MERIDIAN180 Transformative Leadership

Meridian 180 Forum: **Central Banks and International Governance**

Fleur Johns
01/22/2013

The questions 'about international governance and cross-border coordination' being broached by the upcoming symposium on central banks could not be more timely or significant, to my mind. One element that struck me, among the questions put forward to begin this discussion,… is a concern with imbalance. This, in turn, brings to mind the roll that central banks seem increasingly to be playing in what might be termed global mood management. The policy measures that central banks adopt – and the way that these are framed and presented – seem attuned as much to managing global optimism as they are with to managing monetary policy. (And the recent Meridian 180 forum on happiness is testament to broader preoccupations in this vein.) In this context, temperance seems a recurrent theme and aspiration. Central banks are, it seems, often cast (ideally) as generators of a particular kind of virtue within global financial markets – virtue identified with moderation, prudence, foresight and humility. We are accustomed, by now, to registering the possible pitfalls of projects along these lines. What would it mean, I wonder, for an 'ideal central bank governance system' to be accountable for its work as an engine of mood and virtue?

I look forward to a fruitful discussion of the many fascinating questions that this forum calls forth.

Fleur

Daxiao SHI
01/29/2013

Today I read a Chinese news report entitled "Data Show China's Currency Over-Issuance Worsens, and New Issuances Account nearly for half of the World's Total". This news report got me thinking. My major concern is how to understand property rights in this context nowadays.

The importance of property rights is self-evident today. Many countries have secured clear protection of property rights in their written constitutions, and some even have enacted more statutes to enhance further protection of property rights. France, Germany, Japan alike have had civil codes for ages, but China also passed the new "Property Law" six years ago. This makes it look close to perfect in terms of legal protection of property rights.

However, up until now, how to legalize property rights and their protection has been problematized largely because of the current central bank systems and of subsequent asset monetization and securitization. To take the Yangpu District of Shanghai where I live for an example, ten years ago, the average home selling price was about 3,000 yuan per square meter, and now it has soared ten-fold to 30,000 yuan per square meter. According to the data collected by the People's Bank of China, in January 2004 (2003 data is unavailable, so I have to start with 2004) the M2 money supply was 22510.193 billion in RMB, while by

December 2012, this number had increased to 97415.946 billion RMB. By laying out the numbers I would like to raise a question: If in 2003 a person deposited a certain amount of money in her bank, now can say her property rights have been protected? Indeed in a traditional sense, her rights do not seem compromised at all, since the bank pays her annual interest. However considering her real purchasing power for the same amount of money, we have to admit her rights are far from well- protected. The money has been significantly devalued compared to a decade ago.

Of course, there are explanations for the issue I raised, such as her personal preference for low-risk investment; or economic theories that accept moderate inflation as conducive to economic growth. But if we are nonetheless going to tackle the issue based on our old conception of property rights developed in an era without central banks, I am afraid now we have to be cautious of our eclipsing property rights.

Perhaps, it’s time to reconsider the notion of "the sacred and inviolable rights of private property”.

Annelise Riles
01/29/2013

Fleur's very interesting reframing of central banks' task of "mood management" makes me think of the current national and international debate concerning monetary policy in Japan. Bowing to extreme political pressure from a new nationalist government, the Bank of Japan has initiated a new quantitative easing policy aimed at weakening the yen against other global currencies. The political argument that forced the Japanese central bank's hand is that the central bank has all kinds of fancy tools it could be using to spur growth but that it has hesitated to use them out of commitment to an outmoded economic model and a commitment to internationalism at the expense of a realistic view of national economic interests. This quantitative easing policy in turn has ignited a global debate about the threat of "currency wars" and has also raised interesting issues about what exactly is moving the yen--is it the direct purchases of the BOJ? Is it central bankers' statements about their future policy goals? Or is it market's reaction to the coming to power of a new nationalist government elected on a platform of attacking bureaucratic elitism and reasserting national interests? This government's election in turn cannot be understood outside the framework of the crisis at Fukushima, the accompanying loss of public confidence in technocratic elites, and the general condition of hopelessness reverberating through economy and society. Mood management indeed. And this in turn makes me wonder what is left out of the very legitimate critiques of the G20 central banks as a closed club of elitist bureaucrats representing elite economies who protect one another and ignore the rest. One thing that is lacking from this framing of the problem is the degree of conflict among distrust among national regulators. Central bankers may enjoy one another's company at international conferences but that does not mean they will stick by one another or defer to one another in crisis situations. The national asset grab by regulators after the Lehman collapse taught us this, and the rise of implicit or explicit currency wars is further evidence of the same. Regulatory nationalism is as alive and well as other kinds of nationalism. But it also makes me very confused about whose side I want to be on, in this debate about elite clubs. There is a certain structural similarity between the arguments on the far left and the far right in many countries that central bankers are an elite club pursuing their own coordinated agendas at the expense of national taxpayers. Is this a good thing or a bad thing? Is it right or wrong? What alternative framings of the current political moment and relationship of states to markets and technocratic expertise to democratic politics could we offer instead?

