploring: the first two concern conditionality on ESCB's conventional liquidity provision to banks, the third corresponds to conditionality on (unconventional) sovereign asset purchase programs, the fourth and fifth the participation of the ECB in the design, negotiation, and monitoring of economic adjustment programs, and the sixth the exercise of financial supervisory powers.

*Firstly*, the ECB has used the *risk control framework of its collateral policy* to influence Member States' fiscal and economic policymaking by making *normal* liquidity provision to their credit institutions "conditional" upon a specific course of action involving the government's adoption of certain economic adjustment reforms. It has been argued that in 2010-11 the ECB threatened to apply its reinforced risk control framework to reject liquidity support to Irish banks as pressure on the Irish government to ask for financial assistance<sup>1013</sup>.

The (then) ECB President's confidential letter to the Irish Minister of Finance of October 2010 is very revealing in this sense. It starts by acknowledging "the recent commitment of the Irish government to develop, in close cooperation with the Commission in liaison with the ECB, a multi-annual economic and fiscal adjustment strategy". It then proceeds by recalling that "the Eurosystem may limit, exclude or suspend counterparties' access to monetary policy instruments on the grounds of prudence" and also that the "assessment of the [ECB] Governing Council...depends very much on progress in economic and policy adjustment". The letter concludes with an admonishment that "[f]uture decisions by the Governing Council of the ECB regarding the terms of liquidity provision to Irish banks will thus need to take into account appropriate progress in the areas of fiscal consolidation, structural reforms and financial sector restructuring".

Both dimensions of conditionality are clear in this letter: the threat to use monetary policy instruments to force the adoption of specific policy reforms that the ECB is also involved in designing and negotiating.<sup>1014</sup>

*Second*, and often intertwined with the previous, the ECB can and has used its veto power over Emergency Lending Assistance (ELA) to the banks of a Member State to force the respective government to adopt an economic adjustment program or pass certain fiscal or economic reforms. ELA is provided by NCBs as the alternative for banks that are cut off from direct lending

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<sup>1013</sup> (BEUKERS, 2013: 1695).

<sup>1014</sup> On Cyprus in 2012 (BEUKERS, 2013), and Greece in 2015 (MOURMOURAS, 2017).

from the ECB, but the latter has the power to halt or cap its provision by a majority of two-thirds with the argument that it interferes with the objectives/tasks of the ESCB.

During the Eurocrisis it was visible in the cases of Italy, Ireland, Cyprus, and Greece how the power to cut off ELA is a powerful bargaining chop in the hands of the ECB to pressure Member States, by making ELA “conditional” upon certain measures<sup>1015</sup>.

In BEUKERS’s account, on March 21, 2013, the ECB decided it would reject ELA provision by the Central Bank of Cyprus in four days (March 25), if no program were put in place in Cyprus by that time that would ensure the solvency of the concerned banks. This effectively pressured Cyprus into – finally – accepting a program nine months after its request for financial assistance on June 25, 2012<sup>1016</sup>.

Two years later, in June 2015, the ECB played this same trump in Greece, freezing the ELA to Greek banks in response to the results of a popular referendum for the non-prolongation of the financial assistance and the economic adjustment program and the consequent halt in the negotiations between the Greek government and the Troika<sup>1017</sup>. In the following days, the Greek Government imposed capital controls and further internal restrictive measures<sup>1018</sup>.

Contradictory assessments have been made on whether the ECB’s decisions on ELAs to Greece, but they have been profoundly consequent, economically and politically, generating immense domestic and international public contestation.<sup>1019</sup>

These conditional provisions of liquidity work both as a negative incentive (threat of punishment by closure), and as a positive incentive (reward) since they open a window of opportunity for Member States to adopt reform. Cheap liquidity to banks makes it easier and even attractive for banks to buy government bonds and thus helps a Member State to refinance itself.<sup>1020</sup>

*Third*, the ECB has adopted a number of unconventional measures of assets purchase accompanied by or including pressure on Member States of the Euro Area to adopt both policy reforms individually and institutional reform collectively<sup>1021</sup>. The CB makes the acquisition on the secondary market of sovereign bonds “conditional” upon a specific course of action by national governments for whom the lower bond yields are an incentive to adopt reforms.

Between 2010-12 the ECB’s SMP purchased in the secondary market government debt securities of five Euro Area countries: Greece, Ireland, Portugal, Spain, and Italy. It has been documented

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<sup>1015</sup> (BEUKERS, 2013: 1593-4), (MOURMOURAS, 2017).

<sup>1016</sup> (BEUKERS, 2013: 1593-4).

<sup>1017</sup> <https://www.ecb.europa.eu/press/pr/date/2015/html/pr150628.en.html> .

<sup>1018</sup> (MOURMOURAS, 2017).

<sup>1019</sup> (SACHS, 2015), (WYPLOSZ, 2015).

<sup>1020</sup> (BEUKERS, 2013).

<sup>1021</sup> (BEUKERS, 2013), (DIESSNER & LISI, 2019: 11-12), (HENNING, 2016).



how the effective implementation of the SMP was conducted to pressure the governments of those countries to adopt specific structural reforms and even to ask for supranational financial assistance attached to an economic adjustment program.<sup>1022</sup>

Although the SMP's conditionality remained implicit or secret, the content and timing of the abovementioned confidential letters sent by the ECB and NCB presidents to the respective national governments demonstrate how specific and pushy were the central bankers. For a program that amassed €218bn at its peak in 2012<sup>1023</sup>, it proved to be quite a relevant pressure tool.

The substituting program, the OMT, was announced in 2012 with conditionality overtly imposed.<sup>1024</sup>

The OMT was never activated but the conditionality was a decisive feature for the program's approval by the ECB-GC and its validation by the CJEU. As AG WATHELET explained in the *Gauweiler* judgment "[t]he Court recognised that, with that condition, it was possible that the OMT programme may, 'indirectly', increase the impetus to comply with those adjustment programmes and thus, to some extent, further the economic-policy objectives of those programmes"<sup>1025</sup>.

The subsequent PSPP and PEPP had different contexts and purposes that did not require national governments to make economic or fiscal adjustments at their outset. Still, both the ECB and CJEU were keen to restate the ECB's power to make the access and manage these programs conditional upon the choices and performance of the fiscal and economic policies of the respective national governments.<sup>1026</sup>

Another example is the Transmission Protection Instrument (2022) was once more subject to explicit conditionality whose fulfillment the ECB will assess with discretion.<sup>1027</sup>

The degree of intrusion of the ECB in the design and negotiation of the national economic reforms and adjustments varies across the ECB programs. While the intervention is the clearest in the OMT, the others leave room for the CB to interact (at least informally) with the relevant national governments and the EU institutions in charge of the design, negotiation, and implementation. More so since the ECB President has a seat at the EU Council's table.

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<sup>1022</sup> ECB Decision establishing the SMP (ECB/2010/5) §4.

<sup>1023</sup> [https://www.ecb.europa.eu/mopo/pdf/SMP\\_breakdown\\_history.csv](https://www.ecb.europa.eu/mopo/pdf/SMP_breakdown_history.csv).

<sup>1024</sup> (ECB, Technical Features, 2012).

<sup>1025</sup> AG WATHELET Opinion on the *Weiss* case C-493/17, §112.

<sup>1026</sup> CJEU Judgment *Weiss* case, C-493-17, §135, §142; AG WATHELET Opinion, §119, ECB Decision (EU) 2020/440) and (ECB/2020/17).

<sup>1027</sup> (ECB, The TPI, 2022).

The analysis of these programs confirms that, notwithstanding their differences, the ECB keeps “designing the settings of its ... policies with a view to their impact on governments’ fiscal behavior”<sup>1028</sup>.

*Fourth*, the ECB assumed new tasks of designing, negotiating, and monitoring specific, economic and fiscal policy reforms and adjustment programs of Member States. The ECB does not act alone, and its interventions are not final in the sense of *per se* and *de jure* establishing economic and fiscal policy changes. Nevertheless, its intervention is significant and *de facto* co-decisive.

Initially the ECB assumed those tasks *ad hoc* when it integrated, with the Commission and IMF, the so-called Troika that designed, negotiated, and monitored the Economic Adjustment Programmes and the underlying Memoranda of Understanding on Economic and Financial Policies and on Specific Economic Policy Conditionality<sup>1029</sup>.

The first time the ECB was invited to take up these tasks was on February 11, 2010 by the EU Heads of State and Government in relation to the (first) financial assistance to Greece through the “Greek Loan Facility”<sup>1030</sup>. The ECB immediately accepted the responsibility, declaring its willingness “to work with the European Commission ... on proposals for necessary additional measures”.<sup>1031</sup>

Subsequently the ECB’s involvement was institutionalized in the European Financial Stability Facility (EFSF) Framework Agreement<sup>1032</sup> and in the Regulation establishing the EFSM<sup>1033</sup> which came to provide financial assistance to Ireland, Portugal, and Greece between 2010 and 2012. Later in 2012, the ESM Treaty created a permanent mechanism, the ESM, confirming the CB’s role in implementing the “strict conditionality” requirement to any required financial assistance pursuant to the amended version of article 136 TFEU<sup>1034</sup>. All these legal documents assign the design, negotiation, and monitoring of the detailed policy conditionality to “the Commission, in liaison with the ECB” or “in consultation with the ECB”.

If the politicization is more obvious when the ECB is involved in prescribing, designing, and negotiating specific economic and fiscal policy reforms, it is also relevant in the monitoring stage as that oversight is consequential (including in terms of release of additional financial assistance) and dynamic (in the sense of leading to adjustments of specific policies)<sup>1035</sup>. Furthermore, the

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<sup>1028</sup> (DIESSNER & LISI, 2019: 2).

<sup>1029</sup> (BEUKERS, 2013), (ZILIOI, 2016), (DIETSCH ET AL., 2018), (AMTENBRINK, 2019: 171-2).

<sup>1030</sup> (EU COM, Financial Assistance to Greece).

<sup>1031</sup> (TRICHET, 2010).

<sup>1032</sup> Arts. 2, 3 and 9 of the EFSF Framework Agreement.

<sup>1033</sup> Art. 3 of the Regulation 407/2010 of 11 May 2010 establishing the EFSM.

<sup>1034</sup> Art. 136 TFEU was amended by the European Council Decision 2011/199/EU. See arts. 5 (6) (g), 13, and 14 (6) of the ESM Treaty.

<sup>1035</sup> (SARMIENTO, 2016: 53).

ECB has an observer seat at the table where bailouts, corrective actions and sanctions are decided by the representatives of the Euro Area Member States – the ESM Board of Governors and the Eurogroup<sup>1036</sup>.

*Fifth* and in parallel to the tasks in these successive financial assistance mechanisms, the ECB was also assigned a role in negotiating and/or monitoring specific policy commitments of national governments in the context of the new EMU legal framework on economic governance, notably in the so-called 2011 “Six-Pack” and 2013 “Two-Pack” legislation<sup>1037</sup>.

The Two-Pack specifically confirmed the same co-role of the ECB in the negotiating (*in liaison*) of a draft macroeconomic adjustment program for a country experiencing serious difficulties with respect to its financial stability<sup>1038</sup>. This EU secondary legislation assigned the ECB a monitoring role in (enhanced) surveillance, and also in review missions to Member States that participate in the Euro Area or in Exchange Rate Mechanism (ERM) II but with the qualification that the Commission invites the ECB to such missions when it finds it “appropriate”<sup>1039</sup>.

*Sixth*, the ECB may use its financial supervision powers to pressure a national government to adopt a specific policy course.

Less explored in the literature, this conditionality became more relevant with the expansion of the ECB’s powers in financial policies – macro and microprudential regulation, supervision, and resolution – and in the face of the bank-sovereign nexus and diabolic loop<sup>1040</sup>, the relevant sovereign exposure with substantial home bias in banks sovereign bond holdings<sup>1041</sup>, and the fragmentation of the Banking Union into national markets.

National governments should be aware of the fiscal footprint of macroprudential policy<sup>1042</sup>, and of the impact that financial policies may have on real economic variables. The ECB may and has used its policies aimed directly at banks to indirectly pressure the respective governments to act in a certain specific direction.

In April 2011 the ECB allegedly pressured Portuguese banks to stop using its liquidity to buy Portuguese bonds with the effect of pressuring Portugal into a request for financial assistance;

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<sup>1036</sup> Arts. 5 (3) and 6 (2) of the ESM Treaty. For the Eurogroup (European Council, Resolution of the Luxembourg European Council in December 1997: §44), (EUROGROUP, Working Methods of the Eurogroup, ECFIN/CEFCPE (2008)REP/50842 rev 1).

<sup>1037</sup> (BEUKERS, 2013: 1589-91), (ZILIOLI, 2016: 178-179).

<sup>1038</sup> Art. 6 and 7 (1) of the Regulation 472/2013.

<sup>1039</sup> See the EU’s Two-Pack and Six-Pack regulations (art. 9 Regulation 1176/2011, arts. 3 (5), 7(4) and 14 (3) of the Regulation 472/2013, and art. 11 (2) of the Council Regulation 1466/97).

<sup>1040</sup> (REIS, 2020), (BRUNNERMEIER, JAMES & LANDAU, 2016).

<sup>1041</sup> (MAI, 2021).

<sup>1042</sup> (REIS, 2020).

and in 2012 it used the financial distress in Bankia to pressure Spain to ask for financial assistance for bank recapitalization<sup>1043</sup>.

The ECB, as European financial authority over significant and critical banks representing over 80% of the EU's banking assets, has multiple powers that it may deploy to pressure national governments. Not only macroprudential policies limiting the banks' purchase of sovereign bonds, but other microprudential supervision of powers affecting the activity and strategy of individual banks or the ECB/SSM's intervention in the resolution process (assessing recovery plans and declaring banks that are failing or likely to fail). In addition, the ECB is involved in intermediate decisions in state aid processes in case of public recapitalization of banks<sup>1044</sup>.

These six channels allow the ECB to interfere with the fiscal and economic policy choices of national governments in those two dimensions of designing the specific policy decisions and pressuring them to make the decisions.

They are apt to generate *high powered, specific policy prescriptions* from unelected CBs in the realm of fiscal and economic decision-making of political authorities.

There is no *formal* change in the legal competence to decide: national governments remain *de jure* competent to decide whether to accept or reject the CBs' prescriptions, pondering the costs inherent in disregarding the conditionality. Even when such costs are high, the governments retain the *de facto* autonomy to reject the conditionality – as Greece experienced in 2015 when its Syriza government rejected and led the people to reject in referendum the extension of the economic adjustment program negotiated with the Troika. Greeks got (themselves) into a situation where they had only “awful choices”, and they went for one that involved repudiating the conditionality and defaulting on their sovereign financial obligations, resulting in tremendous economic and social hardship<sup>1045</sup>.

This is an extreme manifestation of a broader reality of governance: in an interdependent world there is no such thing as unconstrained autonomy of governments. Since the GFC, the ECB has emerged as an actor with relevant and effective constraining power over the autonomy of national political authorities.

Empirical studies are needed to measure the relative weight of the ECB's contributions to the specific economic and fiscal policy decisions and reforms effectively adopted by the national governments at stake.

The intervention of the Commission and of the Eurogroup (and the IMF) in designing, negotiating, and monitoring (with consequence) the adjustment programs is also relevant. There

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<sup>1043</sup> (BEUKERS, 2013).

<sup>1044</sup> (EU COM, Communication, 2013/C 216/01).

<sup>1045</sup> (KLEIN, 2015), (THOMSEN, 2019).

might even be some dissonance between the *real* and the *publicly perceived* relative roles of each institution and of the ECB in particular – for instance, the ECB seemed more salient and central in the processes of assistance to Greece and Cyprus, but less so in the Portuguese case where the Commission and IMF were the visible faces of imposition and conditionality<sup>1046</sup>.

Nonetheless, the specific expertise, increased independence in comparison to the Commission, and usage of monetary and supervisory tools as levers of power make the ECB a significant influence.

The ECB interventions in the political process are consequential, in terms of *de facto* shaping the substantial policies assigned to the national political branches, but also in impacting the political process more generally. It has been argued that at least in two cases – of Italy and Greece – it led to a change of government in Member States, whose leaderships were taken by technocrats<sup>1047</sup>.

The public perception of such influence is fueled by the combination of the opacity of these financial assistance and macroeconomic surveillance processes, by the comparative dysfunctionality, diffusion of actors and procedural slowness of the European and national political processes, and by the politicians' tendency for blame shifting – heightened at EU level where national governments dislike taking responsibility for unpopular measures imposed on other national governments.

The conditionality strategy politicizes European central banking in all senses of politicization: the CB effectively intervenes in the making of substantively political choices revealing “the political character of the policy impositions of Europe’s central bank”<sup>1048</sup>. That intervention spurs significant public contestation, which in turn entices political actors to interfere in central banking through the *ex ante* and *ex post* democratic controls described above.

#### **6.4. THE LEGALITY OF THE (OUTPUT) POLITICIZATION OF CENTRAL BANKS**

It has been established as a fact that CBs are political, and their outputs have been increasingly politicized. But what does the law say of that?

Legal objections have been raised against the politicization of ICBs.

One strand of legal challenges, common to other independent or non-majoritarian institutions, is that constitutional principles of representative democracy and (strict) separation of powers inspire a set of legal doctrines establishing *a positive dimension of independence* and a *monopoly of the electoral-representative political branches and process over substantive political choices*,

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<sup>1046</sup> In the Portuguese case there was no published story about the ECB that would be equivalent to the infamous letters or to the bargaining with Greece and Cyprus for their banks' access to ELA.

<sup>1047</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016: 322).

<sup>1048</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016: 343). Similarly (DIETSCH ET AL., 2018: 17), (AMTENBRINK, 2019: 171-2),.

e.g., the American doctrines of political questions and non-delegation, and the European prevalence of legislation, reserved legislative competence, or the allocation of the Italian function of *indirizzo politico*.

The other strand applies the *principle of conferral of competences* to the horizontal and vertical distribution of macroeconomic policymaking competences to conclude that ICBs are legally forbidden to encroach on, or affect the objectives, choices and conduct of fiscal or other economic policies under the purview of classic political policymakers, even if through indirect and/or unintended side-effects, fiscal footprint or imposition of conditionality on political decision-making.

ICBs imposing economic and fiscal side effects or conditionality would breach the limits of confer, would act *ultra vires*, and thus illegally.

The following subsections analyze both strands of legal challenges as follows: first, to repudiate the existence of a legal monopoly of the classic political branches over the decision of substantive political questions; second, to present the CJEU's functionalist interpretation of the principle of conferral in a sense that legally admits the fiscal and economic side effects and footprint of central banking; third, building on the CJEU case law to reject the two legal arguments of positive independence and the principle of conferral to oppose CBs' interferences on classic political decision-making through expressions and conditionality.

#### **6.4.1. NO LEGAL MONOPOLY OF SUBSTANTIVE POLITICAL QUESTIONS**

In Western liberal democracies there is no infra-constitutional monopoly of classic political branches over substantive political decisions.

The pluralistic and liberal conception of the constitutional principles of democracy and balanced separation of powers are inclined to *predominantly* assign substantive political questions to the electoral-representative process with its classic political branches. However, such inclination is non-monopolistic, and those principles comprehend (and require) the allocations of some of those political questions to independent institutions with broad discretion left to their non-majoritarian and specialized process.

The current understanding of a host of legal doctrines on both sides of the Atlantic express this hybrid or mixed allocation of political decisions.

To begin with, the generalized triumph of a balanced/limited separation of powers over the strict/absolute separation model<sup>1049</sup>, protects the allocation of a *core* of political issues to the Legislature and to the Executive, while allowing substantive interventions by other institutions under the large umbrella of checks and balances.

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<sup>1049</sup> Ch. 2.1., (LEITÃO AMARO, 2022b).

In the modern balanced separation, (certain) courts have judicial review power to ultimately settle certain conflicts in substantive and primary terms (e.g., involving individual fundamental rights<sup>1050</sup>) and non-majoritarian administrative institutions have been recognized relevant substantive, primary policy-making powers<sup>1051</sup>.

The gradual thinning of the US “political question doctrine”<sup>1052</sup> and “non delegation doctrine”<sup>1053</sup> is another example of the acceptance of non-partisan political decision-making. Both doctrines were born to preserve the domains of the classic political branches, from intrusion of courts and (unelected) administrative agencies, respectively. With time, “political questions” became an exception or reduced to a very narrow list, and the norm of “non delegation” became satisfied by a thin legislative intervention invoking a vague, unspecified public interest with little-to-none primary definition of objectives and settlement of the underlying conflicts<sup>1054</sup>.

In Continental Europe the principle of prevalence of legislation has been eroded and relativized, namely as the principle of legality was replaced by a principle of constitutionality with cases where the constitution immediately enables administrative action<sup>1055</sup>. The relativization of the parliamentary law as the quintessential instrument to settle political conflicts was reinforced by the erosion of parliamentary primacy<sup>1056</sup>, the emerging material dominance of lawmaking by majoritarian Executives<sup>1057</sup>, and the evolution of the concept of law to include not only general and abstract norms, but also concrete and individualized laws<sup>1058</sup>.

Furthermore, the doctrine of “reserved legislative competence” (*Gesetzesvorbehalt*) in many situations demands a less than exhaustive primary regulation by the political legislator<sup>1059</sup>.

A proverbial example of how thin this legislative reservation can be is article 165 (1) o) of the Portuguese Constitution on the EMU. This norm reserves for parliamentary legislation the regulation of the “monetary system”, with permission for the Parliament to authorize the

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<sup>1050</sup> (KOMESAR, 1994, explaining that in issues with concentrated high stakes the classical political process exhibits majoritarian biases, and the judicial process appears as a comparatively superior decision-making mode).

<sup>1051</sup> (ACKERMAN, 2000).

<sup>1052</sup> This doctrine reflected “a historical understanding that certain prerogatives were reserved to the political Branches of Government.” (*N. Pipeline*, 458 U.S. 50, 67), (Chief Justice MARSHALL, in *Marbury v. Madison*, 5 U.S. (1 Cranch) 170). There is a “classical” and a “prudential” doctrine, the latter accepting the courts’ limitations in confronting complex issues of popular government. (HENKIN, 1976), (BACOW, 2002), (HARVARD LAW REVIEW Note, 2016), (SEIDMAN, 2004).

<sup>1053</sup> (BREYER ET AL., 2010)

<sup>1054</sup> (BACOW, 2002), (HARVARD LAW REVIEW Note, 2016, defending “political question doctrine as the exception”). Differently, (SEIDMAN, 2004).

<sup>1055</sup> (CANOTILHO, 2003: 723), (OTERO, 2002).

<sup>1056</sup> (OTERO, 2002), (MIRANDA, 2010, V: 194-200).

<sup>1057</sup> (OTERO, 2010, II: 218).

<sup>1058</sup> (CANOTILHO, 2003: 715-9).

<sup>1059</sup> (MORAIS, 2008: 200), (CANOTILHO, 2003: 728), (MIRANDA, 2010, V: 214, 237).

Executive to legislate on the issue. However, both Portuguese classic political branches opted to transfer to the EU, and the ECB in particular, almost all primary decision-making over such issues, by means of an international treaty (Maastricht). The Portuguese Executive and Parliament somehow intervened in (a very thin) primary regulation of the monetary system when they participated in the negotiation and eventually ratified, respectively, the EU Treaty and the appended ESCB Statute.

Yet, the TFEU and the Statute do not exhaust the primary regulation of the EMU's monetary system and policy, leaving an incomplete mandate to the ESCB; furthermore, the role of the Portuguese political branches in the elaboration of the Treaty was partial and non-dominant (one out of many governments); and the form and procedure of that regulation – international treaty adoption – are significantly different from the *legislative* form and procedures prescribed by article 165.

The constitutionality of such deviation may have been saved by the general, enabling clause on European Integration (article 8 (4) of the Constitution), but it remains clear that the substantive, formal and procedural demands of the reserve of legislative competence were ignored and not met.

Moreover, in certain material domains of public activity heavier on efficiency and optimization concerns, the principle of legality is satisfied if the legislator enacts the administrative delegation with some general objectives accompanied by mechanisms of political and judicial control. The principle only prohibits a pure “blank check” but stands far from demanding an exhaustive primary regulation of the political conflict at stake<sup>1060</sup>.

There is no legal cover for the view that, in general, redistributive and loss-generating decisions are exclusive to the political branches. Constitutions of advanced economies do not establish an *absolute* nexus between majoritarian democratic instruments and public decisions that are *primary* and with redistributive effects and/or involving risk of losses (including for the taxpayers in general). Nor do they establish an outright legal prohibition for courts or independent administrative agencies to make such types of decisions.

The distrust of majoritarian biases affecting those types of decisions is reflected in constitutional norms such as those entrusting constitutional and supreme courts with the settlement of conflicts over fundamental rights, prohibitions of referendums on taxation or budgetary matters<sup>1061</sup>, and norms affirming that the CB is independent or autonomous in exercising its functions<sup>1062</sup> which necessarily include distributive effects and risk of losses<sup>1063</sup>.

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<sup>1060</sup> (CANOTILHO, 2003: 733).

<sup>1061</sup> Constitutions of Denmark (art. 42 Section 6 (6)), Latvia (art. 73), and Portugal (art. 115 (4) b)).

<sup>1062</sup> (BIS, 2009).

<sup>1063</sup> (PETCH, 2013: 19).



Southern European constitutional scholarship autonomizes the “*indirizzo politico*”, a function of “political direction” or primary, innovative and tendentially normative orientation of the polity that would have to be in the hands of the classical political branches. However, the acceptance and clarity of this doctrine has waned.<sup>1064</sup>

On the one hand, the boundaries distinguishing legislative and governmental actions that are or are not political have been blurred and contested, compromising the doctrine’s operational utility. On the other hand, the character of political direction of certain actions of public institutions other than Parliament and the Executive, e.g., the Head of State in semi-presidential systems, the constitutional and supreme courts, and non-majoritarian institutions such as CBs – have been increasingly recognized.

This rejection of an infra-constitutional monopoly of classic political branches over political decisions is consistent with the constitutional openness to (some) role of independent institutions on substantive political decision-making per constitutional or legislative delegation, e.g., for the ESCB the TFEU and authorizations in constitutions of Member States for the European integration and EMU<sup>1065</sup>, for the Fed the US Constitution (article I, Section 8, fifth paragraph) and the FRA, and for the BoE its Acts of 1946 and 1998.

However, such acceptance does not mean that independent institutions have political supremacy in the sense of having the last infra-constitutional word when their politically substantive decisions clash with those of the Legislature or the Executive. That claim of ultimate authority has been made about judicial review of legislative and executive actions on certain issues, more strongly in the realm of fundamental rights.

Regarding ICBs, their permission to make substantive political choices does not imply supremacy over legislative acts that shape the delegation and provide primary political orientation. The Fed, BoE, but also the ECB (whenever EU Council and Parliament are competent to legislate) are subordinated to their legislative bases and cannot operate *contra legem*.

On the one hand, CBs, their independence, and activity exist, and are structured and subject to a (good enough) degree of *ex ante* and *ex post* control of their delegation by DRs, including through the ultimate R-Bomb.

On the other hand, the vague mandates and broad discretion delegated by DRs plus the CBI protections usually give CBs some room for making political choices and preserving (*de jure*) infra-legislative supremacy of such choices over non-legislative signals sent by the Legislature or the Executive (while courts are obsequious to the CBs’ political reign).

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<sup>1064</sup> (CANOTILHO, 2003: 566, 649), (LUPO, 2021), (OTERO, 2003, 790-2 and 2010, II: 311-2), (MORAIS, 2008: 23-31), (MIRANDA, 2010, V: 22-29).

<sup>1065</sup> Arts. 119 (2), 127, 128 TFEU and ESCB-Stat.

ICBs sometimes have to specify an incomplete primary legislative determination (i.e., making a primary but subordinated/second-level political decision) or dare to make a primary first-level political choice knowing that the Legislative power is latent and can come into action if its passive acquiescence ceases.

This admission of independent/non-majoritarian political decisions is not a generalized principle. It does not cover all or most decisions by courts and administrative agencies (the majority of which consist of secondary policymaking or non-innovative implementation). It is a rather limited possibility that varies across political and legal systems and exists for a circumscribed set of those independent institutions whose position, institutional characteristics and procedures developed and matured in terms that legitimated such a political role.<sup>1066</sup>

Where the constitutional or ordinary legislator left primary regulation incomplete, delegated away or simply omitted primary decisions on fundamental conflicts, in *certain issues and conditions*, independent institutions do, can and should take the political shots.<sup>1067</sup>

Their omission to decide in such cases would be a decision in itself, an endorsement of the *status quo*, and a choice of a specific balance of preferences and interests.

CBs are part of that limited subset of independent institutions that matured and gained their legal space as political actors, making political choices in the broader substantive sense and that have, in recent decades, built a political capacity of their own.<sup>1068</sup>

With differences, the main models of the relationship between ICB and the political branches confirm the legal permissibility of CBs making substantive political choices.

British, American, and European CBs are all delegated multiple functions and various vague mandates give them an implicit legal delegation to make substantive primary trade-offs of conflicting values and interests. The legal charters of the CBs of Canada<sup>1069</sup>, Australia,<sup>1070</sup> and New Zealand<sup>1071</sup> formulate mandates even more openly and are prone to generate primary conflicts of values.

The British model (BoE, RBNZ, RBA, BoCan) is exceptional in granting the Executive more *formal* powers to specify the legislated mandate and to override and issue concrete instructions.

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<sup>1066</sup> On judicial policymaking footnote 268. (BLANCO MORAIS: 2008, 26), (CANOTILHO, 2003), (MIRANDA, 2010, V: 35), (MANETTI, 1994: 12), (OTERO, 2003), (MOREIRA, 2003: 136).

<sup>1067</sup> (MERUSI & PASSARO, 2003: 86), (DE MARCO, 1999: 138-9).

<sup>1068</sup> (VAUCHEZ, 2016: 4).

<sup>1069</sup> Its preamble refers to “the best interests of the economic life of the nation” and “generally to promote the economic and financial welfare of Canada”.

<sup>1070</sup> Art. 10 RBA Act, setting a triple mandate that includes “the economic prosperity and welfare of the people of Australia”.

<sup>1071</sup> Art. 1A of the NZRB Act.

In addition, (not the law but) the British Executive's remit for the MPC requires the BoE to report and justify a significant deviation from the inflation target and gives the Executive the opportunity to respond and ask the BoE to adjust its policy response through an exchange of letters.

GOODHART argues that the "UK has an inbuilt mechanism for restoring the decision-making process to the political arena whenever the short-term trade-offs look to become really difficult and potentially contentious" and concludes that "at least in the UK" the short-run conflicts between inflation and output do not "get one back to the realm of value judgments over trade-offs between alternative objectives"<sup>1072</sup>.

However, GOODHART infers too much. Those powers give the UK Treasury a *limited possibility* to intervene, which is substantively and procedurally constrained<sup>1073</sup>, and the Executive may choose not to exercise it. While it demonstrates the *ultimate* political supremacy, it also confirms that the CB has authority to make substantive political judgments when the Executive is unable or unwilling to oppose them.

The American delegation of a dual mandate is the clearest implicit assumption that Congress legally trusted the Fed to make a political judgment that balances vaguely defined values (price stability and maximum employment<sup>1074</sup>). "The United States has obliged its CB by law to balance the needs of workers who want low unemployment and high wage growth, against the needs of bondholders, who want lower inflation and higher real returns on assets... Get it wrong, and real people suffer"<sup>1075</sup>.

MENAND's original interpretation that the Fed has a single mandate does not dispense it from plenty of choices of undecided political conflicts<sup>1076</sup>. The rare and narrow powers of the US Treasury to instruct or override the Fed fall very short of eliminating its legally delegated room to make substantive political choices.

As to the ESCB, the traditional (and its quasi-official) position that "the law, at least, does not allow the ECB to take political decisions"<sup>1077</sup> can only hold in the classic or formalistic sense of political decisions.<sup>1078</sup>

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<sup>1072</sup> (GOODHART, 2003: 101-2).

<sup>1073</sup> The Executive's reserve power has to be "required in the public interest and by extreme economic circumstances" (art. 19), and the open letters exchange applies only in case of deviations of inflation larger than 1pp.

<sup>1074</sup> Art 2A FRA.

<sup>1075</sup> (GREELY & SCRAGGS, 2018).

<sup>1076</sup> (MENAND, 2022).

<sup>1077</sup> (ZILIOLI, 2016: 182).

<sup>1078</sup> See ch. 6.2

In the substantive sense, the constitutionalization, vagueness (or broad discretion), and multiplicity of functions and objectives, together with the strong protection of independence, “institutional loneliness”, and the absence of (ample) legislative or executive powers to specify or override the ECB (at least in the field of monetary policy), amount to an implicit legal delegation of competence for making the necessary and adequate trade-offs, i.e., political choices.

The President of the CJEU LENAERTS recently acknowledged that “the ECB decisions establishing the OMT programme and the PSPP concerning purchase of public sector assets on secondary markets touch on an inherently political and complex area, which justifies limiting the Court’s review of proportionality to manifest errors of assessment or misuse of powers”; and that “the Court observed that policy-making in that [monetary policy] area involves not only ‘technical choices’ but also ‘complex assessments’, emphasizing that ‘questions of monetary policy are usually of a controversial nature’”<sup>1079</sup>.

The constitutionalized primacy of price stability entails a positive command to prevent significant variations and volatility in prices, and a negative prohibition to act in the pursuit of other values in a way that would seriously compromise price stability<sup>1080</sup>. However, the primacy of one amongst multiple mandates does not solve all political conflicts, including over monetary policy.

Price stability is a legal principle, a protection of the essential, and a command for optimization subject to balancing of competing protected values according to the proportionality principle<sup>1081</sup>.

According to the established principle of proportionality, the ECB is not required to keep prices precisely and rigidly within a certain target *at all costs*. Instead, it should consider and balance effects in other values and it is allowed to seek other values or secondary objectives as long as it does not significantly compromise price stability. Neither a socio-economic tragedy in the short term is an acceptable price to pay to prevent inflation, nor is a mild short-term increase in inflation a reason to preclude measures that enhance financial stability, real growth, or employment.

The CJEU has confirmed that “[i]n making monetary policy decisions, the Governing Council systematically assesses the proportionality of its measures. This assessment includes an analysis of the *benefits* and the possible *side effects* of monetary policy measures, their *interaction* and their *balance over time*. The assessment of the benefits applies to the transmission to financing

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<sup>1079</sup> (LENAERTS, 2022, citing CJEU’s judgments in cases *Gauweiler*, § 75 and *Weiss*, § 91).

<sup>1080</sup> (SIMS, 2018).

<sup>1081</sup> Art 2 TEU, with the criteria for applying the principle of proportionality indicated in the Protocol (No 2) to the Treaties.

conditions as well as to the intended effect on inflation, while the assessment of possible side effects relates to the unintended effects on the real economy and on the financial system”<sup>1082</sup>.

Proportionality judgments are required from all public decisions of EU institutions, be they substantively political or not. Yet, the legal concept of price *stability* (like that of financial *stability* or *smoothness* of the payment systems) is so vague and embeds such a broad discretion that it requires further *primary* level, i.e., substantively political, specification.

It cannot be ignored that article 127 (2) first indent TFEU gives the ECB the basic task to *define* as well as implement the monetary policy of the Union. Such a definition is as technical as it is political in the substantive sense.

With political undecideds left and delegated away by constitutional and ordinary legislators, CBs’ paralysis in their field of competence would be a political choice in itself. It would have to be legally treated as an endorsement of a political trade-off (the status quo) and scrutinized like other alternative chosen trade-offs.

The judicial deference towards CBs is another element confirming the legal admission of the latter’s *political* policymaking. Such deference means that courts refrain from imposing their own substantive political judgments in the fields of competence of CBs, from substituting their own interpretation of the constitutional or legislative mandate for that of CBs, and from invalidating CBs’ political judgment.

In the USA, courts grant significant deference to the Fed which is almost completely sealed off from judicial review<sup>1083</sup>.

In the EU, the CJEU has adopted the view that the ESCB should be afforded a considerable degree of deference “in view of the [its] broad discretion”, and the Court’s President has explicitly justified such deference due to the inherent substantive political dimension (together with the technical dimension) of the ECB’s decisions within its “broad margin of (political) assessment”.<sup>1084</sup>

Adopting such a considerable degree of deference, the judicial branch abdicates from shifting the settlement of undecided political conflicts away from CBs.

#### **6.4.2. SIDE EFFECTS AND THE CONFERRAL OF COMPETENCES**

A related but different legal challenge to modern central banking is based on the legal principle of conferral of competences.

It determines that CBs shall act within the limits of the powers conferred on them by the respective legal basis and would therefore be prohibited from acting in terms that correspond

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<sup>1082</sup> (ECB, An overview of the ECB’s monetary policy strategy, 2021).

<sup>1083</sup> (CONTI-BROWN & ZARING, 2019), (EGIDY, 2019), (ZARING, 2015).

<sup>1084</sup> (LENAERTS, 2022).

to the exercise of competences conferred by law on other (political) policymakers. They are prohibited from conducting fiscal, other economic or foreign policies.

In addition to this horizontal delimitation of competences, the conferral principle has also a vertical dimension according to which the supranational or federal entity shall act within the limits of the competences conferred upon it by the constitution or treaty and stay clear of the competences left with the national states.

Based on that principle, it has been argued that it is illegal for CBs' actions to produce effects, including indirect side effects or unintended consequences in the field of competence of fiscal and economic policymakers that typically are the classic political branches. Their measures generating economic side effects, redistributive impacts on wealth, income or the allocation of credit, and liquidity assistance or alliances with foreign authorities or economies would be illegal due to encroachment on the conferred competences of the classic political policymakers<sup>1085</sup>.

This traditional view of strict separation of macroeconomic policies has been raised as a legal argument in the context of the EU where the primary law explicitly enshrines the principle of conferral in both vertical and horizontal dimensions.<sup>1086</sup>

Considering that the EU and the ESCB were conferred an almost exclusive competence on (internal) monetary policy, but that economic policies remain under the purview of national political authorities, only subject to coordination within the Council<sup>1087</sup>, the CB cannot encroach on those fiscal and economic policies. Furthermore, the TFEU's prohibition of monetary financing and the no bail-out clause would reinforce the institutional separation of monetary and fiscal policy.<sup>1088</sup>

The distribution of financial prudential policies and foreign policy is more complex since the EU has some competences<sup>1089</sup>, but Member States maintain relevant ones and the ECB is given no role in the Foreign Common Policy of the Union (Title V of the TEU) and limited powers to act externally, allegedly under political subordination.

Claims of violations of the conferral principle were at the core of the requests for preliminary rulings submitted to the CJEU in the most important cases for the EMU in the last decade: the *Pringle*, *Gauweiler* and *Weiss* cases.

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<sup>1085</sup> (SINN, 2018).

<sup>1086</sup> Arts. 5 and 13 (2) TEU, respectively.

<sup>1087</sup> Arts. 127 TFEU and 12 ESCB-Stat on monetary policy, and 119 (1), 120 and 121 TFEU and art. 2 (3) TEU on the national competence and European coordination of economic policies.

<sup>1088</sup> Arts. 123 and 125 TFEU, respectively.

<sup>1089</sup> Art. 127 (5) and (6) TFEU on prudential policies on credit institutions, and arts. 2 (4) and 24 TEU on foreign policy. In both cases the Council is conferred the functional leadership.

In the first case, the CJEU was questioned whether potential effects of the activities of the ESM on price stability should be characterized as monetary policy and, thus, an illegal violation of the ECB's exclusive competence over such policy. In the other cases, the German Constitutional Court questioned whether two ECB asset purchase programs (OMT and PSPP) could be *ultra vires* actions as they generated economic side effects that would transform the ECB action into economic policy measures whose competence belongs to national political authorities.

In all cases, the CJEU responded negatively by adopting a functional approach to the conferral principle. The Court concluded that it is the objective pursued and the means or tools implemented that define the nature of the policy and competence<sup>1090</sup>, while indirect consequences in other fields are not sufficient to transform the nature of the measure.

In *Pringle* the CJEU found that "any effect of the activities of the ESM on price stability is not such as to call into question that finding [that the activities of the ESM do not fall within monetary policy]. Even if the activities of the ESM might influence the rate of inflation, such an influence would constitute only the indirect consequence of the economic policy measures adopted"<sup>1091</sup>.

In *Gauweiler* the Court found that "a monetary policy measure does not become an economic policy measure merely because it may have indirect effects on the economic policy of the Union and the Member States... [E]very measure that is given effect through monetary policy instruments constitutes monetary policy". The use of such instruments creates "an initial presumption" that the measures fall within the competences of the ESCB, which "could be rebutted if, for example, the measure were to pursue objectives other than those specifically" assigned to the ESCB by the Treaty"<sup>1092</sup>.

In *Weiss*, the CJEU subscribed to the view that the ESCB measures may generate indirect and unintended economic side effects and distributional consequences, which need not to be "limited", "ancillary" or even "marginal", as long as they do not undermine the price stability objective<sup>1093</sup>.

Interdependencies and spillovers from monetary and prudential policies into fiscal and other economic policies are inevitable and the CB cannot legally ignore them and let them run loose and unmanaged. Confronted with such potential spillovers or with political undecideds (*lacunae*) in need of decision in their field of competence, its passivity and omission would be in themselves a policy and political choice of a status quo that is not necessarily superior.

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<sup>1090</sup> (LENAERTS, 2022).

<sup>1091</sup> CJEU, Judgment on the *Pringle* Case, §97.

<sup>1092</sup> AG CRUZ-VILLALÓN, Opinion *Gauweiler*, C-62/14: §129, 130, 132, accepted by the CJEU in *Gauweiler* case C-62/14: § 51-52.

<sup>1093</sup> AG WATHELET Opinion on the *Weiss* case, §110-113.

Contrariwise, the CB is *authorized* and has the *legal duty* to ponder and seek (indirect) economic effects which can be foreseeable, certain, probable, and with immediate link<sup>1094</sup>, subject to conditions that avoid breaching the conferral principle.

This legal authorization and duty are based on six legal justifications: (i) the balanced model of separation of power); (ii) the principle of substantive rule of law; (iii) the proportionality principle; (iv) the instrumental need to ponder distributional effects as a condition for better performance of the price stability mandate; (v) the explicit conferral to CBs of economic objectives (other than price stability); (vi) the implicit delegation through incomplete mandates and acquiescence; and (vii) the rejection of the alleged bluntness of monetary policy as justification for the ignorance of particularistic economic side effects and distributional consequences.

(i) The application of the *balanced model of separation of powers* to the distribution of macroeconomic policies entails the rejection of a strict separation of powers and the admission of certain contributions and interference in related and interdependent policies in the field of competence of other macroeconomic policymakers, under the condition of respecting the core of those competences.<sup>1095</sup>

(ii) The *substantive rule of law principle* requires all public decision-makers, CBs included, to be considerate and responsible for the full consequences of their policy judgments and choices, and to take into consideration not only the legal norms and values laid down in their statutory bases, but the fundamental values of their polity and legal order, including distributive justice, fundamental rights and other fundamental values. “Even within that broad margin, however, EU institutions or bodies must fully comply with fundamental rights”<sup>1096</sup>. It does not mean that CBs have to treat and pursue all legal values and collective objectives as their mission or with equal priority – the conferral principle is meant to divide relative responsibilities amongst policymakers. But it means they cannot disregard them and should somehow take them into consideration in the performance of their mandates.

The EU Treaties assist the ESCB navigating the complex sea of juridicity by indicating, not exhaustively, a few legal principles that constraint the pursuit of its mandate. In designing its policy measures “the ESCB is obliged, under Article 127(1) TFEU, read in conjunction with Article 119(3) TFEU, to comply with the guiding principle that public finances must be sound”<sup>1097</sup>, but

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<sup>1094</sup> *Idem*.

<sup>1095</sup> Ch. 2.1., (LEITÃO AMARO, 2022b).

<sup>1096</sup> (LENAERTS, 2022).

<sup>1097</sup> CJEU, Judgment on *Gauweiler case*, C-62/14: §61, (TRIDIMAS & XANTHOULIS 2016: 25).



also the principle “that there is no shared financial liability”<sup>1098</sup>, the principle of an open market economy with free competition, favouring an efficient allocation of resources and of sustainable balance of payments.

In the EU, all institutions, the ECB included, are bound by the substantive rule of law principle<sup>1099</sup>. They are also required to practice mutual sincere cooperation with other EU institutions and Member States<sup>1100</sup>, which means that they should (seek to) refrain from generating spillovers and side effects that (excessively) perturb the functions and objectives conferred on other EU institutions or national political authorities.

The principle of proportionality, derived from the rule of law, is the specific legal tool to calibrate the balancing of those economic effects, and more generally, it governs the use (within the limits) of the competences conferred on the CB. The conferral principle is about the limits of competences, and the proportionality principle is about the use of conferred competences, together with the subsidiarity principle in case of non-exclusive competences.<sup>1101</sup>

In the pursuit of its mandate, the ICB must carefully assess the *necessity* and *suitability* of policy action to deliver on the mandate, while also considering whether this policy action is *less intrusive compared with other options* for achieving the same goal<sup>1102</sup>.

(iii) The *principle of proportionality* curbs the *excesses* of content and form of CBs’ actions<sup>1103</sup>, in both directions. It avoids that they pursue price or financial stability *at all costs*, like “the police should not shoot at sparrows with cannons”<sup>1104</sup>. The CJEU’s case law “ensured that [the ECB] monetary policy measures would not work against the effectiveness of the economic policies followed by the Member States”<sup>1105</sup>.

But the proportionality principle also prevents CBs from giving too much weight to economic effects in their policies at the expense of price stability. Both excesses violate the conferral by compromising and substituting for the political policymakers’ exercise of their economic policy competences.

The existence of the principle of proportionality entails the duty of ICBs to assess and appraise the different impacts of their measures on other legal values, and on the objectives and conduct

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<sup>1098</sup> AG CRUZ-VILLALÓN, Opinion *Gauweiler*, C-62/14: §129, 130, 132, accepted by the CJEU in *Gauweiler case* C-62/14: § 51-52.

<sup>1099</sup> Art. 2 TEU.

<sup>1100</sup> Arts. 4 (3) and 13 (2) TEU.

<sup>1101</sup> (LENAERTS, 2022).

<sup>1102</sup> For the ESCB, Art. 5 TEU and Protocol (No 2) on the application of the principles of subsidiarity and proportionality, (LENAERTS, 2022), (ELDERSON, 2022). In the USA (JACKSON, 2015), (MATHEWS, 2017); in financial policies (RESTOY, 2019), (BASEL COMMITTEE ON BANKING SUPERVISION, 2019).

<sup>1103</sup> (LENAERTS, 2022).

<sup>1104</sup> (FLEINER, 1928: 404 cit. by MATHEWS, 2017).

<sup>1105</sup> (TRIDIMAS & XANTHOULIS 2016: 25).

of other economic policies. In reviewing the implementation of the legal proportionality principle, the CJEU “does require that institutions have in place a due process that ensures that within their margin of assessment, all factors and circumstances of relevance at the time of a policy decision are considered, including the impact of the action on other policies and the existence of less intrusive means to achieve the set objective” <sup>1106</sup>.

In its recent strategy review, the ECB sharpened its methodology to assess proportionality, now consisting of “an integrated assessment framework” that “builds on two interdependent analyses: the economic analysis and the monetary and financial analysis. The economic analysis focuses on real and nominal economic developments which includes economic activity, employment and price and wage developments. The monetary and financial analysis examines monetary and financial indicators which includes lending by banks and non-banks, asset prices and financing conditions” <sup>1107</sup>.

(iv) ICBs have a *duty to ponder distributional impacts* not only as economic effects balanced *against* the price stability benefits, but also *instrumentally as dimension/parts of the delivery of such price stability benefits*.

The BUNDESBANK explained that “it is nevertheless important that monetary policymakers, too, analyse distributional effects in greater depth to gain a better understanding of the potential interaction between monetary policy and distribution to help them perform their monetary policy mandate in the best possible way”<sup>1108</sup>. In other words, the price stability mandate imposes an instrumental duty on CBs to ponder distributional effects that may affect the transmission and effectiveness of monetary policy.

The ECB confessed this instrumental duty when it justified the recently created TPI and the flexibility in the PEPP reinvestments, which are (territorially) redistributive by design, with the argument of required instrumentality. They were “necessary to support the effective transmission of monetary policy”, the ECB declared.<sup>1109</sup>

(v) The most unequivocal legal confirmation that ICBs are allowed and required to ponder and pursue economic and other objectives and effects beyond price and financial stability is that they *were explicitly conferred the competence to do so*.

Departing from the quasi-exclusive fixation of central banking traditionalists on price and financial stability mandates, the legal bases of major ICBs assign them other objectives, either as part of multiple, unranked mandates (e.g., Fed, BoCan, RBNZ, RBA) or secondary mandates to

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<sup>1106</sup> (ELDERSON, 2022).

<sup>1107</sup> *Idem*.

<sup>1108</sup> (DEUTSCHE BUNDESBANK, 2016).

<sup>1109</sup> (ECB, The TPI, 2022).

support the economic policies of the Union/government (ESCB, and BoE<sup>1110</sup>). These two legal techniques differ in how far the pursuit of economic or other objectives may go, and to which extent the institution should cater to the price stability objective. But both *authorize* and *require* monetary policy and other central banking measures aimed at producing other effects.

Specifically, on the ESCB, AG WATHELET observed that the TFEU “adds support for general economic policies in the Union to the objective of price stability without limiting the scope of such support. On the contrary, Article 127(1) TFEU requires the ESCB to act in that manner since, written in the present tense, it stipulates that ‘the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union’”; and, “[i]f there are isolated economic-policy aspects to the [monetary policy] measure at issue, the latter will be compatible with the ECB’s mandate only as long as it serves to ‘support’ economic policy measures and is subordinate to the ECB’s overriding objective.”<sup>1111</sup>

It has even been argued, not without dispute<sup>1112</sup>, that the CJEU’s *Gauweiler* “judgment grants to the ECB much more than merely a supporting role [in secondary objectives]. Given that the concept of the ‘general economic policies in the Union’ is very vague, the Court of Justice interprets that vagueness in favour of the ECB by allowing it not only a supportive but also a proactive role”<sup>1113</sup>.

That proactivity means that the Eurosystem is already required to align its policy with economic policy more generally (and possibly with “the Council recommendations on the economic policy of the euro area”), but only to the extent that it does not (sensibly) affect price stability<sup>1114</sup>.

Obediently, the ECB has intensified its efforts to improve to improve the consideration of proportionality and side effects<sup>1115</sup>.

(vi) Beyond this explicit conferral, *constitutional or ordinary legislators implicitly confirmed the ICB’s competence to pursue and support economic and other effects, ab initio* by opting for vague and incomplete delegations, and when they acquiesced to over a decade of dramatic functional expansions and the augmented macroeconomic centrality of CBs.

Faced with such expansions and its consequences, DRs have not legislated to bring them to an end. On the contrary, most of their statements have been largely supportive of CBs’ actions<sup>1116</sup>.

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<sup>1110</sup> The BoE Act sects. 9C (1) and 9D (1) and 11 (b) and 12 (1) (b).

<sup>1111</sup> AG WATHELET Opinion in *Weiss Case* §113.

<sup>1112</sup> AG CRUZ-VILLALÓN Opinion in *Gauweiler* case, §143, argued that the ECB role in such economic policies is not to go “beyond ‘support’ for economic policy.”

<sup>1113</sup> (TRIDIMAS & XANTHOULIS, 2016: 33).

<sup>1114</sup> (GOLDMANN, 2020).

<sup>1115</sup> (LANE, 2022), (ELDERSON, 2022).

<sup>1116</sup> EU PARL Resolutions on the ECB Annual Report.

Even if there is something of a legislative paralysis or dysfunctionality there, it is hard to deny some degree of democratic acquiescence, and thus, democratic legitimization of the CBs' expansive activist stances.

Despite some criticism for their financial neglect in the run-up to the GFC, legislators awarded them with more powers in the context of profound regulatory and institutional reforms in the financial domain, e.g., the Dodd-Frank Act in the USA, the Banking Act of 2009 and Financial Services Act of 2012 in the UK, and the creation of the Banking Union, other treaties and EU secondary legislation reforming the EMU's macroeconomic governance.

(vii) Finally, the argument of unsuitability must be rejected. The claim is that monetary policy is too blunt a tool for CBs to aim for and manage particularistic economic side effects and distributional consequences.

However, knowledge and tools have evolved so much that CBs now have much deeper empirical information, expertise, and capacity to understand and calibrate those particular differentiated and heterogenous effects, and to sharpen the policy tools. They now can fine-tune those tools, and "go directly targeted and intentionally distributive"<sup>1117</sup>. Empirical science has evolved and gained ability to understand benefits conferred and costs imposed by monetary policy on identifiable groups. More sophisticated models have been developed to substitute older ones that largely ignored the distributional effects of monetary policy<sup>1118</sup>.

In this context, central bankers have a legal duty to sharpen policymaking, use selective, targeted and flexible tools, rather than taking bluntness as a given, so that they can manage to better combine the fulfilment of the price stability objective with more adjusted and adequate control of differentiated effects.

There are two momentous issues that exemplify this debate about the legal limits of the conferral on CBs: the impacts of central banking in (in)equality and climate change.

Various constitutions are more or less explicit that inequality is legally unworthy and should be addressed<sup>1119</sup>. A rising number of constitutions, fundamental laws and binding international law instruments have committed public powers to align their policies to combat climate change and for broader environmental protection.

CBs' favorite strategy has been to demonstrate how inequality and climate change – and so their actions upon them – are instrumental to their explicit mandates of price and financial stability. Such efforts are helpful to strengthen their legal cover, but CBs should not ignore their direct subordination to broader legal principles.

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<sup>1117</sup> (BARTSCH ET AL., 2020: 11).

<sup>1118</sup> (KAPLAN, MOLL & VIOLANTE, 2016, on the evolution from the RANK to the HANK model).

<sup>1119</sup> (DIETSCH ET AL., 2018: 33-4)

The ESCB, in particular, has to consider and integrate the impacts of (on) inequality and climate change in (of) their policymaking, not only via the instrumental and indirect effect on price and financial stability, but also due to its rule of law subordination to the fundamental values of the Union, the implementation of the proportionality principle and its secondary mandate to contribute to the achievement of the objectives of the Union as laid down in Article 3 TEU which include “balanced economic growth”, “full employment”, “a high level of protection and improvement of the quality of the environment”, “social justice”, “economic, social and territorial cohesion, and solidarity among Member States”.<sup>1120</sup>

To conclude, it is curious how progressive defenders of expansive central banking have somehow become accomplices of the traditionalists’ legal objection against this functional interpretation of the principle of conferral. By insisting on the indispensability of the enactment of new mandates for CBs to act, they were wasting the potential of the proportionality principle, the substantive rule of law, and secondary mandates.<sup>1121</sup>

In a nutshell, according to the prevailing functional interpretation of the principle of conferral, the ECB is *authorized* and has *a legal duty to ponder and seek* economic and other side effects and distributional consequences of its measures, subject to conditions under which such effects do not change the nature of the ECB’s action within its field of competence.

Those conditions are as follows:

*First*, the ICB must demonstrate it is following one of the primary or secondary objectives it was delegated, using the instruments it was legally authorized.

*Second*, when seeking a primary objective or any of the unranked objectives the CB must not “act in a single-minded manner and without due regard to other economic policy objectives”<sup>1122</sup>, but with regard to such objectives according to the various steps of the principle of proportionality (necessity, suitability and proportionality as such<sup>1123</sup>).

*Third*, when seeking a secondary objective, it is subject to the primary objective of price stability, but that subordination is proportional. The official position of the ECB is somehow different, rejecting any compromise to the primary mandate<sup>1124</sup>, and arguing that it can only choose “the configuration that best supports those general economic policies of the EU” amongst the “different sets of instruments that are equally conducive to price stability”<sup>1125</sup>.

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<sup>1120</sup> See arts. 9, 11, and 174 TFEU.

<sup>1121</sup> (DIETSCH ET AL., 2018: 19-45, 102-105).

<sup>1122</sup> (Statement to the ECOFIN by the Chairman of Buba and CoG POHL in the drafting of the ECB statute, September 8, 1990, *apud* JAMES, 2012: 285).

<sup>1123</sup> (ELDERSON, 2022).

<sup>1124</sup> (JAMES, 2012).

<sup>1125</sup> (ELDERSON, 2022).

However, the Treaties demand a *proportional* rather than an *absolute* exercise of competences and pursuit of mandates. This criterion ought to apply to the ponderations both between mandated and non-mandated objectives, and within mandated objectives (either ranked or not). The pursuit of secondary objectives is not limited to “zero sacrifice” to the primary objective; it is allowed some non-essential impairment of the primary objective if necessary, suitable and proportional to achieve greater benefits to the secondary objectives. In other words, when choosing between policy alternatives, the ECB must opt for the one that delivers greater support to the general economic policies of the EU, as long as it is *equally* conducive *or not significantly worse* to price stability.

*Fourth*, when the secondary objective is to support the general policies of the Union or the government, the CB ought to defer to the competent (political) policymakers on the definition of the economic policy objectives.

*Fifth*, in the case of multiple unranked mandates, the CB has to balance the costs and benefits of each policy alternative against each of its objectives in a logic of optimization rather than *all-or-nothing*. The sacrifice ratio for price stability in a Fed-like unranked dual mandate seems to be higher than with a ranked mandate like the ESCB.

*Sixth*, in serving all objectives the CB must also respect other overarching specific or general constraints and principles of law, some of which were non-exhaustively indicated to the ESCB in Articles 119 and 127 TFEU.

#### **6.4.3. IS CONDITIONALITY LEGAL?**

Beyond their own policy measures producing economic effects and distributional or diplomatic impacts, CBs have also interfered in the decision-making of classic political branches by expression and conditionality.

Such interventions have various levels of increasing gravity: general expressions, specific expressions, conditionality, and full or bi-dimensional conditionality where the CB makes its policy facilities and tools conditional upon the political branch adopting certain policies in whose design the CB specifically interferes.

There are no legal impediments for the long-standing practice of central bankers expressing opinions on the fiscal stance and structural reforms.

Various laws require or structure the ICB’s advice to the political institutions within its field of competence, but they are generally silent on advice and expression of preferences over policies outside its field of competence.

However, separate intergovernmental treaties amongst Euro Area members and secondary EU legislation have conferred roles to the ECB that include expressing views and even participating in the design, negotiation and/or monitoring of specific economic measures and macroeconomic

adjustments programs including fiscal and structural reforms. It has been noted that the status of the ECB here is “that of the ‘junior partner’, since the Eurogroup makes the decisions on the provision of financial assistance, and the Commission has the fundamental operational and preparatory tasks and “in turn [it] has the obligation to undertake these tasks ‘in liaison with the ECB’ or ‘in cooperation with the ECB’”<sup>1126</sup>.

