Institutional Metamorphosis: The Backlash Against Independent Central Banking

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Institutional Metamorphosis: The Backlash Against Independent Central Banking

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Abstract
The predominance of technocracy and preference for institutional independence that was key to the market-state relationship since the end of the cold-war is being challenged by renewed calls for re-politicisation from across the political spectrum. The prime examples in developed economies are President Trump in the USA and the Labour Party leadership under Jeremy Corbyn in Britain. Re-politicisation points to a different, state-centric, model of accountability and legitimacy for the operation of institutions. This chapter examines calls for a return to political-institutional environments long extinct in the west, and (up until recently) in retreat in the developing world. The chapter argues that the contemporary critique of central bank independence has nothing to do with the literature on empowerment and greater accountability that was developed at the time of (and since) the financial crisis; and reflects on a metamorphosis of debates towards undemocratic, capricious, populist and state-centric directions. This phenomenon has profound implications for emerging economies where efforts to build a pro-market institutional and legal framework have long focused on the promotion of independent institutions, like central banks. The chapter argues that these developments in the political centres of the west directly undermine modernising efforts in emerging economies.

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Introduction

The second decade of the 21st century has blessed us to live in interesting times. One of the ways this finds expression is through a historical change in our perception of institutions and state behaviour. The predominance of technocracy and institutional independence that underpinned our understanding of the market-state relationship since the end of the cold-war is being upended by renewed calls for re-politicisation from across the political spectrum. This is particularly evident in the area of central banking. The prime examples of this change of attitude towards independent institutions are of course the actions of President Trump in the USA and the proposed policies of the Labour Party leadership in Britain. Other examples from emerging economies include pressures on central banks ranging from President Erdogan of Turkey to tensions in India. The focus on the desirability (or not) of maintaining the technocratic status of central banks is a significant development for two reasons. Firstly, it points to a different, state centric, model of accountability and legitimacy for the operation of institutions. Secondly, it is significant because it is unfolding in an environment where a critique of institutional independence, based on issues like democratic accountability, is being overtaken -one could argue even hijacked- by a reactionary (extreme-left or hard-right nationalistic) critique that is at its base paternalistic (suggesting, a leader-knows-best approach). Such critique has little to do with the literature on empowerment and greater accountability that was developed at the time of (and since) the financial crisis. What we are dealing with now is a metamorphosis of a debate on economic management towards undemocratic, capricious and state centric directions. A political economy context such as the one described in this chapter influences central banking, particularly in emerging economies. As a result, in a sharp reversal to what had become orthodox thinking at the end of the 20th and the beginning of the 21st century, partisan politics is back on the driving seat of debates about central banks and their operations.

The chapter starts by explaining how institutional independence (and central bank independence in particular) represented a meeting point between market freedom and state support for economic development. It explains through the lens of institutional economics how legal and political initiatives led to the development of a stable equilibrium between democracy and the policy predictability needed for markets to flourish. The chapter then investigates how the idea of central bank independence took root and became the orthodoxy of macroeconomic policy. The discussion moves on to the critique of central bank independence and the consequences of a sustained attack from the left (but also the right) of the political spectrum on eroding the consensus in favour of institutional independence. The chapter concludes by highlighting the potentially destabilising effects for emerging market economies of a populist-driven retreat from independence in the west and reflects on how to preserve the core benefits of central bank independence for emerging economies.

Where we were

The purpose of this chapter is to present how the changing political economy of central banking is affecting and will affect the future of central banks in emerging economies. In order to do this, the chapter begins with a presentation of the orthodox view of the state-market relationship as it operated from the fall of communism in the early 1990s, till the financial crisis of 2008. The legacy of the 1990s and the collapse of centrally planned economies has had a profound effect on our understanding of the state-market relationship (Glinavos 2013). We no longer view it as a relationship of opposition (in which the market stands against the state) but as a co-existent relationship in which state and market are mutually supportive. Institutional economists like Douglass North and Oliver Williamson have helped us understand the connections by offering a framework for explaining how state action and a foundation of law are complementary to successful market institutions (Groenewegen et al. 2010). An associated development has been increased recognition of the fact that democratic regimes are essential to the development of transparent and accountable states, within which, the market is the ultimate good. This is because through market promotion policy makers believe that economic and social rights are guaranteed (Anghie 2000). Binding democratic politics with law-based policy making (consistent with market respecting boundaries) is best achieved via politically independent institutions that place checks both on politicians' interpretations of the popular will, and protect the public from possible arbitrariness, unpredictability or capriciousness of political leaderships. Independent central banks, have been a key example of such independent institutions, forming the core of the contemporary (orthodox) understanding of economic processes and the state-market relationship.

