

Harold James

*Central Banks: Between
Internationalization and Domestic
Political Control*

COMMENT

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Harold James (HJ) points

- Independence should be studied in the “political and social setting within which CBs work” (p.8)
- There are cycles in CB independence
- **CB's independence increases with economic integration** (from unitary to federal state to global integration, pp.9-12)

Napoleon (1805)

The Banque de France does not belong to its shareholders only; it also belongs to the State as it is the latter that entrusts it with the privilege of issuing money...I want the Bank to be just enough but not too much under Government's control

(Quoted by Crouzet 1993, p.544)

Sayers (1957)

“The essence of central banking is discretionary control of the monetary system.. By comparative study we may hope to find some generalization about the behaviour of central banks.. but we are doomed to disappointment if we look for rules applicable to all times and all places. We have central banks for the very reason that there are no such rules” (Sayers 1957, 1-7)

Cairncross (1988)

“The British experience has been that there is no alternative to a close relationship [between the Government and the Bank] with each preserving its independence of judgment but with responsibility for major decisions resting inevitably on the government of the day”

Thatcher (1995)

The return to a mechanism of price stability “should not entail giving new autonomy to the Bank of England. Ultimately, it is the politicians who must be accountable for economic policy”

(The Path to Power, London 1995:570).

HJ on CB independence & globalization

- A stable monetary order is a critical part of the process of globalization (p.12);
- Internationally: governments are not trusted to maintain price stability, independent CBs are
- Domestically: as international cooperation “requires countries to do something that they do not find to be in their immediate interests”: it is politically expedient to delegate such action to unelected officials who enjoy the trust of international partners

Luzzatti and the international bank

Politics is in the way of a clear vision of long term economic self interest. Central banks are better equipped to understand such interests.

“There is no absolute remedy for financial crises what I simply ask for are agreements among experts capable of eliminating from inevitable crises those elements that are due (..) to the lack of agreement for mutual self-interested gold lending” (Luzzatti 1907)

Lending of last resort (LLR)

- Little attention to LLR in discussing CB independence by HJ
- LLR is a central feature of Central Banking
- LLR at the core of the current discussion of the future of central banks
- LLR highlights issues of CB independence both from governments and the private banking sector

1930s vs. 2010s

will history repeat itself?

The increasing politicization of central banks looks like a dramatic repeat of the interwar story (..) the pendulum is swinging back toward a nationalized Bank of England, a more accountable Fed, and ECB that answers the people of Europe. How likely is this outcome?

1920s vs. 2000s

Similarities:

Easy money

Inept intellectual framework
(*cum* ideological hubris)

Regulatory failures

1931 vs. 2009

- **2009 potentially more devastating than 1931**
 - ✓ **Higher Financial liabilities/GDP**
 - ✓ **Higher leverage and short term debt**
 - ✓ **More global markets (+ technology)**
- **Stubborn deflation vs. monetary and fiscal expansion**
- **Little vs. huge lending of last resort and financial restructuring**
- **Output decline for two more years vs. real economy recovery**

1930s vs. 2010s

- 1930s: independent central banks the villains
 - major mistakes made
 - governments happy to shift on them common responsibilities
- 2010s: popular rage focused on banks and financial markets. Governments blamed for bailouts.

Likely outcome for central bank independence

- More accountability and more supervisory and regulatory responsibility
- Swollen CB balance sheets will require closer cooperation with governments
- Realization that ECB can act swifter than governments in financial emergencies
- No much change from current separation of responsibilities, & cooperation, between central banks and governments