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FORUM

Applause, puzzlement, worry

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Abstract

In this commentary, I argue that Leon Wansleben's focus on financial plumbing as a source of central banks' epistemic and instrumental power will be met by the profession with a mixture of relief, incredulity, and worry. More importantly, I maintain that central bankers' relationship with finance varies according to whether or not they are independent from elected government, an under researched area. All this works as a point of departure for remarks, drawing on my own memories, on central banking's relationship with neoliberalism in monetary policy, monetary operations, and banking. Finally, I urge that Wansleben's method be applied to anti-trust and the micro-economic regulation of utility services.

Keywords: central banks; neoliberalism; monetary policy; politics

The Rise of Central Banks is an important book. It is important because rather than just focusing on high-level policy regimes and outcomes, it takes organisations seriously. By organisations, I mean the flesh and blood people who lead, manage and work in central banks, and the processes they employ to do so. In other words, Leon Wansleben takes the agency of central bankers seriously.

That matters for several reasons. One is that a central banking organisation might be run so poorly that it is not fit for purpose: it is not up to the job required by the regime. Another is that the incentives set up within the organisation might cut across the purpose of the regime. That is why good monetary regimes have something to say about a central bank's organisation. In practice, regimes vary in how far (or how well) they do that. At present, therefore, a terribly important question about the rise in underlying inflation is whether that can mainly be attributed to flawed regimes or misfiring organisations.

I also want to applaud the author for interviewing past officials. Relying entirely on the written record risks giving too much weight to those officials who, whether by disposition or as part of their job, write lots of internal thought pieces, give lots of public speeches, or publish lots of research with their name on it. Of course, interviews can be conducted only with the living. So far as the treatment of the Bank of England is concerned, it is a great pity, therefore, that the author was not able to interview George Blunden (deputy governor 1987–90, and first chair of the Basel Committee) and Eddie George (deputy then governor, 1990–2003), both lifers and two of the modern Bank's small handful of architects. Drawing inspiration from their combination of monetary plumbing and organisational strategy, I will offer some reflections on the issues raised by *The Rise of Central Banks*. In doing so, I will draw a distinction between the

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very different circumstances of a central bank organisation before and after independence. That leads to the bigger question of central banking's relationship with neoliberalism.

Central banks as expert plumbers

At the heart of Wansleben's book is a thesis that central bankers' power, sense of identity and mission is rooted in their hold – epistemic and instrumental – over the plumbing of the core of the financial system. This will be met by many central bankers with a mixture of relief (it is true), incredulity (obviously so), and worry. The last because not a few commentators on the Left seem to think it has radical implications, which risks getting the mechanics of the money-credit system out of proportion (Tucker, 2020).

Central bankers are bankers at the centre; or the pivot of the credit-money machine, to use Francis Baring's term in his late-eighteenth century articulation of lending of last resort.

Their mission requires them to know their way around the most intricate levels of the payments, clearing and settlement systems on which participants in financial markets rely; knowledge which in the private sector is often consigned to back-office specialists rather than being a (normative) prerequisite for the top jobs.

Intellectually, such central bankers, having acquired a good deal of their craft on the job, inhabit a space between high monetary theory and ground-level operations. Politically, this gave a non-independent Bank of England a lever in the power game with Whitehall, but at the cost of risking capture by the City. After independence, the game was transformed, and the relationship with the City likewise. Independent central banks need to face outwards to the people rather than remaining in the undergrowth. That risks diminishing the prestige of plumbing expertise, even though it remains as important. The Federal Reserve has been suffering from this problem for some years, as I suspect does the Swiss National Bank given the way Credit Suisse unravelled in spring 2023.

Monetary base control and central bank-treasury relations

In any case, even in their pomp, expert plumbers cannot trump the dictates of quotidian politics. An example comes from Britain's monetarist period. When they took office, the Thatcher government was committed to introducing monetary base control (which combines target with operating technique), believing it would both underline their commitment to price stability and deliver it. Putting it lightly, the Bank had severe doubts but, not being independent, it could not simply decline. Nor did it sum up its arguments with something as frank as 'this is rubbish' (backed up by published reasons, of course). The point here is not whether it was, in fact, rubbish – although it quickly turned out it was – but that an advisory central bank has distinct incentives. Acting like a courtier rather than a principal, it trims in order to stay in the game.

