The Institutional Paradoxes of Monetary Orthodoxy: Reflections on the Political Economy of Central Bank Independence

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Philip Arestis and Malcolm C. Sawyer (eds), *The Political Economy of Central Banking*, Cheltenham: Edward Elgar, 1998 [hereafter AS].

Torben Iversen, Jonas Pontusson and David Soskice (eds), *Unions, Employers, and Central Banks: Macroeconomic Co-ordination and Institutional Change in Social Market Economies*, Cambridge: Cambridge University Press, 2000 [hereafter IPS].

Thomas Mayer, *Monetary Policy and the Great Inflation in the United States*, Cheltenham: Edward Elgar, 1999.

I. Introduction

There can be no doubting the increasing importance of central banks to processes of international economic management.[1] Whilst the names of prominent central bankers may be less well known than those of politicians, and whilst the functions their banks perform receive scant public recognition, the decisions taken by central bankers have a significant bearing on the conduct of everyday life.

Academic studies of central banking typically divide into one of two traditions. For some, central bankers have shown that, once trusted to operate policy autonomously, they can consistently deliver low and stable inflation at no obvious cost in terms of output and employment.[2] The analysis of central bank independence (hereafter CBI) is thus reduced to a discussion of the technical efficiency of the policy-making process. Given the presumed efficiency of CBI, it is usual for authors in this tradition to express a normative preference for CBI over alternative institutional arrangements for the conduct of monetary policy.

For others, however, this is to over-emphasise the economic dimension of CBI. A rather different line of argument is also evident within the literature. Whilst casting doubt on the empirical fact that CBI leads necessarily to superior policy performance, authors in this latter tradition suggest that this is not, in any case, the main issue.[3] Instead, they focus on CBI as a political strategy, whereby certain societal demands for price stability are provided with an institutional guarantor. Such demands are clearly political in nature; yet, through CBI, they are insulated from political contestation. Since such insulation undermines the ability to challenge the economic basis of the prevailing social structure, it is perhaps unsurprising that authors who insist on a more political reading of CBI are less likely to argue the case for increased central bank independence than those who adopt a more economic reading.

The aim of this article is to review the contribution of the books listed above to our understanding of the process of CBI. Each raises a number of significant implications for the study of central banking that take the reader to the heart of the disputes which divide the literature. My review is based around three core themes. Firstly, I analyse the genealogy of ideas about CBI, paying particular attention to the significance of the disciplinary origins of those ideas. Secondly, I suggest likely sources of institutional dysfunctionality arising from increased CBI. Thirdly, I argue that the real motivation for CBI, given these institutional pathologies-in-waiting, are primarily domestic and political rather than global and economic. I conclude that the current trend towards CBI may lead to important sources of policy failure in the future.

II. Understanding CBI: Preferences, Institutions and Ideas

CBI and Orthodox Economic Analysis

The core of the intellectual case for CBI revolves around the assumption of a persistent inflationary bias built into politicians' monetary policy preferences. It is argued that this bias can only be negated by vesting authority in policy-makers who can be trusted to choose a policy rule that is non-accommodating of inflationary tendencies; namely central bankers.[4] Central bankers are assumed to be better placed than politicians to enforce such a rule, since there is no clear symmetry of interest between the central bank and the labour market in the way that there is between the government and the labour market. Whilst legitimacy is conferred upon governments by voters in popular elections, central bankers only need satisfy a much smaller group of actors concentrated within financial markets in order to enhance their reputations. As such, central bankers are assumed to be less constrained by social pressures for accommodating inflation. This ensures that they can commit more 'credibly' than governments to operating monetary policy in line with a low inflation equilibrium and, as a result, produce superior inflation performance. So the argument goes.

