

## CENTRAL BANKING BEYOND INFLATION

by Benjamin Braun



# Central banking beyond inflation

## About the author

**Benjamin Braun** is a political scientist at the Max Planck Institute for the Study of Societies. His research focuses on two areas: the state-finance nexus, especially the politics of central banking; and the political economy of 'asset manager capitalism' – a configuration in which control over capital is concentrated among a small number of global asset management firms.

Email: [bb@mpifg.de](mailto:bb@mpifg.de)

Twitter: [@BJMBraun](https://twitter.com/BJMBraun)

Website: <https://www.benjaminbraun.org>

# TRANSFORMATIVE RESPONSES TO THE CRISIS

Permission requests should be directed to *Transformative Responses to the crisis*, Finanzwende / Heinrich-Böll-Foundation.

Published in the course of *Transformative Responses to the crisis*, a project by Finanzwende and Heinrich-Böll-Foundation.

More: <https://transformative-responses.org/>

Licence: Creative Commons (CC BY-NC-ND 4.0)

<https://creativecommons.org/licenses/by-nc-nd/4.0>

The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the Transformative Responses Network.



Bürgerbewegung Finanzwende  
Motzstraße 32  
10777 Berlin  
[info@finanzwende.de](mailto:info@finanzwende.de)



Heinrich-Böll-Stiftung e. V.  
Schumannstraße 8  
10117 Berlin  
[info@boell.de](mailto:info@boell.de)

The Transformative Responses project  
is supported by:

Hans Böckler  
Stiftung 

OPEN SOCIETY  
FOUNDATIONS



## **Table of Contents**

Introduction	3
1. Central banking beyond inflation: Political, legal, and ideational obstacles	5
2. Against amnesia: Central banks did many things in the past	7
3. Against strategic ignorance: The extracurricular activities of the ECB	9
Conclusion	15

## Preface

by Michael Peters, Finanzwende

Should the European Central Bank be more active in the social-ecological transformation? Critics automatically counter that the ECB's only task is to maintain price stability. However, as this paper shows, the ECB does many other things beyond price stability, and history validates that this has always been the case. Central banks have, in practice, consistently exceeded their formal mandates. They have shaped labour markets, financial markets, and steered capital.

To prevent criticism and uphold the narrow mandate, the ECB claims its monetary policy is "market neutral". However, central bank interventions are by definition not neutral. They create winners and losers by selecting some markets to intervene and allowing certain financial assets as collateral. The ECB's decision to rely on repo markets for implementing their monetary policy has promoted the growth of the unstable shadow banking system. Central banks steer capital and, through their bond purchase programmes, prioritise companies with access to global capital markets, which are disproportionately carbon-intensive sectors.<sup>1</sup> Central banks thus shape financial markets. The ECB has also been active in advocating the deregulation of labour policies in the European Union.

All of these actions have distributional consequences. It is time to acknowledge these effects. The paper's key message is that central banks and their role always prioritise certain market segments over others. The ECB has never just focussed on price stability. This is why it is absolutely legitimate to think about a new role for central banks, especially in light of the social-ecological challenges of the 21st century.

<sup>1</sup> Nicolas Hercelin, "Why the ECB should go beyond 'market neutrality'", Positive Money, 18 September 2019, <https://www.positivemoney.eu/2019/09/ecb-market-neutrality-doctrine/>.

## Introduction

The world around central banks has shifted. Europe is confronting an unprecedented combination of environmental, economic, and social challenges. Reducing carbon emissions to zero fast enough to avoid catastrophic global warming is difficult; doing so while also reducing economic inequality so as to avert social disintegration and democratic backsliding is very difficult. Addressing this twin challenge will require the state – and the European Union – to deploy all economic policy instruments already at its disposal, and to develop new ones and coordinate their use in new ways.

As things stand, several of the most powerful of these instruments are controlled by the European Central Bank (ECB). A public debate has therefore erupted about whether – and how – to redeploy these instruments. The problem, of course, is that the ECB is legally committed to the pursuit of price stability as its primary goal. While (monetary) conservatives have been steadfast in their rejection of any repurposing of central bank instruments away from price stability, progressive voices in politics and civil society are facing a dilemma. On the one hand, they have spoken out against the empowerment of unelected central bankers, especially in the context of the disempowerment of fiscal policy.<sup>2</sup> On the other hand, they have increasingly been calling for a re-orientation of monetary policy towards green and social purposes.<sup>3</sup>

Although this paper takes the progressive concern with excessive “unelected power”<sup>4</sup> seriously, it does not call for a return to the narrow, price-stability focused central bank envisaged by the Maastricht Treaty. The reason is that this ideal has always been an illusion. In a complex, financialised economy, the central bank inevitably does a lot more than move the short-term interest rate up or down in 0.25 percentage-point increments.