Even when not *de jure* decisive, such channels for the ECB to express itself and influence the economic policies of Member States are legally permitted and required. They were validated by the CJEU in the *Pringle*, *Mallis and Malli*, and *Ledra* cases.

The ESM Treaty confers multiple responsibilities on the ECB in the course of a financial assistance programme, including participation in negotiations and monitoring<sup>1127</sup>. The ECB is therefore involved in the elaboration of the conditionality imposed on the State requesting assistance whilst, subsequently, it also takes part in the task of monitoring compliance with conditionality, which is crucial if the program is actually to continue and eventually to come to an end<sup>1128</sup>. The TSCG Treaty and the Six-Pack and Two-Pack legislation assigned the ECB a role in negotiating and/or monitoring specific policy commitments of national governments in the context of the new EMU legal framework on economic governance<sup>1129</sup>.

While general expressions gather little opposition, traditionalists reject *specific* policy pronouncements falling within the competences of political branches<sup>1130</sup>, let alone full conditionality.

Some intermediate positions acknowledge the lack of legal impediments to specific policy pronouncements, formulating the objection in political or normative terms instead, and recommend central bankers adopt an ethics of self-restraint in their institutional and personal expressions<sup>1131</sup>.

For others the limits are necessarily blurred and contextual, and “the more remote an issue is from the ECB’s mandate, the more cautious its approach should be, in terms of the detail of the message – substantively and procedurally – and the type of pressure exercised. In other words, pressure related to recapitalization of banks for the sake of the stability of the financial system would be easier to justify than an intervention related to the specific legal instrument to be used for labour market reform for the sake of improving competitiveness”<sup>1132</sup>.

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<sup>1126</sup> (ZILIOLI, 2016: 179-182).

<sup>1127</sup> Art. 13(3) and (7) of the ESM Treaty.

<sup>1128</sup> AG CRUZ-VILALLON, Opinion on *Gauweiler*, §144.

<sup>1129</sup> (DIESSNER & LISI, 2019: 11-12).

<sup>1130</sup> (BEUKERS, 2013).

<sup>1131</sup> See CB’s internal codes of conduct footnotes above, (TUCKER, 2018: 564-7).

<sup>1132</sup> (BEUKERS, 2013: 1612).

The CJEU, however, came to validate even the most problematic cumulation of the two dimensions of conditionality<sup>1133</sup>. The legal admissibility of CBs' imposition-cum-crafting of conditionality on substantive fiscal and economic policies of the political process reflects a broader point: the CJEU's admission of (some degree of) CB interference in the proper domain of classic political process.

The Court and legal literature have entertained two major legal objections to full conditionality: one based on a purported positive dimension of CBI that would prohibit efforts of CBs to influence classic political branches, and another on a (strictly separatist) interpretation of the principle of conferral of competences.<sup>1134</sup>

The dismissal of such objections is based on: (i) the rejection of a legally established positive dimension of CBI; and the arguments (ii) that even if some prohibition of influence existed, it would be confined to decisive influences which is not the case with the *de facto* conditionality where the ECB is not decisive (at least *de jure*); (iii) that regardless of their decisiveness, the ECB actions are justified by the principle of conferral when at the service of mandated objectives and using delegated policy tools; and finally (iv) that the ECB is complying with other legal guiding principles to which it is specifically subordinated, including those of "sound public finances", and of "an open market economy with free competition, favouring an efficient allocation of resources".

#### **a) NO PROHIBITION OF INFLUENCES**

It has been suggested that the EU Treaties' establishment of a negative dimension of CBI, i.e., the prohibition of influences *from* politics, "should be complemented by a positive dimension, compelling CBs to abstain from actively participating in politics"<sup>1135</sup>.

If CBs need to be shielded from the dynamics of politics in order to undertake a sound and technically impeccable monetary policy, "it is reasonable to expect that they will also depart from participation in everyday politics"<sup>1136</sup>.

The Treaties do not establish symmetry or reciprocity of prohibitions. They institutionalize mutual dialogue and cross-participation, but create notorious differences in the legal treatment and obligations of ICBs and political branches.

The TFEU explicitly assigns the ECB an advisory role within its field of competence and a secondary objective to "support the general economic policies in the Union", and it imposes a prohibition from seeking or accepting instructions from EU or national political institutions, but

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<sup>1133</sup> See below on the *Pringle* and *Gauweiler* cases.

<sup>1134</sup> (AG CRUZ-VILLALÓN'S Opinion in the *Gauweiler* case, §143-150), (SARMIENTO, 2016).

<sup>1135</sup> (ZILIOLI & RISO, 2018:168).

<sup>1136</sup> (SARMIENTO, 2016: 53).



no ban on trying to influence the political institutions. There is nothing that “obliges the ECB not to contribute to the political discussion”<sup>1137</sup>.

Article 130 TFEU prohibits EU and national political authorities from intervening in ESCB decision-making, but “[t]he normative limits to instructions, influence and pressure in the opposite direction are less obvious. In fact, there is no parallel treaty provision that prohibits ECB intervention in economic policy making.”<sup>1138</sup>

#### **b) NO PROHIBITION OF NON-BINDING INFLUENCES**

Moreover, it would not really matter if the ECB had such symmetrical or reciprocal positive prohibition to influence the political institutions because that would only cover binding interferences, which is not the case of the ECB’s said conditionality.

According to the heads of ECB’s Legal Division, the CB has a role of mere technical support on the negotiation and design of conditionality, in which they have no power to adopt economic and fiscal policies and reforms<sup>1139</sup>.

They are right that article 130 TFEU only prohibits *decisive* influences *from* classic political actors, and that it does not cover efforts *from* central bankers aimed at political actors, let alone if they are not binding.

They are also right in noting that, on the EU-side, decisions on the requirements of adjustment programs and of sanctions in surveillance procedures are determined by competent (political) authorities other than the ECB (Eurogroup, and Council).

In the context of financial assistance (ESM and other Troika programs) and the macro-surveillance procedures the ECB acts formally as a “junior partner” to the Commission which in turn has the obligation to undertake these tasks “in liaison with the ECB” or “in cooperation with the ECB”. According to the CJEU in their judgments in the *Mallis and Malli* and *Ledra* cases, “the ECB has been considered to have no decision-making powers in either the Eurogroup or ESM”.<sup>1140</sup>

The two ECB directors also rightly suggest that the acceptance of, and a country’s commitment to, a macroeconomic adjustment program and the legal adoption and effective implementation of economic reforms have to be decided by the national political authorities through their own internal political processes. The fiscal or structural reform decisions are ultimately and voluntarily taken by the political body.

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<sup>1137</sup> (ZILIOLI, 2016: 182).

<sup>1138</sup> (BEUKERS, 2013: 1610), (ZILIOLI & RISO, 2018:168), (SARMIENTO, 2016: 53).

<sup>1139</sup> (ZILIOLI, 2016), (ZILIOLI & RISO, 2018:168).

<sup>1140</sup> (SARMIENTO, 2016).

The ECB “only participates as an expert advisor”<sup>1141</sup>. Their interventions are not legally decisive nor productive of legally binding economic policy measures of individual Member States.

However, it is an understatement to claim that the ECB’s role is merely of technical support or advisory, or that it does not go beyond expressive advocacy. “[T]he Court of Justice underplayed the multiple roles that the ECB performs”<sup>1142</sup>. In fact, “the ECB has been more visible as a member of the *troika* than a mere advisor would normally be, given the authoritativeness of its advice”<sup>1143</sup>. “The ECB’s role in the design, adoption and regular monitoring of those programmes is significant, not to say decisive”<sup>1144</sup>.

It sends “messages” concerning (i) individual Member States, with (ii) great detail about the necessary fiscal and structural reforms, combined with (iii) great and effective pressure... The combination of these three characteristics of the “messages” given by the ECB to Member States in relation to their fiscal policy and structural reforms is unprecedented, and justifies speaking of central bank intervention in the area of economic policy making”<sup>1145</sup>.

When the ECB explicitly or secretly threatens by using the conditional access to its policy instruments to leverage its specific economic policy advice, it multiplies the influence of its “technical opinions” and goes much beyond a junior partner and technical advisor.

The national authority might maintain its *de jure* autonomy to decide on whether to pass and implement the measures or to consider alternative policies or the cost for deviating from the ECB’s demands. However, its *de facto* autonomy may wane. If a national government decides to rebel against the ECB, that may ultimately cost the population an enormous economic and social toll and national politicians may lose their position in office.

Furthermore, the ECB may gain some practical supremacy over the European political institutions in the process of conditionality, namely by using its superior expertise, leveraging its decisional expediency, protection under CBI and separation of powers.

In conclusion, if the ECB’s conditionality interventions are not *de jure* decisive, they may be *de facto* decisive: effective and consequential in shaping specific(ally) economic policies assigned to the national political branches.

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<sup>1141</sup> (ZILIOLI, 2016: 179-182), (ZILIOLI & RISO, 2018: 169), (AMTENBRINK, 2019: 171-2).

<sup>1142</sup> (TRIDIMAS & XANTHOULIS, 2016: 39).

<sup>1143</sup> (ZILIOLI, 2016: 182).

<sup>1144</sup> (TRIDIMAS & XANTHOULIS, 2016: 34), (BEUKERS, 2013: 1591, FN 55).

<sup>1145</sup> (BEUKERS, 2013: 1581, 1583).

### c) CONFERRED AUTHORITY

The legal question, thus, is about “the limits imposed on [the ECB] by the conferred competences doctrine, rather than from an application of the principle of independence”<sup>1146</sup>, and whether the CB is illegally encroaching on economic and other classic political policies.

The CJEU reviewed and validated under the light of the principle of conferral these ECB interventions on policies assigned to the classic political branches. It found that the different types of conditionality were actions adopted and implemented inside the area assigned to monetary policy, functionally defined according to “both the objectives of monetary policy and the instruments which are available to the ESCB for the purpose of implementing that policy”<sup>1147</sup>. In the *Pringle* case the Court found that the ECB role in negotiating and monitoring economic policy conditionality and its participation in enhanced surveillance missions fall within the CB’s secondary mandate to “support the general economic policies in the Union”<sup>1148</sup>. It was following the ECB’s 2011 Opinion on economic governance reform in the European Union<sup>1149</sup>.

When the Court revisited conditionality in the *Gauweiler* case it justified the ECB’s exigence of a macroeconomic adjustment program as condition for the access to the OMT facilities by combining references to the primary, the secondary mandate, and further legal limits on the ECB’s competence.

Firstly, the Court found that the OMT program in general falls within the primary mandate because of its aim “to safeguard both ‘an appropriate monetary policy transmission and the singleness of the monetary policy’”<sup>1150</sup>.

Second, it judges that the conditionality itself fits within the limits of the primary mandate because it maintains the OMT program focused on price stability objective and its intermediate goal of restoring the effectiveness of the monetary policy, while it prevents a deviation towards the goal of supporting the financing conditions on Member States<sup>1151</sup>. The CB’s conditionality would then be explained by a monetary policy consideration that demanded a combination of unconventional monetary policies and economic conditionality “to break through the so-called adverse feedback loop that exists between a Member State’s fiscal position and monetary policy”<sup>1152</sup>.

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<sup>1146</sup> (ZILIOI, 2016: 182).

<sup>1147</sup> CJEU Judgment on the *Pringle* case, §53, and *Gauweiler* case, §42.

<sup>1148</sup> CJEU, Judgment on the *Pringle* case, §165.

<sup>1149</sup> (BEUKERS, 2013: 1617, citing the ECB, Opinion of 16 Feb. 2011).

<sup>1150</sup> CJEU, Judgment on the *Gauweiler* case, §46-56.

<sup>1151</sup> *Idem*, §60-61.

<sup>1152</sup> (BEUKERS, 2013: 1606).

Third, the conditionality serves the secondary mandate of supporting the general economic policies in the Union, in the sense that is “possible that a government bond-buying programme may, indirectly, increase the impetus to comply with those adjustment programmes and thus, to some extent, further the economic-policy objectives of those programmes” and “thus ensures that the monetary policy measures it has adopted will not work against the effectiveness of the economic policies followed by the Member States<sup>1153</sup>.”

#### **d) SERVING LEGAL PRINCIPLES**

A final argument to support the legality of the imposition of economic conditionality on the access to ECB policy facilities is that it is a manifestation of several legal principles that control the *use* (rather than the limits) of the ECB conferred competence on monetary policy.

The unconventional scale and selectivity of the announced OMT program and the vulnerable financial condition (and need for financing) of the beneficiary countries were seen as triggering risks of breaching certain legal principles that the conditionality seeks to preserve and thus lessen those risks

It follows the principle that the “ESCB is obliged, under Article 127(1) TFEU, read in conjunction with Article 119(3) TFEU, to comply with the guiding principle that public finances must be sound”. The imposed “conditions... prevent that [OMT] programme from acting as an incentive to Member States to allow their financial situation to deteriorate”<sup>1154</sup>.

The imposition of conditionality is also seen as manifestation of the prohibition of monetary financing and fiscal dominance<sup>1155</sup>, which may be described as specializations of the guiding principle of “sound public finances and monetary conditions”<sup>1156</sup>.

Finally, the economic conditionality may also find some legal cover under the legal principle of proportionality.<sup>1157</sup> It may be described as one (among various) of the features of the ECB facility that prevents excesses beyond what could be considered necessary, suitable, or proportional. Several undesirable risks or costs of the OMT may be avoided and some benefits augmented due to the imposition and implementation of macroeconomic adjustment programs that create an impetus for compliance with sound fiscal policies.

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<sup>1153</sup> CJEU, Judgment on the *Gauweiler* case, §59-60.

<sup>1154</sup> *Idem*, §61, 111. (ZILIOLI, 2016: 181), (SARMIENTO, 2016: 53).

<sup>1155</sup> Art. 123 TFEU, CJEU, Judgement *Gauweiler* case, §120-1, (BRUNNERMEIER, JAMES & LANDAU, 2016: 314, 340).

<sup>1156</sup> Art. 119 (3) TFEU.

<sup>1157</sup> Art. 5 (4) TEU.

Furthermore, the conditionality reduces the probability of losses to the ECB, protecting its financial independence<sup>1158</sup>, helps saving the euro and financial stability<sup>1159</sup>, and contributes to the congruence of monetary policy and economic policy measures in complementarity to achieve the objectives of the Union.<sup>1160</sup>

This does not mean that the imposition of conditionality is the only means to comply with the principles of “sound public finances”, prohibition of monetary financing, and proportionality. In the *Gauweiler* case, the CJEU identified other important features of the OMT program constraining the management and holdings of the sovereign securities that were designed to preserve those same principles.

In the PSPP program the ECB dispensed with the economic conditionality while maintaining other constraints, which was validated by the CJEU in the *Weiss* case.

Finally in the PEPP the ECB dropped many constraints (including on limits on holdings and credit quality) and allowed itself ample flexibility<sup>1161</sup>. The idea behind such evolution is that the need, suitability, and proportionality of the economic conditionality depends on the underlying conditions and the complete set of features of the monetary policy at stake.

Conditionality and other CB interventions in economic and other policies under the competence of classic political branches are not rejected as such. Despite their interference in the political process, sound legal arguments have been found to validate them even when they are *de facto* consequential, albeit not *de jure* decisive.

The conferral, the proportionality principle and democratic principle have to be called upon to assess the admissibility of each case of CB intervention and conditionality. They have to guarantee that political branches maintain an ultimate control of CBs in general and an effective autonomy/freedom to decide on economic and other measures, so such interventions have to serve legally mandated primary or secondary objectives through authorized instruments. In addition, the procedural guarantees stemming from the proportionality principle ought to apply: the CB must make public and transparent its decisions, reasons, background information, alternatives, and limits, and carefully explain them to the political branches and the public, exposing their own decision-making to *ex ante* and *ex post* contestation.

## **6.5. POLITICIZATION AS PUBLIC CONTESTATION**

Confronted with ICBs’ interventions in substantive political choices and in the classic political process, public and classic political actors are expected to act and react.

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<sup>1158</sup> (ZILIOLI & RISO, 2018: 168).

<sup>1159</sup> (BRUNNERMEIER, JAMES & LANDAU, 2016: 314, 340).

<sup>1160</sup> (ZILIOLI, 2016: 181).

<sup>1161</sup> (MERSCH, 2020, defending how the PEPP meets the proportionality principle).

If the issues are substantively political, the public gets *naturally* interested and political actors are activated *per vocation* and/or *to defend* what they see as their own field of competence, to counter the existence or excesses of monetary dominance or to keep the central banking process operating under conditions and constraints of public contestation.

Chapter 1 depicted how post-GFC central banking generated and got involved in higher levels of public contestation in the three senses of increased salience, polarization, and public participation.

Various CBs' decisions in history have captured immense public attention and generated serious public contestation – more recently, post-GFC unconventional policies and bailouts of financial institutions and governments, pandemic stabilization efforts, and the current anti-inflationary measures.

The massive bailouts of private banks caused immense public debate on the allocation of public resources, fostering populist attacks that CBs benefited the few. Swap lines to foreign CBs fueled nationalist bouts that they privileged foreigners.

Central bankers were blamed for the recent crises (GFC and Eurocrisis) and for societal evils such as inequality allegedly promoted by their unconventional monetary policies or their alleged sponsorship of fiscal austerity.

Yet, exposure to heated public contestation is not a post-GFC novelty.

On the contrary, it is a feature of the most normal of the CBs' tasks: to fight inflation surges. The VOLCKER's Fed faced some of the harshest periods of public criticism and heated debate over policies of the past half century. The current post-pandemic inflation is bringing ICBs to the spotlight and can head that same contentious way.

That is not an unintended consequence. The staple utilitarian justification of the delegation to ICBs is their (alleged) superior capacity to endure public criticism and decide correctly under conditions of public contestation.

CBI is meant for public contestation.

The discussion should then be whether ICBs should ignore or consider and even engage with such public contestation.

Traditionalists go the first way: central bankers ought to ignore the public and be tied to the mast of the purportedly clear mandate they previously received from their democratic principal. One key conclusion of this research is that CBs do and ought to ponder public contestation and be exposed to and engage with the public. It is a condition of their legitimacy and a new avenue of legitimation they have explored<sup>1162</sup>, and it is also one of their comparative institutional advantages.

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<sup>1162</sup> (MOSCHELLA, PINTO & DIODATI, 2020).

There are normative reasons to believe that in the specific fields of competence they developed (monetary and financial policies), ICBs may be superior governing institutions, which includes superiority in pondering public contestation of the issues and choices at stake.

With some improvements, that superiority may be solidified.

Taking into consideration and getting engaged in public contestation does not mean “leaning in favor of the wind”. It means promoting and contributing to that public contestation and selectively and unbiasedly profiting from the inputs and participation the public brings to that contestation.

There are signs that CBs have been doing both.

On the one hand, in the past two decades CBs dramatically changed their approach and openness to the public. The transparency of decisions, of their reasons, and of the decision-makers and their decision-making processes increased enormously. For instance, “in a notable shift for an institution that has been traditionally wary of disclosing too much information to the public, the ECB moved in this direction by starting publishing accounts of its internal deliberations in January 2015. The ECB also started the practice of appearing before a number of national parliaments, increased the frequency of communication with the European Parliament, engaged with debates on fiscal policy and structural adjustment; and even toured Europe in order ‘to engage, explain and listen’ to European public”<sup>1163</sup>. The centralverse in general experienced a Copernican revolution from opaque to transparent central banking.

On the other hand, the multiplication of avenues for dialogue with and inputs from the public – and not only the largest financial market actors – allowed CBs to gauge the public(s’) sentiments directly and without filters. CBs seem to be increasingly aware of the biases, asymmetries and (un)representativeness problems affecting public debates and the interventions in the public sphere.

ICBs seem to have been aligned with societal preferences in some difficult discretionary decisions, such as the GFC rescues of financial institutions, the pandemic advances in lending directly to governments and crisis-struck firms (against earlier taboos), and their evolving participation in combating climate change.<sup>1164</sup>

Devoid of prior legislative authorizations or formal ratifications, CBs seem to have found in public contestation over these and other difficult political conflicts the source and guide for decisions legitimated by a broad societal consensus.

It is important, though, not to see too much in every public controversy. Not all public contestation concerns a political conflict, i.e., a substantive political choice. Not all

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<sup>1163</sup> *Idem*.

<sup>1164</sup> (VAN’T KLOOSTER, 2021).

disagreements about their policies concern innovative and fundamental choices since most of the CBs' choices are not substantively political.

Public contestation is substantively political when the disagreement concerns the management of primary unresolved conflicts ("politically undecideds"), but not the "mere" public *heat over the implementation* of previously decided political choices.

As described above, there are various cases where CBs primarily address what are still "politically undecideds", where the substantive fundamentality of underlying choices, the public's attention, and interest in engaging, and the intensity of polarization and disagreement are no different from those surrounding quintessential political choices in fiscal and other economic policies. Those are the cases involving distributional and value-weighting in the combats against high inflation or against deflation, the balancing of price and financial stability objectives in normal times, the trade-offs between different risks at stake in short-term economic stabilization during crises, and the clash of ideas and redistributive calls involved in LOLR and MMLR interventions.<sup>1165</sup>

On other occasions though, contestation concerns the *implementation* of what were thought to be politically decideds. Initially, such public contestation is perceived as mere reverberation of past fought and resolved political fights. CBI as commitment strategy seems to be good and sufficient then.

However, that contestation over implementation may grow to a different level, soon generate second-round efforts seeking to reverse primary decisions or open new ones. Even the mere expression of dissatisfaction with the implementation of prior political decisions cannot be ignored. "Since the situation changes all the time, the demands of the public change too"<sup>1166</sup>. Discontentment and disagreement have to be channeled somehow.

Politics and democracy are about accepting and taming the open future<sup>1167</sup>. CBs may be a powerful and useful constitutional institution to channel, promote and deal with the never-definitely-decideds, the public contestation and the open future – albeit at a non-ultimate level and under constraints

## **6.6. POLITICIANS STRIKE BACK**

Such openness of CBs to deal with political life does not mean acceptance of unlimited politicization of CBs, of their supremacy and full discretion, nor the exclusion of DRs.

DRs keep *ex ante* signaling powers to steer and warn central bankers but also *ex post* powers to judge and possibly ratify and ultimately correct the course or "punish" the CB for its choices.

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<sup>1165</sup> (BERNANKE, 2015: 216, 220), (BLINDER, 2016).

<sup>1166</sup> (VAN MIDDELAAR, 2013: 307).

<sup>1167</sup> *Idem*, 310.



Those two dimensions of politicization of CBs – when they intervene in substantive political choices and face and engage with public contestation – tend, in turn, to entice DRs to influence the central banking process and mobilize those *ex ante* and *ex post* controls.

CBs are *in* politics and have to manage the classic political branches<sup>1168</sup>. The latter’s inputs and contestation through framing mandates and other constraints, signaling, coordination or accountability *exist*, and in various forms are legally and normatively *accepted* and even demanded.

The respect of CBI does not mean obliviousness or passivity from DRs. “What the Fed does is too important not to argue about” and it “is possible to show too much deference to the Fed” by “quietly pretending that it is a purely technical institution”<sup>1169</sup>.

The EU’s landscape is the most complex in this regard. The EU institutions have increasingly engaged with the ECB, and the European Parliament has gone to pains to deepen the monetary and supervisory dialogues with the ECB.

But the democratic authorities of the EU Member States are in a more difficult position in this context. Political institutions of large and small countries alike have contested the ECB, including the CBI-passionate German Bundestag<sup>1170</sup>. The ECB even started the practice of appearing before a number of national parliaments<sup>1171</sup>.

Domestic politicians and isolated national governments of smaller Member States have less capacity to move the clogs of democratic control of such an EU-wide supranational institution. Yet, they are not irrelevant, normatively or *de facto*. They are like individual voters that, *per se*, are almost always irrelevant in democratic elections but whose right to participate is nevertheless fundamental. With aggregation, coalition building, and veto rights, national political actors might become effective at the EU-ECB level. The power of national governments to cross-veto other issues requiring unanimity in the Council, the national interest and voice of European parliamentarians and the home bias of the governors of NCBs may give some hope to national political actors to mobilize the European process in ways that manage to effectively influence the ECB.

The traditional tale is that politicization and CBI are in an opposing relationship, more of the former would reduce the latter. The former tends to attract public contestation which, in turn, entices the interference and controlling efforts of DRs, thereby threatening CBI.

However, in the past decades the strengthening of CBI has been associated with more politicization of CBs’ outputs, namely their substantive political decision-making.

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<sup>1168</sup> (GREELY & SCRAGGS, 2018).

<sup>1169</sup> *Idem*.

<sup>1170</sup> (HÖGENAUER, 2019: 294).

<sup>1171</sup> (MOSCHELLA, PINTO & DIODATI, 2020: 400).

Historically, what earned CBs the reputation of stronger independence was not the absence of public contestation or political pressures on them, but that they faced and arguably passed the test of such contestation and political pressures, e.g., MONTAGU NORMAN's BoE, VOLCKER's Fed, the German Bundesbank in various conflicts<sup>1172</sup>, TRICHET's ECB.

That counterintuitive association of the rises of independence and politicization of outputs was observed in the judicial branch. Judicial independence and the politicization of judicial outputs which came to be known as "judicialization of politics" are interconnected and have generally evolved in the same rising direction.<sup>1173</sup>

Descriptively the historical trend has been of more judicialization with more independent courts. Normatively the support came from core ideas of liberal democracy: independent courts in charge of the counter-majoritarian protection of individual and minority rights and the substantive rule of law regime.

Such protection of fundamental rights, the advancement of European integration by the very independent CJEU, and, more generally, the constitutional and administrative judicial review in which judges sometimes engage in substantive policymaking are examples of that combined rise.

However, it is when both reach higher levels that they become more problematic, particularly for democracies. Independence without judicialization, and vice-versa, would be less problematic in the democratic and separation of powers perspectives.

In effect, that relationship is not endlessly linear, and it may actually reverse at a certain level of politicization of outputs beyond which independence wanes and politicization of inputs into the judiciary increases.

KELEMEN argued that in a democracy, beyond certain levels of judicialization, it is necessary to mitigate independence and introduce some (inputs) politicization of the judiciary to sustain the legitimacy of the judicial function.<sup>1174</sup> That is why judges of supreme and constitutional courts responsible for the ultimate judicial review are generally appointed by elected officials.

The question that follows for CBs is whether they have reached their peak of politicization-cum-independence.

## **6.7. THE LIMITS OF POLITICIZED INDEPENDENT CENTRAL BANKS**

The general rise of transparency and political accountability of CBs, the Dodd-Frank Act reform requiring the US Treasury's prior approval to the Fed's emergency lending to non-banks; "the

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<sup>1172</sup> (MAIER & DE HAAN, 2000: 36-37), (BERGER & SCHNEIDER, 2000: 60-61).

<sup>1173</sup> Judicialization of politics or politicization of judicial outputs refers to the trend of increased intervention of the judiciary in policymaking. It contrasts with the *inputs politicization* of the judiciary.

<sup>1174</sup> (KELEMEN, 2013), (GAROUPA & GINSBURG, 2008: 60).

decision not to give the role of Single Resolution Mechanism to the ECB (much more politically sensitive than SSM); the rise of the comparative centrality of (political) fiscal policymakers in response to the pandemic crisis are insightful signals that the CB “may have reached the limits of its political power for the time being”<sup>1175</sup>.

Instead of endorsing this “peak-politicization” view and thus the retrenchment of either politicization or independence, there might be alternatives that reconcile democratic and independent politicization.

The mainstream approach has been to improve and increase the inputs from partisan DRs without jeopardizing the essence of independence.

Another way of dealing with those limits of politicization is to explore “new forms of democratic connections”, alternative to partisan democratic instruments, capable of sustaining the necessary public contestation and legitimizing the more politicized-and-independent central banking.

To conclude, CBs are *in*, not *above*, politics in all the senses of the term<sup>1176</sup>. Central banking is neither *hors-champs* of the political<sup>1177</sup>, nor outside the democratic process broadly considered. “[T]here is indeed an authentic politics that lies underneath this long thread of experts, but this is a politics that does not take on habitual forms of party politics”<sup>1178</sup>.

Adapting CLAUSEWITZ, *central banking is politics by other means*<sup>1179</sup>.

In fact, politicization does not necessarily mean partisanship (favoring one candidate or political party over another), bias or sectional favoritism (favoring one social, political, or economic group at the expense of another)<sup>1180</sup>.

Its independence and specialized expertise structure enable a different *rationalized, non-partisan* politicization, more disengaged from “the democratic circuit of the *political-electoral representation* that characterizes the traditional administration”, with its decision-making insulated from “considerations of contingent politics” and the political class’s short-term focus on the electoral cycle<sup>1181</sup>.

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<sup>1175</sup> (EUROPEAN UNION CENTER OF NORTH CAROLINA, 2013).

<sup>1176</sup> (RILES, 2018: 2).

<sup>1177</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>1178</sup> (VAUCHEZ, 2016: 45).

<sup>1179</sup> (CLAUSEWITZ, 1852).

<sup>1180</sup> (RILES, 2018: 7), (WILL, 2022).

<sup>1181</sup> (MERUSI & PASSARO, 2003: 83).

Independence and expertise prevent partisan politicization and colonization of CBs by political parties<sup>1182</sup>, and habilitate them to be countervailing powers (“*contropoteri*”) to the partisan political power<sup>1183</sup>.

“[T]he old and perhaps still dominant approach [that] mimicks the ostrich with its head in the sand – to simply ignore or deny [politicization’s] existence completely” is not acceptable. But the opposite extreme of “choos[ing] simply to cave to politics – to embrace or at least accept the overt politicization of finance” is equally dangerous.<sup>1184</sup>

The reflection on the politicization of central banking has to go deeper and further: on its real conditions, allowing economic agents to adjust to it<sup>1185</sup>; and on its normative case, to support society’s deliberation about the fact and choice of politicization of central banking<sup>1186</sup>. Importantly, it is necessary to reflect on the ways to improve the non-partisan, political aptitude of independent CBs<sup>1187</sup>, balancing the triangle of their normative advantages, clarifying and strengthening the *ex ante* and *ex post* democratic controls while exploring new democratic forms, and also buttressing the epistemic advantages of ICBs.

To come to terms with the steady and significant rise of ICBs (and other independent institutions) it is better to *adapt* the democratization strategy, rather than narrowing it down to “majoritarization” or parliamentarization<sup>1188</sup>.

It is better to explore other often forgotten territories of democracy by deciphering the political role of CBs, coming up with new checks and balances that could be established in the democratic system, new forms of democratic connections with the independent branch, and conditions under which the independents can be integrated in the public sphere and be opened to more democratic responsibilities<sup>1189</sup>.

There is evidence that CBs are already paving that way<sup>1190</sup>.

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<sup>1182</sup> (OTERO, 2003: 294-5).

<sup>1183</sup> (MANETTI, 1994).

<sup>1184</sup> (RILES, 2018: 19-20).

<sup>1185</sup> (REDWOOD, 2021).

<sup>1186</sup> Differently, (DIETSCH ET AL., 2018: 21).

<sup>1187</sup> (FOSTER, 2017), (VAUCHEZ, 2016).

<sup>1188</sup> (TUCKER, 2018), (AMTENBRINK, 2019: 178-9), (DE BOER & VAN’T KLOOSTER, 2021). Differently, (MOSCHELLA, PINTO & DIODATI, 2020).

<sup>1189</sup> (VAUCHEZ, 2016: 4-5).

<sup>1190</sup> (MOSCHELLA, PINTO & DIODATI, 2020).

## PART IV NORMATIVE ANALYSIS

### 7. NORMATIVE DEFENSE OF POLITICAL & INDEPENDENT CENTRAL BANKING

#### 7.1. RECONSTRUCTING THE NORMATIVE DEFENSE OF CBI

##### 7.1.1. FALSE DUALISM

The normative debate on the justification and appropriateness of CBI has generally played out as a clash between functional (or utilitarian) and democratic ideals. That is a false dichotomy, though.

*Functionalists* emphasize the importance of CBI as a superior procedural device for credible commitment in policymaking, which by insulating decisionmakers from partisan politics, delivers superior outcomes in terms of macroeconomic performance<sup>1191</sup>.

Multiple empirical studies found a negative relation between CBI and inflation average and variance<sup>1192</sup>, and positive<sup>1193</sup> (or no negative<sup>1194</sup>) effects on real variables such as economic growth and stabilization, and on fiscal discipline and debt sustainability<sup>1195</sup>.

Indirectly through its enhancement of price stability, CBI would mitigate the negative economic consequences of inflation, such as falling real incomes (especially for lower-income households), high nominal and real interest rates, “shoe leather costs”, suboptimal allocation of goods and services, distortions in tax systems, de-anchoring of inflation expectations, heightened economic uncertainty, all of which undermine consumer spending and business investment.<sup>1196</sup>

There were also empirical findings of political consequences of CBI on cabinets’ durability<sup>1197</sup>.

Basically, the functionalist *justification* sees the delegation of monetary policy to the (constrained) discretion of ICBs as a superior alternative to both the classic political process and to a regime of *rigid rules* that lack the flexibility needed to deal with varying economic conditions and moments of financial stress.

The classic political process is described as less capable of credible commitment to the price stability goal due to its electoral business cycle, short-termism and intertemporal inconsistency which lead elected officials to manipulate monetary policy to finance excessive government

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<sup>1191</sup> (KYDLAND & PRESCOTT, 1977), (SARGENT, 1982), (BARRO & GORDON, 1983), (ROGOFF, 1985), (ALESINA, 1988), (ALESINA & TABELLINI, 2008), (LAURENS ET AL., 2009), (LASTRA, 2015), (BERNANKE, 2015).

<sup>1192</sup> (BADE & PARKIN, 1982), (ALESINA, 1988), (PERSSON & TABELLINI 1990), (GRILLI, MASCIANDARO & TABELLINI, 1991), (CUKIERMAN, WEBB, & NEYAPTI 1992), (ALESINA & SUMMERS, 1993), (LAURENS ET AL., 2009), (ALESINA & STELLA, 2010), (BODEA & HICKS 2015), (GARRIGA, 2016), (DE HAAN & EIJFFINGER, 2016: 4).

<sup>1193</sup> (WALLER & WALSH, 1996: 1146-7), (LAURENS ET AL., 2009), (MILLER & WHITFORD, 2016).

<sup>1194</sup> (ALESINA & SUMMERS, 1993), (SVENSSON, 1997).

<sup>1195</sup> (LAURENS ET AL., 2009), (GIORDANO & TOMMASINO, 2011), (BODEA, 2013), (BODEA & HIGASHIJIMA, 2015).

<sup>1196</sup> (SARGENT, 1982), (GARRIGA, 2016), (MERSCH, 2017), (OECD, 2022).

<sup>1197</sup> CBI complicates the durability of governments without control of monetary policy (BERNHARD AND LEBLANG, 2002), (CLARK, GOLDER & POAST, 2013).

spending and generate short-term output gains (*strong version*) or to resist taking the unpopular, albeit necessary decisions to tame inflation (*mild version*, probably more realistic)<sup>1198</sup>.

Such political manipulation results in a prolonged and excessive issuance of money that frequently leads to high inflation and even hyperinflation, and considerable depreciation of domestic currency, and thus an inflation bias or at least an inefficient inflation stabilization bias.<sup>1199</sup>

Even though prudential financial policies and fiscal policies also suffer from those pathologies of the political process, monetary policy was initially singled out due to its especially vulnerable temporal profile, as it operates with long lags, and the pain of fighting inflation (higher unemployment for a while) comes well in advance of the benefits (permanently lower inflation)<sup>1200</sup>. That requires weighing benefits not yet perceived against what hurts immediately, which is difficult to comprehend for the public, mass media and politicians who play the short-cycled game of partisan and electoral politics, made even shorter by the transformation of public debate as a consequence of the digital and social media revolutions.

Partisan politics causes, first, an inertial attitude towards inflation, and subsequently, a likely overreaction to severe inflation surges that provoke otherwise unnecessary recessions and hard landings.

On the contrary, an ICB offers more credible commitment, changing and anchoring inflation expectations in advance of lower actual inflation.

Such superior commitment credibility would stem from the insulation of central bankers from the short-cycled and time-inconsistent game of partisan and electoral politics or equivalent short-term incentives, from their additional specialized expertise to ponder the technical and intertemporal dimensions of those policies, and their different incentive structure privileging a longer-term perspective and professional standing and public reputation for attaining the legal mandate where price stability figures prominently<sup>1201</sup>.

Such justification has been criticized even from a functionalist or utilitarian perspective.

One objection was that CBI does not offer sufficient credibility of commitment because central bankers themselves have systematic inflationary-bias and time-dynamic inconsistency.<sup>1202</sup> Thus, it would be necessary either to revert to a regime of rigid rules where monetary authorities are mechanic implementers stripped of meaningful discretion, or to supplement CBI with other

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<sup>1198</sup> (ALESINA, 1998), (ALESINA & SUMMERS, 1993), (BLINDER, 1997: 118 and 1998), (CUKIERMAN, MILLER & NEYAPTI, 2002), (GOODHART, 2003), (KING, 2004), (BERNANKE, 2016).

<sup>1199</sup> (GREENSPAN, 1996), (KING, 2004), (SVENSSON, 1997).

<sup>1200</sup> (BLINDER, 1997: 118 and 1998: 55), (GOODHART, 2003).

<sup>1201</sup> (TUCKER, 2018: 107).

<sup>1202</sup> (BARRO & GORDON, 1983), (BIBOW, 2004).

conditions and devices, such as the selection of conservative central bankers or contracts with punishments or rewards for performance in terms of the price stability standards and targets<sup>1203</sup>. Others questioned the consequentialist merits of CBI. Empirical studies found contradicting evidence on the relation between CBI and (low) inflation, suggesting that such relation “is not very robust”, or that some correlation does not necessarily mean causality<sup>1204</sup>, or even that “causation goes the other way”<sup>1205</sup>.

Others noted that benefits might be context-dependent, being weaker or inexistent in developing countries and periods of deflationary pressures (such as the 1930s and Japan post-1990s)<sup>1206</sup>.

Others warn that giving greater weight to the inflation goal tends to generate greater output volatility<sup>1207</sup>, and that CBI increases vulnerability to financial shocks<sup>1208</sup>.

However, the most severe opposition came from majoritarian democratic arguments.

Such opponents claimed that CBI removes important macroeconomic policies and the management of primary political conflicts and distributional choices from the direct control of the electoral-representative process and the classic political branches, which would be the appropriate procedural and institutional realm.

Modern ICBs, and the ECB above all, would have a democratic deficit.<sup>1209</sup>

It would fail in procedural justice for not allowing the People to (ultimately) control those choices through their DRs or to use elections to regularly guide and correct the policy course and reflect the will, choice, and possible sanction of the People.

CBI would thwart free and equal participation and deliberation by the majority in monetary policy and other delegated functions.

Delegation to ICBs would leave “one of the major instruments of government policy” and crucial powers over the fundamental technologies of money and credit “under the control of an unelected, unrepresentative elite”, or a minority, Special Interest Group of financiers.

It would fail the aspiration of substantive democratic justice by not giving (equal) consideration to all affected interests and in particular, the worst-off.

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<sup>1203</sup> (ROGOFF, 1985), (WALSH, 1993).

<sup>1204</sup> With methodological reproaches (FORDER, 1996), (POSEN, 1993 and 1995), (DE HAAN & KOOI, 2000), or different empirical results finding insignificant effects (KLOMP & DE HAAN, 2010), (WALSH, 1997), (BANAIA ET AL., 1998), (BLINDER, 1997 and 1998: 56).

<sup>1205</sup> (POSEN, 1993), (SIKLOS, 2002).

<sup>1206</sup> (BLINDER, 1998: 80, fn2).

<sup>1207</sup> (BERLEMANN & HIELSCHER, 2016).

<sup>1208</sup> (AKLIN & KERN, 2021), (DE BELLIS, 2015: 81).

<sup>1209</sup> (GORMLEY & DE HAAN, 1996), (EIJFFINGER & DE HAAN, 1996), (AMTENBRINK, 1999), (MCNAMARA, 2002), (HARRIS ET AL., 2011).

CBI would create a government *by a few, for a few*<sup>1210</sup>.

The democratic majoritarian view argues that the mix of fiscal and monetary policies should be under unified political control, so the latter becomes “part of a general policy package, not as an independent policy tool<sup>1211</sup>. It refuses to let classic political branches lose control of such tools to improve the lives of their constituents<sup>1212</sup>.

Heterodox economic theories, including the notorious “Modern Monetary Theory”, were advanced to suggest welfare benefits from that unified political control of all macroeconomic policies. However, they recurrently ignored or rejected established economic principles, such as the neutrality of money (and monetary policy) at least in the long run and the detrimental aggregate costs of surrendering the governance of money to partisan whims and away from price stability.

Some functionalists considered the democratic objections and offered two responses.

The first plays down the conflict between functionalist and democratic values, by belittling the democratic costs of the delegation to unelected central bankers. It incorrectly assumes that ICBs are delegated simply Pareto-efficiency policy issues and tasks of low political salience, which require mere technical choices and implementation under a consensus assignment after values have been broadly settled in the polity.

The claim is that democracy-critical choices involving fundamental political conflicts have already been made by the electoral-representative process, and in any case cannot be left to the discretion delegated to ICBs.

The second response acknowledges the conflict between functionalist benefits and democratic costs and that CBs inevitably make value and distributional choices, but concludes that the welfare benefits outweigh the democratic costs.

CBI is defined as a restriction of the democratic principle that is legitimate because it was democratically self-enacted. DRs may freely decide to tie themselves to the mast of CBI.

This seems to be the perspective adopted by the German Constitutional Court which, in successive decisions, accepted the EMU, the single currency and a supranational ICB as a “restriction” or “modification of the democratic principle” which “is still compatible with democratic principles because it takes the tested and scientifically documented special character of monetary policy into account that an independent CB is more likely to safeguard monetary stability, and thus the general economic basis for budgetary policies, than state bodies whose

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<sup>1210</sup> (HARCOURT, ET AL., 2018), (SCHWARTZ, 1987, 434-5).

<sup>1211</sup> *Idem*.

<sup>1212</sup> (VAN’T KLOOSTER, 2020: 19).



actions depend on money supply and value and which need to rely on short-term approval by political forces”<sup>1213</sup>.

Chapter 6.3 demonstrated how elusive and unsustainable is the assumption underpinning the first response, that CBs only make Pareto efficiency-improving choices. ICBs are political actors who inevitably make substantive political choices.

The second response, i.e., that the benefits of CBI outweigh the democratic costs, is put into question by the discovery of the unappreciated democratic credentials of CBI: (i) further opportunities for democratic interaction and improvement; (ii) the beneficial competition of influences; and (iii) the transformations in modern central banking towards more powers and politicization in the various senses.

Costs, benefits, and balances have to be reconsidered.

Looking forward, traditional *functionalists* reasserted the depoliticization of ICBs, defending a return to narrow central banking, sticking to narrower discretion and less functions and objectives – one single price stability goal and conventional monetary policy instruments – while doing away with prudential functions and other economic or social objectives. Accordingly, whenever CBs face incomplete mandates, uncertainty or emergencies, they would have to surrender command back to DRs, who would be called up to reassert goals and even some instruments dependence<sup>1214</sup>.

They dispute the normative admissibility of many post-GFC evolutions and the politicization of central banking. They want to preserve the extant levels of independence but for a lot less central banking.

In the other extreme, *majoritarian democrats* accept the expansion (and activism) of central banking but want to dismantle CBI as it is. They believe that the time has come to devolve monetary policy and CBs to political subordination, or at least to some form of limited bureaucratic autonomy.

The moderate amongst majoritarian democrats accept that delegating monetary policy to an ICB improves the quality of decision-making and admit that the elected government may lose competences and policy instruments.<sup>1215</sup> However, they seek to mitigate such losses and rebalance the trade-off between the utility of the rule by experts and the democratic control that representatives voluntarily ceded.<sup>1216</sup>

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<sup>1213</sup> GCC decision in *Brunner case*, BVerfGE 89, 155, 2 BvR 2134/92 (1993), para. 96.

<sup>1214</sup> GCC decision in *OMT case*, BVerfG, 2 BvR 2728/13, (2014), para. 59 (1). (TUCKER, 2018).

<sup>1215</sup> (VAN’T KLOOSTER, 2020).

<sup>1216</sup> (RILES, 2018: 13).

They seek to preserve the functionalist advantages of CBI, and rather than denying the politicization of central banking, they want to enhance its democratic credentials by increasing *ex ante* and/or *ex post* democratic controls.

There are calls for tightening *ex ante* control of the legislative delegation, for a renewal of the democratic mandate<sup>1217</sup>, imperative “regular re-chartering of the CB”<sup>1218</sup>, the enhancement of democratic authorization through “targeted democratic guidance”<sup>1219</sup>, or British-style Executive interventions to specify mandates.<sup>1220</sup>

Even more common (and moderate) are the appeals to the expansion of democratic accountability of ICBs.<sup>1221</sup>

This moderate majoritarian democratic approach correctly acknowledges the profound post-GFC transformations in the centralverse and how they exposed the artificiality and inadequacy of the depoliticization/neutrality assumption underlying the traditional CBI case<sup>1222</sup>.

The approach is rightly grounded in some comparative institutional analysis, but they forgot to update it.

It seems excessively grounded in a majoritarian conception of democracy, and thus, its main variable of adjustment to the changes in central banking has been the (compensatory) increase of partisan, electoral-representative control of central banking, which risks tilting the balance of values to the point of compromising the integrity of central banking.

It misses the justificatory potential, the democratic possibilities and the moderating capabilities of a more complex pluralistic CBI and pluralist conception of liberal democracy.

Like the functionalist view, it fails in framing an inevitable conflict between technocratic and democratic values and technologies, between welfare benefits and majoritarian control<sup>1223</sup>.

This tension or opposition between functionalism and democracy is false. CBI is not the choice of one over the other. Both are part of the modern conception of democracy, and they are reconciled through the pluralistic model of CBI.<sup>1224</sup>

This normative chapter seeks to update the comparative institutional analysis of the governance of money and credit.

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<sup>1217</sup> (BINDER ET AL., 2020), (CLAEYS ET AL., 2021).

<sup>1218</sup> (DOWNEY, 2021).

<sup>1219</sup> (DE BOER & VAN’T KLOOSTER, 2020).

<sup>1220</sup> (GOODHART, 2003).

<sup>1221</sup> (RILES, 2018: 13-19), (AMTENBRINK, 2019, 176-178).

<sup>1222</sup> (MANETTI, 1994).

<sup>1223</sup> (CONTI-BROWN & ZARING, 2019), (BLINDER, 1997: 116), (TUCKER, 2018: 556).

<sup>1224</sup> (MADURO, privately, 2022).

It tries to articulate a stronger, broader defense of political *and* independent central banking as a political technology that can be framed within the democratic framework<sup>1225</sup>, rather than a triumph of technocracy, and that offers further democratic advantages and contributes to building non-partisan but democratic forms of politics.

Previous chapters demonstrated that (and how) central banking *is* independent and political. The following chapter argues that it *can* be so.

The normative claim is that in certain contexts – more evident in the American divided political system and the European consociational and incomplete macroeconomic integration than in majoritarian Britain – and stages of development and maturity, central banking (the distinguished specialized art and science, law and practice of autonomy, embracing politicization in various senses) *can be* independent and political.

European, American and British CBs have converged, by history and choice, in developing the conditions necessary to strengthen the comparative institutional advantages of CBI. Yet, such maturation is not complete and they still have some way to go to strengthen such advantages. The past decades brought significant evolutions to modern central banking that put into question the normative consensus of the three precedent decades and created a theoretical disequilibrium that demands normative reflection.

Traditionalist retrenchment and majoritarian subordination are less promising alternatives than an intellectual rebirth of CBI in solidier, pluralistic normative grounds.

Reconstructing the comparative institutional analysis of a novel concept of pluralistic CBI is essential to test and validate that updated normative case and to find improvements in its framework *for democracy*.

### **7.1.2. COMPARATIVE INSTITUTIONAL ANALYSIS**

The normative analysis must *compare* alternative institutions that are *compatible* with the polity's fundamental values.

It incorporates but goes beyond the question of legitimacy, which involves “single institutional” analysis. Legitimacy is indispensable, but it is only one segment of comparative institutional analysis that filters which alternatives are accepted/-able from the perspective of input, output (and even *throughput* and *imagined output*).<sup>1226</sup>

The institutional analysis must ponder “the relative merits of the two institutions, when compared to each other”, to choose that with a more positive balance of benefits and costs in terms of the standard of comparison.<sup>1227</sup>

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<sup>1225</sup> (JAMES, 2022: 23).

<sup>1226</sup> (SCHARPF, 1999), (ROSANVALLON, 2012), (BELLAMY & PARAU, 2011: 255), (SCHMIDT, 2013 and 2019), (WEILER, 2017: 345).

<sup>1227</sup> (KOMESAR, 1994: 6, 21-22).

“The [institutional] choice is always a choice among highly imperfect alternatives”.<sup>1228</sup> Pluralistic CBI is imperfect and ICBs had failures over the past decades, but so did political authorities and markets.

The ensuing task is to demonstrate that the former have comparative advantages that make them the “less imperfect and costly” of the alternatives”.<sup>1229</sup>

The traditional case for CBI was framed as a comparison with the classic political process in the governance of monetary policy. Yet, the comparative analysis must be broadened in the *standards, context, and scope*.

First, it needs to go beyond the *functionalist* standard of the traditional *approach* that downplayed democratic values.

The proposal here is to adopt a normative triad with three input-based pillars, which are the standards of institutional comparison: (1) specialized expertise; (2) democratic credentials, both under the classic electoral-representative paradigm and other non-partisan and non-majoritarian democratic values and channels; and (3) mitigation of systematic majoritarian and minoritarian biases. The results will subsequently be validated under an objective and subjective outcomes-based approach.

The claim is that in comparison to institutional alternatives, pluralistic independent central banking has *epistemic-functionalist, democratic, and liberal/impartiality advantages* to govern money and credit.

Second, instead of the traditional narrow focus on inflationary contexts and the role of ICBs as inflation fighters, a proper analysis must broaden the investigation of CBI for “all seasons”, different contexts and the various normative goals. Pluralistic CBI is an institutional technology that suits the (various) sets of objectives chosen by DRs, including the fundamental concern and commitment to price stability.

Third, the scope of comparison needs to be extended to a broader range of functions in the government of money and credit (beyond internal monetary policy) and against various potential institutional alternatives.

It is assumed that path dependency, positive choice, relative advantages of concentrating functions in mature CBs, the interdependencies between functions, and the limits of that internal segregation disavow alleviating ICBs from those other functions that they have accumulated and specialized in across time (e.g., external monetary policy, financial policies, crisis management, bank to banks and governments).

And the advantage of CBI over the *market process* and the *adjudication process* is assumed.<sup>1230</sup>

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<sup>1228</sup> *Idem*.

<sup>1229</sup> (KOMESAR, 1994: 2, 5, 30), (EPSTEIN & O’HALLORAN, 1999: 47-49).

<sup>1230</sup> (LEITÃO AMARO, 2022b).

The market process would organize the governance of money and credit through full competition of private monies, complete deregulation of financial markets, and entirely free exchange rates and capital flows.

Its main arguments are the (need to eliminate violations of) freedom of enterprise, a belief in the efficiency of the decentralized market discipline and price signalling, promotion of innovation, and avoidance of failures of state/public intervention such as political transaction costs and inefficiencies, political cycling, arbitrariness, and agency problems stemming from shirking, rent-seeking, and capture.

Its main disadvantages are serious failures in monetary and financial markets, the lack of flexibility and dynamic instability problem (procyclicality, lack of fiscal anchors, limitations of anchors), the inefficiency caused by the lack of a uniform means of payment, and the problems of concentration of private power in case of monopolistic or oligopolistic private currencies or financial institutions.

Governance through the adjudication process would mean that Courts make the ultimate calls on monetary or financial policies, which is normatively questionable on two accounts.

Firstly, the structural features of the judicial process are comparatively inadequate for policymaking in general and the ordinary governance of these types of complex and technical macroeconomic policies in particular. Its passive intervention, relative lack of specialized technical expertise in complex macroeconomic issues, limited scale and human resources, long formalistic adversarial procedures, high costs of access and litigation, limited possibilities of cooperative coordination with political policymakers, and extreme insulation from some meaningful democratic control make it comparatively inept to exercise discretionary policymaking in these areas.

Second, the governance of money through the adjudication process would have to rely on a system of rigid rules that Courts would be entrusted with implementing, enforcing, and eventually adjusting. However, regimes of rigid rules, such as the historical commodity standards or the theoretical monetary rules, lack indispensable flexibility, elasticity and efficiency and risk dynamic ignorance, which led to their historical abandonment and replacement with discretionary regimes.

Still, CBI does not exclude some role for those market and judicial processes.

The governance of money, payments and finance evolved into a hybrid of public intervention and private market processes, combining decentralized decisions with the predominance of ICBs. Courts exercise important, albeit limited, judicial accountability of ICBs, checking the legal substantive and procedural limits of delegated discretion. Judicial review is more intrusive where regulatory and supervisory actions violate individual rights.

However, the most important comparative analyses are between the realistic versions of pluralistic CBI and the electoral-representative processes, both political technologies of indirect democracy.

## **7.2. THE IDEAL: NORMATIVE CONCEPTION OF PLURALISTIC LIBERAL DEMOCRACY**

Normative debates on CBI and its democratic credentials and legitimacy are frequently “informed by standards derived from the majoritarian model” of democracy, where the idea that “majority rule is the only source of democratic legitimacy is still generally accepted”.<sup>1231</sup>

However, “a normative appraisal of non-majoritarian mechanisms [such as CBI] – blatant violation of democratic principles or legitimate instruments of democratic governance – depends crucially on the model of democracy one adopts”.<sup>1232</sup>

The literature on conceptions of democracy is immense and cannot be covered here in detail.<sup>1233</sup>

The position taken is that the majoritarian conception is neither realistic nor the superior normative ideal. Universal (free and regular) suffrage and majority rule are not sufficient conditions for liberal democracy, which prevails across advanced Western countries.

Instead, a thick conception of pluralist liberal democracy is assumed. This involves a balance and endless tension between the democratic and liberal components and its two core values of equality and liberty.

A better conception of the democratic component demands more than competitive elections by universal suffrage and elected representatives deciding by majority.

It requires pluralism in active and equalized participation and representation, open political competition of parties but also of ideas and cross-cutting factions, institutionalized opposition, integrative and qualified public deliberation.

It must secure the possibility of non-violent removal of government officials and an open future where decisions are not irreversible. In addition, procedural and substantive fairness, where “we can all understand ourselves as co-equal authors of the laws that bind us”, particularly those affected (and, from a certain perspective, the worse off).

The liberal component has a negative pluralist dimension of limitation and regularization of power through the rule of law, substantive separation of powers, fundamental rights, and other procedural devices to check the abuses of the majority and that may require insulating certain questions from the politics of the day.

It also has a positive dimension of a pluralist call for the multiplication and openness of institutional devices, practices, and agents that broaden the involvement in decision-making and mobilize expertise and intergenerational perspectives.

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<sup>1231</sup> (MAJONE, 1996: 284-5), (DOWNEY, 2020).

<sup>1232</sup> (MAJONE, 1996).

<sup>1233</sup> (LEITÃO AMARO, 2023c, for references and brief discussion).

Pluralistic liberal democracy is a more complex system, combining the edited and disciplined electoral-representative process (and direct democracy mechanisms) under majority rule with multiple other non-majoritarian devices and institutions of indirect democracy.

It includes (pluralistic) CBI under the condition of exhibiting comparative advantages in the three standards of comparative analysis, which are normatively grounded in that conception of pluralist liberal democracy.

The epistemic standard is demanded by the liberal component, but also the dimensions of deliberation, pluralistic competition, and fairness of the democratic component.

The impartiality (or balanced representation) standard is based on the liberal demand of non-domination by majoritarian or minoritarian biases and the demands of equal and pluralistic participation and consideration of the democratic component.

The democratic standard emerges from the various dimensions of the democratic component and also the liberal protection of rights.

### **7.3. THE REAL: THE CLASSIC POLITICAL PROCESS WELL UNDERSTOOD**

“[N]o one believes any longer that democracy can be reduced to a system of competitive elections culminating in majority rule”<sup>1234</sup>.

That is both a descriptive and a normative assertion: the *real* electoral-representative processes in advanced economies depart from the stylized ideal of the classic political process, and on the other hand, the (prevailing) normative conception of (liberal) democracy demands more than (and something different from) competitive elections to choose representatives that govern by majority.

The majoritarian ideal of democratic control of macroeconomic policy rests on the belief that substantive political power is shared by Legislative and Executive branches, whose representatives are selected and mandated directly or indirectly by the People through regular and competitive elections.

The Legislative and Executive decide and execute, respectively, the fundamental political choices and policy decisions. Parliamentarians are expected to shape and guide policymaking through their laws, and scrutinize their implementation by the Executive by means of parliamentary accountability. The ideal accommodates both visions of parliamentary supremacy (Westminster model) and of checks and balances between the political branches (American model).

Deliberations of the People (elections) and its DRs are made by majority rule, with its voting members on equal footing.

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<sup>1234</sup> (ROSANVALLON, 2011: 219).

Regular and competitive elections allow the People to *ex ante* issue (broad and unprecise) mandates and to sanction and even replace their DRs *ex post* if they are not content with their performance.

Political parties have central roles in selecting, guiding, and disciplining candidates and elected officials and building political platforms and policy agendas that they advance in office.

The separation of powers, popular impulse and guidance through regular and competitive elections, majority decision-making and the centrality of political parties are indeed structural features of liberal democracies.

However, their concrete manifestation in each political system varies, and the simplistic majoritarian ideal is untenable, even for the democratic “poster boy” of macroeconomic policies, fiscal policy. The *real* political processes show *de jure* and *de facto* deviations from and constraints on that ideal.

### **7.3.1. NO MAJORITARIAN MONOPOLY OVER TECHNOLOGIES OF SOCIETAL CONTROL**

One fundamental breakaway is that in modern democratic states not all technologies for societal control need or are under political, let alone majoritarian control.

Religion is separated from the state and largely governed by market processes – with some of its large operators organized hierarchically.<sup>1235</sup>

Justice is administered by independent courts through the adjudication process.<sup>1236</sup>

Defense is partially governed by the military with a great deal of autonomy from civil (political) governments, working at arms’ length on most operational choices, various of which pose fundamental conflicts of values. In liberal democracies, the military are ultimately subordinated to civilian government, but the political decisions on defense matters tend to be removed from the normal openness and transparency and processes of political and majoritarian deliberation.<sup>1237</sup>

Regulation and supervision of important markets – e.g., media and communications, elections, energy, water, transportation, various financial services, and of competition across the economy – have been assigned to independent administrative agencies. The degree and scope of their independence are more circumscribed than those of courts and CBs, yet they exemplify non-majoritarian technologies of governance and societal control.<sup>1238</sup>

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<sup>1235</sup> (FINKE, 1990), (FASOLT, 2004), (FUKUYAMA, 2012), (VAN DE VELDE, 2012), (DE BEAUFORT & VAN SCHIE, 2012).

