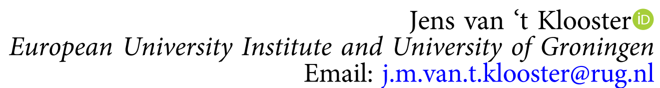
and policy documents. This made it difficult to engage critically with the normative justifications of the existing regulatory framework. Consider the distributional effects of QE already mentioned. Clément Fontan, François Claveau and Peter Dietsch (2016) perform a labour-intensive systematic analysis of central bank speeches to demonstrate that central bankers disavow responsibility for these effects. Tucker acknowledges the distributional effects and explains why he believes final responsibility for them lies with elected governments. In developing his Principles of Delegation, Tucker puts forward a systematized account of the views held within the central banking community and lifts them up to the level of a political philosophy of central banking. His vision of central bank independence is likely to be invoked and contested in the years to come.



Jens van 't Klooster
European University Institute and University of Groningen
Email: j.m.van.t.klooster@rug.nl

References

Bunn P., A. Pugh and C. Yeates 2018. *The Distributional Impact of Monetary Policy Easing in the UK between 2008 and 2014*. Staff Working Paper No. 720. Bank of England.

Fontan C., F. Claveau and P. Dietsch 2016. Central banking and inequalities: taking off the blinders. *Politics, Philosophy & Economics* **15**, 319–57.

Klooster J. van 't 2018. Central banking in Rawls's property-owning democracy. *Political Theory*. https://doi.org/10.1177/0090591718810377.

Klooster J. van 't and C. Fontan 2019. The myth of market neutrality: a comparative study of the European Central Bank's and the Swiss National Bank's corporate security purchases. *New Political Economy*, August. https://doi.org/10.1080/13563467.2019.1657077.

Matikainen S., E. Campiglio and D. Zenghelis 2017. The climate impact of quantitative easing. *Grantham Institute Policy Papers*, 1–36.

Jens van 't Klooster is a Max Weber Fellow at the European University Institute in Florence and a PhD candidate at the Department of Economics and Business of the University of Groningen.

Do Central Banks Serve the People? Peter Dietsch, Francois Claveau and Clement Fontan. Polity Press, 2018, vii + 135 pages.
doi:10.1017/S026626711900035X

Central banks have exercised so much power since the financial crisis that it is both natural and good that there is renewed public debate about quite what they are for and how they fit into a system of constitutional democracy.

The cue for Peter Dietsch, Francois Claveau and Clement Fontan's contribution to this debate is Bank of England Governor Mark Carney's 2014 reconfiguring of the British central bank's mission statement to emphasize it exists 'to promote the good

https://doi.org/10.1017/S026626711900035X Published online by Cambridge University Press

of the people of the United Kingdom . . .'[1] Taking that at face value, they pointedly ask: *Do Central Banks Serve the People?* Their answer, in a nutshell, is: not really.

Had their question been 'have central banks maintained low and stable inflation?', the answer would have to be, yes. Had it been 'have they maintained financial stability?', the answer would surely have been: definitely not in the years leading up to 2007, and it is too early to tell whether things are decisively better now. And if the question were 'have they fulfilled their statutory duties?', the answer is: depends on which central bank you are talking about.

But Dietsch *et al.* are not really asking whether central banks could make a better job of fulfilling their statutory mandates but, more fundamentally, what their mandate should be and, implicitly, how far, if at all, a central bank that 'serves the people' should be insulated from day-to-day politics.

The result is in the style of a tract or polemic, but none the worse for that as on the whole it wears its biases on its sleeve and presses important issues. My summary verdict is that the challenges they pose are salient, their analysis interesting but incomplete, and their prescriptions worthy of debate. The authors have usefully highlighted the paucity of serious political analysis about the social purposes of central banking without themselves taking that debate much further forward or nailing the various levels at which it needs to be conducted. So why do I say that?

Chapter 1: central banking: the essentials

The book opens with an admirably crisp summary of central banking for non-specialists. Two facts are rightly emphasized. First, that just about everything turns on a central bank being the monopoly supplier of the ultimate means of settling debts, legal-tender money. That means that they are the lender of last resort (LOLR); and, also, that they can steer the rate of inflation over the medium-to-long run by controlling either the quantity or price of their money in the economy.

