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FORUM

Infrastructural power, institutional karma, and existential choices

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Abstract

Leon Wansleben's new book, *The Rise of Central Banks: State Power in Financial Capitalism*, tells an intricately complex story of the world's most influential central banks successfully harnessing the forces of financial globalization to build their institutional power as the principal managers of their national economies. The book argues that, regardless of central banks' rationales and rationalizations, the resulting expansion of global money markets has failed to generate the intended macroeconomic and societal benefits. Instead, as became evident in the post-2008 era, the world's most powerful central banks are now structurally dependent on the increasingly self-referential markets for financial assets. While the book's narrative is focused on inflation targeting and other monetary policy innovations since the 1970s, it raises much broader questions and invites further reflection on the nonlinear dynamics of power in today's financial markets and the uncertain future of central banks.

Keywords: Central banking; finance; monetary policy; CBDC

Reading Leon Wansleben's new book, *The Rise of Central Banks: State Power in Financial Capitalism*, has been a real treat, especially for a U.S. legal scholar of finance. The book is a good window into the broader intellectual discourse around central banking – a phenomenon that my colleagues and I have long been studying 'from the ground up'. In my world, the research journey typically starts with a concrete issue of law or policy within the Federal Reserve's jurisdiction, which raises questions or invites corrections beyond its immediate scope or intended impact. In our field, academic expertise is generally rooted in the deep technical understanding of how the financial system operates, how it is governed, and where the existing modalities of operation and governance are misaligned or otherwise problematic. We often disagree in our diagnoses and normative precepts, but we all ultimately aim to use our technical knowledge to offer potential solutions to the problems we identify. U.S. law academe is very much a tribe of reformers and problem-solvers, in aspiration if not always in practice.

Wansleben's book has reminded me of the importance of climbing out of the law-and-policy trenches, at least occasionally, and contemplating the wider canvas against which today's battles over the proper role and tools of central banking are being waged. The book tells an intricately complex story of several central banks, including the Federal Reserve, systematically building their institutional power as the principal managers of their respective national economies by harnessing the forces of financial globalization and

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arbitrage. It was both fascinating and enlightening to see the growth of money markets and shadow banking – a very familiar and well-researched phenomenon – through the lens of central banks' evolving monetary policy and their quest for macroeconomic 'win-win' outcomes. The story is deliberately constructed, and the details are expertly triaged, to support the author's argument and to keep the reader's attention on what serves that goal. Whether or not one agrees with specific parts of this story, it is hard to disagree with the book's conclusion that, regardless of central banks' rationales and rationalizations, the resulting expansion of the financial sector and the overall financialization of the economy have failed to generate the widespread benefits for the macroeconomy. Instead, as became evident in the post-2008 era, the world's most powerful central banks and the financial markets they supposedly govern are caught in the web of deep structural interdependencies.

The impact of these interdependencies, however, is decidedly asymmetrical. Today, global finance is still very much a successful self-serving agent that continues to grow and solidify its dominance in every relevant area. Central banks, on the other hand, are increasingly visibly locked into their existing – limited and reactive – modes of action. These powerful institutions that, since the early 1970s, have meticulously cultivated their collective image as masters of behind-the-scenes financial statecraft are finding themselves under constant and harsh scrutiny. In the eyes of many members of the public, central banks are not benevolent technocrats that keep the economy stable but highly politicized bodies that serve the interests of the wealthy elites and corrupt financiers. At the same time, in many developed economies, central banks are the only public agencies with the apparently elastic balance sheets and institutional infrastructures that enable them to act directly and decisively inside financial and broader economic markets. Central banks are accordingly under an increasing external pressure to use their power to resolve numerous economic, environmental, social, and political problems that bitterly divided legislatures and cash-strapped fiscal authorities cannot resolve. Yet, as Wansleben's book convincingly argues, the fact that central banks have so closely tied their fortunes to the constant growth of financial asset trading effectively renders them unable to act outside of, or independently from, these markets and the private financial interests that run them.

In a sense, what Wansleben offers us is a close look at central banks' institutional karma. At the end of the book, he stresses that, since 2008, central banks' actions have been increasingly premised not on the projected macroeconomic benefits of supporting a healthy financial system – their original justification for nurturing financialization – but on the 'perceived inevitability' of supporting financial institutions and markets in an economy nearly entirely dependent on the financial sector (Wansleben, 2023: 220). And then comes what might be the most poignant sentence in the entire book: 'In other words, we are in a captive situation, and central banks and financial market logics remain dominant by default'. (Wansleben, 2023: 225).

This short sentence at the book's conclusion raises unsettling questions and invites further reflection on a few big-picture issues.