<sup>2</sup> Peter Dietsch, François Claveau, and Clement Fontan. *Do Central Banks Serve the People?* (Cambridge, MA: Polity, 2018); Leah Downey, “Delegation in Democracy: A Temporal Analysis”, *Journal of Political Philosophy*, Advance Online Publication (2020); Jens van ’t Klooster, “The Ethics of Delegating Monetary Policy”, *The Journal of Politics*, Advance Online Publication (2020).

<sup>3</sup> Emanuele Campiglio, Yannis Dafermos, Pierre Monnin, Josh Ryan-Collins, Guido Schotten, and Misa Tanaka, “Climate Change Challenges for Central Banks and Financial Regulators”, *Nature Climate Change* 8, no. 6 (2018): 462–68; Simon Dikau, and Ulrich Volz, “Central Bank Mandates, Sustainability Objectives and the Promotion of Green Finance”, SOAS Department of Economics Working Paper No. 232 (London, 2020).

<sup>4</sup> Paul Tucker, *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State* (Princeton, NJ: Princeton University Press, 2018).

The question is who gets to determine how – and to what ends – the central bank should wield these powers. This question is inextricably linked to the broader macro-financial architecture, which, in turn, hinges on the hierarchy – and level of coordination – between fiscal and monetary policy. These broader questions are discussed in Daniela Gabor’s accompanying policy brief.<sup>5</sup>

The paper proceeds in three steps. Section 1 discusses three distinct challenges – legal, political, and ideational – for the debate on the future of central banking. The remainder of the paper will tackle the two main *ideational* challenges, namely, institutional amnesia (forgetting the past realities of central banking) and strategic ignorance (ignoring the present realities of central banking). To overcome institutional amnesia, Section 2 briefly reviews the history of central banking, showing that price stability is only one of several goals that central banking has, historically, been associated with. To overcome strategic ignorance, Section 3 reviews three mandate-remote, or “extracurricular” areas of ECB activity, showing that the ECB does, in fact, have many more instruments at its disposal than just short-term (or, more recently, long-term) interest rates.

<sup>5</sup> Daniela Gabor, “Revolution without revolutionaries: Interrogating the return of monetary financing”, Transformative Responses Policy Brief (2021). For an introduction on macro-financial architectures, see Daniela Gabor, “Critical Macro-Finance: A Theoretical Lens”, *Finance and Society* 6, no. 1(2020): 45–55.

## 1. Central banking beyond inflation: Political, legal, and ideational obstacles

Since the 1990s, most central banks, including the ECB, have pledged allegiance to the “holy trinity” of the inflation targeting paradigm: “price stability as the primary *goal* of the central bank; central bank independence as the *institutional arrangement*; and the short-term interest rate as the *operational target*”.<sup>6</sup> In practice, however, central banks’ responses to the global financial crisis have dramatically diverged from the maxims of the holy trinity, sparking an ever louder debate about which paradigm should succeed inflation targeting. To situate this paper within this debate, it is helpful to distinguish between three crucial challenges.

*Politically*, central banking as we know it is designed to protect the economic interests of a specific support coalition, namely wealth owners and financial sector firms, who generally fear full employment and inflation.<sup>7</sup> The global diffusion of central bank independence in the wake of the Great Inflation of the 1970s reflected the victory of this “deflationary bloc” over workers’ interests,<sup>8</sup> which continue to benefit from an independent central bank with a price stability mandate. Although outside of the scope of the present paper, this point is nevertheless crucial for proponents of progressive macro-financial agendas: It takes a political support coalition to replace a political support coalition.

The *legal* challenge concerns the rigidity of the ECB’s mandate. Even if the political opposition of financial and other actors could be overcome, changing the ECB’s narrow price stability mandate would still be a tall order. Unlike other central bank mandates, the ECB’s mandate cannot be changed through a simple parliamentary majority but instead requires a change in the Maastricht Treaty. Legal obstacles can, however, be overcome once the political will exists; Jens van ‘t Klooster’s accompanying policy brief sketches feasible options to adjust or amend the ECB’s political mandate.<sup>9</sup>

<sup>6</sup> Here and elsewhere in this paper, I draw on ideas developed and published in Benjamin Braun and Leah Downey, “Against Amnesia: Re-Imagining Central Banking”, CEP Discussion Note 2020/1 (Zurich: Council on Economic Policies, 2020).

<sup>7</sup> Michal Kalecki, “Political Aspects of Full Employment”, *The Political Quarterly* 14, no. 4 (1943): 322–31.

