Shaky foundations

Central bank independence in the 21st century

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Abstract: Central bank independence (CBI) has often been presented as a superior institutional arrangement demonstrated by economists in the 1980s for achieving a common good in a non-partisan manner. In this article, we argue that this view must be challenged. First, research in the history of economic facts and thought shows that the idea of CBI is not new, and was adopted under peculiar socio-historical conditions, in response to particular interests. Rather than an indisputable progress in economic science, CBI is the foundation for a particular configuration of the monetary regime, perishable like its predecessors. Secondly, we argue that the simplistic case imagined by the CBI theory (the setting of a single interest rate disconnected from political pressures) is long overdue. For nearly two decades, central banks have been increasing their footprint on the economy, embarking on large asset purchase programs and adopting macroprudential policies. This pro-activism forces independent central banks to constantly address new distributional - and therefore political - issues, leading to a growing number of criticisms of their actions with regard to inequality or climate change. This growing gap between theory and practices makes plausible a further shift of the institutional arrangement towards a democratization of monetary policy.

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1. Introduction

At the end of February 2022, the freezing of the 640 billion dollars of foreign exchange reserves of the Russian central bank decided in response to the invasion of Ukraine by Russia, marks the alignment of international finance with the political sanctions decided by the majority of Western leaders against Russia:

> "We [the leaders of the European Commission, France, Germany, Italy, the United Kingdom, Canada, and the United States] commit to imposing restrictive measures that will prevent the Russian Central Bank from deploying its international reserves in ways that undermine the impact of our sanctions" (European Commission, 2022).

At first glance, such a weaponization of international finance, which comes at the same time as the exclusion of several Russian banks from the SWIFT messaging system, may come as a surprise in an international context that has seen finance acquire a strong independence from politics over the past 40 years. This is particularly the case for central banks, whose actions have been measured against the dogma of independence since the 1990s. However, regardless of the exceptional measures taken against Russia, it is clear that this doctrine of independence has been largely undermined by recent developments in central bank practices, as illustrated, for example, by the massive recourse to unconventional monetary policies since the 2007-2008 crisis. Moreover, recent calls for a greening of central bank action (Bolton et al., 2020; Elderson, 2021) or for consideration of its impact on inequalities (Schnabel, 2021) seem to outline the contours of a movement that runs counter to the dogma of independence. In this context, the objective of this article is to question the relevance of the independence paradigm in an era that seems to be marked by an increasing repoliticization of central bank action.

Central bank independence (CBI) is an institutional response to the fear that monetary policy might be pressured by politics (McNamara, 2002). If the objective of monetary policy is to ensure price stability by keeping inflation as close as possible to its target, then it is indeed preferable to subject the actions of central banks to rules rather than to the discretion of governments that are always likely to pursue private interests (Barro and Gordon, 1983; Kydland and Prescott, 1977). There is then a science of monetary policy (Clarida et al., 1999) that can be implemented independently of any political decision-making. It is clear, however, that for the last twenty years or so, this science has been overwhelmed by events, such as the 2007-2008 crisis, which have forced central bankers to step outside the strict framework of rules. The situation is then paradoxical, since the *de jure* independence thought to respond to a

precise objective (price stability) is circumvented by a *de facto* re-politicization of central bank action made necessary by the definition of new objectives (financial stability, ecological transition, reaction to pandemics, etc.) formulated in response to the various crises affecting the world economy. In other words, the multiplication of "black swan" type events, the occurrence of which cannot by definition be predicted by rules, is increasingly forcing central banks to adopt discretionary behaviors, even though the dogma of independence was intended to replace such behaviors. This is because in a context of radical uncertainty, discretion is necessary since the rules are always already outdated. It is therefore the relevance of the doctrine of independence itself that is called into question, especially since it does not seem capable of curbing the accelerating inflation that is currently threatening many developed economies.

This article therefore aims to study the concept of CBI at a time when central banks seem to be increasingly involved in issues that largely affect the future of societies, such as climate change and inequality. To do this, we adopt a double approach. First, we adopt a historical perspective that aims at situating the concept of independence in the long history of economic facts and thought. Historical hindsight allows to situate the particularities of the recent period concerning both the practices of central banks and the theories that frame them. Second, we embrace an analytical perspective to confront CBI theory with the actions of central banks over the last twenty years. This allows us to highlight the contradictions between *de jure* definitions and justifications of CBI and *de facto* actions that push central banks further and further away from their mandate as new unforeseen crisis unfold. Finally, we sketch different paths of institutional evolution that would either bridge the gap between the practices and mandates of central banks, or reconsider the very principle of separating central banks from political power and democratic legitimacy.

