

Central Banking in Rawls's Property-Owning Democracy

Political Theory
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Abstract

The dramatic events of the crisis have reignited debates on the independence of central banks and the scope of their mandates. In this article, I contribute to the normative understanding of these developments by discussing John Rawls's position in debates of the 1950s and 1960s on the independence of the US Federal Reserve. Rawls's account of the central bank in his property-owning democracy, Democratic Central Banking (DCB), assigns authority over monetary policy directly to the government and prioritizes low unemployment over price stability. I contrast DCB with Central Bank Independence (CBI), which requires that the central bank is independent of the government and pursues low inflation. I evaluate DCB by asking whether justice as fairness requires democratic control of the central bank and argue that it does not. Instead, so I argue, the choice between DCB and CBI should be justified in terms of the difference principle. By reflecting on central banking in a property-owning democracy, I cast new light on the Rawlsian realistic utopia of a just capitalist society, while also investigating democratic objections to today's independent central banks.

Keywords

John Rawls, central bank independence, property-owning democracy, political equality

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Introduction

In the decades leading up to the Global Financial Crisis of 2007 and 2008, countries around the world endorsed the ideal of Central Bank Independence. This ideal is motivated by the belief that monetary policy should first and foremost aim for a low and stable level of inflation. But, for reasons that I will review in more detail below, governments are thought to do best in achieving this goal if they leave monetary policy to an independent central bank.¹ Spurred on by these ideas, governments in advanced capitalist economies started forfeiting on their formal and informal means of influencing monetary policy. Through diplomatic pressure and IMF conditionality, developing countries were often pressured into doing the same.²

The dramatic events of the crisis have reignited debates on the independence of central banks and the scope of their mandates. The crisis led central bankers to take up a much more prominent role in economic policy making. They acquired new duties in regulating banks and new goals in safeguarding financial stability. They also came to pursue their price stability mandate by means of entirely new tools.³ But the dramatic expansion of the central bank's roles did not give rise to new constitutional structures of democratic accountability.

Although many worry that central banks today are insufficiently democratic, debates on this topic take place in relative isolation from normative democratic theory. Philosophical work on central banking remains scarce and has focused mostly on substantive issues of justice, rather than democratic legitimacy.⁴ This article turns to one of the few philosophical texts that deals with the place of a central bank in a democratic state.⁵ While philosophers have noted that John Rawls features surprisingly often in public statements of central bankers, his comments on central banking have so far not been discussed.⁶ Reflecting debates on monetary policy and central bank independence raging in the 1950s and 1960s, Rawls's 1971 *A Theory of Justice* contains a sketch of the central bank in a property-owning democracy. Without explicitly rejecting CBI, Rawls suggests that final authority over monetary policy should remain in the hands of an elected government, which uses it to pursue low unemployment and to facilitate investment.⁷ This radical proposal, which I refer to as Democratic Central Banking (DCB), is the topic of this article. Interpreting and evaluating it allows me to investigate democratic objections to today's independent central banks while also casting new light on the Rawlsian realistic utopia of a just capitalist society.

I do three things. First, I interpret Rawls's account of the central bank. I do this by situating his views in the context of debates in the 1950s and 1960s on the independence of the Federal Reserve. I show that Rawlsian DCB

constitutes a striking departure from the status quo of the time, which is better described as an early instance of today's ideal of Central Bank Independence (CBI). Second, I evaluate the case for DCB by asking whether there is a democratic reason to favour it over CBI. To this end, I distinguish two interpretations of the principle of equal political participation, which lead to different conclusions. On an unrestricted interpretation, equal political participation requires that all political decisions are made by democratic institutions. From this perspective, which I attribute to Rawls, final authority over monetary policy should remain with elected governments rather than being delegated to the central bank. I put forward a range of objections to such a view and argue in favour of a restricted interpretation that permits central bank independence as a means for governments to realise economic justice. On this view, the decision on endorsing or rejecting CBI should itself be treated as a topic of democratic debate. In distinguishing these different visions of a property-owning democracy, I clarify Rawls's account of the relation between economic democracy and justice. Finally, building on my reflections on the central bank in a property-owning democracy, I draw out the consequences of the discussion for contemporary debates on the future of CBI. I argue that central banks need renewed democratic scrutiny of their role, in particular their current narrowly defined price stability mandates.

The rest of the article is structured as follows. In the first section, I outline Rawls's justice as fairness and explain how it provides a normative foundation for the ideal of a property-owning democracy. In the second section, I introduce DCB through a discussion of the debates on the Federal Reserve in the post-war United States. I then show how DCB departs from the status quo of the times. After outlining Rawls's views on central banking in a property-owning democracy, I turn to the question of whether justice as fairness supports such a rejection of the status quo. In the third section, I discuss whether the singular pursuit of price stability is indeed incompatible with the difference principle. I then introduce the unrestricted interpretation of the principle of equal political participation and show that it is incompatible with CBI. In the fourth section, I propose an alternative interpretation that is compatible with both DCB and CBI and assigns a crucial role to the difference principle. I conclude by spelling out the implications of this view for today's central banks.

My focus here will be on *A Theory of Justice* because this is where Rawls puts forward his views on central banking. My reading of Rawls is informed by his clarifications in *Justice as Fairness*, to which I will refer where appropriate.⁸ The discussion is limited to questions of domestic justice. *The Law of Peoples* refers to a "central bank," but what Rawls means is more like an idealized version of the IMF and the World Bank.⁹

Democracy and Political Economy

Rawls's ideas on central banking are formulated in the context of his account of a just capitalist society. My emphasis here will be on the democratic dimension of the political economy outlined in *A Theory of Justice*.

Rawls's theory of justice, justice as fairness, is a normative theory for the major social and political institutions of a society (its "basic structure"). The application of that theory to a society takes place in accordance with a four-stage sequence.¹⁰ The most famous stage is the first, known as the original position, in which the parties deliberate on the most fundamental questions of justice behind an encompassing veil of ignorance. They do not know their own conceptions of the good life, what sort of institutions their society will have, or their society's "natural circumstances and resources, its level of economic advance and political culture."¹¹ Their knowledge is limited to the circumstances of justice, which are basic social facts that motivate the very need for a theory of justice such as the scarcity of resources, limited altruism, and the need for social cooperation.¹² In later stages, more information becomes available to the parties so that they can settle increasingly fine-grained political questions. The stages, of course, are not actual historical periods in the development of a society. Rather, they offer different perspectives from which the question can be asked whether institutions meet standards that all citizens can reasonably be expected to endorse.