<sup>8</sup> Adam S. Posen, “Why Central Bank Independence Does Not Cause Low Inflation: There Is No Institutional Fix for Politics”, in *Finance and the International Economy: 7, the Amex Bank Review Prize Essays*, ed. Richard O’Brien, pp. 41–65 (Oxford: Oxford University Press, 1993). For a recent update of this argument, see Yakov Feygin, “The Deflationary Bloc”, (9 January 2021), <https://phenomenalworld.org/analysis/deflation-inflation>.

<sup>9</sup> Jens van ‘t Klooster, “The ECB’s Conundrum and 21st-Century Monetary Policy: How European Monetary Policy Can Be Green, Social and Democratic”, *Transformative Responses Policy Brief* (2021). See also Nik de Boer and Jens van ‘t Klooster, “The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss”, *Common Market Law Review* 57, no. 6 (2020): 28; Martin Höpner, “Proportionality and Karlsruhe’s Ultra Vires Verdict: Ways out of Constitutional Pluralism?”, *MPIfG Discussion Paper* (Cologne: Max Planck Institute for the Study of Societies, forthcoming).

Finally, in order to overcome political and legal obstacles, we need *ideas* for alternative institutional arrangements. Such ideas have been harder to come by than one might think. Voters, politicians, and economists tend to regard price stability – and, during crisis times, financial stability – as the only conceivable function of the central bank. Two intellectual obstructions hinder the formation and circulation of new ideas. The first is a form of “*institutional amnesia*” – a collective forgetting of the fact that central bank independence and inflation targeting were specific institutional solutions at a historically specific juncture. Prior to that juncture, different macro-financial regimes meant that central banks used different instruments to pursue different goals.<sup>10</sup> The second is a form of “*strategic ignorance*” – a collective insistence that central banks have only *one* instrument at their disposal (the short-term interest rate) and can therefore only pursue one goal (price stability). In reality, anyone who cares to look can see that central banks do, even today, deploy a range of instruments in pursuit of a range of goals.<sup>11</sup>

Institutional amnesia and strategic ignorance have done great damage since the global financial crisis – one is tempted to speak of a lost decade for innovation in macroeconomic policy in general, and in the area of central banking in particular. The ECB has strategically underplayed its options as a central bank. In order to appear faithful to its narrow price stability mandate, it has depicted everything it has done – from unconventional monetary policy measures such as quantitative easing to its proactive shaping of financial system and labour market institutions – as serving the achievement of its price stability objective.<sup>12</sup>

The following section puts this institutional amnesia in historical perspective. Section 3 zooms in on the mandate-remote economy shaping done by the ECB, in spite of an official discourse that insists that the ECB has always been – and will only ever be – concerned with price stability.

<sup>10</sup> Braun and Downey, “Against Amnesia: Re-Imagining Central Banking” (see note 6).

<sup>11</sup> On the concept of strategic ignorance, see Linsey McGoey, *The Unknowers: How Strategic Ignorance Rules the World* (London: Zed Books, 2019); “The Logic of Strategic Ignorance”, *The British Journal of Sociology* 63, no. 3 (2012): 533–76.

<sup>12</sup> De Boer and van ‘t Klooster, “The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss” (see note 9).

## 2. Against amnesia: Central banks did many things in the past

Since the 1990s, most central banks, including the ECB, have adhered to the holy trinity of the inflation targeting paradigm: “price stability as the primary *goal* of the central bank; central bank independence as the *institutional arrangement*; and the short-term interest rate as the *operational target*”<sup>13</sup>. Its global diffusion and persistence, even after the global financial crisis of 2008, has resulted in a severe case of institutional amnesia that has prevented an enlightened debate about alternatives.

In the interest of enlightened debate, it is important to remember that the holy trinity is but a snapshot in the long history of central banking. Indeed, so varied is this history that different authors have emphasised vastly different aspects as being the driving forces behind the emergence of central banking.<sup>14</sup> At least four main narratives about the origins of modern central banking can be found in the literature. According to Charles Goodhart’s classic history, central banking evolved via the lender of last resort function. As banking became more complex and vulnerable, a (public) liquidity backstop was necessary to stabilise the system.<sup>15</sup> A second origin story emphasises states’ fiscal needs in the context of war financing as the driving force behind the establishment of central banks. Relatively independent central banks offered a “commitment technology that improved the government’s ability to borrow”.<sup>16</sup> A third account emphasises the price stability function of central banks, which grew more important over time as money became more and more abstract, culminating in the shift to pure fiat money in the early 1970s.<sup>17</sup> Finally, according to Karl Polanyi, modern central banking evolved as part of the social “countermovement” during the late 19th and early 20th centuries, when central banks did what they could to protect their domestic economies from the disruptive adjustment pressures emanating from the international gold standard regime.<sup>18</sup>

<sup>13</sup> Braun and Downey, “Against Amnesia: Re-Imagining Central Banking”, p. 1 (see note 6).