Second, Dietsch *et al.* point out that, as a matter of historical fact, central bank mandates have tended to be narrower, the more they are formally insulated from day-to-day politics (independence). In the quarter century or so up to the 2008 crisis, their formal independence tended to increase, and their mandates to narrow. In an important, because revealing, footnote (fn 1, 118), the authors attribute this to 'the spread of neoliberal beliefs, geopolitical changes (such as the collapse of the communist bloc), and pressures from international organisations (such as the EU and the IMF)'. There are both normative and positive points to be made here. (Some of what follows is, strictly, a response to the book's second chapter, but when I come to that I want to concentrate on Dietsch *et al.*'s prescriptions.)

Normatively, the authors do not engage with whether the values of constitutional democracy place constraints on what can decently be delegated to unelected officials insulated from quotidian politics but ultimately backed by the coercive powers of the state. Are narrow mandates a reflection of our deep political values? Or should

[1]The previous language was simply, 'The Bank of England exists to ensure monetary stability and to protect and enhance the stability of the financial system', which crisply paraphrased the law.

https://doi.org/10.1017/S026626711900035X Published online by Cambridge University Press

we be relaxed about ever broader mandates that effectively give technocrats the power to balance values and conceptions of the good?[2]

Positively, the history of how the advanced-economy countries embraced (and, yes, then proselytized) central bank independence is somewhat richer and more bipartisan than the authors would have readers believe. The critical juncture came not so much during the administrations of Reagan/Thatcher and their successors, but in the unravelling during the early 1970s of the post-Second World War Bretton Woods system, which had carried into the modern world the essence of the 18th/19th century gold standard. When, under the pressure of funding the Vietnam War and its civil rights programme, the US government could no longer maintain the dollar's stipulated value in terms of gold, the world moved to a permanent system of fiat money. That was precisely because the disciplines of a commodity-type monetary standard could not be reconciled with the popular demands of full-franchise democracy. What followed was initially a mess: stagflation, which is to say high and highly volatile inflation together with falling economic activity and jobs. Big picture, by giving up a monetary anchor, government seemed also to lose its ability to stabilize the economy (jobs and output) in the face of shocks and disruptions.

Dietsch *et al.* maintain that the response was to embrace conservative central bankers as paragons of monetary rectitude, and up to a point that is true. But delegating price stability to an insulated authority was as much about finding a way to resuscitate the kind of economic stabilization policy that had been central to the aims of the Keynesian revolution. Looked at that way, independent monetary authorities became part of the social democratic 'embedded liberalism' that, from the middle of the 20th century, sought to reconcile the welfare state with a market economy (Ruggie 1982). That is why central banks are unpopular with parts of the libertarian Right.

As it happens, I would argue that, in the background, something more profound was going on at the level of our constitutional values.

Monetary independence as a corollary of the high-level separation of powers

One of the decisive steps towards our modern system of constitutional governance was insistence that representative assemblies formally approve a monarch's desire to levy taxes. That separation of powers would be undermined if the executive government controlled the money-printing press. It would at very least be able to defer any need to go to the legislature for extra 'supply', and at worst could inflate away the real burden of its debts to reduce the amount of taxation requiring Parliamentary or Congressional sanction. In other words, it could usurp the legislature's prerogatives.

Seen thus, delegating to a monetary authority designed to be immune from the exigencies and temptations of short-term popularity is a *means* to underpin a core value of the separation of powers (once the step to fiat money has been taken). In that sense, central bank independence finds a place in constitutionalism (Tucker 2018: Ch. 12).

[2]That is the question addressed in Tucker (2018).

https://doi.org/10.1017/S026626711900035X Published online by Cambridge University Press

Chapter 2: central banking and inequalities

For me, this is the book's most accomplished and important chapter. Dietsch and co-authors argue that the sustained monetary stimulus since the 2008 crisis has had distributional effects, exacerbating inequality, in particular by making the very rich richer; that (some) central bankers should quit pretending otherwise; and, most important, that their remits should be amended to ensure that central banks can become instruments of distributional justice rather than knowing or accidental purveyors of injustice. These are big points, going right to the heart of economic policy.

Asking why low and stable inflation is worth pursuing (22), the authors argue that it can only ever be of instrumental interest, a means to some more basic end, whereas inequality is intrinsically bad and so, impliedly (although this is not explicit), should trump price stability. As the authors put it, 'we [meaning, I think, the people] might be prepared to accept a slightly higher level of inflation in exchange for a significantly less inegalitarian distributive outcome' (33).

