

Outline of Federal Central Bank Project

1. Introduction.

This study will investigate the following main topics:

- a) the double dynamic of federal-confederal political systems, and central banking and federal (reserve) banking
- b) the changing determination of CB charters according to political conjunctures
- c) the rise of monetary macroeconomics and its inherent centralizing features
- d) Global Financial Crisis and the effectiveness of Fed Reserve and ECB
- e) questions of legitimacy raised by large increase in functions of CBs, the inequitable legacy of the global financial crisis, and the lack of accountability of central banks to citizens.
- f) a Bretton Woods solution to Eurozone.

2. History Lessons

Covering the period from the establishment of the Federal Reserve System in 1913 and the later establishment of the European System of Central Banks and the European Central Bank in 1997, this study examines and discusses the evolution of the role of central banking in the USA and in the Eurozone, noting the operation of these institutions in the federal/confederal political contexts in which they operate.

3. How federal should a central bank be, can be?

Anti-centralization forces in the US (Biddle v. Jackson & Wilson v. Carter Glass).
Regionalism built into Federal Reserve 1913-1933.
New Deal: centralization offset by fiscal regionalism. Treasury dominance.
Pre-history of ECB as a progressive institutional force solving supra-nation state level. Pinder criteria of democratic institutions at federal level.
Actual contingent history in Kohl – Mitterrand agreement.
Regional representation and weak regional response.

4. Changes in functions and justifications of central banks.

1935-1970s: Pre monetarist policies.

Banker to the state (taxation flows and bond issuer) with close relationship to Treasury, sound money. Controlling role over banking system and markets via payment systems, bank reserves and open market operations. LOLR if required. Capital controls. Fixed exchange rate (\$ to gold) as part of Bretton Woods/IMF international currency system.

Pre-justification. Technical functions. Macro economic policy lay with government and Treasury; central bank carried out government policy broadly interpreted, though Fed had autonomy on interest rates (Plaza agreement 1951).

Post 1980s

Neoliberal ideology: much reduced role of fiscal policy, breaking of link of Treasury to central bank and the promotion of "independent" central banks, de-regulation, CB accommodation and unchecked bank assets. Payment systems operated through wholesale money markets with CBs playing short-term role in overnight/repo facilities. Monetarist measures replaced by forward guidance.

Post-Justification: Equilibrium theory of Wicksell and New Keynesians that market prices would regulate the whole economy, including government debt, but banking and finance not included in the model. Institutional powers replaced with rational expectation theory of agents.

Forgotten competences of CBs return after GFC: LOLR, massive intervention into bond markets, prudential regulation.

5. Effectiveness of ECB compared to Fed Reserve

This in the light of 4). Relative effectiveness, overall effectiveness - given the different credit channels Europe and US and salience of property markets. Fundamental difficulty facing CBs of pushing back a wall of debt - speculative property in US especially and Euro-denominated debt in EU countries. No market clearing of debts, few haircuts much bailouts.

Liquidity functions of CBs. Emergency to permanent types of QE. QE to GDP ratios. Regional responsiveness. Distributional and allocative consequences. Differential return of private banks to profitability.

Richard Koo and others argue that recovery could have been achieved more effectively and faster by more politically directed policies.

6. Loss of legitimacy and trust.

CB's own technocratic justification. Plus new justifications for existence - prudential regulation.

CBs in taking over responsibility for macroeconomic policy are in firing line, even though they complain about politicians' failure to make fiscal (reflationary) decisions.

Difficulties of hitting inflation targets under current institutional framework.

Longest financial crisis in history without full restoration of economies.

Congress authorizes inadequate policies of Fed.

ECB constitution allows Draghi to extend remit but ad hocery of European response to GFC, eg Merkel in Council, Financial Stability Fund, Finance Ministers, IMF etc.

Little transparency in bond-buying programmes of CBs . Who benefited through CB subsidization?

Stand-off on structural reform and need for convergent economies.

7. Quo vadis?

A European Bretton Woods as Madisonian strengthening bonds of union.

The new rules:

- a) disciplines and benefits of a common currency
- b) dangers of unadjusted deficits and surpluses in national/regional economies
- c) finance ministry and budget (Europe's own IMF) + continuing debt problems + base money and payment systems - retail and short-term repos.
- d) structural adjustment funds.
- e) regional representation and responsiveness.
- f) role of national CBs and Treasuries.