Central banking, finance and power

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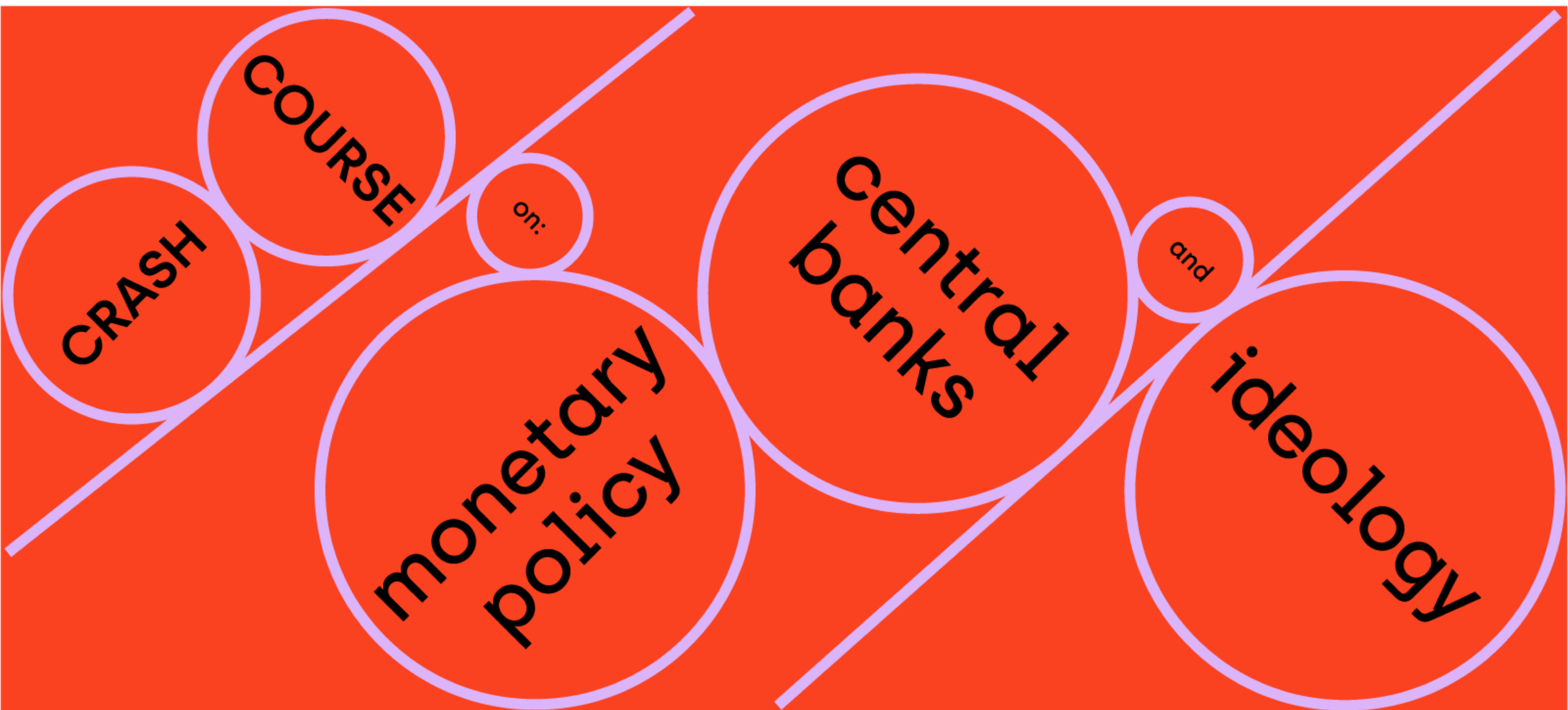


1. Central bank independence & power

Conventional monetary economics view

- CB power exempted for democratic accountability to achieve price stability
- Narrow mandate limits damage to democratic principles

Critical political economy view

- Monetary policy operates in and through financial markets
- Central banks shape the financial system
- Should the financial system be shaped by the needs of monetary policy?