<sup>14</sup> Stefano Ugolini, *The Evolution of Central Banking: Theory and History* (Berlin: Springer, 2017).

<sup>15</sup> Charles Goodhart, *The Evolution of Central Banks* (Cambridge, MA: MIT Press, 1988).

<sup>16</sup> Lawrence J. Broz, “The Origins of Central Banking: Solutions to the Free-Rider Problem”, *International Organization* 52, no. 2 (1998): 231–68. Note that in other contexts, central banks supported government expenditures via direct monetary financing.

<sup>17</sup> Curzio Giannini, *The Age of Central Banks* (Cheltenham: Edward Elgar, 2011).

<sup>18</sup> Karl Polanyi, *The Great Transformation. The Political and Economic Origins of Our Time* (Boston, MA: Beacon Press, 2001), ch. 16.

The fact that the history of central banking is so varied that even the origins of central banking are contested helps put the recent past in perspective. Central bank independence and inflation targeting were the historically specific answers to a historically specific juncture – namely, the end of the macro-financial regime of Bretton Woods. At the international level, this regime anchored national currencies through a combination of fixed (but adjustable) exchange rates, a US dollar pegged to gold and, most importantly, severe restrictions on cross-border capital flows. At the domestic level, the Bretton Woods regime prioritised the government’s ability to stabilise the economy via Keynesian fiscal stabilisation policy and to play an active part in the creation of money and allocation of credit.<sup>19</sup>

This all changed with the end of the Bretton Woods regime. Following a period of upheaval and experimentation, a new macro-financial regime emerged. At the international level, the free movement of capital across borders gained priority, and the major currencies switched to floating exchange rates. At the domestic level, governments deregulated financial markets and cut back on employment protection and welfare state spending.<sup>20</sup> Most importantly, and in line with the preferences of international financial investors, macroeconomic policy shifted from Keynesian demand stabilisation under the leadership of the fiscal authority to price stabilisation under the leadership of the central bank, which almost everywhere was granted considerable independence from the government.<sup>21</sup>

<sup>19</sup> An excellent study of this regime in action is Eric Monnet, *Controlling Credit: Central Banking and the Planned Economy in Postwar France, 1948-1973* (Cambridge: Cambridge University Press, 2018).

<sup>20</sup> Instead of many, see Fritz W. Scharpf, *Crisis and Choice in European Social Democracy* (Ithaca: Cornell University Press, 1991).

<sup>21</sup> On the political economy of central bank independence, see Posen, “Why Central Bank Independence Does Not Cause Low Inflation” (see note 8).

### 3. Against strategic ignorance: The extracurricular activities of the ECB

The ECB is considered the world's most independent central bank. Its statute exempts it from democratic accountability in the field of monetary policy while, unlike other central banks, it lacks a powerful fiscal counterpart at the supranational level.<sup>22</sup> The mandated goal of price stability is sufficiently broad to justify virtually any policy measure taken by the ECB, effectively neutralising even court-based accountability.<sup>23</sup> It should therefore not be surprising that the ECB's activities have, in practice, consistently exceeded its formal mandate. A serious debate about what the ECB can or should do in the future must begin by acknowledging these "extracurricular" activities of the ECB. Most notably, the ECB shapes financial markets, labour markets, and steers the allocation of capital.

#### Shaping financial markets

The ECB shapes financial markets in two main ways. The first is a quasi-automatic by-product of monetary policy, whereas the second involves more explicit regulatory action.<sup>24</sup> The former occurs because the ECB's monetary policy is implemented and transmitted via financial markets. Every aspect of the ECB's operational framework – such as its collateral framework – shapes the financial market segments in which it transacts with private financial institutions. Consider the fact that in the run-up to the launch of the euro, it was decided that the ECB was going to manage liquidity conditions in the interbank market via open-market transactions in the repo market. The ECB's presence gave the repo market a big boost, contributing to an explosion of repo lending that enabled the growth of shadow banking and was at the very heart of the global financial crisis of 2008. This pattern of central bank-led financialisation – intermediated via the repo market – is not unique to the euro area.<sup>25</sup>

<sup>22</sup> See Benjamin Braun, "Two Sides of the Same Coin? Independence and Accountability of the European Central Bank" (Transparency International EU, 2017); Mark Dawson, Adina Maricut-Akbik, and Ana Bobić, "Reconciling Independence and Accountability at the European Central Bank: The False Promise of Proceduralism", *European Law Journal* 25, no. 1 (2019): 75–93.