There are two broad political economy challenges to this standard economic conclusion: one empirical, the other conceptual. The first empirically focused challenge suggests that CBI leads to superior inflation performance *only* when it is accompanied by labour market institutions that facilitate solidaristic wage bargaining. This work attempts to increase the explanatory power of the orthodox model of monetary policy-making by adding further institutional variables to those that relate solely to the legal status of the central bank. In contrast, the second and more theoretical challenge suggests that the orthodox economics account of CBI mis-specifies the whole nature of monetary relations within contemporary capitalism. This work attempts to recast the very basis of orthodox explanations of monetary policy-making.

CBI and Wage Bargaining Institutions: Iversen, Pontusson and Soskice

Of the books under review, the collection edited by Iversen et al constitutes the most notable empirical challenge to the assumption of a simple correlation between CBI and superior inflation performance. The volume seeks to emphasise "institutional interaction across different political-economic arenas" (Iversen and Pontusson [IPS], p. 2), suggesting that "linear models [of inflation performance] fail because they are not sufficiently attentive to the consequences of [such] interaction" (p. 19; see also Soskice [IPS], p. 40). Particular attention is paid to the way in which differences in the wage bargaining process can lead to different inflation outcomes, even in the presence of identical central bank inflation preferences. The logic is that wage bargainers are assumed to be able to socialise the costs of inflationary pay demands in the context of encompassing labour market institutions (Franzese and Hall [IPS]; Iversen [IPS]). Such institutions are shown to act as a further restraint on inflation over and above that which can be attributed to the formal independence of the central bank. Given such a logic, it may even be the case that central banks can be *too* independent to ensure efficient economic outcomes in such circumstances. The implementation of a strict non-accommodating policy rule by the central bank may disrupt the solidaristic wage bargaining that has been a key component of the counter-inflationary culture associated with encompassing labour market institutions.

Empirical evidence from Northern Europe suggests that a non-discretionary monetary policy exacerbates the conflict between different distributive interests within the wage bargaining structure. This has led to a reduction in solidaristic wage behaviour, as individualistic concerns increasingly dominate the wage bargain. The ensuing collapse of wage solidarism can lead to greater inflationary pressures being exacted through the pay structure – a perverse outcome of the central bank attempting to enforce a strict non-accommodating monetary rule (Iversen and Pontusson [IPS], pp. 18-21).

There is much to commend in the technical detail of the contributions to Iversen et al, and there is also much to admire in the way in which the individual authors render problematic many of the core conclusions of the orthodox economics literature on central bank independence. However, it is still questionable whether the volume represents a *fundamental* critique of the orthodoxy. For, the applied institutional analysis contained therein accepts key features of the conceptual framework in which the orthodoxy is grounded.[5]

Specifically, the idea that there is both an inflationary bias originating within the political process and an institutional fix for such a bias is a recurring theme throughout the volume. It challenges orthodox conclusions of the *nature* of the institutional fix, but not the underlying assumption of its *existence*. Consequently, inflationary outcomes continue to be thought of as the product of institutionally ‘inefficient’ policies; the only real dispute is over the source of the inefficiency.

In this respect, monetary policy decisions remain overwhelmingly technical decisions, as politics is reduced to the struggle for the authority to impose efficient institutions for monetary policy-making. Whilst the Iversen et al volume contains many notable accounts of developments in both domestic party systems and the international economy that may constrain successful institutional reform, the conception of politics as the search for efficient institutions is one to which most orthodox economists would subscribe.

CBI and the Politics of Ideas: Arestis and Sawyer

There is, however, another body of economic work that questions, indeed rejects, the notion that monetary policy exists in a purely technical realm. Drawing on his experience as both academic and central banker, Alan Blinder suggests that the key to understanding CBI is to uncover the political dynamics that remain hidden within formal macroeconomic models of monetary policy-making. For Blinder, the politics of macroeconomics is not so much the struggle for the authority to impose efficient institutions, as it is the struggle to legitimise self-appointed authority on the basis of technical expertise.