Justice as fairness holds that deliberation amongst the parties in the original position will lead them to agree on two principles. First, the liberty principle, according to which "each person is to have an equal right to the most extensive scheme of equal basic liberties compatible with a similar scheme of liberties for others."¹³ The basic liberties consist of civil liberties such as free speech and freedom of conscience as well as political liberties that guarantee the ability of citizens to take part in the political process. The second principle, which does not have a name, holds that:

Social and economic inequalities are to be arranged so that they are both (a) to the greatest expected benefit of the least advantaged and (b) attached to offices and positions open to all under conditions of fair equality of opportunity.¹⁴

These principles have a lexical ordering in the sense that the conditions to satisfy the first principle take priority over those of the second principle and clause (b) is to take priority over (a).¹⁵ In Part I of *A Theory of Justice*, Rawls argues for his claim that these principles would be agreed on under the idealized conditions of the original position.

In Part II, Rawls moves to the application of his theory to the design of institutions. In the second stage of the four-part sequence, called the “constitutional convention,” the parties set out to discover what institutions can fulfil the two principles. In the constitutional convention, the parties are still largely behind the veil of ignorance but they know enough about how individuals will operate within a given constitution to protect basic civil liberties and ensure that political institutions distribute power fairly.¹⁶ The parties do not know what particular political views they will have so as to ensure that institutions are sufficiently democratic. In this context, Rawls argues that the parties will agree on a principle of equal political participation, which holds that where there is sincere disagreement over what justice requires, decisions should be made by democratic institutions.

On Rawls’s account, the principle of equal political participation goes beyond a merely formal prohibition of laws that hinder certain groups of citizens from taking up positions of power. Such equal opportunity for political office is covered by part (b) of the second principle. Political liberties have a special status in that the constitution must be organized so that citizens have a roughly equal ability to take part in the political process.¹⁷ In accordance with this principle, majority voting is the default option for the distribution of political power: “If minority rule is allowed, there is no obvious criterion to select which one is to decide and equality is violated.”¹⁸

Rawls argues that the parties can allow for certain exceptions to this rule, but, in accordance with the priority of liberty, only to protect political liberty itself or one of the other basic liberties. For example, a constitution can be used to delay decision making and thereby compel a majority to make a more “considered and deliberate decision.”¹⁹ Judicial review is to have a role in protecting the civil liberties and in particular the rule of law. Even plural voting, where some votes count more than others, or forms of epistocracy are allowed where it can be shown to lead a better overall protection of rights. Rawls also briefly sketches how the device of deliberation behind a veil of ignorance can be used to test the permissibility of limitations to equal political participation. The only thing that is not permitted, as Rawls repeatedly makes clear, is to justify such exceptions with reference to economic and social benefits.²⁰

His emphasis on democratization allows Rawls to make far-reaching claims about the economic institutions that justice as fairness requires. For Rawls, economic institutions should be democratized over and beyond the freedoms offered in both existing forms of state socialism and welfare state capitalism. The term *democracy*, which takes a backseat to discussions of justice and liberty in the preceding chapters, appears prominently in his discussion of political economy. The socialist economy compatible with justice

as fairness is a form of democratic socialism. Rawls's version of capitalism is, following James Meade, a property-owning democracy.²¹ These issues of political economy can be settled in Part II of *A Theory of Justice* exactly because they are treated as a matter of protecting liberties and not in terms of economic distribution.

As will be important for interpreting his remarks on central banking, the priority of liberty leads Rawls to assign a prominent role to democratic institutions in regulating the economy of a property-owning democracy. But economic policy itself is only decided on in the third, legislative stage. Here, justice as fairness is applied by the legislators who act within the constitutional structures designed in the constitutional convention.²² Rawls argues that decision making in this stage will depend on "speculative political and economic doctrines and upon social theory generally," on which there will be "reasonable differences of opinion."²³ Thus, for Rawls, rather than making economic justice into a matter of constitutional rights, economic policy is left to elected governments who make policies in accordance with and with the aim of realizing the second principle; "maximizing the long-term expectations of the least advantaged under conditions of fair equality of opportunity, subject to the equal liberties being maintained."²⁴ In the fourth stage, judges and bureaucrats, as well as ordinary citizens, apply and interpret the laws.

In discussing the property-owning democracy, Rawls hopes to show that justice as fairness can be realized in an idealized capitalist democracy that is neither identical to, nor entirely unlike, the 1950s and 1960s United States. One of the features that distinguishes a property-owning democracy from welfare state capitalism is that property is not concentrated at the top of the wealth distribution. The aim of a property-owning democracy is to "disperse the ownership of wealth and capital, and thus to prevent a small part of society from controlling the economy and indirectly political life itself."²⁵ Small firms can be owned by individuals, but the ownership of large firms is distributed more widely over society.

The property-owning democracy is not only meant to do better in meeting the difference principle than welfare state capitalism. Rawls argues that the economic institutions of a property-owning democracy are also crucial for securing the political liberties. In a society of extensive economic inequalities, Rawls argues, poor citizens will over time lose real influence over political procedures. Therefore, property-owning democracy is compatible with justice as fairness, whereas welfare state capitalism is not. But even sympathetic readers question whether welfare state capitalism is indeed incompatible with political equality.²⁶ As Martin O'Neill argues, it is unclear how political equality would be threatened in a version of welfare state capitalism in which political institutions are sufficiently shielded from economic

interests.²⁷ The connection between individual ownership and political power is simply too contingent on further institutional conditions.

In the following, I will ask whether arguments premised on political equality have more bite when used to criticize the institutions of economic governance typical of welfare state capitalism. Rawls takes his principle of equal political participation to be incompatible with any concentration of power in the hands of a closed elite. State socialism centralizes power over the economy in the planning bureau, which leads Rawls to reject state socialism. But power over the economy can be concentrated in a capitalist economy, even if legal ownership is widely dispersed. The idea that a particular branch of government would be outside of democratic control yet still exercise considerable power is entirely foreign to the democratic ideals that inform Rawls's political economy. A striking example of such undemocratic power concentration in the US post-war era is the Federal Reserve, which already in the 1950s and 1960s set its monetary policy without accepting instruction from the Treasury. It is therefore not surprising to find some reflection on central banking in *A Theory of Justice*.