To begin with, it offers us a chance to deepen our appreciation of the nonlinear dynamics of power in modern finance. It is not just the public that is a 'captive' victim of the corrosively self-referential financial asset trading – ironically, so are the world's most powerful central banks. The more indispensable they become as 'last resort' market-makers and guarantors of financial asset tradability, the deeper they are trapped inside the game they do not control, 'upholding an unsustainable regime' (Wansleben, 2023: 243).

Michael Mann's theory of infrastructural power (Mann, 1984), which underlies much of the book's argumentation, is a helpful device for understanding what made the world's most prominent central banks the victims of their own success. Of course, monetary policy innovations, despite their obvious importance, are only one driver of the process through which central banks have successfully reinvented and augmented their infrastructural

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power. A lot of that reinvention happened through the multitude of central banks' actions outside their monetary policy ambit, which facilitated and encouraged the gradual restructuring of the financial system. In many jurisdictions, central banks perform significant regulatory and supervisory roles with respect to banks and other financial institutions. The Federal Reserve, for example, is a powerful regulator overseeing various activities of both banks and nonbanks and directly supervising financial conglomerates that have a U.S. bank in their corporate structures. Wansleben's chapter on financial regulation discusses the Federal Reserve's regulatory activities only very briefly and mainly from the angle of banks' liquidity management. It does not touch on the richly complicated history of the Federal Reserve's use of its regulatory powers in multiple areas (other than capital or liquidity standards) to enable the excessive growth of unregulated and lightly regulated shadow banking activities (Gerding, 2013). Some of these policy choices were enacted through formal rules, which made them binding and visible. Far more frequently, these choices took the form of informal decisions granted by the Federal Reserve's in-house lawyers to individual firms asking for individual exemptions from specific rules (Gerding, 2013; Omarova, 2011, 2013). Through these seemingly technical interpretations of specific statutory provisions, the Federal Reserve's legal staff quietly aided deeply consequential structural shifts in the U.S. financial system.

These decisions may not have directly targeted global money markets, but they effectively legalized the massive flow of public subsidies from regulated U.S. banks to their nonbank trading counterparties and affiliated firms active in those markets (Gerding, 2013; Omarova, 2011). Among other things, that is a big part of the explanation for the exponential growth of global trading in complex derivatives and structured products from the early 1980s until the 2008 crisis. Even more directly, this regulatory loosening of structural controls on bank subsidies has led to the rise of giant, implicitly (and explicitly) subsidized financial conglomerates – the new breed of universal dealers in financial risk – institutionally attached to central banks and their balance sheets (Omarova, 2013; Omarova, 2019; Wilmarth, 2020). These developments are not part of Wansleben's narrative, which focuses on central banks' use of inflation targeting and expectation management techniques to turn global money markets into their policy transmission channels. Nevertheless, they are an integral part of the broader story of how central banks turned themselves into captive guarantors of the private financial markets' self-perpetuating growth.

That broader story provides an important historical context for analyzing the emerging new challenges to central banks' institutional power. Although, for obvious reasons, central banks' monetary policy choices occupy the center stage in today's academic and policy debates, it is the more fundamental structural shifts in the financial system that increasingly threaten to deprive central banks of their remaining autonomy vis-à-vis private finance.

The primary driver of these shifts is the technological 'disruption' that began with the launch of Bitcoin, the prototypical private cryptocurrency, in the immediate aftermath of the 2008 crisis (Werbach, 2018). Since then, the rapidly evolving digital technology has changed the way financial services are delivered, transactions are conducted, and marketplaces are organized. An infinite variety of financial claims can now be represented as software-generated tokens, programmable bits of data stored and transferred within a dedicated digital infrastructure, or the ledger (Werbach, 2018; Omarova, 2019). This ability to create autonomous trading ecosystems is fundamentally transforming financial market dynamics. Traditional institutional mechanisms and functions are being algorithmically replicated and replaced, and well-established relational linkages are giving way to new interactions and expectations (Werbach, 2018; Allen, 2023). The financial system is growing bigger, faster, and more complex with numerous new players – technology startups, crypto exchanges, Decentralized Autonomous Organizations, and so forth –

entering the space long inhabited by banks, securities broker-dealers, fund managers, and other licensed and regulated financial institutions. These new entrants offer an ever-expanding menu of products and services that do not fit neatly within the existing legal categories and often serve no productive purpose. Opaque and highly unstable, these new markets are designed to operate independently from the needs of the real economy (Omarova, 2019, 2020; Allen, 2023).

