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The Power of Coordination and Deliberation

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Abstract: I provide comments and replies to the seven insightful contributions that discussed "The Democratic Challenge of Central Bank Credit Policies" and the proposal for a European Credit Council. I review how interdisciplinary scholarship on the political economy of central banking have shown the limits of simple principal-agent framework applied to central bank power and legitimacy. I emphasize why a change to central bank independence is not necessary for a fundamental change in the financial system and credit policies. I also argue that deliberations can have strong effects on decision-making and that the power of the people is not restricted to the legislative power.

Keywords: central banking, monetary policy, credit policy, deliberative democracy, central bank independence

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Table of Contents

Toward a European Credit Council?

1. The Democratic Challenge of Central Bank Credit Policies, by Eric Monnet, https://doi.org/10.1515/ael-2022-0113.
2. The Changing and Growing Roles of Independent Central Banks Now Do Require a Reconsideration of Their Mandate, by Charles Goodhart and Rosa Lastra, https://doi.org/10.1515/ael-2022-0097.
3. Is Asking Questions Free of Charge? Questioning the Value of Independent Central Banks through the Lens of a European Credit Council, by Matthias Thiemann, https://doi.org/10.1515/ael-2022-0108.
4. The Democratic Dangers of Central Bank Planning, by Nathan Coombs, https://doi.org/10.1515/ael-2022-0063.

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5. A European Credit Council for Consistent and Informed Policymaking, by Agnieszka Smoleńska, https://doi.org/10.1515/ael-2022-0065.
6. The Case for a European Credit Council: Historical and Constitutional Fine-Tuning, by Jens van ’t Klooster, https://doi.org/10.1515/ael-2022-0074.
7. A European Credit Council? Lessons from the History of Italian Central Banking after World War II, by Mattia Lupi, https://doi.org/10.1515/ael-2022-0071.
8. The Power of Coordination and Deliberation, by Eric Monnet, https://doi.org/10.1515/ael-2022-0114.
9. The Credit Council in the US Context, by John Davis Feldmann, https://doi.org/10.1515/ael-2023-0134.
10. Democratic Central Banking: Power Not Deliberation, by Leah Rose Ely Downey, https://doi.org/10.1515/ael-2022-0073.

I am grateful to Matthias Thiemann for organising this symposium and for writing his own contribution, as well as to the seven other colleagues who took the time to read my text and wrote very insightful articles on the important issues of central banking today. I feel all the more honoured that the various contributions make strong arguments that respond to each other, so that if the proposal for a European Credit Council was a start, it is clear that the debate goes far beyond this initial reference and stands on its own. The stakes are not limited to the European Union and most contributions tackle general issues of central banking that apply to all democracies today. I will not be able to discuss each contribution in detail, but let me stress the pleasure of reading them all and of having stimulated such important discussions with divergent views. Those who like academic debates to remain abstract and consensual will certainly be disappointed here. Indeed, the different contributions show essential differences on how scholars perceive the role of independent democratic authorities such as central banks. Whether deliberative democracy is as legitimate – and powerful for economic policy-making – as representative democracy is a contentious issue as well. Part of the debate also concerns the specificity of the European Union and the role of inter-institutional dialogues within it (see also Berès, 2021 for a recent discussion of the European Credit Council in this perspective).

