The paradoxes of central bankers

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I wrote yesterday on what I will be calling a safe haven policy for the world's capital. I think this new idea may be a recurring theme for this blog over coming months and maybe longer.

In the context of that thinking I was interested to read (much of) the G30 report to the IMF meeting in Lima last week. That report, by four former central bankers, addressed the future of central banking. Two paragraphs, from the summary highlight issues I think if importance. The first addresses an issue where I have provoked some debate this summer:

It is crucial that the independence of central banks be maintained. Central banks must be able to focus on policies orientated toward longer-term objec- tives. They must be kept free from undue political or popular pressures to provide short-term stimulus or other policy actions that are ultimately inconsistent with this core mandate. The indispensable accountability should be ensured without prejudice to the principle of central bank independence.

Let me offer the second paragraph, which is the overall conclusion of the report before commenting:

Central banks worked alongside governments to address the unfolding crises during 2007—09, and their actions were a necessary and appropriate crisis management response. But central bank policies alone should not be expected to deliver sustainable economic growth. Such policies must be complemented by other policy measures implemented by governments. At present, much remains to be done by governments, parliaments, public authorities, and the private sector to tackle policy, economic, and structural weak- nesses that originate outside the control or influence of central banks. In order to contribute to sustainable economic growth, the report presumes that all other actors fulfill their responsibilities.

There are obvious paradoxes here. I wonder whether the bankes are even aware of them?

There is an arrogance implicit in the claim to independence: the unstated but obvious contention is that the central banker can be trusted more than the politician. This is reiterated in the opening sentence of the conclusion but then the apology (or is it doubt in the form of reducing expectation?) creeps in as the bankers state that they cannot deliver growth.

That, of course is true. It's not even clear central bankers can deliver the 'longer-term price stability [that] is the most important contribution central banks can make to ensuring strong and sustainable growth' according to the report. But with caveats then noted the central bankers then seek, unapologetically and despite their claim to be the holders of the higher ground as protectors of economic stability, to apportion responsibility for fulfilment of that task to the government's from which they wish to stand apart. The final sentence is almost comical as a result: caveat emptor would appear to be the message.

In that case what does central bank independence mean? I cannot help but believe that it is a claim to exercise control by an elite seeking unaccountable power whilst, as this report seems to make clear, wishing to avoid the responsibility for doing so. It is as if they were saying to governments that all things being equal they're able to deliver but that they know in advance that all things are not equal, despite which they wish the power anyway. The paradox in doing so is that inevitably all things cannot be equal because they wish to exclude themselves from that equality that they think embraces governments, parliaments, public authorities, and even the private sector but which, in their view, does not include central banks.

In that case if, as I argue, governments are to provide a safe haven for capital, but central bankers see themselves outside the system of government, then they represent an obstacle to that process of equal participation in solution building. We cannot have the ability of the state or its governments constrained by central bankers.

This is not to undermine the role of central banks. Nor is it to deny the skills they have to offer or the role that they have to play in monetary policy. Nor is it a call for the end of central bank independence to the extent that such independence represents the granting of devolved authority to manage with suitable controls in place to ensure integration in other economic policy. It is simply to say that integration into the overall context of the delivery of economic policy and independence as it is represented to be are not possible: one contradicts the other.

So what are we to have? Independent central banks on whom over reliance is placed (as at present)? Or governments willing to intervene, including through the use of monetary policy that central bankers manage on their behalf in coordination with other goals? Since the G30 report rejects the former and also recognises that growth requires multi-participant action then surely the integration of the second approach is the only viable option? In that case the semantics of independence that too many economists have made an article of faith without appearing to think through its consequences needs to be dropped.

Let's stop putting central bankers on a pedestal. Let's stop presuming they have power they clearly do not posses. Let's stop affording privilege where none is due. Let's start talking about the necessary tools for managing an integrated economy. Independent central bankers are admitting they cannot deliver that. In that case let's heed their advice in the report. They suggest advance planning for crisis is needed when saying this:

However, the ultimate resolution of crises that have their roots in excessive credit creation and debt accumulation often can only be accomplished through arms of government other than the central bank. Preparations made beforehand, such as legislation concerning bankruptcies, are crucial.

I would say advance planning for the crisis by restating the integral and not separate role of central banks is another condition for survival. Then, and only then, will it also be the case that politicians will accept their role as well. At present it is too easy for them to pretend they do not have one, as these central bankers are clearly implying. So the illusions of politicians need to be shattered as well.

To put it politely, the next crisis will require all hands to the pump. Petty divisions will not help achieve that. Making clear the limits to central bank independence is a critical part of achieving that necessary goal of unity.