Democratic Central Banking

I will now outline Rawls's conception of the central bank in his property-owning democracy, which I refer to as Democratic Central Banking (DCB). To situate Rawls's remarks about central banking in their intellectual and historical context, it is important to first consider the Federal Reserve of his day.

The constitutional powers of the Fed were a topic of fierce debate in the decades preceding the publication of *A Theory of Justice*. Article one of the US Constitution gives Congress the power to "coin money, regulate the value thereof." *McCulloch vs Maryland* (1819) interprets this article as extending to the printing of bills. With the Federal Reserve Act of 1913, Congress delegated this power to the newly created Federal Reserve system. This independent agency was initially led by twelve regional Reserve Banks whose presidents were elected by the commercial banks who are members of the system. These presidents all made their monetary policy largely independent of each other, until 1932, when Congress created a special committee, the Federal Open Market Committee (FOMC), that was given the responsibility of maintaining convertibility of the dollar to gold and act as lenders of last resort to the banking system.²⁸ From then on, five of twelve Presidents of the regional Reserve Banks serve on the FOMC on a rotating basis. They are counterbalanced by the Board of Governors that consists of seven board members who are appointed by the President and confirmed by Congress.²⁹

After the war, the Truman administration sought to transfer control over the Fed to the Treasury with the aim of supporting investment and public borrowing. The Fed board and the banking sector resisted these efforts, in favour of using monetary policy for the pursuit of low inflation under the authority of the FOMC.³⁰ They were ultimately successful when the Federal Reserve regained its statutory independence through the 1951 Accord between the Federal Reserve and the Treasury. Truman subsequently appointed the negotiator on the side of the Treasury, William McChesney Martin, as Chair of the Board of Governors, but, against Truman's expectations, Martin turned out to be a conservative central banker. Today, Martin is best known for his claim that the Fed should take the punchbowl away just when the party gets started.³¹ He used his power within the FOMC to pursue a policy of tight money, stating in his 1951 acceptance speech that inflation posed "an even more serious threat to the vitality of our country than the more spectacular aggressions of enemies outside our borders" and committed himself to "support all reasonable measures to preserve the purchasing power of the dollar."³² Martin held his position as Fed Chairman until 1970, and under his leadership the Fed sought to keep inflation low, while acting independently of and at times in conflict with the aims of the Treasury.

The power of the Federal Reserve remained a topic of debate throughout the 1960s. A prominent role in these debates went to Congressman Wright Patman (D-Texas), who from 1963 served as chair of the House Committee on Banking and Currency. In 1964, he organized a congressional hearing on the occasion of the fiftieth anniversary of the Federal Reserve Act featuring prominent economists such as Milton Friedman, Abba Lerner, and Paul Samuelson, as well as Fed board members and other economic policy makers. The hearings provide a good insight into the debates on monetary policy going on at the time of writing *A Theory of Justice*. As Rawls kept up with the economic ideas of his time, it is almost certain that he was aware of these debates and that they are reflected in his views.³³

First, there is considerable debate on the relative merits of fiscal and monetary tools, reflecting deeper ideological divides over the effectiveness of markets and governments in allocating economic resources.³⁴ Second, there were questions concerning what monetary policy, if there was to be any, should aim for. Should it aim for economic growth, full employment, or price stability? To what extent were there, as emphasized by Lerner and Samuelson, trade-offs between these various aims?³⁵ Third, there was a debate over the implementation of monetary policy. Should it target short-term interest rates, long-term interest rates, or the quantity of money?³⁶ Finally, while all agreed that day-to-day operations should be left to experts, there was debate over

who should have the final authority over monetary policy. Opposing existing central bank independence, Samuelson testified

Whatever may have been true in a few countries for a few decades in the 19th century, there can never be a place in American life for a central bank that is like a Supreme Court, or 1831 House of Lords—truly independent, dedicated to the public weal but answerable for its decisions and conduct only to its own discretion.³⁷

Even if monetary policy was to be left to the Fed, should it be decided by the present FOMC or, as repeatedly proposed, should monetary policy be taken from the privately elected Presidents and left entirely to the Fed board members?³⁸ On this topic, Patman stated:

It disturbs me to think that the private banks, with an ax to grind, with a special interest in money, the volume of money and interest rates, should be represented on boards to determine these questions for the whole country.³⁹

An entirely different option, championed by Milton Friedman and other economists at the University of Chicago, was to make the Fed subject to an explicit rule for money growth because, in Friedman's words, "money is too important to be left to central bankers."⁴⁰ Friedman promoted this structure as being more democratic because it ends all central bank discretion.⁴¹

Many of the objections to central bank independence raised in the hearings of 1964 invoke ideals that also inform the Rawlsian vision of a property-owning democracy. The independent political position of the Fed in the 1950s and 1960s does not fit well with the ideal of political equality, let alone policy making by unelected bankers, and it could, therefore, be expected that Rawls addresses the topic head-on. Yet, his discussion of a property-owning democracy contains no explicit objections to the independence of the central bank. This omission of more critical comments concerning the status quo is not unique to the issue of central banking. In his later writings, Rawls has repeatedly expressed regret that his early writings do not make clear how the institutions of a property-owning democracy differ from those of welfare state capitalism.⁴² It is with this in mind that we should interpret Rawls's comments on monetary policy.

In his most explicit passage, Rawls points directly to the need for democratic control over interest rates and the volume of investment. Addressing the traditional tools of monetary policy, he writes:

In conformity with political decisions reached democratically, the government regulates the economic climate by adjusting certain elements under its control,

such as the overall amount of investment, the rate of interest, and the quantity of money, and so on.⁴³

In some sense, according to Rawls, decisions on monetary policy are to be left to democratic institutions. It is not immediately clear from this passage how the required democratic decisions relate to the role that it ascribes to the government in setting monetary policy. First, there is a question of whether the democratic control at issue is that of the legislature or that of the executive. As the independent Federal Reserve's powers derive from laws passed by Congress, it acts in conformity with decisions that have been reached democratically. But this cannot be what is meant because the passage ascribes a more direct role to the government in regulating the economic climate. The legislature is not in any meaningful sense in "control" of interest rates and quantities of money nor able to "adjust" them to "regulate" economic conditions. Rather than legislative authorization, the type of control at issue is one of executive action.