2. Central bank independence: Scientific revolution or ideological recycling?

In 1988, Alberto Alesina wrote that "independent central banks have been associated with a lower average inflation rate and may have been responsible for reducing politically induced volatility policy and inflation" (Alesina, 1988, p. 17). Ten years later, this declaration has become a consensus and has led to a wave of adoption of the CBI around the world, from New Zealand to Japan, from England to the ECB. Some have suggested that the rapid appropriation of this idea and its institutional translation was simply a reflection of a scientific revolution in economic theory (Goodfriend, 2007). However, this interpretation is false.

2.1. Déjà vu, déjà fait*: Historical and theoretical precursors*

First, the idea of CBI is not new, and had another heyday in the 1920s, as shown by do Vale (2021, 2022). World War I brought about the collapse of the international monetary system centered on the gold standard and floating exchange rates. The financing of the war and the post-war boom generated inflationary pressures. In this context, the League of Nations made CBI an international prescription. With the objective of reconstructing the international monetary system, the League of Nations promoted multilateral initiatives, notably the international financial conferences of Brussels (1920) and Genoa (1922). These initiatives gave prominence to the independence of central banks, which was considered by many to be a desirable institutional arrangement for combating inflation in a fiat currency regime and for pursuing deflationary policies that would allow a return to the gold standard, which had been abandoned with the First World War.

Adherence to this prescription involved not only practitioners but also policy makers and economic and financial "experts" (Capie et al., 1994). In the absence of a theory of central banking at the time, Montagu Norman, the Governor of the Bank of England, played a decisive role in devising a doctrine justifying greater central bank independence (do Vale, 2021). This recommendation for independence was motivated by the desire to provide a "sound" basis for many nascent central banks, especially in the British Empire and the Dominions. He also played a key role in structuring the community of central bankers of the time who, following hyperinflationary experiences, supported, within the framework of monetary stabilization plans under the supervision of the League of Nations, the reforms of the statutes of the central banks of Austria (1923), Hungary (1924) and the Allies for Germany, legally granting them independence.

If these policymakers and experts were not academics, the idea of a scientific revolution within the economic discipline is also highly questionable. Empirical work very similar to that of Alesina preceded it, without having revolutionized thinking (Parkin and Bade, 1978). Forder (2005) shows very convincingly, by listing a number of works, that the idea of CBI was perfectly understood before 1988. It was discussed and had supporters and opponents. So how can we explain the fact that this idea did not take hold earlier? How can we explain its speed of diffusion and adoption by the community of economists, policy makers and central bankers?

2.2. The 1980s: alignment of interest and window of opportunity

A first observation is that the shift in the 1980s was concomitant with a shift in disciplinary boundaries. From the post-World War II period until the 1970s, the economic literature abandoned the analysis of CBI. This object of study was monopolized by the theory of bureaucracy, which deals with the organization of the state and the relations between its institutions (Panico and Rizza, 2003). After 1988, the theory of bureaucracy as applied to central banks once again faded from the academic literature, precisely at the moment when economics once again picked it up. From the post-World War II period until the end of the 1960s, the prevailing economic consensus was that democratically elected bodies should assume responsibility for the most important economic and monetary decisions, leaving the operational functioning of monetary policy, i.e., the day-to-day management of it, to the experts of central banks. The setting of central bank objectives was therefore a political matter. The Radcliffe Report (1959) is probably the high point of this consensus. The central bank was seen as "a highly qualified executor in the monetary field of the current economic policy of the central government".

Gradually, during the 1960s, the predominance of Keynesian positions over monetarist positions receded among economists. As early as 1959, the Radcliffe Report was greeted with much criticism in central banking circles for its Keynesianism and its plea for increased dependence on the Chancellor of the Exchequer (Musella and Panico, 1996). This shift away from Keynesian monetary ideas was reinforced following the end of the Bretton Woods Agreement in 1971 and the stagflation that followed the 1973 oil shock. The new macroeconomic context prompted a gradual change in the conduct of monetary policy. The central banks of the Federal Republic of Germany and Switzerland led the way, shortly after the first oil shock, by adopting policies that were more focused on fighting inflation. The United States, Canada, Great Britain, France and Australia made a similar choice in 1976. But the real turning point came in October 1979, after the second oil shock, when the U.S. Federal Reserve announced the introduction of new monetary policy procedures based on monetarist recommendations.

Yet Friedman was not a fan of CBI, as his 1962 essay shows, and a number of other important conditions favored the adoption of CBI (Goodhart and Lastra, 2018). The first, and most important, was the general acceptance of the concept of a vertical Phillips curve in the medium to long run. As they put it, this concept "allowed central bankers to declare with conviction that the adoption of a low inflation target had absolutely no longer-term deleterious effect on growth, but actually reinforced it by removing the inevitable distortions within the

economy that significant inflation introduced. This was crucial to the delegation of price stability to an independent central bank." Goodhart and Lastra (2018) also point out that public sector debt ratios in many developed countries had reached their postwar lows. As a result, public debt management was perceived to be more easily decoupled from the central bank than had been the case in previous decades. Possible increases in interest rates to control inflation were thus seen as less problematic. This contextual element would explain in part why the proposal for CBI was so quickly accepted.