David Westbrook
02/02/2013

In response Annelise's call for alternative framings, wWe might abandon some of the Enlightened political suppositions that frame this exchange. In confronting the asymmetry between multinational financial flows and national jurisdictions, it is worth remembering that central banks are historically the creatures of sovereigns, (bracket the ECB). Banks have been founded by kings to make capital available without raising taxes (which generally requires calling Parliament, and who knows where that might lead?) -- debt financing of recent US adventures should make one a bit skeptical that we've come very far.

Only a few currencies are widely used, and hence only a few central banks have much power. But sovereignty in the sense of power, rather the legalistic idealization of the state, has never been evenly distributed. Nor can one say much about "global governance" of economic matters much beyond what the nineteenth century called the practice of civilized nations and what we somewhat more euphemistically call "best practices." Consider, in this regard, how slow progress in the GATT/WTO regime has been, the Dexia/Fortis debacle, and of course Lehman. So the framing of this question presumes a political landscape which is rationalistic and idealistic -- normative rather than descriptive -- in the international law tradition, in realms where that tradition has had little traction.

And, as Fleur suggests, monetary policy is at odds with Enlightened rationality at its core: "mood management" may sometimes be cheered by a cut in interest rates (the US after 9/11, with troubling consequences), sometimes not (Japan). Currencies have always been about confidence, and that has never been terribly rational (not even gold, traditionally discussed in terms of lust or the light of heaven). So we see central banks, with limited and unpredictable success, coping with the less than rational in large numbers, pushing on string. Hardly "governance."

Insofar as central banks engage in governance, it is not governance for democratic ends. Some years back, in City of Gold: An Apology for Global Capitalism in a Time of Discontent, I argued that basing politics upon market interaction entailed a turning away from the hopes of politics founded upon rational argument among equals. We do not participate in markets in an effort to be equal, and it is our desires (incentives) not our ideas, that we serve. For example, in borrowing money at interest in order to go to war, the sovereign avoids, or at least postpones, democratic decision.

I would begin reframing by looking at the Feds dual mandate of employment and price stability without the Englightenment pieties. The demand for sound money, now as ever, comes from the rentier class. What is different about our age, having securitized society and its institions, is that while the traditional concerns for employment remain, we are all rentiers now. So what does a "social capitalism" that doesn't really aspire to democracy look like? How do the inhabitants imagine their world? Good news for anthropologists.

Katharina Pistor
02/10/2013

Central banks are for sure a creature of sovereign states and of law. it makes sense to give them a mandate and I agree that full employment should be taken more seriously than it has been in the past (the Fed seems to have acknowledge this of late). However, not all what central banks do or don't do is predetermined by their creators. The financial system we have created or allowed to develop -- one that is highly instable and thus hudgely dependent on the backstopping function only central banks of powerful states can provide -- has forced central banks to take on tasks they were reluctant to perform: They have evolved from lenders to dealears of last resort in the last crisis. The more frequent and the more extensive these tasks the greater the distributional effects of central bank action - or the power they exercise however much reluctantly. The more obviously political their decisions become the stronger the political backlash against central bank discretion is likley to be. Yet, taking away central bank discretion may well deprive the financial system -- and all those who depend on it -- of an effective emergency response system. We may not like its distributional effects of central bank action, but society at large probably benefits from greater rather than less stability.

Central banks do not stand outside the finanical system, they are part of it. Financial systems do not stand outside the law or states that created it, they are a part of it. The system evolves endogenously and given its complexity frequently creates unforseen effects. We do not yet know how to get out of the cycle of quantitative easing and have not yet grasped what effects an indefinite central bank put will have on the future of finance. It certainly seems deeply ironic that after decades of financialization and deregulation we end up with a financial system that is more dependent on state backing than ever before.

