RETHINKING CENTRAL-BANK INDEPENDENCE

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"Can Trump Fire Jerome Powell? It's a political question," read a *Wall Street Journal* commentary on 10 December 2018. The author of the opinion piece drily reminded his audience that Powell, upon his appointment by U.S. president Donald Trump as the new chair of the Federal Reserve Board in February, had not been kidding when he started his remarks by saying that it was "a challenging time for central banking."[1] Yet the revelation ten months later that Trump, unhappy about Fed interest-rate hikes that he blamed for a stock-market nosedive, had been discussing the idea of sacking the top central banker still took much of the financial and political world by surprise.

Although many had gotten used to the U.S. president's habit of engaging in unorthodox bluster, Trump seemed to cross yet another red line by openly questioning one of the last "sacred principles" of modern economic policy making: the notion that central banks should operate free of political influence or pressure. Trump, however, is not the only politician to question central-bank independence, nor is he the most successful (Powell as of this writing in March 2019 still has his job). Indeed, the challenges are widespread, and have been growing for some time. There is surely room to worry about the future of central-bank independence—the alternatives could be a lot worse—but does that mean that central banks should be entirely left to their own devices without any political oversight?

Starting in the early 1990s, the world had seen a startling level of convergence on the principle of central-bank independence. Ideas and interests combined to make the notion that monetary policy should be shielded from partisan politics into a virtually uncontested norm. Although a few naysayers questioned the wisdom of this consensus, the boom years that followed seemed to confirm that, when it comes to setting monetary policy, technocrats will do a better job than politicians. During "normal" times, leaving monetary-policy decisions to central banks has ambiguous effects in the short term, but promises greater stability and flexibility in the longer term. The global financial crisis of 2008, however, made it plain that central bankers are not mere technocrats, but powerful political actors in their own right. As they have gone far beyond their institutional mandates, their actions and policies have had more overtly distributive effects, yielding clear winners and losers. This naturally raises two questions: Is the technocratic argument for "apolitical" central banks still valid today? How, moreover, can the idea of central-bank independence be reconciled with the need for political legitimacy and accountability in "extraordinary" times such as ours, when interest rates are close to zero and financial systems are widely seen as fragile?

There are many good reasons, both theoretical and practical, to expose existing central banks to greater levels of public scrutiny, particularly during hard times. Indeed, central bankers seem to be bending over backward to make themselves more accountable. Rather than savage them as some (not always good-faith) critics have done, we seek to push the debate in a more constructive direction. We believe there are moments when it is useful for central banks to be independent from political oversight in the conduct of monetary policy. We also realize that there are times when central bankers must execute policies that are more overtly political. In those moments, we think central bankers' decisions should be embedded in democratic political institutions and made subject to political oversight. The challenge is to imagine exactly how to switch from one regime to another, and under what conditions.[2]

Not So Boring Any More

Central bankers used to be bland. They were comfortable playing the role of faceless technocrats who operated quietly in the shadows. The central bankers claimed that, since their policy domain was highly technical and demanded expert knowledge of the nation's macro economy, they should be insulated from the day-to-day noise and scrutiny of political life. They carefully guarded their precious political independence, justified by popular acceptance of their narrow mandate to maintain stable prices.[3]

Those days now seem like ancient history. In the past few years, pretty much everywhere you look, politicians have been eager to pick public fights with their central bankers. The independent institutions that set monetary policy and are now often also in charge of regulating the financial system have become much more overtly politicized. The unelected agents running central banks have been turned into their elected principals' favorite targets of blame for much of what is going wrong with the economy. These attacks are often part of a wider effort by politicians to gloss over their own failings.