That framing is incomplete if, on the argument sketched above, fidelity to our constitutionalist values has intrinsic value or, in welfarist terms, if price stability releases resources to address inequality. The latter is not farfetched. As the authors observe, 'fluctuations in the rate of inflation, which historically tend to be larger at higher rates of inflation, create uncertainty' (23). But while they relate that to investment, uncertainty about the future value of money also raises the costs of government borrowing (via nominal bonds). If an independent monetary institution reduces those costs, it gives government more fiscal capacity to address inequality and other social issues.[3] Research suggests the numbers could be quite big.[4] Any trade-off between inflation and inequality might be less straightforward than the authors suggest.

Objectives versus constraints: doing good vs. avoiding harm

But whether or not the authors are mistaken about the nature of any trade-offs does not go to their forceful argument that inequality matters and central bank policy might be making it worse. Their prescription is that 'the monetary policy rule (sic) could simply be extended to include distributional objectives or constraints' (39). They do not, however, bring out a slightly subtle but important distinction between, on the one hand, giving monetary policy makers an objective for inequality (somehow measured) and, on the other hand, imposing constraints on the use of their balance sheets.

In the economics literature, the standard objective for monetary policy is typically approximated by, in the jargon, a quadratic loss function, where the central banker aims to minimize the sum of squared deviations from a target for inflation and squared deviations from (an estimate of) full-employment

[3]By reducing the premium charged for the risk that higher average rates of inflation tend to be associated with more volatile inflation (which is distinct from the compensation for higher *expected* inflation).

[4]When the Bank of England was made independent in 1997, longer-term nominal rates fell by around 50 basis points. Recent research suggests that a good portion of that, maybe around half, might represent a fall in risk premia. If so, the impact on debt-servicing costs would be quite something given risk-free real rates of interest averaged around 2.5–3% at the time: a reduction of between 5 and 10% of the real rate of interest paid on nominal bonds. For example, see Joyce *et al.* (2010).

https://doi.org/10.1017/S026626711900035X Published online by Cambridge University Press

economic output. In principle, other things could be added, including squared deviations of a measure of inequality from a target for inequality.

This would be demanding. First, the inequality target might, due to politics, swing around, depending on which party was in government. Second, the central bank would need a reasonably robust model of how its policy instruments affect inequality, and of how shocks to inflation, aggregate demand and the economy's productive capacity affect inequality, and vice versa. Third, the central bankers' exercise of discretion would be greater the more there is a long run trade-off between inflation and inequality or between the sustainable path of output and inequality. My best guess is that neither the current state of knowledge nor our tolerance for unelected officials making those big calls supports an early move to this approach, which I shall call the 'doing good' option.

The alternative is an 'avoid harm' option. This would take the form of elected politicians setting a hard (or soft) law constraint on central bankers using their balance sheets in ways that exacerbate inequality. In principle, such a constraint could take a number of forms. One might be: do not purchase corporate securities unless also purchasing securities backed by loans to households and small firms. Another, adopted by the Bank of England in 2012 and later emulated by the European Central Bank, might be to make the terms of their lending to banks depend on how banks use the money. It would be important whether the constraint was for normal times or crises, and if the latter who determined the state of exception.

Helicopter money and the fiscal realm

The authors' own favoured approach, I think for crises, is 'a "helicopter drop" . . . a direct deposit of money in citizens' bank accounts', which they say would have been more powerful and no more radical than quantitative easing (QE) (30).

Unlike QE, 'helicopter money' is, by design, a permanent injection of money into the economy. It would not have to be effected by gifts of money to individual households, but it could be. As such, distributional choices are unavoidable. For example, should only citizens be given money, or long-term residents too? Should each eligible person/household get the same amount (a poll transfer) or should the amount depend on a person's income or wealth (and if so, how progressive or regressive should the transfer be)? In democracies, I think we would want elected representatives to make those choices, not unelected technocrats. But what about the amount of money injected: could that decently be delegated?

Whatever one's answers, it becomes apparent that the missing actor in the book's argument is elected government and the missing policy is fiscal policy. Why did governments not use their tax and spending powers to offset/soften some of the distributional effects of QE? Why, more generally, was macroeconomic recovery so reliant on unelected monetary policymakers rather than elected fiscal policymakers? Once these issues are allowed in, debt-financed fiscal stimulus emerges as an option before money-financed transfers.

For those reasons, it is simply incorrect for the authors to say 'the current division of institutional labour does not contain a mechanism to include the unintended distributional consequences of monetary policy in policy design'

https://doi.org/10.1017/S026626711900035X Published online by Cambridge University Press

(33). Our democratic system of government leaves that space open, in practice and as a matter of law, to the elected fiscal authority.

