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The institutions of the people, by the people and for the people? Addressing central banks' power and social responsibility in a democracy

LOUIS-PHILIPPE ROCHON and GUILLAUME VALLET*

Abstract:

This paper sheds light on an overlooked issue in economics, namely the social responsibility of central banks in a democracy. We consider central banks as institutions of power, and, as such, neither are they nor their policies neutral, in the sense that there are inevitable winners and losers. In this context, we explain why and how their power should be regulated and controlled by society. Specifically, we focus on the income distributive nature of monetary policy to demonstrate this assertion. From this, we explain that the time is ripe to build a new framework for central banking aiming at improving central banks' social responsibility consistent with the spirit of a democratic system, and resting on new rules, new types of inner organization and, more broadly, an ethics of responsibility of a new kind.

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Obviously the passion for power is one of the most moving passions that exists in man; and after all, democracies are based on the proposition that power is very dangerous and that it is extremely important not to let any one man or any one small group have too much power for too long a time.

Aldous Huxley¹

Since at least the 2007-2008 financial crisis and, indeed, more recently with the current COVID-19 crisis, monetary policy has come under greater scrutiny with respect to its effectiveness. As interest rates have been pushed back down to the lower bound in many countries, and in negative territory in some others, it has become clear that monetary policy cannot go it alone; in other words, on its own, monetary policy cannot spur investment and

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¹ "Mike Wallace interviews Aldous Huxley," May 18, 1958, see the YouTube video available at: <https://www.youtube.com/watch?v=HSx91KiNyFU>; the transcript is available at: http://www.cuttingthroughthetmatrix.com/articles/Mike_Wallace_interviews_Aldous_Huxley_May_18_1958.html.

aggregate demand. In this context, fiscal policy has come back with a vengeance, resulting in unprecedented levels of public debt. It is, indeed, the return of the master (Skidelsky, 2009). More than ever, policy makers are realizing the limits of monetary policy in times of crises, and how indeed you simply cannot push on a string, or force a horse to drink.

Nevertheless, these crises have mobilized central banks to an extent rarely seen in history, not only regarding the near-zero interest rate policy implemented in numerous countries, but also with respect to their massive ‘assets purchase programs’, as central banks and monetary policy try to remain relevant in the face of unprecedented times.

In addition, a number of central banks have relaxed their approach to a ‘strict’ inflation targeting (IT) regime, either by adopting a dual mandate, as in New Zealand – or proposing to do so for the European Central Bank (Marsh, 2020) – or moving to an average inflation targeting regime, as is the case in the USA.

Yet, through it all, the overall mission of central banks has nevertheless remained the same, regardless of whether they follow a strict IT policy or a more relaxed one: the production of an alleged public good (low inflation) in the spirit of maximizing prosperity for all and society’s net welfare. In this context, inflation is described as an evil (Johnson, 2016) affecting everybody, but in particular the weak and vulnerable and those in lower income brackets. Central bankers therefore justify and legitimize their policies for this reason: the fight against inflation serves the people, and especially the disadvantaged.

As such, mainstream monetary policy is focused on fine-tuning, that is the incremental changes in interest rates, up and down,² in order to reach a natural or neutral rate and, in the process, influence economic activity with the aim of achieving low and stable inflation, around a stated target (Rochon and Vallet, 2019). Dual mandates and flexible inflation targeting may paint a softer face to monetary policy, but it does not change the purpose of monetary policy.

While central banks are not poised to give up their inflation obsession anytime soon, in this paper, we wish to explore a different view of monetary policy – different from the mainstream and, indeed, different from some circles within the post-Keynesian economic camp. This approach, which we explore in the next section, sees monetary policy in terms of its income distributive consequences, in both the short and the long run. This stands in contrast, of course, to the mainstream emphasis regarding the long-run neutrality of money.

Yet, if monetary policy has distributional consequences in the long run, this then raises important questions about the ability and the power of central banks and of central bankers of imposing what essentially becomes an incomes policy over the long run (Rochon and Seccareccia, 2021). As such, it also raises questions about their rightful place within a democracy; in other words, we question the role of central banks and of central bankers as unelected bureaucrats with the ability to impose their conception of the role of money vis-à-vis the functioning of the economy and society, and in particular on specific social groups.

This article is divided into the following five sections. Section 1 discusses the income distributive nature of monetary policy from both a mainstream and a heterodox/post-Keynesian perspective. Section 2 discusses the income distributive nature of monetary policy but in the context of the exercise of central bank power in a democracy. Section 3 argues that central banks are not the only way of addressing income inequality, and that fiscal policy also has an important role to play. Finally, section 4 ends by discussing central banking in terms of its relationship to social responsibility. Section 5 concludes.

² The expression ‘fine-tuning’ is certainly misplaced in light of the fact that central banks usually move interest rates several times up and several times down, resembling more waves than ‘fine-tuning’.

1. The income distributive nature of monetary policy

As discussed above, mainstream theory rests on the notion that monetary policy is a powerful tool of economic policy; by controlling the rate of interest, central bankers somehow hope to fine-tune economic activity in a way that delivers a low and stable inflation rate, around a given inflation target, for a minimum of social costs. The premise therefore is that monetary policy is effective in delivering a target rate of inflation at low cost in terms of unemployment or loss of output.

According to this view, incremental changes in the rate of interest will have repercussions that work themselves through a series of transmission mechanisms, usually associated with the notion that changes in interest rates represent a ‘cost’ in terms of either lending or borrowing. In this sense, increases in rates will typically slow down economic activity by impacting the more interest-sensitive components of aggregate demand, and rate decreases will spur activity – or so the theory goes. The ultimate objective is two-fold: to force the convergence of central bank interest rates to their natural level, which in turn will push inflation to its targeted value, which can be seen from the central bank’s perspective as the ‘natural’ rate of inflation.