Orthodox macroeconomists seek to sustain their authoritative voice in advocating CBI on the basis of claims that this will maximise the social welfare function. Yet, as Blinder argues, the social welfare function bears no objective form beyond its dominant social construction.[6] It appears in orthodox models of CBI in precise mathematical terms, and the precision of the mathematical structure creates the impression that the function can be solved and an optimal policy then designed. However, the ‘solution’ that is offered exists only at the level of formal mathematical logic; the social welfare function has no explicit economic meaning that can be ascertained empirically before being used as the basis for policy.[7] Thus, the most important question to ask about the process of central banking is who defines the social welfare function that acts as the guide for central bank interventions in the economy?

Yet, this question cannot be asked within an orthodox intellectual framework that denies the constitutive role of politics in the economy. Within orthodox macroeconomic analysis the social welfare function is said to approximate the policy preferences of the 'representative' individual within society.[8] However, those models conceptualise the representative individual as one who adopts the same cognitive approach to the question of monetary policy-making as that of orthodox macroeconomists. By little more than a definitional trick, orthodox macroeconomists are thus able to elevate themselves to the position of legitimate intellectual guardians of society's concerns for the key settings of economic management. The intellectual case for CBI is therefore less clear than its current political appeal would seem to suggest.

The major contribution of the Arestis and Sawyer volume is to deepen the conceptual challenge to these orthodox economic arguments. The orthodox case rests on the assumption that monetary policy-making institutions become efficient the more that they are deemed to be 'credible'. Credibility is conferred upon institutions by the public, who are thus granted some sort of veto over the success of policy. If the public does not believe that policy-makers will abide by their commitments to price stability, it will not adjust its behaviour in line with announcements of counter-inflationary policy, and such policy will fail.

Yet, as Ilene Grabel argues ([AS], p. 90), a number of conditions must be met for standard credibility theory to be an accurate reflection of actual practice. Firstly, all market agents must derive the same knowledge about the economy for the public to act collectively in this way. Secondly, this knowledge must be correct. Thirdly, it must fit with a standard neoclassical account of the nature of the inflation/unemployment trade-off. Fourthly, this account must also be correct. If any of these conditions fail to be met, the standard intellectual case for orthodox monetary policy cannot be sustained. Yet, given opinion poll data that show consistent public confusion about the very *nature* of inflation,[9] it is difficult to understand why we should expect any of these conditions to hold. If the representative individual does not even know what inflation is, it is unlikely that the public will be equipped with perfect knowledge of the government's inflation preferences.

Moreover, as Keith Bain points out, a further assumption is required if it is to be argued that only an *independent* central bank can enforce a credible counter-inflationary policy. Governments are assumed to be less able to implement a non-accommodating policy rule because electoral considerations mean that it will always be willing to trade-off more inflation for less unemployment. Yet, there is no long-run inflation/unemployment trade-off in the neoclassical model, only a natural rate of unemployment at which prices are stable.[10] Given the conditions listed above, the assumption of perfect knowledge guarantees that all market agents know this to be the case. As such, it is necessary to add the further assumption that individuals form their expectations differently as voters than as market agents; in effect, that the act of voting initiates a temporary collective delusion on the part of all market agents. In the absence of such an assumption, it would be impossible to explain why individuals would vote for a government that would attempt to trade-off more inflation for less unemployment in a manner that they, as market agents, know to be impossible (Bain [AS], pp. 90-1). However, without this assumption, the orthodox case for CBI begins to fall apart.

Indeed, that case is completely dissolved when we recall that it is grounded in the assertion that governments have political incentives to be lax in the control of the money supply, whereas central bankers can ensure monetary discipline because they do not.[11] For, this is fundamentally to misunderstand the nature of the money supply within contemporary capitalism. A central bank can never have complete control over the money supply, irrespective of the extent of its independence, because complete control is not its to have. An important element of money growth is endogenous to the financial system. As Sheila Dow and Carlos Rodríguez-Fuentes argue ([AS], p. 1), "an endogenous money supply…means that monetary policy, using whatever instrument, does not determine the money stock but is only one of its multiple determinants". As such, the introduction of inflationary pressures into the economy originates not only with the decisions of central bankers, but also with those of financial managers within the private sector.