2. Administrative vs. market-based state agency

- **Conventional view** of state-economy interactions: state governs through rule making and rule enforcement
- **However**: State not just regulator, but also *participant* in financial markets
  - Debt issuance by the treasury
  - Open market operations by the central bank
- **Two different modes of economic governance**
  - Governance by issuing rules & regulations
  - Governance by issuing liabilities & purchasing assets

Administrative agency: Prior to the 1980s, central banks used **direct** monetary policy instruments such as

- credit controls
- interest rate ceilings

Market-based agency: Since the 1980s, central banks shifted to **indirect** monetary policy instruments such as

- standing facilities
- open market operations

Infrastructural entanglement

- **Public** actors provide the backstop infrastructure for the creation and trading of **private** credit money
- **Private** actors provide the infrastructure through which **public** monetary governance operates
- Central bankers manage these **infrastructural entanglements** in pursuit of governability (price stability & financial stability)
- Infrastructural power *of finance*: manifestation of the ‘two-way street’ nature of infrastructural power as conceptualised by Michael Mann

Three types of financial-sector power

- **Instrumental power:** Capacity to organize and lobby state actors
- **Structural power:** State actors fearing a 'capital strike'
- **Infrastructural power:** State actors seeking to govern through financial markets

The political economy of infrastructural power

- State actors seeking to govern through financial markets tend to want ‘deep’ and ‘liquid’ markets
- Deep & liquid = big & powerful
- Yes: monetary governance is a public good
- But: a financial system that maximises monetary governability $\neq$ financial system that maximised the public good

1970s: Petrodollar recycling through the Eurodollar market

- Large USD surpluses in oil-exporting countries & deficits in oil-importing countries
- Two questions:
  - Who will issue the debt that will absorb the oil exporters' 'petrodollar'?
  - Who will finance current account deficits of oil importers?
- Public solution: 'recycling' via governments & IMF
- Private solution: 'recycling' via Eurodollar market
- **Result:** Central bank backstops supported global growth of foreign-currency debt

Read more:

Braun, B., A. Krampf, and S. Murau. 2020. "Financial globalization as positive integration: monetary technocrats and the Eurodollar market in the 1970s." Review of International Political Economy.

1990-2000s: Repo markets in the US, UK & euro area

Result: Deep and liquid repo market that forms the backbone of the global shadow banking system and was at the core the 2008 banking crisis

Read more:

Gabor, Daniela, and Cornel Ban. 2016. "Banking on bonds: The New Links Between States and Markets." Journal of Common Market Studies 54 (3): 617-35.

Gabor, Daniela. 2016. "The (impossible) repo trinity: the political economy of repo markets." Review of International Political Economy 23 (6): 967-1000.

Walter, Timo, and Leon Wansleben. 2019. "How central bankers learned to love financialization: The Fed, the Bank, and the enlisting of unfettered markets in the conduct of monetary policy." Socio-Economic Review.

Wansleben, Leon. 2020. "Formal institution building in financialized capitalism: the case of repo markets." Theory and Society.

2008-2018: The ECB and the securitization market

- **Collateral easing:** ECB allows banks to use securitization to unload loans onto the ECB's balance sheet
- **Quantitative easing:** ABSPP irrelevant in macroeconomic terms but a 'signal' to markets that the ECB will support the securitization
- **Regulatory easing:** the ECB's loan-level data initiative will 'become an important building block along the path towards *standardisation*, *simpler* structures and better post-trade price *transparency*' (González-Páramo, 2010)
- **Result:** Formerly 'toxic' asset class became 'Simple, transparent, and standardized (STS) securitisation' in 2017 EU legislation