In this sense, monetary policy may have a short-run impact on economic activity, or on unemployment and output, which in turn will impact inflation. This is a common belief among all mainstream economists: monetary policy works through well-behaved IS and Phillips curves. Yet, the impact is considered short-lived; in other words, monetary policy is neutral in the long run. This is one of the most fundamental and sacrosanct assumptions of mainstream monetary thinking (see Rochon, 2022, for a criticism of this approach).

This convenient assumption reduces monetary policy to a sterile and quasi-mechanistic operation: if the economy is overheating, you raise interest rates, and the job is done. In many ways, it is the very definition of a ‘reaction function’: central banks simply ‘react’ to, say, inflationary expectations and adjust rates accordingly. Mainstream thinking is careful to frame this debate in very sterile terms: there are no individual winners and losers, but rather it is society that wins or loses depending on the level of inflation. As stated above, inflation is seen as an evil. Monetary policy therefore is seen as delivering a common good (low inflation), for the benefit of the whole society: everybody wins when inflation is low and stable.

Framing the debate in these terms has a very clear objective: it absolves central bankers from any responsibility regarding any possible socially-ill consequences their policy may have; if they recognize such ills, they are quick to point out that these ill consequences are necessarily short-lived, in the name of the long-run neutrality of money.

This is particularly the case in terms of the relationship between monetary policy and income distribution, research on which has grown considerably since the 2007-2008 financial crisis (see Kappes, 2021, for a survey; see also Kappes et al., 2022). The conclusions are very clear: any impact monetary policy has on inequality is (must be) only short-lived, and, as such, is inconsequential for policy. They are, in fact, considered simply the inevitable ‘side-effects’ of sound monetary policy. As a result, central banks (Cœuré, 2013)

should refrain from engaging in income redistribution, which should be sanctioned by parliaments. This does not imply that monetary policy actions do not have distributive consequences – in fact, they always have. But these are the side-effects of a strategy that aims to ensure price stability, which is by essence neutral as regards income distribution.

Post-Keynesian theory, however, takes a radically different view of monetary policy, one where there are clear winners and losers, not only in terms of individuals but also in terms of social classes (Lavoie and Seccareccia, 2020), and where central bank policy carries long-lasting effects and possibly leads to structural changes in the way economies operate. This said, not all post-Keynesians agree. Rochon and Setterfield (2008) identified two very distinct approaches, which they labelled the activist and the parking-it approaches.

The activist approach is clear: central banks should use incremental changes in interest rates as a way of influencing economic activity and hit some target, albeit some real variable, perhaps unemployment, growth or capacity utilization. This post-Keynesian approach is not significantly different from the mainstream New Consensus model, for instance, in which central banks change interest rates in order to target a monetary target – or an inflation target, which is now the dominant central bank approach. In both views, the power of the central bank should be utilized in order to minimize the cost of achieving some targeted variable; and in both approaches, monetary policy relies on some very traditional transmission mechanisms, usually focused on demand.

In some way, it is perhaps understandable why some post-Keynesians would want to see an activist central bank: after all, post-Keynesians are united in advocating for activist institutions, especially fiscal policy, as a way of righting the wrongs of free markets, and an activist central bank using monetary policy as an unemployment and growth strategy would be a natural extension of this thinking.³

Yet, the reason post-Keynesians advocate for an activist *fiscal* approach, for example, is because there is ample empirical evidence to support the notion that it works, that higher fiscal spending reduces unemployment, for example. Studies have clearly identified important fiscal multiplier effects benefiting economic activity (see Qazizada and Stockhammer, 2015).

As for monetary policy, its success in terms of achieving a given target as a result of fine-tuning is not clear. Indeed, many have pointed out the limitations of a countercyclical monetary policy, where consumption and investment may not respond to incremental changes in interest rates. For instance, Cynamon et al. (2013, p. 13) have argued that:

The transmission mechanism from monetary policy to aggregate spending in new consensus models relies on the interest sensitivity of consumption. It is difficult, however, to find empirical evidence that households do indeed raise or lower consumption by a significant amount when interest rates change. Some authors have generalized the link to include business investments [...] but a robust interest elasticity of investment has also been difficult to demonstrate empirically.

Moreover, according to Sharpe and Suarez (2015, p. 1), “A large body of empirical research offers mixed evidence, at best, for substantial interest-rate effects on investment. [...] Our research] find that most firms claim their investment plans to be quite insensitive to decreases in interest rates, and only somewhat more responsive to interest rate increases” – what Krugman (2018) called the profession’s “dirty little secret”. In the end, there may not be any empirical support for either an activist central bank or an activist monetary policy.

³ We would argue that central banks are already activist on many levels, and there is no need to further argue in terms of interest rate activism. This argument deserves further reflection.

1.1. Monetary policy as income distribution

It is largely because of the ineffectiveness of monetary policy that some post-Keynesians – closely related to the revolutionary endogenous money tradition (see Rochon, 1999) – have proposed a new channel of transmission: the income distributive channel (see, for instance, Rochon and Seccareccia, 2021). This is in line with Rochon and Setterfield's work (2008) on “parking-it” monetary policy rules.

Accordingly, interest rates are not seen as a way of influencing economic activity through traditional channels (which rely on seeing interest rates as a cost variable), or as an equilibrium price between saving and investment, or between lending and borrowing. Rather, this approach sees the rate of interest itself as an income distributive variable, either directly (see, for instance, Rogers, 1999; Lavoie, 2014), that is relying on a view that sees interest rates as the source of an income stream to the rentier class, or indirectly, that is through labour markets or even through financial markets. In this sense, it places income or social groups at the heart of the discussion over monetary policy.

For instance, emphasizing specifically the limited effectiveness of fine-tuning (see also Rochon, 2021), Lavoie (1996, p. 537) explained this alternative post-Keynesian view:

It then becomes clear that monetary policy should not so much be designed to control the level of activity, but rather to find the level of interest rates that will be proper for the economy from a distribution point of view. The aim of such a policy should be to minimize conflict over the income shares, in the hope of simultaneously keeping inflation low and activity high.