<sup>23</sup> Höpner, "Proportionality and Karlsruhe's Ultra Vires Verdict" (see note 9); de Boer and van 't Klooster, "The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss" (see note 9).

<sup>24</sup> Höpner, "Proportionality and Karlsruhe's Ultra Vires Verdict" (see note 9); de Boer and van 't Klooster, "The ECB, the CThis section draws on Benjamin Braun, "Central Banking and the Infrastructural Power of Finance: The Case of ECB Support for Repo and Securitization Markets", *Socio-Economic Review* 18, no. 2 (2020): 395–418.

<sup>25</sup> Daniela Gabor, "The (Impossible) Repo Trinity: The Political Economy of Repo Markets", *Review of International Political Economy* 23, no. 6 (2016): 967–1000; Leon Wansleben, "Formal Institution Building in Financialized Capitalism: The Case of Repo Markets", *Theory and Society* 49, no. 2 (2020): 187–213; Timo Walter and Leon Wansleben, "How Central Bankers Learned to Love Financialization: The Fed, the Bank, and the Enlisting of Unfettered Markets in the Conduct of Monetary Policy", *Socio-Economic Review* 18, no. 3 (2020): 625–53.

The second type of financial market-shaping concerns securitisation, the financial technique that precipitated the US subprime crisis. Here, the ECB's role has been more proactive and political. Following the collapse of European securitisation activity in 2008, the ECB – regarding it as an important infrastructure for risk sharing and the transmission of monetary policy – used collateral, quantitative, and regulatory easing to revive this segment of the financial market. By reducing the rating thresholds for asset-backed securities pledged as collateral with the ECB, in its own words, provided a “great support to this market segment”. It did so again when it launched its programme of quantitative easing, which from the very beginning included an ABS (Asset-Backed Securities) Purchase Programme. The ECB also sought to exercise political influence by urging the European Commission to provide regulatory easing for the securitisation market. When the market-friendly 2017 European Union regulation establishing a “framework for simple, transparent and standardised securitisation” (STS) passed in the European Parliament in 2017, the language echoed that of Jose González-Páramo, who, speaking at a securitisation industry conference in 2010, already saw the securitisation market on “a path towards standardisation, simpler structures and better post-trade price transparency”.

Former ECB official Benoît Cœuré has argued that “[f]inancial structures should be the outcome of market forces” and that “central banks should, in principle, play no active role” in that area.<sup>26</sup> There is nothing wrong, however, with state actors shaping financial markets so as to better serve the collectively defined public good. The problem is that, at present, the main state actor doing that shaping is the central bank, with little ex-ante input or ex-post accountability from outside the financial system.

## Shaping labour markets

From the beginning, the heterogenous labour market and welfare state institutions in euro-area member states posed a challenge for the ECB's single monetary policy.<sup>27</sup> Rejecting any notion of ex ante coordination between wage setters and monetary policy, the ECB instead used every means at its disposal to advocate for structural labour market and welfare state reforms in member states. To understand why, it is necessary to take a closer look at the theory and – more importantly – the practice of central bank independence.

<sup>26</sup> Benoît Cœuré, “The Future of Central Bank Money”, Speech at the International Center for Monetary and Banking Studies, Geneva (14 May 2018).

<sup>27</sup> Mattias Vermeiren. „One-Size-Fits-Some! Capitalist Diversity, Sectoral Interests and Monetary Policy in the Euro Area.” *Review of International Political Economy* 24, no. 6 (2017): 929-57.

Central bank independence is an institutionalisation of the idea that elected governments – beholden, according to the dominant strand of macroeconomic thinking since the 1970s, to the short-sightedness of voters – should have no say in monetary policy. As one influential economist put it during the early days of the ECB, the rise of central bank independence since the 1980 was “all about [...] getting rid of democratic money which is always shortsighted, bad money”.<sup>28</sup> Independent central banks, the argument went, could resist political pressure for monetary easing, even when doing so led to high unemployment. In reality, however, central banks are more averse to unemployment than this theory suggests. Like any other institution, the central bank depends on its public legitimacy, which is a function of its success in guaranteeing not only low inflation but also – regardless of the specifics of its mandate – low unemployment.<sup>29</sup> Its aversion to unemployment explains why the ECB consistently advocated for structural labour market reforms in member states.

