# Review article for French Politics

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Size of the text : 8,723words

# Theoretical perspectives on the new era of central banking.

Abstract

The role played by central banks in our economies has changed drastically since 2007, when they became key players in the stabilisation of financial and economic systems. In addition to gaining new competences, their policies strayed increasingly into the political realm and became more controversial. This new era of central banking has revived scholarly debates and vibrant future research perspectives on both dimensions of their independence: towards political and financial institutions. In this article, we review the theoretical debates between economists, political scientists, economic sociologists, and political philosophers on this issue.

## Introduction.

Because they are the sole public institutions that have been granted a monopoly over the issuance of legal tender, central banks are located at the interface between political authorities and financial markets (Feiertag and Margairaz, 2016). Throughout history, the scope of the policy objectives delegated to central banks and their autonomy towards states and markets have evolved according to dominant economic ideas (Singleton, 2010).

The role played by central banks in our societies today is defined by the Central Bank Independence (CBI) template, which mushroomed around the world in the early 1990’s. Under this model, central banks are granted a high level of independence from political authorities to reach the narrow objective of price stability. While they were considered as apolitical technocratic institutions for almost two decades (Marcussen, 2009), central banks moved away from their narrow technical role and strayed increasingly into political territory in response to the 2007 financial crisis (Goodharth, 2011).

Today, social sciences’ research agendas are catching up with the tectonic changes that have occurred in the practice of central banking in the last ten years. Besides renewing key questions in the economic field, the new role played by central banks in political and financial systems is debated in many academic disciplines, including political science, political economy, financial ethics, and economic sociology.[[2]](#footnote-2)

This article reviews this new body of research by zooming in on the two dimensions of central bank independence: towards political authorities and financial markets. The first issue relates to the politicisation of central banks and their appropriate degree of isolation from elected policymakers. The second issue relates to their independence from the financial sector, which has been questioned in light of their failure to prevent speculative bubbles and the prompt and large amount of liquidities provided to the banking and financial sector after the Lehman Brothers’ bankruptcy.

In section 1, we introduce the initial debates on the CBI paradigm and how the financial crisis challenged it. In sections 2 and 3, we explore how the academic literature has tackled the two dimensions of central bank independency.

1. Central Bank independence: a paradigm challenged by the crisis

The CBI theoretical framework was developed during the 1970’s inflationary episodes in industrialised countries. The New classical macroeconomics (Kydland and Prescott, 1977; Barro and Gordon, 1983) explained those inflation pressures by the “time-inconsistency” problem. According to this stream of research, elected authorities cannot refrain from manipulating the money supply (for example, to boost employment before the elections). Yet, price stability is a long-run objective that is seen to require stable and predictable behaviour from monetary authorities. Hence, Rogoff (1985) suggests appointing central bankers who are more inflation-adverse than are governmental authorities to reach an optimal policy-mix. Moreover, in this view, central bankers need to operate in an independent institution protected from political interferences to be credible in the eyes of financial markets. This high level of independence is justified by the restriction of the central bank’s objectives to the narrow goal of price stability, which is neutral from a distributional point of view in both the middle- and the long-run (Issing et al., 2001). In other words, a “stable” monetary policy should benefit society as a whole, and not just some economic agents at the expense of others. In fact, the CBI model implies a clear division of institutional labour between, on the one hand, macroeconomic policies, such as fiscal policy, with distributive consequences that belong to the political realm, and, on the other hand, monetary policy, which should be managed by independent technocrats, as it is considered neutral in distributive terms in both the middle- and the long-run.

Outside of the New classical macroeconomics consensus, however, CBI was controversial among economists. From an empirical point of view, “heterodox” and comparative political economists found that decreasing inflation rates in industrialised countries since the 1970’s cannot be solely explained by the existence of independent central banks but, rather, by taking into account wider social preferences and institutional arrangements (Hayo, 1998). It is argued, for example, that, without strong trade unions, the highly independent German Bundesbank could not have performed so well (Hall & Franzeze, 1998). Moreover, the French “Regulation school” underlines that central banks are unavoidably political institutions, since money requires a high level of trust among its users and is deeply embedded within states ‘sovereignty (Aglietta et al., 2016). Besides, central banks make political choices: when they set their interest rate, they face a trade-off between low inflation rates and the level of economic activity and employment (Fernandez-Albertos, 2015; Epstein, 2005).