Forder (2005) offers a stimulating re-reading of the genealogy of this idea of independence and especially of the speed of its adoption, which runs counter to what is generally written on the subject. He insists on the multiplicity of reasons that explain the rapid acceptance of the idea of CBI. Among these, he points to the collective interest of the economics profession, whose prestige had been eroded by economic policies perceived by the public as failures, particularly in terms of inflation. In this context, the independence of central banks made it possible to implicitly shift the blame for this failure from economists to politicians, and thus to clear them.

This argument justifies the popularity of independence among economists, but does not explain why governments have so readily adopted it, unless one accepts the blame for it. From this perspective, McNamara (2002) interpretation complements Folder's by stating that "governments choose to delegate not because of narrow functional advantages, but rather because delegation has important legitimate and symbolic properties that make it attractive in times of economic uncertainty or distress" (McNamara, 2002, p. 59). Finally, Folder also argues that the strength of the defense of independence in the economics profession is explained by considerations of objective self-interest. Indeed, central banks offer economists not only opportunities for research funding but also career opportunities: research positions, appointments to boards of directors or monetary policy committees.

2.3. (Im)mortality of paradigms and historical variety of monetary regimes

Whatever the multiple and convergent reasons for the rapid adoption of this idea of CBI among economists and policy makers, the lesson to be learned is that central banking regimes are mortal whether the death is slow or quick (Scialom, 2022).

Indeed, central banks' functions, operational practices, and doctrines have historically shown a great deal of plasticity, constantly adapting to the macroeconomic, institutional and

political context (Bordo et al., 2016; Collins, 1993). These adaptations do not only concern the operational modalities of monetary policy, they are also reflected in the evolution of central bank doctrine, i.e. in what is considered at a given moment in time as the duties, missions and powers of central banks. Central banking therefore does not obey to any predefined principles. Their contours evolve in response to periods of crisis (wars, economic and financial crisis, and today's climate emergency) and also according to financial structures. Goodhart (2010) identifies three historical periods of relative stability in the central banking regime and more troubled intermediate periods of trial and error before a new consensus is established:

- The Victorian era, which began around 1840 and ended in 1914,
- The period of strong government control from the 1930s to the late 1960s,
- The era of market triumph from the 1980s to 2007.

Despite their differences, the gold standard era (1840-1914) and the period defined by inflation targeting (1980s to 2007) were both characterized by a strong confidence in market mechanisms and by a large degree of autonomy of central banks. As we have shown, the latter was already explicitly promoted in the 1920s as an institutional arrangement favorable to the fight against inflation and a return to the gold standard, and then revived in the 1980s after half a century of neglect. Thus, central banking regimes are not mortal in the ultimate sense, but subject to long periods of hibernation and reconfiguration according to the needs of policymakers and the challenges they face.

The question that arises is therefore to assess whether we are at the end of the cycle, and thus at the dawn of a new shift in the central banking regime. Both the levels of public debt and the imperative of financing the ecological transition are pushing for a repoliticization of money management, which has already largely begun, as will be seen in the next section.

3. Towards an irrepressible repoliticization of central banks?

The management of the financial crisis, through the implementation of unconventional monetary policies meant to preserve the integrity of the eurozone, questions the very foundations of CBI. Indeed, the distributive choices induced by the new instruments used by central banks to fulfill their objectives put the question of central banks action legitimacy back in the limelight. Such a question is closely related to that of the repoliticization of their action.

3.1. A de facto repoliticization in response to the crisis of the late 2000s

> “The financial crisis and politicians’ indecisiveness have pushed us into a new role, and we allowed it to happen. As a result, we intervene ever more deeply in individual markets and now have a problematic proximity to financial policy […]” (Oltermann, 2016).

This quote from Jens Weidmann, who was Deutsche Bundesbank President between 2011 and 2021, highlights the paradoxical situation in which central banks in developed countries were placed by the crisis of the late 2000s. While they had acquired, during the 1990s, an independence that was supposed to protect their actions from any political influence, they found themselves, at the time of the crisis, being forced to intervene massively beyond their mandate to prevent the economic system from collapsing (Schmidt, 2016). This is due to the fact that the independence dogma called into question the required coordination between the fiscal and monetary instruments and thus considerably weakened the capacity of the State/Central Bank couple to produce an appropriate and effective response when a crisis occurred. In this context, the wait-and-see attitude of governments in the wake of the crisis has forced central banks to deploy a whole range of measures whose political neutrality, and therefore consistency with the dogma of independence, is questionable. From independent, central banks thus found themselves lonely to deal with a crisis that would have required an explicitly coordinated response between monetary and fiscal policy (Mabbett and Schelkle, 2019). Faced with political authorities' inaction, central banks became the “only game in town” (Rajan, 2012). Mario Draghi's famous “whatever it takes” exemplifies this.