While Nathan Coombs thinks that my analysis and proposals “may bolster rather than challenge technocracy” by introducing too much economic *dirigisme* into the economy, Leah Downey and Matthias Thiemann fear (with very different arguments), on the contrary, that I am too complacent with the current independence of central banks. According to this second view, my reluctance to attack the legal independence of the central bank and my focus on deliberation lead to a position that is too weak and does not give enough power to the people to challenge the current order. Based on a precise study of Italian postwar history, Mattia Lupi shares my conclusion on the lack of democratic legitimacy and actual deliberation of the credit councils that existed in the past (for this very reason, I designed the European Credit Council as a means of empowering the European Parliament, rather than being merely a coordination of existing bodies), but he also worries that it is not clear what concrete operational role the new council should play if the central bank remains independent. The two separate articles by Agnieszka Smoleńska and Jens van ’t Klooster actually provide answers to these concerns. They explain – in a much clearer and more powerful way than I could – why deliberation and inter-institutionality matter enormously. Reforming the institutions where these deliberations take place in practice can paradoxically have much more effect than legal changes in strengthening the power of elected officials over technocratic policies and improving the effectiveness of economic policy. Agnieszka Smoleńska shows this clearly by applying this logic to the issues of foreign currency loans and the financing of the ecological transition. In the same vein, Rosa Lastra and Charles Goodhart’s contribution wants to reconsider the institutional structure of central banking in order to allow an appropriate degree of coordination between fiscal and monetary policy, while “preserving the virtues of central bank independence”.

1 The Virtues of Interdisciplinarity

Despite their differences, all these contributions have much in common. They all belong to a dynamic, interdisciplinary field of research that studies central bank policy and, in particular, how recent central bank policies have broad consequences for societies, well beyond an effect on price stability (see Braun & Gabor, 2020; Coombs & Thiemann, 2022; Baerg & Cross, 2022; Moschella, 2023 for recent reviews of the field). This symposium reflects the interdisciplinary nature of this research, where philosophers, sociologists, political scientists, lawyers, economists and economic historians can debate on common ground and a common understanding. It is interesting to note that economists are not the dominant voice in this field. This is in contrast to the way economists shaped the debate on central bank design in the 1980s, and in fact limited it to the issues of central bank independence and interest rate rules for monetary policy. This view was itself based on a simple principle-agent framework where the elected representative of the people (Parliament) delegates its power to an agent (the central bank). This works well as long as the delegation is very precise (i.e. the terms of the mandate are clearly specified) and the delegated policy has consequences that are easily predictable and confined to the mandate. The 2008 crisis and its aftermath have fuelled a huge body of research that has shown that this model mischaracterises what a central bank does in practice and the consequences of its policy (even before 2008). Central banks shape the market and thus make implicit or explicit normative choices about how the financial market is supposed to work. Their policy has important consequences for many other types of public policy (fiscal policy, housing, green transition, etc.). What Jens van ’t Klooster reveals here is that these problems were in fact anticipated and expressed by those who built the central banking architecture in the 1990s. Let me reproduce here two fascinating quotes that van't Klooster extracted from the discussions that led to the creation of the European Monetary Union and that took place between the governors of the European central banks in 1990. About the relationship between central bank intervention and market principles, Wim Duisenberg noted that "some of the actions undertaken by central banks could always be regarded as inconsistent with free and competitive markets; for example, the setting of key official interest rates could be seen as an exogenous act which might not be in conformity with local market conditions". About whether the mandate of the central bank can be very precise and narrow, Jacques de Larosière added that the central bankers "should be careful not to limit the scope of the System", which "should be evolutionary and designed to deal with unforeseen circumstances." It is perhaps no coincidence that de Larosière was one of the main architects of macroprudential policy in Europe from 2009 onwards, recognising that the existing framework failed to coordinate the central bank and other agencies dealing with financial instability.

That central banking is always economic interventionism (to use Karl Polanyi's words), with many potential distributional consequences and interactions with other economic policies, and that the central bank's mandate cannot include all unforeseen circumstances are, in my view, the two fundamental features that show the limitations of the current institutional framework of central banks. They have been known for a long time, but it is really the recent evolution of central bank policies and the work of researchers from different fields (many of whom are contributing to this symposium) that make this clear enough.