The following is based on a detailed analysis of the public speeches delivered by presidents and Executive Board members, which reveals an almost two-decades-long ECB campaign advocating for structural labour market reforms and downward wage flexibility (see Figure 1).<sup>30</sup> Unwilling to ease monetary policy in the early 2000s – which it argued could only create a short-lived boom but was inflationary in the long term – the ECB called for structural labour market reforms as being the only way to reduce what it considered “structural unemployment”.<sup>31</sup> Starting in 2005, under the leadership of Jean-Claude Trichet, the ECB became aware of divergent wage – and therefore competitiveness – trajectories across the euro area. It urged member state governments to implement structural reforms to allow for downward wage flexibility and called on trade unions to exercise wage restraint. This prefigured the interpretation of the euro area debt crisis – promoted after 2010 by both the ECB and the European Commission – as a crisis of fiscal and wage profligacy, and a concomitant loss of competitiveness that had to be restored via internal wage deflation.<sup>32</sup>

<sup>28</sup> Rüdiger Dornbusch, “Essays 1998/2001”, p. 182, <http://web.mit.edu/15.018/attach/Dornbusch,%20R.%20Es-says%201998-2001.pdf>. For a discussion of the historical and intellectual context in which mainstream economists acquired such views, see Wolfgang Streeck, *Buying Time: The Delayed Crisis of Democratic Capitalism* (London: Verso, 2014).

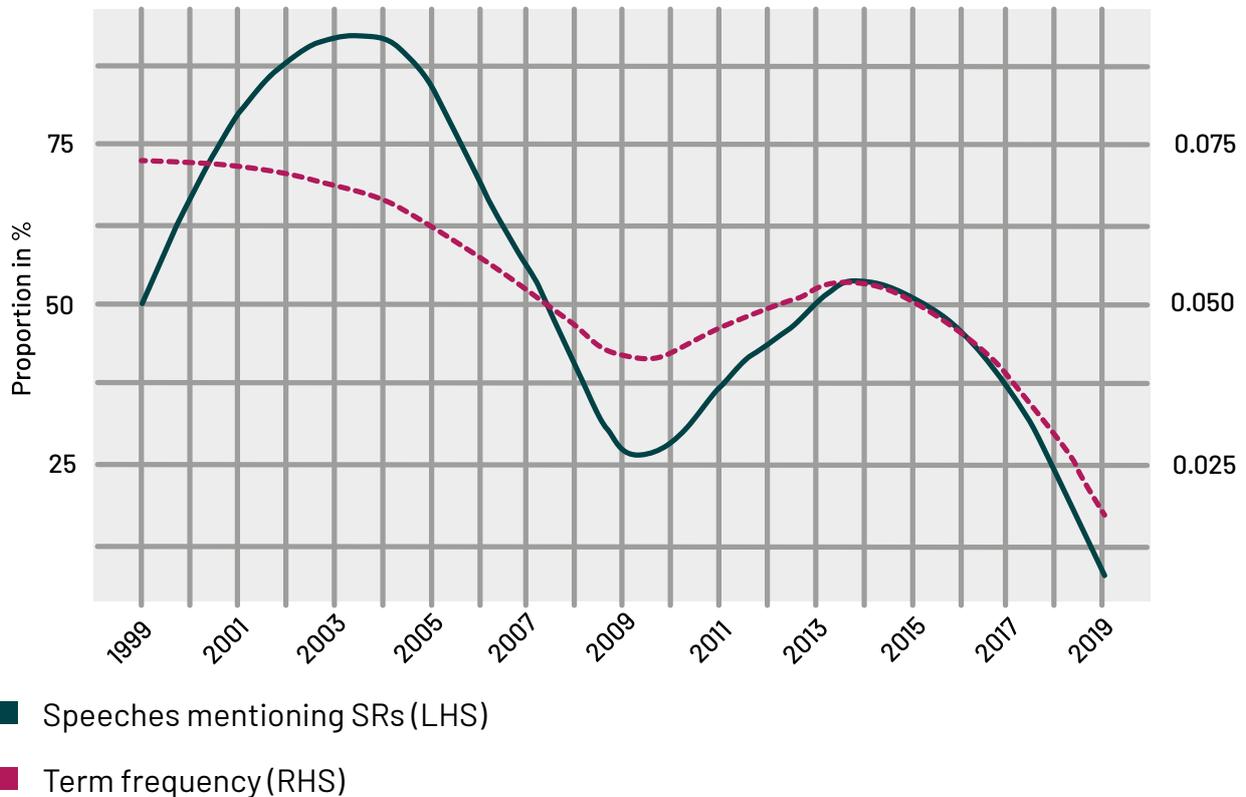
<sup>29</sup> On the importance of legitimacy considerations for the ECB, see Vivien A. Schmidt, *Europe’s Crisis of Legitimacy: Governing by Rules and Ruling by Numbers in the Eurozone* (Oxford: Oxford University Press, 2020).