The second question is whether Rawls thinks of the executive as the administration or whether he could not (also) refer to an independent central bank. In the 1950s and 1960s, the presidential administration was not in any meaningful sense in control of monetary policy. Decisions on the rate of interest and, thereby, the quantity of money were left to the FOMC in conformity with a mandate decided on by Congress, but day-to-day operations are not under the control of elected officials. As I showed in the previous section, the idea of economic policy made by an unelected branch of government is foreign to the political system of a property-owning democracy. Majority rule serves as the default, and exceptions cannot be justified in terms of economic and social benefits.

Where Rawls talks about monetary policy set by a government, he will thus have had in mind elected government rather than an independent central bank. This is the first, and most striking, feature of DCB: Monetary policy in a property-owning democracy remains under the control of elected officials.

Rawls also touches on monetary questions in his discussion of the stabilization branch of government. Drawing on Richard Musgrave's 1959 *The Theory of Public Finance*, Rawls divides the roles of the government into four functionally differentiated components of government economic policy. The stabilization branch of government

strives to bring about reasonably full employment in the sense that those who want work can find it and the free choice of occupation and the deployment of finance are supported by strong effective demand.⁴⁴

This passage bears on DCB in two ways. First, it provides further support for the reading already proposed. In introducing the idea of a branch, Rawls

leaves open the possibility of further differentiating various bodies within the government that are responsible for achieving a given policy aim.⁴⁵ It is then telling that his description of the stabilization branch omits reference to any functional differentiation between the central bank and the treasury.

Second, more importantly, the discussion of stabilization also brings out a further distinctive feature of DCB. Instead of price stability, the primary aims of the stabilization branch are to reduce unemployment and stimulate investment. It is on this choice of aims that the difference principle can be thought to bear on central banking. Traditional justifications of a price stability mandate focus on its economic benefits.⁴⁶ By keeping inflation low, the central bank facilitates an efficient allocation of economic resources. But achieving these benefits comes at a cost. To maintain price stability, the central bank raises interest rates to stop economic growth early in the business cycle in anticipation of rising inflation. The central bank does this irrespective of whether the economy has already achieved full employment. Rather, the pursuit of price stability is achieved, at least in the short run, at the expense of some of the unemployed.⁴⁷

Since the unemployed have a good claim to being some of the least advantaged members of a capitalist society, the pursuit of price stability through involuntary unemployment raises a potential conflict with the difference principle. I will return to this issue in the following.

A Democratic Critique of Central Bank Independence

In criticizing the Federal Reserve of the 1950s and 1960s, Rawls takes aim at an early pioneer of the ideal of Central Bank Independence (CBI).⁴⁸ Today, most central banks around the world meet the two demands that inform this ideal. First, as an independent institution, the central bank does not receive direct instructions from the government in setting interest rates. Instead, the central bank has a more or less explicit mandate for achieving specific macroeconomic outcomes. This mandate is interpreted by the central bank's board or an independent committee. Second, an important aim of monetary policy is price stability, which is achieved when prices develop along a trajectory that involves a minimal level of inflation. The central bank should pursue these aims even if they conflict with other macroeconomic priorities set by the government. Accordingly, there are two aspects of the central bank in Rawls's property-owning democracy that conflict with CBI. First, under DCB the central bank uses monetary policy to pursue a full employment policy and support investment even at the expense of some inflation. Second,

final authority over monetary policy remains with the government. I will now explore whether these features can be defended against CBI from the perspective of justice as fairness.

Consider first the aims of monetary policy. To show that the stabilization branch of monetary policy should prioritize full employment over price stability, it must be the case that this is to the benefit of the least advantaged. Rawls's emphasis on employment was widely shared amongst Keynesian economists of the time and it is also an important part of Meade's version of a property-owning democracy.⁴⁹ With the rise of Milton Friedman's monetarism, however, these ideas became much more controversial.⁵⁰

According to Friedman, there is a "natural" rate of unemployment, which is the level of unemployment that is compatible with long-term price stability.⁵¹ Should a central bank attempt to bring unemployment below the natural rate, so Friedman argues, the benefits will only be transient. Full employment allows wages to rise, which in turn raises consumer prices. The higher price level will depress demand and bring unemployment back to its initial level. Now, by itself, transient improvements to unemployment are to be preferred over permanently high unemployment. But, according to Friedman, firms and workers will over time come to expect the inflationary effects of monetary policy. In response, they will simply raise prices to anticipate expected inflation, thereby, offsetting even the short-term benefits. Thus, "there is always a temporary trade-off between inflation and unemployment; there is no permanent trade-off. . . . A rising rate of inflation may reduce unemployment, a high rate will not."⁵² As a consequence, setting monetary policy to reduce unemployment below the natural rate will not even be to the long-term benefit of the unemployed.

Monetarism remains very influential in central banking practice today. Those who believe that there is a natural rate and, crucially, that the stabilization branch of government will have a good idea at what level it is to be found, need not see any conflict between the practice of inflation-targeting and the difference principle. The stabilization branch, so they could argue, should aim to keep unemployment at, but not allow it to rise above, the natural rate. Doing more will not benefit the unemployed in any non-transient way and merely serve to bring about higher levels of inflation.

Those who reject these ideas, as economists increasingly do (and as evidence suggests they should), or even those who doubt the ability of central bankers to establish the natural rate (which was Friedman's own position) will find it difficult to justify achieving price stability through involuntary unemployment.⁵³ It clearly goes against the difference principle to sacrifice the well-being of those who become unemployed merely to benefit the already well-off. Moreover, an inflation-targeting monetary policy creates

downward pressure on wages, which increases economic inequalities.⁵⁴ This conflicts with the avowed aim of a property-owning democracy, which is to reduce the tendency towards inequality already inherent in a capitalist economy. The crucial issues here, however, are all very contested and largely empirical in nature so I will not explore them further. But, as will be important going forward, they are exactly the type of topics that, according to Rawls, are to be decided by legislators rather than outside the political domain by constitutional rules.