An integral part of the way the market-state relationship has found balance in the last 20 years is through this idea of institutional independence from political control, with the most prominent expression of the promotion of institutional independence being central bank independence. Central bank independence ensures that macroeconomic policy is determined solely by 'economic' concerns. This promotes the pursuit of policies deemed good for the 'investment climate'. It also, however, limits governmental discretion and this has led to popular consternation and significant political critique. States are less able to control their economy or to pursue expansionary economic policies to achieve policy objectives (Watson 2002). We will now consider the provenance of the doctrine of central bank independence in some more depth.

The core of the intellectual case for central bank independence revolves around the assumption of a persistent inflationary bias built into politicians' monetary policy preferences (Glinavos 2013, p. 50). It is argued that this bias can only be negated by vesting authority in policy makers who can be trusted to choose a policy rule that is non-accommodating of inflationary tendencies; namely central bankers. Central bankers are assumed to be better placed than politicians to enforce such a rule, since there is no clear symmetry of interest between the central bank and the labour market in the way that there is between the government and the labour market (Watson 2002, p. 184). Put in a simpler way, there is an assumption that political control over monetary policy makes the business cycle dependant on the political-election timetable, with politicians trying to manipulate economic performance to gain short term political gain. Research (King 2005) suggests that in Britain, for instance, the Conservative governments that preceded Labour prior to 1997 engaged actively in trying to manipulate economic indicators for political purposes. There is also supportive evidence of political manipulation from the United States (Nordhaus 1975). Accepting this argument (as to the perverse incentives of politicians and their effects in distorting the economic cycle) was a key precondition to allowing the idea of independence to take root as a positive policy innovation.

The notion of central bank independence has a much longer pedigree however than debates on specific countries' electoral politics. It was introduced by David Ricardo in 1824 (Nika 2018). While Ricardo did not use the term 'independence' himself, he highlighted the dangers that might be created when elected representatives are entrusted to issue paper money. Ricardo also argued against having central banks financing directly their governments' deficits. In Ricardo's words (McCulloch 1888, p. 506):

> It is said that Government could not be safely entrusted with the power of issuing paper money; that it would most certainly abuse it; and that, on any occasion when it was pressed for money to carry on a war, it would cease to pay coin, on demand, for its notes; and from that moment the currency would become a forced Government paper.

King assessed the ascendency of the idea in the 1990s that monetary policy ought to be determined by technocratic criteria through independent central banks. Historically, attempts to depoliticise banking rested on distrust of both politicians and of the public to behave in a way conducive to the country's best interests (Glinavos 2013, p. 48). Thomas Hutchinson, an 18th century governor of Massachusetts, for instance, declared that 'the great cause of paper money evil was democratic government. The ignorant majority, when unrestrained by a superior class, always sought to temper with sound money' (Coggan 2011, p. 36). According to Chernow (1994, p. 132–40) the Federal Reserve was created, in a rather clandestine manner, in 1913 to implement banking and currency reforms to prevent periodic banking crises. According to Das (2011, p. 130) central bank authority focused on ensuring that the value of money was not undermined by inflation, an idea consistent with Friedrich von Hayek's (1944) argument that mechanistic rules ought to limit the central bank's discretion (and as a consequence the influence of political process over central bank policies). Technocracy however suggested a distancing from democracy. According to Lastra and Miller (Kleineman 2001, p. 159):

> Central banks are not majoritarian, democratic institutions. Central banks are, instead, technocratic bureaucracies, staffed by career employees and, typically, a few leaders elected by the political authorities. It might be said that any bureaucratic agency is non-majoritarian…But the problem is greatly exacerbated in the case of central banks as compared with typical bureaucracies. Central banks do not simply administer a technical regulatory scheme affecting discrete industries or interests. They regulate price levels, which is one of the most fundamental powers of government, and one of the most important practical concerns of the public at large.