Moreover, despite the shared economic ideology of these two sets of actors, financial managers will disrupt the central bank's inflation strategy by generating new sources of endogenous money growth so long as they believe it to be in their interests to do so. Banks add to the money supply whenever additional demand for money makes such action profitable (Aybar and Harris [AS], p. 25). Thus, there is no simple one-to-one link between central bank policy and money supply growth and, as such, there can be no simple one-to-one link between central bank policy and inflation performance. Yet, the whole rationale for CBI is based on the assumption of such a link. Given such flawed economic reasoning the likely long-term implications of such inappropriate institutional changes are likely to be neither optimal nor efficient.

III. *CBI, Path-Dependence, and 'the Poverty of Theory'*

The Problem with a 'General' Theory …

Social scientists have become increasingly interested in the path-dependent nature of political processes, particularly in circumstances in which those processes are bounded by institutional ‘norms’.[12] Under conditions of path-dependence, patterns of behaviour consistent with the institutional norm become the subject of routine reproduction, often to the point of becoming locked in. The timing of institutional reform therefore has significant long-run consequences, because it is usual to base reform on attempts to embed the dominant norm of the day. Whilst the prevailing norm may only be temporary, once institutionally embedded it is likely to continue to influence behaviour. In this section, I argue that the recent trend towards CBI may prove to have path-dependent effects – many of which will have perverse economic consequences. CBI can only be more than a temporary palliative to inflation if it is an institutional reflection of a general theory of inflation which is universally applicable across all points of time and space, rather than a reaction to contingent political events. It is my contention that the latter characterisation is the more appropriate.

Economists may well claim that contemporary credibility theory provides a general theory of inflation that allows them to identify the ideal institutional framework for controlling inflationary tendencies. Yet, claims for the existence of a general theory of inflation are far from new, having appeared at frequent intervals within the economics literature. However, each time a general theory has been identified, it has been a *different* ‘general’ theory, which means that none of them have been actual, time-invariant, general theories at all. Given this, it may be necessary to question the very notion of a general theory of inflation. For, if the price level is subjected to a range of different inflationary pressures, the notion of a translocal institutional fix becomes highly problematic.

A Genealogy of Inflated Ideas?

The twentieth century was unusually inflation-prone compared with those that preceded it. However, this was not a simple linear expansion in the price level.

Inflationary pressures may have persisted, but the *nature* of those pressures changed over time. These are developments on which the existing literature on CBI says little. Much of that literature is concerned only with quantitative rather than qualitative indices of inflation. It focuses upon changes in the *value* of inflation, whilst neglecting changes in its *type*. Yet, if we compare different decades in the post-war period, we find that economists' ideas concerning what inflation was and what it was caused by changed over time. Somewhat predictably in such circumstances, assumptions about the necessary institutional reform to quell inflationary pressures also changed.

Heuristic distinctions can be drawn to highlight perceived changes in the experience of inflation in the post-war period. In the 1960s, inflationary pressures were assumed to result from balance of payments disparities as different economies embedded rather different Fordist production structures within the wider context of the Bretton Woods fixed exchange rate regime. The proposed institutional solution was to reconfigure international monetary relations in line with more flexible exchange rates and enable different productivity rates to be absorbed in changing currency prices, rather than in the price of consumer goods.[13]

In the 1970s, inflationary pressures were assumed to result from one-off supply shocks that exacerbated increasing technological obsolescence at the end of the Fordist era, coupled with overly optimistic assumptions about the nature of the inflation-unemployment trade-off. The proposed institutional solution was to create additional policy-making capacities able to sustain prolonged periods of crisis management whilst the shift to a new technological-economic paradigm was negotiated.[14]