<sup>1236</sup> (KAUFMAN, 1980), (SHAPIRO, 1981 and 1988), (FEREJOHN, 1999), (STONE SWEET, 2000), (GUARNIERI, 2001), (RUSSELL, 2001), (BURBANK & FRIEDMAN, 2002), (KOSAR, 2013).

<sup>1237</sup> (HUNTINGTON, 1957), (KOHN, 1997), (FEAVER, 1999), (ACKERMAN, 2010), (COLLINS, 2012), (BRUNNEAU & CROISSANT, 2019).

<sup>1238</sup> (SHAPIRO, 2010), (HALBERSTAM, 2010).



Whilst the movements towards the separation of church and state, judicial independence, and military autonomy started various centuries ago, the independence of other administrative agencies (and CBs) is a more recent trend, initiated over a century ago in the USA and spreading across liberal democracies in the last quarter of the 20th century.

The myth of pure majoritarian control is also crumbling in the realm of macroeconomic policies. In addition to monetary and financial policies, fiscal and credit policies have witnessed a growing trends towards the intervention of non-majoritarian, independent fiscal and investment institutions.<sup>1239</sup>

Furthermore, in fiscal policy there are other various deviations to the ideal of parliamentary fiscal sovereignty/authority: the non-comprehensiveness and the Executive dominance of the budget process, the centralization in the finance minister, delegation to professional bureaucracy, procedural constraints, and substantive fiscal rules and frameworks<sup>1240</sup>.

Only in totalitarian regimes could all fields and issues be subject to only one governance technology.

On the contrary, in liberal democracies “the political system will reveal many processes and their related procedures – certainly not merely the ... legislative, executive, .... a political party process, and an electoral process. There will be a tendency to create new procedures to meet the new needs”<sup>1241</sup>.

Independent, non-majoritarian institutions such as constitutional courts, CBs and independent administrative agencies have gained increased prominence and intervention in substantive political questions.

Real political systems are complex combinations of various processes, with an open competition of inputs, signaling and decision-making.

Contemporary liberal democracies are pluralistic. They involve “negotiation between actors operating in separate institutions and expressing a combination of different state or sectional and partisan interests and views”<sup>1242</sup>.

Public power is distributed in various ways beyond the classic tripartite model<sup>1243</sup>. It is divided horizontally in further functional specializations, and the separation is not strict but balanced or limited. It is also divided vertically, with federalism and decentralization to subnational governments<sup>1244</sup>, and integration and power-sharing with supranational institutions.

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<sup>1239</sup> Ch. 2.1., (LEITÃO AMARO, 2022b).

<sup>1240</sup> (VINAY & POOLE, 2019: 446-7), (WEHNER, 2010), (SCHICK, 2002).

<sup>1241</sup> (VILE, 1997: 379).

<sup>1242</sup> (FABBRINI, 2017).

<sup>1243</sup> (ACKERMAN, 2002).

<sup>1244</sup> (OECD/KIPF, 2016), (DAM, 1977).

The real picture of the political process stands far from a monopoly of elections, national Legislatures and Executives.

### **7.3.2. INTERDEPENDENCIES IN THE POLITICAL PROCESS AND SOVEREIGNTY**

Countries and their political authorities do not live in autarchy, but rather in a highly interdependent world, where major decisions and events cause spillovers across national and legal borders.

If that is true in trade, climate, health, food, energy, migrations, defense and security, it is also evident in money and finance where globalization, openness and interdependencies have risen dramatically since WWII and in the post-Bretton Woods world. If the pandemic and war might change the profile of such interdependencies, they will not end, and technological evolution will, most likely, deepen them.

The point is that not all conflicts among competing claims on public finances, money and credit are indeed resolved within the classic political democratic framework. Interdependencies and spillovers undermine parliamentary and executive control of macroeconomic policy and spread “nondecisions” that are determined by developments exogenous to the political process.

CBI is not the first and only breach of parliamentary or majoritarian sovereignty. But in its pluralistic version, open to intense international coordination, it may prove to be a better, and still democratic, political technology to manage such interdependencies.

### **7.3.3. LIBERAL DEVICES WITHIN THE ELECTORAL-REPRESENTATIVE PROCESS**

Elections, Legislatures and Executives have a non-monopolistic but predominant role amongst public institutions in societal control, management of primary political conflicts, and the political process *latu sensu*.

However, their electoral-representative processes do not squarely fit the majoritarian ideal. They embed various liberal devices and other concessions with non-majoritarian principles that involve “editing and disciplining” the majority will and insulating certain questions from the politics of the day”<sup>1245</sup>.

One group of liberal devices are the “divided-power institutions” such as strong federalism and decentralization, strong bicameralism, rigid amendment rules, independent judicial review, and functional delegation to independent CBs<sup>1246</sup>.

Another group includes the *de jure* institutional and procedural mitigations to majoritarianism such as: the non-proportionality of the membership of the US Senate and of the US presidential Electoral College; the unanimity rules and intergovernmental pillar of the EU governance,

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<sup>1245</sup> (MADURO, 2012).

<sup>1246</sup> (LIJPHART, 2012).

including the decisive legislative and political power of the EU Council where representation and conflicts are not according to ideological or partisan cleavages or direct electoral representation, but unified representations of national interests; or the effective powers, including to delay legislation, of the semi-aristocratic House of Lords in the UK.

Another type of device is the “manufactured majorities” that are artificially created by the electoral system out of mere pluralities of the vote<sup>1247</sup>. An example is the single-member plurality system (first-past-the-post) adopted in various electoral systems, such as the British and American. The “majority bonus” in (semi-)proportional electoral systems, used in Greece and previously in Italy, go in the same direction of distorting representation and the conversion of wills from the election to the Legislature.

While these systems tend to facilitate the creation of governing majorities, when compared to proportional electoral systems they dispense with the voices of many voters, i.e., parts of the People.

Such mitigations allowed two recent American Presidents, GEORGE W. BUSH and DONALD TRUMP, to be elected against the majority of the popular vote, and one single EU Member State to block decisions that all other 26 states and the overwhelming majority of the European Parliament supported.

Another group of liberal devices are *substantive policy rules and frameworks* that were democratically adopted by competent rulemaking bodies to constraint the discretion of instant majorities. Fiscal and monetary rules and frameworks are vivid examples of this technique of tying representative bodies to the mast of fiscal and monetary discipline.

They are legitimate as long as they were democratically-enacted/endorsed, and can be somehow democratically amended. They can be “exterior” and legally binding if laid down on a hierarchically superior legal source such as the constitution, an international binding agreement or decision, a law of superior force, or simply a statute to be implemented by the Executive.

Still, even self-imposed substantive constraints can have some dissuasive effect on the instant majority willing to reverse prior orientations.

Another group of deviations stems from *internal procedural and organizational constraints* that classic political branches use to rationalize their activity. They include requirements of supermajority or unanimity voting, external consultation and expert input, cooling-off barriers, secrecy rules on sensitive topics, and asymmetric distribution of powers despite the formally equal representative credentials of elected representatives.

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<sup>1247</sup> (RAE, 1967: 74), (LIJPHART, 2012: 14).

For instance, leaders of parties and parliamentary committees carry more weight on policy choices than back-benchers. The distribution of asymmetric roles distorts the equality and even proportionality in political deliberation.

One of the most important techniques of rationalization in the realm of macroeconomic policies is the centralization in the finance minister of internal authority to conduct the political process and control its implementation. Such centralization, which is effective in fiscal policy and the budgetary process, would extend to monetary and financial policies if these were be put under Executive control.

A rigorous institutional comparison has to bear in mind that the alternative to CBI would be a political process largely centralized in this specific official, rather than an open, plural collegial process.

Finance ministers are expected to consider the overall fiscal and financial situation and impacts and be a “gatekeeper” or “fiscal entrepreneur” to whom a centralized internal control is delegated<sup>1248</sup>. That hierarchical centralization impacts the whole macroeconomic political process and actors, and the functioning and initiative within the Cabinet, Parliament and parties, from the coordination of the preparation of the policy proposal to the negotiation with Parliament, and importantly in the implementation.

Finance ministers are often delegated veto and amendment powers in the implementation stage that introduce deviations from the parliamentary decisions<sup>1249</sup>.

Such centralization on a single central player tends to be more effective in terms of fiscal discipline in countries with majoritarian electoral and party systems with single-party governments or with slight ideological distance. But it tends to be less effective or even unfeasible in consensus democracies with proportional electoral systems, and in coalition governments with significant ideological divergence.<sup>1250</sup>

In any case, as a systemic solution, such concentration of powers in a single player and on her discretion seems based on a naïve optimism about her superior commitment to credibility and fiscal righteousness and providential capacities to better adjudicate between conflicting allocation priorities.

It might be argued that traditions in selection, internal culture within finance ministries, the country’s political culture, peer pressure in international fora, particular attention and sensitivity to market discipline (as the minister is also responsible for the public debt management), and reputational incentives for individuals who tend to pursue careers in the financial and

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<sup>1248</sup> (THE FEDERALIST PAPERS, nr. 36), (ALLEN & TOMMASI, 2001), (HALLERBERG, STRAUCH & VON HAGEN, 2009).

<sup>1249</sup> (CONSELHO DAS FINANÇAS PÚBLICAS, 2020: 24-27), (ALLEN & TOMMASI, 2001: 65-66).

<sup>1250</sup> (HALLERBERG, STRAUCH & VON HAGEN, 2009).

macroeconomic cosmos, all contribute to keep the finance minister in check with the expectations for such internal control role.

However, there are typically no structured incentives schemes to prevent the choice or her performance from turning sour<sup>1251</sup>, and not rarely, her vocational focus on the bottom line (deficit and debt) blinds and biases her judgment on the fiscal composition with possible detrimental results in the long run and limited transparency (and accountability) on such judgments.

Furthermore, the expertise and credible commitment advantages of the centralization in the finance ministers are weaker than with ICBs. The sacrifice ratio of a finance minister is still in the (lower) range of partisan politics. Her dependence on the head of government – president or prime minister – exists and is effective, because such a strong centralization is barely impossible without an equally strong backing from the head of the executive who is the (most important) channel of democratic legitimation and accountability of the Executive, before Parliament and electors in general.

Centralization in strong finance ministers challenges democratic ideals of parliamentary primacy and Cabinet's collegial decision-making in macroeconomic policy. It is hard to deny that such centralization is counter-majoritarian when compared to a larger, more diverse and representative Cabinet, and to the Legislative Assembly<sup>1252</sup>.

Finally, such centralization contrasts with the trend towards collegiality in central banking.

#### **7.3.4. DELEGATION TO (PROFESSIONAL) BUREAUCRACY**

Only in stylized descriptions of the political process are complex policies fully decided and implemented by elected officials or implemented in objective and mechanical fashion by strictly dependent bureaucracies.

The rise of the modern state is also the growth of the administrative state and powerful, professional but unrepresentative bureaucracies.

Treasury departments, tax authorities, public debt management offices, public investment agencies and development banks, economic research and forecasting departments, statistics offices, and certain non-independent financial regulators, supervisors and resolution authorities are some of the existent examples of professional, but politically subordinated bureaucracies in macroeconomic fields.

Their delegations allow *de jure*, and even more *de facto*, the exercise of certain discretion in policymaking. For the purpose of comparative institutional analysis, the political process would better be described as a combination of political and bureaucratic processes.

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<sup>1251</sup> On the bad emperor problem (FUKUYAMA, 2012).

<sup>1252</sup> (ALESINA & PASSALACQUA, 2015: 46-7).

“The political decision-making process is in the hands of the bureaucracy”, and the implementation of the various policies “is in the hands of [technocrats and bureaucrats] who intervene *a priori* advising the political decisionmaker, and *a posteriori* executing the decision”<sup>1253</sup>.

It creates “bureaucratic obscurity” in the classic political process, since the unrepresentative bureaucracy and its activity are less salient, and its output is even less assignable and measurable than those of CBs.

The counter-argument that such bureaucracy fits the democratic ideal because of its political subordination turns a blind eye to the serious difficulties that elected Executives and Parliaments have in the control of those formally dependent bureaucracies.

The political *ex ante* control and accountability are complicated by opacity, distance and exploitable information asymmetry with the political principals, blame-shifting, civil service culture and career protections, misalignment and potential enticement from self-interest, external capture and bureaucratic institutionalization that lead the bureaucracies to interpret or redirect the pursuit of the mandated goals, or to subvert or circumvent rules that clash with those other interests.

Like the centralization in the minister of finance, the delegation of implementation and even certain discretion to subordinated but specialized bureaucracies and executive agencies seeks to promote professionalism and expertise<sup>1254</sup>, rationalization, credible commitment in policymaking, and maybe even some insulation from daily partisan politics.

However, when compared to independent central banking, due to their political subordination and more limited technical resources and specialization, they score lower in terms of those epistemic-functional advantages and liberal-impartiality advantages. On the other hand, the difficulties in democratic control suggest that the real political process, with this bureaucratic component, does not fit the democratic ideal as purely as normally believed.

### **7.3.5. DISCONTINUITIES IN POLITICAL REPRESENTATION**

Finally, by definition the electoral-representative process departs from an ideal of democratic control as permanent, effective and true translation of the popular preferences into the choice and implementation of public policies.

In fact, representation renders the People’s control over policies limited, periodic, intermittent, synthetized and selective rather than comprehensive. It is a model of indirect democracy.

In a democracy without delegation to ICBs, if the People have strong feelings about some concrete monetary or financial policy choice, their power to influence such choice would be

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<sup>1253</sup> (OTERO, 2003, 296-298).

<sup>1254</sup> (MILLER & WHITFORD, 2016: 149).

rather limited even if the competence rested with elected legislators or executives. In fact, it would not be so different from their power to pressure modern CBs that operate under conditions of public contestation.

People vote and are free to discuss, criticize, and demand at all times, but they are not able to give legally binding instructions to the government. They do not deliberate *ex ante* on specific policy preferences, nor can they *ex post* sanction representatives with anticipated removal<sup>1255</sup>. In periodic elections they choose amongst candidates to public offices and political platforms typically organized and offered by sectional organizations, the political parties, and they can outvote those whose performances they disliked.

Such electoral sanctioning authority augments the power to pressure elected officials, but only limitedly and vaguely. The degree of preferences' specification is quite low.

Indeed, electoral judgments are of limited rationality and attention to each specific topic, and are instead largely emotive decisions that aggregate vague preferences about candidates' profiles and policy programs.

Literature has profusely discussed the difficulties in revealing the preferences of the People and even the electorate, the worth of majority rule and its comparative advantages vis-à-vis unanimity and other voting models<sup>1256</sup>.

Studies demonstrated how voting is ambiguous because electoral outcomes do not necessarily reflect "the popular will"<sup>1257</sup>. The correspondence of general will and majority will is a fiction, and "societies increasingly understand themselves in terms of minorities: People has become the plural of "minority". Democracy rests on this necessary fiction that assimilates the majority to the unanimous whole, which was never made explicit. The majority principle was a reduction of complexity in the interest of governability. As a "mere empirical convention... its legitimacy is imperfect and must be strengthened by other modes of democratic legitimation"<sup>1258</sup>.

Normative expectations about representation ought to be moderated because it has been questionable whether individuals are the best judges of their own interests, there are serious difficulties in aggregating their preferences into a collective will, and governments have structural incentives to represent the interests of a coalition of minimum-sufficient majority or sector corresponding to the median voter, albeit the position of the median voter may vary over time and more recently there has been a growing polarization away from the median voter<sup>1259</sup>.

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<sup>1255</sup> (MANIN, PRZEWORSKI & STOKES, 1999: 3).

<sup>1256</sup> (ARROW, 1963, identifying the difficulties of instability, incoherence or manipulation in the formation of collective decisions based on voting), (BUCHANAN & TULLOCK, 1965). Differently (BELLAMY, 2010).

<sup>1257</sup> (ARROW, 1963), (RIKER, 1982).

<sup>1258</sup> (ROSANVALLON, 2011: 4, 13-14).

<sup>1259</sup> (MANIN, PRZEWORSKI & STOKES, 1999).

Furthermore, large parts of the electorate simply do not participate in elections and in the political process, even if their abstention can be attributed to rational inattention. Only in extremely rare occasions is it possible to say that the People expressed a specific preference over some choice of macroeconomic policy. Monetary and financial policy hardly ever rank amongst the most salient topics of a campaign, the electoral competition and voters' decisions. Moreover, elections are only periodic, like the appointment and (re)composition of CBs' boards, albeit with shorter cycles. As the distance grows between the election and concrete policy decisions, the connection wanes.

It is not only the electoral, but also the representative leg of the political process that suffers from structural limitations and discontinuities in the translation of democratic preferences into policy choices and implementation.

Representation involves a comprehensive filtering, refining, and mediating process of political will formation and expression<sup>1260</sup>.

Politicians have to make too many decisions, many of which are unforeseeable or involve technical expertise and cannot be covered by a tight mandate. In effect, representation involves this ineluctable gap between representative and represented.<sup>1261</sup>

In addition to the liberal devices and delegation to professional bureaucracy described above, certain *practices* make classic political decision-making removed from the ideal of loyal expression of the popular will.

One is Executive dominance that skews the division of labor between Legislative and Executive, also in the fields of macroeconomic policy<sup>1262</sup>. *De facto* executive dominance is of particular importance because the large majority of executives in advanced economies are selected by the Legislature and dependent on its confidence, and only a small minority has the head of the executive selected by voters and not dependent on legislative confidence – in the USA, Korea, and France as a hybrid with the cabinet but not the president being dependent on legislative confidence<sup>1263</sup>.

Such Executive dominance over the Legislature is widely documented in fiscal policy and the budget process, and parliaments have difficulties in controlling the budget.<sup>1264</sup>

If monetary and financial policies were returned to the purview of the (national) political branches with the purpose of reinstating democratic control by parliaments, such objective would soon be jeopardized. The same structural features that created Executive dominance

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<sup>1260</sup> (URBINATI, 2006).

<sup>1261</sup> (BELLAMY & PARAU, 2013: 256-8).

<sup>1262</sup> (DAM, 1977: 278-9).

<sup>1263</sup> (LIJPHART, 2012: chapter 7).

<sup>1264</sup> (WEHNER, 2010: 129-141).



during the 20th century would be in play in those two macroeconomic policies and their control would end up in the hands of the Executive and centralized in the finance minister, which are both (far) less plural, open, (equally) participatory and integrative of minorities than the parliamentary process.

The discontinuity of equal representation is more significant in Executives that are not directly elected, which is the majority, with America as an exception. And it increases in appointed Executives that are less reflexive of direct outcomes of elections, as occurs in technocratic governments (e.g., Italian and Greek experiences), and even in consensual Executives based on more distant, and even “unnatural” or unexpected coalitions of parliamentary forces with serious ideological differences or difficulties of coherence.

This is not to question the procedural democratic legitimacy of such governments, but to note that they imply a great deal of creative and largely autonomous (re)interpretation of popular preferences. They are particularly indirect forms of democracy.

In the case of EU governance, with its more “technocratic” Commission and the Council operating on national rather than ideological/partisan cleavages, and a still relatively weak European Parliament, there are abundant accusations of “democratic deficit”<sup>1265</sup>. Whatever the final assessment on the democratic credentials of the EU, it is indisputable that it stands far from the purist majoritarian ideal of democracy based on a nation-state.

Conceptions of consensual and consociational democracy open ways to accommodate these experiences. Although they lead to a more pluralist and proportional breadth of elected officials, they also create opportunities for negotiation and compromise between political elites that might contribute to the idea of the distance and discontinuity between the electoral preferences expressed in elections and the control of government.

The extant control of democracy by political elites might increase the efficiency and effectiveness of government, and protection against rule by the mob, with epistemic and liberal advantages, but it departs from purist majoritarian ideals that typically underlie the so-called democratic critiques of CBI.

In more redistributive political choices, the strategic behavior of elected officials often fosters political “horse trading”, “pork barrel spending” and creates vulnerability to excessive partisanship and Special Interest Group capture. Such practices, often detected in other macroeconomic policies governed by the electoral-representative process - notably, maxime fiscal policy – tend to generate choices that are hardly optimal or coherent translations of the electorally expressed preferences.

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<sup>1265</sup> (WEILER, 2017: 342-3), (CRAIG & DE BÚRCA, 2020), (MORAVCSIK, 2002).

Much of those negotiations occur outside parliament<sup>1266</sup> or behind the curtains, and together with so many last-minute compromises, tweaks and amendments to the budget bill, they go without the transparency and opportunity for public debate and informed deliberation that parliamentary fiscal primacy was supposed to warrant.

They depart from the democratic ideal of mirroring the diversity and equality of the elected representation, of the public openness and transparency of decision-making, and of the coherent translation of ideological preferences manifested by electors.

These structural and practical discontinuities and imperfections prove that the democratic control over policy through the electoral-representative political process is indirect, intermittent and imperfect.

They might not be sufficient to defeat the partial conclusion that the electoral-representative process is still the most mature and specialized process to translate popular preferences into policy choices and implementation.

Despite those deviations and gaps, representation might seem *prima facie* to be undemocratic<sup>1267</sup>, but it is the best possible, and better than direct democracy, in fundamental political tasks such as lawmaking with generality. Representation is superior in legislation and making judgments in complexity, as it is better at mirroring (the diversity of) wills and interests and generating a more reflected and non-impulsive political judgment.<sup>1268</sup>

Yet, those deviations and gaps put strains on the purist approaches defending the return of the governance of money and credit to the classic political process so that the People can guide, correct and sanction policymaking.

They confirm that the proper institutional comparison of CBI should be with the real, rather than the mythical ideal of the classic political process. Its democratic advantage to independent central banking is one of degree, and probably smaller than idealistic approaches suggest.

Moreover, such advantage varies according to the concrete political system and CBI framework of each country.

### **7.3.6. VARIETIES OF DEMOCRATIC GOVERNMENT**

The concrete liberal democracies and electoral-representative processes of advanced countries have relevant deviations from the stylized ideal model of liberal democracy. They vary in structures and practices, levels of representation, effectiveness of government, and presence of non-majoritarian and divided-power institutions.

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<sup>1266</sup> (SCHICK, 2002: 23).

<sup>1267</sup> (BELLAMY & PARAU, 2013: 256-8).

<sup>1268</sup> (WALDRON, 2016, 1, 141-144).

LIJPHART identified two cluster patterns and regularities of democracies: “majoritarian and consensus government”<sup>1269</sup>, to conclude that the former represents about a third, mostly limited to the UK and Commonwealth countries, plus Greece, Spain, Korea, and arguably France.

Most democracies are consensual or have important dimensions of consensualism, including the EU and most of its Member States, Switzerland and Japan.<sup>1270</sup>

The UK stands out as “the closest approximation of the Westminster model”, the purest form of majoritarianism. Its main features are the concentration of Executive power in one-party and bare-majority cabinets, cabinet dominance that inverts the nominal relationship of dependence in such parliamentary systems, a two-party system, majoritarian and disproportional system of elections, unitary and centralized government, and constitutional flexibility.

However, even the British system has deviations from the pure model. The part-aristocratic, part-appointed House of Lords counters the concentration of legislative power in a unicameral Legislature, and the independent judicial review and independent central banking are important non-majoritarian institutions that emerged in the UK in the late 20th century. On the other hand, all those deviations, including the degree of *de jure* CBI, are smaller than in any other countries closer to the consensual model.

The EU political system escapes traditional models of state organization and division of powers, but matches the concept of consensus democracy with executive power-sharing in broad coalition cabinets; executive-legislative balance of power, with the Council as kind of upper legislative house and the EU Parliament with growing importance; multiparty system and proportional representation at the European Parliament and some proportionality in Council (more than in equalitarian senates); strong bicameralism; constitutional rigidity; creative and activist judicial review; more (con)federal and decentralized government than national states; and strong CBI.

The US is a hybrid, despite its plurality electoral system, presidential system, and one-party majority cabinets. Although it lacks the proportional representation and a parliamentary system of government typical of consensus democracies, it has a strong separation of powers with multiple checks and balances and sturdy divided-power institutions such as federalism, bicameralism, independent judicial review, rigid constitutional amendment rules, and CBI.

Conventional wisdom is that “one-party majority governments typically produced by plurality elections are more decisive and hence more effective policy-makers”.

However, LIJPHART found that “the overall performance record of the consensus democracies is clearly superior”, not only in providing more accurate representation and better representation

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<sup>1269</sup> (LIJPHART, 2012).

<sup>1270</sup> (LIJPHART, 1984 and 2012), (ANDEWEG, 2000).

and protection of minority interests, but also “with regard to effective policymaking and the quality of democracy”. One reason might be that “fast decisions are not necessarily wise decisions”, and the expected coherent policies of majoritarian governments are negated by the alternation of these governments, with detrimental consequences to macroeconomic performance, which prefers a *steady* over a *strong* hand.<sup>1271</sup>

For the purposes of the institutional comparison, this research offers three lessons: first, real representative democracies of advanced countries have relevant deviations from pure models, including in terms of representation and majority rule.

Second, non-majoritarian institutions and liberal elements, including CBI, are deeply embedded in the various patterns of democracies, including the more majoritarian British system. Moreover they are associated with consensual governments that generate better overall performances in terms of both effective policymaking and the quality of democracy.

Finally, the democratic gap between the pure ideal of the political process and the traditional (stricter separation) model of CBI that are the typical objects of the institutional comparisons is significantly wider than the effective democratic gap between the real political processes and the pluralistic CBI.

### **7.3.7. DIFFERENTIAL REPRESENTATIVENESS IN REAL DEMOCRATIC PROCESSES**

DAHL once questioned: “In a political system where nearly every adult may vote but where knowledge, wealth, social position, access to officials, and other resources are unequally distributed, who actually governs?”<sup>1272</sup>

Major theories of democratic representation posit that elected officials ought to reflect the preferences of their constituents and act accordingly. And the democratic principle of political equality suggests that governments should not just be responsive overall, but they should also be equally responsive to their citizens<sup>1273</sup>.

Growing research has suggested the existence of *differential representativeness* and *responsiveness* of democratic politics. It offers four theoretical suggestions on which set of actors has more influence over public policy: average citizens, economic elites, or organized Interest Groups, mass-based or business-oriented<sup>1274</sup>.

Increasing evidence contradicts the ideal of democratic politics, where citizens are considered political equals and have equal influence over policymaking. Research indicates that economic elites and organized groups representing business interests have more substantial, independent

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<sup>1271</sup> (LIJPHART, 2012).

<sup>1272</sup> (DAHL, 1961).

<sup>1273</sup> (PETERS & ENSINK, 2015), (LUPU & CASTRO, 2022).

<sup>1274</sup> (GILENS & PAGE, 2014).

influence on government policy in Western liberal democracies than average citizens and mass-based interest groups. Such findings arose first in the USA, then Europe, and more recently around the world.<sup>1275</sup>

Various explanations have been advanced for the *differentiated representativeness*, namely a preference gap between income groups, disparate levels of voter turnout (rich participate more), information asymmetries, differential degrees of attention amongst groups, distinct networks with public officials and likelihood to contribute money and energy to political campaigns”, the background of elected officials, party financing rules, lobbying regimes and practices, the structure of the party system and of the mass and social media system, and generally the threshold costs of access to the electoral-representative process<sup>1276</sup>.

These justifications seem consistent with the thesis that in democratic partisan politics “economic inequality inevitably generates political inequality, which in turn reproduces economic inequality”<sup>1277</sup>.

However, there is a “seeming contradiction between the literature pointing to inequality in political representation in the United States and the literature showing that public policy does tend to represent public opinion in general”.<sup>1278</sup>

The explanation from a milder version of the Minoritarian Bias/Domination theories is that although “major legislation usually moves policy in the direction favored by low-income voters (e.g., redistribution, government programs) [u]pper-income voters and interest groups...are able to slow the pace of liberal change” because “the rich participate more than the poor and enjoy greater influence on political outcomes”<sup>1279</sup>.

An Unbiased Pluralist theory of democracy counter-argues that in certain conditions of democracy such unequal representation can be mitigated, and will tend to fade away with an increase in the implementation of social redistribution policies, education, and a reduction of economic inequalities<sup>1280</sup>.

An adequate pluralistic framework for the various processes of governance, CBI included, may also contribute, protecting from minoritarian biases and creating new channels with the public and underrepresented groups.

#### **7.4. A MULTI-LEVEL COMPARISON**

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<sup>1275</sup> (GILENS, 2012), (GILENS & PAGE, 2014), (ROSSET, 2016), (BARTELS, 2017), (PETERS & ENSINK, 2015), (LUPU & WARNER, 2022), (MATHISEN, 2022, finding differently for a social democracy like Norway).

<sup>1276</sup> (PETERS & ENSINK, 2015), (ROSSET, 2016), (BARTELS, 2017: 252).

<sup>1277</sup> (PRZEWORSKI, 2012).

<sup>1278</sup> (ERIKSON, 2015).

<sup>1279</sup> *Idem*.

<sup>1280</sup> (GILENS, 2012), (MATHISEN, 2022).

The institutional comparison between the classic political process and (political and) independent central banking must be broken down in multiple levels of decision-making for each policy function

Three normative standards perform differently at each level, depending on whether the decision is about: (i) the primary definition of the polity's goals and the institutional structure and the selection of the individuals that command it – the first-level (or second-order) policymaking; or (ii) other substantive political choices under discretion, including to make trade-offs with other positive values or objectives and distributive choices – the second-level (or first-order) policymaking; or (iii) non-discretionary or technically discretionary decisions and policy implementation – the third level.

This partition for analytical purposes is conceptual and stylized, and the dividing lines are blurred and empirically irregular. Yet, it permits a focus on what is contentious and innovative – the second level of decision-making – while bringing clarity to what is more consensual but could still cause analytical confusion.

At the third level of non-discretionary or implementation of policymaking, the epistemic concerns are of *relatively* greater importance, both because the implementation of monetary and financial policies is complex, permanent and highly technical, and the participatory (democratic) concern is at its lowest. It is not that the decisions are absolutely free of value judgments, trade-offs, distributional effects and public contestation, but these tend to be significantly lower.

These third-level macroeconomic choices are areas where most citizens remain rationally ignorant or non-participatory<sup>1281</sup>. As the public tends to devote little interest and attention to them, but not the narrow groups with higher per capita stakes, the risks of exploitation of information asymmetry, time inconsistency, and Special Interest capture increase, and thus the liberal concern matters.

The election process is structurally inapt for this third-level decision-making because of its periodicity and intermittence, equality above expertise logic, and amalgamation of judgments that confound backward- and forward-looking perspectives and personalities. Even the Democratic Representative process is relatively unfit for purpose. The decisions are Executive, rather than Legislative in nature.

In this third-level type of decision-making and implementation, the proper comparison of CBI is with the professional, albeit politically subordinated bureaucracy (including dependent CBs) to which the classic political branches normally delegate those sorts of tasks.

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<sup>1281</sup> (MORAVCSIK, 2002).

In money and credit, that delegation is especially important, albeit to an independent agency with even more expertise and commitment and reduces the risk of contamination by demagoguery and short-termism.

Firstly, ICBs are superior epistemically because they are relatively more likely to invest in expertise resources, practices, and culture (staff, training, research, institutional culture), and to be sensitive to the disciplining influence of professional epistemic communities. On the other hand, subordinated bureaucracies have greater incentives to trade expertise for partisan interests and pressure.

Second, bureaucracies might be worse in terms of vulnerability to systematic biases because the greater opacity and more diffused (specified) public accountability of dependent bureaucracies makes them more prone to Special Interest capture than the increasingly salient, transparent ICBs which have (more) developed frameworks and ethics on the interaction with Special Interests.

Third, subordinated CBs or other bureaucracies might not bring relevant gains in public contestation or public and parliamentary accountability. Even *effective ex ante* controls of the Executive over subordinated, professional bureaucracies are *de facto* superior to those that currently impend over political and independent CBs.

Conversely, at the first level of decision-making the importance of democratic concerns skyrockets.

There are three constitutional-like, fundamental second-order policymaking decisions: whether to delegate which powers to whom, which are the societal objectives that such functions must pursue, and who are the concrete leaders of that agency.

Those three choices raise demands of self-government by the polity in equal participation and free competition of political platforms and personalities.

They require a significant level of intervention by the electoral-representative process.

The model of pluralistic political and independent central banking does not mean separation from the state, neither self-asserted or self-standing power, nor the severance from the democratic genealogy and derivative legitimacy of ICBs. Monetary and financial policies are and ought to be ultimately under democratic control.

Still, important epistemic and liberal concerns remain about the governance of these high-level decisions.

They discourage the popular election of central bankers or use of direct democracy tools such as referenda as methods to make first- and second-level decisions about money and credit. To imagine a plebiscite on the existence of the CB or the monetary framework is enough to recall the populist experiences of the American presidential elections of 1832 when ANDREW JACKSON'S ire against the Second Bank of the United States dominated the campaign. And in the 1896

election, the loser WILLIAM JENNINGS BRYAN made the attacks on the gold standard central to his campaign.

Likewise, a referendum to establish inflation targets, fix interest or exchange rates, decide banks' capital requirements or approve a bank bailout would be structurally inadequate in terms of timing, resources and deliberation.

The experience of electing independent judges in various states of the USA is not brilliant, and discourages replication to other non-majoritarian institutions.

Those methods would contaminate ICBs with the worse limitations of the classic political process that their independence was created to cure, including short-termism, the political electoral cycle, time inconsistency, influence of Special Interest groups, and even populism and demagoguery.

The electoral-representative process, with the People electing DRs, the Legislative branch deciding the delegation and mandate, and the democratic Executive appointing central bankers, is superior and should make the first and ultimate calls.

In the continuum between technical and value issues, the first-level choices of second-order policymaking are the closest to the latter end. Their generality<sup>1282</sup>, axiological fundamentality and susceptibility to political conflict elevate the democratic standard above all others. Even if facts (and truth) about choices were settleable, the primary values-disagreements are often irreducible, therefore citizens need to sense ownership and craftsmanship in their (re)solution or accommodation<sup>1283</sup>.

Citizens, through their elected representatives, need to be able to author and thus be liable for the choices of delegation, objectives and specific central bankers. They must have some possibility of removing (or not reappointing) those that underperform, and their delegations and choices cannot be definitive or irreversible, as they must have an open future in their hands. The public must be able to decide and/or correct the direction of the most important policy choices facing their nations<sup>1284</sup>.

The relative importance of the democratic standard grows, but those of the epistemic and liberal standards do not disappear.

It would be troublesome that lawmakers could freely and arbitrarily invoke their majoritarian electoral support (as justification) to abrogate price stability and financial stability from the primary objectives of monetary and fiscal policies. And it would be dangerous if they could fill CBs' policy boards with ignorant and unexperienced partisans and self-interested cronies.

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<sup>1282</sup> (WALDRON, 2016).

<sup>1283</sup> (SHAPIRO, 1999).

<sup>1284</sup> (NICHOLS, 2017: 12).



There are still ponderous shortcomings in the classic political process that can affect those primary legislative acts and appointment choices if left unrestrained in the hands of the instant majorities and the politics of the day.

That has two normative implications.

First, the minimum normatively required content of the first level that ought to be in the hands of the two classic political branches is rather thin, or thinner than traditionalists defended.

The democratic connection and generality of the constitutional or legislative processes are necessary for the approval, amendment and revocation of the delegation and broad policy objectives. These objectives need to indicate some axiological direction of the delegation, but they need not exhaust the solution to political conflicts.

Ample discretion and incomplete mandates are possible as long as the legislative branch maintains the ultimate power of control and is able to act as a circuit-breaker and guide. The positive regimes of the American non-delegation doctrine, and the Continental European reserve of legislative power, confirm that it is democratically acceptable for the *ex ante guidance* to be rather vague and undetailed, as long as the DRs maintain other formal or informal possibilities to signal their views *ex ante* (even if non-binding) and *ex post* to control the performance, sanction and even amend or revoke the delegation if the CB is not responsive.

The cruciality of the democratic standard wanes as the type of decision-making moves towards the governance of the policy, to the first-order policymaking.

DRs delegate discretion, and thus they must keep good enough democratic control. However, they must be constrained and stay at arm's length to avoid jeopardizing the benefits of the delegation to an independent institution.

It is sufficient that lawmakers are able to revisit, tweak or revoke the delegation. This latent power, and the persistence of the delegation as long as it is not changed, is normatively sufficient.

It would actually be excessive to require the periodic renewal of the delegation by an expressive act (for instance by introducing sunset clauses), because it would over-empower one instant majority over the succession of multiple majorities.

The second normative implication is that those primary powers of the political branches should themselves be constrained by liberal devices serving concerns with expertise, non-domination, mitigation of biases, intergenerational representation, and substantive fairness.

Examples of such devices are the constitutionalization of the delegation and the policy objectives (e.g., EU and Sweden) or the imposition of procedural barriers such as qualified majorities, presidential veto, or the requirement of external expert consultation, including of the CB itself. Or the development of certain ethics of legislative self-restraint, as in the USA. Or else the

international efforts to harmonize the main institutional aspects of the delegation, as in the historical contributions from the IMF, BIS, and OECD.

Likewise, the power to appoint central bankers should not be left unrestricted to the partisan majority of the moment.

Most countries trust their democratic executive and/or the upper legislative chamber, rather than the ordinary legislature, to appoint central bankers for a combination of historical reasons, affinity of executive functions, and to avoid turning the appointment into partisan bargaining.

Yet, plenty of constraints on the political appointment are normatively recommendable: (i) substantive eligibility requirements to foster expertise and diversity and limit partisanship of central bankers; (ii) distribution of the powers of intervention according to different principles (who short lists, who nominates, and veto/consent power); (iii) the length of tenures and timing of the appointments to reduce majoritarian domination and multiply the majorities involved in composing the policy board; (iv) protection of tenures, restriction of both the early termination (only for cause) and reappointability; and (v) procedural requirements, such as public hearings, to test expertise, diversity and gather inputs on the appointees.

In a nutshell, the model of pluralistic CBI has no claim to be superior to the classic political process in the fundamental first level of decision-making in the governance of money and finance.

On the other hand, it holds a solid comparative advantage over the classic political process and its expected delegation to subordinated bureaucracy when it comes to third-level non-discretionary decisions and policy implementation, consistent with the traditionalist narrow central banking doctrine and the defenses of narrow majoritarianism.

What is more problematic and deserves deeper comparative analysis is the second level of decision-making, where the role of independent central bankers expanded to the point where it seems clear that they make substantive political choices.

In this intermediate level, issues of macroeconomic policy are both technical and value-laden, complex and salient, have both efficiency and distributive effects or material or identitarian losses for certain groups whose compensation may or not be feasible.<sup>1285</sup> They entice the attention of and discussion amongst experts and the public and between the two groups.

What matters for the normative analysis of political and independent central banking is: Who should make (second-level) monetary and financial policy decisions under discretion? These decisions include many politically undecided issues with potential distributive and other effects, which are prone to generate public contestation.

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<sup>1285</sup> (KING, 2015), (BECK, 2009).

Which of these two institutions of indirect democracy has comparative advantages? The pluralistic CBI subject to “good enough democratic control”, or the classic political process which would involve some division of labor between the Executive and Legislative, with its non-negligible gaps and deviations in representation?

The three normative standards seek to identify which of the institutional alternatives is superior to process these highly technical *and* political decisions in terms of the following questions:

Firstly, which makes the most informed, knowledge-based and functionally efficient deliberation?

Second, which deliberative process warrants *acceptable* and *better* democratic control over those technical and political choices, which in any case is indirect, representative and not-wholly majoritarian?

Third, which deliberative process is the least biased, uneven-handed or over- or under-represented?

In each of the three questions, there are dimensions of political equality and liberty. The three are framed in proceduralist terms, in the language of *input and throughput*.

The three normative standards will be analyzed in the following chapters knowing that they intersect. For instance, failures of expertise or false positives and negatives can arise from domination or majoritarian or minoritarian biases, which in turn can also be framed as faults to political equality well understood.

Yet, the comparative analysis should also be tested in consequentialist terms from an output perspective.

Despite some solid empirical findings on the impact of certain limited societal goals (e.g., price and financial stability), there are too many empirical and normative fragilities preventing the consequentialist approach from dominating the comparative institutional analysis.

The fourth question, then, will be which of the two institutional alternatives generates (more) just or optimal outcomes for society objectively, or more subjective satisfaction in the polity subjectively?

## **7.5. COMPARING EPISTEMIC ADVANTAGES**

One of the three normative standards on comparative institutional advantages corresponds to the epistemic conditions for a process to deliver closer to optimal policymaking and be more “truth revealing”<sup>1286</sup> for mobilizing relatively more expertise and functional efficiency into the policymaking process.

This has been the staple argument for delegating policymaking to specialized expert agencies and their technocrats.

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<sup>1286</sup> (BELLAMY, 2010).

This normative argument has three versions.

First, that CBs and other specialized agencies have more expertise, resources and a specialized and knowledge-oriented procedure that are decisive in regulatory policies that are merely technical and politically settled or consensual. This argument suits the third level of decision-making but is insufficient for the others.

Second, that the “disagreements they confront can be resolved more consensually as a result of their engaging in a more deliberative and ‘truth orientated’ discursive process than, say, legislatures”<sup>1287</sup> and the electoral-representative process.

The third and weaker version is that specialized expert agencies “are more likely (or, in an even weaker version, are as likely) to make conscientious and informed decisions about certain policies because they are freer from some of the potentially malign incentives that exist in a system of majority rule”<sup>1288</sup>. In addition, they can make such decisions because of their epistemic commitment to rationality and the integrity of the specialized art and science of central banking. This chapter is dedicated to the epistemic aspects related, first and foremost, to the specialized expertise resources and devices, and second, to their functionality as a governance process.

#### **7.5.1. SUPERIOR EXPERTISE**

Modern CBs are textbook examples of specialized expert agencies that developed unparalleled bodies of knowledge, skills, methodologies, and practice in the fields of money and finance.

##### **a) EXPANDING SPECIALIZED EXPERTISE**

They make unmatched efforts (i) in the selection, training, institutionalization, and professional discipline of skilled and experienced officials and staff; (ii) to develop sophisticated methodologies and economic models, and research, legal, and statistical departments; and (iii) to enhance information processing, analytical and prospective capabilities.

Specialization means that they allocate higher proportions of their time and attention to a limited and related number of issues.

Moreover, it is not only about the human, financial, time, technological, and intellectual resources they dedicate to breed the specialized expertise.

It is also about the process, institutional constraints and culture. Their constant improvement of a distinctive and sophisticated *art* and *science* of central banking. Their critical consideration of alternative economic theories, various tools and different analytical approaches<sup>1289</sup>. Their trial and error in the face of unknowns and uncertainty. The rationality-inducing procedural

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<sup>1287</sup> *Idem.*

<sup>1288</sup> *Idem.*

<sup>1289</sup> (BLINDER, 1998), (CASTILLO-MARTINEZ & REIS, 2019).

constraints which they are subject to by general administrative law and specific statutory and self-given regulations. Their evolution towards collegiality, accountability-enabling transparency, critical-thinking and some diversity. Their deep and fruitful interactions with other CBs and the surrounding epistemic community. The “social code” and professional discipline that impose targets, expectations and norms, and put pressure on their agents to abide for the sake of their reputation and professional standing.

CBs invest seriously in maintaining leadership and even systemic influence in expertise. Professionalism<sup>1290</sup>, scientization<sup>1291</sup>, or ethics of accreditation<sup>1292</sup> have been used to describe this process of relentlessly nurturing and checking the epistemic advantage.

This expertise of ICBs covers not only the “control of inflation”, but the governance of money more broadly, in different states of the world and uncertainty, and other macroeconomic functions.

The revolution in CBs’ bidirectional communication and relation with the public and other Influencers created other sources of input and throughput to independent policymaking that carry additional information, diverse viewpoints and consideration of all interests.

While the traditionalist credible commitment defense of CBI justifies only the delegation of anti-inflationary monetary policy, this vaster epistemic superiority in the governance of money and credit, in “all seasons”, under uncertainty<sup>1293</sup> and under conditions of public contestation, supports a broader delegation to ICBs.

## **b) LIMITS OF EXPERTISE**

On the other hand, the functional scope of CBs’ specialized expertise should also define the normative boundaries of the scope of their delegation and independence.

Where their epistemic advantage ceases, the justification for their autonomy subsides.

For instance, doubts about their relative expertise on credit easing and allocation<sup>1294</sup> put into question whether ICBs should be in charge of deciding credit allocation.

All the efforts to develop unmatched expertise on monetary and financial policy issues do not mean that CBs are omniscient or omniscient.

Central bankers err, have cognitive limitations, and they are particularly vulnerable to biases, such as groupthink and hubris, that are reinforced by expert processes.

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<sup>1290</sup> (MILLER & WHITFORD, 2016).

<sup>1291</sup> (MARCUSSEN, 2009).

<sup>1292</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>1293</sup> Differently (TUCKER, 2018: 101), (RAJAN, 2023).

<sup>1294</sup> (STRACCA, 2018: 66).

Their utility preferences too can be manipulated away from truth-revealing decision-making, by external influencers or even by a dominant chair.<sup>1295</sup>

Like politicians, they too are vulnerable to malign incentives and can be influenced by cycles.<sup>1296</sup>

Economics is not an exact or hard science despite its evolution. Scientific frameworks of monetary policy have limitations and problems, and uncertainty and unprecedented situations expose even further such epistemic limitations<sup>1297</sup>.

Furthermore, while professionalism and epistemic communities tend to nurture and check expertise, they can also be endogamic and generate self-serving expert norms.<sup>1298</sup>

The downside of the exclusivity of expertise and specialized discourses is that raising the participation threshold may restrict access. Thus, they might be denied vital information by foreclosing feedback from public opinion regarding the impact of their decisions, exhibit professional bias, be unduly subservient to the politicians or others that select them, and even be more open to regulatory capture. Furthermore, they will tend to overlook the “circumstances of politics”, such as fallibility and reasonable normative and empirical disagreements<sup>1299</sup>.

Therefore, if left unchecked expertise process may increase the likelihood of creating False Positives – e.g., serving partial concerns<sup>1300</sup> – or False Negatives, like the exclusion of affected groups.

That said, while scientific and economic skepticism is healthy, scientific and economic nihilism is wrong. Ignoring information, established knowledge, and methodologies can turn decision-making into guessing. Critical scrutiny of experts is desirable, but there is growing anti-intellectualist criticism of experts, the signs of a “cult of ignorance” that started with a “populist dream of omnicompetence” and a “romantic notion of the wisdom of the common people”. Over the past decades, this has turned into hostile campaigns against established knowledge.<sup>1301</sup> Experts err, but they get things more right than wrong (at least in matters of fact), and they are less likely to err than non-experts and processes of non-experts.<sup>1302</sup>

Expertise could never mean perfect information and capacity to know in anticipation all the correct models and theories of behavior. Such pretension is actually dangerous.

Expertise is about learning, improving and substantiating decisions. Seeking truth, and not just rhetoric and purportedly without trying to artificially recreate truths.

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<sup>1295</sup> (BELLAMY, 2010).

<sup>1296</sup> (BELLAMY, 2010), (EPSTEIN & O’HALLORAN, 1999: 47- 49).

<sup>1297</sup> (BLINDER, 1998: 6-8, and 2016), (HOLMES, 2013), (RILES, 2018: 30-31).

<sup>1298</sup> (MARCUSSEN. 2009: 390).

<sup>1299</sup> (BELLAMY, 2010: 10-11).

<sup>1300</sup> *Idem*.

<sup>1301</sup> (ASIMOV, 1980), (NICHOLS, 2017: 17-18, 38).

<sup>1302</sup> (NICHOLS, 2017).

The scientific frameworks and epistemic capacities of central banking have epistemic limitations, but they are still useful<sup>1303</sup>. The greater the uncertainty, the more expertise is needed in the decision.

Normatively, the expertise and information processing capacity need not be perfect, only “good enough to work”<sup>1304</sup> and superior to the institutional alternatives.

### c) COMPARATIVE ADVANTAGE

It is fairly consensual that the electoral-representative process has relatively less skills, expertise and qualifications in monetary and financial fields than central bank(er)s<sup>1305</sup>, and that in complex and technical fields the latter “can probably outperform amateurs from the political realm”.<sup>1306</sup> Such epistemic advantage extends from the obvious third level of decision-making to the second, where the very broad, fundamental societal goals are consensual (e.g., macroeconomic stabilities and maximization), but the undecided choices are simultaneously complex, technical, and substantively political, namely for value disagreements and redistribution.

The complexity and technicality of policies like the monetary and financial augment the “deliberative shade” where politicians can deviate from the truth and from the revelation and pursuit of societal preferences. In those conditions the electoral-representative process takes a bigger toll on the quality of the deliberation.

CONDORCET concluded that the majoritarian electoral-representative leads to the imposition of haste, ignorant, unstable, herd-like, and despotic will.<sup>1307</sup>

In the second-level decision-making of these complex issues, the separability between technical and value choices is illusory. Thus, in low-information and low-expertise deliberative processes, the epistemic errors are more likely, which tends to increase the downfall in terms of policy outputs. If expertise and knowledge-based criteria of a decision falter, more room is left for other criteria, interests and incentives to weigh on the decision.

The challenge is to have a decision-making process that *combines* the *indispensable* mobilization of expertise, *with* the (expansion of) more equal participation, free from representation biases. Expertise is a rather exclusive mastery of skills, bodies of knowledge, their practice and methodologies, and self-policing professionalism, which is built on education and training,

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<sup>1303</sup> (BLINDER, 1998: 6-8).

<sup>1304</sup> (BLINDER, 1998).

<sup>1305</sup> (AMTENBRINK & DE HAAN, 2002: 69), (LASTRA, 2015: 69).

<sup>1306</sup> (BLINDER, 1997: 118).

<sup>1307</sup> (CONDORCET cit by COHEN, 2018: 79).

talent, experience, and peer accreditation institutionally and within the epistemic community<sup>1308</sup>.

Neither the exclusivity<sup>1309</sup>, nor these features are natural and structural to the democratic electoral-representative process. The latter also involves skills, learning, practices, and accreditation that are important in a functioning democracy, but that are different, not based on technical and scientific norms and conditions.

Voters participate according to the principle of equality, not of any exclusive expertise. The universal suffrage consisted in eliminating qualifications, gender, race or wealth as conditions to elect or be elected. Some political parties organize political training, but it is not mandatory. Learning “political skills” is essentially informal and based on experience.

“A good politician is skilled at expressing the basic normative orientations of large groups of voters”<sup>1310</sup>, at mobilizing public support in key moments, and at navigating the corridors of power.

(Exclusivist) political elites exist, but their composition is not defined by technical specialized knowledge, even if some specialized expertise helps upgrading someone’s political standing. A technical expert might be given political office and even a ministerial position based on her technical credentials and reputation, but her political authority and duration will depend on demonstrating other abilities, particularly in mastering political power and its process.

The methods of electoral and partisan politics are more rhetoric and persuasion based, than technical, scientific, or factual truth-oriented.

The output legitimacy of politicians is articulated in subjective terms, i.e., based on the satisfaction of voters, much more than in some objective measurement of the attainment of certain societal goals.

Politicians do not compete in terms of technical or sectoral expertise, which is (at the most) one aspect pondered in the larger and generally different judgment of voters selecting, rewarding and punishing them.

The legislative and executive processes have facts- and truth-revealing components, but they are auxiliary. “[P]oliticians simply lack the time to sift the relevant facts; insofar as they are concerned with the merits of an issue, they are much more likely to consider how the facts appear to the general public than the way they look after disciplined and sustained investigation”<sup>1311</sup>.

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<sup>1308</sup> (NICHOLS, 2017: 35), (MILLER & WHITFORD, 2016).

<sup>1309</sup> (NICHOLS, 2017).

<sup>1310</sup> (ACKERMAN, 2000: 641-2).

<sup>1311</sup> (ACKERMAN, 2020: 686).



Moreover, the best policy course often cedes to the realistic, in terms of feasible implementation, popular satisfaction and partisan support by the relevant constituency.

Such realism is well expressed in BISMARCK'S statement that "politics is the art of the possible, the attainable — the art of the next best."<sup>1312</sup>

In terms of the criteria of decision-making, the classic political process is more prone to departures from the epistemic criteria for the sake of opportunism – serving individual or another partial or sectional interest – or partisanism in either the sense of ideological preferences or control of power (*real politik*)<sup>1313</sup>.

In the election segment of the political process, the People are expected to use their voting, speaking or mobilizing powers to signal or reward good policy or sanction bad policy on the part of the government.

Yet, electoral campaign and popular votes are (epistemologically) poor methodologies to debate, weigh and judge complex, technically-heavy and sectoral-specific issues, even if they involve value-disagreements and political conflict<sup>1314</sup>. They tend to oversimplify and be more emotional, often leaning to demagoguery.

Citizens, who (s)elect, punish and orient policymakers through multiple democratic mechanisms, are no experts and often they do not even know what they want. Even when they know what they want, individuals may be uncertain about some relevant states of the world, exogenous conditions or effects of policies<sup>1315</sup>.

They tend to have imperfect understanding – per ignorance or irrationality, possibly aggravated by ideology, or simply rational inattention – about the macroeconomic policies, their operation, constraints, intertemporal dimensions, policy lags and interdependencies and spillovers, monetary illusion, and opacity<sup>1316</sup>.

In a stronger version they are accused of a growing cult of ignorance, with the rise of "low-information voters" and intellectual self-reliant (ignorant but arrogant) publics, notwithstanding the efforts of mass education, technology and specialized expertise<sup>1317</sup>.

That is also why in representative democracy the electorate delegates decision-making to representatives whose job is to take "good decisions" that the individual elector has neither time nor probably the competence to make<sup>1318</sup>.

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<sup>1312</sup> (BISMARCK, 1867).

<sup>1313</sup> (OTERO, 2003: 294-5), (BERGER & WOITEK, 1997).

<sup>1314</sup> (MANIN, PRZEWORSKI & STOKES, 1999: 11).

<sup>1315</sup> *Idem*.

<sup>1316</sup> (ALESINA & PASSALACQUA, 2015).

<sup>1317</sup> (ASIMOV, 1980), (NICHOLS, 2017: 17-18, 38), (BARKOW, 2021).

<sup>1318</sup> (WREN-LEWIS, 2012: 66).

#### **d) ADVANTAGE OVER ELECTED REPRESENTATIVES**

Democratic representation also faces epistemic shortcomings because (i) the two main controlling systems of DR policymakers are less expertise-oriented and disciplined than the checking systems of ICBs, and because (ii) DRs are themselves less specialized experts than central bankers.

The first control system of representation is the role of the democratic principal. Yet, the People (in the singular) is so ill-equipped that the quality and effectiveness of its control over the democratic agents/representatives is imperfect, leaving multiple opportunities for principal-agent problems and malign incentives that cause sub-optimal policymaking, namely due to information asymmetries between government (agent) and citizens (principal), which the former can and do exploit<sup>1319</sup>.

Citizens may be fully rational but less (imperfectly) informed than (by) policymakers about the conditions and facts underlying the macroeconomic decisions at stake due to lack of comparable attention- or knowledge-resources of the former, or due to manipulation or opacity by the latter (e.g., optimistic forecasting, hidden information, off-budgeting), which might lead voters to make sub-optimal choices.

Similar problems exist in the other main system of control of representation, which is the separation of powers amongst representative branches that enables them to check on one another. There are also exploitable information asymmetries between DRs. For example, Executives tend to have more access to information and expertise than Legislatures, and governments more than oppositions.<sup>1320</sup>

Information asymmetries may be exploited by incumbent politicians for their material or electoral self-interest or some sectional interest at the expense of the rest, causing an arbitrary intra- and/or inter-temporal (re)distribution of resources that fails to meet substantive and procedural democratic criteria. By relying on (or manipulating) asymmetric information, the formal democratic participation and deliberation becomes epistemologically defective and uneven-handed, failing to take all into equal consideration, and especially those more affected in the present and future.

If ICBs are even more experts than politicians, their informational edge over citizens and DRs shall be even greater, and they too could exploit the asymmetry. They might have some incentives to do it, for instance, if they want to cover up some past policy failure, forecast error or supervisory omission<sup>1321</sup>.

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<sup>1319</sup> *Idem.*

<sup>1320</sup> (BERNHARD, 1998).

<sup>1321</sup> (KRUMPAL, 2013).

However, they have greater incentives not to abuse, and DRs tend to have greater incentives to exploit information asymmetries than ICBs.

The former can use them directly to manipulate the outcome of elections and parliamentary votes that can immediately impact their survival in power.

The latter are embedded in a system of professionalism in which the epistemic community has instruments to patrol and even sanction – in terms of professional standing – those practices.

Furthermore, beyond the relative epistemic inferiority of their controlling systems, DRs themselves have less competence, knowledge, resources, and time, when compared to specialized experts.<sup>1322</sup>

Moreover, their constrained utility function generates incentives to disregard expertise and (critical) rationality in decision-making. Their greater preferences for recognition as popularity and for job security (whose prospects are defined by electoral support) incentivizes politicians to tweak decisions according to electoral or partisan support, rather than the truth and long-term overall impacts. Their less constrained preference for economic gain increases their vulnerability to bargain in favor of present or future financial contributors, rather than the optimal decision and the interests of the mass with lower and diffused stakes.

Legislatures in particular have structural epistemological limitations compared to specialized independent agencies.<sup>1323</sup>

The rise of hyperpartisanship and political polarization and the growing disrespect for experts across society have contributed to a decreased role of nonpartisan expertise in the legislative process which exacerbates deficiencies that are inherent in the legislative process.

Legislatures make wholesale policy with little individualized feedback on how their policies are applying to real-world scenarios, and often legislators have specific outlier problems or prototypes in mind when they draft legislation, and if there is not an expert fact-finding process in place to study a proposal, cognitive biases may go unchecked<sup>1324</sup>.

If Parliaments are “excellent for resolving straightforward questions of interests but not for complex issues”<sup>1325</sup>, macroeconomic policies belong to a third category of questions of interests with great complexity.

In addition to the partisanship as criterion, the relatively low-information capabilities, the decline of expertise, and the inequalitarian dominance by political elites, Legislatures also engage in self-interested bargaining and block votes, casting serious doubts over the deliberative

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<sup>1322</sup> (WREN-LEWIS, 2012: 66).

<sup>1323</sup> (CHURCHILL, 1930), (BARCOW, 2021).

<sup>1324</sup> *Idem*.

<sup>1325</sup> (BUDD, 2013).

quality of the legislative process in comparison to modern CBs after their own revolution in their relationship with multiple Influencers.

Four main arguments have been used to counter the epistemic superiority of CBI in such technical-and-substantively-political second-level decision-making.