Presaging his criticisms of Jerome Powell, Trump during the 2016 presidential campaign repeatedly criticized Janet Yellen—appointed to chair the Federal Reserve by President Barack Obama in 2014—for "doing political things." Trump asserted that Yellen "should be ashamed of herself" for keeping interest rates too low for too long, adding that she was "obviously political and doing what Obama wants her to do."[4] In Britain after the 2016 Brexit vote, the influential Conservative Party backbencher Jacob Rees-Mogg singled out Bank of England (BoE) governor Mark Carney as an "enemy" of the referendum's "Leave" verdict who had been "consistently wrong" in his predictions. Rees-Mogg added that Carney's warnings about Brexit as a threat to financial stability were "beneath the dignity of the Bank of England."[5]

In Germany, two-term finance minister Wolfgang Schäuble blamed European Central Bank (ECB) president Mario Draghi for the electoral success of the Alternative for Germany (AfD), the German far-right party that opposes immigration and the euro currency. Schäuble charged that by keeping interest rates low with an expanding money supply (a policy known as "quantitative easing" or QE), the ECB had condemned German retirees to skimpy returns on their savings and put them in a mood to back radical parties such as the AfD: "I said to Mario Draghi . . . be very proud: you can attribute 50 per cent of the results of a party that seems to be new and successful in Germany to the design of this policy."[6] In India, top central banker Urjit Patel resigned in late 2018 after months of pressure from Prime Minister Narendra Modi's government, which wants a looser monetary policy in anticipation of the 2019 general elections.[7]

In smaller countries, too, central bankers have borne the anger of politicians and voters. The top central banker of Cyprus, Panicos Demetriades, was all but forced to step down after President Nicos Anastasiades questionably tarred him as incompetent. In Slovenia, a police raid authorized by national authorities targeted the central bank's headquarters and led to the investigation of its governor. When Bank of Italy chief Ignacio Visco came up for reappointment in 2017, then-premier Matteo Renzi of the center-left Democratic Party persistently denounced him (he was eventually reappointed by the president).[8]

What is behind this recent surge of political scrutiny and public controversy? First, central banks have become more important. The 2008 financial crisis and its aftermath have left central bankers with more discretion and more ability to make policy. They have changed how they use their policy instruments both to stabilize the financial system and to restore their influence over the wider economy. All this has implications for distributive outcomes. Second, the crisis led elected politicians to see the interaction of monetary policy and financial supervision in a different light. Central banks now have a much stronger hand in regulating private financial institutions, bringing these banks into more frequent conflict with private interests and their political patrons.

As the distributive effects of monetary policy and the higher profile of central banks in financial supervision have put central bankers in the political crosshairs, other shapers of macroeconomic policy and regulators of financial markets have found it easier to avoid blame for their own lack of effectiveness by using central bankers as convenient scapegoats.[9]

Given the shifting nature of accountability in democratic systems, we should think again about the relationship between central banks and political institutions. This is hardly the first time the question has arisen. There have been long periods when central bankers were thought of as private actors, and even periods when they were viewed as unnecessary.[10]

The institutional evolution of central banks during the nineteenth and twentieth centuries should make us very skeptical of any positive or normative argument that major public-policy instruments with distributive consequences should be located outside traditional accountability structures. While there may have been many good reasons for central-bank independence in the past, circumstances have changed, and it is only natural for accountability requirements to change along with them.

Second, we need to think again about how other interested parties might try to manipulate central banks for their own ends. Those who stand to benefit *directly* from the adoption of a particular monetary policy are an obvious source of threat. Yet perhaps even more important may be potential manipulators who stand to benefit *indirectly* by shifting their own responsibility for public-policy outcomes onto central banks.

Manipulation might take the form of bureaucratic capture, with manipulators trying to "lock in" institutional designs that have become dysfunctional. Manipulation could also involve attempts to end the whole paradigm of central-bank independence, throwing the proverbial independence baby out with the monetary bathwater. The growing strength of populist forces in advanced democracies suggests that this is a real risk.[11]

The Long Road to Political Independence

The modern consensus that central banks should operate independently of politics is not an obvious historical outcome. On the contrary, it is a retreat from much of the history of the nineteenth and early-twentieth centuries. For more than 150 years, central banks were becoming more overtly political in their design and function. Then, once they reached the height of their power and influence, central bankers changed direction and moved outside direct political control.