Especially troubling in this regards is that only few states have the ability to provide effective backstopping to the global financial system. Only those with access to unlimited resources of high-powered money have -- which excludes all those who do not control their own currency or have to borrow in foreign currency. For the remaining states we must ask whether they have the poitical will to stand in for their currency and/or the global financial system. The close coordination of central banks during the ongoing financial crisis (consider the swap lines the C5 afforded each other) notwithstanding -- the political will seems to be limited. It makes perfect sense to limit the responsiblity of national central banks -- and yet, the global financial system as it exists can hardly exist without a global backstop. So far the Fed has played this role. It is hard to think of another central bank that could do the same. And yet, it may be prevented poitically from continuing to assume this role. This may be all well and good for reasons of democratic accountability. But it may cost the world dearly in the next crisis.

Douglas R. Holmes
02/12/2013

I want to make a brief response to Katarina's observations regarding central bank discretion.

The Fed and other major central banks have extraordinary powers that can be invoked in event of war or other calamities. The Fed was acting under these powers in the wake of 9/11. During my sojourns in late-2008 I heard asides about special powers invoked at other central banks. Foolishly or shrewdly, I did not pursue the precise nature of these powers nor did I explore how they were mandated in national law. When I questioned one official about the constitutionality of a particularly sweeping intervention, he responded to the effect that he was instructed to do what ever was necessary (to save the financial system).

To what degree do emergency powers continue to serve as the legal rationale of discretionary policies?

Since September 2008 the boundary between monetary policy and financial stability has become increasingly blurred. Monetary policy was re-functioned for financial stability. QE was conceptualized for precisely this purpose. Discretionary monetary policy has been based, since the 1920s, on an intellectual regime that is and must be experimental and free of metallic orthodoxies.

I heard Richard Fisher, President of the Dallas Fed, aver that the cold war was fought (and won) with monetary policy. That reminded me, that some of the most profound and consequential aspects of central banking are unmarked, undocumented, and outside the bounds of any precise legal mandate.

Central banker are, of course, within the financial system, but the constituencies with whom they must collaborate to keep it functioning—businesspeople, executives of banks, hedge funds, insurance companies, real estate firms, and rating agencies along with various distinguished academics—have failed if not betrayed them.

Central bankers responded to the crisis with a staggering range of unorthodox monetary interventions, an extraordinary array of emergency funding schemes, and endless programs of regulatory reform and oversight.

But they also needed constituencies beyond finance per se, with who they could collaborate anew in the making of a regime in which mood matters. In the parallel M180 central banking symposium, I set out these issues as a function of communication.

John Wagner
02/12/2013

Doug Holmes's latest post observes that "some of the most profound and consequential aspects of central banking are unmarked, undocumented, and outside the bounds of any precise legal mandate." I think it is interesting to consider cases in which central banks pursue a single objective through both monetary policy tools and regulatory/supervisory tools, especially when the objective is outside of the bank's legal mandate for monetary policy. Specifically, to what extent is a central bank's choice of instrument to pursue such an objective based solely on the relative effectiveness of monetary policy as opposed to regulatory/supervisory policy, and do the different kinds of political and communicative challenges associated with these two central bank functions - referenced by Annelise and Diana in their introduction – influence the bank's decision making?

Federal Reserve Governor Jeremy Stein delivered a speech last week that is timely for the purpose of this discussion. Governor Stein considered how policymakers should respond to credit market overheating. He argued against a “decoupling approach,” whereby the central bank’s monetary policy would restrict its attention to price stability and maximum employment, and only supervisory and regulatory tools would be used to safeguard financial stability. Instead, Governor Stein appeared to accept financial stability as a de facto third mandate for the Fed’s monetary policy authority, citing several reasons for why, in certain situations, monetary policy might prove more effective than regulatory and supervisory efforts in addressing overheating credit markets.

Governor Stein argues that monetary policy tools may simply be the best suited of the Fed’s options to address overheating credit markets (he argues that supervisory and regulatory tools are imperfect, blunt options for dealing with financial stability concerns; that monetary policy is more flexible and can “get in the cracks”; and that monetary policy is useful in that it consists of multiple instruments, i.e. the federal funds rate and asset holdings). But beyond the policy reasons, to what extent do the political and communicative realities of the Fed’s monetary policy function influence its desire to leave the door open for the use of monetary policy to address financial stability?