In the 1980s, inflationary pressures were assumed to result from supply rigidities within the labour market that led to cost increases above the rate of productivity growth and, as a consequence, wage-push inflation. The proposed institutional solution was to engage in labour market reform to restrict the access of trade unions to the wage negotiating process and, hence, to provide a disciplinary anchor for wage increases.[15]

In the 1990s, inflationary pressures were assumed to result from financial market actors failing to confer a reputation for counter-inflationary credibility onto domestic monetary policy-makers. The proposed institutional solution was to provide a policy-making context that tied the hands of governments by creating an external enforcement mechanism for counter-inflationary policy.[16]

As such, it was only in the 1990s that assumptions about the prevailing *type* of inflation led to arguments for CBI. Moreover, not all countries experienced the conditions that are conventionally assumed to necessitate central bank independence to the same degree during that decade. Inflation shocks take on markedly different characteristics in different economies (Chadha and Janssen [AS], p. 164), depending on the organisation of those economies. In fact, even in circumstances in which two economies display identical numerical inflation *rates*, there is no guarantee that they will be sharing the same inflationary *experience*.

Such a conclusion is almost entirely lost within the orthodox economics literature. Much of the existing empirical work on inflation differences tends to focus simply on the legal status of the central bank. Yet, as Marta Campillo and Jeffrey Miron argue, once the model of inflation performance is extended to include other variables relating to the organisation of the economy as a whole, "institutional arrangements [relating to CBI] play almost no role in determining inflation outcomes". The implications of this finding are clear. As Campillo and Miron themselves conclude, their results "suggest that quick fixes [in terms of increasing CBI] do not make a big difference unless the underlying conditions for low inflation are present".[17]

Mayer and the Poverty of (Trans)historicism

At most, then, credibility theories of monetary policy-making can explain the inflationary experiences of the 1990s, but only in some instances and then only partially. Increases in the independence of the central bank therefore represent a widespread institutional response that is only consistent with particular inflationary experiences which themselves are strictly limited in both time and space. However, assuming the existence of path-dependent institutional norms, the effects of moving to a monetary policy regime dominated by CBI are likely to be felt long after the conditions which were thought to necessitate that independence have faded. Existing institutional arrangements tend to lock in certain patterns of behaviour, by filtering out alternative policy proposals that go against the institutional norm. So long as prevailing institutional arrangements are reproduced, it may be expected that future policy responses to inflationary pressures will resemble current policy responses, even in circumstances in which the current institutional norm is only appropriate to inflationary pressures that are no longer present.

Of course, we have no means of predicting the way in which future price trends will play themselves out, nor the form that future inflationary tendencies will take. However, should factors other than reputation for counter-inflationary credibility dominate the emergence of inflationary tendencies in the future, current institutional provisions for CBI may become increasingly dysfunctional. Institutional reforms cast solely in the image of credibility theories will therefore be likely to inject new sources of contradiction into the process of economic management within contemporary capitalism.

Indeed, institutionalised policy-making cast in the image of any ‘general’ theory of inflation is likely to prove contradictory whenever the contextually-specific determinants of inflation change. This, at any rate, would appear to be the main conclusion of Thomas Mayer’s account of the inflationary experience of the 1970s in the United States. Mayer asks whether the experience of the 'Great Inflation' can be understood in terms of the evolution of perfectly efficient monetary policy-making institutions. He concludes (p. 49) that it cannot. Rather, he focuses on the extent to which popular assumptions that extant institutional arrangements were *already* efficient led to clearly sub-optimal policy outcomes.

Mayer's primary contribution to our understanding of the process of central banking is to highlight the degree to which central bankers are guided by the ideas of economists. He shows that Federal Reserve governors hardly ever challenged either staff forecasts or the reasoning on which they were based (pp. 18-19); that the ideas of economists thus became deeply embedded as an institutionalised 'common-sense' (p. 92); and that policy was consequently slow to adjust to the emergence of qualitatively new inflationary pressures (pp. 119-24).[18] The economists who were advising the Federal Reserve believed both that they had intimate knowledge of the nature of the inflationary process and that institutional capabilities were already in place to tackle inflationary pressures at source.

