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HOW THE ECB AND OTHER INDEPENDENT AGENCIES REVEAL A GAP IN CONSTITUTIONALISM: A SPECTRUM OF INSTITUTIONS FOR COMMITMENT

"The centre or pivot, for enabling [the monetary and credit] machine to perform."

Francis Baring, founder of the English banking dynasty, on the Bank of England, 1796[1]

"Should there be a truly 'independent' monetary authority? A fourth branch of the constitutional structure coordinate with the legislature, the executive, and the judiciary?"

Milton Friedman, striking a deeply sceptical note, Testimony to US House of Representatives' Banking Committee, 1964[2]

"Institutions [can] do the work of rules, and monetary rules should be avoided; instead, institutions should be drafted to solve time-inconsistency problems."

Larry Summers, 1991[3]

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[1] Baring, Francis. "Observations on the Establishment of the Bank of England. And on the Paper Circulation of the Country." 1797.

[2] Friedman, Milton. "Statement, Testimony, and Comments" to the US House of Representatives' Banking and Currency Committee, Hearings on the Federal Reserve System after Fifty Years, before the Subcommittee on Domestic Finance, 88th Congress, 2nd Session, March 3, 1964. In *The Federal Reserve System after Fifty Years.* US Congress House of Representatives, Committee on Banking and Currency, 1133–78, Washington, DC: US Government Printing Office.

[3] Summers, Lawrence. "Price Stability: How Should Long-term Monetary Policy Be Determined?" *Journal of Money, Credit and Banking* 23, no. 3, Part 2: Price Stability (1991): 625–31.

> *"A press conference is not enough to call it 'democracy'. I do not expect this illegitimate institution to hear my voice"*
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> Josephine Witt, protesting at the European Central Bank's 15 April 2015 press conference

Those four quotations more or less sum up the debate on independent central banks over the past two centuries, and still today. Somehow, the institution of central banking is simultaneously elemental, objectionable, better than the alternatives, and profoundly alienating. For some on the political Left, independent monetary authorities create a 'democratic deficit'; for parts of the Right, their exercise of discretionary power violates the values of the 'rule of law'.[4]

Meanwhile, central bankers themselves --- and likewise most of their academic-economist outriders --- are either largely oblivious or even indifferent to those complaints. Citing classic papers in economics by Kydland & Prescott, Barro & Gordon and others, they deem it sufficient to explain that independent monetary authorities help societies solve a serious commitment problem in macroeconomic policy and, by doing so, enhance aggregate welfare.[5]

There are various problems with that myopic stance. First, even on its own terms, it fails to explain how it could be that, as Larry Summers argued, institutions can do the work of rules. Why isn't the underlying time-

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[4] On the Left, see for example: Stiglitz, Joseph. "Central Banking in a Democratic Society." De Economist 146, no. 2 (1998): 199–226. McNamara, Kathleen R. "Rational Fictions: Central Bank Independence and the Social Logic of Delegation." *West European Politics* 25, no. 1 (2002): 47–76. Roberts, Alasdair. *The Logic of Discipline: Global Capitalism and the Architecture of Government*. New York: Oxford University Press, 2011. On the Right, see for example Simons, Henry. "Rules versus Authorities in Monetary Policy." *The Journal of Political Economy* 44, no. 1 (1936): 1–30. Paul, Ron, *End the Fed*. New York: Grand Central Publishing, 2009.

[5] Kydland, Finn E., and Edward C. Prescott. "Rules Rather than Discretion: The Inconsistency of Optimal Plans." *The Journal of Political Economy* 85, no. 3 (1977): 473–92. Barro, Robert and David B. Gordon. "Rules, Discretion and Reputation in a Model of Monetary Policy." *Journal of Monetary Economics* 12, no. 1 (1983): 101–121.

inconsistency problem, as economists call it, simply relocated? Indeed, why do economists assume that rules themselves would be obeyed rather than broken or ignored? This is the realm of political scientists.

Second, and more prosaically, it would be naïve for supporters of monetary independence to ignore the battery of concerns when, as now, they crop up across the political spectrum and in multiple jurisdictions. If, overcoming factional rivalry, the various complainants found common cause in their distaste for discretionary technocracy, the upshot could be substantive legislative reform or, alternatively, less visible actions that diluted the political insulation of today's central banks. This is the realm of legislators and lobbyists.

Third, and at a higher level, it is hardly for unelected central bankers to self-legitimate by esoteric declaration. These are issues in constitutionalism. They are neither confined to the mysteries of central banking, nor beyond the ken of citizens. Indeed, the big issue is whether governmental commitment devices can be squared with the values of representative democracy. This is what will preoccupy me this evening. It is the realm of constitutional theorists and jurists, and so it is a very great privilege and pleasure that my moderator is a member of Germany's Constitutional Court**.**

Plan of the Lecture

This lecture, which draws heavily on my book *Unelected Power*, has six parts.[6] It begins with an account of why people across the world are uneasy about today's central banks. Since that will take us beyond monetary policy, narrowly conceived, to banking regulation, Part 2 broadens the discussion to law-making by unelected, independent regulatory agencies, and the problems it poses for democratic legitimacy. Part 3 reconciles institutionalised commitment devices with constitutional democracy, but brings out how there is a menu of choices according to the degree of formal entrenchment the commitment technology

[6] Paul Tucker, *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State*, Princeton University Press 2018.

enjoys. Part 4 summarises the *Principles for Delegation* that, I believe, should frame delegation to independent agencies insulated from day-today politics. Part 5 extends that discussion, revealing that there is something distinct about the constitutional position of an economy's monetary authority. Part 6 concludes with where all this leaves the European Central Bank (ECB).