However, if such emergency measures were necessary at the peak of the crisis, their continuous use for nearly a decade, or their inclusion within a regulatory corpus meant to last, calls into question the relevance of the concept of independence. Indeed, if central banks regularly and persistently interfere, through such interventions, with the way resources are allocated, it is necessary to make explicit the mandate that justifies these interventions. Without such an explanation, the pessimistic interpretation of macroprudential policy, as a means thanks to which neoliberalism manages to overcome its contradictions, gains in relevance (Casey, 2015). Thus, the instruments implemented in the wake of the crisis must be evaluated in order to assess their real impact on the economy, since by their very nature they have a much greater redistributive effect than traditional instruments (Honohan, 2019). Indeed, both monetary and macro-prudential policies over the last 15 years have considerably increased the distributional impact of central banks, although this has not always been recognized by central banks.

With respect to monetary policy, at least three recent developments drove central bank practices away from the CBI frame (van 't Klooster, 2021; Monnet, 2021a). First, sovereign debt buyback policies have become so normalized that the eligibility of government bonds for such policies has become an important variable in assessing the sustainability of public debt. This allowed eurozone member states to provide unconditional support to their economies during the Covid crisis since almost all post-Covid debts were bought back by the ECB. Second, the Targeted Longer-Term Refinancing Operations (TLTROs), which effectively direct capital to certain sectors and maturities, radically contradict the neutrality that is supposed to characterize central bank interventions according to the dogma of independence. The fact that such a policy of credit guidance is decided outside the democratic framework is problematic because people are never given the opportunity to express their opinion on the favored sectors. Besides, such preferential refinancing artificially led to transfers in the favor of banks. Third, corporate sector purchase programs (CSPPs) are an innovation compared to the usual practice of central banks in terms of collateral because they potentially hold assets until maturity, making central banks actual investors rather than mere liquidity providers. Besides, such purchase programs were criticized for their carbon bias, actively subsidizing polluting activities (Dafermos et al., 2020; Matikainen et al., 2017).

In the same vein, despite its extremely important redistributive effects, the implementation of macroprudential policy in the last decade has tried to fit in the CBI frame. The opposition of the Irish in 2015 to the macroprudential measures decided by their central bank illustrates these redistributive and therefore political effects of macroprudential policy. Indeed, the introduction of constraints on credit, such as loan-to-value and loan-to-income ratios, had the direct effect of making it more difficult for first-time buyers to buy property. In response, the Irish have called for "a little understanding" (The Irish Times, 2020) from the central bank in the face of measures whose social impact is immediate and violent. Yet, despite the magnitude of the social effects of macroprudential policy, the choice has, in most cases, been made to delegate it to an independent agency (Masciandaro and Volpicella, 2016). There may be many reasons for delegating macroprudential policy to such agencies (Lombardi and Moschella, 2017), but such a delegation endorses a conception of economic policy as the implementation of expert knowledge (Thiemann et al., 2021). In this framework, the question of the societal responsibility of independent agencies is always delegitimized by the invocation of an expert science that produces knowledge that should not be subject to controversy.

In sum, the institutional arrangement on which monetary and macroprudential policies are founded is based on the assumption that their legitimacy is always already granted. While this may have been justified right after the 2007-2008 crisis, it is problematic that policies with such important redistributive effects are not democratically accountable at all. Indeed, the changes in monetary policy and the adoption of the macroprudential agenda by central banks and independent agencies, given their inherently interventionist and preventive nature, which is at odds with the idea of neutrality, makes it necessary to revisit the independence assumption itself. Indeed, it is rather unconvincing to defend the private bond purchase policies undertaken by central banks on the sole grounds of price stability, which is nevertheless the argument put forward by central bankers (van ’t Klooster and Fontan, 2020). This discrepancy between the nature of the tools used and the rhetoric used to justify them constitutes the core of a “technocratic Keynesianism” (van ’t Klooster, 2021). The latter combines a certain distrust toward financial markets, which are seen as always subject to fads and herding behaviors, with a reluctance to engage in any form of deep reflection on finance and its *raison d'être*.