Of course, the ideas on which orthodox economists base their general theories of inflation today are very different to those of their predecessors in the 1970s. However, the technical details are not the most significant aspect of the debate. It is more important to note that, of all the social sciences, intellectual consensus is most prevalent within economics.[19] At frequent intervals, the economics profession has converged on a single explanatory model of the economy, and has been slow to adapt that model when the material conditions that underpinned its applicability have changed. In circumstances in which institutional capacities have been cast in the image of the dominant model, changing economic conditions have tended to be met by policy-making inertia. This was certainly true in the 1970s, when an embedded belief in the existence of a Phillips curve trade-off between inflation and unemployment led to a deterioration in economic performance following a change in the nature of inflationary pressures. It is a sobering thought that it may come true again, with attendant sources of potential policy failure, following recent experiments with central bank independence.

Given all this, if orthodox arguments for CBI, even those which incorporate other variables such as 'politics' and 'wage bargaining institutions', replicate the same questionable reasoning, why then would governments buy into such a logic? No definitive answer to this question can be given. Yet, a reasonable case can be made for two related political, as opposed to economic, problems that CBI solves for politicians: externalising distributional problems and providing an automatic pilot for potentially unpopular policies.

IV. Political Logics for CBI?

Domestic Distribution and CBI

Whilst much has been written about CBI and the need for 'market sensitive' policies within contemporary capitalism, little effort has been made to analyse the implications of increased 'market sensitivity' for the distribution of power within society. It is clear that financial markets have a significant impact on the way in which society is organised, since the allocation of credit is the sine qua non of distributional politics. Consequently, when the decision to cede operational autonomy to central bankers is justified in terms of the need for market sensitive policies, it is equally clear that a particular way of organising society is being simultaneously constructed and defended against possible redefinition. The social basis of financial trading has changed markedly in recent years, and has changed in a way which is selective of a social structure of accumulation grounded in the monetary orthodoxy that CBI is designed to deliver.

The most significant recent development in the internal operation of financial markets has been the increasing exposure of an ever greater number of people to dominant patterns of market trading. For some, such exposure has been consciously accepted through attempts to diversify savings away from simple interest earning bank accounts. For others, increased exposure has been less conscious, being an unintended consequence of having a mortgage and a private pension plan.

The social basis of market sensitivity has therefore spread ever more widely throughout society. In consequence, more people now have a direct material interest in the future health of the financial system. Thus, the fact that more people are now exposed to dominant patterns of trading within financial markets corresponds to the likelihood that more will seek the implementation of the type of policies that independent central banks routinely introduce to bolster and support those patterns.

Of course, the social basis of demands for orthodox monetary policies is by no means spread evenly throughout society. Those with savings benefit from an accumulation strategy built upon monetary orthodoxy whilst those lacking such resources tend to be socially excluded. As such, when central banks display continuing dependence on market sensitivity to inform their policy decisions, they thus become responsible for reinforcing prevailing patterns of social inclusion and exclusion.

Indeed, this may be the very reason that many governments have ceded increased formal policy-making independence to their central banks. By delegating policy-making powers to central bankers, governments have displaced responsibility for reproducing prevailing patterns of social inclusion and exclusion. Formal CBI provides not only an institutional guarantor of monetary orthodoxy, but also a *political guarantor* allowing governments to avoid responsibility for the social consequences of the asymmetric distributions arising from monetary orthodoxy.

CBI: Automatic Pilot for Policy

Understood this way, the reasons for increasing the level of CBI would appear to originate within domestic politics rather than the globalised economy. Thus, we must treat with care the common assertion by politicians that CBI represents the means through which domestic monetary policy is de-politicised *as a necessary response to the structural imperatives of globalisation*. Indeed, the very ideas of de-politicisation and global imperatives need careful examination.