2 What Kind of Fundamental Institutional Change Do We Need?

The diagnosis is shared but the means to cure the disease differ. I see a strong contradiction when Nathan Coombs argues that it is better to return to the pre-2008 situation while acknowledging the strong "infrastructural power" of central banks, i.e. their ability to shape and mobilise markets towards their goal. Coombs fears that strengthening Parliament's ability to discuss financial and credit policies related to central banks could lead us to technocratic economic planning where Parliament delegates even more tasks to unelected bodies – even quasi-fiscal policies – in order to avoid being accountable to voters. Indeed, it might be tempting for a government to delegate all ecological transition policies to an unelected body rather than engage seriously with difficult choices. This is a danger that must be avoided, as I have clearly written (the central bank is not a public investment bank, nor the Treasury). And for this, I see no other way than discussions in Parliament and in society in general about the responsibility of each public body. The status quo is worse because the infrastructural power of central banks and their distributive consequences are already here, but almost unchecked and undiscussed.

Coombs believes that my proposal will stimulate economic planning with little democratic accountability, whereas, in contrast, Downey, Thiemann and Lupi argue that a body that institutionalises deliberation would be too weak to bring about substantial change (implicitly, sufficient economic planning to guide the green transition). Yet Coombs also notes that since "central banks' infrastructural power has grown in tandem with market-based finance since the 1980s, attempts to democratise central banking without fundamental institutional change are doomed to fail." This echoes Thiemann's conclusion: "What we need is an increasing pressure on the political status quo, which recognizes that independent central banks are nothing else but anchors of inequality and class domination". Thus, these different views actually converge on the idea that only "fundamental institutional change" (which none of the authors describe) can make a difference.

There are indeed many fundamental changes that need to be made in the financial sector to support the green transition and to prevent the increase in economic inequality, but I don't think they require a fundamental change in the legal framework of central banking. The fact that the actions of central banks today support the development of shadow banking and financialisation is a sign of the unwillingness of governments to regulate the financial sector (partly because they benefit from the liquidity of public debt) and the temptation to let the central bank run the markets, rather than letting Parliament take responsibility for credit policy (Gabor, 2016; Menand, 2022). Giving more power to central banks in order to reform the financial system will only reinforce this temptation. It is misleading to focus on central bank independence when the problem is the lack of financial regulation and coordination of credit policies, which is the responsibility of Parliament. Central bank mandates and policy instruments are very flexible and adaptable to different financial systems and credit policies. If one wants to take an extreme example, let me recall that the central bank of China is, according to standard metrics based on legal charters, more independent from the government than many central banks of OECD countries (Garriga, 2016; Romelli, 2022). China is clearly not a democratic model, and my proposal does not in any way seek to copy the Chinese model. The Chinese case nevertheless illustrates that the degree of economic *dirigisme* regarding credit policy has little to do with the legal independence of the central bank.

Recent research confirms that there is in fact no association between *de jure* central bank independence and *de facto* independence from the government's views since the 1970s (Ioannidou et al., 2022). Some historical examples also support this view (see Monnet, 2018, chp.7). France's post-war credit policy (which articulated central bank policy with the government's financial and fiscal policies) involved significant reform of the financial system and the creation of new agencies to coordinate policies, but it did not make any changes to the central bank's charter (which was designed and reformed in 1936, for the first time since 1806, when the central bank was still private). It was not until 1974 that French law was amended to stipulate, for the first time, that monetary policy was decided by the government. This legal takeover of the central bank by the government lasted until 1993. As in many other countries, the central bank was legally under the orders of the government when the major financial liberalisation of the 1980s reforms took place. By contrast, the Bank of England was reformed in 1946 and the government was given the power to set interest rates and monetary policy objectives. Yet, during the immediate postwar era, the financial system was less reformed and therefore credit policy much less organised and coordinated than on the other side of the channel.

Therefore, one should not expect a major overhaul of the financial sector through institutional reform of central bank independence. The question of whether the financial sector should be reformed should be a decision of governments and the Parliament – not of the central bank through the infrastructural power – and I think that the Parliament would be better placed to make this decision if its members had access to more financial expertise and had more visibility on the different existing credit policy initiatives and their limitations. Empowering the Parliament to do this is the objective of the European Credit Council. The idea that central bank independence works against democracy because democracy leads to inefficient economic outcomes is a legacy of the conservative turn in the 1980s. It needs not be. Central bank independence can be seen instead as an element of checks and balances with epistemic virtues in a democracy (see Estlund & Landemore, 2018 on epistemic virtues of democratic deliberation).