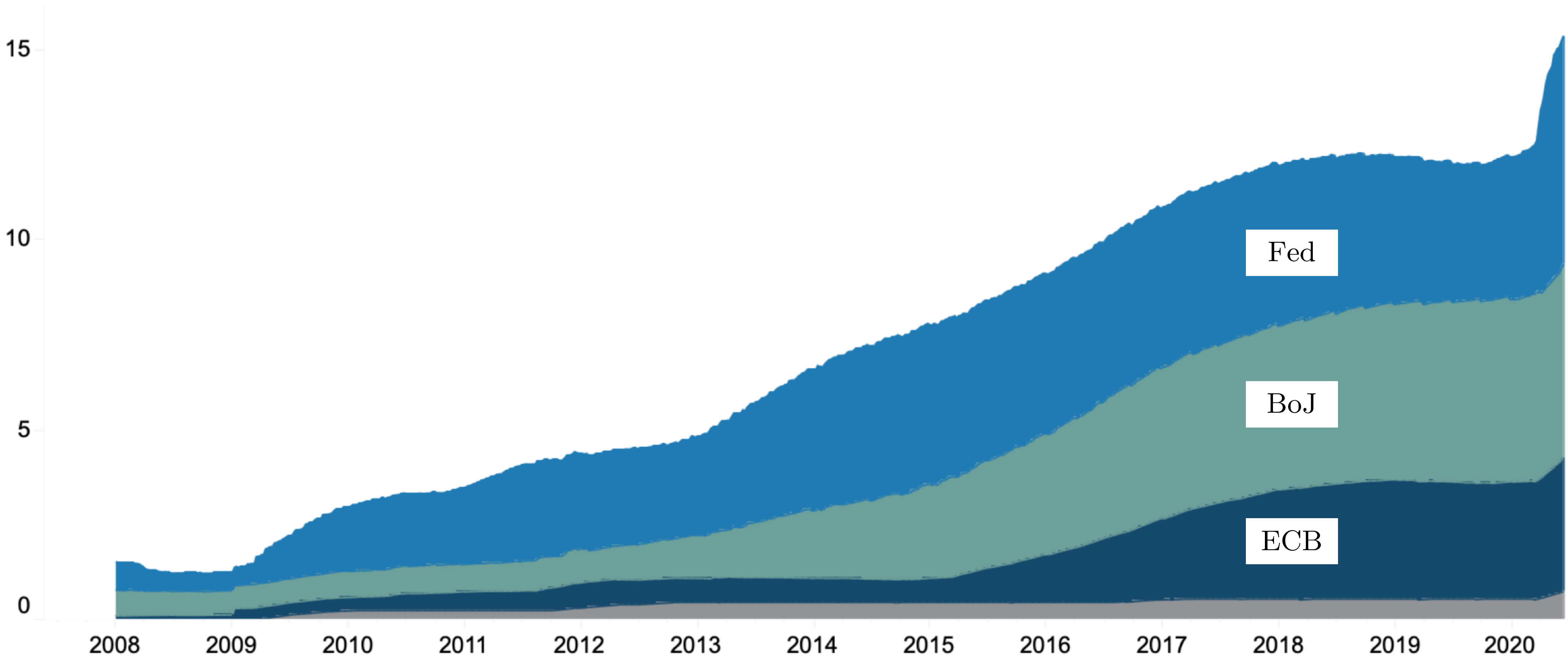
Read more:

Braun, B. 2018. "Central banking and the infrastructural power of finance: The case of ECB support for repo and securitization markets." Socio-Economic Review.

Braun, B, and M. Hübner. 2018. "Fiscal fault, financial fix? Capital Markets Union and the quest for macroeconomic stabilization in the euro area." Competition & Change 22 (2): 117–38.

2010s and 2020s: Large-scale asset purchases

Securities held by central banks, USD trillion



Source: omfif.org/policy-tracker

Outlook

‘Financial structures should be the outcome of market forces. ... [C]entral banks should, in principle, play no active role here.’ (Benoit Cœuré, 2018)

Central banks have *always* played a major role here.

Envisioning alternative macro-financial orders starts with grappling with this fact.

‘Although we work through financial markets, our goal is to help Main Street, not Wall Street.’ (Janet Yellen, 2014)

Catch 22 of infrastructural entanglement: More financialization increases the capacity of the central bank to act in the economy *but also* its readiness to defend financial interests in the political process.

Result: More financialization & central banks reach Main Street at ever higher distributional costs.