*First* is the claim of epistemic superiority of the electoral-representative process – at least for higher level choices, involving moral or political disagreements – that would stem from the added information and reflection provided by diversity of viewpoints and experiences, larger numbers, and different degrees of intensity<sup>1326</sup>. Moreover, “electoral campaigns and debates in legislatures and committees [are] not devoid of deliberation” and voters can register policy spillovers (feel the broad effects of decisions) that a given expert body lacks the competence or feedback to tackle or appreciate. DRs have singular capability to tap into shifting currents and values of public opinion<sup>1327</sup>.

*Second*, is a more radical, relativist argument claiming that “[t]here is no truth in politics. There is only the balance of social forces that dictates the way in which we interpret our political and social world. What matters is the power that comes from being able to build coalitions and majorities strong enough to implement a political programme.”<sup>1328</sup>

*Third*, elected politicians minimize technical insufficiencies by regularly seeking expert advice. In politically charged and technically complex issues, politicians can and do resort to separate expert advisory while maintaining political control. Supported by ancillary experts, politicians have purportedly proven able to formulate sophisticated policies, such as tax policy<sup>1329</sup>.

This argument is expanded to suggest that claims of expertise and technocratic legitimacy do not really distinguish independent from non-independent expert agencies, and that in many countries there is plenty of technical expertise in various units of many of the cabinet departments and ministries, and that would be so with subordinate CBs and financial supervisors.<sup>1330</sup>

*Fourth*, the Executive, with its subordinated, professional bureaucracy provides a good enough balance, where specialized expertise can be mobilized across the policymaking cycle, but the most substantive and contested decisions remain under political control. In the macroeconomic field, the tradition of technically competent and politically relevant ministers of finance would be the pivot of such balance *within politics*.

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<sup>1326</sup> (LANDEMORE, 2017). For the opposite view (BRENNAN, 2016).

<sup>1327</sup> (BELLAMY, 2010: 9-10).

<sup>1328</sup> (BICKERTON, 2020).

<sup>1329</sup> (TUCKER, 2018: 95), (BELLAMY, 2010: 9-10).

<sup>1330</sup> (SHAPIRO, 2010).

As to the first argument regarding the epistemic and deliberative advantages of the classic political process these are, at best, concentrated in the first level of decision-making where moral or political disagreements concern the highest principles and choices are of second-order policymaking. Differently, they wane with the rise of technical complexity in first order policymaking.

Furthermore, LEVITSKY & ZIBLATT caution against relying on “the collective wisdom of voters”, which “assumes too much of democracy”<sup>1331</sup>, and can become “the collective wisdom of individual ignorance”<sup>1332</sup>.

As to the second, the relativist (or nihilist) argument, taken to its word it leads to the same direction of the “cult of ignorance” that dismisses the indispensability of improving the epistemic basis and deliberative quality of democratic decision-making that liberalism and republicanism advocated for over a century and that PLATO also alluded to.

On the third argument, the input of expertise through ancillary professional advisory does improve the political process, but it is not sufficient in the fields of monetary and financial policy where substantive politicalness and technicality are both intense and indivisible.

It is necessary to incorporate knowledge into the very entity and moment of the decision.

This internalization of expertise by the decision-maker (guaranteed by independent expert agencies) is decisive to guarantee that judgments are based on the best knowledge available, and not left to unwitting political calculation, where the self-interest of politicians could simply ignore the advice of ancillary experts.<sup>1333</sup>

It is not enough to relegate the expert input to an external element of an earlier segment of the policymaking process and leave unskilled politicians dominating the procedure with merely partisan criteria, starting from the agenda, to the framing of topics, information processing, and the discussion and choice of policies.

If expertise is externalized in the representative process, the risk of it being disregarded in the moment of deciding is aggravated by the utility function of politicians.

Furthermore, there is a difference of expertise between independent and non-independent experts. Independence improves the commitment to and conditions of expertise.

Independents are structurally more protected against participatory and representation biases, while non-independents are relatively more likely to forgo their specialized expertise and acquired information and to deviate from knowledge-based decision-making and the orientation

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<sup>1331</sup> (LEVITSKY & ZIBLATT, 2018: 23).

<sup>1332</sup> (NIELSEN, 2022, quoting THOMAS CARLYLE).

<sup>1333</sup> (VIBERT, 2007: 21).

to the truth, societal preferences, or optimal policies, for the sake of narrow political incentives and partisan or other partial interests.

As to the fourth argument of the reliance on the political Executive supported by a subordinated professional bureaucracy and other ancillary and external input from experts, this arrangement is inferior to independent specialized agencies in terms of the expertise-enhancing structure and resources, while it poses the same problems, “malign incentives” and systematic biases of the legislative process in general. It offers less expertise than ICBs, at the cost of plurality and transparency of the deliberative process.

ICBs foster greater specialization and consistency<sup>1334</sup>, attention and efficiency, and self-legitimizing or Niskanenian-expansive investment to cement the epistemic advantage.

Furthermore, the concentration of monetary and financial policies in the hands of the same political Executive that controls fiscal policy would, in addition to the liberal-democratic problems of political domination and fiscal dominance, increase the risk of deviating monetary and financial policymaking away from decisions made according to the best knowledge available and the integrity of the art and science of central banking.

On the contrary, the professionalism within the ICB and its epistemic community, with its methods, ethics, and discipline, reduces the arbitrariness that could result from their independence<sup>1335</sup>. At the same time, the transparency and the competition of influences of the pluralistic CBI help to check the cognitive limitations and biases.

Moreover, the transformations of modern central banking into the model of pluralistic CBI expanded its epistemic advantages.

In the early stages of CBI, ICBs developed the specialized technical expertise and professionalism that enable informed decision-making, rather than partisaniship.

Their more recent progress towards pluralism and politicization provides the ICB with the openness, transparency, diversity, critical scrutiny, and checks and participation that improve the deliberative process and mitigate systematic biases.

Finally, it's necessary to compare pluralistic CBI with traditional CBI under this epistemic standard. The traditionalist conceptions focus essentially on the rigid insulation from political Influencers and partisan politics. In that sense, they nominally reduce the risks of partisan-based deviations from knowledge-based decision-making.

However, such traditionalist views are epistemically poorer and more dangerous. Poor because they block or disregard the diversity of other inputs from other relevant Influencers that can carry information and knowledge about facts, interests, impacts, and conditions of

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<sup>1334</sup> (MORAVCSIK, 2002), (MAJONE, 1996: 286).

<sup>1335</sup> (MILLER & WHITFORD, 2016).

implementation. On the other hand, their focus on the insulation from partisan politics disregards the incentives and influences from highly motivated but partial affected interests that, if left unattended, might deviate the process from the orientation to the truth.

The greater regulated proximity-cum-insulation with the distinct Influencers and the competition of influences enabled by pluralistic CBI carry epistemic benefits that neither strict CBI nor accountable independence is capable of offering.

The update of the CBI framework may help prevent those entry points for epistemic inputs from becoming channels of capture or bias.

### **7.5.2. (DYS)FUNCTIONALISM**

One common argument in defense of delegation to non-majoritarian institutions is their purported superior functional efficiency or effectiveness compared to the traditional political process.

#### **a) DEALING WITH POLITICAL DYNFUNCTIONALITY**

Accusations of dysfunctionality in the domestic political system have escalated over the years, at alarming levels in the USA and other advanced economies<sup>1336</sup>. The polarization and formation of political bubbles have exploded, with demo-politics being accused of not solving but generating more conflicts by fostering animosity and gridlock, with disagreements about information and facts turned into questions about identity and way of life<sup>1337</sup>.

Dysfunctionalities associated with political polarization, enhanced by division of powers and multiplication of political veto-points, tend to generate a “war of attrition”. Although all parties would presumably benefit from a sound money position, no party has the incentive to bear the costs of bringing this position about. Political groups of similar size or strength perceive the possibility of shifting this burden elsewhere, incentivizing each group to attempt to wait the others out, and complicating their agreement on how to share the costs of the stabilization. Such political impediments lead to strategic behavior that delays policy responses, the adjustment of policy stances, and measures of monetary or credit tightening that cause the accumulation of inflationary pressures and financial risks<sup>1338</sup>.

The difficulties of time and conditions to (reach a consensus to) approve the necessary measures in the Legislature would justify substituting politicians – who duck what they should do – and delegating complex yet politically divisive macroeconomic policies to an ICB.

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<sup>1336</sup> (LUCE, 2018), (MOUNK, 2018), (SVOLIK, 2019).

<sup>1337</sup> (THE ECONOMIST, 2020).

<sup>1338</sup> (CHEIBUB, 2006: 354-5), (ALESINA & PASSALACQUA, 2015).

These arguments of functional efficiency in monetary and financial policies offer valuable insights, even though they can also be framed in terms of the three selected normative standards.

If the concern is with the lack of expediency of the legislative process, political executives offer an alternative to decide and implement policies quickly and effectively.

If the concern is with the polarization and partisan dysfunctionality that inhibits the Legislature from reaching much-needed decisions where political conflicts and disagreements are more intense, it is not normatively possible to simply grant a wild card or blank check to independent institutions to solve all substantive political conflicts.

Firstly, there is the argument that the transaction costs in terms of time, resources and procedures imposed by the legislative process are necessary and supplanted by the benefits it delivers in terms of rationality, diverse representativeness, critical and open discussion and, in general, the quality of deliberation in issues where *generality* is essential in the resolution or accommodation of profound political cleavages. Overall, the Legislature's institutional specialization in deliberating in conditions of generality would be more functionally efficient<sup>1339</sup>.

Second, caution is required in the interpretation and the extrapolation of the lack of the necessary legislative consensus to approve various macroeconomic measures. Even if the lack of consensus is attributable to dysfunction, rather than to the normal functioning of the deliberative process in plural societies, only under certain conditions can it create an implicit democratic authorization for the independent institution to overcome the inexistence of the necessary consensus.

## **b) MANAGING INTERDEPENDENCIES**

There is still another functionalist argument supporting the superiority of ICBs over national political authorities in managing spillovers and interdependencies between distinct domestic macroeconomic policies, and internationally between policies of different countries.

On the domestic front, ICBs offers a good balance between maximum concentration of all macroeconomic powers in the Executive, and maximum fragmentation of powers with each macroeconomic function being assigned to a distinct agency.<sup>1340</sup>

The former alternative would enable a fully internalized coordination of policies, but the partisan and electoral incentives of politicians would lead to a biased and suboptimal policy mix.

The alternative of maximum division of macroeconomic powers creates an inefficient deficit of coordination. The fragmentation would be excessive if each macroeconomic function were to

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<sup>1339</sup> (WALDRON, 2016).

<sup>1340</sup> (LEITÃO AMARO, 2022b).



be assigned to a separate institution – fiscal policy, internal and external monetary policies, financial regulation, macroprudential and microprudential supervision, consumer protection, LOLR, resolution authority, payment systems oversight, etc.

Such maximum fragmentation would disseminate specialized resources that are scarce in any economy, thereby dissipating the formation of centers of critical capacity and knowledge. It would generate transaction costs in information sharing and management of policy interdependencies and spillovers. It would create domestic institutional competition that might generate regulatory arbitrage and dangerous blindspots.

The more power-centers are insulated and proliferate, the greater is the difficulty in coordinating the separated powers into a coherent whole.<sup>1341</sup>

A strong, multiple-function ICB as a relatively separated partner to political macroeconomic authorities seems to be the most efficient balance of division and coordination.

Supranational CBs, independent from any particular national government, offer an efficient way to deal with monetary and financial interdependencies across borders. KEYNES's proposal in Bretton Woods for an International Clearing Union that would manage a kind of global currency called *bancor* was an example that failed to be accepted.

In Europe, though, the ECB was created as a supranational ICB managing a single currency, with 20 members of the Euro Area. Functional efficiencies in the management of a single monetary policy and later of a banking union were, along with political reasons, the fundamental drivers for European monetary integration led by one of the most independent CBs in the world<sup>1342</sup>.

There are still various economic or institutional gaps causing inefficiencies in the EMU.

The strong independence of the ECB helps to deal more efficiently with the shortcomings and incompleteness of the EMU. It safeguards the vertical attribution of competences between the EU and the Member States, given that monetary policy is an exclusive EU competence, while economic and fiscal policies remain essentially national in nature<sup>1343</sup>. Moreover, It facilitates the coordination and alignment of the Single Monetary Policy (and its supranational interests) with the multiple non-harmonized national policies such as fiscal and labor policies. Such alignment and coordination would be harder if the European monetary authority were partisan<sup>1344</sup>.

The ECB has participated or launched its own policy initiatives to deal with the economic asymmetries, incompleteness, and functional inefficiencies of the EMU, namely the banking union and the reforms to the EU macroeconomic governance after the Eurocrisis, the purchase of the novel pandemic related EU-Bonds to finance the NextGenerationEU recovery programme,

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<sup>1341</sup> (ACKERMAN, 2000).

<sup>1342</sup> (DYSON & FEATHERSTON, 1999), (JAMES, 2012), (BRUNNERMEIER, LANDAU & JAMES, 2016).

<sup>1343</sup> (HINAREJOS, 2019).

<sup>1344</sup> (MERSCH, 2017).

or the ECB's flexibility and anti-fragmentation tools such as the 2012 OMT, the 2020-22 flexibility in the PEPP, and the more recent TPI.

Moreover, even where CBs remain national, their independence facilitates the management of cross-border interdependencies and spillovers from and to macroeconomic policies in other countries.

This functionalist argument on policy interdependencies seems to tilt the balance towards ICBs, but it can be framed as one more dimension of the epistemic and liberal advantages. Independent central bankers are better at managing interdependencies because they *know better* how they operate and can be dealt with, and they are *less biased* by political, partisan or majoritarian interests in deciding how to manage them.

## **7.6. RETHINKING THE DEMOCRATIC ADVANTAGE: BALANCING MAJORITARIAN CONTROL WITH STRONGER UNPARTISAN DEMOCRATIC POLITICIZATION**

The first democratic principle is that people ought to have a substantial participation and influence on governance and policy decisions that affect their lives.

It corresponds to the idea of popular sovereignty, that the People are the ultimate source of the authority of their government, who, in a specific territory, should have the power to make directly or indirectly the substantive political choices by which they are to be bound.<sup>1345</sup>

A second democratic principle underlines the importance of political equality, in the sense “that governments should not just be responsive overall, but they should also be equally responsive to their citizens”<sup>1346</sup>. It entails an “all affected principle”, meaning that all those affected by a decision must be permitted to participate in the making of the decision, and also the “principle of impartiality as non-domination”.<sup>1347</sup>

This section discusses the comparative *standard of democratic control*, which assesses whether the people have the power, through participation and consideration in conditions of public contestation, to shape the rules of the system they live in, to issue inputs, guidance, and guardrails on policymaking, to ensure a democratic feedback loop and be able to overturn and change policy course, and sanction their representatives if they disapprove of their performance, thereby ensuring they have an open future in their hands.<sup>1348</sup>

It is a comparison between two *processes of indirect democracy*: on the one hand, contemporary political and pluralistic central banking, which combines more democratic control by DRs than

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<sup>1345</sup> (THOMPSON, 2005: 245), (KOMESAR, 1994: 200).

<sup>1346</sup> (PETERS & ENSINK, 2015).

<sup>1347</sup> (COHEN, 2018: 77), (PETERS & ENSINK, 2015).

<sup>1348</sup> (KOMESAR, 1994: 200), (VAN MIDDELAAR, 2012: 275), (AMTENBRINK, 2019).

traditionally expected with direct channels of democratic relation and popular participation and consideration (outside the electoral and partisan channels).

On the other hand, the realistic electoral-representative process, which incurs representation difficulties that mitigate the effectiveness and quality of its democratic control.

### **7.6.1. TRADITIONAL REJECTIONS – INDEPENDENCE FROM DEMOCRACY**

In the traditional view, ICBs are by design insulated from political control and subject to *weak* democratic control.

It is above dispute that monetary and financial policies are democratically relevant, so the insulation of such an institution with low democratic credentials is permitted as an *exception* or a *restrictive modification* from democracy, contained within narrow functional limits and conditions.

The assumption is that their *conventional* policies would be about technical and efficiency-only questions, purportedly with low political salience, and that they are politically decided or have negligible distributional and value determinations to be made. This allows a delegation to ICBs of limited scope, under consensus assignment, and dependent on a cumulative or “compensatory guarantee of legitimacy” provided by their expertise.<sup>1349</sup>

Contrariwise, those new tasks, and unconventional and activist policies that are inherently political should be “repoliticized” and in the purview of political branches and their subordinated agencies.<sup>1350</sup>

In this view, the democratic weakness of independent central banking stems from its lack of democratic credentials that “traditional administration” would allegedly have, such as subjection to the principle of political-electoral representation, the rule of parliamentary responsibility, the direction of a democratic Executive, and the possibility of voters directly voting unappreciated policymakers out of office<sup>1351</sup>. Allegedly, CBI would restrict access and participation, accountability, and responsiveness to the People, and it would worsen (by dispersion) the system’s accountability for public policies – “no one accepts responsibility for overall management”<sup>1352</sup>.

The general accountability for macroeconomic governance would decrease due to the CBs’ deliberations behind closed doors, the downsizing of the Executive’s role when it gave up the control over money, and the loss by parliaments of the oversight of monetary decisions as part of the parliamentary control of executive taxation, borrowing and spending. Furthermore, such

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<sup>1349</sup> (MORAVCSIK, 2002), (TUORI, 2015: 222-3), (MILLER & WHITFORD, 2016:14-20), (TUCKER, 2018: 555-7).

<sup>1350</sup> Critically (BELLAMY, 2010). (MAJONE, 1996), (MORAVCSIK, 2002).

<sup>1351</sup> (MERUSI & PASSARO, 2003: 83).

<sup>1352</sup> (FRIEDMAN, 1962), (BELLAMY, 2010: 10-11), (VAN’T KLOOSTER, 2020: 19).

a delegation would promote a mutual blame game about the economic outcomes and the respective shares of the macroeconomic policy mix.<sup>1353</sup>

Of all major CBs, the ECB is singled out as suffering the most acute democratic deficit<sup>1354</sup>.

First, the constitutionalization of key elements of the tasks and institutional framework of the ECB complicates the amendment of most of its legal basis, more than the Fed and BoE, thereby reducing the powers of instant political majorities to guide the CB.

Second, the Council and the Commission have no role in the dismissal of the members of the ECB-EB who also participate in the ECB-GC, be it performance based or otherwise. Furthermore, members of the Executive Board still cannot be dismissed for reasons of bad performance in achieving the primary objective of the ECB – contrary, for instance, to the NZRB.

Third, the European Parliament still plays a minor overall role, be it in the context of the amendment of its legal basis, the appointment and dismissal of CB officials, or in approving or reviewing its autonomous budget. It contrasts with the stronger powers of the US Congress and British Parliament. Although the role of the European Parliament in holding the ECB to account has substantially improved over time, elected politicians cannot hide the fact that the latter do not have any instruments to sanction the ECB.

Fourth, the political branches of the EU or of Member States have no possibility to override monetary policy decisions or give instructions in this regard, as admitted for the BoE and Fed in certain specific and exceptional conditions.

Fifth, despite positive developments in the ECB's democratic accountability that are not the law in the books, the momentous post-GFC changes in the functions and policymaking of the ECB are said to have strained its democratic legitimacy "more than ever before" and caused a transformation of the ECB which "has not been accompanied by sufficiently robust accountability arrangements in the hands of democratically elected"<sup>1355</sup>.

The traditionalist view in general is that the exceptional and narrow assignment of apolitical issues to ICBs could be accepted under the condition that DRs confer them some derivative democratic legitimacy. To start with, through the foundational Act that establishes the delegation and its objectives, and by the implicit and latent existence of the R-bomb.

Die-hard traditionalists would reject any further democratic *ex ante* intervention. ROGOFF even defended removing the substantive political content of the appointment power by imposing on political branches the appointment of conservative central bankers with rigid ideational preferences. Similarly, WALSH suggested neutralizing the politicization of the appointment

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<sup>1353</sup> (FRIEDMAN, 1962).

<sup>1354</sup> (GORMLEY & DE HAAN, 1996), (AMTENBRINK, 2019: 316-19).

<sup>1355</sup> (AMTENBRINK, 2019: 316-19).

channel by a contract that would tie central bankers' discretion and would reconstruct their incentives.

Moderates with the accountable-independence view suggested reinforcing the democratic credentials through tighter *ex post* parliamentary accountability, and more institutional, legal, and administrative constraints.<sup>1356</sup>

Most believe that the modern and expanded CBI lacks democratic legitimacy, and went too far, breaking their favored equilibrium of strong insulation-weak democratic credentials-low politicization.

However, what is fundamentally wrong in those views is their assessment of the real democratic control of modern ICBs in comparison with the control of the *real* electoral-representative process.

### **7.6.2. NEW DEMOCRATIC POSSIBILITIES: CBI FOR DEMOCRACY**

The innovative contribution is that CBI is not an exception or a restrictive modification *from* democracy, but a variety of the principle of democracy.

Pluralistic CBI is independence *for* democracy.

It is a process with democratic legitimacy and that, under conditions, compares well with the classic electoral-representative process in terms of democratic control. It might even improve the (e)quality of such control.

This favorable comparative position of modern central banking rests on three bases: (1) it is under (more) classic democratic control than expected; (2) it generates new channels and possibilities of non-partisan indirect democracy that increase the democratization of its process and of the governance of the delegated macroeconomic policies; (3), the alternative electoral-representative process is not as democratic as idealized.

Pluralistic CBI is a political technology that matured in a specific, very complex and technical field to the point of expanding the possibilities or varieties of indirect democracy.

ICBs still derive a good deal of derivative legitimacy from the generally constituted branches within whose sphere of influence and supervision they operate<sup>1357</sup>.

What is new here is, firstly, the conclusion that the People maintain *good enough* (or even better) *control* of ICBs, by their DRs, than if the delegated policymaking were assigned to a combination of political branches, a centralist finance minister and a subordinated bureaucratic agency.

The second new idea is that ICBs' derivative legitimacy is and should be complemented with new and compensatory forms of non-partisan and non-majoritarian democracy. They must "go

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<sup>1356</sup> (LEINO-SANDBERG, 2000), (AMTENBRINK & DE HAAN, 2002).

<sup>1357</sup> (HALBERSTAM, 2010: 193).

beyond expertise to incorporate public opinion and social and economic interests” and be sensitive to the concerns of ordinary citizens and civil society groups.<sup>1358</sup>

The third new idea is that pluralistic CBI can also be a “compensation for the perceived shortcomings of the generally constituted branches of government” which might “help to get the job of government done”.

In fact, due to representation gaps and democratic difficulties in the electoral-representative process, which are aggravated in technically complex yet distributive-prone fields like macroeconomic policies, the solution for democratic difficulties is not to be sought, entirely or mostly, in an increase in the classic electoral legitimacy of central banking. Instead, it can be found in the non-partisan democratization of the functioning of the independent institutions<sup>1359</sup>. ICBs “are sought out to fix perceived problems in the constitutional architecture of the particular system they operate [in]”.<sup>1360</sup>

This new approach assumes, in line with pluralist theories of democracy and away from majoritarian theories, that no single branch of government holds a monopoly on the vindication of any of the liberal democratic values<sup>1361</sup>.

The electoral-partisan process is not and cannot be the sole means of control in a democratic system, as there are other political, non-electoral channels of control such as the disintermediated relationship with the citizenry, Interest Groups, media and the internal control and balance of government agencies and organizations against each other.<sup>1362</sup>

In a pluralistic democracy, pluralistic CBI is one of those means of indirect democratic control, where CBs and their officials are still representatives and devices of indirect democracy. Political ICBs are responsive, accountable, but also representative in the sense of “acting in the interest of the represented”<sup>1363</sup>.

Modern political ICBs combine an indirect relationship with Citizenry via DRs, with a growing direct relationship through a disintermediated collaborative engagement with the wider public and other societal representatives beyond parties and financial elites, e.g., NGOs and communities.

Both are and ought to be bidirectional and involve popular inputs and judgment, feedback and sanctions of outputs. The indirect relationship involves a breadth of good enough channels of

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<sup>1358</sup> (ROSE-ACKERMAN & LINDSETH, 2010: 7).

<sup>1359</sup> (VAUCHEZ, 2016).

<sup>1360</sup> (HALBERSTAM, 2010: 194, 201).

<sup>1361</sup> (HALBERSTAM, 2010: 193).

<sup>1362</sup> (VILE, 1998: 363-5).

<sup>1363</sup> (MANIN, PRZEWORSKI & STOKES, 1999: 10).

democratic control, and the direct a series of still developing channels for speaking and explaining to and listening and learning from the citizenry.

This pluralistic view rejects that the electoral-representative process can be dispensed as a central pillar of a liberal democracy, and also of the legitimization of independent non-majoritarian institutions.

It is not a claim that *in general* independent institutions are normatively superior at intermediating popular will. A government system composed solely or mostly of completely standalone independent institutions would become technocratic and cease to be sufficiently democratic.

Even where autonomous regulatory powers exert political power autonomously, they are dependent on others for democratic and constitutional legitimacy – autonomy does not mean that these agents are or can be, in themselves, “constitutionalised”, i.e., experienced as self-legitimizing, without derivative or mediated legitimacy through the nation state and its classic political process.

On the other hand, the pluralistic view also rejects the electoral representative process’s monopoly of representation and of legitimization of independent institutions.<sup>1364</sup>

There is democratic added value in integrating certain (mature and limited-scope) independent institutions in the constitutional system.

The following sections seek to demonstrate that under conditions, political ICBs fit and even advance liberal democracy. They are under good enough control from DRs and offer new channels of indirect democracy that can build a democratic advantage in the specific fields of monetary and financial policies.

### **7.6.3. GOOD ENOUGH DEMOCRATIC CONTROL THROUGH THE ELECTORAL-REPRESENTATIVE PROCESS**

Both alternatives – CBI and the electoral-representative process – give the People an indirect control of policymaking.

Yet, CBI introduces one additional leg to indirect representative democracy, and mitigates the power of DRs over (parts of) monetary and financial policies by preventing their direct management/first-order operation of the delegated policies, and increasing the burden of regulating second-order/finality intervention.

Insulation from politics has important normative advantages, but the mitigation of traditional democratic control can never be absolute, only limited. It “cannot be taken too far, otherwise it becomes a challenge to democracy itself” and “deprive[s] the democratic process of its central significance” in macroeconomic fields<sup>1365</sup>. Balance is needed.

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<sup>1364</sup> (FORESTER, 2017 citing WARREN & MANSBRIDGE, 2013).

<sup>1365</sup> (MADURO, 2012), (ACKERMAN, 2000).

Modern political and independent central banking needs democratic and constitutional legitimacy, and the new direct democratic channels do not dispense the role of the DRs in providing derivative legitimacy and ultimate democratic control.

The novel relationship between DRs and more political ICBs is “driven less by unilateral constraint than by mutual exchanges and influence”<sup>1366</sup>.

This relationship and the degree of legitimation and control of ICBs by DRs mark a significant difference between CBI and judicial independence, as the judiciary is subject to some, but much more limited possibilities of democratic control, which is consistent with the more circumscribed role of the judiciary in substantive policy decisions.

The normative claim is that political and independent CBs are (and may be) subject to “good enough democratic control” or, in ACKERMAN’s words, a “longer run political supervision”<sup>1367</sup>.

Chapter 5 detailed the many formal and informal channels of *ex ante* and *ex post* control of ICBs by DRs.

When comparing the democratic control and representation of the People over the governance of monetary and financial policies by the classic political process (political branches and subordinated agencies) and by ICBs, the conclusion is that the controls over the former are less effective and comprehensive than in the idealised majoritarian model, while the latter are subject to better control than traditionally argued.

That is so because, as demonstrated in the following sections, (a) political CBI has foundational democratic legitimacy; (b) it has a broad but limited, and thus acceptable, scope of delegated political discretion; (c) the People and DRs maintain the ultimate power of the delegated policies and thus an open future; and (d) it has a degree of control and public contestation that are effective and not relatively inferior to the delegation to a political Executive or subordinated CB or other agency.

#### **a) CBI AS A DEMOCRATIC CHOICE THAT OFFERS FOUNDATIONAL LEGITIMACY**

The state and public intervention in the governance of money and credit are not inevitable.

There are also imperfect alternatives, such as private (commodity or fiat) currencies competition, unregulated financial activities, decentralized finance, or globally dominant currencies and financial actors.

It is always the People who explicitly or implicitly choose the governing mechanism that it accepts.

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<sup>1366</sup> (FROMAGE ET AL., 2019: 10).

<sup>1367</sup> (ACKERMAN, 2000: 708).



The choice of the non-majoritarian CBI was *explicitly* made by the DRs, who also make the decisions to institute (or empower) an ICB, to delegate to it important public macroeconomic functions, to design the basic institutional framework of CBI, and to choose goals and instruments as extensively as they want. These choices are made by democratically elected lawmakers pursuant to primary democratic, political processes of constitutional or legislative lawmaking.

From the outset, CBI is democracy-compatible because decisions on (i) whether or not to delegate; (ii) how much discretion; and (iii) under which procedural and substantive conditions, are made democratically.<sup>1368</sup>

This explicit, elaborated and conscious decision of DRs endows ICBs with a foundational, derivate democratic legitimacy because in their free will, they have democratically decided to self-limit their own power and put the governance of money and credit at arm's length<sup>1369</sup>. This self-limitation of/by democracy is what constitutionalism is about.

However, if this foundational democratic legitimacy is necessary, it is not sufficient.

The conscious and free democratic choice provides one time legitimacy, but it cannot dispense with mechanisms of *ex ante* and *ex post* democratic control over the performance of the delegated policies and the new channels of democratization<sup>1370</sup>.

#### **b) ULTIMATE MAJORITARIAN CONTROL: REVERSIBILITY, APPROVING SILENCE, AND OPEN FUTURE**

People cannot be endlessly bound to past choices. They must have power to shape their present and have an open future.

Their DRs and the electoral-representative process have not only the original, but also the *ultimate* power over the public governance of monetary and financial policies.

First and foremost, the delegation to ICBs is not definitive, its existence, contours and performance ought to be reviewable, reassessed, and reversible by DRs to warrant an open future.

Second, if such latent powers exist and are effectively available, not excessively burdensome, nor paralyzed by political dysfunctionality, it can be assumed with normative relevance that the foundational popular and majoritarian support for CBI persists as long as no majoritarian will terminates or amends the delegation.

It forms an ongoing *tacit renewal of the democratic endorsement of CBI* and, at least in the overall and in the longer run, of its policymaking. In a weaker but still democratically relevant version, it means at least that no sufficient opposing majority exists against CBI.

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<sup>1368</sup> (VAN'T KLOOSTER, 2021: 15-16).

<sup>1369</sup> (LASTRA, 2015: 69), (BLINDER, 1998: 67-68).

<sup>1370</sup> (EU COM, 1991: 20), (AMTENBRINK & DE HAAN, 2002: 74).

Caution is needed when extending this interpretation of an *approving silence* of the institution and its independence in general to concrete policy choices.

This silence has to be irrelevant in the first level of decision-making where independent institutions lack of sufficient democratic legitimacy to self-enact new functions and primary objectives. It is hard to defend the tacit acquiescence of *ultra vires* interactions.

Differently, in the second and third levels of decision-making, there is a delegation with broad primary objectives and *good enough* instruments of *ex ante* and *ex post* control by DRs, and the doctrine of implied powers gives legal cover to ICBs' actions despite the absence of explicit conferral.<sup>1371</sup> These constitute strong, *prima facie* indicators that until DRs reach a consensus in the opposite sense, their silence may be interpreted as democratic acceptance of the ICB's decision.

Otherwise, political dysfunctionality or rational disagreements between DRs that impede a minimal majority to pass some legal commandment would in practice mean an endorsement of a status quo, that possibly no one prefers.

CHRISTIANO suggested that the legislative power has complete control if it keeps, albeit lying latent, the ultimate power to correct the agency. It can determine or change the policies' aims at any time and provided it gathers sufficient *democratic* support to pass legislation.

The CB may, in practice, make some decisions about the ends of policymaking and if the Legislature does not act in the wake of such policy specification, the legislative silence can be interpreted as assent to the specification of the CB, which is treated as a piece of "advice". The Legislature retains ultimate power because, should the CB misstep, the Legislature can always legislate to correct it<sup>1372</sup> (even with the effects circumscribed to current and future situations).

Nonetheless, in areas of uncertainty or unclarity in the mandate, ICBs ought to exercise some self-restraint and humility, and wait for clear and generalized signals of social consensus about policy innovations that they can reveal but which they should not lead. Those signs may come from various channels, not limited to legislative action, but they should precede ICBs' action.

The significance of silence depends on the effective availability of the ultimate power, and on the of existence informed, engaged, and active accountability of central banking towards DRs in all the dimensions identified in chapter 5.3.

On the other hand, if the essence of CBI – the integrity of the art and science of central banking – is to be preserved, that accountability must be structured, and the path to effect changes in the framework and objectives of the delegation must be (procedurally) demanding along liberal lines in order to rationalize and cool off short-termist majoritarian impulses.

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<sup>1371</sup> (CRAIG & DE BURCA, 2020: 105-107).

<sup>1372</sup> (CHRISTIANO, 2005).

CBI protections, intergenerational, and supermajoritarian requirements may increase the costs of imposing political sanctions or even dropping the R-bomb.

There needs to be a balance between the degree of exigence of majority-constraining barriers, and the viability of the ultimate power to review and reverse.

More *concrete* and *retrospective* interventions in policymaking must be especially constrained and truly exceptional (if admitted at all) because they offend the credibility of the commitment of the delegation and they would operate in the segment of policymaking where the political process has the least comparative advantages. That is why CBI frameworks should be intolerant of specific policy overrides and the removal of central bankers from office for policy disagreements<sup>1373</sup>.

On the contrary, when it comes to *prospective* choices with *generality*, the limitations need not be so stringent because the electoral-representative process is at its best in first-level decision-making<sup>1374</sup>.

In any case, if a serious and fairly prolonged imbalance persists between what central bankers think is right and what political majorities find acceptable, the latter will end up acting and prevailing.

If the procedural burdens are excessive and the People and their representatives are unreasonably straightjacketed, those hurdles will be challenged or even ignored. As MADISON alerted, constitutional or statutory constraints can become like “parchment barriers”<sup>1375</sup>.

First, politicians (and others that act through them) will seek informal ways of interfering. That tends to be problematic, because those informal, unstructured channels are more unequal, vulnerable to unchecked biases, and less rationalized.

It is not clear in general and *ex ante* what is the *sacrifice ratio*<sup>2</sup> in central banking, i.e., how much CBI holds and central bankers resist the public discontent and political backlash resulting from the pain that CBs need to inflict, for instance, in terms of weaker growth and unemployment in order to bring inflation back under control<sup>1376</sup>.

The accumulation of popular good will towards the institution during stable and easing times is necessary to cushion the skepticism and disagreement during periods of unpopular restrictive measures.

The BURNS and VOLCKER Feds offer opposing examples of the capacity to make initial tough decisions, and *maintain them for long enough* to produce durable effects, namely to end inflation. They started alike, but the former quickly shied away from criticism and reversed

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<sup>1373</sup> (BLINDER, 1997: 122-3).

<sup>1374</sup> (WALDRON, 2016, defining generality as the functional advantage of the legislative procedure).

<sup>1375</sup> (THE FEDERALIST PAPERS NR 58).

<sup>1376</sup> (ANDERSEN & WASCHER, 1999).

restrictive policies too early, while the latter won its place in history for its unyielding commitment to dominate inflation.<sup>1377</sup>

Second, in the extreme, “a lack of broad public support or the total absence of political involvement in monetary policy would lead to a central bank eventually being overridden”<sup>1378</sup>.

As LOCKE noticed, the People always have an escape clause. Collapsing currencies highlight the precarity of monetary and financial authority, and the trust that underlies it. The choice of CBI, the authority of ICBs, the acceptance and implementation of their policymaking hold only as long as there is political will.

This is another sense in which CBI is political.

The practical security that the independent institution enjoys as a whole is entirely dependent on the whims of the popular branches and of the People themselves.

In normal political circumstances there is legislative deference to the ICB, but the threat is always there, namely through congressional powers to strip jurisdiction, abolish the ICB, affect its resources or lower the hurdle for removal or impeachments.<sup>1379</sup>

It should be expected that central bankers rationally anticipate such risk, and thus act strategically to manage the partisan and popular feelings about their performance.

Such dynamics contribute to embedding central banking within the political system, operating under public contestation.

In case of strong political impetus (and consensus) towards a serious shift in policy stance, the time horizons of central banking and political processes would be dramatically shortened alike. Does that ultimate political dependence of all institutional solutions mean that failures of the political process can contaminate the whole policy process, and thereby destroy the credible commitment?<sup>1380</sup>

CBI does move the time-consistency issue one step back and, like other constitutional barriers, its purpose is to impose sufficient costs and require sufficient time so that the instant majority's interests and capacity to override the CB fades, thereby making commitment credible<sup>1381</sup>.

That ultimate political power does not destroy credible commitment, in the sense that it was never supposed to be absolute, but only comparatively more credible with CBI due to the relatively higher transaction costs faced by instant majorities.

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<sup>1377</sup> (SARGENT & SILBERT, 2022).

<sup>1378</sup> (BRENTFORD, 1998: 109), (LEINO-SANDBERG, 2019: 196-7).

<sup>1379</sup> (FEREJOHN, 1999: 382).

<sup>1380</sup> (DOWNEY, 2021).

<sup>1381</sup> (KING, 2004).

Yet, the ultimate power allows the People and their elected representatives to control excesses of independence and maintain the open future, and therefore, the continuing existence of the political community through time.

A democratic society always retains the discretion to reinvent itself; and should the people of a country make a considered, deliberate choice to seek some other good, the institutions of CBI should respect that decision<sup>1382</sup>.

Free and competitive elections, parliamentary opposition, political appointments and the R-Bomb are the ultimate power guarantee that central bankers have a political calling and “a statute higher than that of mere technocrats”, but not *final authority*<sup>1383</sup>.

In this sense, ICBs are in a very different position than Supreme and Constitutional Courts. They are power weaker but democratically stronger than the independent judiciary.

The discussion of whether the latter might superimpose or not their interpretation of the constitution and fundamental values on constituted political branches – the Legislative and the Executive – does not take place in central banking.

CBs have no role of “policing the process of representation”<sup>1384</sup>. Instead, they are delegated and precarious exercises of representation.

That conclusion is more obvious with non-constitutionalized CBs, such as the Fed and the BoE, whose interpretations of their statutory mandates and of constitutional norms prevail only as long as the respective Legislatures do not (legitimately) decide to amend such statutes and reorient (second-order) policymaking.

But, even in the case of CBs with constitutionalized mandates such as the ECB, there is no claim of a power of the CB to overrule the political branches.

Where the EU primary law allows the EU political branches – Council, European Council and Parliament – to intervene, the ECB is bound to comply with the resulting regulation, directive or international treaty.

It does so in multiple domains: in financial policies the EU lawmaking bodies have extensive regulatory competences, in external monetary policy the Council can issue general orientations and enter into international agreements<sup>1385</sup>, and even in the context of internal monetary policy the EU political branches have rulemaking roles, namely, to specify the definition of the ECB’s monetary financing prohibition and to set out broad economic policy guidelines that shape the role of the ECB in realizing its secondary mandate<sup>1386</sup>.

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<sup>1382</sup> (LASTRA, 2015: 76).

<sup>1383</sup> (WALDRON, 2016), (ELY, 1980).

<sup>1384</sup> (ELY, 1980).

<sup>1385</sup> Art. 219 TFEU.

<sup>1386</sup> (DE BOER & VAN’T KLOOSTER, 2020).

Moreover, the Treaties expressly de-constitutionalize certain provisions of the ESCB Statute which the European Parliament and Council can amend through the ordinary legislative procedure, including those statutory provisions that specify the instruments of monetary policy<sup>1387</sup>.

Where EU primary law assigns vertically and horizontally exclusive competence to the ECB, the EU political institutions have no legally binding say on first-order policymaking decisions, but they still can signal their preferences, informally or when their representatives sit, speak, and even make proposals at the ECB-GC's table.<sup>1388</sup>

Moreover, in limited cases, the EU political branches can dynamize the simplified treaty revision of provisions of the EU Treaties relating to the ECB and of the ESCB Statute, subject to the condition that the amendments do not increase the competences of the Union and are approved by Member States.<sup>1389</sup>

Elsewhere, the ultimate political authority lies with national governments' political authorities either by collectively amending the Treaty<sup>1390</sup>, or in the extreme by exiting the EU or, arguably, the group of Member States whose currency is the euro.<sup>1391</sup>

The ECB is not endowed with a definitive transfer of political power.

One important clarification is that this *finality* of democratic control is about open future, not open past.

It is about shaping prospectively and with generality the second-order policymaking, the existence and design of the institution, and the generality that characterizes the determination of primary policy goals and the choices of top policymakers.

That finality reveals who holds the master key to the future, which is different from allowing the re-openability of all past choices. That is not a democratic demand.

Not even the most majoritarian policy fields allow elected legislators or presidents to annul or overturn every concrete policy decision made by subordinated executives or bureaucrats<sup>1392</sup>.

The democratic demand of policymaking under conditions of public contestation implies the informational, explanatory, debate, and judgment components of accountability of all types of policymakers. Differently, the *ex post* sanctioning power of political override or appeal of specific, discretionary policy decisions is not an indispensable demand of democratic governance.

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<sup>1387</sup> Art. 129 (3) TFEU, (DE BOER & VAN 'T KLOOSTER, 2020).

<sup>1388</sup> Art. 284 (1) TFEU.

<sup>1389</sup> Art. 48 (6) TEU.

<sup>1390</sup> Some countries internal constitutional requirements demand a popular vote.

<sup>1391</sup> Only the exit of the EU is regulated, under art. 51 TFEU.

<sup>1392</sup> (LOHMANN, 1998), (BLINDER, 1998: 48).

Finally, CBs are themselves subject to judicial review, whose *dicta* on constitutional and statutory interpretation bind the CB. The history of CJEU's review of ECB's policymaking confirms how both institutions accept that the Court has the last word. The judicial dialogue between the CJEU and the GCC was also a fight for supremacy on the last word, between two courts, not ICBs.

CBs do not guard themselves, courts do.

The latter usually exercise deference to ICBs' discretionary policymaking, but they are the ultimate arbiters of the boundaries of that discretion, and their restraint is self-regulated.

### **c) EFFECTIVE DEMOCRATIC GUIDANCE AND ACCOUNTABILITY**

Both electoral-representative and independent central banking processes give the People, through its representatives, the democratic foundational choice, ultimate power, an open future, the general (and at least prospectively) reversibility of policies, mandates and delegations, and also their regular reassessment.

Chapter 5 demonstrated in detail that CBs are subject *de jure* and *de facto* to multiple channels of political constraint, guidance and accountability.

As concluded above, the sum of those channels provides good enough democratic control, which is less than hierarchical, but more than weak proceduralist control or political abdication.

It was also demonstrated that ICBs operate under conditions of public contestation.

This model of political and independent CBI creates an iterative governance, and respects and preserves the effective power of the People, through their representative lawmakers, to regularly reassess and change the monetary and financial policymaking governance regime over time, and to shape the rules of the system they live in.

A common criticism is that primary or ordinary lawmakers – i.e., national governments for the ECB and Congress for the Fed – have only a formal power that is materially dormant or atrophied. It is of rare, burdensome, and limited use, thus favoring the status quo.

The existent system is seen as restricted to democratic “guardrails” enshrined in the mandate and backward-looking legislative accountability to monitor compliance with those guardrails but lacks the power to define the appropriate course of monetary policy.<sup>1393</sup>

The informal or tacit consent from politicians is “a weak substitute for democratic authorization via the legislative process”.<sup>1394</sup> The extraction of any meaning, such as tacit approval, from legislative silence is even more problematic where the political process is dysfunctional or polarized.

Those critiques turn into proposals for “enhancing the democratic authorization” of CBs.

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<sup>1393</sup> (DOWNEY, 2021), (BLINDER, 1998: 55).

<sup>1394</sup> (DE BOER & VAN’T KLOOSTER, 2020).

One suggestion is to increase the Legislature's intervention, namely by requiring it to pass more specified delegation, to subject the whole of the ICBs' policy package to legislative veto by a single up-or-down vote<sup>1395</sup>, or to impose automatic sunset clauses on the CB charter or statutory mandate. Where procedural legislative burdens are greater, such sunset clauses would prevent the hold-up by any veto player and offer the opportunity to deliberate once a decade whether the existing mandate is still the desired one<sup>1396</sup>.

Another strategy is to empower political Executives, spreading the UK-style mandate specification to determine, on a recurring basis, the policy targets and interpret secondary objectives in the mandate<sup>1397</sup>.

A third distinct approach is the proposal for the creation of a Euro Parliament to replace the Eurogroup, with powers to appoint the ECB-GC and conduct 5- and 10-year revisions of the ECB mandate and toolkit. Its members would be elected or selected by sortition, either from among the demos at large or among Member State parliamentarians of the countries of the Euro Area, and supported by specialist staff<sup>1398</sup>.

Contrariwise, the view taken here is that existent channels for *ex ante* forward-looking and *ex post* backward-looking democratic control are normatively sufficient and good enough.

Both US Congress and EU political branches already have important powers that are still underexplored.

As explained above, there is more democratic meaning in tacit endorsements than those critics acknowledge. The continuation of the mandate and implicit authorization for the CB to act is often preferable to their inaction in the wait for political approval. The lack of legislative amendments does not mean that such power has "materially atrophied", but possibly that there is no sufficient majoritarian will to use it to its fullest, or even that there is a silent societal consensus supporting its existent formulation and the interpretation adopted by the CB.

In fact, despite copious popular(istic) reproaches, most innovative and daring measures since the GFC have followed a broad societal consensus, e.g., the 2008 bank rescues, the evolution of the CBs' positions on their role on climate policy, and the 2020 pandemic expansionist responses (including direct lending).<sup>1399</sup>

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<sup>1395</sup> (BLINDER, 1997: 124).

<sup>1396</sup> (DE BOER & VAN'T KLOOSTER, 2020), (DOWNEY, 2021).

<sup>1397</sup> *Idem*.

<sup>1398</sup> (BINDER ET AL., 2020).

<sup>1399</sup> (VAN'T KLOOSTER, 2021: 17-8) .



There seems to be some rapport and significant syntony between ICBs' fundamental options and popular sentiment. The empirical evidence of home bias confirms that "independent central banks tend to follow the policy preferences of their domestic government" or constituencies.<sup>1400</sup> It seems that critics demand more of the central banking process than of the elected-representative process.

To start with, neither mandatory regular reassessment of the mandate by the Legislature nor time-limited delegations are a general principle of democratic representation. Most legislation, including that with delegations of discretion to subordinate bureaucracy, is subject to *possible* rather than *mandatory* and *timed* reviews, and rarely as a condition to continue in force.

If the Legislature remains silent, such passivity in itself must have equal normative interpretation namely in terms of the consequences of the lack of formal deliberation by a pluralistic Legislature with an intervening opposition, regardless of whether the delegated agent is partisan (executive or bureaucracy) or independent.

The counter argument that elections warrant regular reassessment of policies of legislators and subordinated bureaucracy assumes too much from elections that are too crude of a channel to convey specific policy options and neglects the *de facto* autonomy of those bureaucracies.

Furthermore, there should be no double standards assessing the normative worth of informal signals. In pluralistic and deliberative conceptions of democracy, such informal signals about policy preferences by elected and partisan agents and by many other actors (Interest Groups, experts, public) have important normative worth. They are important parts of open debate and public deliberation. It is hard to see why that worth would wane when the addressee/formal policymaker is independent – yet democratically embedded and delegated – rather than partisan.

It is one thing to say that structured signals and consent might be preferable to informal ones, but this is not to suggest that the latter are devoid of democratic meaning.

Another common, implicit fiction is to single out independent central banking as the institutional alternative that prevents permanent popular feedback and iterative governance. Howe, in the electoral-representative process the People also intervene sparsely and (all) DRs have electoral, legislative and administrative cycles that are elongated by constitutional and legal procedural constraints. Only a utopic direct democracy using online digital tools could warrant immediate and "live" democratic input.

The cycles of inputs and control of the electoral-representative process are shorter than those of independent central banking, and they can be vulnerable to further acceleration within the

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<sup>1400</sup> (LEITÃO AMARO, 2023a), (VAN'T KLOOSTER, CB: 17-8).

electoral cycle due to the dynamics of partisan pressures and public debate. But they are neither immediate, nor universal.

Both ICBs' and political processes warrant *indirect* and *mediate* democratic control, with CBI imposing "longer run political supervision". When "political guidance operates over the long term: a series of new appointments can have profound effects, and if performance remains unsatisfactory, Congress and the President are free to change the Fed's governing statute".<sup>1401</sup> ICBs have some Burkean flavor here as it makes it harder for political branches to change policy, unless they mobilize large, persistent or successive majorities.

There is indeed a consequential difference in the normal lengths of the two cycles, but it is essentially a difference of degree.

On the other hand, extreme contexts and swapping political impetus (and consensus) can dramatically abbreviate the time horizons of the two processes alike. For instance, in moments of crisis, constitutional lawmakers can react quickly, forcefully and condense all formal approvals necessary to amend the powers and guidance to relevant policymakers.

Unrealistic assumptions about the democratic credentials of the classic political process<sup>1402</sup>, double standards or exaggeration of differences are common in comparative analyses of the two processes.

For instance, if all macroeconomic policies were left with the electoral-representative process, most substantive policymaking would be delegated and/or dominated by the Executive, and particularly the finance minister, and also to subordinated bureaucracies. With the exception of the leader of the Executive in presidential systems, cabinet members and subordinated bureaucracies are not directly elected by the People, as central bankers are not. The former are appointed by periodically formed political majorities and usually without limits on reappointability, while the latter are appointed less regularly but by a sum of multiple, sequential majorities.

In addition to the limited judgments that elections convey regarding specific monetary and financial policies, the appointment procedure of the political policymakers that would be in charge of those sectoral policies is not that different in terms of democratic input than the procedure to appoint central bankers.

For instance, in the US both the Treasury Secretary and the Chair of the Fed are appointed by nomination of every elected President, subject to the advice and consent of the Senate pursuant to the same procedure.

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<sup>1401</sup> (ACKERMAN, 2000: 708).

<sup>1402</sup> Ch. 7.3.

In the EU, each of the six members of the ECB-EB is appointed by the European Council, upon the vote of a non-binding but influential opinion of the European Parliament, on the basis of a Council recommendation.

The EU Commissioners are also approved by the European Council, after a vote by the European Parliament and a proposal of the President of the European Commission. However, the European Council and European Parliament decisions are made on the body of Commissioners as whole – although the Parliament approves individual evaluations .

In contrast, the President of the Eurogroup is opaquely chosen within the Council of the EU, and there is no EU-wide role in the appointment of members of the Council of the EU.

In presidential systems, the leader of the Executive cannot be dismissed by the People('s representatives) on political grounds, except through arduous impeachments. The bar for anticipated removal of unappreciated central bankers is high, but still less constrained than for presidents in these systems.

In contrast with the myth that political branches strictly follow the instructions of the People, their democratic mandate is not imperative, but often vague and limited, with plenty of room for innovative recreation and deviations by the representatives, and a lot of trust in the role of anticipatory judgments of what would be popular will manifested in electoral accountability.

Furthermore, there is plenty of room and opportunities for gaps and deviations of representation, distortive intermediation of parties, capture and manipulation of information of the People by their DRs.

Appointed executives tend to dominate the political system and the legislatures that were expected to guide and control them.

All these phenomena tend to be aggravated in more complex and technical fields where most elected politicians feel uncomfortable and unprepared. Even in elected and plural political branches, real political power tends to be concentrated in the hands of a few (powerful political elite) that are much less representative than ideally expected.

In a nutshell, the breadth, quality and effectiveness of the popular control of complex macroeconomic policies through the electoral-representative process is weaker and more indirect than expected.

In turn, political ICBs have mandates that can be changed by legislative action, have increasingly operated under conditions of public contestation and subject to multiple informal and formal channels through which the People – directly and through their elected representatives – can and do convey signals of policy preferences and of feedback on past performances, so that CBs have been more responsive, accountable, and representative than was traditionally believed.

Finally, it is beyond doubt that CBI creates partisan and electoral insulation, institutional constraints and effective procedural barriers that DRs have to surmount in order to change or

correct central bankers and their mandates. CBI creates a “longer run” but also more burdensome political supervision, i.e., with higher transaction costs.

Yet, such insulation and constraints are desirable from the perspective of liberal and democratic values. In fact, institutional and procedural constraints on instant political majorities are defining features of constitutionalism that apply, pervasively albeit with nuances, in the other policy fields which are not delegated to ICBs.

Such additional transaction costs that CBI imposes on democratic control can actually be democracy-improving, as explored below.

It is worth, in the meanwhile, consider the possibility of a *paradox of control*: that such higher transaction costs actually improve both the performance of the delegated agent and the quality and effectiveness of the democratic control.

The first effect is suggested by MILLER & WHITFORD who argue that sometimes more control leads to poorer performance, whilst more autonomy would lead to higher-effort and higher-quality decision-making, particularly when policymakers have longer run horizon and cooperative coordination is beneficial<sup>1403</sup>.

The second counter-intuitive effect is based on two advantages.

One is that when monetary and financial policies are concentrated in the political branches, the democratic scrutiny of the Legislative by voters and public in general, and of the Executive by citizenry and legislators is amalgamated with many other functions and dispersed in the joint accountability for all.

Differently, the insulation of those same functions in a discrete institution, which is also subject to strong accountability mechanisms, allows for more focused, specialized, profound and consequential scrutiny, both public and political.

From another perspective, governments can distract and diffuse political accountability on certain policy misdeeds by (trying to) offsetting the errors with successes in other policies or through suboptimal policy compensation, or simply by changing the discussion in the public sphere using its mediatic agenda-setting capabilities.

Differently, CBs do not have the same breadth of functions and agenda-setting ability to deflect political accountability and thus democratic control.

The other advantage of the barriers of independence to democratic control is that they increase the public (reputational) and transaction costs of politically partisan, captured or somehow misguided influences and orders, which in turn expose them more to the public and to the democratic thicker requirements of deliberation.

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<sup>1403</sup> (MILLER & WHITFORD, 2016:120-140).

Politicians that try to reduce or circumvent CBI face (prohibitively high) political costs. It is expected that various constituencies react, namely voters and firms that benefit from lower inflation, opposing parties who enjoy greater oversight and limited resources on the government side, CBs themselves seeking to salvage their independence, and potentially markets in the form of higher borrowing costs and exchange rate volatility<sup>1404</sup>.

Such transaction costs are alarm sirens to call for the mobilization of Influencers that are friends of CBI.

A pluralistic conception of democracy and CBI suggests that such competition of Influencers and the complementarity thereof tend to increase the intensity and quality of democratic deliberation about central banking, its policies and performance.

CBs have managed to have significant visibility. Since the GFC such visibility and even centrality has grown, which means that the paradox of control might actually be even more effective. That this control paradox might exist only because ICBs are delegated a limited set of functions, reinforces that this is another normative democratic condition of political and independent central banking.

#### **d) THE EXCEPTIONALISM OF LIMITED, RESPONSIVE, BUT NOT OVERMIGHTY CENTRAL BANKS**

The rise of central banking, particularly after the GFC and the pandemic, motivated the accusation that CBs had become overmighty.

The expansive centrality of the new style central banking with its unprecedented balance sheets, unconventional monetary policies and successive rounds of quantitative easing, direct and targeted lending, extensive liquidity and solvency support, backstops to governments and private actors, and their absorption of certain countries' whole sovereign debt net issuances in the pandemic years raised concerns.

The expansion of their financial prudential and resolution functions, their engagement with climate policy, inequality issues, digital currencies and CBDCs, to name just a few, aggravated the preoccupations.

The contrasting paralysis or relative passivity of fiscal (political) policymakers for most of that period reinforced the anxieties.

Conservatives and libertarians object that CBs spearheaded too much state intervention in monetary and financial markets and in the economy in general, to the point of silencing decentralized market- and price-signaling mechanisms, distorting economic incentives, discouraging more efficient market-based alternatives, and ultimately menacing freedom,

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<sup>1404</sup> (POSEN, 1998), (BODEA & HICKS, 2015), (DE HAAN & EIJJFINGER, 2016), (AKLIN & KERN, 2021: 3).

welfare, price stability and economic efficiency. Those “excesses” are often blamed for the post-pandemic inflation burst.

On the progressive side, the argument is that such a level of public intervention in the economy could only be managed directly by democratically elected representatives, and that politicization and expansion of central banking would turn democracies into technocracies.

Previous chapters confirmed that ICBs gained absolute and relative centrality in the overall structure of government and the public sphere.

Certain transformations were expressly authorized by democratic lawmakers, while others were (allegedly) expansions within the existent delegation and mandate, with the tacit or informal acquiescence or incentive from DRs, and occasionally with formal, albeit disputed, validation by higher courts.

The claim is that their expanded democratic delegation and activism are *still* and *generally* contained within adequate limits.

They are limited. Less than what traditionalists wish but limited as they ought to be.

First, because the normative justification of CBI holds only where CBs have a superior institutional and functional specialization, which is circumscribed to a limited “well-defined” scope of functions in the realm of monetary and financial policies.<sup>1405</sup>

Second, because such justification covers only the limited scope that was democratically authorized and has a general societal consensus.

Third, for separation of powers reasons that disfavor the excessive accumulation of power by any institution in general, and also particularly in the realm of macroeconomic policies.

General liberal arguments for non-domination and separation of powers reject the transformation of the ICB into a second Leviathan alongside the political Executive.

Specifically in the macroeconomic field, it is worth maintaining the *partial* or *balanced* separation of fiscal policies from monetary and financial policies on the other.

Such model avoids detrimental monetary, fiscal or financial dominance,<sup>1406</sup> and improper “*subordinate* monetary financing”<sup>1407</sup>, while allowing for optimizing “coordination without subordination” between separated, independent and majoritarian macroeconomic policymakers. It allows CBs to accumulate multiple, but not all, macroeconomic hats, thereby reaping the benefits of internal coordination and adjudication of trade-offs between monetary and financial policy functions, and of the reduction of regulatory gaps, informational discontinuities and inter-agency conflicts and turf wars.

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<sup>1405</sup> (ZILIOLI & RISO, 2018).

<sup>1406</sup> (SARGENT & WALLACE, 1981).

<sup>1407</sup> (GABOR, 2021).

However, because such accumulation of hats poses risks of its own, the limitation of the scope of delegation to CBs is an alternative or complement to internal institutional segregation.

Beyond a certain degree, the expansion and centrality of the delegation to CBs would be excessive. So far it is not, at least in general.

Modern central banking is still adequately limited in two senses: (i) the material scope; and (ii) the nature of its activism.