The diffusion of the CBI model has been explained by the whole spectrum of political sciences’ schools of thought; ranging from constructivists to rational choice models. According to historical institutionalists and constructivist scholars, central banks became independent because of coercive pressures from supra-national organisations (such as the EU and the IMF) and the diffusion of neo-classical ideas among economists and policy-makers (Verdun, 1998; McNamara, 2002). Moreover, this delegation of monetary competences to independent agencies provides policymakers with opportunities to pursue “blame-avoidance” strategies and consolidate alliances between “strange bedfellows” (Dyson & Featherstone, 1999; Jabko, 2006). Finally, rational choice scholars explain the rise of CBI with costs/benefits analysis, such as the Principal/Agent approach (Elgie, 2002; Majone, 1996). Echoing neo-classical economists’ arguments (Alesina & Tabellini, 2007), they claim that the delegation of powers to independent agencies is motivated by the rational expectations of reducing transaction costs and taming inflationary pressures.

The 2007 financial crisis has shaken the CBI template on three fronts. First, it became clear that price stability was not sufficient to ensure macroeconomic stability and prevent financial crashes, as was believed before the crisis. This “benign neglect” doctrine *de facto* failed to prevent the formation of asset prices bubbles on both sides of the Atlantic. The Federal Reserve (Fed) did not pay enough attention to the speculative tensions on the US housing market, while the European Central Bank (ECB) underestimated the risks of financial imbalances within the Eurozone. This complacency was one of the main regulatory failures that led to the 2007 financial crisis (Engelen et al., 2011; Krippner, 2012).

Second, to save the financial system from a catastrophic meltdown, central bankers radically modified the settings of their monetary instruments. After the collapse of Lehman Brothers in September 2008, they lowered key policy rates at the zero lower bound and extended their liquidity offers in size, range of collateral, and length, as can be exemplified by the ECB´s Long Term Refinancing Operations (LTRO). As these measures were not sufficient to revive the economy, central bankers turned towards unconventional measures, including the purchase of financial assets (qualitative and quantitative easing).[[3]](#footnote-3) Political economists noticed that the manipulation of their balance-sheets became the main policy tool for central bankers (Mehrling, 2010; Buiter and Rahbari, 2012). In turn, the distributional consequences of monetary policy, i.e., its impact on wealth distribution among economic agents, was exacerbated (Bell et al., 2012).

Third, central banks acquired financial supervision competences, which they had been deprived of since the beginning of the 1990’s. In particular, the ECB and the Bank of England (BoE) gained macro and micro supervision competences: they now monitor systemic imbalances and perform on-site inspections within financial institutions.

In sum, since 2007, central banks have clearly moved beyond the narrow role assigned to them by the CBI template: their policy goals have expanded, and the instrumentation of their monetary policy has changed. Following these changes, central banks have been increasingly straying into the political realm (Goodhart et al., 2014). Yet, in this new era of central banking, central banks’ interactions with political authorities and other regulatory agencies have not evolved to the same extent as has the role they play in the economy. According to comparative studies and central bankers themselves, their level of independence has not significantly changed since the crisis (Blinder et al., 2016; De Haan et al., 2018; Schultz 2017). While bearing in mind the discrepancy between the stability of central banks’ autonomy and the extension of the role they play in the economy, we turn now to the two dimensions of their independence.

## The political dimension of central bank independence

Three research agendas have emerged from the puzzling interaction between central banks and political authorities since 2007. Political scientists have explored the changing power relationships between governments and central bankers. Moreover, economists have argued in favour of an increased coordination between central banks and governmental authorities. Finally, researchers in the field of financial ethics have criticised the distributive implications of unconventional monetary tools.

1. Powerful central banks, weak governments?

While it is undisputed that central banks have increased their power since the crisis, political scientists disagree as to *why* and *how* this expansion of power occurred and whether central banks overstretched their mandate, particularly in the case of the ECB.