The Fed’s responsibility for both monetary policy and certain regulatory and supervisory functions of course creates an unusual dynamic whereby the monetary policy function is designed for insulation from political influence, while the regulatory and supervisory function is expected to have a certain level of political accountability and responsiveness. When pursuing a financial stability goal, will the Fed be more likely to use a monetary policy tool because of its insulation from political pressure? And, when using a monetary policy tool to pursue a goal that is not explicitly part of its dual mandate, should the Fed be entitled to the ordinary degree of independence?

Katharina Pistor
02/12/2013

Just a quick response to Douglas: I agree that the discretionary powers of the Central Banks are worrysome and should be reigned it. However, without a deep restructuring of the financial system to make it less prone to collapse the need for an ultimate backstop with discretionary powers will persist. Tightening the rules will not be good enough - they will be breached in the next crisis, as they have been in the past and as the central bankers you interviewed readily admit. Should instead Central Bank decision making be infused with a greater variety of norms, ideas and interests? One thing is clear: A central bank that is as deeply engaged in distributional tasks and power brokerage as our current breed is politically unacceptable. But I would not settle on broadening representation and thereby implicitly underwriting the increasingly political role central banks play without first having thought through how to reorganize the system to make it overall less dependent on central banks. Even then more diversity may be desirable but would be less pressing.

Martin Chanock
02/14/2013

Underlying much of this thoughtful and interesting discussion is an anxiety about the discretion that Central Banks now have. They are making policies that create the parameters within which our representative institutions can function, but they are not accountable, democratically, and their discretionary range is in practice undefined.

I am guessing, but I wonder if the same writers would feel the same anxiety about constitutional rights jurisprudence. In this case we, that is citizens, legislators and judges, have deliberately put beyond the ambit of representative majorities the most basic rights that govern our political and social lives. Most lawyers, at least, accept that there is good reason to do this.

But, if we now pause to think what representative democracy means, the two most important areas, the underlying settings of economic policy, and our most important rights, have taken places beyond majoritarian political processes.

Is there an analogy between these two areas? How important is the majoritarian representative model if there is? Would it be 'better' in any sense if both or either, of these areas, were subject to the majoritarian political process?

Hirokazu Miyazaki
02/23/2013

My I very much appreciate this conversation about the place of central banks in the global financial system. My ethnographic work has focused on traders and investment bankers who carefully monitor and, both implicitly and explicitly, seek to profit from, economic policy statements issued by central banks, so Fleur Johns's attention to central banks' role in what she calls "global mood management" (or Doug Holmes's attention to the "economy of words" in central bankers' efforts to manage the national and global economies) makes intuitive sense to me. What has prompted me to post a comment this time, however, is something more specific, that is, the ongoing debate about the so-called independence of the Bank of Japan. Since the election of Shinzo Abe as Prime Minister and the spectacularly euphoric effect of "Abenomics" on Japan's stock market, this debate has intensified. I do not have the kind of expertise some of the other contributors to this forum have, but it seems to me that what is at stake in the Japanese debate about the independence of the Bank of Japan is not so much the question of whether the Bank of Japan should have more or less power in the management of the economy, as whether Prime Minister Abe's and his economic advisors' determination to use the Bank of Japan's tools of market governance to achieve the economic policy goals adheres to the principles of democracy.

The policy of inflation targeting is destined to have far-reaching economic effects and clearly raises a broader range of policy considerations, such as employment policy, than the functions the Bank of Japan is normally entrusted to perform. Can the government bypass policy debate by elected officials in order to effectively make significant economic policy changes under the guise of the seemingly populist and popular critique of the central bank's longstanding (and arguably well-calibrated) hesitation to deploy its tools? The question is closely related to a more general concern about the political implications of Abenomics. In his lecture he delivered in Washington, DC, yesterday, Prime Minister Abe jokingly pointed out that the "market," not he, coined the word "Abenomics." Can, and should, the market dictate the terms of politics?

The Japanese case is a reminder of the importance of paying close attention to the local and regional ramifications of the global debate about the politics of central banking. Sometimes we debate a seemingly unquestionably global policy or philosophical issue as if it means the same thing and serves the same purpose everywhere. But we are often talking past each other without even knowing it. In my view, one of the goals of Meridian 180 is to offer a space for making this explicit. This may lead to a different framework for collaboration.