### **(i) Limited Functional Scope**

ICBs' material scope is fairly contained in terms of the absolute latitude of their delegated public functions, and their relative weight in the overall structure of government, and in the economy. ICBs' share of government is limited. Their decisions and implementation of policies are tiny fractions of the whole public decision-making in any given period in time. JAMES observed that "[i]f central banks can do a lot, and I think that was exactly the experience of the last decade, they actually can't clearly do everything: they can't make vaccines, antiviral drugs or, for that matter, anti-tank missiles"<sup>1408</sup>.

In assessing an institution's relative importance in the overall system of government, a few quantitative and qualitative fallacies should be avoided.

To start with, quantity or public salience of an institution's decisions do not necessarily mean that they are important in terms of impact on society as a whole or on particularly affected groups – the public's interest does not necessarily equate with public interest<sup>1409</sup>.

Furthermore, making (some) important decisions is different from deciding most of what is important. With CBs as with high courts, it is necessary to avoid the "fallacious leap from the accurate premise that much of what the [institution] does is important to the erroneous conclusion that much of what is important is done by the [institution]"<sup>1410</sup>.

A CB may episodically be "a central player in the dominant issue of the time"<sup>1411</sup>, which does not make it generally dominant, and certainly not for most of the time.

CBs probably were decisive, in good and bad senses, in moments of crisis such as the Great Depression<sup>1412</sup>, the GFC and the Eurocrisis (and relatively less the pandemic<sup>1413</sup>), and in both the 1980s' and today's crusades against inflation. Yet they were essentially acting within their expected and delegated roles, far from taking the general reins of government.

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<sup>1408</sup> (JAMES, 2022: 17).

<sup>1409</sup> (SCHAUER, 2006, 11, 44, 49), (MOUNK, 2018:289, footnote 58).

<sup>1410</sup> (SCHAUER, 2006: 8).

<sup>1411</sup> (SCHAUER, 2006: 43).

<sup>1412</sup> (FRIEDMAN & SCHWARTZ, 1963).

<sup>1413</sup> In the pandemic, fiscal policymakers acted much more forcefully, but health authorities were even more central.

Even if the assessment is circumscribed to the economy and the macroeconomic performance, the conclusion is still that CBs have important but limited roles. Their policy actions and errors might be consequential in terms of price, financial stability and short-term economic stabilization, but there is only so much they can do to affect the real economic variables, especially in the long term.

In terms of CBs' weight in financial markets, exacerbated by the financialization of the economy, it is true that they were decisive in saving the entire global financial system after the GFC. Their balance sheets exploded, and they have greatly increased their intervention in financial markets since then, even more so during the pandemic.

Their role was particularly impressive in sovereign debt markets where during the years of the pandemic CBs bought most or even all of certain countries' net issuances. There are also signs that their policies muted some market price-signaling mechanisms and effectively inflated financial and real estate housing prices (albeit they are not the whole story).

That said, their balance sheets are a small proportion of the global financial sector, and their rise and size pale in comparison with those of the non-bank private financial sector.<sup>1414</sup>

As to the CBs' heavier weight on some sovereign debt markets, their absorption of most or all of the annual net issuances was a brief and exceptional condition to respond to a once in a century pandemic shock, further motivated and reinforced by a severe drought of liquidity in financial markets.

Only two years later, all major CBs except the BoJ are going in the reverse direction, albeit at different speeds, with the Fed and BoE leading the tightening amongst advanced economies.

There is also some merit, and central bankers' endorsement, to the view that the massive purchase of sovereign bonds by CBs is not a product of their fiscal dominance (or the so called "subordinate monetary financing"), nor of their suppression of private market mechanisms.

On the contrary, in a financialized economy and with the rise of shadow banking, CBs buy sovereign bonds to anchor inflationary expectations and stabilize the inherently fragile market-based financial system, whereby sovereign bonds play a critical macro financial role<sup>1415</sup>. From this perspective, they are not the overmighty lord of the markets, but a powerful squire instead. Curiously, both conservative-libertarian and progressive critics begin with a protest against the expansion of CBs and their excessive powers and interventions, but their reaction is not out of fear of monetary dominance, but mostly that their expansion is the instrument for fiscal dominance, suggest the former, or financial dominance, claim the latter.

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<sup>1414</sup> (FINANCIAL STABILITY BOARD, 2021).

<sup>1415</sup> (GABOR, 2021).



They seem less concerned that central bankers have become financial leviathans, and more that they might become subordinate to profligate governments or mighty and opaque financial elites. For a period since the GFC, the perception of the importance of CBs in the determination of economic conditions was largely due to the temporary passivity or retrenchment of fiscal policymakers, by option or political dysfunctionality. That did not mean that political branches had lost their powers and central role, as the pandemic definitely demonstrated. Neither did that mean that CBs would have to mimic them, surrender their powers and consequently fail to carry out their delegated responsibilities.

CBs should not refrain from acting to serve their mandate just because other political actors have left the arena.

Such asymmetric behavior is problematic because it leads to a suboptimal macroeconomic policy mix and it might increase society's expectations about the role, powers, and capabilities of CBs. Central bankers understood the perils of being perceived and expected to be *the only game in town*. That is why they repeatedly called out governments to deploy their fiscal powers and to make structural reforms. They did it in the period of low growth-low inflation-low interest rates after the GFC, and now in relation to the supply-side aspects of the inflationary surge.

CBs ought to be humble, self-constrained, and pedagogical about the limitations of their powers.

## **(ii) Limited and responsive activism**

Since the GFC, CBs have pushed the breadth of their functions and objectives, but the scope and nature of their functional innovation and activism are less than commonly argued.

In fact, their ventures into financial stability policies and economic stabilization, their intervention in the allocation of capital and credit, and their heightened role in sovereign debt markets with the effect (even if indirect) of easing the sovereigns' financing conditions are not unfamiliar to CBs, but a certain return to functions that they have exercised at some moments in time since the mid-19th century.

What might seem to be a transformation of the model of central banking of the Great Moderation is often a return to older versions when objectives such as bank stability or government financing were the core of central banking. This includes periods with some manifestations of CBI, such as the BoE and the German Reichsbank in the 1920s<sup>1416</sup>.

Of course they face some novel issues and tasks because there are financial innovations, new technologies and modes of social interaction, and collective challenges.

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<sup>1416</sup> (MEE, 2019), (MONNET, 2021).

Over the past 150 years, CBs have in essence revolved around the same limited set of monetary and financial functions to pursue a circumscribed group of objectives that varies back and forth from time to time.

Such variations of CBs' mandates are actually healthy repercussions of evolutions in societal priorities that are normally aligned with the periodical swings in the pendulum of societal preferences and ideas.

The alternations between Keynesianism and Monetarism, regulatory interventionism and free markets, price stability and financial or economic stability and stimulation are curiously evidence that central banking can deliver pluralism within a limited scope (just not as narrow as traditionalists vie for), and in significant sync with societal preferences.

That confirms that modern CBs are limited also in terms of the type of activism and innovation they exhibit.

Their activism is *generally* within the delegation, even if sometimes DRs had to explicitly expand the boundaries of the delegation. The (re-)addition of financial stability mandates after the GFC is exemplary.

Second, CBs try to be revealers, rather than leaders, let alone vanguards, of social transformation. Being more political does not allow them to disregard, or transform on their own, the order of societal preferences.

The modern CB has neither the nature nor the functional specialization and democratic superiority to "lead the political process" of societal transformations. Its limited activism "follows broader changes in society and doesn't want to be the first to move"<sup>1417</sup>.

Despite their imperfections – e.g. paralysis, inflation bias, partisan and sectional capture, inertia, lack of knowledge – the classic political branches are more mature, specialized and legitimate to lead such societal transformations into policies, particularly at the primary level of first-level decision-making.

The CBs' new democratic channels and credentials allow them to better read and reveal fairly consensualized social transformations, but not to instigate or lead them.

Theirs is a limited or *responsive activism*.

They were responsive when they acted forcefully to prevent the GFC from turning into a new Great Depression, when they forced financial institutions to increase their robustness and resilience, and when they reflected how the widespread societal concerns with climate change and inequality interplayed with the policies under their purview.

Still, there are critics countering that such activism is excessive, poses legal and normative risks, amounts even to *ultra vires* activity and mission creep.

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<sup>1417</sup> (VAN 'T KLOOSTER, 2022).

However, that responsive activism is justified as long as it sticks to the scope of functions and goals where CBs have demonstrated superior institutional and functional specialization, received some foundational democratic authorization, and corresponds to a general, primary societal consensus.

In that case, it is not mission creep, but full mission accomplished.

So far, the main constitutional branches have legally backed and democratically legitimized this limited and responsive CB activism: Courts, such as the CJEU in its judicial dialogue with the German Constitutional Court, and Executives tacitly when engaging in cooperative coordination with CBs. And also broad majorities in Parliaments as they express informally in hearings, semi-formally in review reports (e.g., UK), and in deliberations such as the European Parliament's annual resolutions on the ECB annual report, and formally in legislation that expanded delegation.

The public in general, expressing sentiment through surveys and media, seems to be generally aligned with the societal consensus that CBs have been revealing or pursuing, and overall supportive of their institutional performance. The existence of pockets of loud dissenters is part of the public contestation with free and inclusive participation and consideration that ought to exist in pluralistic democracies.

### **(iii) Maturation Process**

Nonetheless, the risk of CBs overstepping their normative and legal boundaries is real, and they have sometimes flirted with those boundaries of functional specialization.

The so-called quasi-fiscal and quasi-foreign policies were much challenged.

Suspensions are justified when they engage in investment and credit allocation and on “all pervasive micromanagement of credit”, or if in the context of “greening of monetary and financial policies” they do not defer to taxonomies approved by the policymakers specialized in climate issues, or if when pursuing the secondary mandates to support governments’ economic policies they seek to recreate the meaning of such policies rather than deferring to the respective political authors.

It was of concern that the ECB side-stepped, without mentioning it, the EU Green Taxonomy of “environmentally sustainable economic activities” approved by EU political legislators<sup>1418</sup>, and adopted its own “climate score methodology” as the basis to “decarbonize its corporate bond holdings”<sup>1419</sup>.

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<sup>1418</sup> Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment.

<sup>1419</sup> ECB, ECB provides details, 2022.

The more recent accusation is that the post-pandemic inflation surge is to be blamed on that activism and the distraction or loss of priorities it causes in CBs. Yet, the blame seems to fall more with epistemic faults due to novelty and uncertainty, errors of judgment, inertia or hubris, possibly a dovish axiological drift, and even some manifestation of fiscal or financial dominance.<sup>1420</sup>

As traumatic as it has been, this inflationary shock comes as an opportunity to demonstrate that political ICBs can be adequately committed to price stability, without renegading the transformations in the centralverse over the previous 15 years.

For a while, this post-pandemic inflation burst will serve as a traumatic cooler of the *excessive* expansionary impetus of CBs; the pluralistic dimension of CBI is decisive in guaranteeing so.

Various Influencers are decisive discipliners of the normative and legal boundaries of what is still *limited* and responsive activism.

DRs have the ultimate power to reassess, legitimize or curb the delegation, but they are not always functional or attentive.

Courts have the power to review actions and uphold the boundaries of competence, but with the exception of the CJEU-GCC judicial dialogue, they tend to revert to deference.

The epistemic community could be a self-reflective professional conscious, but it is also prone to problematic Niskanenian maximizing tendencies.

Financial markets may discipline excesses, but they also overreact to policy adjustments in ways that reveal addiction to recent activist liquidity-provision by ICBs.

The restraining effect of their competition might be mute, but can also be active.

In any case, it does not dispense CBs themselves from exercising self-restraint in loyalty with the normative – epistemic and democratic – justifications of their independence.

Humility about their capabilities, possibilities and their role in the grand scheme of collective governance, caution not to create unrealistic expectations on the publics about such capabilities, and cultivation of internal diversity, critical thinking and professionalism are decisive.

Politicized and pluralistic CBI is not about changing the objectives of macroeconomic policies but offering a better institutional framework to serve with them, which are those positively assigned by the polity, ideally according to a criterion of institutional specialization based on comparative institutional analysis.<sup>1421</sup>

The maturation process of this new style of central banking includes reasserting the importance of price stability, learning how to master all functions and tools assigned, with loyalty to the

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<sup>1420</sup> (LEITÃO AMARO, 2023b).

<sup>1421</sup> (WALDRON, 2016).

mandate, and building the credibility of its commitment to such mandate in its entirety, not just the price stability fraction.

The consolidation of the appropriate boundaries of a limited, but not narrow, independent central banking is one of the aspects where its institutional maturation is not yet complete.

#### **(iv) Exceptionalism for liberal democracy**

This defense of political and independent central banking should not be confused with the support for an open-ended expansion of their role, for their dominance of macroeconomic policymaking, let alone for the generalization of such sort of non-majoritarian mechanisms as tools of governance across public policies and social realms.

Democratic governance is accepted because it proved to be “the worst form of Government except all those other forms that have been tried from time to time.”<sup>1422</sup> It is the most flexible and effective in maintaining people’s welfare and, perhaps, most elementally, the best in history to date in gradually recognizing, mitigating, and containing wrongs done to the governed by their governors<sup>1423</sup>.

The classic political process, with its predominant electoral, partisan and majoritarian indirect representation is accepted as a fundamental model to govern state intervention in democracies. Yet, liberal democracy does not equate with monopoly of centralized partisan government. It encompasses fundamental and comprehensives spheres of governance by market-based, decentralized processes, and also the governance of limited yet relevant spheres by independent institutions.

It is a system where, under conditions, functionally circumscribed and specialized non-majoritarian institutions such as ICBs fit.

CBI is not an exception to democracy, but an exceptional mechanism or technology of liberal democratic government.

ICBs went through a solid yet unfinished process of institutional maturing that justified and solidified their comparative advantages.

Their sort of *exceptionalism* is shared with only a handful of other institutional technologies of social control, namely, religious institutions that are separated from states, courts that are independent from political power, and the military which is autonomous from civil government. Their degree of insulation and political control stands in between the courts and the military, and they are probably the most democratically embeddedn of all.

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<sup>1422</sup> (CHURCHILL, 1957).

<sup>1423</sup> (TUCKER, 2018: 549).

Such exceptionalism, democratic embeddedness, and good enough democratic control prevent strong ICBs from transforming the regime into a technocracy.

What is more, the pluralistic independence of political CBs can also offer improvements to the democratic qualities of liberal democracies.

#### **7.6.4. BUILDING A DEMOCRATIC ADVANTAGE**

In the governance of limited fields of functional specialization, this model of pluralistic independence of political CBs offers a democratic advantage compared to the traditional alternatives of strict CBI and the electoral-representative process.

The strict CBI model is averse to democratization and politicization (in all senses) of central banking. Independence is described as an exception from democracy. Traditionalists themselves would accept that pluralistic CBI is more democratic than their preferred strict CBI, albeit for the wrong reasons.

The virtue that they see in cutting ties with democratic elements beyond the foundational legitimation rests on fictitious assumptions of depoliticization, overlooks the potential of pluralism, and wastes the optimizing potential of cooperative but non-subordinate coordination of macroeconomic policies.

As to the comparison with the electoral-representative process, the claim here is that central banking is one of those selected areas where an independent institution and its process can compensate and “repair the major flaws in the majoritarian democracy of the ballot box”<sup>1424</sup>. Pluralistic CBI provides an alternative, yet constitutionally embedded form of democracy, that “palliate[s] the constitutive deficiencies of the circuit of the electoral consultation and the legislative deliberation”<sup>1425</sup>, generates “democracy-enhancing externalities”<sup>1426</sup>, and thereby assists against the purported crisis of liberal democracies<sup>1427</sup>.

The pluralism of CBI and the politicization of ICBs in the sense of operation under conditions of public contestation, debate, and deliberation, however contentious, are in and of themselves democratically legitimating<sup>1428</sup>.

They *broaden* and *upgrade* democracy, in both axes of equality and truth-revealing dimensions of participation, consideration and deliberation by and of the people.

Such broadening and upgrade result from the unique combination of non-absolute insulation and competition of influences that secure CBI’s superior specialized expertise, impartiality, good

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<sup>1424</sup> (ROSANVALLON, 2011: 220-21), (HALBERSTAM, 2010: 194, 201).

<sup>1425</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>1426</sup> (WILLIAMS, 2006).

<sup>1427</sup> (LUCE, 2017), (MOUNK, 2018), (LEVITSKY & ZIBLATT, 2018).

<sup>1428</sup> (PETTIT, 2004), (MADURO, 2012), (SCHMIDT, 2019: 15)

enough political control through the classic political branches and new democratic channels directly with the people.

Equal participation and consideration is broadened within and across time, and CBI promotes bipartisanship, multi-period majoritarianism and the integration of future generations at the expense of absolute control by the instant majorities.

With the insistence on a new bidirectional relation with the public and affected interests through expanded transparency and consultations, notice and comment rulemaking, and other numerous avenues of formal and informal participation, “democratic forces are systematically brought to the administrative process itself, albeit in a manner that hopes to blunt the force of concentrated well-heeled interest groups” and political parties.<sup>1429</sup>

The transparency and the novel openness of CBs to structured and competing relationships with diverse Influencers transforms their process into a *permanent, iterative* democratic process of governance – that goes beyond sporadic and simpler elections –, increases the public debate which is a precondition for democratic collective will-formation and for holding those in power to account.

The epistemic and impartiality advantages of CBI mitigate false positives and negatives in democratic deliberation while anchoring it further to facts, knowledge, and primary societal goals rather than inconsistent and short-termist partisan or sectional interests. In that sense, CBI complements the majoritarian principle by emphasizing the general interest and the need to include all citizens, even members of the minority.

These capabilities to correct faults and enhance democracy can contribute to overcome the so-called crisis of liberal democracy, and particularly the populist menace.

That might seem audacious considering that technocrats are usually amongst the favorite targets of populists. The classic view was of conflict and opposition between populism and technocracy. Populists describe unelected technocrats in general and central bankers in particular as examples of government by and for the few. The aftermath of the GFC saw a rise in that populist resentment<sup>1430</sup>.

The claim here is that contrary to traditional strict CBI, the pluralistic version refuses the separation and institutional disintermediation between politics and society.

Curiously, traditional CBI as a classic technocratic view, shares with populism a common underlying distrust of forms of political mediation, and therefore they cannot function as effective remedies for each other<sup>1431</sup>.

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<sup>1429</sup> (HALBERSTAM, 2010: 195).

<sup>1430</sup> (GOOHART & LASTRA, 2018), (BICKERTON, 2020), (CONTI-BROWN, 2018: 1), (TUCKER, 2018: 548), (JAMES, 2012: 345).

<sup>1431</sup> (BICKERTON & ACETTI, 2020).

Traditional CBI abdicates from politics and the relation between the few decision-makers and the people at large. Departing from the illusion of depoliticization and low political salience, it sincerely defends the technocratic insulation, and the governance of money and credit as a realm for a privileged few.

Pluralistic CBI, on the contrary, cherishes this relation between policymakers and the public, and tries to improve it by combining improved intermediation through the classic political process with direct relation between ICBs and the public, with a fairness duty to consider the affected interests and the “left-behinds”, always relying on their specialized expertise and building credible commitment to the entirety of their mandate.

Contrary to the traditional version, pluralistic CBI accepts “the reality that ‘the people’ do not exist as a coherent political group, that expertise is never neutral once it is translated into policy, and that unmediated interaction with the electorate gives no clear direction for government”<sup>1432</sup>.

Rather than assuming an illusory end or (re)solution of societal cleavages, it offers a pluralistic institutional framework where ideological and partisan schisms are only a fraction that coexist with distinct cross-sectional rifts that are better dealt with by other institutional channels.

Looking at the crisis of liberal democracy, pluralistic CBI does not count on a revitalization of the political parties and ideological struggles of the last century<sup>1433</sup>. Instead of abdicating from political mediation, it offers a complementary, corrective, and enhancing form of institutional intermediation<sup>1434</sup>, where non-partisan political intermediation has a role in managing the concrete conflicts of values that exist in the current society.

Pluralistic CBI cannot be confused with some techno-utopian future where ICBs would have an exclusive relationship with the people using the advanced digital communications and network technologies.

That alternative would eliminate any post-constitutional partisan, electoral-representative intermediation, with central bankers being directly appointed by the People (for instance amongst a short-list of experts selected by the CB), whom they would regularly call to vote online – digital apps, social media, etc – on policy decisions, after a period of public debate that CBs would conduct to maximize the technical rigor.

Such an alternative would combine non-majoritarian expertise and direct democracy with the purpose of being “a corrective both to the presumed self-interested bargaining of party democracy and self-serving or selective technical expertise”. Yet “these methods may be even

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<sup>1432</sup> (JONES, 2022).

<sup>1433</sup> (BICKERTON & ACETTI, 2020).

<sup>1434</sup> (JONES, 2022).



more prone to capture by single-issue societal groups, and considerable political bargaining and lobbying by unaccountable and unrepresentative groups”<sup>1435</sup>.

Finally, CBI has another democratic-enhancing externality which is to preserve the separation of macroeconomic powers between classic political branches.

On aggregate CBI improves the internal, democratic balance between the two classic political branches by protecting the representative prerogatives of the Legislature on taxation and fiscal policies against abuses and manipulation from the less representative Executive, which could use the power to print money as a substitute for legislated taxation<sup>1436</sup>.

The Executive would at the very least be able to defer any need to go to the Legislature for extra supply, and at worst could generate inflation taxes and inflate away the real burden of government debts to reduce the amount of taxation which requires parliamentary approval.

“In other words, it could usurp the legislature’s prerogatives. The conclusion is stark: the last people who should hold the monetary power are the elected executive.”<sup>1437</sup>.

Similarly with financial policies whose concentration could allow the Executive to impose financial repression, requiring the domestic banks to purchase and hold sovereign debt, which would circumvent the need for taxation approved by parliament.

Therefore, democratic delegation of monetary and financial policies to ICBs would be the price to pay to *de jure* and *de facto* maintain taxation and fiscal policy in the hands of representative parliaments, which has been a leitmotif of democratic (r)evolutions.

## **7.7. THE ADVANTAGE OF IMPARTIALITY AS BALANCED REPRESENTATION IN MACROECONOMIC POLICYMAKING**

While the first democratic principle determines that governments should be responsive to the People in general, the second democratic principle underlines that governments should “be equally responsive to their citizens”.

### **a) IDEAL OF BALANCED REPRESENTATION**

This equal responsiveness entails an “all affected principle”, meaning that all those affected by a decision must be permitted to participate in the making of the decision (*positive impartiality*), and a “principle of impartiality as non-domination” that requires that policymaking is not systematically biased towards either a majority or a minority. While this cannot mean that the

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<sup>1435</sup> (BELLAMY, 2010).

<sup>1436</sup> (TUCKER, 2018).

<sup>1437</sup> (TUCKER, 2020, 433), (BECKER, 2009).

government follows each citizen's wish all the time, it does imply that any inequality in terms of representation should not be structural (*negative impartiality*).<sup>1438</sup>

It seeks to "prevent the emergence of permanent and insulated minorities (*net losers*), the development of rigid and insulated majorities or minorities and creation of pivotal players"<sup>1439</sup>.

The concept of impartiality itself is disputed, and has received multiple definitions<sup>1440</sup>.

It does not mean absolute insulation, nor invulnerability to all external influences, but the ideal of balanced representation that rejects and mitigates systematic biases of overrepresentation (that generates false positives) and underrepresentation of marginal or silenced groups (causing false negatives).<sup>1441</sup>

Here, it labels the third normative standard of institutional comparison, and it could also be designated as balanced or unbiased representation, liberal non-domination, or certain weaker senses of neutrality<sup>1442</sup>.

That is so, because from the perspective of higher values, this standard of impartiality can be framed and is supported in democratic (participatory), liberal, and functionalist-epistemic terms.<sup>1443</sup>

As seen, the value or second principle of political equality demands that impartiality or even-handedness of participation and consideration so that one's particular situation is included and taken into account and fully assessed by the government.<sup>1444</sup>

The liberal concern is with avoiding domination of All by the Many or a Few, which affects the liberty of participation and action of each individual or group.<sup>1445</sup> It is attuned to the idea that in democracy no one can monopolize power,<sup>1446</sup> and (macroeconomic) power should be divided and not excessively concentrated. This became even more important in the modern age of mighty political Executives with massive sizes, resources, and powers, and the *de facto* Executive dominance in the contemporary political system.

The liberal concern is also with avoiding minoritarian biases favoring a financial, economic, or political elite. It seeks to prevent the capture of open policymaking and processes by powerful particularistic minorities with intense and immediate interests (Special Interests).<sup>1447</sup>

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<sup>1438</sup> (ROSANVALLON, 2011), (PETERS & ENSINK, 2015), (COHEN, 2018: 77), (LUPU & CASTRO, 2022).

<sup>1439</sup> (MADURO, 2012: 47).

<sup>1440</sup> (SEN, 2009), (SHAPIRO, 2016), (JOLIMORE, 2022).

<sup>1441</sup> (PETTIT, 2004), (BELLAMY, 2010).

<sup>1442</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>1443</sup> (MORAVSICK, 2002: 614).

<sup>1444</sup> (ROSANVALLON, 2011: 97).

<sup>1445</sup> (LOCKE, 2012), (THE FEDERALIST PAPERS, 2003), (TOCQUEVILLE, 2007).

<sup>1446</sup> (ROSANVALLON, 2011: 98).

<sup>1447</sup> (MORAVSICK, 2002).

This normative ideal cannot be pure neutrality of policymakers, nor influence-free policymaking. VILE explained the impossibility of neutrality of a governance system, because its “controls” are not pieces of machinery in the mechanical sense... they are all procedures operated by human beings”<sup>1448</sup>. ACKERMAN recalled that “there is no such thing as a perfectly neutral way of understanding reality. Every ‘expert’ construction of the world contains a host of controversial presuppositions”<sup>1449</sup>.

Moreover, both positive liberty<sup>1450</sup> and political equality<sup>1451</sup> understood in the prism of democratic justice require acknowledging that certain groups face greater obstacles to their participation and/or the consideration of their legitimate interests and demand from the institutional design and decisionmakers an effort to equalize or balance opportunities of participation, to reduce threshold costs of access to the policymaking process, and even to create new channels for participation.

This positive dimension of impartiality demands a recalibration of representation which entails “a much more active hand in identifying interests, communities, and perspectives that are likely to be absent, marginalized, or unrepresented in open comment processes and ensuring that their voices and perspectives are heard through formalized institutional mechanisms.”<sup>1452</sup>

Political equality and positive impartiality would demand “a series of structural, power-shifting reforms” and even an active policy of equalization of resources between and among parties to the policy process to level the participatory playing field before the ICB.<sup>1453</sup>

Therefore, including from a “participation-oriented, representation-reinforcing approach”, it is normatively decisive which of the institutional processes is relatively better at preventing or mitigating the emergence of systematic biases and secure balanced representation.<sup>1454</sup>

The institutional structure of government should be able to set aside the electoral-representative process when it is undeserving of trust, namely, “when (1) the ins are choking off the channels of political change to ensure that they will stay in and the outs will stay out, or (2) though no one is actually denied a voice or a vote, representatives beholden to an effective majority are systematically disadvantaging some minority”<sup>1455</sup>.

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<sup>1448</sup> (VILE, 1998: 365).

<sup>1449</sup> (ACKERMAN, 2000: 697-8).

<sup>1450</sup> (BERLIN, 1969).

<sup>1451</sup> [ALEMANNO, 2020).

<sup>1452</sup> (WALTERS, 2022).

<sup>1453</sup> [ALEMANNO, 2020).

<sup>1454</sup> (ELY, 1980: 87), (KOMESAR, 1994).

<sup>1455</sup> (ELY, 1980: 103).

In addition, from the perspective of the system of government as whole, the separation of powers that results from delegation to independent agencies mitigates overmighty executives<sup>1456</sup>, while ensuring that they will not surpass the overall power of those executives.

## **b) CBI AS IMPARTIALITY**

All major macroeconomic policies are structurally fertile ground for systematic biases in both majoritarian and minoritarian directions as they all have skewed distributions of per capita stakes and tend to imply relevant threshold costs of information and participation.

CBI is a way to divide mighty macroeconomic power<sup>1457</sup> and structure the delegated monetary and financial policies to better secure both *negative* and *positive* impartiality.

Modern central banking developed – and may develop further – structural design, procedures and incentives systems that, compared to both the electoral-representative process and the traditional narrow CBI, make the former more likely to impartially engage, include and weigh all aspects of a problem and decide without over- or underrepresentation.

Those institutional constraints and structural features are simultaneously conditions and normative predicaments for CBs to gain that impartiality advantage, which are expected to improve with a comprehensive framework of pluralistic independence.

They are necessary because central bankers are no angels but humans whose utility functions, ideas, and preferences over policies can be manipulated. They are affected in multiple ways by self-interest and malign incentives, selective expertise, sensitivity to public contestation, and they have a natural operational proximity to large financial actors. Such sensitivity and proximity offer benefits, but also threats and opportunities for majoritarian or minoritarian dominance.

Nonetheless, political and pluralistically independent central bankers are still *more* impartial than partisan political actors and even than central bankers as defined by the traditional narrow version of CBI.

On the one hand, pluralistic ICBs benefit from the same structural features and constraints of non-majoritarian institutions that, according to the traditional defense of CBI, makes them better at preventing systematic majoritarian biases that are pervasive and structural in the electoral-representative process.

CBI gives CBs superior credible commitment and non-partisanship, less sensitivity to the electoral cycle, short-termism, time inconsistency, and political instability, which are forms of systematic biases and cases of over- or underrepresentation.

In general, high courts are trusted to address *ex post* the malfunctioning of representation.<sup>1458</sup>

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<sup>1456</sup> (POSNER & VERMEULE, 2010: 59).

<sup>1457</sup> (LIJPHART, 2012).

<sup>1458</sup> (ELY, 1980).

However, in monetary and financial policies, it does not suffice to wait for an *ex post* casuist redress. The necessary anticipation at the constitutional/institutional design level materializes in CBI and its distance from the vagaries of partisan politics.

On the other hand, the pluralistic and politicized CBI shuns the critique of minoritarian bias frequently leveled against ICBs and technocrats more generally, whose (absolutist) insulation from politics would make them under-representative and increase the opportunities for “malign incentives”, Interest Group capture, elitism, or favoritism.

Pluralistic CBI seeks to cure the traditionalists’ disregard for the CB’s privileged relations and contacts with private financial actors, risks of financial dominance, revolving doors, prior business socialization and other sources of private capture that create serious vulnerability to a substitution of biases towards a minority with concentrated and higher per capita stakes in the policymaking.

Because pluralistic independence is relative and plural, it guards policymaking not only from political power, the instant majority, and the ruling democratic elite, but also from the other relevant Influencers, with a particular emphasis here on the private financial interests. It protects from a plurality of influences, but also permits and occasionally requires ICBs to be exposed to others.

And, in the end, it is the ICB who decides as a non-partisan and non-factional third party with external views to the parties. Because two biased opinions do not make an unbiased opinion.

It is that combination of an *impartial third party* with *barriers against* and *permission of competition between* Influencers that enables the cumulation of superior protection and mutual checks against systematic biases, with epistemic- and democratic-enhancing inputs and channels. This renders central banking a superior deliberative process for the governance of money and credit.

But is it not the case that by accepting *relative* insulation, the humanity and influentiability of central bankers, the politicization and openness to the competition of Influencers, and a new relation with the general public and with insulated groups, pluralistic CBI poses more risks to impartiality than traditionalist, narrower CBI or even “accountable independence”?

The traditionalists will certainly argue that it does, and that their stricter CBI is more insulated from majoritarian pressures.

However, that advantage does not hold so well in reality, as DRs will always find formal or informal cracks to influence, and the public exerts (often successful) pressures directly through channels other than elections and elected officials, which traditionalists tend to disregard.

Pluralistic CBI goes beyond traditional CBI in protecting impartiality against minoritarian biases.

But also, in assuming the need for *positive* impartiality that demands ICBs more actively identify unrepresented interests and ensure that silenced or marginalized “voices and perspectives are heard through formalized institutional mechanisms.”<sup>1459</sup>

Instead of ignoring all those tendencies and normative needs, pluralistic CBI takes them as both facts and normative predicaments for central banking embedded in a liberal democracy, and, in turn, seeks to frame those inevitable influences in adequate terms that preserve the essence of CBI.

This way, pluralistic CBI keeps a significant advantage of impartiality when compared to the partisan political process, and it offers a more realistic and thus robust advantage compared to traditionalist CBI.

### 7.7.1. AVOIDING SYSTEMATIC MAJORITARIAN BIASES

The prevention of systematic majoritarian biases that tend to afflict the governance of macroeconomic policies by the electoral-representative process is the staple defense of CBI and non-majoritarian institutions more generally<sup>1460</sup>.

CBs, and more so *political* ICBs, are neither immune nor insensitive to majoritarian influences from elected politicians through various formal or informal screening and sanctioning mechanisms, and from the public through mass and social media and other direct channels, whose contestation has risen in the past two decades, as described above. CBs, like “[c]ourts, banks, and medical bodies all find it hard to buck sustained national majorities”<sup>1461</sup>.

One of the contributions of pluralistic CBI is to evaluate, frame and under certain conditions block some of those influences and permit others as long as they do not create a *systematic bias*. Due to its structural features and the incentives system, the electoral-representative political process is more likely to generate majoritarian biases, create “false negatives” with the exclusion of affected groups, and register “false positives” that sacrifice long-term goals for the sake of short-term electoral advantages or to other opportunistic interests or partisan preferences of the instant majority.<sup>1462</sup>

The weakening of the credibility of the political policymakers’ commitment to long-term goals such as price and financial stability aggravates the inflation bias and volatility through rational anticipation.

There are broadly two ways in which majorities in electoral and partisan politics affect the conduct of monetary and financial policies: the *opportunistic* and the *partisan*<sup>1463</sup>.

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<sup>1459</sup> (WALTERS, 2022).

<sup>1460</sup> (MORAVSICK, 2002: 614).

<sup>1461</sup> (BELLAMY, 2010).

<sup>1462</sup> *Idem*.

<sup>1463</sup> (BERGER & WOITEK, 1997), (MANETTI, 1994).

The majoritarian bias refers indistinctly to the instant majority in the government, and the majority of the voters, although the two might not coincide. The former can act as proxy for the perceived short-term interest of the current popular majority but sacrificing minorities or future majorities.

But it can also behave like a minority elite that manipulates information asymmetries and the cycle of policy effects for the benefit of its permanence in power (or granting some rents to a certain group) but at the cost of the interest and preference of the majority and the societal goals.

#### **a) OPPORTUNISTIC POLICYMAKING: ELECTORAL CYCLES, SHORT-TERMISM AND TIME-INCONSISTENCY**

One reason why monetary policy is prone to opportunistic manipulation by the political majority is that electoral cycles are different, often shorter, than policy cycles and because, due to the latter's lags, costs and benefits are not synced. Asymmetries of information and distributional effects can also be manipulated.

In monetary and financial policy, there are problems of a skewed distribution of stakes and risks of moral hazard. The interlink between the electoral cycle and the intertemporal distribution of stimulative policy stances (with the time lag between short-term benefits and long-term costs), the possibility of exploiting information imperfections, and the difficulties in defining the optimal level of the stock of money and credit, the NAIRU<sup>1464</sup>, and the better pace and method to get there, provide impatient governments with incentives to break their commitments and deviate from the long-term objective or general interest in monetary and financial stability.

There are a strong and a weaker version of such opportunistic policymaking.

In a strong version, the opportunistic interpretation suggests that incumbent governments use expansionary monetary and macroprudential policies to improve economic performance and thereby re-election prospects before an election and to adopt contractionary policies after elections<sup>1465</sup>. Elected officials manipulate those policies to generate short-term output gains benefiting from the fact that electoral and reputational cycles in politics are short<sup>1466</sup>.

In this version, elected politicians would have a preference for money creation and borrowing from the CB because it could produce short-term real stimulative effects on economic agents and avoid taxation and associated costs. It would also circumvent monetary or macroprudential tightening that would lead to a temporary slowdown of economic activity and aggravate the budgetary position of the government (fewer seigniorage profits, higher interest burden of

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<sup>1464</sup> Non-accelerating inflation rate of unemployment.

<sup>1465</sup> (BERGER & WOITEK, 1997).

<sup>1466</sup> (MERSCH, 2017).

public debt), which are contrary to both electoral and resources-maximizing interests of political incumbents.<sup>1467</sup>

Similarly, political incumbents have short-term incentive to inflate public and private debts away with (unexpected) inflation, in their own interests (more budgetary room for policies pleasing themselves and their parties and constituencies) and/or per capture by the debtors' constituency.<sup>1468</sup>

To the objection that a rational, informed electorate would punish such short-termist behavior, it may be replied, first, that the information imperfection and asymmetries above mentioned are even more significant with the large and inattentive mass of voters.

Second, the conjugation of the electoral cycle with the monetary policy time profile and lag may allow the short-term gains of easing policy to materialize ahead of the election, while the long-run inflationary pains may be felt much later.

Third, that elections are rarely, if ever, single-issue votes, with each vote decision bundling many judgments – on candidates, on ideas, on both expectations about the future, and assessments of past performances of many policies. Thus, excluding dramatic cases, such as hyperinflation or dramatic inflation bursts, it is unlikely that a deviation from the voters' monetary policy preferences constitutes sufficient sanction for political incumbents.

Fourth, even if there were such risk of political sanction, incumbents can mobilize minimum winning coalitions of constituencies that benefit from "easy money" directly or through other compensatory regulatory or fiscal policies that incumbents also control.

There is also the possibility of incumbents "just" being captured by sectional interests (sectional capture), which they prioritize over their electoral prospects.

It might even be the case that voters do punish easy-money incumbents, replacing them with politicians and parties with the opposite preference. The argument then is that the inherent possibility of such variation of ideological preferences, policy agendas, and actors in the political process leads to inflation volatility (which is welfare detrimental).

From the perspective of the People as a whole (in a unitary vision of the Political Principal), this electoral change in the winning majority and the prevailing policy preference can be framed as time inconsistency with the same consequences of complicating the anchoring of inflation expectations and affecting the credibility of the polity's commitment to "sound money", thus feeding into the inflation bias.

This opportunism breaks the announced commitment to the policy goals and framework.

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<sup>1467</sup> (KISCH & ELKIN, 1928 CIT VALE, 2021: 18-19), (EIJFFINGER & DE HAAN, 1996).

<sup>1468</sup> (ALESINA & STELLA, 2010: 12).



While changing parliamentary majorities and cabinets tend to induce a variation of preferences that contribute to inflation bias and volatility, ICBs with their insulation from electoral cycles, the long and staggered terms of central bankers, and continuing staff and institutional reputation tend to adopt more stable policies<sup>1469</sup>.

Electoral politics is not the only source of opportunistic behavior and commitment problems. There is also a (non-necessarily electoral) time-inconsistency problem: if People and political actors have knowledge and stable preferences, the incumbents can find it optimal (or lack the fortitude not) to deviate from their promised monetary policy course. The best plan made in the present for some future period is no longer optimal when that period actually starts<sup>1470</sup>.

This time-inconsistency is also detected in the functions of LOLR and preservation of financial stability<sup>1471</sup>: despite their *ex ante* commitment to “no bail out” policies in order to avoid moral hazard and create incentives to more prudent behavior of large financial institutions, *ex post* they have an incentive to break the commitment and provide liquidity and taxpayer money to insure and save those same institutions<sup>1472</sup>.

The lack of credible commitment is normatively problematic from both consequentialist welfarist and proceduralist democratic perspectives.

From the consequentialist perspective, the lack of credible commitment has negative welfare consequences by causing inflation bias, inflation volatility, and lower economic growth<sup>1473</sup>, decreasing policy effectiveness, unanchoring inflation expectations, and frustrating legitimate expectations legally protected by the substantive rule of law principle.

From the proceduralist perspective, it redistributes prior allocations of stakes through procedures that might fail to meet the same standards of deliberation (participation, transparency, equal consideration). When time inconsistency materializes, policy promises are broken without giving procedural and substantive consideration to all affected interests as political equality democratically demands. This becomes particularly clear in policy shifts generating unexpected inflation, which has significant distributional effects. It also puts at stake the constitutionalization of democratic fairness through separation of powers.

This strong version of opportunistic policymaking exists also in microprudential and crisis management functions, both in *ex post* and *ex ante* interventions in financial institutions<sup>1474</sup>. Just as governments have an incentive to inflate economies *ex post* given inflation expectations, they

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<sup>1469</sup> (KISCH & ELKIN, 1928, cit by VALE, 2021: 18-19).

<sup>1470</sup> (KYDLAND & PRESCOTT, 1977), (BARRO & GORDON, 1983), (MANKIW, 2001: 795).

<sup>1471</sup> (BLINDER, 1997, and 1998).

<sup>1472</sup> (ALESINA & STELLA, 2010: 12).

<sup>1473</sup> (ALESINA & SUMMERS, 1993).

<sup>1474</sup> (BRUNNERMEIER, JAMES & LANDAU: 207-8).

also have an incentive to stabilize the economy through redistributing more than was expected and providing excessive amounts of insurance.

In other cases of systemic financial crisis, the provision of excessive support can be provided under pressure from a large number of bank depositors. A less expert and more influenceable political branch is more likely than a more experienced, expert, and ICB to offer excessive liquidity or even solvency support in response to widespread financial fears.

Another way partisan policymakers could be worse than independent ones is that the former might be tempted to use fiscal powers to cover errors in financial supervision or other policies. An ICB without such fiscal powers will eventually have to accept blame, correct failures, and thereby learn from its own errors, as the scientific method demands. Partisan financial supervisors will cross-subsidize the cover-up of their errors, which entails an unfair redistribution and frustrates the necessary learning process.

The mild version of the opportunistic argument identifies policy inertia rather than manipulation. Elected officials resist taking the unpopular, albeit necessary decisions to tame inflation, or to tighten credit to in order to avoid the accumulation of financial risks and bubbles. Such resistance damages their credibility and creates self-fulfilling inflation biases.

There is a long body of traditional literature explaining why ICBs are relatively more immune to this opportunistic policymaking plagued by electoral cycling, short-termism, and time inconsistency.

Traditional CBI literature suggested five strategies of structural and institutional constraints and incentives to mitigate the opportunistic behavior of central bankers and distinguish them even more from elected officials notwithstanding their own humanity, fallibility, manipulability, and heterogeneity.

They are (i) barriers to protect independence and insulation from politics; (ii) the selection of conservative central bankers; (iii) grant narrow and clear mandates; (iv) incentives of economic compensation for performance under optimal inflation contracts; and (v) incentives of reputational compensation through a combination of inflation targeting with accountability for the results.

Pluralistic CBI accepts *relative* insulation and interactions, cooperative coordination with political policymakers, and that mandates are vague and incomplete. It repudiates conservatism and the activation of the interest in economic gain through optimal contracts. Still, it implies a solid and more comprehensive framework of independence protections that guarantee that ICBs remain by far less prone to those opportunistic sources of majoritarian biases.

The contribution of the pluralistic concept of CBI is to highlight other factors that reinforce and sustain the comparative resistance to such majoritarian opportunism.

The predominance of professional reputation in central bankers' constrained utility function is decisively reinforced by the effect of the competition of influences and in particular the weight of professional discipline, socialization, and institutional cultivation (the "Thomas-à-Becket-effect") induced by the institution and the epistemic community – and possibly by certain sectional interests such as financial investors. It works along with the *de jure* protections against political influences to align central bankers' strategic interest with the policy cycle and statutory goals, and thereby maintain this advantage of impartiality from majoritarian biases.

Central bankers themselves acknowledge the credibility-enhancing, "important legitimising and symbolic properties" of CBI.<sup>1475</sup> That is why they reinforce such commitment through the adoption of self-restraining policy operational frameworks and targets that are self-enforceable (reporting), professionally and through public and judicial accountability.

## **b) PARTISANSHIP**

Another explanation for systematic majoritarian bias is the hypothesis of partisanship or party loyalty that argues that politicians are not opportunistic, but rather decide on macroeconomic policies according to their partisan preference<sup>1476</sup>, either as ideological preference or as a pragmatic interest of their political party.

The ideological version argues that right-leaning governments pursue less expansionary macroeconomic policies than left-leaning governments.<sup>1477</sup>

A hybrid version is that governments are composed of ideologues who have no choice but to behave opportunistically when facing binding re-election constraints<sup>1478</sup>.

Partisanship becomes a form of majoritarian bias in democracies in the sense that the process tends to overrepresent the view of the winning coalition.

It is a partisan bias in the sense that what dominates decisionmaking are the criteria of the party and the "truth" it reveals.

Partisanship might actually pull elected decision-makers in the same policy direction as the opportunistic biases, but it operates through different channels, it is a force and cause of its own. It commands and disciplines political actors, elected or appointed officials or candidates, through *loyalty* to the political party's organization, interest and/or ideas.

It builds a system of incentives and conformity that resembles professionalism. But it is a rival system of social control that seeks to order the behavior of its members (elected and

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<sup>1475</sup> (MCNAMARA, 2002: 48).

<sup>1476</sup> (MANETTI, 1994), (ALESINA, 1988), (BERGER & WOITEK, 1997).

<sup>1477</sup> (BERGER & WOITEK, 1997).

<sup>1478</sup> *Idem*.

appointees), limiting the effects of their heterogeneity with the purpose of controlling the power over a larger tool of societal control.

Like professionalism, partisanship includes membership (based on acceptance of the party's ideas, interests, and rules), and an organization, structure, and typically some internal hierarchy. It involves indoctrination and cultivation of the members through socialization within the party. It also has a social code that includes functioning rules and either a well-defined ideology, or some less coherent and clear bundle of policy positions, or merely a more pragmatically aggregative process of defining policy positions and organizing competition for the control of power.

It has a more or less strict regime of party discipline based on loyalty and an incentives scheme of rewards and punishment that generate and maintain some grip of the party over its candidates.

The operating principle of the party is not expertise, knowledge, or scientific methods. It is, in fact, an alternative path oriented to promote the truth, which is the party's truth, i.e., its project of power.

The electoral-representative process, with more or less formal and tight discipline, is strongly sensitive to such partisanship. Different countries, with distinct political, electoral, and party systems show, across time, varying degrees of partisan grip over DRs.

Parties try to defend their monopolies over electoral competition and political representation. The refusal of independent candidates and elected parliamentarians, and regimes of exclusive public campaign financing circumscribed to political parties tend to increase the party grip.

In the opposite direction go regimes with looser party discipline (or none), elections opened to independents, individual candidacies in uninominal elections, cabinets open to non-partisans, supranational yet political governing bodies where representation is national-based rather than partisan-based.

The partisan bias means that decision-making is governed by partisan preferences – either opportunistic or ideological, short or long term. The serious risk is that such preferences deviate from optimal policies and societal goals, and even from expressed popular preferences. And, even when they do not deviate, their justification is *really* not the knowledge, optimality and alignment with societal preferences, but loyalty to the party's preference.

Political parties are not mere sounding boards of public preferences and interest. They have their own ideas, agenda and interests which often they seek to inculcate on the electorate and public discourse<sup>1479</sup>. They can be captured by sectional interests. They are intermediators, but they can also be disrupters of democratic control.

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<sup>1479</sup> (CRABTREE & DURAND, 2017: 12).

This partisan bias is aggravated by the rises of political polarization and of the “crisis of expertise” (the “cult of ignorance”).

With the growing political polarization, voters and elected officials are increasingly “willing to trade off democratic principles for partisan interests”. “[R]ejection of science and of expertise become[s] demonstration of political loyalty”. It seems that nobody likes science or empiricism when it conflicts with their deeply held views.<sup>1480</sup>

Pluralistic CBI concedes that ICBs are subject to external influences, and even that central bankers might exhibit some systematic biases, including a degree of partisan loyalty to political appointers or (conservative or dovish) ideologies, or a loyalty to the perceived interest of their home country or region.

However, such biases are much weaker, and definitely less systematic than for politicians. The protections of independence, particularly against political influence and public opinion pressure, the strong internal cultivation of institutional loyalty, professionalism against partisanship, and exposure to competing influencers generate heterogeneity of central bankers and drastically mitigate partisan loyalty.

On a different and critical approach, CBI has been described as a “procedural solution” at the service of a partisan-ideological choice for neo-liberalism and free market ideologies.

Instead of avoiding, it would institutionally embed partisanship, skewing policymaking towards a commitment to the values of neoliberalism, “all ultimately center[ed] on the risk of inflation and its potential for detrimental long term effects on the economy” and “solidifying a specific set of ideologies and partisan positions which favour certain groups in society over others”.<sup>1481</sup>

It suggests that CBI locks policy into a partisan view, regardless of whether it corresponds to the preference of the governing political majority and the sentiment of the (majority of the) People expressed in elections, polls, or public debates. CBI would be “designed to skew policies away from the preference of the majority of voters”.<sup>1482</sup>

However, the historical association of CBI with free market doctrine seems questionable. The equivalence of CBI and “absence of intervention in the allocation of capital and credit...is a myth that is not supported by historical comparisons. The independent Reichsbank – even before SCHACHT – invented the (in)famous Mefo bills, the Bundesbank was the greatest advocate of capital control in the 1960-1970s, etc. The deliberate role of the CB in export credit financing could also have been discussed.”<sup>1483</sup>

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<sup>1480</sup> (SVOLIK, 2019), (NICHOLS, 2017 and 2020).

<sup>1481</sup> (McNAMARA, 2002).

<sup>1482</sup> *Idem*.

<sup>1483</sup> (MEE, 2019: 368), (MONNET, 2021).

The Post-GFC activism, the massive bailouts and LOLR and MMLR roles, the significant interventions to stabilize financial markets and real output, the “go-direct and targeted” strategies in the pandemic, and the assumption of roles in the fight against climate change and inequality confirm how ICBs are often interventionist and the relationship between CBI and free market (and thus the the “definition of the former) has fluctuated throughout history”.<sup>1484</sup>

One scholar has suggested that instead of a victory of neoliberalism, this new style central banking represents the triumph of a “technocratic Keynesianism”<sup>1485</sup>.

In financial policies, the evolution went in the direction opposite to liberalization and deregulation. ICBs and other regulators have imposed more regulation and regulatory costs – including in administrative compliance and capital or quasi-capital buffering – and assumed principles of burden-sharing and limitation of moral hazard in the functions of LOLR and resolution.

Furthermore, hypotheses of conservative and partisan biases of central bankers are empirically and structurally weak, and how the home bias could actually be more decisive.<sup>1486</sup>

On the other hand, it shows that heterogeneity, rather than partisan or ideological homogeneity, is dominant.

Where the traditional CBI sees (a mythic) objectivity, strict insulation from partisan politics, and one-sided conservatism, pluralistic CBI finds heterogeneity but without partisan loyalty, and offers a possibility of non-partisan politics.

In any case, its relative insulation is always less partisan than the electoral-representative process.

### **7.7.2. PREVENTING SYSTEMATIC MINORITARIAN BIAS FAVORING THE FINANCIAL ELITE**

One of the most pointing charges against CBI is that it generates a systematic minoritarian bias in policymaking, that it registers false positives by attending too much to unrepresentative groups, and that it contributes to captured governance where undue influence over decision-makers comes overwhelmingly from one set of interests to the exclusion of others.

#### **a) CONDITIONS OF PROXIMITY**

Economists and sociologists have often described how ICBs can be captured by Interest Groups, just like they can be manipulated by politicians or bureaucrats.<sup>1487</sup> They can even be indirectly

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<sup>1484</sup>(MONNET, 2021).

<sup>1485</sup> (VAN’T KLOOSTER, 2021).

<sup>1486</sup> (LEITÃO AMARO, 2023a).

<sup>1487</sup> (ROSANVALLON, 2011: 97-100).

captured by Interest Groups who directly capture and manipulate elected politicians and media<sup>1488</sup>.

In a hybrid fiat money system, banks and increasingly non-banks are providers of inside money and credit to the economy, and are amongst the few counterparties (together with public entities and foreign CBs) with direct access and accounts at the CB. Also, they are sources of information indispensable to macroeconomic policymaking, the main direct addressees of financial policies, essential pieces in the transmission mechanism of monetary policy and generally in the implementation of monetary and financial policies, and they have come to rely on ICBs as providers of liquidity and LOLR and MMLR in moments of crisis.

Those roles give them a privileged access, a close relationship and dependency, and the capability to be one of the main Influencers of monetary and financial authorities.

Therefore, the strict separation and the prohibition of interactions and influences from financial actors over monetary and financial authorities are both untenable and undesirable.

On the other hand, these financial actors have their own sectional interests that do not necessarily coincide and frequently conflict with the public interest, the optimization of social welfare or the short- or long-term preferences of the popular majority.

Moreover, financial markets tend to have even shorter time horizons and more “irrational exuberance” than the populace and elected officials<sup>1489</sup>.

In addition, the impartiality problem is not uniform across all policy fields. Socio-economic issues with distributional and efficiency challenges are more susceptible to minoritarian biases because of their skewed distribution of per-capita stakes.

That is even more so in policies, like monetary and financial, with high levels of complexity and technicality that increase the costs of access to the decision-making procedure, that inspire and induce less popular participation and thus, the gap in preferences and participation turnout between groups.

In that vein, economic elites tend to concentrate their efforts to influence decision-making only on those policies and specific decision-makers (officials and departments) where their stakes are higher.

Preferential targets tend to be finance ministries, legislative committees in charge with socio-economic issues, the CB and other regulatory agencies, “in which the rules of economic game are forged and from which key policies affecting businesses flow. Influences over other offices of the state may be important, but secondary”<sup>1490</sup>.

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<sup>1488</sup> (PAGLIARI, 2012: 18-20), (MILLER & WHITFORD, 2016: 19), (TUCKER, 2018. 108).

<sup>1489</sup> (BLINDER, 1998: 61-2).

<sup>1490</sup> (CRABTREE & DURAND, 2017: 4).

## **b) PROS AND CONS**

Yet, proximity and even cooperative coordination are not subordination. They can amount to dialogues between autonomous equals that, appropriately managed, might leave the integrity of the public decision-making process unscathed.

They can also carry benefits for the quality and effectiveness of policymaking, and check other undue influences, including from majoritarian biases.

However, such influences might also be undue if they are relevant and inappropriate, i.e., if the influence and overrepresentation of a well-off minority were systematic or structural and thereby compromises the integrity of the given decision-making process as policymaking method.

A systematically biased policymaking in favor of a minority, particularly a well-off group, is normatively undesirable on various accounts.

It is substantively unfair in procedural terms because it violates fundamental liberal democratic values of political equality: all interests should be considered and structural unbalanced representation rejected.<sup>1491</sup>

It tends to generate substantively unfair outcomes, as policies relatively less responsive to the conditions of the worse-off are more likely to aggravate economic inequalities and thus the conditions of democratic justice.

On the other hand, there might be a normative case for accepting certain minoritarian biases favoring the worse-off groups, as defended by RAWLS and RAZ.<sup>1492</sup>

That case would reinforce the abovementioned concept of positive impartiality, where policymakers are under a special duty to correct the unequal opportunities of those minorities that are in a disadvantaged position.

The normative prescription is not a strong version of neutrality, but this *comparative advantage of impartiality* determines which institution is better at preventing undue influences and overrepresentation of minority or pivotal players not justified by democratic justice.

## **c) COMPARING PROCESSES**

To the surprise of critics of CBI, the answer is not straightforward.

The *real* classic political process is not as equal in representation as *ideally* assumed, nor is independent central banking as systematically biased as often suggested.

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<sup>1491</sup> (PETERS & ENSINK, 2015), (LUPU & CASTRO, 2022).

<sup>1492</sup> (RAWLS, 1971), (RAZ, 1998: 46).



As described above,<sup>1493</sup> the classic democratic process is plagued by differential representativeness, with financial elites and organized groups having more substantial, independent influence on government policy in Western liberal democracies than average citizens and mass-based Interest Groups.

There is an abundance of literature acknowledging that the electoral-representative process is prone to corporate state (or political) capture and Special Interest Group politics. Elected officials register false positives by attending too much to unrepresentative groups, such as voters in marginal seats, actual or potential donors to their campaigns, and organized special interests able to exercise pressure disproportionate to their electoral strength through their direct supply of information, campaign financing, and other material incentives. These groups can further persuade elected policymakers using their power in the economy, media, and other potential sources of social influence on voter behavior.<sup>1494</sup>

*Real* central bankers and their decision-making are exposed to channels for malign incentives and manipulation of central bankers' utility function, and for *capture* and *structural power* that can be risk factors leading to a systematic bias in favor of minoritarian, well-off financial interests.<sup>1495</sup>

Such minoritarian bias would explain CBs' traditional opposition to inflation and commitment to price stability<sup>1496</sup>; their alleged deregulatory preference and lethargy in the face of the accumulation of financial risks prior to the GFC; their choice of crisis-responses with preference for size and inflation of asset prices which allegedly generated a "very skewed recovery"<sup>1497</sup>; and their purported favorable treatment of struggling markets over distressed states during the Eurozone crisis<sup>1498</sup>.

However, it was also conveyed above how copious studies of academics and from the central banking community have demonstrated that (higher, unexpected) inflation hurts disproportionately more the poor (who thus benefit more from price stability commitment), and that major policy innovations that are usually suspected of favoring the financial elite, namely the wave of bailouts to financial institutions and the massive unconventional monetary policies since the GFC, in fact did not aggravate but mitigated economic inequality, protected employment (particularly amongst the worse-off), and benefited relatively more the interests of the poor compared to scenarios where such policies did not exist. It is not that the financial elite

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<sup>1493</sup> Ch. 7.3.

<sup>1494</sup> (DENZAU & MUNGER, 1986), (BECKER, 1993), (PERSSON, 1998), (CIGLER ET AL., 2016), (LISI ET AL., 2022).

<sup>1495</sup> (LEITÃO AMARO, 2023a).

<sup>1496</sup> (POSEN, 1993 and 1995).

<sup>1497</sup> (LUCE, 2021).

<sup>1498</sup> (FONTAN, 2018).

and the top one percent have not gained significantly, but others might have gained more in relative terms.

For those claiming that the current inflation burst is the cumulative outcome of a policy cycle of more than 15 years of (misguided) new style central banking, they should wait for the overall assessment at the end of this cycle, after accounting for the welfare costs and distributional impacts and the economic recession and social pain probably needed to control inflation back to the targets.<sup>1499</sup>

On the other hand, it seems hard to sustain that in the same period political branches have used their macroeconomic powers – fiscal powers, financial and other sectoral regulation, supply side reforms – in a more equally representative fashion and have done more to prevent and combat crises and economic inequality, and to foster economic stability, employment, and social welfare, in terms more advantageous to the least advantaged.

There were plenty of signs of political inaction, dysfunctionality and fiscal passivity before and after the GFC and the Eurocrisis, and during the low growth conditions thereafter until the pandemic. There were multiple diagnoses of political incapacity to reform loopholed tax regimes, competition rules, public expenditure, labor and product market regulation, etc.

For instance, the fiscal austerity in the EU in the early 2010 was politically driven, in the USA the 2017 tax cuts that were expected to disproportionately favor the riches were decided politically<sup>1500</sup>, and in 2020-22 the possibly excessive and inflation-inducive fiscal stimuli were also politically decided.