First, rational-choice scholars argue that the inability of governmental authorities to act in a swift and decisive way to tame the crisis is the main explanation for the expansion of central banks’ competences. Their argument, which is rooted in the Principal-Agent approach, goes as follows. On the one hand, political leaders *rationally* supported the unconventional measures implemented by central bankers, because direct governmental measures to stabilise the banking system would have been either unfeasible or more politically costly (Quaglia and Howarth, 2016; Binder & Spiegel, 2017; Schoeller, 2018). In a similar vein, delegating supervisory competences to central banks was a costless solution and was also likely to facilitate blame-avoidance in case of future financial failures. Moreover, asset purchases’ programmes help to mitigate the recessionary effects induced by insufficient fiscal stimulus (Pontusson, forthcoming). On the other hand, central bankers were reluctant to implement these measures and to gain supervisory competences because they perceived that their statute of independence was at risk (Hodson, 2011; Torres, 2013; Lombardi & Moschella, 2014). Only when it became clear that inaction would become more costly in economic and reputational terms did central bankers go beyond their narrow role defined by the CBI template. Finally, the rational-choice literature generally found the hypothesis of agency shrinking to be inconclusive: central bankers were careful to act in line with governments’ interests, and their increased accountability efforts gave them “throughput legitimacy[[4]](#footnote-4)” for their new role (Torres, 2013).

Second, economic sociologists and political economists underlined that central bankers acted as strategic players, as they used the crisis as a window of opportunity to expand their power and competences. For example, central bankers relied on the recognition of their high level of financial expertise and their intimate knowledge of financial markets to gain the financial supervision competences they had been deprived of since the 1990´s (McPhilemy, 2016; Conti-Brown, 2016; Howarth & Quaglia, 2016; Chang, 2018). Moreover, this strand of literature explains that the ECB relied on the coercive use of its monetary instruments and its epistemic authority to force long-wanted economic reforms in Eurozone peripheral countries (Fontan, 2013; Streeck, 2014; Vauchez, 2016). More specifically, they claim that the ECB influence was conducive to the isolation of the formulation of public policies from electoral outcomes in Eurozone countries. The financial pressures exerted on peripheral Eurozone countries (such as Greece) to force them to accept austerity measures are a good example (Fontan, 2018). Finally, these authors often found that the accountability procedures under which central banks operate are not coercive enough to provide sufficient democratic controls over their activities (Best, 2016; Högenauer & Howarth, 2016; Collignon & Diesner, 2016, Riles, 2018).

Third, “EU studies” scholars and central bankers themselves stressed the positive role played by the ECB in fostering European integration and ensuring Eurozone survival. They underlined that the ECB “political leadership” (Henning, 2015; Verdun 2017) and the “charisma” of its chairperson (Tortola & Pansardi, 2018) were decisive in coordinating EU authorities and taming the crisis. Some have even claimed that ECB policies limited social unrest and anti-austerity protests, but their research is flawed with methodological shortcomings[[5]](#footnote-5) (Genovese at al., 2016). It is peculiar that these analyses strongly echo the claims made by ECB policymakers in top “EU studies” academic journals a few years earlier (Drudi et al., 2012; Salines et al., 2012; Yiangou et al., 2013).

We propose two explanations for the strong divergences in the academic literature on the reasons, mechanisms, and consequences of the ECB action during the crisis. First, prior theoretical assumptions matter: rational choices’ scholars consider that actors’ preferences derive from legal contracts and “chicken games”, whereas political economists underline that they are contingent to the co-construction of political and economic fields. Second, scholars’ fields of specialisation influence their research results, especially in the case of the ECB. EU studies consider banking and financial topics as one of the many public policies fields in which their hypotheses about the nature of European integration should be tested (Smith, 2014). Hence, they are less well equipped than are political economists and economist sociologists to grasp the specificity of the financial logics underlying central banks’ policies, and they tend to develop an implicit positive bias in favour of more integration.

1. An evolving paradigm?

Unconventional monetary policies revived the seemingly old-fashioned Keynesian doctrine, which suggests that public expenditures should support aggregate demand when private demand from households and firms is sluggish. Both post-Keynesian and new-Keynesian scholars,[[6]](#footnote-6) who are otherwise in strong disagreement, argue that the best combination of policies to address deflation risks is one where the central bank is directly involved in public debt management through large purchases of sovereign debt, while the government implements a counter-cyclical fiscal policy (IMF, 2013; De Grauwe, 2011; Ball et al., 2016: p. 42–44; Kriesler & Lavoie, 2016; Dow, 2017).