The fact that there is likely to be severe disagreement over monetary policy serves to illustrate the crucial importance of the political procedures that govern monetary policy. This is a topic on which Rawls had a lot more to say and it brings us to the second feature of DCB, which is the demand that final authority over monetary policy should remain in the hands of elected officials. An obvious place to look for a moral justification of DCB is Rawls's principle of equal political participation, which holds that "all citizens are to have an equal right to take part in, and to determine the outcome of, the constitutional process that establishes the laws with which they are to comply".⁵⁵

Whether the principle of equal political participation is itself enough to justify DCB over CBI depends on how the principle is interpreted. On an unrestricted interpretation, the principle prohibits any constitutional constraints that unduly limit the powers of elected governments or the ability of citizens to influence and participate in the political process. The unrestricted interpretation of the principle of political equality does allow for some constraints on political liberty but, as a consequence of the lexical ordering of the two principles, limits cannot be justified with reference to economic or social benefits. Rather, the only permissible considerations are those that invoke either civil or other political liberties. Using the device of the original position, Rawls's test for the permissibility of a constraint on political liberty is whether the limitation could be accepted by those with the most constrained ability to participate.⁵⁶ To limit political liberty, it must be shown that

the less extensive freedom of participation is sufficiently outweighed by the greater security and extent of the other liberties. . . . At no point is there a reference to compensating economic and social benefits.⁵⁷

On an unrestricted reading, every constraint on the exercise of political power must have a role in securing other political and civil liberties. In the next section, I will contrast this interpretation with a restricted interpretation, where limits are permissible if they are themselves decided through the legislative

process. Here, I will first show that the unrestricted interpretation is incompatible with the independence of the central bank.

By delegating the authority over monetary policy to an independent committee, CBI limits the ability of citizens to participate in making economic policy in at least three ways. First, positions in central bank boards are generally open to a very narrow subset of the population.⁵⁸ This is not an essential feature of CBI, but it is a direct consequence of the fact that boards of independent central banks do not need to reflect the electorate that they represent. Instead, appointments to positions of political power result from a bureaucratic procedure internal to the government. Second, CBI limits the political liberties of voters because they have no say over appointments. Board members are neither directly elected nor readily replaceable by citizens. For these two reasons, central bank deliberation may reflect views of justice that are only held by bankers and bureaucrats rather than those of the wider society. CBI also constrains the power of institutions that are accountable to citizens. CBI bars the executive from using monetary policy tools to support its own policies. Under certain conditions, the central bank may even use its power to directly offset economic policies that it deems incompatible with its aims in lowering inflation.

Commonly used justifications of CBI focus on economic outcomes to limit democratic control over the money supply. Consider arguments that invoke the idea of a political business cycle. In the run-up to elections, so the argument goes, governments use monetary policy to increase the economic output irrespective of what would be the most optimal long-term use of the money supply. From the early 1980s onwards, economists invoke manipulation of the money supply to connect democratic control of the central bank to undesirable levels of inflation. Central bank independence, in contrast, is meant to protect monetary policy from political interference and thereby realize better economic outcomes. But the priority of liberty precludes invoking better economic outcomes to limit the political participation of citizens. Such limitations can only be justified if it can be shown that, as Rawls puts it, “the inequality of right would be accepted by the less favoured in return for the greater protection of other liberties that result from this restriction.”⁵⁹

Are there considerations in favour of central bank independence that invoke political liberty? One possible line of argument focuses on the powers that are at the disposal of governments under CBI. To some extent, fiscal and monetary policy can have similar macroeconomic effects. As governments retain control over fiscal policy, their ability to pursue a certain level of macroeconomic stabilization is not impeded. But even if this is partially true, the equivalence does not hold in its entire generality. As a consequence, governments and those who vote for them will unavoidably have less influence over economic policy when they cannot use monetary policy tools. Strict priority of the first principles

precludes any trade-off between political participation and economic benefits, even if such benefits are overwhelmingly on the economic side.

A second set of arguments links CBI to democratic values of accountability and transparency, but the institutional link they invoke is tenuous.⁶⁰ Independence, so it is argued, hinders governments from using the money supply for their own electoral interests. A government that controls the central bank can use monetary policy to its electoral advantage, with negative effects only materializing in the long run. For example, in 1971 President Nixon instructed the Fed to stimulate credit with an eye to his own re-election campaign of 1972.⁶¹ Even if abuse of the money supply can indeed undermine the accountability of governments to voters, it is not clear that the best way to prevent this is independence. First, if the problem of inflation-bias is understood to lie in *covert* use of monetary policy, independence is not required to prevent it. The real problem is a lack of transparency, which can also be addressed by adapting procedures. For example, the Norwegian government needs to inform parliament whenever it instructs the central bank.⁶² Moreover, independence may not even solve the problem as an independent central bank can still secretly pursue policies that support election campaigns. Second, when inflation-bias persists even under transparent policies, CBI does not serve to realize political liberty but rather limits it. Under DCB, voters can freely decide whether they support inflationary policies in the same way as they can judge other economic policy choices. Instead, independence is simply meant to exclude the electorate or elected politicians, who are deemed less competent in setting monetary policy than central bankers. That is clearly not a consideration of political equality.

Central bank independence also finds no obvious justification in the overall scheme of civil liberties that it secures. To defend CBI against an objection premised on an unrestricted reading of the principle of equal political participation, it would need to be shown that even though CBI sets limits to that liberty, this limitation is outweighed by more important civil liberties. But there is no clear connection between any of the civil liberties that Rawls distinguishes and central bank independence. Central bank independence limits the ability of the government to influence monetary policy and thereby limits the political liberties of citizens that elect it. This is incompatible with an unrestricted interpretation of the principle of political participation and the priority of liberty.

Political Equality and Central Banking

So far, I have emphasized the radical implications of the liberty principle for existing institutions of central bank independence. These implications

are premised on an unrestricted interpretation of the principle of political equality. I will now question this interpretation and argue for a very different view, which does not require that the final authority over monetary policy remain with elected officials. Rather, on the restricted interpretation, securing an equal ability to participate in the political process merely requires that the decision to delegate monetary policy is made by elected officials.

Part II of *A Theory of Justice* tests the plausibility of justice as fairness. Through a detailed exploration of the institutions of a property-owning democracy, it shows that the two principles of justice are “a reasonable approximation to, and extension of, our considered judgments.”⁶³ This cannot be done through the device of the original position alone but requires assumptions about human nature and the tendency of citizens to comply with social rules. Thus, depending on the type of society in which they are applied, the principles of justice will require different institutions.