To appreciate this back-and-forth history of central banking, it is important to note that central banks are first and foremost *banks*. Around the end of the eighteenth century, central banks such as the Bank of England (founded in 1694), the First Bank of the United States (founded in 1791), and the Banque de France (created by Napoleon in 1800) were essentially business-to-business financial-services providers. They often had unique government charters, but typically they were under the control of their largest clients, the money-center banks. The role of the central banks was to provide liquidity—or "money"—in the form of broadly accepted negotiable instruments that could be used to purchase bank paper at a discounted value. Such instruments could be based on commodities, foreign currency, or sovereign debt. What mattered was that these instruments could be accepted as payment by the money-center banks or their clients. Central banks were simply the bankers for other banks.[12]

The liquidity that central banks provided originally came from the money-center banks themselves. Those banks deposited capital in the central bank so that there would be resources to draw on if they ever needed cash to pay back their own depositors or other creditors. They also used the central bank to safeguard funds held in reserve to deal with any sudden run on deposits. In turn, the discount that the central bank applied on its lending to other banks was a function of the quality of the assets that the money-center banks could pledge as collateral plus the central bank's own assessment of the creditworthiness of any bank seeking assistance. Like any other bank, a central bank made money by charging a higher effective rate of interest on the money it lent than it paid as interest on the deposits it safeguarded.

The money-center banks provided similar services to other credit-issuing institutions in the economy. The difference was that the money-center banks' client base was much larger and more diverse than the central bank's. Hence the money-center banks played a more central role in the system. They also absorbed more risk—both in terms of the quality of the assets they bought and the loans they made, and in terms of the volatility that could affect their ability to access credit (or deposits). The central banks acted as insurers of a sort, underwriting the liquidity of individual institutions in order to prevent the spread of panic across the financial system as a whole: The central banks were there to keep runs on banks and bank failures from (as we would say today) "going viral" and knocking the whole economy off track.

From this perspective, it is easy to see why some policy makers could consider central banks optional. Financial institutions can exist without underwriting so long as investors and creditors are prepared to take the associated risks. It is also not difficult to understand why policy makers might regard central banks with suspicion. The banks that act as direct shareholders in the central bank have a distinct competitive advantage over other financial institutions because they can access money more readily and more cheaply.

Policy makers also worried about the power that central bankers wielded. With the central bank's place at the heart of the financial system comes vast influence over the rates that other institutions can charge and must pay. More importantly, the central bank can "pick winners and losers," saving institutions that it deems worthy through timely intervention while condemning others by denying them access to its discount window.

The problem with not having a central bank, however, is that *some* institution must provide liquidity in times of financial distress. The Bank of England, for example, played a prominent role in stabilizing the British financial system during the panic of 1866. In the United States, there was no analogous institution. President Andrew Jackson had driven the Second Bank of the United States out of existence on populist grounds in the 1830s. Hence the panics of 1893–96 and 1907 caught U.S. financial institutions in a highly vulnerable position. Distortions in the credit markets triggered deposit flights that could not be absorbed, bringing down otherwise sound financial institutions. During the 1907 panic, the main New York City banks relied on clearing houses to provide emergency liquidity assistance. While this worked as a stopgap, it was not enough to stabilize the whole system. Panic spread to the wider economy, causing business failures and job losses.[13]

The alternative to ad hoc crisis-response measures was to create a central bank (or network of regional central banks) that could maintain a standing pool of highly liquid assets and could even, if necessary, issue its own paper backed by adequate collateral. Doing this, however, was an intensely political act. The money-center banks might play a role in governing this new institution by filling seats on the boards of directors of the various regional branches, but the central bank would be a public institution and its governors would be political appointees.[14]

Birth of the Fed

The creation of the Federal Reserve System in the United States took place in 1913, well before the Great Depression and the Keynesian revolution in economic policymaking. That latter era, the 1930s and 1940s, was an important period because it saw central banks move beyond a focus on financial-system stability in order to add the making of macroeconomic policy—especially regarding the money supply—to their brief. One of the things that John Maynard Keynes and others noted about central banking, both in the United Kingdom and elsewhere, is the close intertwining of the interest rates that banks charge one another with the rates they charge their nonbank clients. The interbank lending markets are also tied to the central bank's discount rate. This means that the banking activities of the central bank can have a considerable influence on the level of economic activity across the whole economy both directly, through the bank-lending channel, and indirectly, through the relative rates of return on bank loans and deposits.[15]