Daniela Gabor
02/26/2013

If I understand correctly the previous post, Prof. Miyazaki raises the question of the political capture of the Bank of Japan arising from the new inflation targeting regime. My view on this is shaped by my training as an economist (and student of central banks). With that caveat, I would like to make to points in response. First, there is some irony in the debate about shifting to inflation targeting in Japan since this policy regime, very popular before 2008, gained its popularity because it enshrined central bank independence - that is, operational independence to achieve a price target set by the government, or the government and the central bank together (as in the UK). If anything, central banks in high income countries have informally abandoned inflation targeting to pursue more unconventional policies - and abandoned independence in the process. Economists these days are less convinced of the benefits of central bank independence, as for example the Fed's famous shadow banking mapper . To quote from Gillian Tett's FT article (previous link):

Instead of considering central bank independence to be a good thing, because it prevents inflation, central banks need to lose that independence, and work under finance ministries instead. Monetary policy and fiscal expansion must both be stimulative, since loose money alone will not work. Thus the central bank needs to monetise the public debt by buying lots of government bonds, say, or take other steps to co-ordinate fiscal and monetary measures.

What this quote suggests, and may be pertinent to Japan, is that coordination between monetary and fiscal authorities is necessary during a crisis. In other words, Bank of Japan's view that further monetary easing is uncessary (and so its objections to inflation targeting) only holds IF there is no coordination with the government (fiscal stimulus). Of course, coordination is a 'technocratic' word for political capture/political interference with central banking, but we may be living in times when conventional wisdoms about the benefits of independence are no longer relevant.

Second, another way to view the debate is to go beyond the strict regime change and think in the context of global financial flows. This is an argument that Bank of Japan has been too conservative in expanding its balance sheet in comparison with central banks in other high income countries. With Abenomics, Japan re-enters the currency wars not because of some misguided domestic politicians (as many argue) but because Japan cannot afford to stay out of the game of competitive devaluations. Abenomics then is simply a strategy to revive the Yen carry trade (see a longer discussion on my blog here.

Douglas R. Holmes
02/28/2013

I think that the last two posts by Hiro Miyazaki and Daniela Gabor have, perhaps, set the stage for the next chapter of this conversation on central banking.

Prime Minister Shinzo Abe and Governor Haruhiko Kuroda are preparing to embark on a series of experiments that may fundamentally alter the relations between politics and monetary policy in Japan. Elements of this drama have been rehearsed in the US and the Euro-zone, but we need to examine the Japanese case on its own terms. Governor Kurdoa's success or failure may depend as much on how he addresses questions about the nature of Japanese democracy as how he endeavors the to stimulate economic growth. Hiro is, I think, suggesting these challenges are inseparable.

Anna Gelpern and I had a brief conversation at our meeting last week about recruiting Adam Posen—now the President of the Peterson Institute—as a participant in this conversation. Posen has been one of the key theorists of inflation targeting and has been one of the earliest to recognize the profound significance of the Japanese conundrum. Posen has been sensitive to the particular character of the challenges facing Japan and the interplay between what were effective and ineffective policies pursued by the government and the central bank.

Eric San Juan and I had a similar conversation about the value of a conversation with Posen.

I think Fleur John's initial post on mood management is relevant here insofar as the future depends on how the Bank of Japan can shape expectations about the democratic management of economic and monetary affairs.

The trick may be to recruit the Japanese public to serve as protagonists, protagonists who can make the decisions that sustain the totality of promises that underwrite a distinctive social order, their social order.

Hirokazu Miyazaki
02/28/2013

In response to Dr. Daniela Gabor's thoughtful and thought-provoking comment, I would like to make two points. First, what I wanted to raise in my earlier comment was something more general than inflation targeting, that is, the importance of public and open debate about the role of central banking in the economy.

Dr. Gabor is right that there is a general consensus among economists and policy makers about the importance of closer coordination between monetary and fiscal policies. As our ongoing forum conversation makes it clear, however, this is not simply a “technical” question but a political question with far-reaching consequences to our economic life. I wonder if this issue has been fully communicated to the public and debated beyond the rather simplistic populist indictments of technocracy or efforts to boost investor confidence. What I am observing in the Japanese debate is an emerging concern with the fact that the role of monetary policy in the management of the economy is being redefined without democratic debate. In the case of Abenomics, an argument can be made that Abe won the lower house elections in December on a set of mandates to drastically change Japan’s economic policies, including a mandate to change the framework of monetary policy. But the fact remains that the independence of the Bank of Japan is still enshrined in law, and Abenomics does look like the political usurpation of the central bank and its privileged functions. In my view, the Japanese debate is an opportunity to reflect not only on the communicative economy of central banking (as suggested by Doug Holmes) but also on the communicative economy of economists and policy makers and their critics.