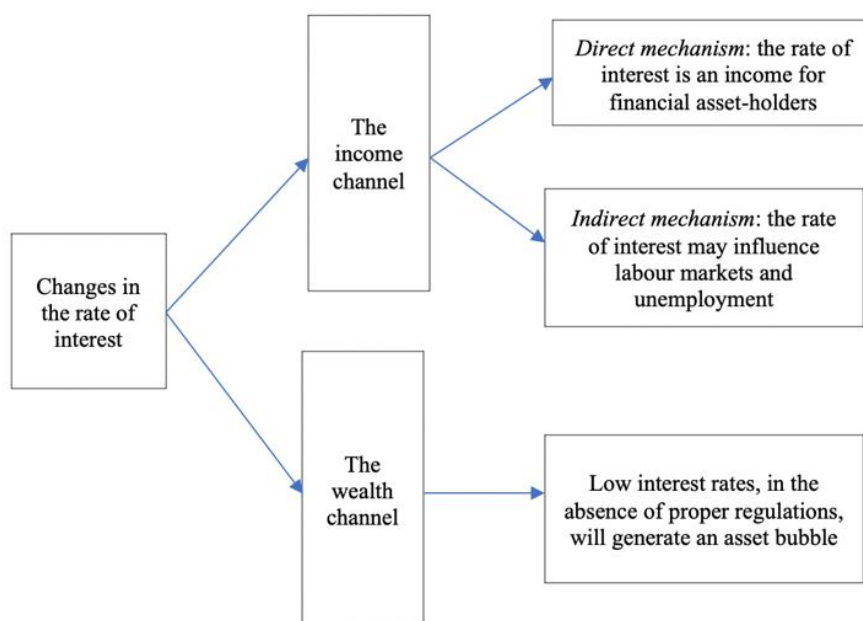
A few years later, Lavoie and Seccareccia (1999) would further explore this view by relying on the work of Pasinetti, and discuss what they called the ‘fair’ rate of interest, that is the “rate of interest that will leave unchanged the distribution of income between interest and non-interest income groups, regardless of lending and borrowing activities” (Lavoie and Seccareccia, 1999, p. 543) – what Rochon and Setterfield (2007, 2008, 2012) would later call the Pasinetti Rule.

However, before the ground-breaking work of Lavoie and Seccareccia, we should mention the work of Niggle (1989). It has been unfortunately largely ignored, yet it contains amazing insights into the impact of monetary policy and income distribution. In particular, Niggle (1989, pp. 818-819) argues that:

The processes connecting monetary policy to changes in the distribution of personal income through the transmission mechanism of the level of interest rates are complex, with at least three causal sequences operating: 1) changes in interest rates can affect the functional distribution of income, and thus the personal distribution; 2) changes in interest rates change the market values of financial assets, effecting capital gains or losses; 3) interest rates influence investment, aggregate demand, employment and income.

The three effects explained by Niggle can be seen in figure 1.

Figure 1 considers ways in which monetary policy can impact income distribution. The income channel is divided into a revenue channel (the direct mechanism) and a cost channel (the indirect mechanism). According to the first channel, interest rates themselves are an income distributive variable by nature: changes in interest rates represent an *income* to the rentier class. Any increase in rates will redistribute, from a monetary policy perspective, income away from the working class to the rentier class. This is why Smithin (1996) has called the years of high rates, the “revenge of the rentier class”.

Figure 1 – *Income distribution channel of monetary policy*

Source: Rochon and Seccareccia (2021).

Moreover, changes in interest rates may have consequences on labour markets and unemployment through an indirect channel. In this context, interest rates are seen as the cost of borrowing or lending: increases in rates may discourage borrowing and lending and lead to predictable outcomes on labour markets, which in turn will impact wages and the wage share. While this is a legitimate channel, its robustness has been called into question, as evidenced in the above quote by Cynamon et al. (2013).

The second channel, the wealth channel, focuses on the consequences of low interest rates on asset prices. Rossi (2020) is among those in heterodox circles who has discussed the issue in some detail. Within the mainstream, the relationship between monetary policy and asset price inflation has received increased attention, in particular since the 2007-2008 financial crisis (see Alonso-Rivera et al., 2019; see also Filardo, 2004).

The above discussion suggests that there are two sources of distribution from the perspective of monetary policy: the policy, on the one hand, by which we mean changes in the rate of interest and their impact on economic activity, and the rate of interest itself.

Hence, the parking-it approach places social classes and groups, and therefore conflict, at the heart of the discussion of monetary policy, leading Seccareccia (2017) to ask, “Which vested interests do central banks really serve?”, similar to Rochon’s (2021) emphasis on the “inherent biases” of monetary policy. In this respect, Epstein (2015, p. 105) has argued very much in the same way, arguing that in a contested terrain approach, central banks “can usefully be analysed as a struggle among key classes (and class-fractions) over economic policy” (see also Epstein and Schor, 1990).

However, the story does not end here, as it is possible to further discuss the impact of monetary policy on specific groups, like women or racialized minorities. Indeed, as far as the

issue of gender is concerned, mention should be made of “ladder effects” (Blanchard, 1995; Braunstein, 2013) related to the distributive nature of monetary policy: for instance, women in a precarious professional and/or family situation are likely to be more affected by variations in aggregate demand caused by variations in a central bank’s interest rate (Thorbecke, 2001). The same is true with regard to the position of women in economic sectors sensitive to variations in the exchange rate and terms of trade (Braunstein and Heintz, 2008). These factors are of utmost importance to women, as employment and access to real-estate ownership have become decisive elements of their empowerment (Vallet, 2020).

