Bologna Institute for Policy Research
Via B. Andreatta, 3 - Bologna (Italy)
+39 051 292 7811 www.bipr.eu

Date: 25 March 2019
Speaker: Sir Paul Tucker, Systematic Risk Council; Harvard Kennedy School, US
Chair: Justin Frosini, Adjunct Professor of Constitutional Law, Johns Hopkins University SAIS Europe, Bologna, Italy

A Gap in Constitutionalism:
Independent Central Banks and Other Commitment Devices
Constitutionalism in Illiberal Democracies Series

In recent decades governments have been ceding more power and responsibility to central banks and other independent agencies, in a shift towards a form of undemocratic liberalism and risking a backlash in the form of illiberal democracy. Central banks like the Federal Reserve, European Central Bank (ECB) and the Bank of England have been using their balance-sheet power in unprecedented ways, and now have new regulatory and supervisory powers too. Today some call central banks the "third central pillar of unelected power" alongside the military and the judiciary. Central banks' and other regulators rule-making powers often amount to law-making, which was traditionally the purview of the legislature in a constitutional democracy. They are also given adjudicatory power over individual banks, a power that used to be associated with the judiciary branch. These developments can make good sense, but only if carefully designed and properly constrained. While the independence of central banks was originally motivated by a desire to take politics out of the battle against inflation. today deeper arguments are needed.

Tucker claims that while many scholars are highlighting the dangers in populist government, it is also important that technocracy should be more carefully constrained in the interest of preserving our system of government. An important characteristic of representative democracy is the ability of citizens to vote out leaders who prove incompetent or ineffective (or unpopular). If government leaders are not subject to these checks, they will not be responsible to the public. If unelected central bankers and regulators can be held to account only by unelected judges, this will not address the democratic deficit. That risks a problem of lack of legitimacy that could erode public trust in government, unless the delegations are principled and widely understood.

Independent agencies are parts of government that are insulated from the day-to-day politics of elected government with control over delegated policy instruments, job security and budgetary autonomy. Some claim that independent regulators are needed because the modern world, including the financial system, has become too complicated to be handled by the traditional three branches of government. Tucker emphasizes that this is a deeply flawed argument and that there are ways of incorporating expertise into the process without leaving policy decisions up to independent regulators. While the expertise of independent agencies can have welfare benefits for the general public, it is important that the system should be consistent with democratic political values. Delegation makes most sense where there is broad-based agreement on goals which are best pursued by sticking to a stable policy: this can be a basis for the elected government framing policy promises that people trust (credible commitment). For example, the Environmental Protection Agency in the United States would not make sense as an independent agency because US citizens have strong diverging opinions on environmental objectives. By contrast, there is not a lobby for returning to high and variable inflation.

Tucker explores the use of commitment devices in democracy. While democracy is about trial and error, commitment devices suspend trial and error, sometimes for the purpose of consistency and fairness. For example, judicial independence and a professional civil service represent examples of commitment devices (to fair adjudication, and integrity in administration). Any delegation to independent agencies must square with the various political values of freedom, rule of law, democratic values and constitutionalism. Legislatures should give clear and measurable objectives to their central banks. At present, large central banks like the US Fed and the ECB choose their own objectives, which represents a flaw in the system. It is also important that central banks use measurements that can be understood by the general public. This is one reason that Tucker recommends inflation targeting over money targeting, which gives numbers that are much more difficult to explain, and so can create a lack of accountability to citizens. Currently there are large gaps in the stated mandate of central banks and the work that they actually do. For example, in Germany and Japan the central bank are not formally bank supervisors (in law), but they have lots of staff working on bank supervision and, as the lenders of last resort in their economies, are unavoidably intimately involved in banking policy. Tucker states that, by modern political values, it is not correct for this power to not be formalized by the law.

Today there is a risk that people are going into central banking to seek increased power as these positions become more prestigious. Instead of the usual "politically literate technocrats," today there are more "technocratically literate politicians" looking for leadership positions in central banks. Because of this, there should be increased scrutiny and transparency. It will also be important to implement reforms and lines of supervision that make politicians more accountable for the design of central banking regimes, and central banks more accountable for their trusteeship of those regimes. Otherwise the illiberal backlash will be greater.