Such a gap between *de facto* practices and the *de jure* mandate to which central bankers firmly adhere, forces them to play on a “strategic ambiguity” (van ’t Klooster, 2021). The latter allows to combine the use of non-conventional instruments with significant redistributive effects with the doctrine of independence. Moreover, by twisting the definition of independence to include macroprudential policy, central banks may have irreparably compromised this definition. This is the paradox of macroprudential policy, as identified by Andrew Baker (2015): transferring the conduct of macroprudential policy to an independent and expert institution has the ultimate consequence of politicizing that institution[4].

3.2. A call for de jure repoliticization: green mandate and taking inequalities into account

The central banks attachment to the CBI principle, and their correlative reluctance to be submitted to any democratic process, is, however, increasingly challenged by calls for the incorporation of social and environmental dimensions into their mandates. Paradoxically, such demands often stem from within central banks themselves (Bolton et al., 2020; Elderson, 2021; Schnabel, 2021).

[4] “Another way of framing this paradox is that efforts to further depoliticise central bank policy making (by assigning macroprudential powers), actually have the opposite effect and increasingly politicise central banks, in ways which may potentially undermine their claims to apolitical technical authority” (Baker, 2015, p. 21).

The interplay between environmental issues and financial markets gives rise to a double concern that fuels calls for greening central banks action (Elderson, 2021). On the one hand, the ecological crisis poses a serious threat to financial stability, since the gradual crossing of planetary boundaries unambiguously leads to a multiplication of "green swan" events (Bolton et al., 2020). Such events are, by their very nature, a matter of radical uncertainty and are therefore not intelligible within the frame of traditional risk models (Chenet et al., 2021). In other words, risk assessment models, including those used to determine regulatory constraints under both Basel 3 and Solvency 2, are unable to properly evaluate the threat to financial stability posed by the ecological crisis. Moreover, the various international commitments, notably the Paris Agreement, will eventually threaten entire sectors of activity and thus the assets that are tied to them. This risk of "stranding" (Carney, 2015) constitutes a major risk to financial stability. On the other hand, there is evidence that the current functioning of financial markets is accelerating the materialization of climate change risks. To the extent that the allocation of financial resources remains dependent on models that poorly assess the risk of environmentally harmful activities, financial markets continue to massively finance these activities. This dual concern is at the root of many calls for a redefinition of the mandate of central banks to include environmental issues.

In the U.S. context, the calls for taking into consideration the societal impact of central banks' actions directly echo the debate over the Fed's role in addressing racial inequalities on the job market (Scialom, 2022). The Fed's dual mandate is indeed rooted in the American civil rights movement. While the objective of full employment was in fact subordinated to that of price stability, particularly in the high inflation context that saw Paul Volcker become head of the Fed in 1979, it was once again brought to the forefront in the wake of the 2007-08 crisis. At that time, the Fed decided to support the economic activity until the unemployment rate, including that of African-Americans, fell to historically low levels. The Fed's objective of supporting activity has recently become more acute because of the very negative impact on economic activity, and in particular on the situation of low-income households, of the Covid crisis and of the successive lockdowns. This inflection is concretely translated into the monitoring of new indicators, in particular the unemployment rate of African-American populations and the wages growth of the lowest-paid workers, in the setting of the monetary policy. At the same time, while the ECB, unlike the Fed, has never recognized that supporting activity is part of its primary mandate, there is a willingness within the ECB itself to consider the effects of monetary policy on inequalities. The speech given by Isabel Schnabel, member

of the ECB's Executive Board, on 9 November 2021, entitled “Monetary Policy and Inequality”, is testimony to this (Schnabel, 2021).

4. Where is European central banking heading to?

The distributional consequences of modern central banking are becoming more visible and are increasingly acknowledged by central bankers themselves. At the same time, demands for taking environmental issues and inequalities into account are being carried out by an increasing number of actors. It thus seems that the very ideological ground on which rests the current central banking regime is shaking. This latter has therefore to be reappraised. Such a reappraisal should necessarily address the following issue: reconciling CBI with the ever-growing tendency of central banks to intervene directly in the economy. This section focuses on the case of the ECB and discusses three possible scenarios for its evolution in the years to come. These scenarios draw a gradient from keeping the ECB independent to completely reintegrating the conduct of monetary policy into the political sphere.

4.1. Scenario 1: institutional loneliness, technocracy and strategic ambiguity

The first scenario consists in keeping alive the current institutional arrangement. In other words, the ECB remains independent and strives to tackle climate change and inequalities without contravening its current mandate. This however does not necessarily mean that the ECB is condemned to replicate the biases that are currently being denounced, whether they concern carbon-related activities or inequalities. Indeed, the letter of the law gives the central bank considerable leeway to interpret its mandate so as to take other objectives into consideration. For instance, to the extent that inequalities or climate risks threaten price stability and financial stability, the ECB may legitimately take these into account in order to fulfill its objectives In other words, if financial markets are shown to systematically misevaluate financial climate risks, it is in the interest of financial stability that the ECB reconsiders its operational principle of market neutrality and seeks to modify the composition of its asset portfolio in order to penalize the most climate-risky assets. Doing so, the ECB seems to square the circle: it keeps its independence while influencing, at the very same time, the allocation of capital. This is totally in line with “technocratic Keynesianism” as described by van 't Klooster (2021), which, as shown in the previous section, rests on “strategic ambiguity”.