Moreover, and most importantly – and this cannot be emphasized enough – these effects may not be temporary but rather long-lasting. It appears, therefore, that the conclusions drawn from this heterodox research go in the opposite direction of what some central banks have claimed, in two important ways. First, they show how money is not neutral, not even in the long run. Indeed, post-Keynesians have been advocating how these income distributive effects are long-lasting, and how this may lead to important structural change. Second, rather than benefiting all members of society, monetary policies dedicated to fighting inflation seem to serve first the interests of some, specifically capitalists and the wealthy. This is what was recently called the “reverse Robin Hood effect” (Casiraghi et al., 2018; see also Rochon and Rossi, 2006). Rochon (2021) has referred to the “inherent biases” of monetary policy.

If what we discuss above can be verified empirically, then it raises important questions about central banks’ power and its relation to democracy – a topic to which we now turn.

2. The income distributive nature of monetary policy and the exercise of central bank power in a democracy

Given the discussion above, two important lines of inquiry are followed here: the relation between central banks and power on the one hand, and the relation between central bankers and democracy, on the other.

2.1. The relation between central banks and power

With respect to the first relation, the distributive feature of monetary policy comes down essentially to the exercise of power, both of central banks, as institutions, and of central bankers, and the dynamics of how such power is exercised. This approach remains largely underdeveloped, especially in economics, although interesting work has emerged in sociology and political science (Dietsch et al., 2018; Pixley, 2018; Riles, 2018).

In a democracy, the power of the central bank is seen as legitimate because it is alleged to serve the people, by delivering a public good. Specifically, central banks are the institutions performing the social mission of producing a public good – macroeconomic stability and prosperity, inflation targeting – by achieving their targeted macroeconomic objectives. Central banks are the “agent” of a “principal” (society) and its political representatives (generally politicians) (Walsh, 1995; Alesina and Tabellini, 2008). Such a framework embodies the dynamic evolution of democracies for over a century: the growing separation between the political and the administrative, without completely abandoning the existing relationship between the two (Tucker, 2018).

Because monetary policy claims to be ‘mechanistic’ or even scientific, central banks are seen as specialized, rationalized and efficient institutions capable of delivering the expected public good for all, while being neutral in the sense that their policies do not favour any specific group.

Hence, for the mainstream, central banks would be independent of any perceived favouritism toward any specific group, thereby legitimizing their power. It is in this sense that we described monetary policy above as ‘mechanistic’. However, the distributive nature of monetary policy erodes the very notion of an independent central bank. After all, how can you have independent institutions if their policies have the power to frame society’s functioning and, worse, profit specific groups? As Adolph (2013, p. 103) concludes, “As long as monetary agents aspire to further wealth or office, paper autonomy alone cannot guarantee the insulation of monetary policy from outside interests”.

However, the income distributive nature of monetary policy challenges such a legitimacy. Indeed, through their policies, central banks have the power to shape economies and societies (Braunstein and Seguino, 2018), particularly through the “income distribution channel”, as explained above. In other words, they exert “structural power” (Strange, 1994), capable of favouring some groups more than others. Likewise, central banks’ “structural power” on income distribution is visible through their quantitative easing (QE) programs, where central banks become creditors to specific economic agents: not only are such programs likely to increase the effectiveness of the aforementioned “wealth channel” by stabilizing the price of financial assets, but these programs give power to central banks as bondholders. Indeed, being an important bondholder is associated with the power to influence the management of the creditors’ economic resources – in order to be paid back – thus modifying the creditors’ income distribution policies. In that sense, central banks exert also a distributive impact on the macroeconomic income of countries.

In the Eurozone, for example, even though the recent massive purchasing programs by the European Central Bank (ECB) – such as the Pandemic Emergency Purchase Programme (PEPP) and the Public Sector Purchase Programme (PSPP) that have been implemented since March 2020 – have been officially without conditionality (unlike previous programs, the PEPP now also includes Greek debt) so far, it is certain that as a bondholder of European public debt, the ECB will have a word to say on the economic policies implemented by the Eurozone countries in the future, in order to get reimbursed. The Governor of the Banque de France, François Villeroy de Galhau, has already warned that “all of this will have to be paid back” (Marsh, 2020).

To sum up, the rise in central banks’ power related to income distribution, particularly visible with the recent two crises, can be explained by three reasons (Tucker, 2018, p. 16):

- Central banks have become part of the fiscal state (through QE programs in particular);
- Central banks have become part of the emergency state (through their role of lender of last resort);
- Central banks have become part of the regulatory state (they have the power to supervise and to create norms that rule the life of the everyday man, for instance in the banking system).

Therefore, such a power questions central banks’ but also central bankers’ actions vis-à-vis the democratic life, to which we now turn.

2.2. The relation between central bankers' power and democracy

In line with the increasingly “bureaucratic” role of central banks in a democracy as discussed above, central bankers who implement monetary policy are supposed to serve democracy through their particular expertise. So far, their expertise has been twofold: “regulatory expertise” and “testimonial expertise” (Dietsch et al., 2018). This double expertise is alleged to give central bankers a legitimate power (namely their authority, from a Weberian perspective) since they would be appointed for their skills only. For that reason, their power is alleged to be politically neutral.

However, the distributive nature of monetary policy gives central bankers a type of power they are neither supposed nor prepared to exert in a democracy, because of the political dimension of such a power. To expound this idea, we should develop the following two points.

First, the majority of central bankers are economists (Diouf and Pépin, 2017). Although they have to build ties with politics (either as simple citizens or also because they have ties with politicians due to their remit – the cases of Lagarde’s and Draghi’s careers come to mind here), central bankers claim that their skills and their mandate put them outside of political debates (Vallet, 2019). The status of independent central banks is the official framework justifying such a stance and thus conferring a legitimacy to their power (Downey, 2020).

Second, a contradiction appears with respect to democratic life: central bankers are non-elected by the people, while they have the power to shape the people’s everyday lives. In other words, the power to implement monetary policy is ultimately in the hands of unelected central bankers, who instead are appointed by politicians on the basis of their competencies (Farvaque et al., 2016) and their ability to reach the targets defined by the “principal” (Walsh, 1995; Alesina and Tabellini, 2008).

More problematic, despite the official reference to the “transparency model” implying regular public communications (their above “testimonial expertise”), central bankers rest on a type of expertise that is not fully understandable by the average citizen.