There is also a wide consensus in the post-crisis economic literature that central banks should be delegated additional financial supervision responsibilities (Goodhart, 2011; Reinhart & Rogoff, 2013; Bernanke, 2013; Blinder, 2016). According to this research, central bankers have the required expertise, the analytical resources, and the relevant information about banks to endorse financial regulation and supervision responsibilities. Moreover, they are less affected than are political authorities by economic patriotism and other forms of bias likely to impair the supervision of domestic banking systems (Clift and Woll, 2012). In the case of the ECB, the delegation was also motivated by functional considerations, coined under the concept of “financial trilemma”, which states that financial stability, cross-border banking activities and national financial policies are incompatible[[7]](#footnote-7) (Schoenmaker, 2011).

Only ordo-liberal economists[[8]](#footnote-8) disagree with this new consensus and argue for a return to the “narrow” model of central banking (Borio, 2011; Issing, 2012; Sinn, 2015). According to them, increased macro-economic coordination and the purchase of sovereign bonds blur the line between fiscal and monetary policies and put central bank independency at risk. Supervisory responsibilities might furthermore jeopardise the pursuit of price stability, as they could increase conflicts of interest between both objectives, reputational risks, and interactions with political authorities.

However, for most economists, these fears are not grounded as long as central banks remain legally independent from the government (Posen, 2010). On the one hand, they believe that increased ex-post and ex-ante channels of communication with governments and accountability procedures with parliamentary authorities are “inevitable and desirable” for controlling the expansion of central banks´ responsibilities (Blinder, 2013). On the other hand, they set limits for the integration of additional objectives within central banks. Indeed, in this predominant view, central banks should not play any role in the formulation of budget and fiscal policies, and they should not centralise all the tasks of financial supervision and regulation, since some of them are highly politicised (Ball et al., 2016). For example, deciding which financial institutions should benefit from a bailout financed by taxpayers is a highly political process that is seen to require a management by governmental authorities.

1. The distributive consequences of monetary policy

There is an overwhelming consensus among central bankers and economists that asset purchasing programmes have increased wealth inequalities, since they augmented the wealth of asset-owners, who are already concentrated at the top end of wealth distributions (Bell et al., 2012; White, 2012; Domanski et al., 2016; ECB, 2016; Montecino & Epstein, 2015). Building on a comparative discursive analysis, Fontan et al. (2016) have compiled the justifications put forward by central bankers and found them wanting: other policy alternatives were not seriously considered, and it was not realistic to rely on governmental redistributive taxation to correct these inequalities, since it is undermined by conditions of capital mobility. These distributive consequences challenge normative models of liberal democracies insofar as the policies of unchecked independent agencies are not supposed to create winners and losers in an arbitrary way (Heritier & Lehmkuhl, 2011). In fact, the reinforcement of economic inequalities in this new age of central banking confirms the research results of the literature focusing on the crises of capitalism: the political answer to the crisis has been interpreted as reflecting a growing influence of the “market constituency” at the expense of the “people constituency” (Streeck & Schäffer, 2013; Green & Lavery, 2015).

Prolonging these financial ethics’ concerns, Fontan (2017) argues that central banks’ purchases of corporate securities also entail distributional implications to the extent that they distort competition between firms: the targeted companies are advantaged over their competitors since they benefit from lower funding costs and can more easily engage in mergers and acquisitions. To address these critics, central bankers have followed a depoliticisation strategy in the instrumentation of their monetary policy. They claim that their purchases are “market neutral” and do not advantage specific firms because they reflect the composition of the whole corporate bonds market. Yet, the firms that are most active on the bond market, that is, multinational companies engaged in carbon-intensive activities, need high levels of external financing (Matikainen et al., 2016; CEO, 2016). Hence, they are advantaged over their competitors.

In sum, researchers agree that, since the crisis, central banks’ responsibilities have expanded, while their level of independence towards political authorities has remained high. The academic consensus stops there, as there is a high level of disagreement on the explaining factors and the desirability of this new era of central banking. Extrapolating from current empirical developments and the state of the literature, we outline three challenging research agendas on the political side of central bank independence.