The use of central-banking instruments for macroeconomic purposes culminated in the widespread nationalization of central banks during and immediately after the Second World War. This tied central banking directly to government policy. Moreover, because this nationalization of central banks took place during an era of capital controls, the influence of monetary policy on macroeconomic performance was at its apex. Governments that promised their people full employment, stable prices, or international competitiveness relied heavily on central bankers to achieve such goals. Whatever the macroeconomic goal, monetary policy was a key tool for reaching it. Thus did political control over monetary policy find its way to a place at the heart of electoral politics.[16]

Over the longer term, however, the explicitly political use of monetary policy started to cause problems. Policy makers who relied on interest-rate changes to drive the economy were likely to run afoul of the balance of payments, resulting in a "stop-go" dynamic as central bankers alternated between setting their instruments to achieve internal and external balance. Even focusing more narrowly on the trade-off between inflation and unemployment created problems. Not only did it lead to alternations in power between left- and right-wing parties or coalitions, it also resulted in opportunistic attempts to game the electoral calendar. A well-timed boom could help incumbents at the polls, but would then require deflating once the votes had been counted. Soon enough, financial markets began to "price in" the political manipulation of monetary policy as they set expectations regarding future prices. Central banks were chipping away at their own perceived legitimacy and losing leverage over the "animal spirits" of the marketplace.[17]

The gradual integration of global capital markets and the subsequent spread of cross-border banking also ate away at central bankers' ability to wield macroeconomic influence. Capital-market integration tightened the links between the setting of policy instruments to achieve domestic objectives and the unintended consequences that such settings would have on the international balance of payments. This tightening complicated the conduct of monetary policy and increased the likelihood of conflicts between one country's monetary-policy officials and those of other countries. Cross-border banking created a whole new array of unintended consequences as the "financial system" began to mean something that went well beyond the national economy. This did not completely strip national governments of control over their respective economies, but it made their task significantly harder.[18]

The consensus on central-bank independence grew out of the growing recognition of the problems associated with political business cycles. It also drew support from the economics of interdependence. The consensus view became that, for the sake of macroeconomic goals, central banks should be insulated in their use of traditional banking instruments. This meant relieving central bankers as much as possible of responsibility for overseeing the financial system and deciding on the solvency or liquidity of specific banks. This responsibility cannot be eliminated entirely, of course: Central banks remain the banks for other banks. But the fencing-off from politics of central bankers as macroeconomic policy makers was seen as the ideal institutional design.[19]

The ECB, which is set up to do little but make macroeconomic policy, is a good illustration of this ideal type. The central banks of its member states retain their links to the local financial economies of their respective countries and engage in open-market operations, while the ECB deliberates about monetary policy. The ECB is unique in this sense among the world's central banks, while also being the most politically independent of them all. It has a mandate to maintain price stability that it alone is allowed to interpret. It was designed to choose whether to take part in setting exchange-rate policy or to oversee financial markets, and originally it declined to do either. Moreover, it is barred by treaty from accepting political instruction while another treaty requirement bans both EU institutions and member-state governments from trying to influence ECB policies. And since EU treaties can be amended only by unanimous accord of all member states, these protections are practically written in stone.[20]

The Impact of the Global Financial Crisis

The heyday of central-bank independence narrowly focused on making monetary policy ended in 2007. When the international financial system was threatened with collapse during the global financial crisis, central bankers had no choice but to shift their focus from macroeconomic policy to financial stability. For some, like the Bank of England, this meant retracing its long road to independence back in the opposite direction. For others, like the ECB, it meant creating a whole new competence in financial supervision and resolution.