Such a feature addresses serious concern about central bankers’ power in democracy. Specifically, central bankers should always have in mind that they serve the people when they implement monetary policy. They ought to ensure that people place confidence in their actions, and central bankers must demonstrate that they are not elites disconnected from the will of the people (Pixley, 2018; Riles, 2018).

This is a basic condition, but it is not enough: since it is a delegated power, citizens should always have the possibility to not only control such a power but also to participate in its exercise, especially because of the distributive nature of monetary policy. To expound, there could be no power of regulation without representation (Tucker, 2018), and central bankers, as elites, must not be a closed-off social group: on the contrary, they should be open to society in its recruitment from a sociological perspective.

3. Central banks should not be the “only game in (a democratic) town” to deal with income distribution: the key role of fiscal policy

If monetary policy does have important distributive effects that stray from the intended (or alleged) *neutral* inflation-targeting mission of central banks, this raises a number of issues about the intent of monetary policy. Of course, while central banks have acknowledged the

income distributive effects, they have argued that these are simply the unintended result – side effect – of sound policy, i.e., inflation fighting, and are short-lived and transitory. As a result, they can be ignored in setting monetary policy. For instance, Ampudia et al. (2018, p. 3) have argued that “The overall effects of monetary policy on income inequality are modest, compared to its observed secular trend”. Similarly, as quoted above but worth repeating here, Cœuré (2013) has argued that central banks

should refrain from engaging in income redistribution, which should be sanctioned by parliaments. This does not imply that monetary policy actions do not have distributive consequences – in fact, they always have. But these are the side-effects of a strategy that aims to ensure price stability, which is by essence neutral as regards income distribution.

Adam Posen (2012, p. 298) from the Bank of England was clear: income distribution should be ignored by central banks: “What matters is that the committee is pursuing a policy that is not clearly motivated or traced to a distributive effect as a goal.” Similarly, Mersch (2014) has echoed the same sentiment: “The ECB has a clear mandate to deliver price stability – and that mandate does not involve policies aimed at the distribution of wealth, income or consumption [...] These distributional side-effects then need to be tolerated”.

However, central banks should not deny their role in income distribution, since there is a political dimension to monetary policy, on two levels:

- (1) The central bank is in interaction with other macroeconomic institutions holding political power and implementing other policies, which is the case with fiscal policy. Although there could be cooperation between monetary and fiscal policies, they could also diverge – which has been modelled through the famous “game of chicken” for instance (see Buiter, 2010). Whether cooperating or not, the nature of the relation between monetary and fiscal policies affects income distribution.

Indeed, fiscal authorities could implement specific policies aimed at offsetting the negative consequences of monetary policies, in reference to a collective definition of social justice. For example, such a situation has occurred frequently in the Eurozone since 1999 between the ECB and the European governments, in spite of the official rules alleged to curb public spending. In reaction to the tightening of monetary policy, government authorities have undertaken a more expansionary fiscal policy. This is what some economists called a “strategic substitutability” (Debrun and Wyplosz, 1999; Cr  el et al., 2002). But, in return, the ECB set up a more restrictive monetary policy to counteract the alleged negative effects of ‘loose’ fiscal policies – consistent with the ECB’s monetarist philosophy, and the need to impose ‘monetary dominance’.

In this case, there is an ‘indirect’ political dimension to monetary policy, even if the income distributive effects are short-lived and transitory. The possible non-cooperation between monetary and fiscal authorities, which could result from the tension between elected politicians and non-elected experts of independent institutions, can distort the distribution of income according to the balance of power given the political structure in place. As the European case exemplifies, if governments are politically ‘stronger’ than the ECB, they succeed in imposing their policies and expansive fiscal policy may favour non-rentiers. Conversely, if the ECB has more power than the governments, ‘monetary dominance’ becomes the rule and low-inflation targeted monetary policies favouring rentiers can be implemented.

Symmetrically, central banks can be compelled to take the lead in the hope of restoring growth and thus exerting income distribution in favour of the people. Defenders of “helicopter money”, for instance, have insisted on this potential role recently (Couppey-Soubeyran, 2020). However, as the limited impact of QE programs has demonstrated,

central banks cannot replace fiscal stimulus, and expansive so-called unconventional monetary policies should be seen as “Hail Mary” policies (Rochon and Vallet, 2019).

- (2) There could also be a ‘direct’ political dimension to monetary policy. Indeed, if central bankers are aware of serving some groups rather than others when setting up and implementing monetary policy (they already admit to the existence of income distributive consequences to monetary policy, though short-lived), then this is a conscious choice related to the exercise of their power to (re)distribute resources. In other words, relying on both personal interests and values, they make the choice to channel the distribution of resources: this is a clearly political choice.

Moreover, we believe that it is not simply monetary policy that has a ‘political’ dimension, but also the central banker. Indeed, we must remember that central bankers are chosen from elite groups – groups that share similar values with central banks: fighting inflation to protect net asset values. In other words, central bankers are chosen for their adherence to this ideal, and for their ‘culture’ and ‘regulatory expertise’ (Johnson, 2016; Dietsch et al., 2018; Vallet, 2019).

Because central bankers linked to the financial sector care about their prospects after leaving the bank, they have strong incentives to cater to this industry’s preferences. The consequences of these findings are devastating for the naive view of central banks as neutral technocrats that use their independence only to be isolated from the myopic pressures of partisan politics. (Fernandez-Albertos, 2015, p. 25)

However, the post-Keynesian conclusions lead to two important sets of questions:

- (a) Which segments of the population do central banks really serve? Why do central banks keep implementing such policies in the name of the common good when there is increasing evidence to the impact of their own policies?
- (b) If indeed monetary policy is alleged to exert long-lasting effects on particular social groups, why are these independent institutions not subject to greater accountability?