My second point concerns the specificity of the Japanese case. One can argue that the Japanese economy was not as seriously affected by the global financial crisis of 2007-2008 as the U.S. and European economies, and a simple comparison of the Bank of Japan’s balance sheet with those of Euro-American central banks may be misleading. Conventional economic indicators and numbers may mask the specific configuration of the problems to which a seemingly general economic policy solution, such as inflation targeting, aims to respond. A more nuanced and more ethnographically grounded understanding of the specificity of cases like Abenomics (and the debate surrounding the policy) would help us to broaden the framework of debate about technical issues.

Prime Minister Abe declared last Friday, “Japan is back.” I am not entirely sure what he meant by that, but thanks to Abenomics, Japan is indeed back as a subject of broader public interest and intellectual debate. I am calling for careful attention to the Japanese permutation of the politics of central banking, not because I believe the Japanese case is qualitatively different, but because I believe it illuminates the even deeper and broader significance of the politics of central banking.

Wataru Takahashi
02/28/2013

The symposium last week was very insightful and stimulating. I would like to thank Professor Riles and everybody at Cornell University Law School for giving me the opportunity to take part in the symposium.

Today, I would like to touch upon one issue that I was not able to talk about during the symposium.

That is, central banks were created by states. Here, I would like to emphasize that although states required [the establishment of] central banks, in essence, it is the markets that require a central bank. That the states established central banks is a significant historical fact. In addition, states often established their central bank to serve as an agency for their fiscal policies. The Bank of England is an exemplary central bank in anybody's eyes. However, it was established to fund a war. But the more important point is that the markets require a central bank. This point has to do with how central banks reign at the apex of the credit system. Distribution of a state's currency and credit is not limited within the territory of that sovereign state. In his *A Market Theory of Money*, Sir John Richard Hicks depicted how the British pound circulated beyond its borders.

For that reason, if currencies and credits circulate beyond national borders, then central banks' activities inevitably become international. And the important point is that if central banks and their activities become international, they need to adhere to the logic of the market even more than if these banks and their activities had remained within their state's sovereign borders

Here, we tend to think about the US dollar when we think of currencies and credits that transcend borders. However, I would like to also point out that in today's economy, currencies and credits of many countries have internationalized, although their extent may vary.

If there is a gap between central banks' sphere of activity and their states' territorial borders, then it will be inappropriate to allow states to control central banks. And taking into consideration that central banks should follow the logic of the market, the appropriate course of action would be to give central banks independence, and let them follow the logic of the market.

Diana Biller
03/01/2013

These conversations about central banking have been incredibly insightful and stimulating. They came up frequently during the Symposium last weekend, as conference participants mentioned themes or comments from the Meridian forums.

To allow the conversation to continue to unfold, the Meridian team has decided to extend the forums for another week. The last day to post comments will now be March 8. At that point, the forums will make way for the next, very exciting, forum topic (the limited time of the Meridian translators means that there are constraints on how many forums can run simultaneously.)

We are actively exploring the next step for this fascinating discussion (as Professor Holmes suggested in his latest comment); one that would be framed by the comments made here. We are eager to have as many of your comments as possible included in the current forums, so that we may have as full a background as possible for whatever comes next. We are also very eager to hear your thoughts and suggestions about what the next chapter to this exchange should be.

Thank you all, so much, for the outstanding conversation so far. I'm looking forward to continuing to watch it unfold.

GUO Li (郭雳)
03/02/2013

The quantitative easing policies applied by multiple central banks have resulted in wide-ranging persistently negative real interest rates, and have posed a new round of challenges to the role of central banks and the central bank's independence. In China, the related debates have been focused on whether the People's Bank of China has been over-issuing the RMB. For example, the current excess broad money supply (M2) is approaching the one hundred trillion mark, while the total GDP in 2012 was about 51 trillion, and this makes the ratio between M2 and GDP approaching 190%. Viewing this dynamic, we see that the surge in China's money supply within the past 4 years (2009-2012) is about 50 trillion yuan, the money stock doubled, and its annual increase significantly outnumbers that of GDP growth. All this led to anxiety for real or potential serious inflation. On the contrary, however, the same ratio between 2004-2008 had been on a stable or even downward curve. Obviously in reaction to the global financial crisis, the sharp growth of credit expansion in China has secured not only sustained prosperity, but also the hidden danger of rapid currency depreciation.