First, the post-democracy and depoliticisation research agendas should focus more on central banks’ policies, which are left out of the analysis to a slight degree (Crouch, 2004; Hay, 2007). For example, the depoliticisation strategies conducted by central bankers in the instrumentation of their monetary policies and their coercive impact on democratic procedures follow similar political patterns to these observed in the implementation of austerity measures.

Second, designing a systematic comparative study on the evolution of democratic controls over central banks would inform the research on the politics of independent regulatory agencies. Indeed, courts of justice, parliaments, and governments have different levers to influence the formulation of central banks’ policies (mandate change, judicial controls, nomination procedures, parliamentary hearings). Comparing how these authorities use their levers in different currency areas would help to outline the causal factors informing the evolution of these democratic controls. In particular, researchers could pay close attention to the nominations of Federal Reserve banks’ presidents under the new Dodd-Frank Act, which forbids the participation of financiers in this process (Conti-Brown, 2016).

Third, economists and political philosophers need to take into account the distributive consequences of monetary policy when advocating macro-economic institutional frameworks. In particular, the combination of austerity measures and monetary expansion fuel economic inequalities to a degree rarely seen since the rise of capitalist societies (Alvaredo et al., 2018). Since inequalities were already too high before the crisis against the standards of most theories of justice, the definition of fairer monetary tools to answer the next crisis in a less problematic way represents a major challenge to academics.

## The other side of independence: financial power and central banking

Before the 2007 crisis, concerns about the other side of central bank independence, namely its isolation from financial market pressures in the pursuit of its policy objectives, were put on the back burner. Yet, the process of financialisation,[[9]](#footnote-9) which is the most important economic change since at least the 1980’s, has affected the relationship between central banks and financial markets in a paradoxical fashion (Dyson, 2009; Krippner, 2012).

On the one hand, financialisation empowers central bankers, because their knowledge of financial markets and their ability to alleviate market pressures becomes more important in the eyes of policymakers. On the other hand, larger, interconnected, and highly leveraged financial systems threaten the pursuit of financial stability objectives, because systemic financial crises become more likely. In light of this ambiguous relationship, economy sociologists and critical political economy researchers study whether central banks are under financial dominance, which “obtains when the attainment of [their] policy goals is compromised by some contingent features of financial markets or patterns of behaviour of market participants” (Dietsch et al., 2018, p. 63). More precisely, this literature has identified three sources of power wielded by the financial sector over central banks: instrumental power, structural power, and infrastructural power.

1. *Capture*

Instrumental power is related to the concept of regulatory capture, which occurs when an industry manages to influence its regulator for its own purposes (Stigler, 1971:4). From an historical perspective, the question of capture emerged from the institutional origins of central banks, which used to be private banks with private equity. For example, the Fed faced risks of financial capture at its inception (Bordo & Roberds, 2013).

The financial crisis has revived academic attention on the issue of central bank capture against the background of the new financial stability goal assigned to central banks (*Competition and Change*, special issue forthcoming; Johnson and Kwak, 2010; Canova, 2011; Boyer & Ponce, 2012; Palley, 2013). Since central banks exert stronger influence on the activities of the banking industry, the latter has more incentives to seek to capture them. As stressed by Buiter (2008) and Couppey-Soubeyran (2015), regulatory capture takes three different forms: direct capture, indirect capture, and cognitive capture.

First, risks of direct capture arise when financial lobbies manage to design their own regulations. For example, during the 1990s, the lobbying of the financial industry was so influential that it participated directly in the first draft of the Basel II agreement, which set the framework for banking regulation at the international level (Baker, 2010). However, this example is the exception, rather than the rule. In fact, the academic literature is not well-equipped to detect direct capture, as material proofs are mostly hard to gather.