The problems for the Bank of England emerged at the start of the global financial crisis. British banks, dependent on interbank markets for funding, were highly vulnerable to liquidity shortages. At the time, however, few policy makers or financial-market participants took seriously the possibility that interbank markets could suddenly dry up. Britain had developed some of the world's most up-to-date monetary-policy institutions and financial-regulatory authorities. The Bank of England was politically independent and focused on monetary policy. The quasijudicial U.K. Financial Services Authority (FSA) was a separate institution that regulated and supervised banks and other financial institutions. When interbank markets seized up in August 2007 and again in September 2008, this bifurcated structure turned out to be problematic. The Bank of England and the FSA had trouble coordinating and sharing information, and the process of communication from one institution to the other invited public scrutiny at a time when discretion and decisiveness were the keys to shoring up public confidence. As a result, the Bank of England had to resume responsibility for financial-market supervision and to rebalance its roles as both Britain's monetary-policy authority and its "bank for banks."[21]

The ECB followed a similar trajectory. At its founding in 1998, its Governing Council had the option of undertaking financial-market supervision, but chose to leave that to national authorities given the diversity of banking practices across Europe. This preference to "let locals handle things" ignored the transformation of national banking institutions into pan-European or even global conglomerates, with levels of complexity that often exceeded national regulators' expertise and balance sheets that dwarfed national resources for resolution and deposit insurance. Even those national central banks that were engaged in financial supervision could not act as effective lenders of last resort because the adoption of the euro meant that they could no longer print money. When the ECB finally moved to stop the crisis, it had to step up as lender of last resort and make itself the single supervisory mechanism for all financial institutions operating within the Eurozone.[22]

The Bank of England and the ECB had to contend with a twofold institutional challenge. On the one hand, they had to strike a balance between their responsibilities as macroeconomic policy makers and their newfound role as financial-market supervisors. On the other hand, they had to justify the obvious distributive consequences of their actions on both sides of that divide. The first challenge is harder to address than may at first seem to be the case. The Bank of England can easily set up a financial-policy committee to operate alongside its monetary-policy committee, just as the ECB can insist on the erection of a wall between its Governing Council and the Single Supervisory Mechanism (SSM). But the problem runs deeper than just decision making insofar as it touches on the actual instruments and settings that central banks use to connect to the rest of the financial system. As a result, not only do monetary-policy decisions have clear implications for banks, but financial-policy decisions also have implications for the growth of the money supply and hence for macroeconomic conditions.

This fundamental tension is most obvious in the context of the ECB. Its president, Mario Draghi, may have committed the ECB to do "whatever it takes" to safeguard the euro, but that commitment did not extend to bailing out the Cypriot or Greek banking systems. Yet everyone in the markets can see that the failure of these banking systems would drive both countries out of the euro, and that the exit of even one Eurozone member state could pose an existential threat to the single currency as a whole. Similarly, the ECB can look the other way as Italy resolves or restructures some of its own major banks, even though this might create incentives that would undermine the stability of the European financial system in the long term.

These are only the most obvious headline illustrations from the front pages of European newspapers. Digging deeper into the financial pages, it is easy to find examples of the intertwining of monetary policy and financial-market supervision as it relates to the ECB's large-scale asset-purchasing program, the structure of bank balance sheets, and the prospects for the completion of a European Banking Union. These illustrations explain why Europe's central bankers have come under closer public scrutiny. They also suggest that central banks have two different operating modes. One is better suited for "normal" situations in which central bankers can focus on steering the macroeconomy. The other is the "crisis" mode, when central bankers must concentrate on stabilizing an at-risk financial system (or systems), and lose leverage over the macroeconomy. These two modes have very different political implications.

The crucial links between the two modes are known collectively as the "monetary-transmission mechanism." This complex set of relationships links the instruments under the central bank's control in its role as "banker to banks" to the performance of the larger economy. When crisis ripples through a financial system and changes behavior within it, the monetary-transmission mechanism becomes broken and the central bank can no longer influence the larger economy. Instead, central banks must lower their sights and focus on stabilizing the financial system to restore normal financial relationships. Central bankers will also look for new ways to influence macroeconomic performance. When they do so, however, they should not be surprised if they quickly find themselves in political hot water.