On monetary-base control, the upshot was both peculiar and damaging. The compromise reached among Treasury and Bank officials led to an operating system that, even after base control had been ditched, was analytically incoherent, and difficult to implement in ways that persisted for almost a quarter century (Tucker, 2004). Consistent with the book's plumbing theme, part of the solution involved liberalising the market in lending money against the security of government bonds.

One might think that an *independent* central bank can assert its expertise to greater effect. It can but, by deciphering the game of independence, politicians can learn how to get their way, except now in moves that are sometimes obscure. In Britain, one key instrument is the annual remit for the monetary policy committee (MPC). In 2013, as well

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as effectively urging the MPC to adopt forward guidance, which got quite a lot of media coverage (and caused some discomfort in the Bank), the then government also committed the Bank to 'monetary activism' (under its second statutory objective), a rather remarkable move that was barely noticed, and that had striking consequences.

In addition to forward guidance (which would supposedly, but in the end did not remotely, marginalise quantitative easing), 'monetary activism' was associated with greater use of credit easing operations to steer the supply of credit towards good causes and away from bad ones, as judged by the political climate. It seemed to return central banking to life before Thatcher and Reagan, which was not lost on Labour think tanks in the run up to the 2017 and 2019 general elections. In opening those doors, Tory governments had travelled a long way from their predecessors' monetarism.

Monetarism as politico-techno project

That earlier period involved an extraordinary conflation – perhaps especially in Britain compared with, say, Germany – of 'monetarism' as a rather narrow empirical claim about some economic relationships (and jettisoned techniques) with 'monetarism' as the signifier of a much broader and overtly political project. The latter now goes by the name 'neoliberalism' but, at the time, the elision was a challenge for central bankers, as opponents of the political project seemed compelled to deny much narrower empirical claims about the long-run neutrality of money: the proposition that increases in the stock of money (or in its rate of growth) do not increase the level (or rate of growth) of activity and jobs in the long run. Conversely, anyone who did believe in long-run neutrality was plainly right wing (or worse). Since most macroeconomists and most central bankers did (and do) believe in long-run neutrality, this made the world of central banking seem right wing – or, at least, in cahoots with right wingers – to much of the Left.

It is a pity that Leon Wansleben did not ask his interviewees more about that. The answers would have been interesting given that the Left, typically preferring a larger state but often facing pressures to keep taxes down, and so potentially relying more on debt finance, have extra incentives to value price stability. That, in effect, was what Gordon Brown grasped in the run up to 1997. But if the point has merit, it would have been as true for Harold Wilson in the 1970s.

Meanwhile, while I agree with Wansleben that monetary aggregates were conceived as a communication device even where targeting them apparently worked, the obvious difference between, for example, the Swiss and British central banks was that the former was insulated from day-to-day politics. Had that not enjoyed wide support in Switzerland, it would not have survived. In that connection, *The Rise of Central Banks* attributes too much agency to the Bank of England during the 1970s and later. Notoriously, governor O'Brien (1966–73) functioned as a counterpart for mandarins not the Chancellor or Prime Minister. Gordon Richardson (1973–83) gradually changed that, creating space to campaign for stability, but not much more. A study of British monetary policy during both the social democrat 1970s and neoliberal 1980s needs to focus on the Treasury and the dynamics of its relations with Number 10, not the Bank: the plumbers were helpers not first-rank actors, and sometimes heard about interest rate changes after the decision had already been taken. The big difference with Switzerland (and Germany) was that, in Britain's first-past-the-post electoral system, there were more pressing things than stability for the politicians, whatever their best intentions. The significance of the dramatic European Exchange Rate Mechanism (ERM) episode is that it was experienced in the Westminster village as a last-chance saloon moment for Treasury improvisation. The plumbers at least were likely to be boring, and it turned out they had a plan, which was definitely an example of agency.

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Central bank plumbers and banking stability

The connection between mastery of the plumbing and policy is, arguably, even tighter on the banking side. The central bank's role in financial stability is rooted in its being the lender of last resort (LOLR). There might perhaps have been more in *The Rise of Central Banks* about this given the social costs of the 2007–2009 financial crisis, coming after a decade when New Labour had moved prudential powers outside the Bank, quite possibly costing them the 2010 election.

