

Time to admit it:

Independent central banking has been a failure

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If one myth has been slain by the financial crisis and the response to it, it's the idea that central banks ought to be independent and unaccountable politically.

The idea of central bank independence was that it would guarantee good monetary policy. During the Great Moderation it certainly seemed that way. But now it's no longer the case.

During the crisis, small, sovereign and open countries like Israel, Switzerland, Iceland and Sweden devalued their currencies and bounced back. Meanwhile the central banks of the US and Eurozone are refusing to pursue expansionary policies, which is driving millions to be unemployed.

The obvious takeaway is that independent central banks don't work.

But the more subtle, and more important, point is that *the choice between inflation and unemployment is a political, not a technical choice*. What's "better"? To screw debtors or creditors? To make millions unemployed or to "debase the currency"? Those are very important questions. More important, they're questions that cannot be solved by economics. They can be informed by them, but at the end of the day what you prefer is going to come down to your own moral value system. In other words, it's a political choice. And the way we make political choices in modern countries is through the democratic process, not through unelected, unaccountable technocrats.

During the Great Moderation, it appeared that you didn't have to make that choice. You could have low inflation and low unemployment, you could have your free lunch, all because we put a super-competent clerisy in

charge. But it turns out that in a balance sheet recession you have to make that choice. (And anyway you can argue the Great Moderation was less due to monetary policy and more due to things like IT-driven productivity improvements and the end of the Cold War.)

It's a political choice, which means that the authorities that make that choice for the whole society need to be appointed, and held accountable, by a political, democratic process.

Now, some objections to this:

- **Politicians would be even more crankish than Bernanke and Draghi.**

Aren't they all screaming about "inflation" even though there isn't any? Politicians are crankish about monetary policy for a simple reason: because they know that it's out of their hands anyway. It's like national politicians in Europe who demagogue about policies that are EU competency. They know they're not going to do anything about it, so they don't have to think about it, they don't have to know about it, and they can say whatever they like. It's interesting to note that, historically, the populist political position was generally pro-inflation—remember William Jennings Bryan and the Cross of Gold? Inflation squeezes creditors—bankers and rich people—and helps debtors—less-rich people. Instead and in defiance of political logic, populists in Europe and in the US are anti-inflation. This is because they don't have to think about monetary policy because they know they can't do anything about it. So they bleat about inflation because when regular people hear "inflation" they hear "higher prices = bad". The more subtle point here is that even if politicians would be crankish central bankers, *if we have crankish central bankers at least we can get*

rid of them. If we have crankish, accountable central bankers during a recession, they'll either course-correct or get fired. Nothing gets politicians' blood flowing like mass unemployment. A politician who pursues crankish monetary policy during a recession will get mass unemployment, which means he'll either change policy or get fired and replaced by someone who will. That's not just *how* democracy works, that's *why* it works.

- **Politicians would be incompetent and we'd get bad monetary policy.**

Would they? Would they be even more obviously incompetent than the lot we've had already? Obviously it's very fashionable to disagree, but elected politicians have the best track record of successful public policy. In aggregate over the past 300 years, countries run by elected officials have had much better public policy than those run by dictators or aristocrats or plutocrats or what have you. Elites in democracies hate democracy so much that they envy *China*, which is one of the most corrupt and shambolic places on Earth. Democracy works! It really does! People point to the debt ceiling debacle to say that politicians would screw the pooch, but they miss the fact that Congress actually did vote the debt ceiling increase, in the end. It also voted TARP, despite knowing how grossly unpopular it would be. When Margaret Thatcher was prime minister of Britain, she was the one who set interest rates at the Bank of England, and we don't recall there being hyperinflation or grossly wrong monetary policy during her tenure. When Jean-Claude Trichet ran the Bank of France, he was independent and he pursued a strong franc policy that killed French industry, and for this he was rewarded with the ECB where he was able to take his butchering ways on a continental scale.

The bottom line is that the argument of super-competence of central bankers is dead and once that's gone you need to revert those powers back to the political process.

If you said that national security was too important to be left to politicians and that the military and security services shouldn't have to answer to anyone because they're so competent, everyone would immediately see why that's an absurd and very dangerous idea. Instead we see civilian leadership of the military as a cornerstone of democratic governance even though we know democratic leaders screw up all the time because a) we view democratic accountability as an important principle and b) it's not at all obvious that political leaders will screw up more than military leaders.

The military can kill lots of people and engineer coups, but monetary policy can drive millions to the unemployment line and affect the political process. But as we've seen monetary policy is just as important, and central bankers are just as prone to "fighting the last war" and being prisoners of their own biases as generals. And central banks use their powers to manipulate the democratic process all the time as The Economist's Ryan Avent noted just yesterday—how in the hell do we let this happen?

At the end of the day, if you want to remove something as important as monetary policy from the democratic process, you need to show that independence is a) *obviously* b) *vastly* superior to the alternative. Since the past 4 years, you can still say that independence is arguably better, but you can't stay with a straight face that it's obviously vastly better. So it needs to go.