Indeed, accountability refers here to both the existence of internal and external norms, where the former refers to norms and rules produced/defined by central banks themselves to help them fulfil their mission: internal organization, forecasting, communication of policies, hiring of orthodox researchers, reinforcement and protection of the message of the evil of inflation. This amounts to the internal culture of central banks, or what Johnson (2016) refers to as a “closed off group”. It is about self-preservation, which requires institutional independence.

External norms refer to norms defined and controlled by society and its representatives to ensure that central banks fulfil their mission. In their actual form, external norms deal with “regular reassessment” of central banks’ policies by the legislature (Downey, 2020). Up to now, such a “regular assessment” has only taken the form of nomination/revocation of governors, as well as speeches of governors pronounced in front of parliament or political representatives of a people – namely other elites – consisting of explaining monetary policies *ex post*. This was well summed up by Paul Volcker, a former chairman of the Federal Reserve, “Congress created us and the Congress can uncreate us” (Stiglitz, 1998, p. 222).

But more importantly, we agree with Tucker (2018) and acknowledge that major distributional power should remain in the hands of elected politicians in charge of implementing fiscal policy, who are elected and thus representative of the people. In other words, central banks’ power should be mitigated through the aforementioned regular reassessment of their policies, but also through the limitations of their prerogatives that imply

an income distributive impact. Central banks should not be the only game in town to deal with such an issue, which should refer mainly to fiscal policy. The increase in central banks' power, visible through the "monetary dominance framework" that has occurred for 40 years, can also be understood as the outcome of the recoil of the role given to fiscal policy. In addition, with their status of independence, such a framework is likely to increase the risk of atrophy, bias and even usurpation of power by central bankers. With respect to the dynamics of democracy, this is problematic, since fiscal policy relates to the people's choices and needs, as explained earlier.

However, the previous arguments have emphasized that there is a *de facto* power given to central banks and central bankers to influence income distribution. For that reason, we explain in the next section why such a feature requires a new framework for central banking, implying for central banks and central bankers a turn to social responsibility.

4. The relationship between central banks, central bankers and their social responsibility: toward a new framework

In contemporary capitalism, there is a growing literature that considers the need for firms to adopt models of social responsibility, which emphasizes the social consequences of their economic actions with the aim of promoting the common good. In the age of climate change, for instance, such a model has gained ground. However, not only is such a model disputable with respect to firms' profit seeking as their main objective, but also private companies are not really compelled by law to do so, particularly because their role toward social responsibility is not carved into constitutions.

By contrast, as underlined in the introduction, central banks are alleged to exert such a role with respect to their constitutional missions and, more broadly, regarding their missions toward democratic rules. Nevertheless, a lesser body of literature has studied the relationship between central banks' power and their social responsibility. This topic deserves more attention; our aim here is to fill this gap.

Indeed, in considering the social responsibility of institutions such as central banks in a democracy, we need to question their relation to the political will of a given people, who are at the core of the dynamics of democracy. The political will of the people, embodied by the people's specific culture (implying specific norms and values), materializes itself in a tangible way through economic and social policies until the common good is reached. As Janet Yellen, the former Governor of the American Federal Reserve System, argued, "In every phase of our work and decision-making, we consider the well-being of the American people and the prosperity of our nation" (Yellen, quoted in Dietsch et al., 2018, p. 1).

This is why the common good in a democracy can change according to the changing will of the people: "Human good is not the good of rest in a permanent status, but of adaptation in a moving process" (Small, 1903, p. 143). This is also why institutions in charge of reaching the common good should be controlled by the people. In totalitarianism regimes, the common good decided by a single person is not the common good.

Therefore, we think that institutions that take seriously their social responsibility follow a Weberian "ethics of responsibility" (Weber, 1963) consistent with the above framework. To elaborate on this idea, let us mention that, although it is not possible to connect ethics to a universal truth, ethics refers here to the mediation towards a common good and general

interest, which is identifiable in a community through its culture, values and norms. Therefore, “all particular moral judgments are implied estimates of the usefulness of the actions concerned with reference to ends contemplated as desirable” (Small, 1903 p. 122). ‘Desirable’ refers here to valuations that stem from moral standards and broadly encapsulates all moral deeds within a community.

Moreover, the “ethics of responsibility” rests on the following three arguments: to follow three principles underpinning individuals’ action (Weber, 1963):

- To be aware of the foreseeable consequences of the action and to be accountable for it.
- A strong commitment to an objective – here the common good.
- To assume the “sense of proportion”: this refers to a pragmatic and practical action, by opposition to the strict respect of rules in the name of a certain moral. On the condition that his/her sole objective is to serve the common good, an individual must have the liberty to choose the best options offered to him/her.

In light of this discussion, we can now address three lines of enquiry with respect to central banks’ and central bankers’ actions in democracy:

- (1) The independence of central banks should be rejected, because it rests on the assumption of a strong opposition between the government and the public: the framework is “opportunistic government vs unified public (with unified and stable preferences)”. But “this is not the way real politics is structured. Instead, government is a contested space and the public is divided, with the conventional division between capital and labor” (Palley, 2019, pp. 11-12). Therefore, central bank independence can lead central bankers to take part in this division, and be either close to capital or to labour. Likewise, economic (and political) actors have different preferences regarding the use of monetary policy. Consequently, we should remember that “central bank independence involves politics” (Palley, 2019, p. 12). Specifically, we agree with Palley (2019) when he argues that central bank independence – in high-income countries in particular – should be understood in terms of class conflict, and even social conflicts taken in a broader sense (including gender, for instance). Conflicts at large are the core of democracy’s life, since they trigger debates on what the common good should be (Touraine, 1994).

Shifting to this framework leads us to reject the idea of an “optimal” monetary policy *à la* Friedman, which in this specific context is “optimal” for some social groups only. With this framework the debate is less about the efficiency of monetary policy but more on the control over monetary policy: if we agree that central banks can have an impact on the inflation rate (especially through the independence framework in developed countries; see Balls et al., 2018), then controlling monetary policy – even through independence, which could lead to lower inflation – is a political issue reflecting social conflicts.