In pursuing a project of ideal theory, Rawls asks whether his principles fit what he describes as a well-ordered society, which is a society where “everyone accepts and knows that the others accept the same principles of justice, and the basic social institutions satisfy and are known to satisfy these principles.”⁶⁴ This is important in the following because it means that the legislature of a well-ordered society is assumed to do its best in finding out what the principles of justice require of monetary policy.⁶⁵ To evaluate the principle of political participation, we must ask whether the institutions it prescribes are plausible approximations of our considered views on what justice requires in the specific context of a well-ordered society.

I have shown that there is a clear conflict between the unrestricted interpretation of the principle of political participation and CBI. Where principles and considered judgments turn out to conflict, this can lead to revising either the principles or the institutions we take to follow from them. In this way, Part II is meant to develop a reflective equilibrium of principles and institutions that live up to those principles. Accordingly, a conflict between justice as fairness and CBI should not automatically lead us to reject existing institutions. Further reflection can, of course, reveal that CBI is mistaken and that we should revise our ideas of what a central bank should be. But it is also possible that it leads us to revise how we understand justice as fairness. I will now argue that we should indeed reject the unrestricted interpretation of the principle of political participation.

The first thing to consider in evaluating the unrestricted interpretation are the arguments that count in its favour. Rawls believes that the principle of political participation follows from the set-up of the original position itself. Parties in the original position are assumed to have what he refers to as a

“sense of justice”; the ability to decide on fair terms of social cooperation. In the original position, the parties know that they will be placed in a society having a sense of justice, but they do not know what their personal view will be. Seeking to maintain the relations of mutual recognition that characterizes the original position, they will, according to Rawls, “transfer” the fundamental equality of competing conceptions of justice to actual political institutions.⁶⁶ Rawls provides a further justification of democratic rule by connecting it to the social bases of self-respect. Without self-respect, according to Rawls, “nothing may seem worth doing, or if some things have value for us, we lack the will to strive for them. All desire and activity becomes empty and vain, and we sink into apathy and cynicism.”⁶⁷ Even if we accept this general empirical claim, it provides no support for accepting the unrestricted interpretation of the principle of equal political participation. On this interpretation, the principle requires that there are no limits at all to political participation but it is difficult to see how that could be required to secure the social bases of self-respect. Consider the case of central bank independence: It seems very unlikely that the decision of governments to delegate monetary policy to an independent central bank deprives individuals of the ability to value their own life choices.

The second thing to consider in evaluating the restricted interpretation is whether it indeed constitutes the most plausible way of thinking about the democratic ideal itself. The four-stage sequence leaves controversial decisions on how to realise a fair distribution of socio-economic benefits to the legislative stage. It is here that an elected government applies the difference principle to social and economic topics where “judgment frequently depends upon speculative political and economic doctrines and upon social theory generally.”⁶⁸ The discussion of monetarism has served to illustrate that the priority of price stability is such a topic. Other questions concerning the design of a central bank also fit this category, including the decision over democratic control or independence, which suggests that these topics too should be left to the legislature.

The question of how to design a central bank is indeed controversial and its answer will depend in important measure on the weighing of contested empirical evidence. As I already discussed, some defenders of CBI draw on the political business cycles literature. But delegating monetary policy to unelected officials can also be thought of as a means of signalling a credible commitment to the price stability objective. Even if a government intends to pursue such a policy, it can find it difficult to convincingly signal its commitment. An independent central bank that is bound by a mandate for price stability can make a government’s commitment more credible and thereby create self-fulfilling expectations. This argument will continue to apply in a

well-ordered capitalist society since expectations would remain crucial to the future path of economic development. Defenders of CBI can also argue that a democratic government will fail to make effective use of monetary policy. Consider the views of former FOMC member Alan Blinder:

politicians in democratic—and even undemocratic—countries are not known for either patience or long time horizons. Neither is the mass media nor the public. And none of these constituencies have much understanding of the long lags in monetary policy. . . . Knowing this, many governments wisely try to depoliticize monetary policy by, e.g., putting it in the hands of unelected technocrats with long terms of office and insulation from the hurly-burly of politics.⁶⁹

Although Blinder defends CBI for reasons that are traditionally cited by opponents of democracy, the traits of human nature that he refers to cannot be assumed to disappear in a well-ordered property-owning democracy. Blinder questions the patience and time horizons of those who participate in political deliberation, as well as their expertise. It is of course possible that in a sufficiently idealized society, these vices will simply disappear. Such a degree of idealization, however, is not that of Rawls, who still holds on to the methodological requirement that we take as given, “persons’ moral and psychological natures and how that nature works within the framework of political and social institutions.”⁷⁰ The complexities of day-to-day policy making can be thought to induce a myopia that technocrats with a specialized mandate do not have. Knowing this, a legislature may believe that the best way to achieve its economic policy objectives is to delegate monetary policy to an independent central bank. Similarly, their own broad responsibilities might limit the expertise of elected officials concerning the transmission of monetary policy.

The different arguments in favour of CBI are, of course, not uncontroversial, but they do show that a good case can be made that independence benefits the least well-off. CBI, I take it, is a view that is “within the range of those that could reasonably be favoured by rational legislators conscientiously trying to follow the principles of justice,” and therefore a topic where “[w]e must rely on the actual course of discussion at the legislative stage to select a policy within the allowed bounds.”⁷¹ Although it is controversial what design of the central bank the difference principle requires, it is exactly for engaging in this kind of controversy that governments are elected in the first place.

Once it is recognized that the debate over central bank independence fits the domain of legislative decision making, it becomes clear that even those

who oppose independent central banks may have qualms with an objection premised on political equality. Indeed, objections to the current status quo tend to be motivated, at least in part, by considerations of economic justice.⁷² For such critics, it can make perfect sense for a democracy to make its central bank independent if it thereby realised fairer economic outcomes. Critics simply believe that independent central banks do less well, or at least not obviously better, in setting monetary policy. Similarly, supporters of property-owning democracy may fear that focusing on its democratic credentials simply undersells the product. Meade, for one, invokes considerations of justice rather than political equality in laying out his case for a property-owning democracy.⁷³

Conclusion: Central Banking Today

Taking these considerations into account, I conclude that the principle of equal political participation should not be taken to require that all political decisions should be made by elected officials. Rather, the independence of the central bank should itself be seen as a part of economic policy made in the legislative arena, where inclusive deliberation can draw on competing political and economic doctrines. What matters in evaluating CBI is that the distributive consequences of the central bank's mandate are properly justified and that delegation takes place in accordance with adequate democratic procedures.