There have been various descriptions of the meaning and forms of central bank independence (Nika 2018). For example, Cukierman (2008) provided four criteria for determining central bank independence: the ability of central bank to appoint and dismiss all of its members, including the members of governing board; the freedom of central bank to determine and decide on the goals of its monetary policy mandate; price stability as the main goal of monetary policy and whether there are lending restrictions imposed to central bank's operation. Later, de Haan and Eijffinger (2016), incorporated two more dimensions into the notion of central bank independence, personnel independence, which involves the capacity of central bank to have the final authority for the appointment and dismissal of its members; and financial independence, which refers to central bank's autonomy of any kind of credit relation with the state, either directly or indirectly.

Ideas matter

Economic policy is influenced by ideological positioning to a greater degree than that assumed by traditional economic models (Rodrik 2014); and in the context of institutional independence, ideas matter more than in other areas of policy-making. North (1981) in his analysis of institutions shows the influence of a country's political economy on the evolution of economic systems. This can help explain the discrepancy between theoretical models and real life. In a fictional world of minimal transaction costs, North suggests, the market would indeed take care of itself, but in the real world, where transaction costs are considerable, he argues that much more is needed. Institutions are formed to reduce the uncertainties that would otherwise hinder economic exchange. By introducing the realities of actual markets – such as lack of information, political factors and ideology – into his theoretical model, North tries to elaborate why a functioning market needs much more than merely a bedrock of property rights and contract laws (Glinavos 2010, p. 111).

Describing the political economy that gave credence to the idea of central bank independence in Britain, King claims that New Labour's decision to give the Bank of England (BoE) operational independence was a political decision, not an economic one. It established New Labour's anti-inflationary credentials and delivered on the party's campaign promise to de-politicise the setting of interest rates (King 2005, p. 94). In fact, BoE independence forms part of a global trend during the 1990s, when more than 30 countries passed legislation acknowledging and increasing the legal independence of their central banks (Maxfield 1997). This trend represents one of the most dramatic changes in monetary frameworks since the deconstruction of the Bretton Woods regime. BoE reform came a decade after the start of the trend in central bank independence, which began with the 1989 reform of the Reserve Bank of New Zealand. The British decision however was not linked to changes in Britain's exchange rate regime, the collapse of the former Soviet Union, the adoption of an IMF programme, or a decision to join the Euro area – explanations that cover most cases of central bank reform in the 1990s (Cukierman 1994, p. 1446), but it was motivated by the internalisation of the idea of independence by the labour leadership (King 2005, pp. 95-96).

A similar political explanation can be found for the German Bundesbank's independent structure. According to Bernhard (1998, p. 322) the German bank's independence resulted from the balance of power politics in Western Germany that could only be maintained by detaching government from the setting of monetary policy. It needs to be stated here that for politicians, academic discussions of economic gains are not enough, there also need to be clear electoral gains for the party in question, in order for them to champion such an institutional change. In a similar fashion, when the electoral costs exceed the electoral gains, politicians will have an incentive to retain the status quo (Glinavos 2013, p. 50). In the case of the BoE, independence provided electoral gains for Tony Blair's New Labour by making the party appear economically prudent and consequently more attractive to voters. By contrast, the Conservatives saw only electoral costs from this reform as it limited their ability to set interest rates strategically. In short, the political salience of institutional reform proposals explains patterns of adoption or rejection (King 2005, p. 115).