<sup>30</sup> This section draws on Benjamin Braun, Donato Di Carlo, Sebastian Diessner, and Maximilian Düsterhöft, “Planning Laissez-Faire: The European Central Bank and Structural Labor Market Reforms” (2021), available at <https://wp.me/a8xqG0-4R>.

<sup>31</sup> For contemporary critiques of the structural unemployment view, see Robert M. Solow, “Keynes Lecture in Economics: What Is Labour-Market Flexibility? What Is It Good For?”, *Proceedings of the British Academy* 97 (1998): 189–211; Lucio Baccaro and Rei Diego, “Institutional Determinants of Unemployment in OECD Countries: Does the Deregulatory View Hold Water?”, *International Organization* 61, no. 3 (2007): 527–69.

<sup>32</sup> Amandine Crespy and Pierre Vanheuverzwijn, “What ‘Brussels’ Means by Structural Reforms: Empty Signifier or Constructive Ambiguity?”, *Comparative European Politics* 17, no. 1 (2019): 92–111; Clement Fontan, “Frankfurt’s Double Standard: The Politics of the European Central Bank During the Eurozone Crisis”, *Cambridge Review of International Affairs* 31, no. 2 (2018): 162–82; Joan Miró, “In the Name of Competitiveness: A Discursive Institutional Analysis of the EU’s Approach to Labour Market Structural Reform, 2007–2016”, *Socio-Economic Review* (2019).

**Figure 1: The phrases “structural reform” or “structural policy” in the public speeches of ECB Executive Board members, 1999–2019 (1=100%)**



Source: Braun et al., “Planning Laissez-Faire” (see note 30)

The ECB also went beyond public rhetoric and behind-the-scenes advocacy. First, together with the European Commission and the International Monetary Fund (IMF), the ECB participated in the official imposition of conditionalities on so-called programme countries that borrowed first from the IMF and other member states, and later from the newly established European Stability Mechanism.<sup>33</sup> In addition to its official role in this “Troika”, then-ECB president, Jean-Claude Trichet, also sent several secret letters to the governments of Ireland, Italy, and Spain, which made government bond purchases conditional on specific structural reforms, including labour market liberalisation.<sup>34</sup>

<sup>33</sup> Susanne Lütz and Matthias Kranke, “The European Rescue of the Washington Consensus? EU and IMF Lending to Central and Eastern European Countries”, *Review of International Political Economy* 21, no. 2 (2014): 310–38; Wade Jacoby and Jonathan Hopkin, “From Lever to Club? Conditionality in the European Union During the Financial Crisis”, *Journal of European Public Policy* (2019).

<sup>34</sup> Adam Tooze, *Crashed: How a Decade of Financial Crises Changed the World* (Penguin, 2018), 398; Cornel Ban, *Ruling Ideas: How Global Neoliberalism Goes Local* (Oxford: Oxford University Press, 2016), 202–04.

Even more than financial markets, labour markets should be shaped by collective, democratic decisions. The requirements of monetary policy are among the least relevant considerations to guide those decisions. Indeed, the first question should be: What kinds of jobs, work conditions, and labour relations do we want as a society? The answer to that question should determine the choice of monetary policy regime. It might be, for instance, that workplace democracy and equitable wages require greater ex-ante coordination between monetary, fiscal, and wage policy. In a democratic society, central bank independence should not stand in the way of such an arrangement.

### Picking winners, steering capital

The holy trinity has routinely been justified on the grounds that it minimises the central bank's footprint in the economy. Up until the 2008 financial crisis, the ECB emphasised its "hands-off" approach to interest rate policy, declaring that "developments in longer-term money market interest rates reflect market forces" and are therefore "beyond the ECB's direct control".<sup>35</sup> Control over long-term rates was considered undesirable on the grounds that long-term interest rates would lose "their important allocational [sic] function in a market economy by virtue of being relative indicators of scarcity".<sup>36</sup> In other words, the ECB claimed – as did other inflation-targeting central banks – that its monetary policy operations were largely "market neutral" and without major distributional effects.

This discourse of market neutrality has rightly been described as a "myth".<sup>37</sup> This matters because opponents of progressive central banking proposals routinely cite the market neutrality argument to support their position. The ECB cannot, according to this argument, give preferential treatment to any subset of financial or non-financial firms because doing so would amount to an industrial policy that, per definition ("picking winners"), exceeds the ECB's mandate.

There is merit to this argument, in the sense that the goals and content of industrial policy should be determined by elected governments rather than independent central banks. However, the argument obscures the fact that virtually every central bank decision or policy impacts the allocation of capital and creates winners and losers.

<sup>35</sup> ECB, "The Analysis of the Euro Money Market from a Monetary Policy Perspective", February (2008), pp. 71, 79.

