Central Banks in the dock

By Barry Eichengreen
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Today, central banks are under attack for missing their inflation targets, failing to maintain financial stability or restore it in transparent ways, and ignoring the global repercussions of their policies. But compromising central bank independence in order to enhance political accountability would be to throw the baby out with the bathwater.

On November 11, 1997, the Bank of England took a big step toward independence, courtesy of the second reading in the House of Commons of a bill amending the Bank Act of 1946. The bill gave legislative affirmation to the decision, taken by then-Chancellor of the Exchequer Gordon Brown, to free central bank operations from governmental control. This was a landmark event for an institution that had been under the yoke of government for a half-century. It symbolized how the need for central bank independence had become conventional wisdom.

Now, however, this wisdom is being questioned, and not just in the United Kingdom. So long as inflation was the real and present danger, it made sense to delegate monetary policy to conservative central bankers insulated from pressure to finance government budget deficits. Today, in contrast, the problem is the opposite, namely the inability of central banks to raise inflation to target levels.

To achieve this, it is necessary for monetary and fiscal policymakers to work together, including by allowing the central bank, *in extremis*, to monetize budget deficits. But when it comes to cooperating with the fiscal authorities, central bank independence is a hindrance, not a help.

Independence was also easier to defend when central bankers' task was limited to keeping inflation low and stable. Given this narrow remit, the distributional consequences of central banks' decisions were limited. It was easier, moreover, to explain how a central bank's policy instruments were linked to its politically mandated targets.

But after the global financial crisis highlighted the dangers of consigning monetary and fiscal policy to separate silos, central banks acquired additional responsibilities. Deciding whether or not to rescue a specific financial institution, whether to ensure systemic stability or for other reasons, has visible consequences for individual investors.

The same is true of unconventional interventions in markets for corporate bonds and mortgage-backed securities. Not surprisingly, the notion of independence for central banks that visibly aided specific financial institutions – and this at a time when society as a whole was under unprecedented economic stress – quickly became politically toxic.

Independence is even more problematic in an age when the cross-border spillovers of national monetary policies have become powerful. Those spillovers make it important for central banks to take into account the impact of their policies on foreign countries and the global system. But the pursuit of global objectives is difficult, bordering on the impossible, when central banks function under the kind of narrow, domestically focused mandates that independence requires.

Today, central banks are under attack for all of these reasons: for missing their inflation targets, for failing to maintain financial stability, for failing to restore stability in transparent ways, and for not adequately taking into account the global repercussions of their

policies. Dissatisfied by their performance, politicians are seeking to reassert control.

Thus, we see the Bank of Italy attacked for its handling of the country's banking crisis. We hear the Bank of England criticized for voicing worries about the macroeconomic repercussions of Brexit. We encounter speculation that US President Donald Trump is intent on packing the Federal Reserve Board with politically compliant appointees.

But compromising central bank independence in order to enhance political accountability would be to throw the baby out with the bathwater. Monetary policy is complex and technical. Returning control to politicians is no more prudent than handing them the keys to a country's nuclear power plants.

Some will say that the way for central banks to ensure their independence is to abandon macroprudential and microprudential policies and foreswear unconventional interventions in securities markets. But a key lesson of the crisis is that macroeconomic and financial policies are closely intertwined, and that their coordination is most effective when the two tasks are housed in the same institution, if run by separate committees. Given the prevailing low level of interest rates, moreover, it is all but certain, come another crisis, that unconventional policies will be back.

What central banks *can* do to head off threats to their independence is become more transparent. They can announce the votes of individual board members on all policy-relevant matters and release minutes without undue delay. They can hold more press conferences and be less platitudinous in explaining their policies. They can avoid pontificating on questions remote from their mandates. They can acknowledge the right of politicians to define the goals the central bank is tasked with achieving.

And to shape the views of those politicians, they can better explain why cooperation with fiscal authorities and foreign central banks is in the public interest. They can publish more detailed financial accounts, including on their individual security transactions and counterparties.

Above all, they can avoid intervening in parliamentary politics, as the European Central Bank did when it hastened the fall of Silvio Berlusconi's government in Italy in 2011. Then they can keep their heads down and hope for the best.

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