This is not to suggest however, that everyone is convinced of the de-politicising effects of independence. Debelle and Fischer (1994) appear unconvinced with what they see as the three foundations of the idea of central bank independence. These foundations, they argue, are the success of the Bundesbank and the German economy, the academic literature on the assumed inflationary bias of politicians, and the literature on the effects of central bank independence. They argue instead that the Bundesbank's unwavering inflation targeting has been very costly on German growth. One could make the same argument about the European Central Bank (ECB) in its pre-quantitative easing, stimulus-prone state. It should also be noted that inflation targeting, as a goal of monetary policy does not automatically require independence for the central bank, and further that the causal relationship between strict monetary policies and independence is not one directional. It could be for instance, that countries have independent central banks because they have chosen monetarist policies and not the other way around as commonly assumed (Glinavos 2013, p. 51).

The de-politicisation of central banking and the transfer of control over interest rates to independent central banks was also a key consequence of the success of the argument that Keynesian demand management was illegitimate. This was largely achieved by Friedman (Brittan 1982) when he sought to demonstrate that a market economy would tend to gravitate towards a natural state of unemployment determined crucially by the cost of productivity and the distribution of labour (Callinicos 2010, p.15). For this reason, governments, Friedman (1963) argued, could not affect the rate of unemployment in the long term, unless they increased spending and cut taxes, which would result in an expansion of the money supply, and thus inflation. Friedman's imperative to maintain monetary and fiscal stability could only be maintained therefore if the economy was run on an autopilot for regulating the quantity of money. This autopilot was achieved via institutionally independent central banks and, one could argue, inadvertently led to a re-naturalisation of economic relations. Such re-naturalisation of economic relations suggest a return to the view that market processes need no state direction, that last held sway prior to the Great Depression (Glinavos 2013, p. 50). What can be done through achieving political consensus however can also be undone when the consensus fractures. It is precisely at this point of fracture that we turn now, examining how a change of perception first on the left, and secondly on the right of the political spectrum has altered the political economy supporting central bank independence in the years since the financial crisis.

Leftist critique

Is it true that institutional independence, and more specifically central bank independence, results in apolitical economic governance, especially in the area of monetary policy? Those approaching the question from a critical standpoint (for critical, see left), argue that independence does not in fact 'de-politicise', but it only cements a particular ideology as the perpetual background to economic decision making. McNamara argues (2002) that the advocacy of central bank independence relies on a series of contestable arguments including its purported de-politicising effects. Delegation of economic decision making to politically independent institutions does not in and of itself eliminate partisan politics and interests, and monetary policy of any type (especially one with a strong anti-inflationary bias) has specific distributional consequences that raise important questions about legitimacy and accountability. While control of inflation is currently the standard priority of all central banks (Fed, BoE, ECB) this does not mean that it is a policy without political content. There is indeed a trade-off between low inflation, growth and employment outcomes (Bernanke and Mishkin 1997), which leads one to ask why is it political meddling to allow higher inflation and keep interest rates low as part of a policy aiming to promote employment and growth (or to eat away at public debt), while it is not political interference to maintain a strict inflation targeting regime in an economic climate (like the one post financial crisis for example) where the target arguably suppresses growth and employment? Callinicos (2010) argues that the effect of the financial crisis has been to broaden political horizons and to allow citizens to question a distinctive feature of economic orthodoxy, which he calls the 'naturalisation' of economic relations. State intervention in the economy in the form of Keynesian policies, or bailouts (such as those experienced in response to the financial crisis post 2008) re-legitimise the idea of political involvement in the economy. The lesson of the Phillips curve which posits a trade-off between inflation and unemployment (Callinicos 2010, p. 14) was that governments could choose the mix of inflation and unemployment that best suited their values and priorities. This ability of governments implies that economic relations are not governed by autonomous mechanisms resembling those driving physical processes (Glinavos 2013, p. 53). Consequently, a central bank run on an inflation obsessed auto-pilot, may not be offering the best service to the nation it operates in.