Second, indirect capture is related to central bankers’ financial career concerns and to the ‘revolving doors’ phenomenon. Adolph (2013) distinguishes between ex-ante and ex-post indirect capture. Ex-ante capture relates to career socialisation, when central bankers are more likely to be influenced in their economic beliefs by the banking sector if they used to work within the financial industry. Ex-post capture refers to practices in the financial industry of hiring central bankers. In such a configuration, central bankers have incentives to send favourable signals to their future employer in the financial sector. For example, central bankers might be deterred from advocating stronger financial regulation because they know that this might lower their chances of reaping the rewards of higher wages and more prestigious career prospects in the financial industry. Both ex-ante and ex-post mechanisms influence central bankers’ interests, so that they move closer to the financial industry interests. In other words, the financial industry does not need to influence central bankers from *outside*,since capture takes place *within* regulatory institutions. While economic sociology research on central bankers’ biographies since the crisis is scarce, preliminary research results show that individuals with a background in mainstream economics and private finance enabled monetary innovations (Lebaron & Dogan, 2016; Fontan, 2016). Moreover, ex-post risks of capture are especially significant, since former central bankers are appointed to a managerial position in the asset management sector after a median period of one year (Carré & Demange, 2017).

Third, cognitive capture does not require either direct or indirect capture (Buiter, 2008; Kwak, 2014). Central bankers and financial operators might share similar economic ideas because of group-thinking or socialisation processes. In fact, central bankers and representatives from the banking sector share similar sociological profiles and scholarly curricula. They meet frequently on different occasions, for example, during central bankers’ speeches. Moreover, an NGO has recently reported that the ECB’s twenty-two advisory groups include an overwhelming majority of representatives from private banks (508 of the 517 seats) (CEO, 2017). As central banks have gained financial supervision competences, the channels of communication between central banks and the financial sector will increase, as will the risk of cognitive capture.

1. *Structural power*

Whereas the instrumental power of finance is direct and relational, its structural power derives from the central role played by financial institutions in our economies (Culpepper & Reinke, 2014). When banks become too-big-to-fail (TBTF) under the financialisation process, it is much more likely that public authorities will bail them out in the case of financial difficulties (Woll, 2014). The awareness that policymakers’ hands are tied creates a problem of moral hazard,[[10]](#footnote-10) since banks have an incentive to grow to the point that they become TBTF. In fact, Federal Reserve insiders acknowledged in 2005 that reputational and economic costs linked to the failure of a TBTF institution would be so high that they would have no choice but to bail out insolvent banks, even though it would trigger a moral hazard and, thus, hamper both medium- and long-term financial stability (Stern & Feldman, 2005).

Arguably, the liquidity offered to insolvent institutions in the early stages of the crisis, and the systemic unconventional monetary tools implemented later on, confirmed that, when central banks are faced with a trade-off between short-term financial stability and long-term financial stability, they tend to favour the former (Jacob and Kings, 2016; Goodhart et al., 2014). In turn, these interventions transformed central banks into “bad banks”, to the extent that they swapped liquidity against risky assets previously owned by commercial banks (Cour-Thimann, 2013). Moreover, banks did not use this favourable situation to recapitalise and consolidate their balance-sheets to be more resilient when the next financial crisis hits (Brunnermeier and Sannikov, 2016). Rather, the discrepancy between the post-crisis lacklustre economic performances and market euphoria suggests that financial operators did not make any fundamental changes to their risky behaviours (Turner, 2014; Admati and Hellwig, 2014).

Alongside central bankers themselves, New Keynesian scholars argue that moral hazard is a small price to pay, considering that the economic and social consequences of the 2007 market meltdown would have been more severe without the swiftness and the scope of central bank interventions (Eichengreen, 2014). However, in this case, we would expect central bankers and other political authorities to support stricter financial regulation and deleveraging of the financial sector to prevent similar problematic scenario in the future. Yet, financial regulation reforms at domestic and supra-national levels did not meaningfully limit the problematic financial activities that led to the crisis (Helleiner, 2014; Couppey-Soubeyran, 2015; Thiemann et al., 2017; Hunt & Hay, 2018). The first research results on the role played by central banks in these reforms show that, far from advocating stricter rules, they have advocated further financialisation of the banking sector (Gabor and Vestergaard, 2018; Conti-Brown, 2016, p.160).