Specifically, as Palley (2019, p. 18) claims, “capital is interested in achieving its optimal inflation target, not in pushing inflation ever lower”. Therefore, the status of independence can serve central bankers if the latter are close to financial groups, with the risk of capture (by private actors in this case): “Independence creates a form of focal point which financial markets can use to discipline monetary and fiscal policy” (Palley, 2019, p. 22). In other words, independence is likely to generate a form of policy lock-in in favour of capital that can be maintained even when democratic elections produce a change in government. Even through financial supervision, independence could be a means for capital to capture central banks.

By the same token, the distributive nature of monetary policy supposes to get rid of monetary rules “à la Friedman” (including the IT framework). Indeed, such rules are a lure and even a denial of democracy: not only are these monetary rules strictly aimed at targeting low inflation not preferable with respect to discretionary monetary policies, but they are also harmful to democracy, for two reasons.

First, if we acknowledge the distributive nature of monetary policy, the alleged neutrality of these rules is wrong, since they serve some groups. Specifically, Friedman’s rules target the monetary base as a unitary whole without considering its unequal distribution among a given population. Monetary rules should exist only on the condition that they participate in improving the common good, which supposes that central banks turn to social responsibility with the “sense of proportion” exposed previously. Note that what Rochon and Setterfield (2007) call “parking-it” rules go a long way in improving the common good, i.e., a better distribution of income from the perspective of monetary policy. This approach is consistent with monetary policies aiming to rest on the aforementioned ‘fair’ rate of interest.

Second, in addition to our development on the political underpinnings of independence, the actual rules “à la Friedman” serve also central bankers, since their career success depends on respecting these rules. *In other words*, rules “à la Friedman” participate in framing a specific culture of central bankers through the social worship of their “regulatory expertise” (Dietsch et al., 2018), leading them to function as a closed-off social group (Johnson, 2016) and to implement policies not understandable for people. Indeed, many studies have emphasized the overlapping connections between central banking and the financial and monetary sector (Diouf and Pépin, 2017; Vallet, 2019): the more that central bankers are labelled “hawks” (fully committed to price stability during their remit), the better their reputation and the higher the probability they’ll get good positions in financial and monetary institutions after their mandate (Adolph, 2013). With respect to the required “ethics of responsibility” followed here, such evidence is not consistent with a strong commitment to the common good democratically framed.

- (2) Therefore, a crucial question should be addressed: in line with the aforementioned need for “regular assessment” of elites in democracies, are central bankers sufficiently controlled, and, if not, should the democratic control exerted over monetary policy be redesigned? Specifically, should this control be enlarged to include the terms and conditions of the delegation of power to central banks, which would involve new democratic bodies of supervision (including those in central banks’ inner organization; see Vallet, 2022)? Moreover, this would ensure that the people retain a credible threat to change this delegated power (Downey, 2020). In democracies, the implicit “contract of trust” between people and central banks is incomplete by design: ordinary people do not really know monetary policy, while being affected by it in their everyday lives (Pixley, 2018).

To elaborate on this idea, two points should be emphasized. First, the existing framework of accountability (communication procedures by central bankers) and control over central bankers’ decisions (speeches and reports to parliament or government associated with the status of independence) are not enough to fully cope with the challenges associated with the distributive nature of monetary policy. This existing framework is externally oriented for central banks (from central banks to society) and does not allow for a

counterbalancing of the power associated with central bankers' "regulatory" and "testimonial" expertise (from society to central banks).

In order to exert an effective democratic control over central bankers' monetary policies, we believe that central banks should be transformed through their inner organizations. Indeed, we should not consider central banks as "black boxes" (Adolph, 2013) but, on the contrary, as "mobilization structures", aiming to serve the common good from their inner organization (Vallet, 2020). Resting on this framework enables one to take into account the social embeddedness of central banks: each central bank's organization has its own features because each monetary zone it embodies has its own objective, history, culture and so on. To follow the aforementioned "ethics of responsibility" compels central bankers to take into account such cultural features: because of the differing contexts, the process of reaching the common good in Switzerland is not the same as reaching the common good in the UK. Therefore, the process of dealing with the distributive nature of monetary policy differs according to the context.

From this, we suggest creating new bodies in central banks, in particular a body devoted to the discussion of the devising of monetary policy. Such a body would gather individuals embodying the social diversity of a given society, which proposes opening central banks to a wide range of different personalities and cultures.

This would be a political body in charge of ensuring that central bankers consider the common good when they design monetary policies. Although such a body would not be a 'small parliament', since its role is not to supersede the parliament nor to discuss fiscal policy, it would avoid 'from the inside' the risk of atrophy and concentration of power by central banks and central bankers. Indeed, central bankers are experts who have been trained to deal with economic/monetary/financial issues. At stake is their capacity to solve a technical problem. But since they create distributive effects, the issue is also about equity (not only efficiency), and hence central bankers cannot be the only actors in charge of dealing with these problems: they are not trained to deal with (or they do not want to deal with) them. Regarding their role toward democracy, they also have to be controlled by the people.⁴

With respect to crucial topics such as income distribution, such a body could discuss the choices of monetary policy. Indeed, this is crucial regarding:

- The risk of capture related to the career of central bankers – namely their post-retirement jobs offered by banking and financial institutions – because these internal bodies correspond to a supervision of what central bankers plan to do and do.
- Transparency, which is highly required for social legitimacy (monetary policy should not be only about 'hitting a target', but the 'tricks of the trade' should be discussed on a large basis too). With respect to the rise of the influence of the rentier class, and with respect to new concerns/issues for which central banks become involved in (environment/inequalities), the members of these bodies could have the mission of supervising the categories of assets that a central bank purchases. By its choice of asset purchases, a central bank channels some investments and has the power to give incentives to economic actors in financial markets. For example, the Banque de France' responsible

⁴ For this reason, elected politicians must be given the responsibility of deciding to mitigate the consequences of monetary policy. Likewise, fiscal policy should be used to compensate the losers of monetary policy.

investment strategy rests on what it calls three pillars aiming to align with France's climate commitments but also with 'safe' social management of companies. They are presented as a way to encourage the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) to integrate sustainability factors into portfolios management, to set an example for economic actors in financial markets (to channel investment) (Banque de France, 2021). By the same token, to give such a power to a body to supervise a central bank's asset purchase programs is equivalent to awarding central banks the above-mentioned status of bondholders: this 'creditor' power should be regulated and serve the common good.