In addition, according to its "secondary" mandate, the ECB is expected to support the economy of the European Union provided that such a support does not contravene to the price stability objective[5]. A narrow interpretation of this "secondary" objective implies that, between two instruments equally efficient at ensuring price stability, the ECB must choose the one that best supports the objectives of the EU. A broader interpretation, which is considered as "more plausible" by ECB lawyers, suggests that the ECB could implement measures only meant to support the objectives of the Union, provided that these measures do not jeopardize price stability (Ioannidis et al., 2021). To summarize, considering both its primary and secondary mandates, the ECB could thus go much further in taking climate or inequalities into account.

However, this situation, which largely consists in reinterpreting the mandate of the ECB is problematic for at least two reasons. First, the ECB cannot indefinitely twist a 30-year mandate without endangering its credibility (Baer et al., 2021). Indeed, the ECB has already been sued for having undertaken actions that some ultimately deemed contrary to its mandate (Fontan and De Cabanes, 2019). So far, the ECB has escaped constitutional disapproval, making "unconventional" policies a new norm. This victory, however, was largely based on the fact that the ECB's response was deemed proportionate in the face of the acute risk of the break-up of the eurozone. Faced with the underlying trends of climate change and rising inequality, it may be difficult for the ECB to justify such assertive activism. Second, the necessity to constantly twist the mandate of the ECB only further underlines the problem of the legitimacy of its distributive choices. Any modification of its action, even meant to better take externalities into account, indeed remains at least partly arbitrary as long as it is insulated from the political power and its explicit delegation. The sole exploitation of the "authorization gaps" (de Boer and van 't Klooster, 2020) that characterize the mandate of the ECB cannot be considered as a satisfactory way to justify the distributive choices it makes. In this respect, the explicit mobilization of the secondary mandate could be a profound paradigm shift, breaking with the process of depoliticization which has characterized the evolution of the ECB since its creation (Deyris, 2022).

Without any radical change of the institutional framework, the ECB has no other option than further grounding its actions in expert knowledge. Indeed, without the legitimacy provided

[5] "[…] without prejudice to the objective of price stability, it [the ECB] shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union".

by democratic control, the ECB can only legitimate its actions through its assumed technical expertise. As a consequence, the ECB will be able to keep its independence only if it constantly phrases monetary and financial issues as technical topics which cannot be subjected to any democratic control. The current tendency of ECB to justify its decisions regarding climate change as being only motivated by financial risks is an example of such a dynamic (Deyris, 2022). The problem with this attitude is that it ultimately falls to stating that financial markets are able to deal with climate risks, which they can precisely not. On the contrary, the last decade has greatly demonstrated that markets fail to deal with climate risks and that modern central banking necessarily implies political choices (Fontan et al., 2016). A more ambitious change of central bank doctrine may thus be needed.

4.2. Scenario 2: democratization, coordination and independence

The second scenario consists in an institutional reform that would seek to alleviate the above-mentioned problems without thoroughly questioning the CBI paradigm. Two strategies are worth considering: either improving the delegation or improving deliberation (Monnet, 2021a, pp. 79–80). Table 1 summarizes the options discussed to implement such strategies.

Table 1. Toward a more democratic but still independent ECB

Delegation	Designation	Designating members of the ECB Governing Council in a more democratic manner
	Objectives	Establishing and monitoring the mandate and the secondary objectives of the ECB in a more democratic manner
Deliberation	Transparency	Disclosing the votes of the Governing Council meetings; Allowing the Chair of the ECON Committee to attend the meetings of the Governing Council
	Expertise	Promoting non-partisan technical reports to better inform members of the European Parliament
	Coordination	Creating a sub-committee dedicated to monetary issues Strengthening the ECON Committee to allow for a more balanced dialogue between the ECB and the Parliament