1. *Infrastructural power*

Commercial banks wield infrastructural power—the control they exert over the transmission channels of monetary policy (Braun, 2018). In fact, central banks do not directly control how prices are set in an economy—those stem from multiple decisions of economic agents—but monetary policy has an indirect impact on prices through various ‘channels of transmission’. Banks play a central role in the transmission of monetary policy, as they modify their credit policy according to central banks’ manipulation of the interbank lending market rates. In the words of Braun, these channels of transmission are “infrastructural entanglements”, which makes central bankers dependent on bankers to steer the economy. Scholars have explored how central bankers’ depoliticisation strategies ignited commercial bank’s infrastructural power before the crisis on both sides of the Atlantic (Krippner, 2012; Gabor & Ban, 2016). Now, they study how this leverage led to the protection and promotion of problematic market activities by central bankers and their lack of control over the use of the liquidity provided to financial operators since the crisis.

First, after Lehman Brothers’ bankruptcy, the Fed, the BoE, and the ECB injected massive amounts of liquidity to stabilise problematic segments of financial markets, such as repo and securitisation markets[[11]](#footnote-11) (Gabor & Ban, 2016). The ECB came to rely so much on the smooth functioning of repo markets for the transmission of its monetary policy that it successfully opposed their inclusion into the EU financial transactions’ tax proposal (Gabor, 2016). The Fed adopted similar lobbying activities to oppose stricter regulation on the US repo markets (Singh, 2015). Moreover, the ECB and the BoE have also been at the forefront of the EU authorities’ efforts to revive securitisation markets under the Capital Market Union proposal [Competition and change, special issue 2018, vol. 22 (2)]. In other words, central bankers have actively defended and promoted problematic market activities that led to the crisis because the transmission of their monetary policy came to rely on their smooth functioning.

Second, there is a huge discrepancy between the amounts of liquidity injected by central banks in the financial markets and their impact on economic performances (Turner, 2014). This is because commercial banks exploit their leverage to use the liquidity provided by central banks for purposes other than providing credit to economic agents (such as either investing in exiting assets or derivatives or engaging in shares’ buybacks). Political economy research on the conditionality attached to monetary instruments has shown that central bankers fail to control the use of their liquidity (Dietsch at al., 2018, chap. 3). For example, as no conditionality was attached to the initial ECB liquidity offers, banks engaged in carry trade activities that are problematic from the point of view of central bank policy objectives: they borrowed liquidity at 1% to purchase risk-free sovereign bonds with higher interest rates and pocketed the difference. When the introduction of some form of conditionality on the use of liquidity was experienced, banks were reluctant to participate in these operations, and the ECB quickly gave up its attempt to control the use of its liquidity.

In sum, isolating central banks from political pressures does not solve the issue of their independence towards financial market interests. Quite the contrary, the answer of independent central banks to the financial crisis has exposed that they are, at least to some extent, under financial dominance, which is caused by the instrumental, structural, and infrastructural power wielded by financial institutions. While being problematic from a societal point of view, financial dominance offers three vibrant research agendas for political economists and economic sociologists.

First, debates about infrastructural power articulate well with the research on the state-finance nexus. For example, economic sociology scholars studying the marketisation of public debt have also highlighted policymakers’ strategies of “governance through financial markets” (Lemoine, 2016; Juven & Lemoine, 2018). Interestingly, while public debt lies at the heart of central bank´s unconventional policies and Eurozone governance debates, there is as yet no study tying both elements together.

Second, researchers exploring banking regulatory reforms may pay closer attention to the role played by central banks in post-crisis times. Indeed, there are clear indications that they became key policy actors in national and supranational reforms thanks to their epistemic authority (Omarova, 2018). From this perspective, the analysis of central bank research production on financial activities and reforms might add a new piece to the puzzle of post-crisis financial regulation.

Third, with the integration of financial stability objectives within central banks, some historical doctrines of central banking are starting to be questioned again in the economic field. For example, the ongoing debate on the design of macro-prudential instruments is linked to the wider theoretical debate regarding two strategies to effectively deal with financial crises: “cleaning up afterwards” vs. “leaning against the wind” (Carré, 2015).

## Conclusion. The future of monetary policy

The practice of central banking has changed dramatically since 2007. Central banks became key players in the stabilisation of financial and economic systems. By doing so, their policies strayed increasingly into the political realm and became more controversial. This new era of central banking has revived scholarly debates and vibrant future research perspectives on both dimensions of their independence: towards political and financial institutions. In conclusion, we would like to explain how these debates would take place within three scenarios on the future of central banking.