If any descriptive conclusion is possible, at least for now, it seems to be that empirical evidence does not support the view that the results of ICBs' policymaking favor relatively more the minoritarian financial elite than policymaking under the purview of political branches.

#### **d) THREE THEORETICAL OBJECTIONS**

Without the comfort of clear empirical findings, three theoretical approaches offer analytical claims of a greater propensity of CBI to generate a minoritarian bias.

(i) The critical political economy approach argues that while the political process might be more open to variation of policies, demands and predominant coalitions of interests, CBI is an institutional and procedural device whose explanation and purpose is to prevent such variation. CBI embeds a certain trade-off among competing goods that benefit the Few (financial and business elites) more than other constituencies, insulating economic policies from the demands of labour and other domestic interest groups<sup>1501</sup>.

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<sup>1499</sup> (LEITÃO AMARO, 2023a).

<sup>1500</sup> (THE NEW YORK TIMES EDITORIAL BOARD, 2017).

<sup>1501</sup> (MCNAMARA, 2002, 54, 67), (BRAUN, 2017), (FONTAN, 2018).

However, this critical theoretical approach is not convincing on various accounts.

Firstly, historical research identifies multiple *explanations* for the adoption of CBI and the domestic and international pursuit of an ideological (so-called “neoliberal”) or sectional-interests’ agenda is only one of them. Oppositions or fading majorities seeking to mitigate the power of future governments, governments seeking blame deflection, international creditor organizations wishing to secure their financial assistance to the country, or epistemic communities are only some of the other possible culprits of CBI-enhancing reforms.

Second, it is not CBI but the legislated mandate and potentially the preferences of central bankers that might lock policymaking into certain ideological or interests’ trade-off. That is one fundamental contribution of the literature on CB conservatism<sup>1502</sup>. If political officials who set the mandate and appoint central bankers decide to have less conservative mandates and decision-makers, CBI will preserve such option.

In fact, pluralistic CBI counters CB conservatism defending that central bankers and their method should promote diversity and critical thinking for epistemic, impartiality and democratic reasons. That being the case, the method of central banking would not skew the interpretation and implementation of the mandate systematically in favor of a certain ideology or Special Interest Group.

CBI is an institutional and procedural device that lives with the legislated mandates, notwithstanding the significant differences, which already exist in the objectives of major ICBs. Post-GFC central banking did not move in a conservative direction, and the post-pandemic inflation burst is often blamed on dovishness or mission creep, and other distractions removed from the interests of a financial elite.<sup>1503</sup>

In financial policies, ICBs and other regulators seem to have a much stronger hand in regulating private financial institutions, having imposed serious regulatory costs and capitalization obligations on them.<sup>1504</sup>

One way to put it is that new style central banking, with internal heterogeneity and more activism and centrality in global economies, is farther away from the conservatism and neoliberal ideals favored by the rich, and possibly closer to an expert-based, impartial and democratically embedded pursuit of the general interest. It is less under the control of a financial elite, and more operating under conditions of public contestation.

It might still suit the elite-dominance theories, but where the elite is different from that group of financial interests, and it does not necessarily serve their interests. CBI would then be a power

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<sup>1502</sup> (ROGOFF, 1985).

<sup>1503</sup> (LEITÃO AMARO, 2023a).

<sup>1504</sup> (JONES & MATTHIJS, 2019).

grab by certain “knowledge-based elite”, which excludes the ordinary, non-professional citizens and politicians from the control of key macroeconomic policies.<sup>1505</sup>

(ii) A second approach is the public choice theory that sees both central bankers and elected officials as rational human beings that make choices to maximize their individual self-interest. Allegedly, the former’s self-interest would be more aligned with the narrow self-interest of large financial companies that in some sense “fund” the CB and where they can find a job after public service, while the politicians’ rational self-interest would be more aligned with the wider public, and their interest is to do what the public wants to avoid being voted out of office.<sup>1506</sup>

However, such terms of comparison are not realistic. Both groups of decision-makers operate under pluralistic conditions – the contemporary political process and modern central banking – subject to competing influences and conflicting forces that pull them towards and away from narrow Special Interest Groups.

Central bankers are heterogeneous, their rationality is bounded and their utility function is constrained. Their preferences cannot be reduced to personal pecuniary, post-employment or partisan interests. Their economic gain factor is more controlled than for politicians, and their recognition preference is more objective and influenced by epistemic/professional concerns while for politicians it is more subjective and non-normative, which creates greater vulnerability to elites with resources to influence debates in the public sphere.

The combination of their constrained utility function, the strong cultural institutionalization efforts within the CB, and the effect of professionalism tend to make their culturally and institutionally embedded preferences more aligned with their epistemic community<sup>1507</sup>.

Furthermore, as noted by RILES, many central bankers can be described as acting for the benefit of some larger good. Most central bankers are not partisan and share some of the citizenry’s concerns about financial regulation. Many central bankers are highly critical of the motivations of large financial players and concerned about the economic welfare of ordinary citizens<sup>1508</sup>.

On the other hand, many politicians are substantively and independently influenced and captured by financial and business elites directly and through influence over public opinion, whilst citizens and mass-based interest groups do not have similarly substantial independent influence.

To seek reelection, politicians compete for votes (yet not all) and also for campaign contributions and support from Interest Groups that have more resources to independently influence (and

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<sup>1505</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>1506</sup> Critically (RILES, 2018: 71-72).

<sup>1507</sup> (VAUCHEZ & FRANÇOIS, 2020).

<sup>1508</sup> (RILES, 2018: 71-72).

manipulate) public opinion<sup>1509</sup>. In countries such as the USA with private, unlimited campaign financing, the weight of those contributions is more blatant. Yet, even where private campaign contributions are limited or prohibited, Interest Groups have a decisive capacity to influence public discussion by other means.

Therefore, both groups can drift either way. The way each defines its own personal interest or the wider societal good is the product of cultural, political, and ideological frames which can change over time through interactions with a new range of actors<sup>1510</sup>.

Departing from equivalent assumptions on the natures of both types of decision-makers and on the functioning conditions of both processes, what becomes more decisive are the constraints on their utility functions and on the relative forces of the competing Influencers.

On the one hand, demands for equality in the electoral-representative process probably explain the greater reluctance to impose legal constraints on the direct interactions between voters/DRs and Special Interest Groups and on the sources of financial and material gains for politicians, compared to central banking.

On the other hand, ICBs are organized to facilitate the attainment of the goal of impartiality as detachment, as disinterestedness so that no one – financial interests included – should benefit from a privilege or advantage. They seek to provide (mildly) neutral venues for disputes between Interest Groups to be resolved<sup>1511</sup>.

Their statutes and internal rules have continuously developed constraints on conflicts of interests and on their relations with the private financial sector. They cultivate an institutional ethos that seeks to maintain a reputation of impartiality and equidistance from different Interest Groups<sup>1512</sup>.

Political parties and partisan loyalty stand for the political process like the epistemic community, professionalism and institutional ethos stand for central banking.

The claim is not that CBI completely neutralizes the making of substantive political choices, which is impossible, but that it creates mildly (albeit not perfectly) impartial political and independent institutions that maintain elements of democratic control through the Democratic Representative process<sup>1513</sup>.

(iii) Finally, there are the participatory theories that compare threshold costs of access to each alternative process.

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<sup>1509</sup> (BECKER, 1983), (DENZAU & MUNGER, 1986).

<sup>1510</sup> (RILES, 2018: 71-72).

<sup>1511</sup> (ROSANVALLON, 2011: 97), (MILLER & WHITFORD, 2016: 19, 165-6), (KISCH & ELKIN, 1928, cit by VALE, 2021).

<sup>1512</sup> (TUCKER, 2018: 102-4), (KISCH & ELKIN, 1928 cit VALE, 2021: 18-19).

<sup>1513</sup> (MANETTI, 1994).

Their central theoretical contribution is that the combination of a skewed distribution of stakes – as in monetary and financial policies – with high threshold access costs facilitates a systematic bias in favor of those groups who combine higher per capita stakes with greater resources to bear those high costs.<sup>1514</sup>

The traditional tale is that the classic political process has lower participation costs, while insulated central banking and expert mechanisms would have higher costs, restricted access and reduced accountability<sup>1515</sup>.

The view is that in procedural mechanisms like CBI “the battle of interests ... is imbalanced, given uneven access to resources and prevalence of policies where benefits (or costs) are concentrated but the counterpart costs (or benefits) are dispersed across the general public”<sup>1516</sup>.

The EU supranational, technocratic governance would offer an extreme example, with its distance from politics and the electorate, vestigial public sphere, a more muted political control and responsiveness, often selective consultation and closeness of regulation to stakeholders<sup>1517</sup>.

However, on both sides of the Atlantic administrative law has developed proceduralist remedies (applicable to central banking) that in various ways seek to expand participation and lower the threshold of access thereto – e.g., consultation on draft rules, transparency, participatory mechanisms, wider access to contest actions and decisions via court.

In the case of modern central banking, the (r)evolutions over the past two decades in the relationship with the public in general, and with Interest Groups other than the highly motivated and resourced financial elite, represent a serious effort to sensibly reduce the threshold of access.

This reduction of participation costs is both a justification and normative predicament of the pluralistic conception of CBI. More transparency, openness, and competition and complementarity of influences equalize opportunities and create new channels for majoritarian or minoritarian groups with lower resources and/or more diffused per capita stakes to have access to central banking and have their interests considered in the decision-making.

The two trends of structuring and constraining central banking to be more impartial and to reduce access costs have gone hand-in-hand with reducing its vulnerability to systematic minoritarian biases. Improvements are still possible and convenient, but pluralistic CBI seems to be going in the right direction to secure the advantage of impartiality demanded by the core values of political equality and liberty.

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<sup>1514</sup> (KOMESAR, 1994).

<sup>1515</sup> (BELLAMY, 2010).

<sup>1516</sup> (TUCKER, 2018: 554). More generally (SHIPAN & HUBER, 2002: 21).

<sup>1517</sup> (BELLAMY, 2010).

In contrast, the developments in the classic political process have generally been towards more partisanship and polarization that increase the barriers to entry and alienate the participation of many (especially moderates and less resourced actors). In the USA, the evolution has also been towards a greater role of private money in the electoral-representative game.

### **7.7.3. DEMOCRATIC DIFFICULTIES IN REDISTRIBUTION**

Most literature on independent institutions is too quick drawing a boundary for independent decision-making where issues have stronger distributive implications, assuming the superiority of the classic political process in redistributive choices for democratic fairness and functional reasons<sup>1518</sup>. It claims that the political process provides to those affected and potentially left worse-off a freer and more equal participation and consideration in the adjudication of distributive conflicts and of compensation of losers.

It argues that fiscal policy is operationally adequate to organize compensation of losers, while monetary is too crude of an instrument to make such compensation.

However, the superiority of the classic political process in redistributive choices is less obvious than usually claimed.

As to the functional argument, it demands too little from the knowledge acquired on the possibilities to calibrate monetary and financial policy instruments. The most modern tools of monetary and financial policy are capable of targeted and direct action, and CBDCs open even further possibilities of programming money and fine-tuning effects.

The claim of democratic fairness is defied by the greater propensity of the electoral-representative process for majoritarian-biased decision-making and potentially for minoritarian bias.

Therefore, when compared to majoritarian partisan politics, and under certain conditions of public contestation and “good enough democratic control”, mature political and independent central banking might secure democratically fairer distributive choices in monetary and financial policies.

Most independent institutions would not pass the tests of “good enough democratic control” and avoidance of systematic minoritarian bias, so ICBs are in an exceptional position amongst them.

Those same conditions explain why this is not a relocation of redistribution to technocratic hands, but from one partisan form of indirect democracy to a non-partisan form of indirect democracy.

The very essence of majoritarian and minoritarian biases is to compromise the equal and free representation of all interests in the game of deciding distributive implications and

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<sup>1518</sup> (ALESINA & TABELLINI, 2008: 444).

compensations. They allow for overrepresentation of winners, and underrepresentation of net losers. It is hardly a fair condition for redistribution.

There are three specific manifestations of biased macroeconomic policymaking that highlight the difficulties of the electoral-representative process in redistribution and that tend to deviate decision-making from optimal policies:

#### **a) THE COMMON POOL PROBLEM**

The *common pool problem* means “the failure by heterogeneous decision-making groups to internalize the cost to the community of their competing claims on the government revenue pool”<sup>1519</sup>.

While groups of beneficiaries with high per-capita beneficial stakes have a larger incentive to mobilize and collude to push for more government macroeconomic benefits (e.g. tax exemptions, in fiscal policy, targeted monetary policy measures such as LOLR and MMLR, tailored macroprudential policies or bailouts of concrete financial institutions) than they would have been willing to support had they been fully responsible for their costs, the group with low per capita (negative) stakes tends to be comparatively more passive.

Such uneven distribution of stakes, plus the information imperfections referred to above, come together with Interest Group politics and short-termism inherent in the articulation of policy time lags and electoral cycles. Winning policymakers have short-term gains, their electoral reputation, or other sectional interests, while the internalization of costs of fiscal tightening, anti-inflationary, or financial repressive policy is delayed for the longer run and future governments.<sup>1520</sup>

That combination of factors explains why the disadvantaged groups might remain passive and the winning policymaking coalition dips into the common pool to reap those short-term net gains.

In policies with particularistic effects, normally very distributional, short-termism and Interest Group politics lead to biased decision-making. In conflicts over redistributive inflation, policy by majority can lead to a worse outcome, including for the majority, compared to the balance of interests that would be struck by a more impartial ICB.<sup>1521</sup>

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<sup>1519</sup> (EYRAUD, GASPARD & POGHOSYAN, 2017: 6-7).

<sup>1520</sup> (BLINDER, 1997: 120-3), (EYRAUD, GASPARD & POGHOSYAN, 2017: 6-7), (ALESINA & PASSALACQUA, 2015: 17-18).

<sup>1521</sup> (BLINDER, 1997: 120-3), (FAUST, 1996).



## **b) INTERGENERATIONAL REPRESENTATION**

The problem of *political absent or underrepresentation of future generations* means that a political process with majority rule tends to generate skewed intergenerational distributions, favoring current generations and majorities over future ones.

On the one hand, low-wealth individuals are likely to be bequest-constrained and thus have lower preference for the situation of future generations, increasing the likelihood of having deficits and issuing debt. On the other hand, a coalition of older voters (more bequest-concerned) and wealthy youngsters, because they prefer leaving lower debt levels, might end up supporting payment of (additional) debt to avoid the intragenerational redistributive consequences of the debt repudiation.<sup>1522</sup>

There is abundant literature on the normative worth of intergenerational fairness, and on the difficulties of the classic electoral-representative process to voice, register, and consider the interests of generations, existent or future, that cannot yet exercise voting and other political rights<sup>1523</sup>.

Fiscal, monetary and financial policies have distributional intergenerational implications<sup>1524</sup>. Constitutional regimes may pursue various strategies to mitigate the intergenerational unfairness of majoritarian politics,<sup>1525</sup> but there is a limit to what can be achieved through the electoral-representative process which is structured to register the present voices and interests. “Making democracy more inclusive – expanding the composition of the sovereign and enhancing its representation – cannot help future citizens. They do not have a voice because they cannot – logically cannot – be citizens now”<sup>1526</sup>.

One alternative strategy would be to impose “an expiration date on consent”, incorporating limits to the temporal reach of any decision, as well as temporal considerations during the process of decision-making<sup>1527</sup>.

In monetary policies there are old and recent versions of this technique, which involve introducing sunset clauses in the legislative delegation and mandates of monetary policy.

Recently there have been calls for the periodic expiration of CBs’ mandates and even of the instruments in their policy toolkit. This would require regular deliberation and renovation of their democratic legitimacy<sup>1528</sup>.

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<sup>1522</sup> (ALESINA & PASSALACQUA, 2015: 32-37), (VINEY & POOLEY, 2019: 449, 469).

<sup>1523</sup> (BURKE, 1993), (RAWLS, 1971), (THOMPSON, 2005), (AMARO, 2012), (COHEN, 2018: 68–76), (VINAY & POOLE, 2019).

<sup>1524</sup> (AZARIADIS & GALASSO, 1998), (TUORI, 2016: 868).

<sup>1525</sup> (AMARO, 2012).

<sup>1526</sup> (THOMPSON, 2005: 247).

<sup>1527</sup> (COHEN, 2018: 77).

<sup>1528</sup> (BINDER ET AL., 2020), (DOWNEY, 2020).

Past experience can teach useful lessons. The American First and Second (central) Banks of the United States had sunset clauses. The political failure to renew the charter of the Second, in a large part due to the successful populism of US President ANDREW JACKSON, brought an end to the delegation of their monetary authority, left the USA without a CB, and was followed by a period of turbulent financial instability. The outcome was clearly suboptimal and it is unlikely that voters would support it if they had deliberated rationally and with complete information.

Sunset clauses create an extreme dependency on the majority of the moment when the consent expires. The cost of a sudden expiration of a monetary or financial authority tends to be greater than the cost of insufficient adaptation. Stakes rise dramatically and so do the incentives for the exploitation of information asymmetries, for the manipulative interference by more resourceful groups (majoritarian or minoritarian)<sup>1529</sup>, and for populism and political polarization.

Other solutions have been offered such as creating independent bodies that act as informational watchdogs to flag inter-generational effects, with the emergence of fiscal institutions largely corresponding to this role, albeit only a limited number of these have strong barking powers<sup>1530</sup>. ICBs, like independent electoral commissions, make this additional step of assigning biting power and dislocating the control of discretionary, intergenerational redistribution to an institution partially removed from the electoral representative process.

Yet, the institutional arrangement of pluralistic CBI might be the most balanced arrangement to deal with intergenerational distribution.

ICBs are structured to adopt a longer view policymaking and to reflect and account for the will of multiple successive majorities rather than one instant majority. The long and staggered tenures of central bankers allow successive majorities to incrementally and jointly shape the decision-making body.

ICBs are subject to “good enough democratic control” or, in ACKERMAN’s words, “longer run political supervision”.

When the traditional defense identifies CBI’s superior dynamic consistency and the intrinsic time inconsistency of the political process, it is reckoning ICBs’ competence to manage the inter-temporal reallocation effects of monetary policy.<sup>1531</sup>

The preordination of democratic delegation and mandate ensures that DRs can shape the values guiding the intergenerational distribution.

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<sup>1529</sup> (BLINDER, 1997: 121).

<sup>1530</sup> (AMARO, 2012), (THOMPSON, 2005: 256-9), (VIBERT, 2008), (JANKOVICS & SHERWOOD, 2017: 7-8), (BEESTMA & DEBRUN, 2018), (OCDE, 2021).

<sup>1531</sup> (WYPLOSZ, 2003: 25), (TUCKER, 2018: 103).

In turn, the delegation of discretionary second-level distributional decision-making enables a more expert, less present-biased and longer view policymaking. One that is not stuck to the status quo, or the “dead hand of the past”.

“Good enough democratic control” in pluralistic CBI preserves the ultimate control of DRs. Under procedural conditions they have the possibility to update the guidance to ICBs, the constraints on intergenerational distribution and even eliminate the CB or the delegation if they are unsatisfied.

It offers a fairer and less biased alternative to sunset clauses, and it is more biting than watchdog solutions to represent future generations.

It leaves open the opportunity for new democratic majorities to amend the framework and mandate of macroeconomic policies but assumes that the system cannot be limited to ordinary legislative amendments by each new instant majority as a way of giving voice to future sovereigns.

First, amendments by later generations might come too late for “large and largely irreversible harms that current generations can inflict on future generations”<sup>1532</sup>, and when they come to make the decision, they will, too, have their eyes in the present.

ICBs are structurally designed to adopt a longer term deliberation in conformity with an ideal of liberal democracy that requires current decisions to take into account future generations.

### **c) REDISTRIBUTION AS IDENTITY CONFLICT**

Finally, the third and probably most difficult phenomenon of redistributive choices involves the cases where *conflicts are reframed in terms of identity*.

Identity politics has become an increasing trend in modern liberal democracies that has been associated with growing political polarization, populism, and difficulties of the electoral-representative process to manage social conflicts<sup>1533</sup>.

Material distribution is reframed as conflicts of national, religious, ethnic, or cultural identities, with the appearance of all-or-nothing, zero-sum games with no middle ground.

Instead of permitting discussions on who gets what and where “people can split the difference and feel content”, the discussion becomes about identity, about people’s ways of life (religion, race, anti-elitism), where compromise can seem like a betrayal. In some sense, identity clashes can be framed as distributional, not only between material but also immaterial resources, including negative and positive freedoms.

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<sup>1532</sup> (THOMPSON, 2005).

<sup>1533</sup> (FUKUYAMA, 2018), (HOLTUG & USLANER, 2018).

Macroeconomic policies have experienced such mutations. The distributional implications of fiscal, monetary, and financial policies and measures within the EMU have been cast as conflicts between North and South, frugals vs. profligates, leaving less room and unwillingness to optimize the management of interdependencies and spillovers.

The electoral-representative process can be worse because it does not solve but instead generates more conflicts by fostering animosity and gridlock amongst polarized poles and identitarian discourses. The dysfunctionality and partisan disagreements about information and facts turn distributional choices into questions about identity and ways of life.

On the contrary, independent institutions may provide the conditions of fairness and tolerance, expertise and impartiality that offer more truth-revealing capabilities and greater immunity to false positives and false negatives. Non-partisan and non-majoritarian institutions can be discrete insulated frictionless points that are superior alternatives to majoritarian-conflict solving. However, anti-elitism and populist attacks on “self-serving elite central bankers” may undermine their credibility in managing conflicts in this new age of identity politics.

This where pluralistic CBI, more open and humble to the public, to heterogeneity and to competing influences, can make a difference and restore such credibility for tolerance and even-handedness. Its proposal of non-partisan politics can facilitate the management of these difficult conflicts.

The CBI’s advantage of impartiality might be of essence in the age of identity politics.

To the surprise of many, the argument concerning distributional implications of macroeconomic policies can actually justify ICBs as “impartial arbiters of this social conflict”<sup>1534</sup>.

## **7.8. OUTPUT-BASED SUPERIORITY AND THE POST-PANDEMIC INFLATION SURGE**

CBI was born and spread around the world on the wings of functionalist and consequentialist arguments.

### **a) OBJECTIVE OUTCOMES**

Scores of studies over the past four decades tested empirically the claim that CBI delivers superior outcomes in terms of macroeconomic performance.

The majority concluded that CBI is associated with better outcomes in terms of social welfare, namely in terms of inflation, real economic growth, economic efficiency, macroeconomic and political stabilities, and other social and economic effects of such outcomes<sup>1535</sup>.

However, such findings did not go without challenge. One line questions the validity of those empirical conclusions favoring CBI, questioning assumptions and conclusions about the

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<sup>1534</sup> (KISCH & ELKIN, 1928 cit by VALE, 2021), (TUCKER, 2018: 97).

<sup>1535</sup> Ch. 7.1.1.

existence and direction of the relation between CBI and macroeconomic stabilities and welfare<sup>1536</sup>.

Another line suggests that, at least in certain (non-inflationary) states of the economy, coordination of macroeconomic policies under some political preeminence would generate better social welfare.

Times of economic or financial crisis, and periods of low growth with low inflation in the vicinity of the monetary policy's effective lower bound would allegedly go better without CBI.

A third line associates CBI with worse outcomes in terms of an overall rise of economic inequality, allegedly because the intended insulation from broader political control would result in policy choices that disproportionately benefit a few, already better off<sup>1537</sup>.

This *objectivist* outcome-based institutional comparison poses serious problems.

First, there are irresolvable disagreements over the *ends* and the measurement of such ends. There are disputes over the generally accepted assessments of the effects of public policies on the relevant normative values, on top of the normative difficulties in defining what is important as output and outcomes of policy, i.e., what is the optimal trade-off between those values, in each context.

Another fundamental normative difficulty is that ends do not justify all means, and output-based comparisons are not normatively sufficient.

## **b) SUBJECTIVE OUTCOMES**

Still within the consequentialist camp, one *subjectivist* alternative suggests that what matters in the end and above all is the general satisfaction and trust of the public in the institution of government.

Instead of measuring the impact on certain indicators, such as macroeconomic stabilities, welfare, or justice, this *subjective* outcome approach would synthesize and convert such impacts into the overall judgment of the People, the creditors of societal values.

From this subjectivist perspective, ICBs would be justified if they gathered *enough* and *more* public trust and support to manage monetary and financial policies than political branches and dependent CBs.

Public sentiment would be measured by surveys, polls, traditional and social media discourse, and ultimately by the political mobilization in favor or against ICBs.

Literature on public support for independent expert institutions and CBs in particular has grown.

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<sup>1536</sup> (POSEN, 1993).

<sup>1537</sup> (AKLIN, KERN & NEGRE, 2021). Contrarily (TOMITA, 2022).

Various studies have found that, with large cross-national variations, “citizens accept—or even prefer—the appointment of external, independent decision makers at the helm of their country”<sup>1538</sup>.

Recent studies in Europe found no popular rejection of independent expert institutions in most countries and detected a negative correlation between greater support for non-majoritarian institutions and “trust in representative political institutions (political parties, national parliament and government) and their beliefs about the benefits of democratic governance”.<sup>1539</sup> The ECB, and all EU institutions, have much higher levels of public trust than national political institutions of the traditional electoral-representative process, meaning parliaments, governments and political parties.<sup>1540</sup>

After historical lows during the Eurocrisis, the public trust in the ECB in the summer of 2022 was at high levels, without registered effects of the inflation surge, despite the rising prices already showing up as the most important single issue for Europeans.<sup>1541</sup>

It might be that, at least so far, respondents have not blamed the ECB for the rise in inflation, nor have they felt the hardship induced by the tightening of ECB policy stance to fight such inflation. Only time will tell what the evolution of the trust in the ECB will be during the ongoing tightening cycle.

That evolution will test the general understanding that institutions accumulate stocks of public trust during periods of “easy” policies and perceived successes which then can absorb periods of dissatisfaction. Every scandal, every failure of the CB prompts criticism that undermines the public trust in the institution.

It is fairly consensual that higher levels of trust in CBs have a legitimating effect of their own, contributing to increasing the credibility of their commitment. This “induces lower inflation expectations on average”<sup>1542</sup> and thus supports the delivery of the price stability mandate.

Furthermore, it is the overall subjective judgment of the people about each institution that tends to determine popular action and democratic decisions on that institution. How does this explain the fact that after the GFC and Eurocrisis, CBs were trusted with more responsibilities even though the public’s trust in them had declined to historical lows? Possibly the reason is comparative: despite their erosion, ICBs maintained levels of public trust significantly higher than those of the political branches.

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<sup>1538</sup> (BERTSOU & CARAMANI, 2020).

<sup>1539</sup> (STANDARD EUROBAROMETER 97), (EUROPEAN VALUES STUDY, 2017-2020), (BERTSOU & CARAMANI, 2020), (BERGBAUER ET AL, 2020), (COSTA LOBO & McMANUS, 2020).

<sup>1540</sup> *Idem*.

<sup>1541</sup> *Idem*.

<sup>1542</sup> (SCHNABEL, 2020), (VAN DER CRUIJSEN & SAMARINA, 2021).

That said, subjective output-based analyses are also problematic as grounds for institutional choice and measured public trust is of limited normative worth as a defining element of institutional choice.

Firstly, because public trust in the CB is not necessarily determined by the latter's choices and performance. There is evidence that "ECB market interventions may have positive effects on the overall level of trust in the long-run" but that factors that are outside the control of the ECB are relevant for the trust-building process of boundedly rational people, namely macroeconomic conditions, socio-economic characteristics and political orientation of individuals, personal suffering during a crisis, and whether they are clients of a bank that received government support during the GFC<sup>1543</sup>.

One study of the Bolsr found that trust in the CBs' policy is associated with its professionalism and independence<sup>1544</sup>, another work concluded that "trust in the ECB ... hinges to a large extent on citizens' perceptions of their personal situation and the overall economic context, as well as their broader attitudes towards the European Union, while other sociodemographic indicators seem to be less relevant"<sup>1545</sup>.

Second, public trust is volatile, ebbing and flowing with great variance. Measurements capture short-term support, without robust tools to distinguish momentous satisfaction from long-term and profound trust and credibility.

Third, the normative reliance on expressed public trust – i.e., subjective output-based analysis – shares and aggravates the difficulties of the electoral representative process in terms of generating false positives, overweighing unrepresentative or short-termist views, etc. Such approach would be normatively dangerous also in the sense that it tends to be systematically biased towards the majority or a minority that disproportionally controls the public sphere.

Fourth, whereas objectivist output-based approaches are based on standards related to fundamental societal values, namely those set on the mandates legislated through a procedurally fair process, the subjectivist approach is morally relativist. Justice and welfare would then be what the "measured" or "expressed" public sentiment would say they were.

This is not to say that public trust and support are normatively irrelevant.

One essential contribution of pluralistic CBI is the distinction between gathering and managing public trust, and being dominated by polls and by short and irrational news- and financial market-cycles.

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<sup>1543</sup> (BURSIAN & FÜRTH, 2013), (HAYO & NEUMEIER, 2017), (VAN DER CRUIJSEN & SAMARINA, 2021), (BROUWER & DE HAAN, 2022).

<sup>1544</sup> (KRIL ET AL., 2016).

<sup>1545</sup> (BERGBAUER ET AL, 2020).

Pluralistic and political CBI gives balanced importance to public trust and support. It is less dominated by such public excitements than political partisan policymaking, but more mindful and engaged with the public and its judgment and feedback than traditional CBI.

The traditional conclusion that CBI tends to deliver monetary and financial policies with better outcomes, measured objectively and subjectively, has normative relevance but does not suffice as justificatory grounds.

This suggests that CBI is generally “*for the people*”.

That is because pluralistic CBI offers the expertise, impartiality and competition of influences that by increasing the weight of knowledge, mitigating false positives and negatives, and increasing diversity, critical thinking and professionalism, generates better decision-making and implementation which, *ceteris paribus*, tend to deliver superior outcomes.

Political CBI admits that CBs manage distributional effects and have an eye on the compensation of losers and improvement of the worse off – all just outcomes.

The competition of influences, the conditions of public contestation and good enough democratic control favor the alignment of those outcomes with societal preferences, while protecting the policymaking process from partisan and other failures of representation in the expression of such societal preferences.

In terms of loyalty to the societal values ingrained in the mandate, whichever they are, pluralistic CBI is more credibly committed than the partisan politics, while it has superior capability than traditional CBI to maintain the interpretation of those values more synced with evolving societal consensus.

From the subjectivist perspective, pluralistic CBI’s better alignment with societal preferences and its new relation and democratic channels with the public, create the conditions for independent central banking to generate greater public trust and appreciation, as long as ICBs remain humble, responsive and educative in their relation with the public.

So far, no robust empirical research exists comparing the outputs of the two models of CBI, the traditional and the pluralistic. Public trust in the CB has increased, at least in Europe, over the last years, but the time span is still too short to allow a conclusion, and measurements of public trust have so many more determinants.

For about a decade, there was a general, mainstream impression that the politicized, pluralistic CBI that emerged since the GFC had proven well.

The comparatively poor performance of TRICHET’S ECB in the onset of the GFC, with its traditionalist and conservative approach that is often blamed for nurturing the conditions leading up to the Euro Area crisis, might be one sign that pluralistic and politicized ICBs do better than traditionalist ones, at least in periods of crisis and low-low. The same could be said for the



success of DRAGHI's more political ECB in fighting the Eurocrisis, and the accomplishment of major CBs in avoiding meltdowns in the pandemic.

The evolution of the inflation burst, the severity of the policy responses, and the economic and social effects will be decisive in assessing how the pluralistic CBI performs in terms of objective and subjective outcomes and compares with traditional CBI.

### **7.9. CENTRAL BANKING OF THE PEOPLE, BY THE PEOPLE AND FOR THE PEOPLE?**

This normative chapter sought to demonstrate the possibility of political and independent CBs meeting the Lincolnian ideal of a "government of the people, by the people and for the people"<sup>1546</sup>.

The model of pluralistic CBI ensures that monetary and financial policies are ruled "by the people", rather than a privileged ruling class of experts. The rise of political and independent CBs is not the triumph of technocrac, under the Platonic aspiration to replace democratic self-rule with some form of rule by experts<sup>1547</sup>. It rejects that only the electoral-representative process can express governance *by and of the people*.<sup>1548</sup>

Good enough democratic control, pluralist interest representation and competition of influences provide democratic inputs and legitimation, combining a farther removed but still *indirect* representation with new direct forms of democratic connection stemming from the institutional characteristics and practices that CBs developed in recent decades to engage with the polity, the public, a plurality of Influencers and collective deliberation.

Pluralistic CBI rejects the elusive neutralization and strict scientization underlying the technocratic case<sup>1549</sup>. It does rely on advantages of expertise and impartiality, but it accepts the impossibility of neutrality and favors a non-partisan form of politics.

It embodies rule by the people because the independence – as negative and positive defenses of the integrity of the matured central banking process – is limited, and ICBs are embedded in and compatible with the constitutional democratic system and subject to competition and complementarity of influences.

In the fields of monetary and financial policies, neutralization of political choices is not viable, and political ICBs represent not a rupture, but a continuity of constitutional government with many elements of democratic administration<sup>1550</sup>.

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<sup>1546</sup> (LINCOLN, 1863, Gettysburg Address) and art. 2 of the French Constitution of 1958.

<sup>1547</sup> (BELLAMY & PARAU, 2011: 255), (BICKERTON & ACETTI, 2020).

<sup>1548</sup> (SCHMIDT, 2006: 155).

<sup>1549</sup> (MANETTI, 1994)

<sup>1550</sup> *Idem*.

Pluralistic CBI is also a form of “government for the people” in the sense of superior outputs and outcomes, both objectively and subjectively assessed, and in the sense of responsiveness by the government to the people’s preferences.

Finally, It offers a government *for various peoples and all seasons*.

In contrast with traditionalist strict CBI, the pluralistic model is adequate for all seasons. The former may suit periods of high inflation, but it struggles to justify its existence in periods of low inflation and low growth, such as that between the GFC and the pandemic, and in periods of financial or economic crisis. In those other contexts, the variations in policy responses in terms of distributive effects and international and domestic fiscal-monetary coordination are barely compatible with the tenets of traditionalist CBI.

In contrast to strict CBI, instead of accepting exceptions or the weakening of independence in those other contexts, the pluralistic model offers a unitary framework that accommodates the necessary flexibility and the greater politicization in all senses that the new normal and those crises entail<sup>1551</sup>.

In turn, the flexibility intrinsic to the pluralistic model enables the adaptation to different peoples and the differences in their democratic regimes and political cultures. The same idea of independent specialized institutions in a competition of influences may lead to different positive configurations. Significant differences were identified in the comparison of the American, British and European frameworks of central banking.

CBI is shaped by and adjusted to the institutional and political context of the country, path dependencies, and the specific players and power relations.

With its flexibility, the pluralistic model is adaptable to the different needs of distinct peoples to compensate the perceived problems in the constitutional architecture of each system where it operates<sup>1552</sup>.

Therefore, each ICB has a distinct national light, with different combinations and declinations of the three comparative advantages.

That country-specificity actually sheds light on one final comparative advantage.

Whilst CBI is important and useful for peoples of all liberal democracies, the benefits tend to be greater, and inversely proportional to each country’s “institutional intellectual capital”.

Not only in emerging countries but also in advanced economies with lower institutional and social capital accumulation, ICBs may be indispensable sources of additional autonomous centers of competence and knowledge in policymaking.

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<sup>1551</sup> (LASTRA, 2015: 30), (KING, 2015), (BRUNNERMEIER, JAMES & LANDAU, 2016: 94), (CONTI-BROWN, 2016: 32-34).

<sup>1552</sup> (HALBERSTAM, 2010: 194, 201).

In countries where think tanks, universities, institutionalized interest groups, and organized intervention outside the political process are scarce, the existence of an autonomous center of knowledge and contribution to the collective conversation is relatively more important.

ICBs can be reservoirs of pluralism in societies with low institutional intellectual capital.

It serves the People by relieving their dependence on the partisan government's information and policymaking capabilities, and thus mitigating risks of political domination. ICBs can become credible truth-telling institutions in the public macroeconomic debate.

Where institutional and social capital is more limited, ICBs contribute to institution building, human capital accumulation, the "International Club" effect<sup>1553</sup>, and improve within and beyond the functions they are exclusively delegated as they are scientific and knowledge production centers autonomously participating in the marketplace of ideas.

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<sup>1553</sup> (WACHTEL & BLEJER, 2020).

## 8. NORMATIVELY STRENGTHENED FRAMEWORK OF CBI

### 8.1. NORMATIVE PRESCRIPTIONS TO BOLSTER THE COMPARATIVE ADVANTAGES

The previous normative institutional analysis demonstrated that under three epistemic, democratic and impartiality or unbiased representation standards, the model of pluralistic CBI has comparative advantages in the governance of money and credit.

It also revealed a number of lessons that are normative prescriptions to update and strengthen the positive framework(s) of CBI.

The evolution of this political technology, especially since the 1990s, built a framework that protects the *integrity of the art and science of central banking*, with institutional and procedural constraints and an incentive scheme for central bankers, as well as practices and commitments. It was developed under the tenets of the traditional view of CBI, which is a fine starting point because there is more that unites traditional and pluralistic models than divides them. However, the framework needs to be adapted, expanded, and strengthened to implement the normative lessons and prescriptions.

Not only the institutional maturation of this pluralistic new style central banking is still incomplete, but there is an unfinished task of sustaining and improving the legitimation and the comparative conditions that materialize the normative advantages.

(i) ICBs and their framework should build *multi-lateral insulation*, not only from political branches and partisan actors but also from all five groups of Influencers, with a concern to avoid the substitution of biases, in particular in favor of specially affected financial interests.

(ii) The *insulation ought to be limited*, rather than absolute, and it should *welcome, structure, and facilitate under conditions the competition and complementarity of those influences*. In the case of federalist systems of CBs, the cultivation and institutionalization of a federalist insulation (and leaning) can be complemented with the openness to decentralized non-oligopolistic competition of home biases.

(iii) The *scope of the functions assigned to ICBs shall be limited but not narrow*, as traditionalists suggest when dreaming about a policymaker exclusively dedicated to using internal monetary policy to control inflation and deliver price stability.

First, it should be limited according to their functional specialization or structural aptitude that justifies their comparative advantage and defines the boundaries of their independence.

Second, it should be limited relatively to the general system of government and also its subset of macroeconomic governance, where political and ICBs are accepted also because they are an exception.

(iv) ICBs should build credibility of their commitment regarding all their functions and objectives in all seasons. This mission is important to defeat the traditionalist claim that ICBs are only suited and credible in the role of inflation fighters.<sup>1554</sup>

ICBs have performed several other public functions in which their successes are less appreciated, and about which there is no narrative similar to what was developed on the tails of VOLCKER's Fed and fight against the Great Inflation.

However, there are signs that ICBs learned to fight crises in the GFC and proved it in the pandemic. Similarly, the evidence of increased robustness of financial institutions suggests advancement in prudential policymaking. They have more way to go to become credible policymakers in contexts of subdued inflation and low real growth.

These improvements require good policymaking, but also adoption of constraints, ethics, and efforts to shape the narrative of the ICB's credibility.

(v) ICBs should *explore the entirety of their statutory mandate*, their functions and the various objectives (secondary included), and also their other constitutional and legal obligations under the rule of law.

The bluntness of the monetary tool is no excuse for ICBs to fail the obligations that legally bind them, and which new knowledge and innovation allow them to address.

They should assume that inertia is a policy choice in itself that favors the status quo without democratic deliberation in support.

(vi) On the other hand, ICBs must *cultivate an ethics of humility*, whose first dimension is *humility regarding their role and function in society and within government*.

Within the boundaries of the delegation they ought to work, through procedural devices, proportionality judgment, transparency and accountability, to prevent discretion from turning into arbitrariness.

Regarding the boundaries of the delegation, they should exercise self-restraint, stick to *limited and responsive activism*, and reveal rather than lead transformations in social consensus.

That humility and prudence recommends independents avoid showing up "[i]n political majesty", as protagonists of the political partisan life and mobilization<sup>1555</sup>.

(vii) Another dimension of *humility is about their expertise*, and the promises of science and truth telling. Central bankers should be aware of the limits of their expertise, acknowledge and ponder the epistemic and cognitive limitations and biases, and improve the quality of their processes and judgments in decisional contexts<sup>1556</sup>.

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<sup>1554</sup> (RAJAN, 2023).

<sup>1555</sup> (VAUCHEZ & FRANCOIS, 2020).

<sup>1556</sup> (BLINDER, 1998: 23), (WOLF, 2022), (WEIDMANN, 2022).

Constitutional framers ought to acknowledge such limitations and devise constraints and an incentive structure accordingly<sup>1557</sup>, but central bankers should do it too. Such humility must be consequential.

As experts, CBs should try and police their own processes to avoid errors. They must keep investing heavily in mechanisms of epistemic advancement, models, and scientific methodologies, and in adequate staff, knowledge resources and technological tools, and they should self-commit to operational frameworks.

(viii) The self-reflexive humility must be complemented with a mission to *educate the public and less-attentive watchers about the limits of their expertise, mandate, and powers*. They need to manage expectations, be aware of the fallibility of all experts, and explain that science advances through trial and error so that people understand why experts err when they do.

They should simplify their policy explanations, expose the counterfactual, and engage in differential transparency and layered communications.

As “[c]entral banks are not almighty... [t]hey must clarify and announce what monetary policy can achieve – and even more importantly, what it cannot deliver.”<sup>1558</sup>

When they err, it is in their and the public’s best interest for them to set about restoring their reputations.

(ix) The framework and ICBs themselves should *cultivate critical expertise and thinking*. That demands incentivizing and investing in human talent, education, and acquisition of knowledge and informational inputs.

It discourages the selection of “representative ignorants” to lead the CB, which is more frequent than could be expected.

*Critical* thinking and deliberation are of the essence. They should be fostered through institutional and procedural constraints and a culture that incentivizes critical analysis, facilitates dissent, mitigates leadership dominance, and controls hubris and groupthink without jeopardizing efficiency and expediency when necessary.

ICBs should structure their decision-making process to upload and consider distinct *plausible* interpretations of facts, methodological assumptions, economic models and theories, different risk scenarios, conduct stress tests and adopt “dynamic programming” to deal with increased uncertainty<sup>1559</sup>

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<sup>1557</sup> (THE FEDERALIST PAPERS, 51), (KING, 2004).

<sup>1558</sup> (ISSING, 2021).

<sup>1559</sup> (BLINDER, 1998: 23).

Expanding the reviewability of CBs' decisions and performance, both internal and external, helps them to reflect on where mistakes were made and show how to get a grip on the consequences. Political and judicial accountability also serve that same purpose.

(x) The *promotion of beautiful heterogeneity* in the composition, inputs and deliberation of CBs' policymaking bodies is also necessary to combat status quo bias, inertia, groupthink, herd behaviour, as well as to improve the representativeness of the population at large. Collegiality-cum-diversity is an obvious normative condition for that heterogeneity that should be of expertise (education and experience), ideas, and representative interest (nations or regions, sectors, socio-demographics).

(xi) ICBs should *enhance professionalism, and their culture, codes, and disciplining mechanisms*, which are heavily reliant on central bankers' preferential concern for professional standing and reputation.

The international and domestic epistemic community plays the essential role in governing this professionalism that is essential in the positive dimension of independence.

This professionalism is not empty or formalist, but with material content corresponding to a distinguished culture, values, commitments, techniques, and views on the art and science of central banking.<sup>1560</sup>

CBs should proactively develop and improve the social code, culture and socialization, which are socially situated and country-variant<sup>1561</sup>.

(xii) *Improve the culture of transparency vis-à-vis all Influencers*, including the public.

In a world of competition of Influencers, transparency has a role in levelling the playing field, and it must work on two dimensions of transparency: one is *to* the Influencers, concerning the decisional materials and justification; and the other concerns the relationship with those Influencers that should, to a certain extent, be disclosed to preserve actual and perceived independence and counter populist reproaches.

Transparency is particularly important in the realm of CBs' substantive political decisions, including in international relations, distributional choices, and quasi-fiscal and quasi-foreign policies.<sup>1562</sup>

(xiii) *Lower the threshold of access to the central banking process* to mitigate the generation of systematic minoritarian biases as a consequence of the uneven distribution of stakes in CBs' policies. The new relationship with the public and the openness to diverse inputs go in that direction.

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<sup>1560</sup> (RILES, 2018: 22-34).

<sup>1561</sup> *Idem*.

<sup>1562</sup> (CONTI-BROWN & ZARING, 2019).

(xiv) *Level the participatory playing field*, including positive actions to incentivize participation of silenced, marginalized, or under-resourced voices of affected interests, and thus *equalize participation*. It is necessary to measure effective outcomes to overcome the overrepresentation of losers and discontents and thus secure ICB's *positive* impartiality.

(xv) *Promotion of political accountability*, which is of the essence to secure good enough democratic control. Such promotion depends on the development of legal and institutional constraints and the availability of the scrutinized CBs.

To increase the quality of that political accountability there should be an effort to qualify and educate political actors and the public in those mechanisms. While it does not require that parliamentarians are trained in monetary affairs, it is important to support them with technical expertise and adequate resources<sup>1563</sup>.

(xvi) *Concrete and retrospective* political interventions, such as specific policy overrides *stricto sensu* and anticipated removal of central bankers for policy disagreements, raise the maximum suspicion from the perspective of CBI.<sup>1564</sup>

They must be specially constrained and truly exceptional (if admitted at all), because they offend more severely the credibility of the commitment of the delegation and would operate in the segment of policymaking where the political process has the least comparative advantages.

For *prospective* legislative or rulemaking interventions with *generality* the limitations need not be so stringent. They (may) connect to the democratic demand of an open future and with the superiority of the electoral-representative process in first-level decision-making.<sup>1565</sup>

(xvii) Even for those that are generalist and prospective, because they are second-order policymaking, it is important to *raise the transaction costs incurred by jurisdictional stripping and other political second-order interferences aimed at reducing CBI*. It can involve liberal barriers on legislative interventions (such as qualified majorities and veto points), proceduralization of such interferences, transparency, and exposure of competitions of influences.

(xviii) *Informal influences and interactions are inevitable, but they should be structured or made transparent*. Even robust protections against formal interferences let some informal and hidden influences pass through the cracks, and in worse situations they might even become "parchment barriers". That might be problematic because those informal, unstructured channels are more unequal and vulnerable to unchecked biases, and less rationalized.

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<sup>1563</sup> (LASTRA, 2020).

<sup>1564</sup> (BLINDER, 1997: 122-3).

<sup>1565</sup> (WALDRON, 2016).



Instead of creating a fiction of impenetrability, it is better to deal with them, and structure informal domestic and international interactions and explicit coordination efforts, including through differential transparency.

The following chapter develops the comprehensive framework of pluralistic CBI, combining more traditional solutions to foster institutional, personal, financial, and operational independence, with updates to accommodate the newer normative concerns.

## **8.2. MORE THAN SIXTY SHADES OF CENTRAL BANK INDEPENDENCE: A PLURALISTIC FRAMEWORK**

A comprehensive framework is necessary to protect the integrity of the distinctive features and comparative advantages of the political technology of CBI.

It departs from the host of protections developed under the traditionalist view, and updates according to the 18 normative lessons and prescriptions of the pluralistic model of CBI.

The CBI framework is comprehensive in various senses. First, it regulates the interactions and relevant influences of the five groups of Influencers, not just the political.

Second, it accepts that not all external influences over ICBs must be *prohibited*. Some are actually *permitted*, and others even *required*, depending on the specific framework's articulation of the demands of independence, good enough democratic control and indirect representation, professionalism, judicial control, and equalized participation of *all* affected interests.

Third, it has a negative vocation of protection against undue influences, but also a positive dimension as it proactively fosters the ICBs' own capacity (institutionalized expertise in terms of knowledge, method, resources), mobilizes and structures the competition and complementary of Influencers to take advantage of their potential as friends of CBI, and manages the interdependencies between macroeconomic policies and policymakers.

This a master analytical framework for liberal democracies of advanced economies, but it has flexibility to adaptively materialize into concrete, positive regimes according to national differences stemming from specific path dependences, political cultures, "specific understandings of the primary constitutional values", "perceived shortcomings of the generally constituted branches of government"<sup>1566</sup>, and the particularities of each political system and regime where the CBI experience flourishes.

However, it does not mean complete relativism.

Despite the specificities and with different normative weights, they preserve the core of the integrity of independent central banking and its comparative advantages

No country's concrete regime of CBI gets top marks in all 67 elements of the master framework. Each regime has some combination of stronger protections in certain aspects, with concessions and compensations in others.

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<sup>1566</sup> (HALBERSTAM, 2010).

Furthermore, there is a cross-pollination between the distinct institutional models generating convergences, and the ebb and flow of institutional dynamics.

Flexibility does not prevent coherence, and there might be an association between levels of division (concentration) of political power and CB independence (dependence).<sup>1567</sup>

For analytical purposes, it seems possible to identify a few stylized models of CBI with their own specific varieties that tend to generate largely coherent models of positive CBI regimes that differ in the law and practice of CBI, of interactions and vulnerability.

In Western advanced economies, three models stand out, which are those of the ESCB, Fed, and BoE.

The ESCB is frequently considered the most independent of all CBs, for the constitutionalization of various protections, for its institutional loneliness within an incomplete EMU with disperse fiscal authorities and divided power between EU institutions, for its distrust of risky crisis management functions, for its rigid rules and strong ethos in favor of a primary objective, and against the political specification of mandate, instructions, overrides, removal power and monetary financing.

Yet, the ESCB has the weakest fiscal backstop, an institutionalized dialogue with other EU institutions, and a system of decentralized but national CBs that incentivizes a significant competition of home biases at various levels. Some of its stringent protections have been significantly flexed through strategic ambiguity, namely in terms of intermediate (monetary) policy objectives and the prohibition of monetary financing.

Moreover, the constitutionalization of the ESCB and its statutory basis is thinner than most expect and suggest, for at least three motives.

First, the TFEU and the ESCB Statute expressly de-constitutionalize and delegate to the EU ordinary legislators various aspects of the regulation of the ESCB and its policies, namely the powers to amend by ordinary legislative procedure various provisions of the statutory basis, to regulate the prohibition of monetary financing, and to confer additional tasks of prudential supervision.<sup>1568</sup>

Second, the TFEU's use of broad and abstract language, namely, to define the ESCB mandate and other substantive constraining principles, reduces the constitutional prescriptive thickness and increases the margin of post-constitutional discretion that the constituted institutions may dispute, but on which EU legislators and courts have largely deferred to the ECB.

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<sup>1567</sup> (LIPJHART, 1984), (HALLERBERG, STRAUCH & VON HAGEN, 2009: 204).

<sup>1568</sup> Arts. 123, 124, 125 (1) and (2), 127 (6), 128 (2), 129 (3) and (4), 132 (1) and (3), 133, 138, and 219 (1) and (2) TFEU.

Third, the ESCB's secondary mandate to support the "general economic policies in the Union" allows the EU political institutions to impact the ECB policymaking by defining and changing the meaning of those economic policies.

The Fed has the longest history of the three, during which informal practices departed from the law of independence in the books.

The US system of checks and balances and multiple veto points may have contributed to leaving dormant in practice a few tools of democratic control, such as the congressional R-bomb and the president's prerogative to remove the Chair.

Although the Congress could, in theory, radically transform the Fed through an ordinary law passed on a moment's notice,<sup>1569</sup> in practice its statutory basis, the FRA, barely changed for almost nine decades, despite the multiple and frequent bills promised or tabled in Congress.<sup>1570</sup> The FRA seems to be a case of *de facto* quasi-constitutionalization.<sup>1571</sup>

"The Fed is a creature of Congress"<sup>1572</sup> which exercises important accountability, but practice brought the Executive to the forefront of political influence and interaction, notwithstanding its modest role in the books of the law and much beyond the appointment channel.

There is an intense practice of informal interaction and Executive pressure, the busted myth of long tenures of governors allows some presidents to make several board appointments, and the president has *de facto* control over the tenure of a chair who is dominant in the system and whose term always expires one year into a new president's term, who can reappoint and even remove him.

The ambiguity of the "double mandate" and the limits of monetary financing, the dominant international role of the US dollar, fiscal agency services rendered by the Fed, and the possibilities of Treasury override and limited fiscal backstop widen the room for the practice to shape the situation of independence above or beyond its formalization.

The Fed's gradually built but strong culture of independence did not develop so much through legal reforms. The most pivotal moments of that process were non-statutory practices such as the Fed-Treasury Accord (whose implied meaning and reach were not in the letter of its single paragraph) and the performances of VOLCKER and GREENSPAN.

The BoE is known to have more concentrated power<sup>1573</sup> but the least formal independence of the three. Its CBI model accepts political specification of the mandate, instructions, overrides, easy (and frequent) legislative amendment of the statutory basis, more openness and flexibility

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<sup>1569</sup> (BLINDER, 2016: 11).

<sup>1570</sup> (BINDER & SPINDEL, 2018).

<sup>1571</sup> (LIPJHART, 2012: 229).

<sup>1572</sup> (ROGOFF, 2022).

<sup>1573</sup> (KOHN, 2020), (HALDANE, 2014, noting that after the GFC it accumulated three functions in the MPC, FPC and PRA).

on monetary financing, and serious accountability towards the Treasury. Of the three it is the model that better suits the aspiration of “goal dependence with instrument independence”.

This model, so suggestive of Executive dominance, sits coherently within the majoritarian British political system where Parliament is dominated by the Executive and its leader.

On the other hand, many of those channels for political interference are structured, formalized, and regulated to a degree that rationalizes the interinstitutional relation and decreases the *de facto* dependence in comparison to those models where influences and pressures run high but are hidden in informality.

The comprehensive framework of CBI encompasses 67 protections organized hereinafter in three pillars of *institutional*, *personal*, and *financial and operational* independence.

### **8.3. INSTITUTIONAL INDEPENDENCE**

The first pillar includes protections that are often labeled or divided into institutional, functional, legal and/or policy independence, and includes other new provisions that reflect the normative lessons and prescriptions of the pluralistic model

#### **8.3.1. LEGAL INSTITUTIONALIZATION**

**(1)** *Creation or recognition of the CB as public authority*<sup>1574</sup> by constitutional or legislative act that bars Executive and other non-legislative acts from eliminating the CB or threatening to eliminate it. The delegation by administrative act or contract would leave the CB extremely vulnerable.

**(2)** Warranting *legal personality and own decision bodies* to the CB, enabling it to act *per se* and bring actions before courts to enforce its powers and independence if necessary.<sup>1575</sup>

**(3)** “*Declaration of independence*” of the CB<sup>1576</sup> by constitutional or statutory provisions.

**(4)** *Conferral of competences – i.e., functions and powers – of CBs within limited, but not narrow, scope.*

First, it is necessary to determine the list of delegated functions. The classic purism of a single function (monetary policy) with one objective was never materialized. It is always a choice amongst multiple functions and how to manage their conflicts and trade-offs.

The selection of functions shall be based on two mutually supportive criteria of functional specialization and independence.

The first means that ICBs should only be assigned functions for which they have comparative institutional advantages, namely a matured specialized expertise or the best structural conditions to develop it in case of new issues and societal needs (e.g., digital currencies). It seems

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<sup>1574</sup> Depending on whether the nature and ownership are public and/or private.

<sup>1575</sup> (ECB, 2017), (IMFx).

<sup>1576</sup> (LASTRA, 2015: 70).

to be the case for the governance of money and credit, but not necessarily including the task of credit allocation.

It also requires a systemic test on the relative relevance of their set of powers in the context of the overall structure of government in general and macroeconomic governance in particular. They cannot be overmighty in the overall, but an exception that coexists with systemically important market and electoral-representative processes.

The independence requires that the nature of functions is such that the ICB is not in a condition of subordination. That raises suspicions over shared competences (such as financial supervision and external monetary policy) and those whose object is to serve the interests of an Influencer (such as fiscal agency services and being the banker of banks or governments).

Still, the delegation is acceptable when the internalized coordination and management of interdependencies is beneficial (e.g., creates overall coherence and effectiveness of the policies)<sup>1577</sup> and the risks of such subordination are dealt with in anticipation. That is possible by structuring and making transparent the interactions with those with whom ICBs share non-exclusive competences<sup>1578</sup> or provide services in terms that preserve the independence of decision-making.

Some degree of internal segregation within the ICB may also help, including in mitigating conflicts of interest.

As to the constitutionalization of these choices, it gives greater immunity to threats of their legislative abolition or reduction of their independence (and respective guarantees), functions or powers through the legislative R-bomb. Yet, because of the rigidity and limitation of legislative power, it was adopted for a limited number of ICBs (the ECB and nine NCBs, the SNB and the Riksbank).

In any case, all legal bases are conditional upon political support and their letter “has little meaning if political support is lacking”.<sup>1579</sup>

### **8.3.2. LEGAL DETERMINATION OF OBJECTIVES AND INSTRUMENTS**

**(5)** *The constitutional or legislative definition of objectives*, which does not need to be as complete as demanded by the traditional account.

That suggested clarity, or “goal dependence”, would increase democratic input-legitimacy and rule of law coverage of ICBs, and exhaust the need and possibility for political interference beyond the statutory mandate, in particular from the Executive.<sup>1580</sup>

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<sup>1577</sup> (EIJFFINGER & DE HAAN, 1996), (LASTRA, 2015).

<sup>1578</sup> (OECD, 2022).

<sup>1579</sup> (ROGOFF, 2019).

<sup>1580</sup> (DEBELLE & FISCHER, 1994), (DEMETRIADIS, 2020), (OECD, 2022: 168).

The affirmation of factual inevitability and normative acceptability of incomplete, broad, and vague objectives, for *all* ICBs in the world, is consistent with the admission of a comparative advantage of the legislative process on first-level decision-making of the fundamental objectives to be pursued with the delegation.

What does not occur, and is not necessary, is that DRs make all relevant substantive political choices or specify *ex ante* the broad and vague normative objectives into clear policy goals or targets.

The legal determination of objectives must be done by the Legislative, which has the institutional specialization for the purpose. Such task cannot be delegated to the less representative Executive.

The Legislature should act with generality and according to a substantive legislative process.<sup>1581</sup> In the USA, the SCOTUS even declared that regarding delegated authority to independent agencies, Congress shall “not act in any legally binding manner outside a closely circumscribed legislative arena, except in specific and enumerated instances” such as impeachment, advice, and consent to appointments and treaty ratification.<sup>1582</sup>

In any case, constitutional or ordinary lawmakers have the R-Bomb to correct or articulate their first-level decision-making. Therefore, their silence on specifications and implementations made by the ICB might, under conditions, have normative relevance as tacit acquiescence.