3 The Power of Deliberation

Does the fact that the European Credit Council is only a deliberative body contradict the power of the people? Is deliberation only about explaining things to people, instead of empowering them – as Leah Downey argues – and should we instead increase legislative power over monetary policy?

Legislative power over monetary policy exists in many countries and is seen as a condition of central bank independence, not a limit to it. The actions and objectives of the central bank are set by law. Legislative power is very limited in countries where the Parliament has no power (as in China, which explains why the Chinese central bank is paradoxically very independent by *de jure* standards). It is also more limited in the European Union, because a change in the legal status of the central bank requires a change in the Treaty. However, several articles of the Treaty allow for changes in the way monetary policy operates with the approval of the Parliament, and the objectives of the European System of Central Banks defined by the Treaty are in fact very broad and open to interpretation, as Jens Van't Klooster reminds us (see also Monnet, 2021). Thus, the Parliament can usually change the objectives of the central bank. In the UK, the government has updated the central bank's mandate to "reflect the importance of environmental sustainability and the transition to net zero". In the US, the 2010 Dodd Frank Act introduced major legislative changes to the central bank's ability to provide funds to individual institutions, following several important Congressional reform of the Fed's emergency arsenal since the 1970s (Elrom, 2022). Yet these legislative changes are nothing if not followed by a change in practice, and history shows many examples of disconnection between rule and practice. So we come back to the same questions, namely: how Parliament can exercise its power once it has voted on the objectives of the central bank? How can the Parliament realize that a legislative change is needed, before a crisis hit?

It would be different if Parliament – or the government – were given the ability to decide on the interest rate or the operations of the central bank. I have already explained in the introduction to this symposium why I think this would not be good and why I defend the political and operational independence of the central bank. I think it is important that the Parliament sets targets but delegates some operations of monetary policy and banking regulation to an independent authority (as with other independent administrative authorities). There are two well-known reasons for this: firstly, to prevent the use of monetary and financial power from distorting elections and, secondly, to give the central bank the ability to react quickly to changing financial and economic conditions. Another reason is specific to the deliberative democracy perspective: in principle, central bank independence increases the diversity of views when it comes to policy coordination and deliberation (although this is not always guaranteed in practice).

Thus, I do not oppose deliberative democracy (deliberation to reach a better decision) and representative democracy (legislative power by elected representatives). Central banks are already strongly marked by representative democracy and legislative power, but I argue that this is not enough to achieve both economic efficiency and democratic legitimacy. Deliberation is not at all about explaining things to people (contrary to "transparency"). Deliberation is important and a source of power for the people, because decision-making involves a number of complex institutions and administrative processes. I agree with Downey that the public good is not something that can be clearly defined or understood. And especially when it comes to monetary policy, representatives are not elected on the basis of a well-defined programme. They represent the people, but it is far from clear what the people think ex ante about the operations of a central bank and about specific measures of credit policy in general. Representatives assess whether the actions of the central bank are in line with the values and interests of their constituents when it comes to the macroeconomic or environmental consequences of monetary policy, its distributive effects and the involvement of the state in the financial sector. In Europe, the strongest views on monetary policy were expressed by conservative representatives who feared that the lines between fiscal and monetary policy were being blurred or by progressives who were concerned about financial dominance or economic inequality.

Thus, members of parliament are not elected on the basis of a clear monetary policy agenda, but because voters believe they will be better equipped than others to make decisions based on broad values that appear similar to when general monetary and financial issues are involved. They agree with the general legal framework that shapes the central bank's actions (or they may try to change it…) but are there to avoid too much discretion on the part of the technocrats and to assess whether the central bank's response to unforeseen events can be compatible with the central bank's mandate and the values of their voters. As Downey acknowledged, citing Richardson (2002), *how* policymakers reason is indeed critical, as voters have confidence in their ability to reason well in order to represent their interest, even if their interest is not precisely defined ex ante (especially when faced with unforeseen circumstances).