Chapter 3: central banking and finance

The central argument of this chapter is that central bankers encouraged the 'financialisation' of the economy in order to make their lives easier, favouring deregulation and innovation in the interests of promoting 'market-based finance', but that this backfired when they found themselves needing to prop up markets in order to keep the show on the road. As a statement of orthodoxy in the central banking community as a whole – as opposed to being a crisp indictment of some prominent individuals – in the years leading up to the 2007/08 crisis, I believe this to be largely wrong, and a distraction from a larger target.

It is not that the authors' details are deeply awry. They do a good job, for example, of describing how what were known as 'originate and distribute' securitization markets interacted with sale-and-repurchase (repo) money markets to disastrous effect. My concern is that they miss the wood for the trees. When, in 2007/08, the music stopped, the heart of the problem was not new-fangled instruments. It was that commercial banks were thinly capitalized, and that too many investment vehicles on the fringes had the inherent fragilities of banking (leverage and maturity mismatches), leaving them vulnerable to self-fulfilling runs. Nothing in that is new: it is more or less the story of every previous crisis.

For that reason, the most important section of the chapter is 'The power of weakness', discussing central banks' role as lenders of last resort and the egregious problem of too big to fail. Here I should have liked to see what the authors make of the new statutory regimes to resolve the largest and most complex firms without taxpayer bailouts, which if effective would make it easier for central banks to turn away fundamentally unsound firms (see Tucker 2019).

More important, I was left unclear whether the authors believe that the perennial fragility of the financial system is a symptom of the political power of financiers or of the attractions, for elected legislators, of regimes that are prone to easy credit conditions and housing booms. Put another way, how, as a matter of political economy, should a democratic republic design a regime where regulators are constrained by legislation to ensure the degree of resilience in the financial system that society demands, and what are the major trade-offs between resilience and other things citizens care about? Whereas Chapter 2 gets into some of the deep issues in the design of a monetary policy regime, this chapter does not achieve the same for central banks' role in financial stability.

Nor are the prescriptions so clear. When, in their Conclusions, the authors air the possibility of 100%-reserve banking, they are indirectly (and possibly inadvertently) advocating more reliance on market finance, not less. When, on the other hand, they air citizens having accounts with the central bank, they are advocating a move towards state-controlled allocation of credit. Those courses are rather different.

https://doi.org/10.1017/S026626711900035X Published online by Cambridge University Press

Chapters 4 and 5: central banking expertise, and institutional options

In their fourth chapter, the authors register concerns about uniformity in debates about central banking, lack of external challenge, and insufficient diversity on policy bodies. Some good evidence is deployed.

My own targets would have been slightly less group think within economics, where (especially in the USA) one can find almost every shade of opinion on monetary affairs, and rather more on making it easier for political scientists, political theorists, sociologists, legal scholars and others to join in the debate.

Summing up, *Do Central Banks Serve the People?* mounts a series of effective provocations, raising important public policy issues that warrant careful debate. While not offered as a stand-alone primer on central banking, it would make a useful companion to a number of other short books, and should definitely be read by incumbent policymakers.

I wish it had addressed the constraints that flow from our deep political values, and how to avoid letting our elected governors off the hook. I would also have liked to see a much more careful distinction between normal and crisis conditions: having technocrats call the state of exception, as occurred in the euro area, was a stunning moment for democratic governance, however well it worked in practice. Ultimately, these are issues in constitutionalism.

Paul Tucker
Harvard Kennedy School

References

Joyce M.A.S., P. Lilholdt and S. Sorensen 2010. Extracting inflation expectations and inflation risk premia from the term structure: a joint model of the UK nominal and real yield curves. *Journal of Banking & Finance* **34**, 281–294.

Ruggie J.G. 1982. International regimes, transactions, and change: embedded liberalism in the postwar economic order. *International Organization* **36**, 379–415.

Tucker P. 2018. *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State*. Princeton, NJ: Princeton University Press.

Tucker P. 2019. Solvency as a fundamental constraint on LOLR policy: principles, history, law. http://paultucker.me/wp-content/uploads/2019/04/Solvency-As-A-Fundamental-Constraint-On-Lolr-Policy.pdf.

Paul Tucker is a research fellow at the Harvard Kennedy School, and author of *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulator State*, Princeton University Press, 2018. He was a central banker until late 2013.

https://doi.org/10.1017/S026626711900035X Published online by Cambridge University Press