What does that mean for central banking at the current historical juncture? From the perspective of the unrestricted interpretation, CBI was always already insufficiently democratic and recent developments merely exacerbate these issues. Parliaments cannot provide central banks with legitimacy merely by periodically reviewing their mandates. The restricted interpretation, in contrast, guides our attention towards the fact that the past decade saw dramatic changes to central bank practice but few legislative changes to central bank mandates.

The discussion so far suggests two distinct lines of critique of central banking today. First, it serves to bring out a crucial role for economic justice. For Rawls, central bank independence should be justified as part of a system of political economy that is to the greatest benefit of the least advantaged. Even from the perspective of a less demanding egalitarian standard, the monetarist ideas that continue to inform central bank mandates have not withstood the test of time well.⁷⁴ It is currently far from clear that central banks should indeed narrowly focus on price stability. If this is to remain the overriding priority of monetary policy, a justification is needed that is different from previous monetarist accounts.

Second, the discussion serves to put the onus on politicians to review mandates and justify the distributive consequences of central bank policies. This means, first of all, that it should be possible for the legislature to revoke independence or, at the very least, revise mandates. This is difficult to reconcile with the current status of the European Central Bank, for example, whose mandate is part of an intergovernmental treaty and not open to revision by national parliaments nor, in large part, open to revision by the EU legislature. The US Congress and other parliaments with more formal powers, however, have also largely refrained from revising central bank mandates. This is striking since central bankers have a range of new tools that were not in any way envisaged at the time that their mandates were drafted.

Both lines of critique converge in suggesting that rather than complaining that unelected officials do too much, we should worry whether elected officials do enough. Discussion of central banking is now largely confined to central bankers and cognoscenti in banking and policy circles. Given the myriad of changes to the practice of central banking in the past decade, more inclusive debates are long overdue.

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Notes

1. Influential contributions include William D. Nordhaus, “The Political Business Cycle,” *The Review of Economic Studies* 42, no. 2 (1975): 169–90; Finn Kydland and Edward Prescott: “Rules Rather than Discretion: The Inconsistency of Optimal Plans,” *Journal of Political Economy* 85, no. 3 (1977): 473–91; Robert Barro and David Gordon, “Rules, Discretion and Reputation in a Model of Monetary Policy,” *Journal of Monetary Economics* 12, no. 1 (1983): 101–21. There is also an empirical literature that seeks to document the benefits of central bank independence: Alberto Alesina and Lawrence H. Summers, “Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence,” *Journal of Money, Credit and Banking* 25, no. 2 (1993): 151–62; Alex Cukierman, *Central Bank Strategy, Credibility, and Independence: Theory and Evidence* (Cambridge, MA: MIT Press, 1992). For early critical discussions

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2. Ha-Joon Chang, *Kicking Away the Ladder* (London: Anthem Press, 2002); Ngaire Woods, *The Globalizers* (Ithaca, NY: Cornell University Press, 2006).
 3. John Singleton, *Central Banking in the Twentieth Century* (Cambridge: Cambridge University Press, 2010); Charles Goodhart, Daniela Gabor, Jakob Vestergaard, and Ismail Ertürk, eds., *Central Banking at a Crossroads: Europe and Beyond* (London: Anthem Press, 2014).
 4. François Claveau, Peter Dietsch, and Clément Fontan, “Central Banking and Inequalities: Taking off the Blinders,” *Politics, Philosophy & Economics* 15, no. 4 (2016): 319–57; Aaron James, *Fairness in Practice: A Social Contract for a Global Economy* (New York: Oxford University Press, 2012); Sanjay G. Reddy, “Developing Just Monetary Arrangements,” *Ethics & International Affairs* 17, no. 1 (2003): 81–93. But see Jacqueline Best, “Rethinking Central Bank Accountability in Uncertain Times,” *Ethics & International Affairs* 30, no. 2 (2016): 215–32; and Jens van 't Klooster, “Democracy and the Emergency Powers of the European Central Bank,” *Midwest Studies in Philosophy* 42 (2018): 270–93.
 5. For an account of the history of monetary thought with a particularly prominent although not entirely favourable role for David Hume, Karl Marx, and Adam Smith: Arie Arnon, *Monetary Theory and Policy from Hume and Smith to Wicksell: Money, Credit, and the Economy* (Cambridge: Cambridge University Press, 2010).
 6. Claveau et al. discuss explicit reference to the difference principle in a speech by Bank of England governor Mark Carney (“Central Banking and Inequalities”: 12f). Martin O’Neill point out that an argument along Rawlsian lines features in Bank of England chief economist Andrew Haldane’s defence of quantitative easing (unpublished manuscript). Benoît Cœuré of the ECB governing council refers to the idea of a veil of ignorance on several occasions.
 7. John Rawls, *A Theory of Justice* (Cambridge, MA: Belknap Press, 1971), 271, 276. In the following, I refer to the revised edition (Cambridge, MA: Belknap Press, 1999), abbreviated as ToJ. The crucial passages on central banking appear there at pages 241 and 244.
 8. John Rawls, *Justice as Fairness: A Restatement*, ed. Erin Kelly (Cambridge, MA: Harvard University Press, 2001).
 9. John Rawls, *The Law of Peoples* (Cambridge, MA: Harvard University Press, 2003), 42f.