Winners and Losers

The trouble for central bankers is that they cannot restore a monetary-transmission mechanism—or work around a broken one—without creating obvious winners and losers. Since creating winners and losers is an inherently political act, it is hard to justify central bankers' independence from politics. Of course, the central bankers can respond that they need to restore the monetary-transmission mechanism so that they can get back to a situation where their particular expertise reigns supreme. They can also respond that picking winners and losers is unavoidable if they are going to achieve their mandate to maintain price stability. The problem is that such claims do not square with the original logic of making central bankers independent, which rested on the idea that no one really knows who wins or loses in the short run and that central bankers offer a better long-term policy outcome. When the winners and losers are obvious in the short run, people are likely to recall Keynes's famous dictum that the long run is simply that time when "we are all dead."

This risk becomes sharpest when interest rates are extremely low. Although any interest-rate setting is going to have distributive consequences, these became far larger in the wake of the financial crisis. Governments, for example, gained tremendously from reduced debt-service costs as well as their treasuries' increased seigniorage profits (another name for the notorious "inflation tax" that savers and investors pay when sovereign governments start printing money to get out of a tight spot). In 2013, the McKinsey Global Institute calculated that from 2007 through 2012, the governments of the United Kingdom, the United States, and the Eurozone countries raked in a collective US$1.6 trillion even as households across their jurisdictions lost $630 billion in interest income.[23]

When we start looking at different demographic groups, moreover, we see radically varying effects. Older households with interest-bearing assets saw their returns fall, while younger households with big mortgages and other types of debt reaped huge benefits, creating a massive transfer of wealth from the old to the young. Nonfinancial corporations also tended to benefit from lower debt-service costs. The effects on banks varied greatly. While ultra-low interest rates ate into the profitability of European banks, U.S. banks saw a substantial increase in their net interest margins as the interest rates they paid to depositors fell more than the interest the banks received on outstanding loans and other assets.[24]

The distributive consequences of saving some banks while letting others fail is even easier to illustrate. Although central bankers like to describe such choices as a technical matter of liquidity and solvency, the general public sees the choice between bailing out and winding up banks as inherently political. Moreover, the situation is "lose-lose" for central bankers. When they bail out the banks, they are choosing Wall Street over Main Street; when they wind up the banks, they are wiping out small investors. The central-bank governors of Cyprus and Slovenia left office under death threats after facing that dilemma. Though the central-bank governor of Italy held onto his office, the governing Democratic Party lost heavily at the polls in March 2018.

With these considerations in mind, the theoretical argument that we present in the Figure concerns the relationship between the transparency of distributive outcomes (winners and losers) and the location of contestation over the actual conduct of monetary policy (inside or outside central banks).

Our basic theoretical claim is that where the distributive consequenc-

Figure—Transparency and Contestation in Monetary Policy

		Are the distributive outcomes of conducting monetary policy transparent?	
		Yes	**No**
Where does contestation over monetary policy take place?	**Inside** the central bank	Weakened political legitimacy	Political *independence* of central banks
	Outside the central bank	Political *accountability* of central banks	Weakened economic performance

es are either ambiguous or opaque (see the right-hand column in the Figure), any contestation over the conduct of monetary policy should take place within the central bank and in the interest of the economy as a whole. This logic follows the classical "time-inconsistency" argument for central-bank independence, in that it shares the presumption that any determination of the optimal monetary policy in the aggregate is better left to experts (upper-right quadrant). Under these circumstances, attempts by politicians to interfere in the conduct of monetary policy are likely to serve electoral or partisan interests and will ultimately hurt the economy as a whole.

By contrast, whenever monetary policy's distributive outcomes are immediately plain to see and create clear winners and losers (left-hand column), central bankers will find it hard to take shelter behind the claim to technocratic legitimacy and the presumption of political independence. Instead, central bankers will find themselves at the center of distributive politics and its contentions. In these circumstances, it will be well to move the contest over monetary policy to an arena that is *not* the central bank and that is more conventionally "political" and closer to citizens, such as an elected parliament or a cabinet chosen from its ranks (lower left-hand quadrant). Then, whether politicians choose to set monetary policy themselves or hand it over to the central bankers, voters can hold politicians accountable.