One could also legitimately ask, for instance, why is it political to run a monetary policy with an eye on social consequences for the worse off, while it is apolitical and technically sound to run such a policy (with price stability as an imperative) when it happens to benefit the already well-off? Joseph Stiglitz noted in an article to the Economist (1998, p. 216) that decisions made by central bankers are not just technical decisions, they involve trade-offs, judgements about whether the risks of inflation are worth the benefits of lower unemployment, and these trade-offs involve value judgements. Stiglitz returned to this theme in fact in Freefall (2010) by arguing that it is not so much the details of regulatory policy that we ought to be considering in the wake of the financial crisis, but the ultimate goals: what is the role of regulation and what type of economy we want? These are key political questions and cannot indeed be answered by institutions independent from politics -and one could argue detached from democratic legitimacy. In the words of McNamara (2002, p. 53) severing the direct institutional ties to elected officials appears to create an apolitical environment for policy making, while central banks continue to make policies which have important, identifiable distributional effects and thus remain resolutely political and therefore partisan institutions. This is true without even beginning to consider the wealth of literature suggesting (as noted earlier) that inflation targeting in itself has dubious beneficial consequences on the economy (Bruno and Easterly 1996).

The independence of the Bank of England (BoE) is recent example of contemporary controversy generated by the left of the political spectrum. Jeremy Corbyn, Leader of the Labour Party (the Opposition in the House of Commons), proposed at the time of the British general election in 2015 a so-called People's Quantitative Easing (PQE) policy (Bootle 2015), which would require the BoE to print money in order to finance government investment. This was to be achieved (Yates 2015) through purchasing bonds issued by a state-owned National Investment Bank. Then this National Investment Bank, would use the money to fund public infrastructure projects, including housing and public transport. This, apart from being a highly politically controversial topic, raised questions as to the possible threat that the proposed policies might pose to the independent status of the BoE, as a PQE would be materially different from the quantitative easing policies pursued after the financial crisis with the aim of injecting liquidity in the private sectors of the economy.

One could argue however, that any policy mix should be at the discretion of the government and that in a democratic polity it is the legislator, empowered by citizens, that gives institutions, like central banks, their independence to begin with. Consequently, a future Labour government could legislate to instruct the BoE to pursue policies including PQE. Mishkin (1998, p. 56) argued that having a central bank with a legislated mandate and goal dependence are basic democratic principles. The public is able to exercise control over government actions, and as by extension the goals of monetary policy are set by the elected government through legislation, the link of accountability is maintained. If the institutional commitment to price stability comes from the government in the form of an explicit, legislated mandate for the central bank to pursue price stability as its overriding, long-run goal, there is no tension between popular mandates and institutional independence. Indeed, central bank independence does not mean lack of accountability, as a higher degree of independence must be accompanied by greater accountability and judicial control to ensure equilibrium in policy-making.

Accountability is naturally linked with central bank independence (Nika 2018), since an independent central bank allows for the delegation of responsibilities to unelected monetary policymakers. Thus, in order to legitimise the role of a central bank within a given constitutional system, a substantial degree of accountability is required to insure against any perception of democratic deficit (Briault et al. 1996). Therefore, the main role of accountability is to ensure the appropriate democratic control and good governance in the delegation of monetary policy powers to technocratic officials. Accountability means in this context that institutions with the power to affect the lives of people are subject to the scrutiny by the elected representatives of these people. As such accountability of institutions is an essential and constituent element of a political economy (Padoa-Schioppa 2004, p. 33). Critiques of central bank independence however may adopt the language of democracy and accountability, while having other goals. It is to these we turn to now, by considering attempts to bring central bankers to heel, following the wishes of political strong-men (Rees 2019) and autocrats in developed and emerging economy contexts.

Populist challenges

With monetary policy being expansionary at a time of sluggish growth since the end of the financial crisis and little inflation in the majority of developed economies, one might have expected few criticisms of central bank policy from the right of the political spectrum. But that has not generally been the case. Some of the criticisms aimed at central banks have related to the slow tempo of the recovery; others to the possibility that one aspect of the unconventional economic recovery measures (such as negative nominal interest rates) may have had unintended effects (for example weakening commercial bank profitability, impairing lending). Perhaps the main general criticism is that the unprecedented low level of nominal and real interest rates has been stimulating over-borrowing, creating a debt over-hang, which may encourage present expenditures, but at the expense of fuelling future fragility and storing potential crises. The main reasons for such attacks though, have related to their distributional and directional effects (Goodhart and Lastra 2018, p.