Source: authors

To strengthen the legitimacy of the delegation process, two main avenues have been suggested. First, the process of designation of central bankers could be democratized. Currently, the designation of the governor of each national central bank follows national procedures, some of which appear to be more democratic than others (see Table 2). For the members of the ECB Executive Board, the European Council suggests a single candidate to the European Parliament, whose role is therefore limited to accepting or rejecting this candidate. Jourdan and Diessner (2019) suggest that the European Council should instead propose a list of candidates to allow members of the European Parliament to weigh more when choosing the governor. This reform, which could be extended to all Eurozone countries, seems all the more important that the profile of central bankers has a significant impact on the policies implemented (Mishra and Reshef, 2019) or the reforms put forward (Bennani, 2015). Furthermore, in order to improve the mechanism of delegation, the "authorization gaps" could be filled in a more democratic way. Rather than letting the ECB freely interpret its mandate and secondary objectives, a democratic institution could provide guidance on a regular basis. Such guidance could be provided *via* the European Parliament (de Boer and van 't Klooster, 2021), its ECON committee (Claeys and Domínguez-Jiménez, 2020), or a newly created European Credit Council (Monnet, 2021a, 2021b). In such a system, the authorization gaps are dealt with in a democratic manner without any radical revision of the very mandate of the ECB, which revision would have to overcome a greater deal of political obstacles.

Table 2. Designation processes for European central banks governors

Executive + Central Bank committee	Estonia, Germany, Greece, Italy
Executive	Austria, Belgium, Cyprus, Finland, Ireland, Luxembourg, Malta, Netherlands, Spain
Executive + Parliament	France, Lithuania, Portugal, Slovenia, Slovenska, European Central Bank
Parliament	Latvia

Source: authors, based on national legal acts

The second way to improve the legitimacy of the ECB is to strengthen the mechanisms of deliberation between the independent authority and the political authority. This consists, for instance, in improving the transparency and accountability of the ECB. In this respect, the ECB has been asked to disclose the minutes of its meetings, as the Federal Reserve and the Bank of

England already do (see e.g. Kraemer, 2022). In the same vein, the Chair of the ECON Committee could be allowed to attend meetings as an observer, as is already the case for the President of the European Council and (at most) one member of the European Commission (Jourdan and Diessner, 2019). More generally, the idea to strengthen the position of the ECON Committee in its relation to the ECB has often been put forward. On the one hand, the latter could benefit from the creation of a European Credit Council offering expert knowledge to members of the European Parliament (Monnet, 2021a, 2021b). For the time being, it is indeed the central banks that hold the bulk of the technical firepower. This leads to a biased expertise that often concludes more favorably than academics on central banks policies efficiency (Dietsch et al., 2019; Fabo et al., 2021). On the other hand, the ECON committee could be strengthened by the creation of a smaller subcommittee specialized in monetary policy. This would allow for a greater degree of expertise and better coordination during the quarterly Monetary Dialogues. Finally, Monetary Dialogues could be improved by allowing parliamentarians to ask additional questions and engage trully in a dialogue rather than only listening to the unilateral explanations provided by the ECB (de Boer and van ’t Klooster, 2021; Claeys et al., 2014; Claeys and Domínguez-Jiménez, 2020).

Taken together, these reforms could improve the ECB's legitimacy while maintaining its independence, since the ECB would still decide autonomously on the policies implemented. On the one hand, dealing with the authorization gaps through democratic processes would limit the risk of questionable interpretations of either the mandate or the secondary objectives (Schmidt, 2016). On the other hand, improving the ECB's accountability and justification procedures *vis-à-vis* its political supervisory authority would force it to better argue its choices, restoring a place for discussion and contestation at the center of the political sphere and moving it away from the judicial sphere.

4.3. Scenario 3: politicization, Strategic State and new institutional arrangement

The previous two sections provide avenues for adapting the functioning of the ECB to today’s challenges, mainly associated with climate change and the rise of inequalities, but don’t question its independence. This last section goes one step forward by reflecting on the very relevance of CBI. Several arguments indeed call for reconsidering this paradigm. We briefly go through these arguments in this section.

First, monetary policy intrinsically consists in making distributive, and therefore political, choices. In that perspective, even though it is most often presented as a mere *procedural* solution to the lack of credibility of time-inconsistent policymakers, CBI in fact contains a *substantive* choice that sets the balance of power between debtors and creditors (McNamara, 2002; Stiglitz, 1998). As Kirshner (2001) puts it, "the inflation rate is best seen as a variable like the exchange rate, with winners and losers from different levels. The inflation rate and the exchange rate only become pathologies at extreme values. At other times, the principal effects are political". Thus, the setting of a price stability objective, and above all its operational translation by the ECB itself due to the broad "price stability" definition set in its mandate necessarily leads to a decision between contradictory interests, which appears difficult to reconcile with its insularity from political power. This critique of CBI in the face of its distributive consequences is all the more valid at a time when central banking is moving away from the Tinbergen principle to intervene in multiple domains, ranging from direct intervention in the market for sovereign bonds (OMT program, etc.), to private bonds (CSPP program, etc.), to the setting of preferential interest rates for banks' lending on a long-term basis (TLTROs, etc.). This wealth of instruments, an undoubted strength of modern central banking, only multiplies the number of distributional dilemmas that quarterly dialogues with part of the European Parliament will hardly be enough to legitimize.