Central banks (mostly) expect to be the prudential supervisor because it is hard to be an effective LOLR without knowledge of banks (and near banks); separation risks extinction of the plumbers. Governments meanwhile, emphasising that they pick up the tab on behalf of taxpayers when banks fail, want to keep a handle on banking policy. And yet when that control is asserted, it is hard for politicians to resist the siren call of light-touch regulation to foster (short-term) growth. Until, following the 2008 rescues, monetary-financial plumbers started thinking seriously about how to resolve insolvent banks in an orderly way without taxpayer equity injections (anther moment of agency), no one had tried to find a way through this dilemma.

The tendency to lax regulatory policy on credit creation (via the calibration of constraints on leverage and liquidity-mismatches) forms part of an understandable narrative about neoliberal deregulation. The path of banking policy was, however, more complex than remember by those who say simply that British finance was deregulated in the 1980s and 1990s. That is both seriously false, and yet also true.

Until 1979, the UK had no statutory regime for the prudential regulation of banks in general. One was introduced in 1979, and considerably strengthened in 1987 (yes, under Thatcher). The Basel Committee launched its now famous minimum capital standards for internationally active banks in 1987/88, having not attempted anything like it during the supposedly more dirigiste 1970s. Away from banking, Britain introduced its first comprehensive regulatory regime for capital markets and investor protection in the late1980s.

There was deregulation, of course. But it was in what services and products intermediaries were allowed to offer and to book on their balance sheets. In a nutshell, firms were much less restricted in *what* functions they could undertake, but much more constrained in *how* they did it. That trajectory, which continues to this day, did not begin in the Bank of England, and it created an interesting reaction within the Bank.

The key deregulation, if that is the right word, was the lifting of capital controls in 1979 (about which Mrs. Thatcher was notoriously cautious). Among many other things, this spurred growth in London's so-called euro markets (mainly in dollars), which had roots in the Cold War (the Soviets holding dollars outside the U.S. in a centre aligned with Washington but with commercial courts credibly devoted to the sanctity of contracts). Since those entrepôt markets were barely subject to local securities regulation, they bypassed constraints on the structure of the domestic equity and government bond markets. That led to pressure for domestic reform, cast in terms of efficiency and, hence, pursued via competition policy (in US-speak, anti-trust policy).

When, however, it came to the core markets for public finance – notably, the market in government bonds – Eddie George (then what is now called Markets Director) was cautious. The gilt market makers, newly permitted to act as both jobbers and brokers (in pre-Big Bang speak), were required to be separately capitalised subsidiaries of the groups to which they belonged, and were subject to a specially designed regulatory regime. As the government's debt manager (from 1694 until 1997/98), the Bank was more hands on the gilt market after Big Bang than beforehand. Where it had policy clout in Whitehall, the Bank was a cautious liberaliser.

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Here we might usefully recall a part of the story in *The Rise of Central Banks* that neatly brings its threads together: the advent of repo markets, their use by shadow banks, and role in the 2007–2008 crash. That episode has led to commentators outside finance and economics discovering the vital importance of collateral markets. But there is nothing new about it. Before gilt repo, which I was involved in introducing, the Bank had conducted its open market operations and discount window lending against bundles of bills of exchange, some purchased outright, some taken as collateral. Collateral markets were, then, just as important, and the famous 2007 'run on repo' was nothing new. The 1866 run on the Overend Gurney discount house is the most significant in history because the Bank's provision of liquidity to the rest of the monetary system became the model of LOLR operations celebrated in Walter Bagehot's famous book *Lombard Street.* That crisis involved (what we now call) a shadow bank and strains in collateral markets. Managing and monitoring collateral bundles was absolutely central in the Bank throughout the twentieth century, being located in what for much of the period was by far the most prestigious department. In contrast to many of the Bank's peers, but in common with the Federal Reserve for much of its existence, a spell there was rite of passage for those destined for top office.

Was central bank independence neoliberal?

Those disparate reflections all feed into what is, perhaps, the biggest issue raised by Wansleben's book: whether central bank independence was a neoliberal project. Certainly, the rise of independent central banks coincided with what social commentators call neoliberalism. But it is worth remembering that Mrs. Thatcher herself opposed independence, and New Labour sought to dilute an independent Bank's power by removing the prudential function from the plumbers.