In our views, these changes would contribute to a renewal of the classical debate rules vs discretion for central banks acting in democracies. Specifically, these internal bodies would have the mission to promote a "constrained discretion" applied to a "pragmatic authority" (Tucker, 2018, p. 151), since "how a delegation is structured also matters, delivering a regime of constrained discretion" (Tucker, 2018, p. 109).

More broadly, the proposal to create new internal bodies in central banks is a way to increase the right given to people to deliberate, which is an objective per se in democracies and which is key to control unelected technocrats' power. Indeed, our vision of democracies refers to John Dewey's, in the sense that we consider democracies are "value-generating processes", largely dependent on public reason and people's participation in public affairs: "No government by experts in which the masses do not have the chance to inform the experts of their needs can be anything but an oligarchy managed in the interests of the few" (Dewey, 1954, p. 208).

Therefore, members of central banks' internal bodies become 'stakeholders' of monetary policies, both in their design, their setting and their control. This is particularly paramount when unelected experts make choices that increase the power some citizens exert over others (Tucker, 2018, p. 249) – such as with income distribution.

To that aim, central banks' 'stakeholders' may be as diverse as possible (Guba and Lincoln, 1989, pp. 191-204; Duran et al., 1995, pp. 52-55) to promote deliberation on public policies, and thus their legitimacy (House, 2005, p. 7). This is key to enhancing (Cousin and Earle, 1992):

- (a) practical finality: a greater participation increases the understanding and hence the use of the results of public policies and their evaluation by 'stakeholders';
- (b) transformative finality: 'stakeholders' are more active in relation to the public policies, either in the institution or in society. In other words, central banks' 'stakeholders' are involved in central banks' social legitimacy by rendering the latter more transparent and understandable to society. Such a form of participation is needed because choices in monetary policies involve a community in the long run, with path dependency effects (money is not neutral).

This type of body already exists to some extent in some central banks. For instance, the so-called Conseil de Banque within the Swiss National Bank (SNB) supervises and controls the management of the affairs of the SNB. Nominated either by the SNB itself or by the Federal Council, the members of the Conseil de Banque are selected for their trustworthiness and their recognized knowledge in the fields of banking and financial services, business management, economic policy or science. In particular, there is always a representative of Swiss industry.

Our idea of creating a new body in charge of supervising and controlling monetary policies goes beyond that. As underlined, the composition of this body should reflect diversity on a larger scale, including people differing in gender, age, ethnicity, sexual orientation and sexual

identity⁵ as well as representatives of unions or other social movements. In order to improve both control and deliberation, diversity is key, since it is wrong to believe that a 'society' has unique and stable preferences, as indicated earlier.

It is certain that the creation of new bodies made up of diverse people does not suffice *per se*, neither to increase people's degree of involvement in public affairs nor to give them an expertise. Therefore, each 'stakeholder' should be trained for that end, and should learn how to promote the common good (Fetterman et al., 1996; Plottu and Plottu, 2009). Once again, the reference to the Conseil de Banque at the SNB is insightful: each member of this committee must have an academic knowledge in the area of banking, finance, business management, economic policy or science. They should have a diploma in these fields.

- (3) In addition to the necessary aforementioned changes aimed at improving central banks' social responsibility, new personnel with new skills should be hired. Indeed, an increased diversity among the personnel is required to enhance creativity and to cope with new challenges that central banks are facing (Haldane, 2016). At stake is the promotion of profiles with new skills, capable of having a "managerial expertise on income distribution". This implies recruiting people with academic backgrounds other than mere economics, such as sociology for instance.

Increasing central banks' personnel diversity is needed regarding the reality of central bankers' culture: the latter is related to the domination of the 'powerful' (male, white, highly educated in macroeconomics or econometrics). This is conspicuous regarding the academic profile of central bankers or their social origins (Johnson, 2016; Vallet, 2019), which has to do with the distributive nature of their monetary policies defending the value of capital and thus favourable to 'rentiers' (Smithin, 1996).

Such a change will foster the 'circulation' of elites, which is a key condition of the democratic life: everyone should have the opportunity to directly participate in the decision-making process to promote the common good.

5. Conclusion

As we have demonstrated throughout the paper, central banks should take seriously their social responsibility. The latter is a matter of economic but also of social and political consequences of central banks' monetary policies on the economy and society. These consequences refer to several issues that overlap sometimes: unemployment, financial stability, but also income distribution, gender and sexual preferences, environment, and social inequalities, among others. These issues demonstrate that neither monetary policies nor central banks as institutions are politically neutral, and this reality must be acknowledged by the 'world of central banking', which includes central bankers themselves.

This is of the utmost importance regarding the current state of democracies: an increasing number of people, in several countries worldwide, have become mistrustful of elites, sometimes rejecting them. Elites are viewed as confiscating the power to the detriment of the people. Such a sentiment is not consistent with democratic principles, which rest first on the idea that one individual equals one voice and, second, that everyone can participate in the

⁵ Although it should be mentioned that the members of the Conseil de Banque should come from different geographical regions of the country.

democratic life. For these reasons, even though central banks should not be the only game in town to deal with the buoyant issues of today's democracies, they are directly concerned because they are institutions of power, and because their members are unelected by the people.

Such major changes occurring in central banking also challenge the scientific analysis of central banks and monetary policy. The time is ripe to rethink the understanding of central banking, with new tools and new approaches (see Kappes et al., 2022).

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