As is clear from the preceding discussion, monetary relations determine the way in which wealth is both held within, and distributed throughout, society. As such, monetary relations can never be fully de-politicised. Whilst central banks may have autonomy from the executive branch of government, central bankers do not act in isolation; they are part of a close-knit community that also includes academic economists, commercial bankers and other money managers. These individuals tend to share common understandings of the 'needs' of the economy at a particular moment in time. In Blinder's words, "central bankers are often tempted to 'follow the markets'; that is, to deliver the interest rate path that the markets have embedded in asset prices".[20]

Specifically, market actors discount future central bank policy on the assumption that shared constructions of economic 'imperatives' render future policy predictable; when central bankers subsequently deliver that policy, market expectations are fulfilled and prior patterns of market activity act as legitimation for current central bank policy. Formal independence from partisan politics and general public opinion is therefore in no sense mirrored by informal independence from the opinions of those that operate within financial markets. As such, CBI represents no mere response to existing economic constraints. It is also an attempt to impose new constraints by reconstituting the social basis of the domestic economy.[21]

V. Conclusions

My conclusions fall into three categories: economic; institutional; and political. Firstly, the act of delegating policy-making responsibility to the central bank is justified by the assumptions that central bankers are less likely than governments to accommodate inflationary pressures, and that they are therefore more likely to control the growth of the money supply in line with a stable non-inflationary equilibrium.

However, I have argued that this is fundamentally to misunderstand the process of credit creation within contemporary capitalism. Money supply growth is determined as much by the actions of the private sector acting in its own interests as by the central bank acting in the public interest. In such circumstances, no amount of CBI can ever be sufficient to render truly credible central bank announcements on the control of the money supply, because the money supply is not solely its to control. So long as actors operating within the private sector retain the ability to create credit as a means of making profits, the money supply will continue to be political in a wider sense of the word. The trend towards CBI is therefore not only built upon flawed economic theory, but a theory which is grounded in a flawed understanding of the very nature of the economy.

Secondly, I have argued that the questionable economic reasoning on which the trend towards CBI is based leads to potentially inappropriate institutional design. Monetary policy-making institutions have often reflected economists' assurances that they have developed a 'general' theory of inflation. However, the subsequent emergence of qualitatively new inflationary pressures has undermined such claims. Doubts remain whether CBI is the optimal institutional response to current inflationary pressures; but, even if this proves to be the case, it is highly improbable that it will also provide the basis for the optimal response to future inflationary pressures. Particular experiences of inflation continue to be dominated by contextually-specific factors. Whilst this remains so, the trend towards CBI has bequeathed a potentially inertial institutional apparatus appropriate to a merely contingent inflationary moment.

Thirdly, I have argued that the debate about CBI must be understood in political as well as economic terms. Although the trend towards CBI may create institutional capacities unsuited to future tasks of economic management, this may not be the most important point. The decision to cede operational responsibility for the conduct of monetary policy should be seen as a statement of social intent. It is a signal by the government that it will defend both a social structure of accumulation based on monetary orthodoxy and also the particular interests incorporated into that structure. CBI therefore creates an institutional guarantor for the continued reproduction of the current balance of social forces both domestically and internationally. The most notable outcome of the trend towards central bank independence is the reduction of the number of potential sites of resistance to the overall orientation of government economic policy.

[1] Whilst exonerating them for responsibility for the contents of this article, I would like to thank Mark Blyth for his wonderfully constructive editing and Colin Hay for his insightful comments on a previous draft.

[2] See Alberto Alesina and Lawrence Summers, 'Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence', *Journal of Money, Credit, and Banking* 25 (1993): 151-62.

[3] Adam Posen, 'Why Central Bank Independence Does Not Cause Low Inflation: There Is No Institutional Fix for Politics', in Richard O'Brien (ed.) *Finance and the International Economy, 7* (Oxford: Oxford University Press, 1993).