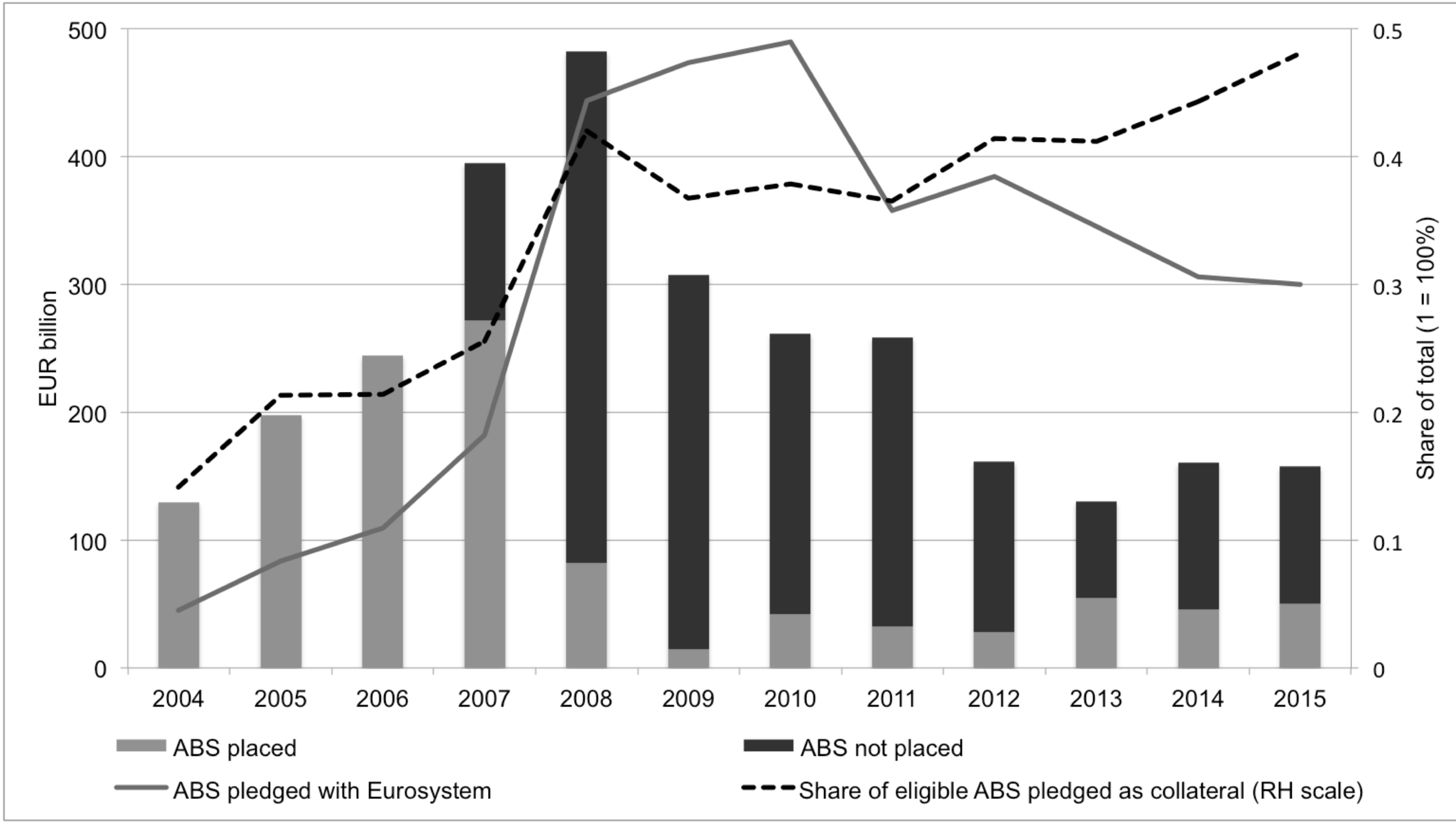
Finance & global warming: two alternatives

(1) State-led approach: Large-scale public investment + state-directed credit policies

(2) Market-led approach: Role of the state limited to price signals via carbon taxes, risk-weights for carbon exposures, etc. Deep and liquid financial markets are seen as part of the solution.

Without legislative changes to their mandates, central banks are likely – because of infrastructural entanglement – to work towards alternative (2).

Additional slides



500
400
300
200
100
0
EUR billion
0.5
0.4
0.3
0.2
0.1
0
Share of total (1 = 100%)
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
ABS placed
ABS not placed
ABS pledged with Eurosystem
Share of eligible ABS pledged as collateral (RH scale)