The first scenario entails that, after ten years of unconventional monetary policy, economic conditions would allow a return to the pre-crisis CBI template. Inflation rates would stabilise at around 2% due to high employment, and central banks would come back to their usual inflation targeting strategies with the manipulation of interest rates as their main policy instrument. CBI proponents and current central bankers, arguably, hope that this scenario will happen, as it would preserve their independence. In this case, the major puzzle for political economists would be to identify the conditions explaining the resilience of the CBI template.

Under the second scenario, central banks become “behemoths”, i.e., very powerful institutions equipped with both monetary and macroprudential instruments and little democratic accountability. As in the 1990s, a new monetary ‘science’, driven by central banks’ powerful research staff, would develop in the economic field to legitimise these changes. Financial institutions would not need to increase their efforts to capture central banks, because the latter would already implement policies in favour of their interests, given their exposure to cognitive capture. Such a scenario would both confirm the research findings of and fuel the critical political economy and sociology literature focusing on post-democracy and depolitisation processes.

The third scenario is inspired by the Japanese example. Unconventional policies, such as “quantitative easing”, become the new norm, given the permanent risk of deflation. Because of the distributive effects of such policies, political authorities would regain control over central bank activities, as feared by the central banking community. In other words, the coordination between central banks and other economic regulators would increase. Practical examples of such coordination include the creation of an ethical committee screening central banks’ purchases (such as in the case of the Norwegian Oil Fund), the financing of “strategic” activities defined by governments (such as in the cases of the Bank of Japan and the Bank of South Korea), and the financing of ecological transition (such as in the case of the People’s Bank of China). Such developments would fuel debates in the political sciences’ literature and increase the relevance of the distributive justice concerns developed in the field of financial ethics.

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1. The authors would like to thank for Isabelle Guinaudeau and Richard Endörfer whose helpful comment have significantly imporve this review article. We benefited from the financial support of the Wallenberg Foundation and the Maison des Sciences de l’Homme Bretagne (GOBACEAC project). The usual disclaimer apply. [↑](#footnote-ref-1)
2. To respect the number of words allotted, we do not cover historical, legal, and ethnographical research on central banking, and we focus only on the European Central Bank, The Federal Reserve, and the Bank of England. [↑](#footnote-ref-2)
3. Quantitative Easing consists of the purchase of financial assets through an *expansion* of the size of the balance-sheet, while Qualitative Easing is only about changing the *composition* of the balance-sheet. Also, note the difference between the use of conventional monetary instruments in an unconventional way (LTRO) and the implantation of unconventional instruments (quantitative and qualitative easing) (Pfister and Valla, 2015). [↑](#footnote-ref-3)
4. This third form of legitimacy usually refers to accountability and deliberative procedures. [↑](#footnote-ref-4)
5. In particular, they propose a dubious correlation between the ECB interest rates and the volume of mass demonstrations to back up their claim (p. 957). [↑](#footnote-ref-5)
6. Post-Keynesians are “heterodox” economists, as they claim the legacy of both Marx and Keynes, while New-Keynesians represent the new “economic orthodoxy”, since they provide a synthesis between the new classical Macroeconomics and Keynesian principles. [↑](#footnote-ref-6)
7. In earlier stages of European economic integration, supranational players, such as the Commission, have justified the creation of the euro with such models of incompatibility (McNamara, 1998). [↑](#footnote-ref-7)
8. Ordo-liberalism is a specific form of neoliberalism, which guided German economic policies since the 1950’s. [↑](#footnote-ref-8)
9. Financialisation refers to the expansion of both the financial industry as a share of the GDP and financial logics within non-financial sectors. [↑](#footnote-ref-9)
10. To address this problem, public authorities must bail out banks suffering from a mere liquidity crunch, while letting insolvent banks fail. [↑](#footnote-ref-10)
11. The transactions taking place on over the counter repo markets are repurchase agreements, in which one party agrees to buy a specific security and sell it back at a later date (usually some days) and at a predetermined price. Today, banks ensure their financing mainly through repo markets. Securitisation refers to the process of bundling loans together to create a financial security, which can be exchanged on secondary markets. Subprime loans have been heavily securitised. [↑](#footnote-ref-11)