10. Miriam Ronzoni, "The Four-Stage Sequence," in *The Cambridge Rawls Lexicon*, ed. Jon Mandle and David A. Reidy (Cambridge: Cambridge University Press, 2014), 290–92.
11. ToJ, 172f.
12. ToJ, 109f.
13. ToJ, 54.
14. ToJ, 72.
15. There is a longstanding contention that the priority of liberty assigns an implausibly high weight to basic as compared to socio-economic liberties. See Herbert L. A. Hart, "Rawls on Liberty and Its Priority," *University of Chicago Law Review* 40, no. 3 (1973); Philippe van Parijs, *Just Democracy: The Rawls-Machiavelli Programme* (Colchester: ECPR Press, 2011); Thomas Pogge, *Realizing Rawls* (Ithaca, NY: Cornell University Press, 1989). I do not question the priority of liberty but do argue for limiting the scope of topics that can be settled in terms of protecting the political liberties.
16. ToJ, 194–206.
17. ToJ, 197.
18. ToJ, 313.
19. ToJ, 201.
20. *Idem.* Also 174f.
21. On the idea of a property-owning democracy, see Martin O'Neill and Thad Williamson, eds., *Property-Owning Democracy: Rawls and Beyond* (London: John Wiley & Sons, 2012); the 2013 special issue of *Analyse und Kritik* and Alan Thomas, *Republic of Equals: Predistribution and Property-Owning Democracy* (New York, NY: Oxford University Press, 2016).
22. For the role of justice as fairness in the political deliberation of a democratic society, see Joshua Cohen, "For a Democratic Society," in Samuel Freedman, *The Cambridge Companion to Rawls* (Cambridge: Cambridge University Press, 2001), 86–138.
23. ToJ, 174.
24. ToJ, 175.
25. ToJ, xiv.
26. Martin O'Neill, "Free (and Fair) Markets without Capitalism: Political Values, Principles of Justice, and Property-Owning Democracy," in O'Neill and Williamson, *Property-Owning Democracy*, 75–100; David Schweickart, "Property-Owning Democracy or Economic Democracy?," in O'Neill and Williamson, *Property-Owning Democracy*, 201–22; Kevin Vallier, "A Moral and Economic Critique of the New Property-Owning Democrats: On Behalf of a Rawlsian Welfare State," *Philosophical Studies* 172, no. 2 (2014): 283–304.
27. O'Neill "Free (and Fair) Markets," 81f.
28. William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country* (New York: Simon & Schuster, 1989); Peter Conti-Brown, *The Power and Independence of the Federal Reserve* (Princeton, NJ: Princeton University Press, 2016).

29. Federal Reserve Act, article 10(1). Dodd-Franks limits voting in appointments of the Presidents to non-banker board members. See Conti-Brown, *The Power and Independence of the Federal Reserve*, 301.
30. Robert L. Hetzel and Ralph Leach, "The Treasury-Fed Accord: A New Narrative Account," *FRB Richmond Economic Quarterly* 87, no. 1 (2001): 33–56.
31. Conti-Brown, *The Power and Independence of the Federal Reserve*.
32. Hetzel and Leach, "Treasury-Fed Accord," 52.
33. Daniel Little discusses Rawls engagement with economic science: "Rawls and Economics," in *A Companion to Rawls*, ed. John Mandle and David Reidy (West Sussex, UK: Wiley & Sons, 2014).
34. US Congress, *The Federal Reserve System after Fifty Years: Hearings before the Subcommittee on Domestic Finance of the Committee on Banking and Currency, House of Representatives, Eighty-Eighth Congress, Second Session, on H.R. 3783, 1964, 1030*.
35. *Ibid.*, 1098. See also 1020, 1034, 1400.
36. *Ibid.*, 997.
37. *Ibid.*, 1105.
38. *Ibid.*, 1023, 1106, 1321.
39. *Ibid.*, 1184.
40. Milton Friedman, "Should There Be an Independent Monetary Authority," in *In Search of a Monetary Constitution*, ed. Leland Yeager (1962; repr., Berlin: De Gruyter, 2014), 219–43.
41. *Ibid.*
42. ToJ, xiv; Rawls *Justice as Fairness*, 139.
43. ToJ, 241.
44. ToJ, 244.
45. ToJ, 243.
46. E.g., Ben Bernanke et al., *Inflation Targeting: Lessons from the International Experience* (Princeton, NJ: Princeton University Press, 2001).
47. See Mark R. Reiff, *On Unemployment: A Micro-theory of Economic Justice*, 2 vols. (New York: Palgrave Macmillan US, 2015).
48. See note 1.
49. James Meade, *Efficiency, Equality, and the Ownership of Property* (London: Allen and Unwin, 1964), 12f.
50. James Forder, *Macroeconomics and the Phillips Curve Myth* (Oxford: Oxford University Press, 2014).
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52. *Ibid.*, 11.
53. James K. Galbraith, "Time to Ditch the NAIRU," *Journal of Economic Perspectives* 11, no. 1 (1997): 93–108; Olivier Blanchard, "Should We Reject the Natural Rate Hypothesis?," *Journal of Economic Perspectives* 32, no. 1 (2018): 97–120.
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- “Innocent Bystanders? Monetary Policy and Inequality in the US,” *Journal of Monetary Economics* 88 (2017): 70–89.
55. ToJ, 194.
 56. ToJ, 203.
 57. ToJ, 201.
 58. Christopher Adolph, *Bankers, Bureaucrats, and Central Bank Politics: The Myth of Neutrality*, Cambridge Studies in Comparative Politics (New York: Cambridge University Press, 2013), 70f.
 59. ToJ, 203.
 60. For a recent example, see Gary J. Miller and Andrew B. Whitford, *Above Politics: Bureaucratic Discretion and Credible Commitment* (New York, NY: Cambridge University Press, 2016).
 61. Greider, *Secrets of the Temple*, 342f.
 62. Jon Elster *Ulysses Unbound* (Cambridge: Cambridge University Press), 153.
 63. ToJ, 171.
 64. ToJ, 397.
 65. ToJ, 200.
 66. ToJ, 194f. Harry Brighouse and Steven Wall consider whether there are independently plausible arguments in favour of the principle of equal political liberty, with Brighouse supporting the principle and Wall rejecting it: Harry Brighouse, “Political Equality in Justice as Fairness,” *Philosophical Studies: An International Journal for Philosophy in the Analytic Tradition* 86, no. 2 (1997): 155–84; Steven Wall, “Rawls and the Status of Political Liberty,” *Pacific Philosophical Quarterly* 87, no. 2 (2006): 245–70. Meena Krishnamurthy extends Rawls’s argument by focusing on the social bases of self-respect in “Completing Rawls’s Arguments for Equal Political Liberty and Its Fair Value: The Argument from Self-Respect,” *Canadian Journal of Philosophy* 43, no. 2 (2013): 179–205.
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 68. ToJ, 174.
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 70. John Rawls *The Law of Peoples*, 7.
 71. ToJ, 318.
 72. E.g., McNamara, “Rational Fictions.” L. Randall Wray, “Central Bank Independence: Myth and Misunderstanding” (Working Paper no 791, Levy Economics Institute of Bard College, Annandale-on-Hudson, NY, 2014).
 73. Meade, *Efficiency*, 11–26.
 74. See notes 55 and 56.

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