The specification of the policy goals should *in principle* be made through self-regulation by the ICB, which has comparative advantages of functional specialization and impartiality over the Executive. To strengthen their independence but also the rule of law, legal certainty, and policy credibility and effectiveness, ICBs do well in approving strategic frameworks – specifying objectives and setting intermediate goals and quantified targets – that they should organize with the procedural, participatory, and transparency conditions typical of rulemaking.

The Executive specification of the mandate has to be an exceptional solution connected to the specificity of the country’s political regime, e.g., majoritarian political systems with strong Executive domination, such as the UK. Still, in those limited cases, the Executive intervention must be structured in a formalized process that preserves the democraticity, impartiality, and expertise of the intervention and the integrity of the ICB’s policymaking.

Regarding the content of the mandate, traditionally, single objectives were thought to protect CBI better and clearly prioritized multiple objectives better than multiple unranked objectives. Allegedly it would be preferable to make the trade-offs at the legislative level to protect ICBs from competing influences on that problem.

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<sup>1581</sup> (WALDRON, 2016).

<sup>1582</sup> SCOTUS, judgment on *Immigration & Naturalization Servs. v. Chadha* case, 462 U.S. 919 (1983), §951-955.

Yet, single mandates are also illusory. ICBs cannot be inflation-nuts, and they are by constitutional, normative, and societal demand required to attend to the effects of their policies in other values and dimensions of society.

In that sense, multiple mandates, eventually ranked, advance general guidance on the necessary balances.

**(6)** ICBs should use *limited and responsive activism* within their mandate and the respective discretion.

They should be activist in the sense of exploring the entirety of their mandate and other legal obligations that they are subject to, and in knowing that inertia and the consequent deference to the *status quo* would be a policy choice, subject to the same scrutiny as any explicit decision would be.

However, their activism is limited because they should decide through rationalizing procedures and according to proportionality tests.

They are limited also in innovation. They are authorized to directly read and reveal, but not lead, established evolutions in societal consensus.

Finally, whenever they are assigned objectives to support government policies (or their objectives) they should defer to the political branch's articulation of the objectives of such policies. Nonetheless, it is entirely up to ICBs to define the meaning, i.e., what those objectives imply in terms of their delegated policies.

**(7)** *The constitutional or legislative authorization of the policy instruments available to the CB is necessary for rule of law reasons*<sup>1583</sup>, but it should be sufficiently comprehensive – including public and private law tools – and leave the *choice* of the instruments to the CBs to preserve their independence.

### **8.3.3. DISCIPLINING INTER-INSTITUTIONAL INTERFERENCES**

**(8)** The *prohibition or limitation of political or third-party interferences and influences* and the *assertion of final authority over specific policy decisions* are quintessential aspects of the protection of CBI.

The following categories of interferences have ascending intrusion on ICB's decisions: (i) informal and formal non-binding efforts to pressure or signal preferences over policies; (ii) required (and binding) consultation of a third party on certain CB's decisions; (iii) CBs themselves seeking instructions or guidance from third parties regarding their own competences; (iv) instructions or directions to the CB, through legal mechanisms, such as unilateral acts or voting rights in the CB's decision-making bodies; (v) other procedural mechanisms to solve policy divergences between the CB and third parties, including political authorities; (vi) *ex ante* or *ex*

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<sup>1583</sup> (LASTRA, 2015: 72).

post veto or override powers of third parties in the form of mandatory prior approval or powers to suspend or annul CB decisions or policy formulation.<sup>1584</sup>

The frameworks' tolerance to each shall depend on their level of intrusiveness measured by the degree of generality, imperative nature, and temporal reach, and on the formalization of the interference.

Less tolerance should exist with more legally binding, more concrete, and retroactive/retrospective interferences. General and prospective signals are less troublesome. Some of the more intrusive modes may be saved from absolute prohibition through tight constraint that structures and formalizes their exercise, as in the British model of interactions between the Executive and BoE.

**(9)** *Constrained openness to international relations with foreign CBs.* ICBs should be allowed to interact with one another, bilaterally and multilaterally, in certain venues such as the BIS or the FSB. Those interactions enable cross-border policy coordination, management of interdependencies, informational exchange and creation of "international club effects" that bring effectiveness, welfare, and epistemic benefits. But they also improve independence, domestically and internationally.

Substantively, ICBs should be attentive to the repercussions of their actions in their relations between countries and their sovereign authorities. They have no autonomy to establish cooperation with counterparties of countries with whom their own country is in conflict, and in extreme cases they might need to adjust their actions (e.g., participate in efforts of financial sanctions to aggressor countries).

Yet for such engagement in international relations to be consistent with the normative demands of CBI, it should follow a procedural framework of transparency, political accountability, and the possibility of public contestation.

It has been suggested that CBs should publicly report to the respective "Parliament on any positions its representatives take in meetings of international bodies, such as the Basel Committee on Banking Supervision"<sup>1585</sup>.

They should consult with the foreign policy authority of the country to monitor the effects on diplomatic relations, and where fundamental issues of sovereignty and security are at stake they should abstain from boycotting the national sovereign strategy and defer to diplomatic judgment.

**(10)** *Openness to structured cooperative coordination with other domestic policymakers.* Cooperative coordination between ICBs and fiscal policymakers is not outright rejected as

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<sup>1584</sup> (LAURENS ET AL., 2009: 137, 143), (LASTRA, 2015).

<sup>1585</sup> (BRAUN, 2017).



suggested by strict views on CBI, nor is it restricted to moments of crisis or non-binding dialogues.

Yet, the moderate openness to such cooperative coordination is conditional upon optimizing the macroeconomic policy mix and respecting the autonomy of the participants' decision-making. Moreover, as most cooperative interactions tend to take informal channels, ICBs and fiscal authorities (and other macroeconomic authorities) should establish *ex ante* the framework to structure their interactions, as in the ECB and BoE interinstitutional agreements with political authorities.

Such framework should regulate some forms of transparency and *ex post* review of the interactions and their effects.

ICBs should develop a practice of recording or elaborating minutes of contacts with political authorities, other public regulators, and foreign central bankers where policy conditions and choices are discussed. Any contributions to domestic or international policy coordination should be "on the record", which should be made available to political authorities with accountability powers and made public with an adequate delay if convenient.

**(11)** In the case of federalist CB systems such as the ESCB and the Fed, it is important that the framework *regulates the vertical relation and that there is some control of the decentralized units by the central institution*, i.e., the ECB-GC over the NCBs, and the Fed BoG and FOMC over RBs.

Such control is necessary to avoid that decentralized units becoming backdoor entries for control of the system by other Influencers, in particular their owners. In the NCBs, the greater risks seems to come from national political authorities, and in the RBs from the stockholder private banks.

The central units may be given powers to issue guidance or instructions that decentralized units have to follow and even to veto their decisions or non-system functions that the latter seek to perform.<sup>1586</sup>

In any case, internal dissent and open criticism by the decentralized units over the centralized policymaking bodies shall not be restrained, let alone prohibited, as it promotes the desired diversity, internal competition, and culture of heterogeneous critical analysis within the system.<sup>1587</sup>

**(12)** *Moderate interferences of ICBs in the Electoral-Representative Process.* The bidirectional relationship between ICBs and political branches and actors includes efforts of the former to influence the latter.

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<sup>1586</sup> Art. 14.4. ESCB-Stat, (MERSCH, 2017).

<sup>1587</sup> (BINI SMAGHI, 2013), (SMITS, 2015).

On the other hand, if ICBs want to be devices of non-partisan politics, they must be careful not to become actors of the partisan game. They should exercise self-restraint particularly in moments of heated partisan conflict, such as periods of election and of key political decisions.

Advice on issues within their fields of competence and expertise is normatively desirable.

But during those heated partisan conflicts, they should be extra careful not to become weapons of partisan warfare or be perceived as trying to tilt the electoral balance towards any one side. They should minimize their interventions in those contexts and make them the most objective and impartial possible.

In the period prior to elections, ICBs should adopt a rule akin to the “quiet periods” they have before policy meetings.

In order to preserve their vocation to non-partisan politics, central bankers should not be allowed to take, run, or campaign for political office, and they should not engage, nor participate in activities of political parties.

Moreover, they should abstain from exerting covert pressure over political branches.

#### **8.3.4. REGULATING EXTERNAL REVIEWS OF CENTRAL BANKING**

The *external review and auditing of CB policy decisions and implementation* are indirect channels to interfere with the independent policymaking of CBs<sup>1588</sup>. If they are to be of some consequence and utility, they have to somehow bite such independence. That impact depends *on the object or scope* – which functions are reviewed, ranging from general operational and financial management of the CB to the conduct of internal monetary policy. It also depends on which aspects are analyzed, from procedures to substantive choices and from financial audits to performance-based audits that may or not include the exercise of policy discretion. However, it also depends on the *consequences* of the reviews, which may go from mere transparency and flagging of problems detected to sanctions and remedies on the institution or the concrete decisions. The protection of independence recommends a negative relationship between scope and consequences of the review.

It should be noted, though, that such forms of accountability also contribute to the protection of independence in a less obvious way. While confronting the CB procedures and decision-making, the reviewers become a check on undue influences and deviations of CB power in the interest of third parties. Their interference enters into competition with and potentially weakens the efforts of other Influencers.

There are at least five types of external review with different degrees of risk for CBI:

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<sup>1588</sup> (CONTI-BROWN, 2016).

**(13)** The *regular audits by private audit companies*, that tend to be the least menacing for independence as they focus on financial management aspects for informative and flagging purposes.

**(14)** The *external technical or policy auditing by (apolitical) public institutions*, such as the OLAF and the EU Court of Auditors and national audit agencies for the ESCB, or the Office of Inspector General and the General Audit Office for the Fed, and the Comptroller and Auditor General for the BoE. The independent nature of the public auditors and the limited scope of their audits, which typically refrain from reviewing discretionary monetary policy, mitigate the risk of political instrumentalization

**(15)** *Special audits or reviews by independent audit companies or external committees* conducted to investigate specific episodes, practices, or policy initiatives can scrutinize discretionary judgments, yet they do not have binding effects on the analyzed decisions.

Such reviews should be mandatory or highly recommended in the case of erroneous or highly contested situations.

There is a preference for external exercises, and some degree of transparency is necessary, provided that rules on privacy and bank secrecy are respected.

**(16)** *Administrative appeals to the finance minister or the Cabinet are generally not applicable to the policy decisions of ICBs* as they would amount to a specific Executive veto or override.

Regarding internal mechanisms of hierarchical appeal, they are also not available for the main monetary *policy decisions* where the policy board or committee typically decides in the last instance/resort. Such possibility might exist in the implementation acts of the governor or some executive body of the CB.

In adjudication-like decisions in supervision or resolution functions, where the CB decisions impose sanctions or restrictive measures on concrete financial institutions, it is convenient to create a regime of internal reviewability.

**(17)** The various *mechanisms of political accountability* expanded immensely to become central tools of *ex post* control by political branches and the public.

Their scope is hard to limit, as it would be democratically strange to restrict the issues and questions that DRs and the public may pose to the CB.

Central bankers have gradually moved to a world of transparency and responsivity where the famous central bankers' refusals to respond and explain would be unacceptable. Therefore, the protection of CBI is concentrated on containing the direct consequences of political accountability, which tend, in general, not to affect specific policy decisions immediately.

The limitation of specific, legally binding effects does not exclude mediate consequences in the form of subsequent personal, financial, or statutory sanctions on the central bank(ers).

**(18)** *The judicial review of specific actions of ICBs* is expected to be the most intrusive of all forms of external review, as courts may annul concrete policy decisions and issue binding orders to ICBs.

The strong tradition of judicial independence gives hope that judicial review will not become an instrument of majoritarian control, but caution is required to avoid the judicial process instilling systematic minoritarian biases into ICBs' policymaking.<sup>1589</sup>

The rule of law imposes the substantive judicial reviewability of all exercises of public power, which no CBI protection can prohibit. However, courts have and should voluntarily adopt a deferential approach to ICBs' discretionary policymaking because they have neither the specialized expertise nor the democratic credentials of pluralistic ICBs.

In this "clash of independents", their self-limitation to the review of procedural failures and gross substantive excesses of ICBs' actions strengthens the latter's independence.

Courts should be the designers and arbiters of the boundaries of deference.

#### **8.3.5. FOSTERING SPECIALIZED EXPERTISE, PROFESSIONALISM AND CRITICAL DELIBERATION**

Specialized expertise is a justification, a condition, and determinant of the delegation to independent experts. Technical specialization of public governance institutions is incompatible with their partisanship and colonization by political parties<sup>1590</sup>.

In the upper stages of development such specialized expertise evolves into *professionalism* as a source of social control and to the formation of epistemic communities, both of which are, potentially, amongst the greatest friends of CBI.<sup>1591</sup>

Therefore, a comprehensive framework of CBI must include provisions to strengthen the specialized expertise and the professionalism of ICBs.

It is like the strategy for a healthy life that requires both protecting against external threats (avoiding unhealthy behaviours and taking immunizers) and exercising the body and soul to make them stronger.

It is important to care for both the quantity and quality of expertise and of the public deliberation, including promoting a culture of critical deliberation, knowledge-based decision-making and openness to innovation."

Other protections elsewhere in this chapter also contribute to these epistemic enhancement strategies, including external audits and the regime of pluralistic appointments with intervention of experts in selection and eligibility requirements filtering for knowledge, expertise, and diversity.

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<sup>1589</sup> (KOMESAR, 1994).

<sup>1590</sup> (OTERO, 2003: 294-5).

<sup>1591</sup> (VIBERT, 2007: 30-33), (MARCUSSEN, 2009), (LASTRA, 2015: 69-70), (MILLER & WHITFORD, 2016: 141-154).

A few others should be adopted:

**(19)** *Duty to invest in the development of specialized expertise.* CBs have long been amongst the institutions, public or private, that invest more in developing their specialized expertise. They are amongst the largest first-hand collectors of economic and financial statistics and the most respected economic forecasters. They run some of the largest economic research departments aimed at providing a “strong conceptual and empirical basis for policy-making”<sup>1592</sup>, and they are prolific publishers of papers and reports and organizers of regular seminars and conferences that expose their leaders and staff to external ideas and the latest advances in the field.

They recruit technically competent people and train them. They sip loads of first-hand information, namely by conversing with economic agents and markets, cooperate and compete actively with academia and external research centers, and interact intensely and exchange information and knowledge with fellow CBs around the world. They do it both episodically and through connections and networks they build with other organizations and their researchers. All those activities consume significant financial, human, technological, and time resources. CBs have the duty to make such investments, and neither the law, nor political authorities should curtail their autonomy and duty to make those resource allocations.

**(20)** *Fostering professionalism with critical deliberation.* Central bankers have built epistemic communities in and through which they developed professionalism.

CBs do well in embracing both agency-based and socialized professionalism<sup>1593</sup>, because they hold and promote the epistemological superiority, integrity and the political insulation of the art and science of central banking.

They should make efforts to cultivate the social code and the mechanisms of professionalism: training, professional discipline by peers, professional standing and reputation as main performance indicators, strong networks of like-skilled peers, a culture of neutrality (non-favoritism), and disconnection from political cycles and instability<sup>1594</sup>.

However, professionalism and epistemic communities create their own risks of biases and capture. The risks of collective cognitive biases (especially hubris and groupthink) and interference of self-interests and attitudes may create favoritism and policy preferences that are not representative of the polity. By definition, neither is the group of professionals representative of society at large, nor are their processes democratic.

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<sup>1592</sup> (TRICHET, 2007).

<sup>1593</sup> (MILLER & WHITFORD, 141-167).

<sup>1594</sup> *Idem*.

Epistemic communities and professions tend to form a closed world, an insulated elite with their own discipline who see themselves as a self-effacing class that does not actively court the public limelight nor cares for public or politicians' approval.<sup>1595</sup>

In addition, they cultivate close proximity with markets, certain specially interested minorities, and the businesses they regulate, with whom they need to be particularly conversant in the gathering and processing of detailed first-hand information and policy inputs to implement policy outputs effectively<sup>1596</sup>.

Therefore, CBI also requires caution with professionalism and the failures of epistemic communities.

They can be friends but also foes of CBI. Thus, they have to be promoted under conditions of moderation and impartiality.

To mitigate risks, ICBs should actively promote critical deliberation, both at leadership and staff levels: (i) enhance internal heterogeneity and diversity of skills and experiences, ideas and technical views, personal characteristics, and home geographies; (ii) stimulate an internal culture of critical thinking and openness to dissent; (iii) encourage methodological and policy innovation; (iv) regularly entertain improbable extreme scenarios and counter-factual testing; (v) subjection to external review and competition of ideas<sup>1597</sup>; and (vi) institutionalization of assessments of past performance.

**(21) *Limiting authority of senior staff.*** In organizations where top leaders are typically selected from outsiders and have time-limited tenures, the most senior staff below them gain obvious preponderance. Their accumulation of expertise and knowledge of past experiences, together with their longer time horizons in the organization and external irremovability, gives them great authority. Such authority is often recognized, e.g., by giving them a contributory non-voting role at the table of the policy committee, as in the FOMC. They often have decisive roles in shaping policy decisions through their intervention in agenda-setting, providing and filtering information, and framing the discussion and policy alternatives.

Such skilled, experienced, and authoritative people protect CBI by enhancing the institution's epistemic superiority and resistance against external pressures.

On the other hand, it is necessary to balance their often-disregarded authority.

One strategy is to have the ICB's top economist and lawyer politically appointed.<sup>1598</sup> However, this proposal maintains (or increases) their authority but changes their incentives to be more

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<sup>1595</sup> (VIBERT, 2007: 30-33).

<sup>1596</sup> *Idem.*

<sup>1597</sup> (TRICHET, 2007).

<sup>1598</sup> (CONTI-BROWN, 2016).

aligned with the political process, which poses the risk of weakening the epistemological and impartiality advantages of their professionalism and long service at the ICB.

Another alternative is to limit the *de facto* authority by clarifying their agenda-setting, information-filtering, and alternative-framing roles and imposing diversity and critical proceduralism on them.

**(22) Internal control structures.** The institutional design of CBs should be structured to create internal bodies and procedures for the supervision, audit or review of their management and policymaking practices. The specific internal governance may vary with the public or private origin of the institution and the corporate or administrative law regime currently applicable.

One option is to divide governance according to some functional segmentation, with a general governing body and specific policy committees for (some of) the main functions of the ICB – e.g., monetary policy, financial stability, prudential behavior, payments systems oversight, as in the Fed, BoE, Bolsr and RBA.

Others are divided in general councils and executive boards<sup>1599</sup>, in boards of directors and supervisory boards or audit committees<sup>1600</sup>, or even more divided still<sup>1601</sup>. Some countries grant the governor extensive executive powers, albeit policy decisions have become mostly collegial. This internal division of powers institutionalizes a system of checks and balances that tends to protect CBI by simultaneously promoting (and controlling for) better decision-making substantively and procedurally and by checking and dissuading external influences, namely from partisan actors.

Another strategy is *personal dissociation*, by integrating outsiders in the policymaking body who should be experts in the field and external to the CB. As they are not in exclusivity in the CB, there should be a special concern with preventing conflicts of interest with their other jobs, responsibilities, and interests.

**(23) Institutionalizing external expert input through diverse advisory committees** created within the sphere of CB so that the “decision-making group ... receive[s] input from as far outside its own boundaries as possible, bringing in “outside experts” to “challenge the views of the core members”<sup>1602</sup>.

It is harder for the ICB to ignore the advisory committees than one-off conferences and other external consultation initiatives.

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<sup>1599</sup> ECB, BoFra, Buba, and Riksbank (whose General Council governs an Audit Unit).

<sup>1600</sup> Bolta, Bolsr, BoJ, and Nederlandsche Bank.

<sup>1601</sup> The BoPrt and SNB.

<sup>1602</sup> (CONTI-BROWN ET AL., 2021: 25).

Compared to *ex post* expert reviews, those committees have the advantage of anticipating contributions and critical viewpoints that might improve policy decisions and prevent avoidable policy errors.

These advisory committees should be *diverse*, “fairly balanced in terms of the points of view represented”, “need[ing] not only interdisciplinary diversity but intradisciplinary diversity”<sup>1603</sup>.

Either one broad and diversified or a combination of various specialized committees should “include[s] a wide range of scientific and technical disciplines” and have the “ability to integrate and cross-connect disciplines”<sup>1604</sup>.

The ICB should reach out when nominating their members, for instance, by soliciting public nominations for those committees or at least publishing a list of committee candidates – either a proposed “final cut” of members, a “short list” of candidates before the final cut, or a more general list of all qualified candidates – and solicit public comments on selections.<sup>1605</sup>

**(24)** *Regular and episodic review and evaluation of policy performance by experts* that provide critical but objective and knowledge-based assessment of past performance.

Public policy evaluation provides retrospective assessments of the implementation, output, and outcome of ICB’s measures, which implies looking backward in order to be able to steer forward better.<sup>1606</sup>

ICBs should institutionalize such evaluation of their policy performances. The creation of regular review exercises does not dispense with episodic, extraordinary reviews whenever some notorious policy choice or macro- or micro-shock occurs.

Many of ICBs’ annual, semi-annual, or quarterly reports, usually published and submitted to the political branches, provide some regular, internal evaluation.

However, these reports are self-interested and tend to be more descriptive than analytical, so they are less likely to be as critical as convenient.

Ideally, policy reviews and performance assessments should be made by independent committees of specialized and internationally respected experts, and their results and reports should be made public<sup>1607</sup> and submitted to the legislative bodies for information.

They should scrutinize the exercise of discretion, its substantive choices and policy procedures and practices, with the expectation that their conclusions and recommendations and the serious reputational sanctions they inflict may contribute to the CB’s self-improvement, or even some legislative change.

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<sup>1603</sup> *Idem*, 30-31, 61-64.

<sup>1604</sup> *Idem*.

<sup>1605</sup> *Idem*.

<sup>1606</sup> (VEDUNG, 2000).

<sup>1607</sup> Provided that the confidentiality of specific information is preserved (FROMAGE ET AL., 2019: 14).



ICBs should commit to respond publicly and thoroughly to those reports and to each of the respective recommendations and to act upon them if not unjustified<sup>1608</sup>.

One step further is to institutionalize the evaluation of the ICB's policy performance through the creation of an Independent Evaluation Office (like the BoE's<sup>1609</sup>), entrusted with the regular reviews of the performance the distinct aspects and functions of the ICB.

### **8.3.6. EXPANDING DIVERSE ACCESS TO THE CENTRAL BANKING PROCESS**

The skewed distribution of stakes of monetary and financial policies tends to generate systematic minoritarian biases in favor of private financial interests, with concentrated, high per capita stakes and abundant resources to pay for elevated costs of access to such technical and complex policymaking. On the contrary, workers and citizens in general have diffused, lower per capita stakes and less financial and attentional resources to participate.

However, the engagement and participation of the public and of diverse affected interests and stakeholders, other than that special financial Interests Group, is fundamental to foster the comparative institutional advantages of modern central banking.

They upload more and diverse information and critical viewpoints to the decision process and download information and explanations about the policies improving their implementation and credibility.

They foster public contestation, accountability, and democratic legitimacy of the ICB and its policies, and check and compete with other Influencers that could otherwise dominate policymaking.

Therefore, a fundamental component of a pluralistic framework of CBI is to balance representation, level the ICB participatory playing field, lower threshold costs of access to the central banking process, and include active policies to positively promote impartiality, including the equalization of resources.<sup>1610</sup>

CBs have to make it part of their job description to reach out beyond their own epistemic community and relations with political branches and create a productive and collaborative, direct and bidirectional political relationship with the citizenry.<sup>1611</sup>

**(25) *Promotion of financial citizenship***, as the first condition to effectively broaden the engagement and inputs from the public and diverse stakeholders.<sup>1612</sup>

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<sup>1608</sup> (BoE, 2013).

<sup>1609</sup> Produced ten thorough reviews since its creation in 2010 (BoE, Independent Evaluation Office). Similar proposals (CONTI-BROWN ET AL., 2021: 63, for the FOMC), (FROMAGE ET AL., 2019: 14, for the ECB's actions in the SSM).

<sup>1610</sup> (ALEMANNO, 2020).

<sup>1611</sup> (RILES, 2018: 67-8).

<sup>1612</sup> *Idem*, 44-48.

This is a prescription of a general approach or attitude where ICBs adopt “political equality by design”<sup>1613</sup>, and that includes various aspects. A similar perspective has coined this mission as the “3E’s of CB communication: Explanation, Engagement and Education”.<sup>1614</sup>

It involves informing and explaining the economic situation, problems, policies, and actions but it also requires adjusting and simplifying the language and media of communication. It includes reaching out via social media, de-biasing the framing which is normally highly technical, and in the case of the ICB, adopting multilingualism.

It implies ICBs take up the task of financial and economic education of the citizenry,<sup>1615</sup> for which they should identify the knowledge gaps of the people and work with them to fill them.

Particularly in the fields of financial supervision and payment systems oversights, it may include the creation of consumer empowerment programs, namely through consumer organizations that aggregate low dispersed stakes.

**(26)** *Balancing transparency and communications in layers* to maximize the amount, rigor and quality of information and data provided to each audience.

As explained above, transparency can be a mixed blessing, so the regime ought to be adapted to minimize risks and maximize advantages.

CBs learned to communicate and be transparent for their first audiences: expert CB watchers and political actors. However, the depth, quantity, and complexity of the communications adequate to those audiences is excessive to the broader public.

Lay people and less knowledgeable stakeholders become overwhelmed, lost, and finally lose interest if that is the only form and content of information available. The cost to decode and interpret it is just too high in comparison with their stakes.

Therefore, to lower the cost of access to the public, CBs should layer and customize their transparency and communication. They should separate transparency to the political branches to whom they are accountable from transparency to the broad public. The former receive unrestricted information in terms that eliminate informational asymmetry, while the latter do not receive information that is confidential, raises concerns with privacy, or could aggravate financial stress.

The layer of the epistemic community should receive more and better information and explanations, while the public should receive the same underlying content and analysis but in a simpler and more relatable form. Different types of media outlets should be privileged for each layer of communications.

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<sup>1613</sup> (ALEMANNO, 2020).

<sup>1614</sup> (HALDANE ET AL., 2020).

<sup>1615</sup> (HALDANE, 2017), (HALDANE ET AL., 2020).

**(27)** *Structure and institutionalize public inputs and consultation.* CBs have developed mechanisms of bottom-up inputs to policymaking. It is not enough to rely on the individual and unstructured contacts of central bankers with organizations and people outside.

They should organize and channel the public and stakeholders' voices and interest in contributing and adopt a framework that includes participation, starting from the reviews of strategic frameworks and other high-level policymaking.

The need for such channels and mechanisms of low-cost public participation increases when the issues under deliberation by the CB are more important, transformative, conflictual, or prone to public contestation. That is the case when CBs are determining and announcing legal interpretations and major policy changes. Public consultation should then be mandatory<sup>1616</sup>.

ICBs should structure these channels in a way that reduces the costs of access and participation in the process, and therefore increases the number and diversity of bottom-up contributions, dissuading industry-concentrated participation.

They should organize them in order to improve the utility, sincerity, and depth of those inputs, and reduce the manipulation and interference from third-party intermediators.

A robust feedback policy, more timely, complete, and certain so as to ensure an effective feedback loop between those who have "shown up" and the policymakers, incentivizes future participation and builds the idea of a "reasoned opinion."<sup>1617</sup>

Organized participation creates a sort of escape valve for discontent citizens and stakeholders to express views and grievances with the system. It reduces distance and the feeling of being left behind that fuels populism.<sup>1618</sup>

To guarantee the quality and accessibility of participation, the ICB may create a "watchdog" or ombudsman of the overall accessibility to the public consultations and participation, including the nature of the interests represented and to check whether the policymaking body has taken into account the opinions expressed by the respondents and provided adequate feedback.<sup>1619</sup>

**(28)** *Develop an active policy of equalization of resources between and among parties to the policy process,* most notably through directing public funding to the Interest Group community, including public Interest Groups in order to build and sustain "the existence of a variety of countervailing organisations".<sup>1620</sup>

To foster positive impartiality by "levelling the participatory playing field" this active equalization may involve mechanisms such as decentralised grant-making to underrepresented voices,

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<sup>1616</sup> (CONTI-BROWN ET AL., 2021: 60).

<sup>1617</sup> (ALEMANNO, 2020).

<sup>1618</sup> Examples are the US Fed's Beige Book, Fed Listens and ECB Listens events mentioned in Ch. 4.

<sup>1619</sup> (ALEMANNO, 2020).

<sup>1620</sup> *Idem*.

investing in participatory capacity-building like a “lobbying aid” device inspired by the systems of legal aid, access to institutional research services that make information and expertise to under-resourced actors, advocacy skill-sharing services, “civic time-off”, and even a “lobbying tax” in the form of registration and/or a public consultation fee applicable solely on participating for profits groups.<sup>1621</sup>

**(29) *CBs should improve their expertise in public relations.*** There is science and skill in how powerful actors and public authorities communicate and relate with the public. CBs should invest in such expertise, ranging from tools (of sociology and anthropology) to understand the wider public and ordinary people<sup>1622</sup>, to skills of communication and mobilization of broader public and stakeholders to increase policy effectiveness and better navigate public contestation. Such expertise in this type of public relations is something in which politicians are expected to relatively excel. That might be one important reason for the appointment of politicians as central bankers.

However, since the appointment of politicians creates problems of its own, it should be restricted to those who left partisan politics sometime before, as described below.

ICBs should also open themselves to media coverage and journalistic scrutiny that may expose problematic behavior, mobilize public debate, and plausibly reduce or prevent capture from private interests that prefer to operate in backrooms and via secretive signals.

**(30) *Harness new technologies for direct dialogue.*** The revolution in digital communications and social media is transforming the possibilities of dialogue between CBs and the outside world. The spectacular advances in communication technologies, new apps, social networks, digitalization, crowdsourcing, big data, and artificial intelligence are crushing the barriers to interactions and the costs for both the public participants and the CB who needs to manage, extract, and use vast amounts of information and inputs.

These technologies expand the possibilities of large-scale participation and the capabilities for processing and aggregating many contributions, without depending on political and mass media intermediation and filtering. CBs should invest in technologies and resources to be as close as possible to the frontier of those new channels for public dialogue.

Types of innovation are the use of design-thinking and gamification that make use of game incentives in policymaking.<sup>1623</sup>

Combining technological and political innovation, ICBs may experiment with diversifying consultations via deliberative mechanisms, namely by introducing decentralized “minipublics”

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<sup>1621</sup> *Idem.*

<sup>1622</sup> (RILES, 2018: 67-8).

<sup>1623</sup> (ALEMANNO, 2020, citing the [regulationroom.org](http://regulationroom.org)).

deliberating on selected policy initiatives or using online deliberative polls, ideally with questions monitored by moderators and answered by competent experts.<sup>1624</sup>

**(31)** *Institutionalize corporatist Interest Group dialogue* based on sectoral or other non-partisan representation that includes central bankers, representatives of industry, labor, and civil society, and finance ministers. It could be an interesting avenue to remove from pure partisan politics the articulation of all the aspects related to the secondary objective of supporting general economic policies of the government/state/Union.<sup>1625</sup> Feasibility depends on national cultures of more corporatist or pluralistic Interest Group politics, with the EU's "Macroeconomic Dialogue" being an example.<sup>1626</sup>

#### **8.4. PERSONAL INDEPENDENCE**

The second pillar of personal independence limits influences over the members of the CB's decision-making bodies. It involves both *collective* and *individual* aspects.

##### **8.4.1. COLLECTIVE INDEPENDENCE**

The collective aspects concern the conditions of committee deliberation that preserve or promote the independence of decision-makers. They include:

**(32)** *Collegiality*, because "a group can defend itself better than a single person from various kinds of pressures and influences, be they economic, psychological, political, or intellectual"<sup>1627</sup>.

**(33)** The principle of *decision by majority* rather than unanimity, as the former protects the committee from being held hostage by a single member who might have misguided motivations, and the latter tends to be more conducive to non-decisions or to biased decisions which are two evils that an independent CB must avoid<sup>1628</sup>.

**(34)** *One person-one vote* rules to emphasize that members participate in a personal capacity for their expertise and experience. The assignment of weights to their votes based on some representative logic (national/regional population, share of capital, etc.) tends to increase home biases<sup>1629</sup>. The Statute of the ESCB sets an exception "where patrimonial decisions are concerned (i.e. decisions relating to the ECB's capital or to the transfer of foreign reserves or to the allocation of profits and losses within the ESCB), the NCB governors' votes are weighted to reflect the share of each NCB in the ECB's capital"<sup>1630</sup>.

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<sup>1624</sup> (ALEMANNO, 2020).

<sup>1625</sup> (SCHMIDT, 2020).

<sup>1626</sup> (SCHMIDT, 2020), (LISI ET AL., 2022).

<sup>1627</sup> (PADOA SCHIOPPA, 2000).

<sup>1628</sup> *Idem*.

<sup>1629</sup> (PADOA SCHIOPPA, 2000), (ATHANASSIOU, 2014: 34).

<sup>1630</sup> (ATHANASSIOU, 2014: 34), Art. 10.3. ESCB-Stat.

**(35)** *Limitation of the participation of government representatives in the CB board*, which cannot be permitted “with a right to vote, even if this vote is not decisive”<sup>1631</sup>. The participation with rights to intervene in discussions and present proposals is in itself suspicious from a CBI perspective as it creates a channel to insert a principle of partisanship and majoritarianism in the ICB’s decision-making<sup>1632</sup>.

On the other hand, this solution adopted for the ECB enables the internalized dialogue and coordination between the CB and political institutions in an institutional environment that might be safer and more independence-protective than public formal exchanges as those between the British Chancellor of the Exchequer<sup>1633</sup>, or informal private discussions in the Executive’s offices as the practice obliges the Fed.

**(36)** *Rules of procedure of the policy committee that incentivize diversity and informed, active, and critical analysis and deliberation* by each individual member of the committee, which are powerful antidotes against groupthink, hubris, and other cognitive biases, and against external capture of the committee which would jeopardize CBI; and finally,

**(37)** *Balanced transparency about the committee’s opinion-formation, discussion, and deliberation*.

The principle of transparency should be weighed regarding the publication of each of the following elements: the minutes of policy meetings with or without individual attribution of remarks, proposals, and forecasts; the record of individual votes and background supporting materials; and the content of the decision and its explanations

Non-attributed transparency fosters democratic accountability and policy effectiveness.

More delicate is the publication of individual attributions that increases individual accountability and the channel of professional recognition, at the cost of complicating negotiation and compromises. In addition, it increases the likelihood of home or sectoral biases and the activation of the individual preference for popularity that incentivize central bankers to posture for their specific home or sectoral audiences and the public in general and thus sacrifices rational deliberation and consensus.

Strong chair (or staff) dominance and the development of a culture of compromise may strike a balance and mitigate the risks of disagreement and isolated capture.<sup>1634</sup>

#### **8.4.2. INDIVIDUAL INDEPENDENCE**

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<sup>1631</sup> (ARDA, 2006), (GRILLI, MASCIANDARO, & TABELLINI, 1991).

<sup>1632</sup> (IMFx).

<sup>1633</sup> The BoE FPC includes one Treasury representative – sect. 9B (1) (f) BoE Act.

<sup>1634</sup> (POSEN, 2022).

The protection of *individual independence* must control conflicting interests, biases, and the manipulation by Influencers of the relevant elements of central bankers' utility function, from job security to recognition, economic gain, power, and attitudinal factors.

On the other hand, it should enable the external inputs with positive effects on CBI, its good enough democratic control and legitimation, and the competitive checks that preserve epistemic and impartiality advantages.

That balance involves variable combinations of the following aspects:

#### **a) REGULATING THE APPOINTMENT CHANNEL**

**(38)** *Pluralistic selection and appointment of the governor and other members of the CB governing and policymaking bodies.*

The appointment of central bankers should follow a model of *plurality* (of actors and legitimacy principles) rather than *concentration*, where a single political branch would alone make the selection and appointment.

There must be some balance between asserting democratic control, protecting CBI, and preventing excesses of partisanship and instant majoritarianism<sup>1635</sup>.

The appointment process has two to three decision (and veto) points that may be assigned to distinct entities: (1) the selection and proposal; (2) the advice and/or consent; and (3) the appointment.

Plurality requires the involvement of more than one institution of government across those stages and that the intervenors have diverse legitimacy sources, i.e., different representation principles (e.g., electoral-representative, internal-technocratic, sectoral-corporatist, external-societal, competitive-merit based), or at least distinct compositions emerging from distinct elections.

The appointers are expected to strategize in order to get the consent from veto holders. They might successfully negotiate diversity and coalitions of interests or generate homogeneous median voters depending on the political culture, or simply fail to fill the seats when polarization is too intense.

In federal systems of central banking, like the Fed and ESCB, plurality also requires a combination of federal, centralized intervention with decentralized powers to appoint.

Pluralistic de-concentration obstructs the power of an instant majority to reshuffle the ICB's policymaking bodies, but it increases political independence.

Yet, it might even extend certain democratic credentials if the process requires the agreement of distinct democratic institutions or qualified bi-partisan majorities. That is not the case when

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<sup>1635</sup> (LASTRA, 2015), (CHRISTODOULOU, 2005).

the pluralism is materialized through a “double veto”, one belonging to a political authority and the other to a body of the CB or another independent public institution such as fiscal councils, courts of auditors, advisory bodies, or agencies of research.<sup>1636</sup>

Regarding who makes the selection (or short-list), the main alternatives are the CB governing board, the minister of finance, an independent committee of previous governors, an internal or independent external search committee, or a human resources consultant.

The recourse to panels of experts appointed by the Executive may turn into “deceiving depoliticization” and move the partisanship just one level up, as the experts are politically nominated and are human beings subject to the normal pressures of friendship, loyalty, and inducement.<sup>1637</sup>

Advice and consent might be required to bring in the input to the Legislature (specialized committee or upper house) or the CB when the whole process is conducted by the political branches.

The Legislature’s role, when it is facultative or mandatory, may go from prior hearing of the appointees to opinion, consent, and rarely the appointment. The requirement of bi-partisanship, namely through a qualified majority in a vote on the opinion, consent, or appointment, would increase democratic legitimation but add transaction costs.

A less demanding alternative to qualified majority is to subject appointees to adversarial legislative hearings with or without a vote of approval (by bare majority).

Parliamentary consent or politicized and partisan-driven nomination battles may increase democratic accountability, but they can also be counterproductive in polarized and paralyzed systems where the culture of compromise falters, leading to vacant seats that impair the efficiency and effectiveness of the ICB or undermining the credibility of appointed officials, without providing additional public confidence in government<sup>1638</sup>

The appointment can be entrusted to the Executive (cabinet or minister of finance), the democratic Head of State (if a monarch, the role is normally ceremonial), or a parliament’s committee or upper house.

A contentious possibility is whether to allow private outsiders to appoint a minority of central bankers. When those outsiders are stakeholders, it raises serious problems of conflict of interests, particularly if it is an uneven-handed prerogative given only to certain sectional interests, such as the financial sector or business representatives.<sup>1639</sup>

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<sup>1636</sup> (BELLING, 2020).

<sup>1637</sup> (LASTRA, 2015: 75).

<sup>1638</sup> (Forester, 2017).

<sup>1639</sup> Art. 4 FRA for the Fed, and arts. 39 and 43 SNB Law.



In the USA, the appointment of RB Presidents, who participate with voting rights in the FOMC, allows for some intervention of the private banks which are stockholders of RBs. There has been some debate on the unconstitutionality of this solution for allegedly breaking the appointments clause, even though Presidents of RBs are selected amongst directors appointed by the Fed BoG and elected by public representatives.<sup>1640</sup>

Another possibility to increase plurality is through *internal hybridity* of the governing/policymaking body, with a mix of members appointed through distinct procedures and actors.

That hybridity is natural in federalist CB systems, but it also may occur in unitary ICBs where part of its officials are outsiders or the (politically appointed) governing board is made responsible for appointing the executive governor and/or deputy governors.

The ECB-GC with six executive members appointed at EU-level and 20 NCBs Governors whose appointment “is left entirely in the hands of their competent national authorities”<sup>1641</sup>, and the FOMC with seven Fed BoG members appointed by federal political branches, plus the RBNY President and four RBs Presidents who are full members on a rotating basis appointed in a hybrid system, exemplify the first case. BoE, BoCan, Sveriges Riksbank, and SNB exemplify the second.<sup>1642</sup>

In federalist systems, the appointment of decentralized members might or might not involve some centralist interventions in the form of a right of consultation or veto by the federal body, which exists in the Fed, but not in the ESCB.<sup>1643</sup>

The ECB’s hybrid model, with long and staggered tenures and heterogenous and un-synced European and national appointments to the ECB-GC, “obstructs a coordinated attempt across the Eurozone to steer the direction of the Governing Council”.<sup>1644</sup>

**(39)** *Transparency of the appointment process* is important to protect independence<sup>1645</sup> as it allows for the control of compliance with eligibility criteria and dissuades or exposes loyalties and secretive deals and *ex ante* policy negotiation. That transparency may include (i) the divulgation of a short-list of selectees (if applicable); (ii) the publication of the resume and credentials of the nominees, conclusions of the vetting process on potential conflicts of interests, demonstration of the fulfillment of criteria and justification for the selection; and (iii) prior public hearings of the nominees before the specialized parliamentary committee.

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<sup>1640</sup> Sect. 4 FRA, (CONTI-BROWN, 2016).

<sup>1641</sup> (ATHANASSIOU, 2014: 33).

<sup>1642</sup> (LEITÃO AMARO, 2022c).

<sup>1643</sup> *Idem*.

<sup>1644</sup> (VAN DER SLUIS, 2021).

<sup>1645</sup> (DALL’ORTO, 2020: 17).

**(40)** *Appointability requirements to constrain political selection and mitigate systematic biases and partisanship.*

Legal requirements imposed on who can be appointed as CB official typically follow a combination of the following strategies (i) expertise; (ii) non-partisanship; (iii) corporatism; and (iv) geographic, personal, or ideational diversity.

(i) The expertise strategy consists of requiring that appointees have demonstrated knowledge, qualification, standing, and/or experience in the fields of policy conferred to the CB (e.g., monetary, financial, and banking).

Knowledge or experience in certain sectors of the economy may be required but with precautions to avoid importing loyalties to sectional interests.

In the case of non-executives, the demonstration of skills necessary to exercise oversight is also relevant.

(ii) The non-partisanship strategy involves excluding or restricting candidates who hold or have recently held political or partisan office or have (active) political affiliations that might suggest some partisan loyalty and/or the intention of serving in political office after the end of the CB tenure.

Traditional CBI seeks complete insulation from politics, and pluralistic CBI admits a balanced relation but offers ICBs as a democratic alternative to non-partisan politics. Therefore, both approaches see serious risks in partisan loyalty or bias and the appearance or likelihood of undesirable partisan interference in central banking.<sup>1646</sup>

The appointment of *current or recent* electoral or partisan actors is too big of a risk to personal independence.<sup>1647</sup>

There are two types of counter arguments. From a subjective perspective, such limitations would impinge on the political fundamental rights of individuals.

Objectively, they deprive ICBs of useful government and political experience that – as long as not at the expense of technical qualifications and expertise – could be beneficial for their art of governing, and increasingly so in the era of increased public exposure and contestation of central banking. In the era of new style central banking, the desired profiles, experience, and skillsets to govern a more politicized CB may be less like pure technocrats and a bit more like politicians.<sup>1648</sup>

Moreover, most politicians-turned-central bankers were finance ministers, who tend to have more expertise and potentially less partisan loyalty. On the other hand, it increases the risks of conflicts of interest between the two roles. The individual could use the CB clout, policy tools

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<sup>1646</sup> (BINI-SMAGHI, 2008, 446, 451–452), (ATHANASSIOU, 2014: 33, 40).

<sup>1647</sup> Recommendations for IFIs (OECD Principles, EU COMp, common principles, nr 7; EU NETWORK OF INDEPENDENT FISCAL INSTITUTIONS, 2016).

<sup>1648</sup> (TORTOLA, 2020).

and informational asymmetry to cover up, (deceivingly) justify, or shift blame for her past actions and policies in the Executive.

Surprisingly, the ESCB, supposedly the most independent of CBs, seems to be the closest to “cross[ing] a red line.”<sup>1649</sup>

Both President and Vice-President of the ECB-EB and multiple NCB Governors are former political officials in national governments and in EU institutions.

The decisive normative criterion should be the temporal proximity to the functions. No elected or partisan actor should be able to transition directly or after a short period from electoral or partisan politics to the ICB.

The adequate length of that cooling-off period should be defined according to the electoral cycle in order to impose the necessary distance.

A reasonable solution would be to prohibit the appointment as central bankers of individuals who serve or served as elected or appointed members of parliament, of the cabinet/government, and of the leading bodies of political parties in the current electoral cycle and at least within the past two or three years (if the electoral cycle was after that).

On the contrary, the appointment of former (and inactive) politicians, with adequate expertise and longer temporal distances from office, should even be encouraged to supply the ICB with useful skills to master the democratic embeddedness of modern ICBs.

This requirement of partisan distance applicable to the members of the ICBs’ governing bodies shall not be applicable to their staff.

In smaller countries, depriving the electoral-representative process of access to the uniquely qualified pool of human resources of ICBs is a luxury they cannot afford.

For big and small ICBs and countries alike, hiring staff with “strong political contacts” and savviness helps ICBs navigate the world of heightened politicization and assists their officials in avoiding falling into the traps and domination by the partisan game.

Staffers do not have the power to make policy decisions, the status and compensation, nor the limited duration of tenures that, in the case of CB officials, offer justification for the temporary restriction of their fundamental rights to political participation. What is a proportional restriction for appointed central bankers would be excessive for staff, often on permanent contracts.

(iii) The corporatist strategy consists of reserving a fraction of seats to representatives of stakeholders in the socio-economic process, such as labor unions, consumer associations, NGOs, non-financial business associations, representatives of financial institutions, institutional investors, and large savings organizations.

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<sup>1649</sup> (MARSH, 2020).

The Fed, and more notably its RBs, assume the representation in CB bodies of sectoral interests, such as “financial, agricultural, industrial, and commercial interests” and smaller community banks, “services, labor and consumers”.<sup>1650</sup>

An intermediate alternative would be to politically select a limited number of individuals specially attuned or informed of the specificities of those different sectors regardless of any current affiliation.<sup>1651</sup>

This corporatist strategy creates the serious risk of institutionalizing elements of sectional capture and jeopardizing the epistemic capabilities of the policymaking bodies.

(iv) Finally, another strategy is to establish requirements of geographic, personal, or ideational diversity of appointees.

Geographic criteria are more common in federalist or federations’ central banking systems. By definition, they operate at the level of the leaders of the decentralized units (NCBs and RBs), but they can also be imposed by law or convention in the federal board (ECB-EB, Fed BoG, SNB).

National citizenship is a common but not universal requirement. It tends to increase the alignment with the national public interest and mitigate the influence of foreign interests, but the acceptance of foreign appointees would expand the pool of highly qualified candidates (more important for smaller countries) and increase their distance from domestic partisan struggles.

It is possible to impose, by law or convention, gender, ethnic, or religious diversity through some sort of quotas.

On the contrary, it is more difficult to establish rigid criteria of diversity of economic views, let alone of ideological preferences.

However, such theoretical-ideational diversity, interdisciplinary and intradisciplinary, may be epistemically enhancing, as long as appointees demonstrate serious knowledge and expertise.<sup>1652</sup>

As to ideological diversity, it relies essentially on the rotation of appointing political majorities, each being expected to select candidates more aligned with their views.

**(41)** *Long and staggered tenures* are indispensable to mold the appointment channel within the democratic control but shield it from short-cycled electoral and partisan majoritarianism. Staggered terms, by law or convention<sup>1653</sup>, should secure both that appointments expire at different times and the non-concurrence of tenures with the electoral cycle.<sup>1654</sup>

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<sup>1650</sup> Sects. 10 (1) and 4 (10)-(12) FRA.

<sup>1651</sup> (LASTRA, 2015: 70).

<sup>1652</sup> (CONTI-BROWN ET AL., 2021: 31).

<sup>1653</sup> Sects. 10 (2) and 4 (24) FRA for the Fed and Schedule 2A, Sect. 1 (2) BoE Act. In the ECB it results from practice.

<sup>1654</sup> (BELLING, 2020).

They seek to prevent any partisan majority from appointing most of the members of the ICB board and policy committee within the same electoral cycle. This means that at each moment in time, the composition emerges and results from the will of not one instant majority but multiple successive majorities.

The sacrifice to the will of the instant majority is for the benefit of building a broader intertemporal super-majoritarian support and legitimacy and containing partisanship because, in competitive open democracies, alternation of parties in government across electoral cycles is expected.

Long tenures also contribute to CBI by extending the distance between the central banker and the political actor that appointed her and by fostering stability and continuity in CB policymaking and implementation, which reduces monetary-policy uncertainty and output variability.<sup>1655</sup>

Regarding the optimal length of central bankers' terms of office, it should be longer than the electoral cycle, with a recommended minimum of five years or higher as the electoral cycles are generally of four or five years (except in the US, where the House of Representative members are elected every two years). CBs that are more independent in general tend to have longer tenures (varying from five years in the NZRB, RBA and Riksbank, to the eight years for ECB-EB Members and the Governor of the BoE, and a maximum of 14 years for the Fed BoG).

On the other hand, they should not be too long, at the risk of inducing lethargic policy management by governing bodies,<sup>1656</sup> impairing *ex ante* democratic steering through the appointment channel, reducing accountability,<sup>1657</sup> perpetuating bad policies and policymakers and preventing the People from indirectly correcting poor policy courses.<sup>1658</sup>

Furthermore, when the statutory length is too long, it might become a dead letter, as in the USA, where the effect of very long, overlapping terms is diluted in practice because board members almost never serve full terms.<sup>1659</sup> It provides a telling example of the chasm between the law in the books and in practice and how *de facto* CBI may depart from *de jure* CBI.<sup>1660</sup>

The Fed's very long 14-year, staggered terms are nominally the most protective of CBI, but in practice the large majority of the members of the Fed BoG has left office before the end of their term, creating situations where many seats are up for appointment within the same electoral cycle – it has been called the “myth of the governors' fourteen year term”<sup>1661</sup>.

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<sup>1655</sup> (OECD, 2022: 174).

<sup>1656</sup> (BRENTFORD, 1998).

<sup>1657</sup> (AMTENBRINK, 1999: 49).

<sup>1658</sup> (WALLER & WALSH, 1996: 141).

<sup>1659</sup> (BERNANKE, 2015: 48).

<sup>1660</sup> (CONTI-BROWN, 2016).

<sup>1661</sup> (CONTI-BROWN, 2015 and 2016).

The constitutionalization of the tenure's length has the advantage of preventing "legislative dismissals", i.e., that legislators pass laws that, with effects on the ongoing offices, shorten the length of terms (done recently in Turkey) or anticipate the compulsory retirement age<sup>1662</sup>.

**(42)** *Prohibition or limitation of reappointment* is a common protection of CBI, as it prevents political branches from using that power as lever of pressure on incumbent central bankers.

As described above,<sup>1663</sup> major CBs have hybrid regimes, with only a minority of their voting members being barred from any reappointment.

Yet, the effects and reasonability of strict limitations to reappointment should be pondered together with the length of the terms and their synchrony with the electoral cycle. Long and staggered tenures tend to reduce the political sway given by the power to reappoint. Moreover, in such conditions the possibility of reappointment may actually invert the direction of subordination, as in the USA where the longest serving Fed Chairs seemed to be more dominant than dominated by instant political majorities and the president.

One alternative approach to prohibition would be "to tie the central banker's reappointment to actual inflation [and output] outcomes". The reappointment would then create an incentive for optimal (inflation-unbiased) policy. However, there are too many difficulties of implementation and risks of divergence in interpretation, namely in the presence of supply shocks where the mechanism would need to be contingent on the underlying shock, which would create a backdoor for political arbitrariness and manipulation.<sup>1664</sup>

**(43)** *The prohibition of arbitrary or free dismissal of central bankers by political authorities* is one of the most decisive protections of CBI.

Chapter 5.3.4 analyzed the political power to remove central bankers and how both legal extremes of free political removal and absolute irremovability are normative and positively inadmissible.

With notorious differences, all major CBs constrain the free removal through the combination of two legal techniques: tenures with terms of years, and imposition of conditions on removal (which were comparatively analyzed above).

Even where those conditions are more lax as in the USA, the practice has proven that political removal of central bankers prior to the end of their terms is rare and *de facto* hard.

Legal, institutional and cultural barriers against the free or arbitrary dismissal of central bankers by political authorities must be complemented by credible, time-effective, and independent

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<sup>1662</sup> (EMI, 1998).

<sup>1663</sup> Ch. 5.2.4.

<sup>1664</sup> (WALSH, 2002).

mechanisms to enforce such prohibition and the correspondent limitations, including the indispensable judicial review by independent and accessible courts of law.<sup>1665</sup>

**(44)** *Prohibition of participation or interference in partisan politics.*

The reasons offered to prohibit politicians in office from being directly appointed to the ICB<sup>1666</sup> are applicable to prohibit central bankers from any elected or appointed political or partisan office or activity or engaging in campaigning or political donations.

Likewise, the justifications for ICBs to moderate interferences in the electoral-representative process<sup>1667</sup> serve to demand individual self-restraint from central bankers in public interventions where they might be perceived as taking sides or seeking to influence hot political rifts or tilt electoral races. When public debates are heavily contested by political parties, ICBs should keep within their fields of expertise and the functional limits of their competences, framing their interventions in objective, facts-based and scientific terms.

**b) CURBING PRIVATE CAPTURE**

A pluralistic model of CBI must be concerned with partisan and majoritarian biases, but also with preventing minoritarian biases favoring specially affected groups, especially the “financial elite”. These private affected interests may use multiple channels to influence and capture central bankers, institutionally but also individually.

The various types of effort to capture<sup>1668</sup> work through present actions, loyalties built in past experiences, and expectations of delayed/future benefits.

A comprehensive CBI framework must combine positive pluralistic strategies with the more classic negative approach.

The positive involve developing adequate institutional capacity in terms of expertise and human, financial and material resources to prevent informational or epistemic capture, and mobilizing professionalism, the epistemic community, transparency, and democratic and public scrutiny to check on special interests’ interferences.

The negative approach consists of imposing limitations and obligations on ICBs situations, interactions, positions, and incentive schemes.

However, not all conditions and channels of potential capture pose the same degree of risk,<sup>1669</sup> and those limitations and obligations (may) restrict the central bankers’ individual rights and

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<sup>1665</sup> (LANGNER, 2020: 421).

<sup>1666</sup> See protection (40) above.

<sup>1667</sup> See protection (12) above.

<sup>1668</sup> Ch. 4.5.

<sup>1669</sup> *Idem*.

freedoms, raising constitutional suspicions. They may also impair or disincentivize the recruitment of capable individuals to the ICB.

Therefore, the design of such limitations ought to be governed by the principle of proportionality, with its demands of necessity, adequacy, and no excess considering the risks of effective or apparent harm to CBI.

Restrictions may go, in descending order of limitation from outright prohibitions (of accumulation of positions, post-employment opportunities, interactions, and financial holding or transaction) to casuistic impediments, the regulation of interactions and contacts, actions subject to case-by-case authorization by the CB bodies (or the government<sup>1670</sup>) to assess in concrete the risk and benefit for the ICB, and finally to transparency and disclosure obligations – and sometimes the situation may be authorized pursuant to a concrete verification of lower levels of risk.

Sometimes the risks are so great that the mere threat of a conflict of interest is sufficient to justify some limitation.

ICBs should not feel satisfied with whatever rules are legislated in statutory provisions, and they should, proactively or per legal delegation, adopt additional constraints in internal regulations, codes of conduct, or ethics.

The prevention of conflicts of interest takes the following forms:

**(45)** *Incompatibilities and prohibition of accumulation of other positions* deemed incompatible with the membership of the ICB's governing bodies, policy committees and even supervisory boards.

Permanent, internal members, in general, should have their job in exclusivity, remunerated, and full-time to avoid dispersion and deviation of the central banker's attention, effort, and availability. The FRA determines that the "members of the [Fed BoG] shall devote their entire time to the business of the Board".<sup>1671</sup>

A common legal technique consists of establishing a list of incompatible or disqualifying positions or activities that central bankers are prohibited from holding, namely: (i) political or civil offices in government, parliament, and public administration or in the public service at any federal, state or subnational level; (ii) any function in the financial industry, including the positions of director or employee of banks and other financial institutions, or their parenting organizations; (iii) other private sector jobs or services that involve engaging in commerce or working for any private company or trade organizations.

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<sup>1670</sup> Art. 61 (2) BoPrt Law.

<sup>1671</sup> Sect. 10 (1) of the FRA.



A less common incompatibility is officer or even member of any political party or movement, candidate in national or local elections, or actively engaging in political activities, in order to reduce partisanship.

Some legal exceptions may be established when the positions are held *ex officio* or in the interest of the CB, or if they are not paid, have lower degrees of risk such as teaching and other academic engagements or are non-executive functions in non-profit organizations that are not dedicated to sectoral representation.

Some incompatibilities may extend to central bankers' close relatives, spouses, and partners, and even children and parents.<sup>1672</sup>

The existence of an incompatibility may trigger one or various consequences, such as the *ope legis* resignation of the central banker<sup>1673</sup>, being the cause for removal or disqualification, or sanctioning with fine or imprisonment<sup>1674</sup>.

**(46)** *Casuistic impediments* to participating in deliberations and decision-making if the central banker has a direct or indirect personal interest in the outcome which conflicts with the public interest or interest of the bank. The impediment may be designed to prevent the receipt of information, participation in the discussion or voting. It is assessed and applies on a case-by-case basis and cannot include the policy decisions that affect the central banker in her general condition as an economic agent.

**(47)** *Post-employment limitations* to curb revolving doors, the manipulation of expectations or promises of future gains by “deep pocket” affected interests, the creation of unfair competitive advantages for the post-employer in terms of information or contacts, and the creation of new channels of privileged contact and capture between the former central banker and those that remained inside.

These limits can restrict the opportunities for office, position, employment, provision of services or some for-gain connection with financial institutions and other companies whose activity or interests might have been specifically affected by decisions and actions of the ICB.

However, they cannot be excessive because they restrict individuals' fundamental freedom to work.

Therefore, cooling-off periods typically have a duration of around two years<sup>1675</sup>, associated with payment of some compensation for the employability restrictions on the former central banker.

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<sup>1672</sup> Sect. 2-3 ch. 2 of the Norges Bank Act.

<sup>1673</sup> Art. 26 (2) BoJ Law.

<sup>1674</sup> Sect. 31 BoCan Act, art. 65 (v) BoJ Law

<sup>1675</sup> Sect. 10 (2) FRA, art. 31 SSM Regulation, (BRAUN, 2017).

What is not common is the imposition of cooling-off periods for posts in government or related agencies<sup>1676</sup>.