Part 1: central bankers as the only game in town

If asked what a central bank is, many people would answer that it is the body that controls the money supply. Of course, that is correct in so far as central banks can either directly set the supply of their own monetary liabilities or indirectly steer demand for money via an interest rate established by acting as the marginal lender and/or borrower of overnight money. But technical descriptions of that kind can all too easily obscure the extraordinary powers of central banks.

Quasi-fiscal capabilities

I will give just three generic examples.

By supplying more money than expected, the monetary authority can generate surprise inflation, which redistributes resources from lenders to borrowers: in other words, like a tax. By providing the economy's final settlement asset, the monetary authority becomes banker to the banks, meaning it is the liquidity re-insurer for both the banking system and the economy as a whole, with powers over commercial life or death. And by conducting financial operations in order to inject (or withdraw) its money into (from) the economy, the monetary authority changes the liability structure and, sometimes, the asset structure of the state's consolidated balance sheet.

That third capability needs a little elaboration. If a central bank buys (or lends against) only government paper, the structure of the state's consolidated liabilities is altered, with monetary liabilities substituted for longer-term debt obligations. If it purchases (or lends against) private-sector paper, the state's consolidated balance sheet is enlarged, its asset portfolio changed, and its risk exposures affected. In either case, any net profits or losses flow to the central treasury. Where losses are incurred, the result is either higher taxes or lower spending in the longer run (and conversely for net profits).

We are, let's be clear, talking about bodies with quasi-fiscal powers.

Central bank independence

It is hardly surprising, then, that the history of central banking is not just a story in monetary economics but also one in the design of modern government.

The 19th century resolved this by formalizing a *money-credit constitution* based on the gold standard, a device employed by property-based political systems to ensure that their currencies maintained external convertibility and stability. As full-franchise democracy became the norm in the early-20th century, however, the volatility entailed in domestic output and employment was no longer politically sustainable. Instead, the public wanted price stability to come in harness with measures to smooth the business cycle.[7]

After World War II, for a while this was attempted via the hybrid system known as Bretton Woods, under which European currencies were pegged to the US dollar but it was pegged to gold. But when, under the weight of US fiscal profligacy and monetary incontinence, that regime first buckled and then broke in the early-1970s, the world's major economies were forced onto fiat money systems for the first time outside major wars. Precisely because this

[7] This is a facet of what has become known as 'embedded liberalism', comprising a system that incorporates measures to mitigate the costs to individuals or groups of free-market capitalism. Ruggie, John G. "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order." *International Organization* 36, no. 2 (1982): 379–415.

restored domestic monetary sovereignty, it presented the problem of how politicians could be deterred from abusing the monetary power.

Independent central banks emerged as the solution: first in Germany and Switzerland, then in the US through the heroic restorative role of Paul Volcker in the 1980s, and then gradually elsewhere in Europe. The initial effort at redesign remained incomplete, however, until after the Great Financial Crisis (GFC) of 2008/09, and perhaps still does.

Two generations ago, in many countries --- perhaps notably Britain and France, but even in the US --- the central bank was viewed as an operational appendage of the finance ministry, albeit inhabiting a distinct sphere of expertise. Its functions were determined by technocratic comparative advantage rooted, as Francis Baring observed two hundred years ago, in its being the pivot of the payments system, which imbued it with a degree of pragmatic authority in the banking community. By that, I mean the authority of a body recognised as capable of providing solutions to collective-action problems, notably as the lender of last resort when basically sound banks will not lend to each other for fear that their peers are unsound.

Today, by contrast, most advanced-economy central banks would probably be viewed as independent government authorities delegated *specific* responsibilities and insulated from day-to-day politics. Up to a point, they do only those things that have been formally delegated, leading to debate about where the boundaries should be drawn. Thus, in the UK, when the Bank of England was granted monetary policy independence in 1997, both banking supervision and government debt-management were transferred elsewhere.

As the GFC revealed, however, underlying tensions between these two modes of existence remain latent when the zone of naturally endowed authority and technical capability is broader than the mandated zone of formal legitimacy.

The longstanding debate about whether central banks can be or should be bank supervisors --- a debate working its way through the EU's courts ---

should be seen in that light. Its roots lie in questions of power and durable constitutional design, not only in what structure will deliver the best results.

From impotence to the Only Game in Town

So where do we find ourselves today?

Compared with the aftermath of the banking crisis, monetary disorder and economic slump of the 1920-30s, when central banks were stripped of authority, standing and power, things could hardly be more different. Central bankers have generally emerged from the latest crisis with more responsibilities and powers. Internationally, recovery seemed to depend on them. They have been, in a popular but deeply troubling phrase, *the Only Game in Town*.