52). The assumption is that if politicians were in charge, they would have done things differently, with better outcomes for -what everyone likes to call- ‘ordinary working people’.

This critique isn’t new. In the USA, concerns about the role of the Federal Reserve (Fed) and its detachment from political processes predates the election of President Trump. For example, in 2016 the Senate rejected the controversial ‘Audit the Fed’ legislation, proposed by Republican Senator Rand Paul’s calling for tougher audits of the Fed. The legislation aimed at eliminating restrictions on the U.S. Government Accountability Office (GAO) audits of the Fed and mandated that the Fed's credit facilities, securities purchases, and quantitative easing activities be subject to congressional oversight. In Paul’s words (2016) ‘nowhere else but in Washington, D.C., would you find an institution with so much unchecked power.’ The Obama White House called Paul’s proposal dangerous and as Jason Furman, Chairman of President Obama’s Council of Economic Advisers, highlighted (Sainato 2016): ‘Congress shouldn’t be telling the Fed what to do with monetary policy.’ This episode also raised questions regarding the independent status of the Fed with Ben Bernake (the then Chairman) stressing (Garver 2016) that this would result in a direct involvement of the government in monetary policy decisions, calling into question the Fed’s independence.

Populist leaders (primarily, but not exclusively) have led criticism of independent central banks in the last few years. Highlights include the firing of the Turkish monetary policy maker Murat Cetinkaya by President Recep Tayyip Erdogan who claimed the power to appoint rate-setters and put his son-in-law in charge of economic policy after winning re-election in 2018; and US President Donald Trump’s attacks on new Federal Reserve Chairman Jerome Powell (and incessant criticism of his predecessors) for raising interest rates. Reports suggested (Amaro 2019) that the US President has also looked at ways to legally demote the Federal Reserve Chairman. Appointment and dismissal procedures are important indicators of legal and de facto central bank independence (Cargill 2016). In 1965, President Lyndon Johnson had also considered firing then-Fed Chairman William McChesney Martin, but upon learning that he lacked the legal powers to do so, opted instead to complaining privately (Murphy 2018). Even the European Central Bank, which is generally viewed as the institution most isolated from politics, saw the head of Germany’s ruling Christian Democratic party urging incoming ECB chief Christine Lagarde to shift monetary policy to make it comply with the bank’s inflation-targeting mandate, while Italy’s Deputy Premier Luigi Di Maio accused the ECB incumbent Mario Draghi of ‘poisoning the climate’ by weighing into the debate about the Italy’s budget (Koc et al. 2019). In Britain, Bank of England Governor Mark Carney has long faced accusations of bias from pro-Brexit politicians, who say he is overly negative about Britain’s future outside the European Union. MP Jacob Rees-Mogg, for instance, dubbed him the ‘high priest of project fear’. Carney denies the charge but was confronted with hostile comments after the BoE published scenarios showing that a no-deal Brexit could unleash a savage recession and a collapse in the pound. UK Prime Minister, Theresa May, had herself criticised the ‘bad side effects’ of BoE policies at the Conservative Party conference in October 2016, prompting Carney to respond that he would not take instruction from politicians on how to do his job (Bruce & Hobson 2016).