<sup>36</sup> Otmar Issing, "Theoretical and Empirical Foundations of the Deutsche Bundesbank's Monetary Targeting", *Inter-economics* 27, no. 6 (1992): 293.

<sup>37</sup> Jens van 't Klooster and Clément Fontan, "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* (2019): 1-15.

This is certainly true for conventional interest rate policy.<sup>38</sup> However, one can argue that the distributional consequences of conventional monetary policy are authorised by the democratic decision to delegate monetary policy authority to an independent central bank.<sup>39</sup> It gets trickier with the more technical aspects of monetary policy, such as the collateral framework, which benefits some financial institutions and instruments over others. The most obvious case, however, concerns large-scale asset purchases. Regardless of how closely the purchases of any type of security track the composition of the market, they benefit the issuers of *those* types of securities. For instance, the ECB's corporate bond purchase programme benefits the largest corporations – smaller firms do not issue corporate bonds. The same holds for the financial stability function of the central bank.<sup>40</sup> When the central bank steps in as the lender of last resort in a financial crisis, hedge funds and private equity funds are among the financial institutions that benefit the most. This is not because they have access to central bank lending operations – they generally do not – but because they are the most leveraged actors in the economy whose ability to buy companies (or other assets) depends on their ability to take on large debts at low cost. In this manner, the lender of last resort underwrites the ability of the most predatory actors in the financial system to profit from financial crises.

To be very clear: The problem is not that the ECB picks winners or steers the allocation of capital. The problem is that it has generally done so for reasons of technical or political expediency, as opposed to doing so in response to visions formulated by elected governments about what collective purposes the financial system should serve. If the European Union embraced an industrial policy that required a macro-financial architecture in which hedge funds and private equity play a much smaller role, and in which state-owned financial institutions play a much larger role, then the ECB – which has a statutory requirement to “support the general economic policies in the Union” – would have to support that agenda, and there would be nothing wrong with it.

<sup>38</sup> Olivier Coibion, Yuriy Gorodnichenko, Lorenz Kueng, and John Silvia, “Innocent Bystanders? Monetary Policy and Inequality”, *Journal of Monetary Economics* 88 (2017): 70–89.

<sup>39</sup> Jens van 't Klooster and Clément Fontan, “The Myth of Market Neutrality” (see note 37); de Boer and van 't Klooster, “The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss” (see note 9).

<sup>40</sup> On discretionary central bank power in last-resort lending, see Steffen Murau, “Shadow Money and the Public Money Supply: The Impact of the 2007-9 Financial Crisis on the Monetary System”, *Review of International Political Economy* 24, no. 5 (2017): 802–38.

## Conclusion

In a democracy, the delegation of executive power to unelected bodies is problematic.<sup>41</sup> Central bank independence is conventionally justified on the grounds that it is limited to conducting monetary policy, and that the pursuit of price stability is largely neutral in its distributional effects. Neither of these arguments holds up against the empirical evidence.<sup>42</sup> In the specific – and particularly problematic – case of the euro area, we have seen that the ECB shapes financial markets, steers the allocation of money and capital, and actively lobbies national governments to implement its preferred labour market and social policies. These extracurricular activities can, in theory, be linked to the ECB's pursuit of price stability. In reality, however, they go beyond the ECB's legal mandate.

As noted at the beginning, the message of this paper is not that the ECB's economy-shaping activities are bad. The problem is that this capacity to shape the macro-financial architecture is far too important to exist – far from public and political deliberation – as a mere support function of monetary policy implementation. Crucially, one does not have to question the central bank's dedication to the public good to find fault with this arrangement. The problem is that, at the centre of the ECB's version of the public good, one finds monetary governability. Its main concern is that the financial system and the labour market facilitate the efficient and effective implementation and transmission of monetary policy. That is not a rational way of designing an economy. A thriving shadow banking sector may increase the ability of monetary policy to reach the far corners of the financial system, but it fuels financialisation, asset price inflation, and financial instability. A frictionless labour market may make national economies more responsive to shocks and monetary policy signals, but it reduces people's incomes and makes their lives harder. The ECB's economy-shaping powers should be wielded, but they should be wielded according to democratic political decisions.

<sup>41</sup> Downey, "Delegation in Democracy" (see note 2); van 't Klooster, "The Ethics of Delegating Monetary Policy" (see note 2).

<sup>42</sup> The most comprehensive study yet of the relation between central bank independence and inequality is Michaël Aklin, Andreas Kern, and Mario Negre. „Does Central Bank Independence Increase Inequality?“ Policy research working paper no. 9522 Washington, DC: World Bank Group, 2021.