Although I have been thinking and writing about the systemic effects of digital finance for a while, Wansleben's analysis of central banks' self-constructed dependency on private institutions of traditional finance recasts this problem in a new light. How will central banks exercise their infrastructural power, when they face a qualitatively different market, inhabited by different private actors operating outside central banks' traditional jurisdiction? Will central banks be able to continue steering the economy through the usual monetary policy signals, or safeguarding financial stability through regulation and supervision, when the financial system is fully virtualized? Perhaps more immediately, how will central banks' monetary policy work in a world where a handful of Big Tech companies and Wall Street giants issue their own tokenized money and operate large-scale proprietary platforms for digital payments and investment? These newly dominant private monetary and financial ecosystems may still rely on the captive central bank's support, but they would not be as responsive to the central bank's interest rate manipulations.

At this point, it is difficult to answer these questions with certainty. It is already clear, however, that technologically driven shifts in the financial system exert an increasingly palpable pressure on central banks' mode of governing the economy. This leads us to the ultimate, and the hardest, set of questions: Where do central banks go from here? Are they capable of freeing themselves – and, more importantly, all of us – from this curse of structural captivity? Or have they already lost the long game?

Leon Wansleben's excellent book does not endeavor to answer these questions. Having taken the reader on a historical tour from the early 1970s to the present moment, it makes the case for more social science research into the broader range of issues related to the state's evolving infrastructural power. There is no doubt that we need more high-quality empirical and theoretical research in this area. Yet, in times of such a profound transformation, academics cannot escape the added responsibility of looking forward and constructing future institutional possibilities. My last point, accordingly, goes to what that might entail.

To reimagine the future of central banks as public institutions, we must identify and think through the concrete ways to harness the power of new financial technologies for the long-term benefit of the public (Omarova, 2020, 2021). Digitization and tokenization of money are essential in this respect. That is because the same capabilities that make privately issued digital tokens attractive as the new means of storing and transferring value – transactional speed, scalability, accessibility, malleability, programmability, and composability – can be directly utilized by central banks as the issuers of sovereign money (BIS, 2023). Central bank digital currency, or CBDC, is the most straightforward mechanism for preserving and even enhancing the fully safe, public character of central bank money in the increasingly virtual financial universe (BIS, 2023). A direct liability of the central bank, CBDC can eliminate the need for private intermediaries in the monetary system and allow universal direct access to central bank money. Doing so would revolutionize our existing system of 'finance franchise', which structurally insulates central banks from non-financial economic actors and thus makes both central banks and the economy inherently dependent on commercial banks' and other financial institutions' performance of their delegated quasi-public duties (Hockett and Omarova, 2017). If a specific CBDC – the digital dollar, euro, pound, etc. – is directly and universally accessible, it will be the game-changing tool in the issuing central bank's hands. It will empower the central bank to

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break its structural dependence on private financial market channels and to reset the underlying terms, channels, and operational efficacy of their infrastructural power.

In the U.S. context, for example, the Federal Reserve could issue CBDC by offering free transactional deposit accounts, or FedAccounts, to every individual and entity. As I have argued in prior work, establishing a direct relationship between the central bank and the public would help stabilize the financial system, simplify its structure, and reduce its complexity (Omarova, 2021). The inherent malleability of digital money, moreover, would enable the Federal Reserve to engage in monetary policy innovation for the purpose of more nimbly and effectively responding to the changing needs of the real economy, instead of simply propping up financial asset prices. On the asset side of its balance sheet, the Federal Reserve could repurpose its existing discount window and open market operations to support prudent private and mixed public-private lending and investment in productive economic activities (Omarova, 2021). Without going into the U.S.-specific details of this proposal, the key point here is simple: a well-designed general-purpose CBDC offers today's embattled central banks a once-in-a-generation (if not a lifetime) chance to reclaim their institutional autonomy and public mission.

To take full advantage of this unique opportunity, however, central banks must be able to appreciate and actively embrace the full transformative potential of CBDC. Yet, the emerging consensus among central bankers is that, if CBDC goes live, it will not in any way displace or compete with private money (BIS, 2023). This crucial normative choice drives and explains central banks' ongoing efforts to make CBDC a less attractive transactional alternative to private digital money. Framed in the usual technocratic terms, these decisions reflect central banks' political commitment to preserving the status quo – that is, the current state of our collective captivity, structural and intellectual.

So, what is the upshot of these high-level reflections inspired by Leon Wansleben's important new book? Central banks' infrastructural power, as it exists today, is as much an institutional curse as it is an operational blessing. The world's largest and most influential central banks are highly efficient and effective in doing 'whatever it takes' to ensure and protect the continuous growth of financial markets but are quick to disclaim their capacity to solve the mounting problems such unfettered growth creates for the real economy – and the people, from whom central banks, as public institutions, ultimately derive their legitimacy. Backed by extensive research, Wansleben's book helps us to see this unsustainable lopsidedness of central banks' infrastructural power as a product of specific institutional choices. Today, central bankers are facing new, tremendously consequential and overtly political, choices. I hope they read this book carefully and take its lessons seriously. Otherwise, the future of their home institutions may not be what they expect it to be.

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