We should take a moment to reflect however on whether it is correct to taint the politicians mentioned above with the label populist. The chapter uses the word ‘populism’ to denote the policies of any political party of the right, or left, that does not share the main economic tenets of an 'orthodox' liberal, central establishment. Adopting the definition of Goodhart and Lastra (2018 p. 50), we can describe 'populism' as involving a major disagreement with the central liberal tenet that allowing the free movement of labour, capital goods and services between nations would be both generally beneficial and desirable in almost all circumstances. A populist therefore is someone wanting to restrict the movements of people, capital, goods and services between nation states. Further, linking to an earlier designation of 'autocratic' leaders, a populist would be a politician who, once having been democratically elected, would then seek to remove the checks and balances generally applied in a democratic state, in order to achieve the objectives upon which he (or she) was originally elected. This dual definition therefore combines the control of the movement of factors of production and products across national borders and a desire to achieve autocratic control over all executive powers of government, once having initially been democratically elected. Not all national populist movements are necessarily antidemocratic however, or totalitarian, or 'fascist' in nature (Eatwell and Goodwin, 2018). Often their challenge is a direct assault on the institutions of liberal democracy that populists consider cut-off from democratic processes, or more broadly (and vaguely) 'the popular will'. This is most evident in the area of economic institutions. The implications of populism on central banking specifically are a challenge to the exclusive focus of central banks on price stability; pitting a deflationary bias of economic policy against employment generation and growth (Rodrik 2018). This, of course, could be a legitimate challenge (as discussed elsewhere in this chapter), yet a populist narrative has negative consequences on the nations' political economy. This is because while the problems identified by populist leaders (for example with respect to central banks) are real, their solutions are irrelevant, wrong or in many cases non-existent (Merler, 2018).

Pressures on central banks are of course not limited to the developed world (Condon 2019). In South Africa, since an attempt by the country's anti-graft ombudsman in 2017 to have the Reserve Bank's mandate altered, it's Governor (Lesetja Kganyago) feels the need to continuously make the case for central bank independence (Kganyago 2019). India's new central bank governor, Shaktikanta Das, is seen as someone more amenable to government requests to relax tough regulations imposed on banks and is likely to ease monetary policy in an attempt to boost growth. Mr Das succeeded Urjit Patel, who resigned after a public row with Prime Minister Narendra Modi's government. In what is perceived as a related development, Deputy Governor Viral Acharya, one of the central bank's most outspoken officials, unexpectedly announced in June 2019 that he was standing down (Shastry 2019). The Pakistani central bank's independence has also come into question after Prime Minister Imran Khan replaced the governor in May 2019 as part of an overhaul of his economic team to address the nation's poor economic performance. In late 2018, he announced plans to make the central bank report any currency adjustments to a committee after successive devaluations of the national currency (Mangi and Dilawar 2018). Central banks in Russia, Nigeria, Greece and Thailand have also been subject to pressures by politicians in recent years.

Central banks have traditionally justified their powers with a mix of intellectual rationales for institutional independence -aimed at what are identified by many as 'elites'-, combined with the cultivation of a mystique of economic success to win over the general public. This set of communication strategies left a critical void according to Adolph (2018). As economic prowess since the financial crisis has fallen away and the success of monetary policy became less visible, the long-term cost of silence on issues such as inequality has come into focus, something that we touched upon earlier when discussing criticisms of central banking from a critical (left) perspective. One could argue that intellectually and rhetorically, the US Fed and other central banks are poorly situated to defend the legal powers of their institutions or the process by which they develop policy. The delay in nurturing an informed debate grounded in the real effects of monetary and fiscal policy has led to the populist hysteria against independent institutions (central banks first amongst them) that we are experiencing today.

But what is it that so many leaders of the world wish to achieve that is undermined by central banks? At the beginning of the chapter we discussed how inflation targeting has been the primary aim of monetary policy and the core objective of central banking in the modern era. We also discussed how such focus on inflation can have consequences on the growth balance of the economy in a number of areas, including on employment. The latter has been the focus of much critique of central banking coming from the left of the political spectrum as already described. The critique from current leaders (belonging mostly to the right wing of politics) may have to do more with the balance between debt and inflation, than effects on employment and growth. President Trump appears to be focused on interest rates, but not on inflation. A looser monetary policy would allow the US government to finance debt more easily by letting the resulting higher inflation erode the value of the currency in circulation and, if a spike in inflation surprises markets, to eat away at the value of pre-existing debt. There is actually good precedent on using inflation as a tool for debt relief, as former US presidents regularly sought to enlarge the budget deficit while persuading the central bank to keep interest rates low. Economists call that practice 'monetizing the budget deficit', and it tends to be part and parcel of rising inflation (Blinder 2019). As discussed earlier, in the 1970s, before the institutionalisation of central bank independence, it was normal for politicians to manipulate interest rates to boost their own popularity (Economist 2019). This however led a number of nations to experience a plague of inflation and in extreme cases, which the United States has thus far managed to avoid, monetizing deficits can lead to hyperinflation, seriously degrading the economic power and prospects of a country. One only needs to look at Zimbabwe and Venezuela as contemporary examples of the effects of unchecked inflation. While one could argue that developed economies are more in danger of deflation (than inflation), at the moment, there is still legitimate concern about using interest rates as means of suppressing debt burdens.