Moreover, no matter what form the central bank's auditing bodies takes, Parliament and other political authorities are constitutionally prohibited from issuing instructions to the ECB. The ECB remains entirely free to pursue its monetary policy as it sees fit, without any disciplinary mechanism that can act as a check if its actions deviate too far from political expectations. In the European context, the members of the Executive Board, appointed for a single term of eight years, have no incentive to submit to the demands of Parliament, and cannot be called to order during their term, let alone dismissed. Although sought after, this dimension is surprising when put in perspective with the economic literature on delegation, since it consists in exacerbating *by design* the agent's tendency to drift from the missions entrusted to him by his principal (McNamara, 2002). In the end, only the threat of legal proceedings remains, but this is conservative in nature, pushing the ECB to favor a strict interpretation of its mandate rather than to push for extra-monetary criteria to be taken into account.

Besides, the reasons that justified the adoption of CBI in the first place now seem largely outdated. For instance, the prohibition of monetary financing, which is one of the pillars of CBI, has been repeatedly circumvented by the numerous purchases of sovereign bonds on secondary

markets that have defined the policy led by the ECB over the last decade. In fact, the *de facto* coordination between fiscal and monetary policies, which has proved to be the only solution to go through the Covid crisis, is likely to become the new norm to deal with crises – a "revolution without revolutionaries" (Gabor, 2021). Furthermore, it is even possible that CBI proves unable to deal with the shape that inflation is currently taking. This latter has recently been driven by bottlenecks of global supply chains, energy prices, and the Ukraine war, against which the ECB could do nothing. In the years to come, it is very likely that the transition toward a low-carbon economy will fuel inflation even more (Schnabel, 2022). In all these cases, the independent ECB is powerless. Indeed, in order to fight this type of inflation, it appears more necessary than ever to carry out targeted policies, such as differentiated interest rates to continue to support the phase-in of low-carbon technologies (van 't Klooster and van Tilburg, 2020) or credit and price controls (Weber, 2021). These measures, which are explicitly discretionary and distributive, are largely incompatible with CBI, and require instead a strong coordination with political institutions.

Finally, questioning CBI may be an opportunity to tackle a problem that is very often neglected: the dependence of central banks *vis-à-vis* financial markets (do Vale, 2022). Rather than focusing on the risk of "fiscal dominance", many studies indeed warn on the risk of a "financial dominance", which would subject central banks to the power of the markets, making the latter the "masters of the masters of the universe" (Diessner and Lisi, 2020). Financial markets indeed benefit from an "infrastructural power" since they are key to the transmission of the monetary policy, especially in extremely financialized economies (Braun, 2020). This interdependence between the soundness, depth and liquidity of the markets and the effectiveness of monetary policy has led the ECB to oppose some reforms that aimed at taxing financial transactions or more strictly regulating these markets (Braun, 2020). It may therefore be desirable to (re)inject some democracy into the governance of central banks in order to decide politically on the channels through which monetary policy should be transmitted, and on the degree of political or private interference tolerated in the pursuit of price stability.

5. Conclusion

Questioning the relevance of CBI in the light of the changes that have affected the practices of central banks and of the resulting growing gap between what they are *de jure* supposed to do and what they are *de facto* doing since the 2007-08 crisis does not necessarily mean wiping out

the past. Institutional structures are indeed strongly path-dependent. Such inertia lies in the very definition of institutions – what are they but sedimented practices? – and is what allows them to hold on through time. This however does not imply that institutions are not subject to changes. On the contrary, having a look at the history of institutional structures reveals that it is subject to tipping points that can act as preludes of radical changes.

Following the financial crisis, the re-politicization of *de jure* "independent" central banks has largely occurred behind the scene. In the case of the ECB, at least three episodes testify of such repolarization: the key role it played during the sovereign debt crisis, its part during the pandemic and, most recently, the sanctions it took against Russia following on the matter the decisions made by the governments of western countries. Such an accumulation of evidence pointing to the existence of a growing gap between the assumed independence of the ECB and what it is actually doing raises the question of a possible shift towards a new central banking regime. This regime would both allow to close this gap in order to restore the legitimacy of the actions led by the ECB and to take action to support the ecological and social transition. On that matter, the climate crisis clearly outlines the inadequacy of the CBI model to the economic, ecological and social challenges of the 21st century. Managing climate change, and more generally the environmental crisis, indeed requires going back to a conception of central banking as an "art" based on some degree of discretion, and not only as a "science" which totally rests on rules. However, such an art should not be understood as the product of an artist isolated in some ivory tower, but as an experience defined by the co-existence of a pluralism of points of view expressed within a common frame (Dewey, 1934). In this latter sense, art can fuel democracy.

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