[4] Fynn Kydland and Edward Prescott, 'Rules Rather than Discretion: The Inconsistency of Optimal Plans', *Journal of Political Economy* 82 (1977): 273-86.

[5] Of course, different authors within the volume display such a tendency to different degrees and in different ways.

[6] Alan Blinder, *Central Banking in Theory and Practice,* paperback edition (Cambridge, MA: MIT Press, 1999), chapter 2, pp. 25-51.

[7] See John Blatt, 'How Economists Misuse Mathematics', in Alfred Eichner (ed.), *Why Economics is Not Yet a Science* (Macmillan: London, 1983), p. 171.

[8] Torsten Persson and Guido Tabellini, *Macroeconomic Policy, Credibility and Politics* (London: Harwood Academic Publishers, 1990).

[9] Ben Bernanke, Thomas Laubach, Frederic Mishkin and Adam Posen, *Inflation Targeting: Lessons from the International Experience* (Princeton, NJ: Princeton University Press, 1999), p. 17.

[10] Milton Friedman, 'The Role of Monetary Policy', *American Economic Review* 58 (1968): 1-17; Edmund Phelps, 'Money Wage Dynamics and Labor Market Equilibrium', *Journal of Political Economy* 76 (1968): 678-711.

[11] Vittorio Grilli, Donato Masciandaro, and Guido Tabellini, 'Political and Monetary Institutions and Public Financial Policies in the Industrial Economies', *Economic Policy* 13 (1991): 342-92.

[12] On which, see Paul Pierson, 'Increasing Returns, Path Dependence and the Study of Politics', *Jean Monnet Chair Papers* 44 (Florence: Robert Schuman Centre at the European University Institute, 1997).

[13] For authoritative reviews of the relevant theoretical literature, see Benjamin Cohen, *Organizing the World's Money: The Political Economy of International Monetary Relations* (London: Macmillan, 1977); Michel Aglietta, *A Theory of Capitalist Regulation* (London: New Left Books, 1979).

[14] Whilst these were the prevalent assumptions about inflation during the 1970s, much of the authoritative academic analysis outlining the theoretical basis of such assumptions appeared in retrospective studies published some time later. See, for instance, Jacob Dreyer, Gottfried Haberler and Thomas Willett, *The International Monetary System: A Time of Turbulence* (Washington, DC: American Enterprise Institute for Public Policy Research, 1982); Michael Bruno and Jeffrey Sachs, *Economics of Worldwide Stagflation* (Oxford: Blackwell, 1985).

[15] For a recent review of this literature, see Finn Ostrup, *Money and the Natural Rate of Unemployment* (Cambridge: Cambridge University Press, 2000).

[16] Much of what is now recognised as the seminal academic literature on this issue was written in the 1980s. See, for instance, David Backus and John Driffill, 'Inflation and Reputation', *American Economic Review* 75 (1985): 530-8; Patrick Minford, 'A Political Model of Credibility', CEPR Working Paper 225 (1988). However, it was only in the 1990s that this became the standard explanation of inflation. See Torsten Persson and Guido Tabellini, *Monetary and Fiscal Policy – Volume 1: Credibility* (Cambridge, MA: MIT Press, 1994).

[17] Marta Campillo and Jeffrey Miron, 'Why Does Inflation Differ Across Countries?', in Christina Romer and David Romer (eds), *Reducing Inflation* (Chicago: University of Chicago Press, 1997), p. 336, p. 356.

[18] For a similar account, see John Taylor, 'Comment', in Christina Romer and David Romer (eds), *Reducing Inflation* (Chicago: University of Chicago Press, 1997).

[19] William Tabb, *Reconstructing Political Economy: The Great Divide in Economic Thought* (London: Routledge, 1999).

[20] Blinder, *Central Banking in Theory and Practice*, p. 60.

[21] This is a claim with which I suspect all the contributors to the volumes reviewed here would wish to subscribe.