Conclusion

Popular perceptions of independent institutions and of the legitimacy of state behaviour are currently changing. The model of central banking prevailing before the financial crisis was the result of a century-long quest for a monetary technology that would achieve two important objectives. Firstly, to be more efficient than the gold standard, and to avoid the sustained inflation and deflation episodes that affected that arrangement. Secondly, it sought to avoid the prolonged and acute price instability that had characterised the period after the gold standard was abandoned around the time of the First World War. From an institutional perspective, the technical and non-political task of identifying the best tools to achieve price stability fits well with the attribution, within a democratic policy, of this task to an independent agency (Papadia and Välimäki 2018, p. 256). The predominance of technocracy and institutional independence that underpinned our understanding of the market-state relationship since the end of the cold war is being upended, however, by renewed calls for re-politicisation from across the political spectrum.

The chapter has discussed how President Trump in the USA and the Labour Party leadership in Britain as well as several prominent leaders in emerging economies have transcended ideological, national and class divides in order to stake a populist challenge to the idea of central bank independence. We are witnessing calls for a return to political-institutional environments long extinct in the west, and (up until recently) in retreat in the developing world. The chapter has argued that this populism-fuelled critique is divergent from the literature on empowerment and greater accountability that was developed in response to the 2008 financial crisis. We are faced therefore with a metamorphosis of a debate towards undemocratic, capricious, populist and state centric directions. This phenomenon has profound implications for emerging economies where efforts to build a pro-market institutional and legal framework have focused on the promotion of independent institutions. What this contemporary environment means for emerging economies is that a new vulnerability is revealed. Emerging economies looked to the western capitalist states for leadership and best practice examples on institutional development. This is not meant to convey the idea that western influence is always benign or always correct; see for example misguided efforts to promote capitalism in post-soviet transition economies during the nineties (Glinavos 2010). Nonetheless, one can be critical of the negative aspects of capitalism and the consequences of western domination, while still accepting institutional innovation as a source of progress.

Governance problems in developing nations and emerging economies are real. Issues with inefficiency, politicisation and corruption are live concerns for millions of people. Missed opportunities and lacklustre growth aren't only the result of western domination, predatory multinationals and unfair world trade rules. The former fits well a populist narrative that tries to blame 'others', usually foreigners, for any and all problems. National economic problems are to a significant proportion the results of domestic failures, inadequate technologies and political machinations. The promotion of independent apolitical institutions is meant to deal precisely with these types of weaknesses experienced by emerging economies. Detaching the setting of interest rates and monetary policy from the political timetables of frequently self-serving politicians sounds undemocratic, but may be a necessary component of a strategy to set a nation on a sustainable growth trajectory. After all, by the same measure that one can decry 'capitalist' institutions for being undemocratic, one could condemn the politicisation that subjects economic rationalism to political calculation for personal gain.

What is the central message of this chapter on the changing political economy around central bank independence? The material presented here demonstrates that the populist assault on institutional independence in the west robs the developing world from the external impetus for reform. If America and Britain (to take two key examples) abandon their ethical leadership, retreat from a defence of liberal values, from free trade and even capitalism itself, what incentive is there for developing nations to continue along the path of reform? And it is to such a path that they should remain committed, as it represents the most likely avenue to an improved future life for their citizens. A collapse of confidence in liberal values in the west strengthens traditionalist, nativist politicians in emerging economies. It weakens those who advocate for reform if the 'shining city upon a hill' (Reagan 1989) is no longer a bright beacon to follow. Independent institutions are a bulwark against autocracy, not a threat to democratic governance. Policy makers in emerging economies would do a service to their nations to think of them as such.

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