Some would argue that since "A total M2 larger than GDP is commonplace world-wide, and the majority of the countries at the top of the M2/GDP ranking list are those with higher per capita income levels", China doesn't have a serious currency over-issuance problem. This is also the view of the People's Bank of China, which believes in countries prioritizing indirect financing like China, compared with countries in favor of direct financing, the general higher ratio of M2/GDP will be normal. With overall balance as the goal, the Chinese central bankers on the one hand emphasize the future long-term ratio between the injection of base money and economic growth, and on the other hand, provide their explanation for the puzzle of "excess money". Their reasoning is the excess money has been largely absorbed in the process of asset monetization driven by market-oriented reforms, so it assumes distinctive Chinese characteristics on this certain stage, hence they argue that the explicit inflation is still controllable.

Article III of The People's Bank of China Law states "the goals of monetary policy are to maintain currency stability, and thereby promote economic growth". Theoretically speaking, this is pitted against currency spamming, but in practice, at least over the past decade, China central banks' specific policies have aimed for multiple goals; economic growth and even others often being prioritized over currency stability. China hopes to continue her economic development, the U.S. is trying to let the world to share its losses, European countries have been forced to monetize their debt problems, Japan is unwilling to run its currency at high levels in the long term, and it's more difficult for other economies to sustain themselves. Now, money has been injected into the market as easily as water, but self-regulation has been hardly expected. Without exception, mutual accusations between countries are more often than not used as a mere stance targeting their own constituencies, and seemingly different orientations yield similar policy-making. Academics and laymen alike have long been spreading talk of a "currency war", and the financial crisis in recent five years undoubtedly adds to this drama a new footnote. In a world where respecting commitments is becoming more difficult, central banks have also changed dramatically from what they used to be.

Wataru Takahashi
03/07/2013

Please forgive me for the brevity of this comment.
Professor Riles' description of the Abe Cabinet as “nationalistic” and Professor Miyazaki’s comment about how democracy is not the same in different parts of the world are both very thought provoking.
I mentioned during the symposium that central banks are anti-democratic. And when their independence is influenced by the tension between democracy and central banks, then the difference in democracies in different countries become an extremely important point.
Advocating for a strong Japan, Prime Minister Abe is strengthening the power of his government. Under such circumstances, it is very difficult to establish the philosophy of “Separation of Powers” that constitutes the basis of a central bank’s independence in Japan. There are suggestions recently that there are varieties of capitalism. The differences in central bank independence among different countries seem to be greatly affected by their differences in democracy.

Katharina Pistor
03/07/2013

I wanted to take the opportunity before this discussion forum closes to express my gratitude for having been part of this and share some further thoughts with you:

- While central banks are created by the state “it is the market that requires a central bank” as Wataru Takahashi put it in an earlier post. This has been true historically; but as Daniela Gabor has pointed out, it is even more true today: When sovereign debt is used as collateral in private repo markets central banks are directly exposed to these markets, which in turn have come to rely on them. In short, our contemporary financial markets are neither public nor private, but essentially hybrid.

- It follows that our legal and conceptual frameworks for what central banks do or should be allowed to do are in tension with what central banks actually do given the financial markets we have. They are not outside of, but central to financial markets; central banks govern markets and yet are exposed to them in ways that frequently force their hands.

- How then should we think about accountability of these institutions? Martin Chanock has drawn an interesting parallel to constitutional courts, two equally independent and democratically unaccountable institutions. Here is how I would distinguish them: Judges rule but don’t act, whereas central bankers act but don’t rule. To retain authority, judges need to persuade and central bankers affect outcomes. Central bank action has distributional effects – and the increasing visibility of these effects undermines their impartiality – a critical ingredient for the legitimacy of both courts and central banks. The politicization of central banks in Japan and elsewhere thus appears as a symptom of a legitimacy crisis with its roo cause in the structure of financial markets.

- We have thus come full circle: Central banks have facilitated the development of financial markets including the evolution from bank centered to market-based credit systems; in this process financial markets and central banks have become deeply inter-dependent; this compromises the actual and perceived impartiality of central bank actions and this is now eroding their independence.