I also disagree with the idea that deliberation cannot influence decision making. Deliberation is not just talk. In order to understand why deliberation is important and can lead to effective policy-making, one has to see it as embedded in a complex chain of inter-institutional dialogues and decisions. This is why – contrary to what Downey argues – this type of deliberation is fundamentally different from transparency and from the recent central bank initiatives such as *ECB listens* and *Fed listens.* Listening to citizens' criticisms is very different from discussing real policy scenarios with Parliament and other agencies (supported by independent and diverse expertise), all of which have decision-making power in their own field, and when the interactions between these agencies can be governed by law or administrative regulations. Agnieszka Smoleńska has explained this so well in her article (based on a long tradition of legal scholars and political scientists studying the European Union) that I can only refer the reader to her arguments. It is important to note that deliberation in Parliament cannot be ignored by the Court of Justice, although how it is considered is not formalized. Even though the Parliament cannot threaten or instruct the central bank, the central bank cannot ignore Parliament's opinion because it knows that it will be taken into account by the Court of Justice in assessing whether the central bank's actions are sufficiently justified and in line with their mandate. As Smoleńska argues, the issue of the composition of the board of the Credit Council is thus key to ensure that different points of view are expressed. This is also where the power of Parliament lies.

Take the example of central bank support for the ecological transition in the European Union. The majority in Parliament may argue that the ECB should set up a green lending scheme because – in accordance with the EU Treaties – it must support the EU's environmental objectives without endangering price stability. Such an argument can only be made if the Parliament can rely on economic modelling to simulate different scenarios that will assess the macroeconomic consequences of this policy, as well as the link between price stability and climate change. The argument will be much stronger if the Parliament can also explain how this policy will be consistent with other EU credit policies regarding green transition financing, in particular those of public investment banks and with the EU green taxonomy (prepared by the Commission and approved by the Parliament). This could explain why ECB lending is necessary without being redundant with other European credit policies, and explain precisely which lines the ECB should not cross. The European Credit Council provides the Parliament with the appropriate tools to do so. In this case, a reluctant ECB will have few arguments to claim that this policy is not compatible with its mandate. A "threat" already exists since the ECB must obey European law and the treaties, and the Court of Justice is ultimately responsible for deciding whether it does so. Alternatively, suppose the ECB decided on its own to engage in green lending, without consulting the Parliament and other European bodies, and by developing its own lending criteria. Then the Parliament – supported by the European Credit Council – will be legitimate to assess whether the ECB has gone too far in using its discretionary bureaucratic power, and without sufficiently explicit consideration of the effects of such a policy which might contradict other European policies. The same reasoning can be applied to the issue of central banks' digital currency. As far as the coordination between monetary policy and fiscal policy is concerned, the situation is more complicated but even more necessary, as rightly argued by Rosa Lastra and Charles Goodhart in their piece. As argued in Monnet (2021), I think the deliberations at the Credit Council will still be useful in this case but should be complemented by more formal agreements between the central bank and the government (or the Commission in the European case) that would formalise joint announcements or decisions about the stance of monetary and fiscal policy. US policies during the covid-19 pandemic have followed this way when special lending scheme were established by the central bank with the authorization and guarantee of the Treasury.

Power in our democracies is much more diluted than the framework of representative democracy suggests. The legislative power of the Parliament is key but decision-making is a process that goes through many interrelated stages and institutions. If one takes the example of environmental issues, we must consider the key role played by the IPPC (a intergovernmental body based on independent expertise), the decision of judges based on interpretation and jurisprudence, those of environmental protection agencies (some of which are independent) and the action of climate activists. They all belong to the democratic realm, together with the legislative power. Ensuring that different viewpoints and policy scenarios can be discussed at all the decision-making stages, with accountability to elected representatives, is as important as ensuring fair elections. Without this, it will be difficult for the representatives themselves to be accountable and to justify that all possible options have been considered that may reflect the interests and values of their constituents.

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