The other two possible combinations are less attractive. Giving politicians direct control over monetary policy instruments when the distributive consequences of their choices are either invisible or unknowable has already been rejected in the original argument for central-bank independence (lower-right quadrant). That combination has generally been bad for economic performance. Giving unelected technocrats free rein and discretionary powers to allocate winners and losers through the setting of monetary-policy instruments is likely to undermine democratic accountability (upper-left quadrant). Hence, that combination is questionable for reasons of political legitimacy.

Given that only two combinations are "stable" ("political independence" in the upper-right quadrant, and "political accountability" in the lower-left quadrant), the institutional challenge will be to come up with an arrangement that can alternate smoothly between them. In other words, it should allow for technocratic determination of monetary policy when the distributive consequences are ambiguous, yet provide for adequate political accountability when they are not.

Most democratic governments achieve this balance by writing the principles of central-bank independence into normal legislation while standing ready to take over the conduct of monetary policy in emergencies. Striking such a balance is more challenging in the context of the EU. Not only is it much harder to change the statute of the European System of Central Banks than it is to amend normal legislation, it is also less clear which other European institution could channel the contestation over unconventional monetary policy.

Reforming the Politics of Central Banking

How should elected politicians decide when central bankers should be left politically independent and when they should be held politically accountable? The theoretical point we made about distributive consequences is not going to work well as an answer, and neither is the test that asks how transparent or opaque those consequences are. Instead, politicians should focus on whether the monetary-transmission mechanism is working properly and also whether central bankers are worried about the success or failure of individual financial institutions or of the financial system as a whole.

When the monetary-transmission mechanism that connects central banks to the wider economy is working properly and when the main financial-stability risks are to individual banks, then the "normal times" consensus on central-bank independence should hold. There are many advantages to insulating central banks from political interference in the normal conduct of monetary policy. When the economy is doing well, moreover, central bankers can easily distinguish between the goals of monetary policy and the requirements of overseeing the banking system.

Once the monetary-transmission mechanism breaks down, however, and central bankers begin to focus more obviously on the stability of the financial system as a whole, then elected politicians should begin more actively to oversee what the bankers are doing. This more active role does not have to be preemptive. Central bankers should have the liberty to respond to an emerging crisis in a timely manner. But the requirements for timeliness do not preclude the possibility that elected policy makers could be required to validate the actions of central bankers after the fact, or that central bankers should be required to justify their actions before elected representatives who are empowered to overrule the central bankers. Executive war powers and decree powers often work on a similar basis: The president or premier does what seems necessary amid urgent circumstances, and then relies on the legislature's validation after the fact. There is no reason why central banking should be any different.

The crucial tests for when the monetary-transmission mechanism is impaired or when systemic financial concerns predominate are already well known among central bankers. Indeed, many if not most of those tests were created in central banks and are applied by central bankers themselves as part of their justification for the unconventional use of traditional policy instruments. Hence the real innovation would be to take that justification to the next level. When they respond to a crisis, central bankers are doing something unconventional; when we argue that in such a context they should be subject to unconventional political oversight, we are not violating the norm of central-bank independence. On the contrary, the creation of this dual accountability structure is a necessary step toward shoring up the democratic legitimacy that central-bank independence requires.

NOTES

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2. This argument is also made by the former deputy governor of the Bank of England, Paul Tucker, both in the context of central banks and more generally with respect to independent agencies in modern politics. See his *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State* (Princeton: Princeton University Press, 2018).

3. See Kathleen McNamara, "Rational Fictions: Central Bank Independence and the Logic of Social Delegation," *West European Politics* 25 (January 2002): 50; and José Fernández-Albertos, "The Politics of Central Bank Independence," *Annual Review of Political Science* 18 (May 2015): 217–37.

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6. Stefan Wagstyl and Claire Jones, "Germany Blames Mario Draghi for Rise of Rightwing AfD Party," *Financial Times,* 10 April 2016.

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8. Andreas Hadjipapas and Kerin Hope, "Cyprus Central Bank Governor Resigns," *Financial Times,* 10 March 2014; see also "Slovenia Central Bank Confirms Investigation of Governor Jazbec," *Deutsche Welle,* 7 July 2016, *www.dw.com/en/slovenia-central-bank-confirms-investigation-of-governor-jazbec/a-19387208*.

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