Nor would I judge many top British central bankers during the 1980s and 1990s neoliberal in a standard way. Among those no longer with us, Richardson was an old-style Keynesian who deplored the violent policies of Thatcherism, as did his unpromoted deputy, Kit McMahon. Robin Leigh Pemberton (governor 1983–93) was a patrician One Nation Tory who was strongly pro-European, and who had a furious row with a top politician about public sector pay, arguing that the country would be in trouble if nurses and teachers did not get fairer pay (I was present). Deputy Governor George Blunden seemed to go with the flow, but some said he was privately a social democrat. Andrew Crocket, who later became head of the Bank for International Settlements, was close to John Smith's Labour Party, and might well have become governor if Smith had lived. Eddie George probably did have stronger convictions about markets but, as we have seen, he was a cautious deregulator-cum-reregulator. Further, while deputy governor, in the run up to the 1992 election, which many expected Neil Kinnock's Labour to win, Eddie talked in Governor's meetings about prospective industrial policy as though it would be the most natural thing in the world (again, I was there). What these people had in common was knowing their place.

Certainly, they all believed monetary system stability was a necessary precondition for enduring prosperity, and for governments to pursue their agendas (whether liberal, conservative, or social democrat). But they varied in how they thought about independence. Blunden used the closing paragraphs of his final speech to argue that independence would be unwise until price stability enjoyed wide support in the country (Blunden, 1990). Leigh Pemberton saw ERM membership as a substitute for Bank independence, and I suspect found it ironic that politicians were prepared to hitch a ride on the tails of a foreign independent bank.

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If there was an independence project inside the Bank during that period, it was to raise the Bank's professionalism. It was a project led in its most vital years by George and Mervyn King, who transformed the organisation, its outputs, and the external communication of the Bank's monetary economists (most notably through the quarterly *Inflation Report*). A study of how the Bank readied itself for independence, where it definitely had agency, is still to be written.

A more important question is whether independence has been associated with neoliberalism because in Britain – in contrast to Germany and Switzerland – it happened during neoliberalism's rise. This conjecture prompts two interesting counterfactuals. The first is whether the association would have been avoided if, during the 1970s, social democrat governments in the US and UK had got on top of inflation. Indeed, that is *the* Big If about the the 1980s' political tides. Would they have been as strong if the Carter administration and Wilson-Callaghan government had not performed so poorly on inflation?

The second counterfactual is whether the Bank would ever have become independent if the Thatcher government and its Tory successor had actually delivered price stability. As it was, the Tory party initially opposed independence when, in 1997, it was introduced, by Blair and Brown. Perhaps New Labour spotted that in a first-past-the-post electoral game of binary comparisons, they probably needed independence more than their opponents. Independence having brought down the inflation risk premium (with big savings for the public finances), a subsequent Tory administration was not going to repeal it.

But it was not their achievement, and in late 2022, almost a decade after the advent of 'monetary activism' (and beyond the period covered by Wansleben's book), they were ready to take risks, which back-fired rather badly. Oddly, the Bank intervened as a market maker of last resort in the gilt market to pick up the pieces, which brings to mind nothing quite so much as the old Whig Bank helping to rescue the very Tory South Sea Company (created to displace Threadneedle Street) in the early decades of the eighteenth century. The plumbers have their uses, but no doubt are irritating when most attached to their craft.

More important, I think they stick to their craft whatever the political ideology of the incumbent government or spirit of the times. While in the late-1950s governor Cameron Cobbold (1949–61) tried to persuade government to rely more on interest rates than credit controls to steer the economy, the Bank bowed to then Treasury orthodoxy. The Bank I joined in 1980 looked back with distaste on the personal intervention of governor Cromer (1961–66) in electoral politics (which cost him a second term).

Broadening the scope of such inquiries

While I have distanced the art and science of central banking from neoliberal government, I most certainly think the kind of exploratory project Wansleben conducts is well worth while. In fact, I want to conclude where he does, contemplating the application of his approach to other fields.

To take only one example, I suggest political sociologists could usefully take Wansleben's method to the population of economic regulators created when utility companies were privatised in the UK and elsewhere. All sorts of problems have developed, from overflowing sewage to bankrupt train lines, posing the headline question of whether the regulatory regime was badly designed, undermined by government tinkering and appointments, or succumbed to moral hazard for some other reason. A big question for political scientists is whether neoliberal governments forgot what their project was built on. A question for organisational sociology is whether the people leading and working in these regulators had agency in the demise of their own institutions, or quite the reverse.

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All that seems ripe for Leon Wansleben's technique of interviews and analysis contextualised by the relevant literatures. It might turn out, contrary to my deliberatively proactive pleadings, that the patterns across different fields would underline his views about monetary policymakers.

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