Faced with the legal impossibility of reappointing the central banker, political incumbents may try to entice her with the promise of future public or political office, with the respective honor, compensation, and perks. Or a DON BRASH or MARIO DRAGHI-inspired central banker might spontaneously start imagining a future move into politics that seduces her to adopt a more popular and possibly inflation-biased/electorally synced policy stance at the CB.

The cooling-off period may be complemented with limitations on the negotiation of post-employment opportunities while the central banker is still in office.

A less restrictive alternative to the prohibition is the requirement that all such negotiations are immediately disclosed to the CB.

A formal and transparent procedure should be instituted to assess post-office employment for senior CB executives, overseen by some type of ethics committee, rather than the governing bodies.<sup>1677</sup>

Such occupational limitations do not exonerate the central banker from much longer, or even perpetual, duties of secrecy on information acquired while in office, and limitations on future contacts with CB officers and staff in the representation of private sector actors.

Finally, the extension of incompatibilities, impediments, and post-employment limitations to the ICB staff cannot be as tight as it must pass the proportionality test.

**(48)** *The transparency of potentially conflicting interests* can be a decent alternative for situations and interactions that may give rise to conflicts of interest but whose prohibition or limitation would be excessive or inconvenient. Transparency protects CBI by publicly exposing the conflicting interests.

One stream of initiatives consists in creating public registries to which central bankers must communicate pertinent personal situations, past and present, such as background, education, occupation, political affiliation, past and present connections to the scientific community, economic gains in x number of previous years, gifts and any other permitted economic gains while in office, the wealth at the starting point and whenever relevant variations occurs, and material contracts or transactions that the central banker entered into with the bank.

Even though the privacy rights of central bankers may need to be compressed in the interest of preventing systematic biases of central banking, proportionality requirements justify that, instead of openly publishing all information, the access may be filtered in relatively easy

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<sup>1676</sup> (BELLING, 2020).

<sup>1677</sup> (BRAUN, 2017).

conditions to whoever demonstrates some relevant interest, including a journalistic, academic, or public interested investigation.

**(49)** *Regulating contacts and interactions with affected interests.* Informal interactions in meetings, calls, or some form of correspondence might be even more threatening for the integrity of independent central banking than formal, structured, and public exchanges.

As those interactions, from non-binding dialogues to cooperative coordination, are valuable for epistemic, functional, and democratic reasons, they should not be prohibited but proportionately regulated.

Three strategies can be combined: (i) imposing *specific restrictions on interactions*, namely “quiet periods” before and on the day of the policy committee meeting during which central bankers should not privately speak to investors, should avoid making comments that could influence expectations about policy decisions, and should restrict interactions with the media and market participants, including interviews or conference speeches.

(ii) *leveling the playing field and* equal access over time by different affected interests to the ICB, to guarantee fair treatment and participation of a wide range of financial actors and institutions. Specific solutions are organizing “analyst calls” for everyone, leaving the gathering of market intelligence to the staff, and creating a rotation principle both for central bankers to avoid the development of too close an affinity with those they regulate, and also for analysts who are regular CB watchers and represent leading financial market participants<sup>1678</sup>;

(iii) *transparency about those interactions with external actors*, including the publication of diaries or the agenda of public and private-but-official meetings, events, and contacts.

Considering the importance of controlling competitive influences, the registry of interactions should include individuals affiliated with or representing all the five groups of Influencers.

Whilst most meetings may and should be immediately disclosed, some contacts with political authorities and supervised institutions in sensitive moments may require some delay to avoid fueling panics and aggravating underlying risks.

A combined strategy is to require that private meetings with private actors and political officials are always attended by the ICB’s staff.

**(50)** *Protections of personal financial independence* by limiting the financial transactions and holdings, restricting external sources of pecuniary or economic gain received as gifts or in exchange for work or services, and prohibiting the owning of beneficial interests in supervised entities.

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<sup>1678</sup> (LAGARDE, Letter, 2021).

**(51)** *Protection and attractiveness of central bankers' remuneration* to preserve personal financial independence. The condition of *protection* operates mostly against political influences, and *attractiveness* against all Influencers, but resourceful private interests above all.

The prohibition or limitation of political or other external manipulation of central bankers' remuneration fosters CBI by preventing political actors from changing or threatening to change the remuneration as an incentive for central bankers to adopt their preferred policy choices. The aim is to neutralize the manipulation of the economic gain factor in the central bankers' utility function.

One way of protecting the manipulative exploitation is by trusting the CB to determine the remunerations of its officials and staff. However, they should not be left entirely free to decide their own compensation. Caution must be exercised because in the end they are paid with public resources and their credibility and reputation might be dented if their compensation is set too high, notably in comparison with the main elected political officials. Recently the BoE Governor BAILEY was chided for making a public appeal for moderation in salary increases in face of inflation when his annual salary exceeds half a million pounds<sup>1679</sup>.

Independent scrutiny or a compensation committee with external experts may assist in the determination of compensation policies and mitigate self-serving or misaligned decisions.

When political branches or subordinated bureaucracy has some say in the matter, they should be prevented from singling out the ICB's officials. One option would then be to treat central bankers together with other top public officials of various sectors, especially those whose functions are also highly technical, complex, and whose competing private sector jobs have attractive remunerations. If CB-specific adjustments are found necessary, then procedural and substantive constraints should prevent their use to press some circumstantial shifts in CB decision-making. For instance, any changes should only be applicable to future tenures, which would avoid pay cuts or rises on ongoing central bankers that could be perceived as sanctions or rewards for past behavior.

Contrary to other independent officials, such as judges, it would be counterproductive to legally protect central bankers against erosion of their real wages. It would mute their individual material incentive to deliver price stability.

*Attractiveness* is guaranteed by compensation packages that are market competitive for talented specialists. It preserves CBI in two perspectives: first, institutionally by enabling the hiring and retention of high-level professionals, who ensure the CBs' epistemic advantage and relative self-sufficiency, and the credibility of its knowledge-based decision-making; second, individually, as it puts central bankers in a comfortable economic position and thus less

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<sup>1679</sup> (REUTERS, 2022), (THOMAS, CAMERON-CHILESHE & GILES, 2022).

vulnerable to side payments or post-employment economic inducements that may shift loyalty to other actors.

One example of such guarantee is the legal reference in the Chilean law to benchmarks for central bankers salaries such as the “salaries being paid by the private sector banking institutions to their top executives”<sup>1680</sup>.

## **8.5. FINANCIAL AND ORGANIZATIONAL INDEPENDENCE**

Financial and operational independence concern the CB’s financial and resource capability to operate and make the policy decisions it sees fit without having to negotiate the consent of the political authorities and without being subject to the explicit or implicit dominance of external actors, particularly fiscal authorities and the financial industry.

The following are the most important aspects:

### **8.5.1. LIMITATIONS ON LENDING TO GOVERNMENT**

**(52)** *Limitations on CB lending to government or financing its deficits via CB credit.* The ability to resist government’s pressure for that purpose has been labeled the “economic test of independence”.<sup>1681</sup>

Limitations on monetary financing or government debt monetization aim to prevent monetary policy decisions from becoming subordinate to the fiscal needs of the government. Such political and fiscal dominance undermines the credibility of the CB and the trust in its ability to keep inflation low and stable. In the extreme, it could lead to hyperinflation, as in the well-known case of Germany and Austria in the mid-1920s, Zimbabwe in 2007-08, and more recently, Venezuela. However, the protection of CBI requires a balance that preserves the CB’s ability to withstand political pressure but falls short of closing all doors.

There is a general consensus – with the exception of some unorthodox economic theories such as the “*modern monetary theory*” – that monetary finance poses serious risks, and that its pervasive usage would seriously damage the independence and credibility of CBs, and sooner or later jeopardize price stability.

However, a full prohibition of any CB involvement with public debt would not be acceptable. To start with, government securities are essential for ordinary monetary policy operations, being purchased (and sold) by CBs in open market operations, repos and as preferential collateral in collateralized lending to financial institutions.

Moreover, CB interventions in sovereign debt markets may be necessary to prevent disruption (volatility, liquidity dry-ups) or fragmentation (especially in monetary unions) that would compromise the primary objectives of price and financial stability.

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<sup>1680</sup> Sect. 10 of the Basic Constitutional Act of the Central Bank of Chile.

<sup>1681</sup> (LASTRA, 2015).

Such risks are aggravated when the sovereign-banks nexus is stronger.

Furthermore, when CBs operate payment systems or the function of fiscal agency at least the grant of intraday credit to the government is operationally necessary to the efficient performance of both functions<sup>1682</sup>.

A complete prohibition would prevent politically dominated decisions. However, it would also prevent monetary finance operations and interventions in public debt markets decided exclusively and independently by CBs with the sole goal of ensuring economic stability”, foregoing “exceptional circumstances” where “monetary finance may provide helpful policy support”.<sup>1683</sup>

In abstract, there should be a difference in CB operations using/purchasing public debt instruments that do not amount to monetary financing, those that do but whose overall effects are beneficial in terms of the CB mandate and thus may be permitted under conditions, and monetary financing operations whose risks (may) overcome the benefits and thus should be prohibited.

Concretely, the dividing lines are unclear.

There are three possible criteria to define or regulate monetary financing based on: (a) the *instrument*, which would not include indirect financing through secondary market purchases; (b) the effect, which would admit operations that do not alter the fiscal constraint; and (c) the function or main objective, which would accept operations designed to preserve price stability or financial stability.

In the EMU, for instance, article 123 TFEU uses the criterion of the instruments, banning direct lending facilities and (primary market) purchases.

For a long time, the ECB invoked other Treaty provisions to use the criterion of effects and thus constrain indirect purchases in the secondary market that could relax national fiscal discipline. However, since the Eurocrisis, the ECB has been gradually changing to the functional criterion to justify that its massive secondary market purchases are not monetary financing because their purpose is to serve its primary objective of price stability or its intermediate objective of repairing the monetary policy transmission.

In the *Gauweiler* and *Weiss* saga, the CJEU endorsed this *functional* criterion.

More recently, when discussing the allocation of the costs associated with tasks given nationally to a NCB, the Court applied the functional criteria to differentiate two types of lending (to compensate losses related to the banking resolution). The Court accepted that a NCB can lend with the objective of compensating for damage due to serious infringement of its duty to

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<sup>1682</sup> Art. 20 Buba Act.

<sup>1683</sup> (AGUR ET AL., 2022).

exercise due care. But it decided that the lending to compensate certain groups' losses as part of a social objective is prohibited monetary financing.<sup>1684</sup>

The legal limitation of CB financing of the public sector and purchasing government debt may take the form of prohibition, imposition of limits and conditions, or merely excluding an obligation to extend credit to the government (or preventing the government from making such a request, formally or informally, to the CB).

The constraints may cover all or some forms of CB financing, including direct or indirect lending to the public sector – by granting credit facilities, overdrafts, and advances – and the purchase or holding of public debt instruments in the primary or secondary market. They should cover financing to national and subnational public entities, regardless of the form.

The constitutionalization of those legal limitations is stronger, but rare – it exists in the EMU, Sweden, Switzerland, Mexico, South Africa, and Chile.

In general, the *instruments* criterion is used to regulate *direct financing*. It is commonly prohibited, with limited exceptions such as intraday operations related to the payments system or fiscal agency services (ESCB, Norges Bank, SNB), certain facilities in the USA and UK (the “ways and means”, the British government’s overdraft account with the BoE), and a permission of a limited amount that the BolSr may temporarily advance to bridge a gap in the Government’s cash flow in executing its budget<sup>1685</sup>. The BoJ has a rare broad exception, allowing it to extend credit to the government “under special circumstances” and a ceiling approved by Parliament.<sup>1686</sup>

Indirect financing through purchasing in the secondary market follows the opposite regime. It is not legally prohibited in general, and it is regulated according to the criteria of effects (e.g., on the fiscal authority’s “impetus to comply with a sound budgetary policy”<sup>1687</sup>), and the functional objective of the ICB’s operation.

ICBs have increasingly alluded to the criterion of the objective, namely, to legitimize the massive interventions in sovereign debt markets since the GFC, but especially during the pandemic when they purchased in the secondary market a large part of governments’ net new debt issuances.<sup>1688</sup>

There is no point in denying that interventions of this relative size impact the conditions of sovereign financing and alleviate the fiscal constraint.

Moreover, they may trigger moral hazard amongst fiscal policymakers. In turn, the accumulation of large stocks of sovereign debt in the balance sheet of CBs risks putting them under fiscal

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<sup>1684</sup> CJUE, judgement on *Banka Slovenije* case, C-45/21 (13/08/2022), §75, (VAN DER SLUJS, twitter, 19.09.2022).

<sup>1685</sup> Sect. 49 BolSr Law.

<sup>1686</sup> Art. 5 of Public Finance Act nr 34 of 1947, and art. 34 BoJ Law.

<sup>1687</sup> CJEU caselaw in *Gauweiler*, *Weiss* and on *Banka Slovenije* (§72) cases.

<sup>1688</sup> (STUBBINGTON & ARNOLD, 2022), (GABOR, 2021).

dominance and vulnerable to financial losses when they have to start raising interest rates (paid by their interest-bearing liabilities, i.e., reserves).

The official reply has been two-fold: the first to classify those as side effects, which would allegedly be suppressed by limitations and conditions attached to their operations, such as imposing quantitative limits on the purchases and holdings, credit quality requirements, allocation of risks to the respective NCBs, and the conditionality of economic reforms (in the EMU); or requiring prior and explicit political authorization and indemnification of any losses incurred by the ICB (in USA and UK).

The second reply uses the functional criteria to justify them, arguing that “not all CB purchases of government bonds are alike, but they should be evaluated against the objectives of the interventions and the broader macro-financial setup of the economy”.<sup>1689</sup>

These post-GFC purchases of sovereign bonds, albeit massive, would not directly seek and serve fiscal policies, but macro-financial objectives “to anchor inflationary expectations and stabilise the inherently fragile market-based financial system, whereby sovereign bonds play a critical macro financial role”.<sup>1690</sup>

The ECB’s concerns with avoiding fragmentation – that led to flexibility in the reinvestment of the PEPP, the reassertion of OMT, and the creation of the new TPI – were justified with the intermediate objective of stable financial conditions to restore the monetary transmission mechanism and, thus, ultimately achieve the primary objective of price stability.

Even the conservative President of the Bundesbank admitted that “large scale purchases of government bonds can be a legitimate and effective monetary policy tool”<sup>1691</sup>.

It was argued that such interventions should not be interpreted as a return to fiscal dominance but “coordination without subordination”.<sup>1692</sup>

It is very hard to discern the point where CB interventions become less about preserving “their institutional dominance and discretionary power to intervene in sovereign bond markets” for the sake of their legal mandate,<sup>1693</sup> and more about keeping governments’ financing conditions under control, alleviating the fiscal constraint, and allowing activist fiscal policies for whatever purpose.

Even the most demanding legal provisions, such as art. 123 TFEU, use brief and vague language opened to constructive ambiguity.<sup>1694</sup>

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<sup>1689</sup> *Idem.*

<sup>1690</sup> *Idem.*

<sup>1691</sup> (WEIDMANN, cit. by REUTERS, 2020).

<sup>1692</sup> (SCHNABEL, 2020), (GABOR, 2021).

<sup>1693</sup> (GABOR, 2021: 6).

<sup>1694</sup> (VAN DER SLUJS, 2020), (VAN’T KLOOSTER, 2021).



It thus leaves the independent judicial branch to arbitrate whether practice circumvents the legal limitations and the prohibition of direct monetary financing.

Courts have the functional specialization to adjudicate the interpretation of the legal limits, but they tend to be deferential to the ICBs' exercise of discretion and judgment of the proportionality of side effects.

While the post-pandemic inflation surge will certainly be suggested as evidence that the economic and legal limits of monetary financing have been crossed, the historically high levels of public debt and the looming fears over the euro disintegration will push the CJEU into pragmatic accommodation that avoids tumultuous short-term effects.

If Courts are called upon to adjudicate the issue, there will be an independent institution controlling the politically thick actions of another independent institution, in a judicial judgment of enormous political significance.

### **8.5.2. PREVENTION OF FINANCIAL DOMINANCE**

**(53)** CBI demands *mitigation of risks of financial dominance*, namely by limiting the relative size of CBs' balance sheets and capping the relative importance of the CB operations on each market.

The continuous expansion of those balance sheets and their absorption of unprecedented amounts of securities since the GFC makes them vulnerable to market gyrations.

Furthermore, the importance they have acquired in financial markets and their policy strategies have made their transmission and effectiveness particularly sensitive to market reactions.

In the ongoing fight against high inflation, the flags are raised for the risk monetary tightening might have on financial stability.

ICBs display significant reluctance to circuit-break the addiction of markets to easy money.

However, they must regularly stress-test their balance sheets to control for excessive exposure to the various financial markets, and for the latter's "addiction" to their ongoing policy stance and the vulnerability to dramatic changes thereto.

**(54)** *Confront the failures of "market neutrality"*. For a long time, it has been argued that CBs' activities in the market should be neutral, in the sense of not substituting for the decentralized allocation of credit and preserving the market price-signaling mechanism. In their interventions, ICBs should be market-takers or followers.

The EU Treaties constitutionalize such a view by establishing that in all its functions, the ESCB shall act in accordance with the "principle of an open market economy with free competition, favouring an efficient allocation of resources"<sup>1695</sup>.

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<sup>1695</sup> Arts. 119 and 127 (1) TFEU.

However, financial markets fail and their competition is not entirely free and openly competitive. In monetary policy and other sizeable open market interventions, ICBs should avoid merely “taking” and amplifying all market outcomes, distortions, and failures.<sup>1696</sup>

Market neutrality cannot turn into blind acceptance of a defective status quo. An ICB cannot be dominated by such market status quo.

Whenever other policymakers are specialized in identifying such market failures (e.g., competition authorities, environmental agencies, or government), the CB should defer to them rather than to the defective markets or their own unspecialized voluntarism. The legal provisions that confer a second mandate to support economic policies of the Union or the government (e.g., TFEU, BoE Act) may provide the legal cover for this confrontation of market failures.

What CBs certainly cannot do is let their particularistic actions, for instance, in the context of collateral policy, support preexistent market failures and thereby boycott the regulatory interventions of other legitimate policymakers.

### **8.5.3. AUTONOMY OF CENTRAL BANKS’ FINANCIAL MANAGEMENT**

Governments can also affect the independence of CBs by interfering in their financial resources and management.

The tension is evident: on the one hand, CBs perform public functions and manage resources that ultimately belong to taxpayers – even when their capital is privately owned, seigniorage profits are supposed to be transferred to the Treasury. In democracies, the primary responsibility for the allocation of taxpayers’ money is assigned to political representatives and central bankers have a fiduciary duty on their “stewardship of taxpayers’ resources generally”<sup>1697</sup>. On the other hand, the “power of the purse” gives the political branches the ability to manipulate and control the actions of the CB by withholding or attaching strings to capitalization or backstop or to use of own funds, or demanding more transfers of profits, or imposing special taxes or levies on them.

Central bankers should be able to adequately balance policy with financial outcomes. The design of political and professional mechanisms of control of CBs’ financial management should allow useful signals to come through to shape appropriate incentives, create the trust that is needed for effective delegation and make decision-makers accountable both for policy and financial outcomes.<sup>1698</sup>

CBI does not require stripping political branches off all financial powers, but it is incompatible with their arbitrary and unconstrained use.

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<sup>1696</sup> (VAN’T KLOOSTER & FONTAN, 2020).

<sup>1697</sup> (ADLER & MOSER-BOHEM, 2013: 47).

<sup>1698</sup> *Idem*.

This has four general implications: (i) CBs ought to be adequately resourced and capitalized for the functions they are conferred; (ii) political guidance and constraints on financial management should be set on clear and foreseeable legislative rules; (iii) CBs ought to be delegated a sensible degree of discretion on financial management, to be exercised on professional grounds; and (iv) further political interventions should be subject to the explicit condition of maintaining the CB with sufficient and adequate financial resources<sup>1699</sup>.

CBI demands protections on the following dimensions of CB financial resources and management:

**(55)** *Each CB must have its own financial resources (balance sheet), legally autonomous and at a sufficient and adequate level to carry out its functions and implement its mandate fully and in an autonomous, sound, efficient manner*<sup>1700</sup>. Particularly within the ESCB, it means that if NCBs are entrusted with non-ESCB tasks, they must have sufficient means to perform both the ESCB-related and the other domestic tasks<sup>1701</sup>.

**(56)** *Guarantee of adequate capitalization of the CB, at all times.* The historical explosion of balance sheets increased risks and questions about the backstop/guarantee of adequate capitalization of the CB.

The current monetary tightening cycle with the increase of interest rates (including those paid on bank deposits) is bringing ICBs' financial results into the red, and the topics of negative equity, reduction of profit transfers, and the eventual need for recapitalization are at the forefront of public concern and debate.

To preserve CBI, politicians should have a constrained role in any of the strategies to deal with negative results, which are present and/or future reduction of profits and using reserves, general recapitalization, or specific fiscal indemnity or backstop.

Of the four possible regimes on the provision of a fiscal backstop the extremes of explicit prohibition and open-ended, general fiscal backstop are worse, while the *ex ante* regulated and limited backstop, and the *ex ante* ambiguity (that interpretation and practice may take either way) try to strike a better balance.<sup>1702</sup>

**(57)** *Limitation of the political determination of the reduction of CB equity and raising levies on its general reserves.*

The reduction of equity should only be directed if based on pre-established objective and technical grounds. Such protection of an adequate capitalization against political manipulation has a specific manifestation within the ESCB, where national political authorities are not

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<sup>1699</sup> (EMI, 1998).

<sup>1700</sup> (ARCHER & MOSER-BOHEM, 2013).

<sup>1701</sup> CJEU, judgment on *Banka Slovenije* case, (IMFx), (ARDA, 2006), (BINI SMAGHI, 2008: 453-4), (DALL'ORTO, 2020: 17).

<sup>1702</sup> See Ch. 5.2.5. d), (LEITÃO AMARO, 2022c) for backstop regimes.

permitted to impose reductions of capital on NCBs without the *ex ante* agreement of their decision-making bodies.<sup>1703</sup>

Political authorities should not be allowed to impose a levy on the ICB's general reserves in an amount likely to affect its ability to carry out its independent functions effectively. The inability to restore those reserves independently would force the ICB to seek the consent of political authorities in order to obtain funding or recapitalization.<sup>1704</sup>

**(58)** *Clear framework for coverage of special risks in crisis management operations.* ICBs should have *general* protections of capital such as a sufficient amount, quality of the balance sheet, a fiscal backstop, and autonomy regarding provisions, reserves and remittances.

But they may also have specific coverage for greater risks connected to certain crisis management operations, such as LOLR and MMLR. In addition to the conditions that must be incorporated in the design of such operations (namely in terms of haircuts, exclusion of insolvent counterparties, asset quality assessment), it may be of interest to create special protections that avoid contagion and spillovers throughout the CB balance sheet and the conduct of ordinary policy operation.

The existence of special protections for these specific crisis management operations, for instance in the form of dedicated fiscal backstops and separate accounts, contains the perimeter of risks. By reducing the vulnerability of the ICB and its dependence on fiscal support, it is relatively healthier in terms of CBI.

The BoE offers a clear example of a financial framework for crisis management that includes both separation of accounts/vehicles and regulated provision of a dedicated fiscal backstop to those specific operations. The Fed lies on the middle ground with a model of *ad hoc* backstop and negotiated authorization by the Treasury. The ESCB is left without a clear backstop, with its NCBs allocated most of the risks but left vulnerable to the political will of the moment for these risky last resort operations.

**(59)** *Limited political interference on the decisions over the constitution of provisions and reserves, determination of profits, and transfer of remittances to the Treasury.* In order to prevent manipulation or politically motivated deterioration of the CB's capital, fiscal authorities shall not be permitted to discretionarily determine the levels or impose a reduction of provisions or reserves, nor the increase of profits and remittances to be transferred in the year<sup>1705</sup>. CBs ought to be free to autonomously create financial provisions to safeguard the real value of their capital and assets, with deference owed to their expert judgment.

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<sup>1703</sup> (BINI SMAGHI, 2008: 453-4), (ARDA, 2006).

<sup>1704</sup> CJEU, judgment on *Banka Slovenije* case, §101-2.

<sup>1705</sup> (BINI SMAGHI, 2008: 453-4), (ARDA, 2006).

In that vein, ICBs should adopt a framework or general policy on the (adequate) constitution of provisions and reserves against risk exposures, retained earnings accounts, and restrictions on the distribution of unrealized gains and losses. The framework should be clear and public so that fiscal authorities know what to expect in advance. It may be publicly contested and politically reoriented through legislative rules but not by other formal or informal political instructions.

**(60)** *Autonomous approval of the budget and internal allocation of resources.* ICBs are in a distinct position compared to many independent agencies who rely on political authorities to authorize their funding because the former control autonomously the seigniorage profits that are an important part of their funding<sup>1706</sup>. Financial independence recommends that CBs are competent to elaborate and adopt their internal budget, in accordance with the criteria of the law to ensure that their expenditures are reasonable<sup>1707</sup>. They should not be subject to parliamentary or executive approval.

As a limited exception, in the ESCB it has been accepted that political branches may have a say in the adoption of the NCB's budget as long as the law provides that such power will be without prejudice to the financial means necessary for carrying out their ESCB-related tasks;

**(61)** *CBs should elaborate and adopt their own accounts and financial statements, subject to constraints.* How things are measured can influence and change the behaviour of central bankers<sup>1708</sup>. They should be protected from political pressures on certain crucial substantive decisions reflected in the accounts, namely the determination of provisions, reserves, profits, and remittances as mentioned above.

On the other hand, financial documents and reports are quintessential tools for the professional, public, and political accountability of CBs. The veracity, reliability, sufficiency, and technical quality of such documents is indispensable.

Various external actors should be mobilized and involved in warranting such quality. Independent external auditors – i.e., solid international audit firms – must analyze, opine, and validate the financial reporting exercise. The responsibility for their selection and delimitation of the scope of their audits may lie either with the CB<sup>1709</sup> or the government<sup>1710</sup>, provided that the examinations, standards, and criteria are professional and independent.

The State audit office or similar may be charged with examining the accounting and financial management, provided that such control is “done on a non-political, independent and purely

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<sup>1706</sup> (BARKOW, 2013: 23).

<sup>1707</sup> (LASTRA, 2015), (ARDA, 2006), (EMI, 1998).

<sup>1708</sup> (ADLER & MOSER-BOHEM, 2013: 47).

<sup>1709</sup> Sect. 7 (5) BoE Act, art. 26 (3) Buba Act.

<sup>1710</sup> Art. 27 ESCB-Stat, art. 20 (1) of the Articles of Association of the Nederlandsche Bank, sect. 28 BoCan Act, art. 57 (2) BoJ Law, and sect. 167 NZRB Act.

professional basis”<sup>1711</sup>. The ESCB Statute is clear in circumscribing the intervention of the Court of Auditors “to an examination of the operational efficiency of the management of the ECB”<sup>1712</sup>. Financial documents have to be public and, thus, open to scrutiny from the epistemic community and the public.

Executives (and shareholders when different) may be required to review and approve or accept (or not) the accounts, and Parliaments to have a specific debate with the CB about them. Such debates may even lead to written feedback and deliberations, such as the famous resolution of the European Parliament on the ECB Annual Report, which includes both a backward-looking assessment of the ECB performance and a host of forward-looking recommendations. The Annual Report, which includes both a policy and financial account of past performance, triggers a healthy competition of influences, with professional auditors, central bankers and their watchers, DRs, and the public taking the opportunity to review, give inputs and thereby potentially shape the choices and actions of the CB.

**(62)** *Application of generally accepted accounting practices or CB-specific accounting rules that use internationally recognized accounting standards*, including for the calculation of profits and losses<sup>1713</sup>. On the one hand, such accounting rules limit the CB’s autonomy by constraining how they can represent their reality and performance and preventing them from strategically using secrecy. On the other hand, the imposition of international standards impedes political authorities from imposing specific rules with the (unconfessed) purpose of steering the CB’s financial management (and profits) towards the (fiscal) short-term interest of the political majority.

Governments should have limited discretion to require ICBs to depart from general accounting rules and practices<sup>1714</sup>.

The international networked community of central bankers and their watchers work to promote and uphold the use of common international accounting standards by ICBs with the view that they correspond to best practices and enable comparability, which then becomes a channel for the influence of the transnational epistemic community.

**(63)** *CB’s tax immunity or exemption*. The underlying concern is that taxation may compromise the financial independence of CBs for at least three reasons: (i) the political power over taxation might be used or threatened to be used to pressure and manipulate central bankers to cater to the will of the political majority and to punish a too independent/non-conformist CB; (ii), taxation can misalign the central bankers’ incentives and lead them to focus

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<sup>1711</sup> (ARDA, 2006), Sect. 166 NZRB Act.

<sup>1712</sup> Art. 27.2. ESCB-Stat.

<sup>1713</sup> (IMFx), (BINI SMAGHI, 2008: 453-4), (ARDA, 2006). Art. 26 (2) Buba Act, art. 27 SNB Act, sect. 164 (1) NZRB Act, and art. 3 ch. 10 SvRB Act.

<sup>1714</sup> Art 26.2. ESCB-Stat, sect. 7 (4) BoE Act, sect. 17 of the Nederlandsche Bank Act. art. 75 Bolsr Law.

on managing taxable earnings and secondary financial outcomes, instead of focusing on their primary policy mandate<sup>1715</sup>; (iii), in federalist CB systems, tax immunity avoids that the political authorities of the territory where the CB units are located can gain unfair comparative advantages in terms of influence over the CB decisions and additional tax revenue.

Therefore, tax immunity and exemptions have been justified as protections of the financial independence of CBs.

However, if taxation is established in general, abstract, and stable legislation, it is not obvious that it jeopardizes independent decision-making or allows political branches to use specific provisions as levers to manipulate ICBs. Stable taxation will be one more external factor that central bankers must consider.

The IMF suggested that an appropriate framework of tax exemption for ICBs should (i) not consist of a blanket provision but be detailed in specific tax legislation; (ii) include an appropriate accounting regime; (iii) exclude ICBs' commercial banking activities; (iv) be conditional upon timely distributions of profits to the government after making appropriate contributions to reserves; (v) not apply to dividends paid to private shareholders, if existent.<sup>1716</sup>

The ECB enjoys a tax exemption across the Member States as "necessary for the performance of its tasks",<sup>1717</sup> and national legislation has discretion to define tax exemptions for NCBs.

In the USA, considering that RBs' profits are transferred to the Federal Treasury, they are exempted from federal, state, and local taxes by federal law (except upon real estate).<sup>1718</sup>

**(64)** *(Unnecessary) limitation of liability to protect the CB from third party claims.* The idea, reflected on a few CBs' legal bases<sup>1719</sup>, is that CBs and their officers implementing their mandates and exercising various functions according to the law and in good faith should have limited or no liability for losses suffered by third parties. Other forms of protection are the prohibition of encumbrances on the CB capital or the indemnification of central bankers by the State for the exercise of their legal powers (unless in bad faith).

However, it is hard to see why CBs should enjoy a liability regime different from any other public body. Such regimes vary significantly across countries, and they have evolved with time. The trend has been towards the reduction of immunities and a substantive implementation of the rule of law.

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<sup>1715</sup> (IMFx), (ADLER & MOSER-BOHEM, 2013), (GRUBER & BENISCH 2007).

<sup>1716</sup> (IMF LEGAL DEPARTMENT, 2017).

<sup>1717</sup> Art. 293 TFEU, art. 39 ESCB-Stat, art. 22 of Protocol (No 7).

<sup>1718</sup> Sect. 7 (c) FRA. Also art. 8 SNB Act.

<sup>1719</sup> Sect. 31 BoCan Act, and sect. 179 (2) NZRB Act, sect. 10B (b) FRA limits liability to losses on advances to individual member banks.

The applicability to CBs of a solid, general framework of liability of public entities creates a formal, structured channel for specially affected interests to seek redress, which, in turn, reduces the need and incentive for them to follow other avenues or pressure over the CB.

CBI seems better protected by acknowledging the interactions of third parties and cautiously structuring channels for their interventions.

#### **8.5.4. OPERATIONAL INDEPENDENCE**

**(65)** CBs should have *autonomy to organize their internal structure* as they see fit<sup>1720</sup>, under the institutional framework established by law. The essential institutional structure of the CB is designed in its legal basis, as described above. Beyond that, the internal organization should be independently determined by the governing bodies of the CB.

**(66)** *Autonomy over the CB staff.* Staff is decisive in the organization and determinant in framing and shaping the policy process. Their expertise, professionalism, and insulation from biases and undue influences are fundamental to warrant the CB's integrity and *de facto* independence.

Many of the protections of personal independence described in relation to the leaders of the CB are applicable to its staff but with relevant adjustments based on proportionality requirements. However, it is no less important for CBI that the CB has ample autonomy to make fundamental decisions regarding its staff, without interference from the political Executive, which has the general responsibility for the management of public servants.

Those fundamental decisions concern the selection and appointment of staff, terms and conditions of employment (including setting the remuneration), discipline, promotions, training, and termination of service.

Autonomy over all or some matters relating to the staff is recognized in many legal bases<sup>1721</sup>, while government interference is a rare exception<sup>1722</sup>.

ICBs can expand their comparative advantages by fostering the expertise and diversity of their staff, requiring full time dedication, offering attractive remuneration and other employment conditions, and selecting them through open and competitive processes.

**(67)** *Informational autonomy* is important to avoid the exploitation of information asymmetries and the risks of epistemic capture, especially by political authorities or the financial industry. Independent, capable, and unbiased policymaking requires that ICBs are given unlimited and timely access to relevant information to carry out their given mandate. Information is power.

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<sup>1720</sup> (ECB, 2007).

<sup>1721</sup> Art. 36.1. ESCB-Stat, sect. 11 (I) FRA, sect. 67-68 RBA Act, art. 31 Buba Act, arts. 19 and 25 Bolta Law, arts. 28, 31 and 32 BoJ Law, sect. 168 of NZRB Act, art. 42 (2) SNB Law.

<sup>1722</sup> Art. L. 142-2 BoFra Statutes.



Other public authorities should be required by law to share with ICBs information and data relevant to the exercise of their competences, subject to the protection of privacy.

ICBs should develop their capabilities for the gathering and processing of detailed first-hand information sourced outside government or politics<sup>1723</sup>. With that responsibility in mind, most of them have built large research, statistics and forecast teams, and capabilities, often (amongst) the best in the country<sup>1724</sup>.

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<sup>1723</sup> (VIBERT, 2007: 30-33).

<sup>1724</sup> (MARCUSSEN, 2009).

## PART V CONCLUSION

### 9. CONCLUSIONS

Almost four decades since the gradual spread of CBI across advanced economies with liberal democracies, its fundamental intuition and prescriptions are still right.

A world of hybrid public and private provision of money and credit needs a public governance process with relevant discretion. The staple mode of representative democracy, the electoral-representative process, is unfit for purpose. Its structural features and incentives lead to detrimental electoral cycling, short-termism, time inconsistency of policymaking, and lack of credible commitment of political authorities to the necessary price and financial stabilities. Partisan-majoritarian politics is flawed and suboptimal in terms of policy output and input. It tends to generate inflationary bias and volatility, worse welfare outcomes, a system of monetary and financial governance systematically biased towards the instant majority and the incumbent Executive, sacrificing optimal and long-term interests, and frustrating the legislative democratic control of fiscal policies and the representativeness of decisions on taxation.

Its correct solution was the functional and institutional separation of monetary and financial policies from other economic policies and their delegation away from the classic political branches and their partisan and majoritarian politics to a non-majoritarian, specialized expert institution, the ICB. That separation and the ensuing autonomy of central banking require legal and *de facto* protections of institutional, personal, financial, and operational independence.

The vision that commanded the global spread of CBI was also right in claiming that in modern liberal democracies, there is a role for non-majoritarian institutions. It fits well with its core values, including the principle of (balanced) separation of powers in the general structure of government and the governance of macroeconomic policies.

CBI would be one of the various technologies of societal control in the hands of non-majoritarian political institutions. Long ago, religion broke away from state control, and the judicial administration of justice is highly independent. Albeit to a lower degree, the military has significant autonomy in national defense, multiple independent administrative agencies regulate and supervise relevant economic sectors, and independent fiscal institutions have gained (barking, not biting) powers in fiscal policy.

The doctrine of CBI also pointed in the right direction that the most fundamental, generalist choice of the commanding values in monetary and financial policies must be made by the electoral-representative process and the Legislature, which has comparative advantages in such first-level decision-making. And also that ICBs should have a limited role in society and the overall structure of government, at the risk of installing a "government of technocrats".

However, the mainstream academic and official version became the CBI doctrine with a strict and narrow flavor and serious normative and descriptive limitations.

Clearly, the traditionalist formulation of CBI is unfit for purpose.

On the one hand, it had limitations of its own. To circumvent democratic difficulties, it relied on unrealistic assumptions or oversimplifications that proved untenable myths and failed analytical and normative scrutiny.

The first was strict separation, in a double sense. It sought almost complete insulation from external influences but was focused almost entirely on the interferences between electoral and partisan politics and the classic political branches.

However, it turned a blind eye to other relevant Influencers, leaving the backdoor unguarded and vulnerable to a substitution of bias, particularly towards a minority of well-resourced financial interests with high-stakes policymaking. Besides, it wasted the potential of beneficial interactions with political actors, which could have informational and democratic signaling value and allow for valuable dialogue and cooperative dialogue that improves the management of interdependencies and the creation of a closer to optimal macroeconomic policy mix.

The second oversimplification was the functional-teleological narrowness of CBI, which would be an instrument simply to avoid high and volatile inflation through conventional internal monetary policy. Thereby, it neglected other usual objectives and functions of CBs that correspond to relevant values incumbent on ICBs through their mandate or other legal principles via the rule of law, and in whose functions they also developed unique, specialized expertise and whose interdependencies with internal monetary policy benefit from some (internal) coordination.

Third, it saw too much in the democratic determination of mandates, supposedly clear and narrow and reflecting a broad consensus that would have settled the politically significant and salient questions.

However, everywhere ICBs receive incomplete legislative mandates with plenty of substantive political undecideds for them to resolve. They cannot just abdicate their delegated responsibility in favor of the tyranny of the status quo.

Fourth, the traditionalist view saw too little in the role and discretion delegated to CBs, which it portrays as an essentially technical function exercised by ICBs objectively and neutrally applying their specialized expertise. That fiction was supported by another myth of a stylized model of central bankers as rational, almost omniscient, neutral, higher-spirited, and homogenous decision-makers who, at most, should be homogeneously conservative.

However, central bankers are only humans with incomplete information, cognitive biases, and limited expertise. They have complex utility functions where their self-interests and preferences must be constrained to mitigate possible external manipulation. They are heterogenous in

multiple dimensions, including ideas and technical theories. If they exhibit some systematic pattern of preferences, it is more likely to be home bias or inertia than conservatism or partisanship. And they strategize internally and with other domestic and international macroeconomic policymakers, often compromising on what they sincerely consider the optimal policy choice.

On the other hand, the traditional view of CBI has proven inadequate for the serious post-GFC transformations in central banking and in its external context, some of which are still unfolding. Externally, while inflation was persistently subdued, other societal challenges emerged, including the financial and economic crisis, contexts of low inflation-low growth, interest rate declines, private and public debt stocks ballooning, and shadow banking and financial interconnectedness triumphing globally. The conditions and public cried for broader public interventions from all macroeconomic functions.

Internally, ICBs responded to the call, sometimes as the only game in town, and expanded and innovated in their actions, new tasks, unconventional policies, skyrocketing balance sheets, historically high intervention in various financial markets, and broadening of their concerns in tune with societies' worries over financial stability, climate change, and inequality. The GFC, Eurocrisis, and the pandemic saw previous red lines being crossed by their activism. And they did not sit idle in the face of further transformations in the macroeconomic context, the digitalization of money, and changes in the international order.

Cognizant of their rise in power and public prominence, they revolutionized their relationship with the public, from mystique and secrecy to a culture of transparency and bidirectional engagement.

The recent post-pandemic inflation burst brought further challenges, importance, and public attention to ICBs and their choices.

This new centrality and politicization of ICBs do not sit well with the traditional doctrine of CBI. Yet, there was a surprising association between the rise of powers and the politicization of central banking and the persistence of their *de jure* and *de facto* independence, all with democratic endorsement. If anything, political representatives responded by assigning even more responsibilities to ICBs without subtracting their independence.

Three strategies emerged in response to the disequilibrium between those transformed conditions and the traditional formulation of CBI.

Traditionalists favored scaling back central banking to their ideal of strict and narrow isolation and their fiction of objective, technical minions.

On the opposite end, the expansion and activism of central banking were welcomed, but at the cost of dismantling CBI as it is and unifying monetary and financial policies under political majoritarian subordination.

In between, some efforts to accommodate those transformations involved partial and insufficient efforts to either increase democratic control through *ex ante* guidance (the operational independence approach), or *ex post* accountability (the accountable independence view), or the replacement of both independence and subordination by a new synthesis called interdependence.

There is a better solution, though.

It is possible and necessary to build on and upgrade the doctrine of CBI into a more comprehensive, realistic, and normatively solid model

This work's fundamental and original contribution is the conception of this novel model of *pluralistic CBI*, its justification, and its framework.

Under the conditions of this new model, ICBs can be political, democratic, and yet robustly independent.

The core idea of CBI remains unchanged: protecting the integrity of the specialized governing process that is the art and science of central banking.

It does not abdicate from political independence but is more (and different) from merely negative strict insulation from politics.

Likewise, pluralistic CBI is not about (the change of) goals, and it does not seek to alter. It is about institutions of government and the proposal of a new process of governing money and credit according to the democratically assigned objectives. It fits well with the envisaged culture of stability, as the current policy response to the inflation surge demonstrates.

However, instead of the traditionalist strict insulation from politics only, it offers pluralistic independence.

Such pluralism adds a positive dimension of independence, which is the commitment to strengthen the institutional specialization and its comparative advantages. It has a vocation for all seasons beyond combating inflation and conventional monetary policy and comprehends multiple relations with all five groups of relevant Influencers.

It is pluralistic because it targets political branches and actors like traditional CBI but expands the aim to cover interactions and influences from the public(s), the judicial branch, the epistemic community of central banking, and the affected interests, particularly the special financial interests.

Not only that, it is pluralistic because it values insulation-vulnerability to preserve the essential integrity of central banking. However, it also acknowledges and seeks to frame other types of connections between ICBs and the relevant Influencers through responsiveness-accountability and engagement-coordination. A bidirectional relationship exists where all sides seek to signal and influence one another.

In addition, it is pluralistic because instead of the traditional all-influences-are-prohibited, it adopts a trivalent approach. Many influences are undue and should be prohibited. Still, some should be tolerated, and others even required as valuable instruments of good enough democratic control, expert input or professional discipline, judicial review, public accountability, rightful participation from affected interests, or cooperative coordination to optimize the macroeconomic policy mix.

Each Influencer is both a potential friend and foe of CBI.

Executives and instant majorities are typically the biggest threats coming from partisan politics, but oppositions and plural legislatures can be allies defending the independence of CBs.

The public, or some of its factions, tend to short termist mob rule identified since Plato. Still, there is an immense potential for ICBs to filter, create new channels of disintermediated relationships, and educate and facilitate a more rationalized public participation that can ultimately support ICBs against time-inconsistent self-interested or privately captured governments.

The proximity with powerful private financial actors creates perils of manipulation and capture, but it is also an indispensable source of information and transmission channel for policymaking and a potential ally against certain deleterious influences.

Courts may intervene to restrain ICBs' activism and self-asserted prerogatives, but they might be a precious friend upholding the protections of CBI and defending them against encroachments from political branches.

The epistemic community can be the nursery for specialized expertise, a source of self-reflexive innovation and professional discipline, fostering the formation of international coalitions that uphold the positive dimension of CBI. However, without the necessary critical thinking and impetus, it can become a force of homogenizing groupthink, hubris, confirmation bias, and ultimately inertia that destroys the rationales for the delegation to an independent expert institution.

Yet, this new model is pluralistic in an even more profound sense. All these Influencers and relations form more than just an aggregation of multidirectional signals.

Together they create a competition of influences with an overall Madisonian effect of mutual checks and balances that, through competition, complementarity and even coalitions can threaten but also protect and improve the independence and rationality of ICBs' policymaking.

The competition of Influencers exposes ICBs to a mosaic of diverse, potentially conflictual inputs that, even if problematic *per se*, on aggregate diffuse the relative threat of each and can enhance independence. It can, thus, become an alternative or complementary method of protection of CBI to the traditional negative barriers.

Pluralism is a description of central banking (even more manifest post-GFC), but it is also a normative prescription of what the institutional model should be, and what should be improved in the framework of CBI.

One of its most profound differences from the traditional doctrine of CBI is the assumption that ICBs are political; they are *in* politics, not *above* or *off*-politics.

It departs from the traditionalist illusion of apolitical or depoliticized monetary and financial policymaking but also from the belief shared by traditionalists and majoritarian democrats that all politics is majoritarian and involves political parties in the electoral-representative process.

Independent central banking is political in multiple senses.

ICBs resolve substantively political questions, decide primary trade-offs of values, manage fundamental conflicts, and make distributional choices. And they do it in conditions of political contestation, in its three dimensions of increased public salience, polarization, and access and participation by the public.

Politicization became evident in post-GFC unconventional monetary policies, crisis management interventions, and go-direct-and-targeted actions that more clearly created winners and losers. It is also so when multi-hatted ICBs have to resolve conflicts within their mandates, including those that are ranked.

Yet, the fight against high inflation through conventional interest rate policies in the context of large debt stocks involves adjudicating trade-offs between competing values, allocating distributional impacts, and managing profound political disagreements in public salience.

ICBs are political also because they interfere in the electoral representative process in multiple ways beyond a “non-controlling” advisory role in their area of expertise. They express views on politicians’ policies, outside their field of competence, through advice, advocacy, and even muscled persuasion. ICBs adopt less conventional policies, such as quasi-fiscal and quasi-foreign policies, whose effects resemble or encroach on fields within the purview of the classic political branches. And particularly in the EMU, they impose conditionality on their own facilities, and policy tools to pressure national governments to adopt certain courses of political action and reforms.

Except for the involvement of central bankers in electoral and partisan activities, all other interferences are acceptable under conditions.

As the relation between ICBs and classic political actors is bidirectional, the latter obviously interferes with the former, ranging from the legitimate and even necessary channels of *ex ante* and post-democratic control to impermissible influences prohibited by the CBI regime.

Finally, it is political because it was created to be held only as long as it has (or does not lack) political support from the People and its representatives.

In monetary and financial policies, there is no escape from politics. Independent central banking is a political technology that offers an alternative form of non-partisan politics, imperfect but free from various limitations and defects of political parties and majoritarianism.

In pluralist liberal democracies, primary conflicts are not fought exclusively along the lines of political parties, electoral platforms, and elected representatives voting by majority. Madison factions disagree and conflict in multiple forms.

Alongside direct democracy and other non-majoritarian institutions, ICBs are an alternative to the classic electoral-representative process, as modes of conciliation and management of such societal conflicts.

They are one other form of indirect democracy, not a government of technocrats.

Pluralistic ICBs have solid democratic credentials from the perspective of a pluralist conception of liberal democracy.

First, ICBs are under good enough democratic control through the electoral-representative process, stemming from a combination of *ex ante* forward-looking or *ex post* backward-judging controls, some of which set the constraints and limits of delegated discretion, others seek to influence within the limits of discretion.

They include multiple formal and informal channels of political constraint, guidance and accountability, including: (i) statutory controls over the delegation and its terms, such as structure, functions, powers, objectives, organization and independence protections; (ii) personal controls through the appointment and limited removal and manipulation of certain material and reputational incentives of central bankers; (iii) financial controls over the allocation of resources through appropriations, provisions and profits, capitalization and backstop, and demands of monetary financing; (iv) signaling of concrete preferences over policy through mandate specification, instructions, recommendations and informal dialogues; (v) manipulation of the interdependencies and spillovers from the macroeconomic policies under their direction; (vi) political vetoes or override of concrete policies or actions; (vii) transparency requirements and reputational judgments and sanctions; and ultimately, and returning to the beginning, (viii) the R-bomb that warrants the ultimate democratic control of the existence and terms of the delegation.

These powers are unevenly distributed by the political branches and their sections, especially finance ministers and parliamentary committees, sometimes demanding the concert of different qualified majorities or various actors with veto power.

Such distribution is regime-specific, and there are three distinguishable models of political relationships with ICBs.

In the Fed's case, the formal seat of political control is the Legislature, which decides the delegation. Yet, the Fed's statutory basis became quasi-constitutionalized, and the vague dual



mandate assigns broad discretion on trade-offs. "Lower cost" consent on appointments and accountability hearings are its main tools of democratic control.

Conversely, the Executive grew beyond its limited powers of political appointment (nominally of rare use considering the very long tenures) and circumscribed regulated possibilities of instruction, veto, and fiscal backstop. The practice of appointments, chair reappointments, intense contacts, private dialogue, and cooperative coordination gives the President and the Treasury Secretary multiple opportunities for informal signals and nudges to the Fed.

The ECB has a constitutionalized delegation and mandate, including strong prohibitions of influences, specific binding instructions, and monetary finance.

On the other hand, this constitutionalization is thinner than often assumed and leaves plenty of room for constructive ambiguity of those prohibitions to accommodate pressing needs. Together with the incompleteness of the EMU with 20 national fiscal authorities that leave the ECB without an obvious political counterparty, or a multitude of weaker ones, this seems to reinforce the ECB's role.

Yet, it does not mean institutional loneliness because the ESCB has a rare regime of institutionalized cross-participation with EU political institutions. It is subject to more of the latter's lawmaking powers than usually expected, and an increasingly strong and highly structured monetary and supervisory dialogue with the European Parliament, a regime of ambiguity and uncertainty on the fiscal backstop, and a degree of national intervention and home bias via NCBs, their majority in the ECB-GB and decentralized functions, that mitigate the concentration of power.

The BoE has, since the GFC, the greatest concentration of monetary and financial powers of all major ICBs. Still, it is also the regime with more powers of political control in the hands of the Executive. These include powers to specify the mandate and issue instructions or veto interventions and regulated possibilities of fiscal backstop and restricted channels of monetary finance.

However, in contrast with the Fed, the more intrusive powers are tightly structured, and their exercise has to be formalized, in writing and transparently, to mitigate channels of informal interaction.

In any of these models, DRs succeed in having more control of independent central banking than traditionalists like to admit.

The foundational decision to vaguely delegate broad discretion, the formal and informal powers and channels for DRs to set the guardrails but also to effectively signal guidance and substantive accountability to ICBs within the margins of discretion and to control excesses, including the ultimate control through the R-Bomb, indicate that they have good enough control. Their

silences throughout the delegation are not abdication but tacit acquiescence and guarantee of an open future in the hands of the People and its DRs.

Second, ICBs have been developing new channels of direct relationships with the People and thus of additional avenues for indirect democratic representation. It started with a (r)evolution in transparency, in publishing and explaining decisions and forward guidance, and evolved to initiatives and channels of permanent bidirectional dialogue, broad-to-mass public participation, including in ICBs' reviews of their strategic frameworks, and proactive efforts of outreach to the less informed and engaged publics.

Third, pluralistic CBI is also democratic in its commitment to impartiality or balanced representation through its structural features, design, and ethics to prevent systematic majoritarian or minoritarian biases in accordance with the values of political equality and liberty. Pluralistic protections of independence, the mobilization of the competition of Influencers, transparency, heterogeneity of central bankers, and conditions of public contestation prevent domination by the instant majority and capture by special interests such as well-resourced and high-staked financial institutions and investors.

Fourth, ICBs are respectfully democratic also because they assume their duty to use the entirety of their mandate with limited and responsive activism, exploring the boundaries of their delegation to reveal rather than lead transformations in social consensus.

Fifth, pluralistic CBI has the surprising contribution of broadening and upgrading modern liberal democracy, within and across time, and assisting against existing threats.

Those new direct channels of relationship with the citizens, the openness to public contestation, and the prevention of capture by a minority of wealthy financial interests dismiss the claims of populists against a self-effacing elite of technocrats.

But this pluralistic model offers more to fully realize the values of a pluralist conception of liberal democracy: it commits ICBs to proactively equalizing representation and leveling the participatory field by bringing to their decision-making process silenced, marginalized or under-resourced affected interests.

It creates a regime of long-term political control that integrates future generations and multi-period majoritarianism, rather than exhausting democratic guidance and accountability in an instant. The regime of political appointments with long and staggered tenures and limitations of anticipated removal is decisive.

ICBs are surprisingly good at making distributive choices, notably in addressing common pool, intergenerational, and distributional-turned-identitarian problems.

Specifically in societies of low institutional capital, ICBs are uniquely valuable guardians and reservoirs of political pluralism offering non-dominated centers of critical mass and production of knowledge, reflection, and assessment of public policies.

For liberal democracies in general, they are non-partisan and non-majoritarian centers of public power that score well in the pluralist conception of liberal democracy, with its concerns with political equality and liberty, non-domination by insulated instant majorities, resourceful minorities or pivotal players, with avoiding mob rule, short-termism and time inconsistency, and warranting intergenerational representation, better participation and deliberation in terms of inclusivity, diversity and rationality.

More decisively, in a comparison between imperfect alternatives, pluralistic CBI is superior to other processes of governing monetary and financial policies.

The comparative institutional analysis between pluralistic CBI and the realistic description of the electoral representative process with its liberal and other non-majoritarian deviations from majoritarian rule and discontinuities in representation unearths quite different results than the contrast between the unrealistic comparison between an idealized majoritarian democracy and the traditional strict CBI.

The institutional comparison is based on three input-based normative standards – epistemic-functional, democratic control, and impartiality or balanced representation – that combine functionalist and democratic values.

The electoral-representative process has functional specialization and democratic superiority in the primary and general definition of the polity's goals, the fundamental options of institutional design, and the appointment of the leaders of non-majoritarian but indirectly representative institutions. It has a comparative advantage in the first level of monetary and financial policymaking.

However, such a level is much thinner, broader, and vaguer than traditionalists and defenders of goal dependence-instrument independence suggest. It must be subject to liberal procedural and substantive devices to rationalize decision-making.

At the second level of policymaking, where other substantively political choices are made under discretion, and more obviously on the third level of non-discretionary or technically discretionary decisions and policy implementation of low political salience, pluralistic CBI has comparative advantages over the political process with its distribution by the Legislative, towering Executive, centralizing minister of finance and subordinate bureaucracy.

Pluralistic CBI has an overall comparative advantage based on three input-based normative standards.

It offers the most informed, knowledge-based, and functionally efficient deliberation.

It is an indirectly representative but non-majoritarian process with adequate, and maybe even better, democratic credentials because it is under good enough democratic control, is less systematically biased or offers a more balanced representation, and repairs deficiencies of the electoral-representative process generating democracy-enhancing externalities.

These comparative advantages are confirmed in output-based assessments: objectively, as ICBs tend to deliver superior outcomes in decisive variables of price and financial stability and long-term growth, and subjectively, in the measured trust of the public.

Contrary to initial predictions, the current post-pandemic inflation burst is confirming the evolution to and of the pluralistic model of CBI.<sup>1725</sup>

The unique combination of supply-side factors and some demand-side factors under radical uncertainty left ICBs in a very difficult situation. Still, they are also to blame for the rise in inflation.

They contributed with their initial delay in understanding the inflationary shocks and expectations drift, in hesitating with conflicting ideas, over-relying on their earned credibility, and certainly with their inertia in reacting with the necessary, albeit unpopular, policy measures. Maybe politicization and the structural features of pluralism have contributed to two possible explanations for such inertia, namely, the undergoing process of economic rethinking and greater exposure to external Influencers that benefit from easy money, such as incumbent governments, private debtors, and many financial investors.

With the benefit of hindsight, this episode proves that expert ICBs are fallible, but not necessarily more than any other process.

However, past that initial inertia, almost all ICBs have changed policy course and adopted strong measures and words that demonstrate the commitment and priority of bringing inflation under control, including the risk of overreacting.

The same features of pluralistic CBI (heterogeneity, diversity, critical thinking, and pluralistic competition of influences), allied with the negative protections of independence, may (i) be structurally beneficial for the quality of central banking; (ii) have mitigated the other possible explanations for inertia, such as information limitations and cognitive biases like hubris and groupthink; (iii) have prevented those strong external influences from turning into dominance; and may (iv) explain why inertia was relatively short-lived and ICBs were soon (albeit not without costs) back on the appropriate track.

Only time will give the definitive verdict on the performance of pluralistic CBI.

If ICBs succeed in exiting the disinflationary phase of the cycle with acceptable and accepted trade-offs, this episode will be seen as the (painful) confirmation-cum-improvement of the politicized, pluralistic CBI and the new style central banking.

If they fail, democratic principals may think otherwise.

So far, this episode is a reminder of the importance of price stability, and it is undoubtedly part of the learning process of this still maturing governing process.

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<sup>1725</sup> (LEITÃO AMARO, 2023b, for a detailed application of the model to this inflationary episode).

As a contribution to this maturation process, the institutional analysis taught 18 normative lessons that should inspire the improvement of the CBI framework.

This upgrade should combine the traditional defensive barriers of institutional, personal, financial, and operational independence, with new channels and devices that strengthen and broaden it along pluralistic lines.

It should be expanded to structure and regulate bidirectional relationships with all five groups of relevant Influencers, combining defenses of limited insulation and competition of influences to avoid substitution of biases.

ICBs may have multiple functions, but they should be restricted to their functional specialization, within which they should explore the entirety of the statutory mandates, but with limited and responsive activism, and an ethics of humility about their expertise and their role and function in society and within government.

They have a duty to advance the three competitive advantages and broaden the credibility of their distinct functions in multiple contexts because independence is not innate, and requires accreditation work and accumulation of resources and disposition.

Therefore, they should invest in enhancing their expert specialization, promote their professionalism, heterogeneity, diversity, a culture of critical thinking, and review, transparency and education of the external expectations about the limits of their capacities, especially under radical uncertainty.

They should equalize participation and level the participatory playing field, engage proactively with the public and lower the threshold of access costs.

They must facilitate *ex post* political accountability, and engage with political branches *ex ante*, preferably in structured, formalized, and transparent ways, while maintaining the integrity of the art and science of central banking and raising the transaction costs of efforts to trump that independence in proportion to their normative gravity.

They should engage internationally, but under conditions of transparency, and deference when national sovereignty interests are at stake.

Judicial review must be effective, but under self-controlled deference so that an unelected unspecialized body avoids the temptation to replace an equally unelected but more specialized expert CB within the limits of the latter's democratically delegated discretion.

Pluralistic CBI mobilizes the traditional defenses of independence and promotes an open and even-handed competition of Influencers to preserve the integrity of the art and science of central banking.

Its comparative advantages and an updated, comprehensive framework serve and foster liberal democracy.

This pluralistic model of CBI meets the demand for a government of money and credit of the People, by the People, and for the People.

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