That reflects their extraordinary exercise of power since global markets broke down in the summer of 2007. Using their balance sheets like never before, they have intervened in almost every part of the bond and loan markets, initially in order to contain market disorder, and later to stimulate economic recovery. Discomfort with this became evident on many fronts: in legal challenges against the ECB in Europe's constitutional courts, in US litigation around the US bailout of AIG, and in political steps in Congress, from both sides of the aisle, to reform the Federal Reserve.

But that is not all. As well as exercising latent powers, they have accumulated more. Banking supervision was granted to the European Central Bank, and returned to the Bank of England, giving each a seat at the regulatory table (the EU's European Banking Authority). In the US, the Federal Reserve now supervises and can issue rules binding those non-bank financial groups judged to be systemically significant. And central banks in many jurisdictions were granted 'macro-prudential' powers to mitigate threats to stability from credit booms.

In terms of the distribution of administrative power, the practical upshot of this reversion to and elaboration of past orthodoxy is that central banks do not inhabit the rarefied zone, allotted to them by 1990s orthodoxy, in which monetary policy experts exercise specialized powers to smooth macroeconomic fluctuations. In a massive development for modern governance, their newly fortified powers to oversee and set the terms of trade for banking and other parts of finance unambiguously make them part of the 'regulatory state' --- a distinctive part of the modern state apparatus that developed during the 20th century, first in the US and later in Europe, leaving public law playing catch-up.

For some of the most fervent advocates of monetary independence, including here in Germany, this risks taking central banks into more overtly political waters, jeopardizing the hard-won achievements of the 1980s and '90s. For those always uncomfortable with CBI, it adds to their unease about a 'democratic deficit'. Concretely, if central banks are to be independent, it must now be on two fronts: from the City of London, Wall Street and the Frankfurt bankers and asset managers, as well as from electoral politics.

More profoundly, deliberations on central banking can no longer be bracketed away from what might have seemed to be largely parallel concerns about a regulatory state empowered to write and issue rules that are legally binding on citizens and businesses.[8]

Part 2: The regulatory state's democratic legitimacy problem

That means confronting deeper, higher-level questions about the legitimacy of delegating power to unelected officials. In our representative democracies, this places power two steps away from the people, who do not get a chance to vote on the technocratic elite governing much of their lives, and whose elected

[8] The academic literature on central banking and the administrative state have long been segmented. Exceptions before the 2007/09 crisis, include Miller, "Independent Agencies"; and Lastra, *International Financial*. Since the crisis, legal scholars have become interested in central banking despite the lack of case law that provides their standard raw material.

representatives have voluntarily surrendered much of the day-to-day control they traditionally exercised over the bureaucracy. Have no doubt, today, most obviously in the United States but also here in Europe, the marginal law-maker is often an unelected technocrat or judge.

Grappling with these difficult issues is necessary to answer the following questions:

- should central bankers be allowed, as regulators, to issue legally binding rules and regulations?
- should they have statutory powers to authorize and close banks?
- could any such powers decently extend to other parts of the financial system?
- should they be free to decide when to provide liquidity assistance to distressed firms?
- should monetary policy and other central banking functions be subject to different standards of judicial review?

The answers --- and I will provide only some of them here --- cannot turn purely on what central bankers might be good at. If, for example, our political values dictate that only elected legislators should set legally binding rules, then central banks should not be regulators. Similarly, if only judges should make adjudicatory decisions, then central banks should not make supervisory decisions, instead being restricted to making formal recommendations to the courts. And if, as some argue, combining the writing of regulations with adjudicatory powers violates the 'separation of powers' at the heart of constitutional government, how much worse when combined with central banks' quasi-fiscal capabilities.

Courts versus administration: rule-of-law and democratic values

Stepping back, the benchmark case of modern administration is a detailed code which is passed by an elected legislature and applied, case by case, via the courts. Where technical expertise is needed, the adjudicators can be

specialist judges, subject to judicial review by generalist courts. Departures from that benchmark need to be justified.

In doing so, we do well to remember that not all laws come through legislation. In adjudicating legal disputes amongst citizens, the judiciary articulates principles along the way. And in applying statutory law, the judiciary has to interpret and construe: it decides what legislation means and/or the boundaries of its reasonable application. In one sense, this reveals the obvious point that judges make law. Law-making is not a monopoly of the legislature.[9]

The crucial point is that, in order to maintain consistency and generality, adjudication, whether in the hands of courts or specialist regulatory agencies, entails an accretion of principles. A series of adjudicatory decisions generates something like an implicit rule or general policy.

By the early 1960s, prominent US legal scholars and justices were making just this point. Judge Henry J. Friendly prominently expressed concern that the regulatory standards applied via adjudicatory decisions were not "sufficiently definite to permit decisions to be fairly predictable and the reasons for them understood" and prescribed that " the case-by case method should…be supplemented by greater use of…policy statements and rulemaking."[10]

Those arguments are rooted in some of the values of the rule of law. Our democratic values take us in the same direction, but throw up a serious constraint.

There are some fields where, it seems, we want regulation to proceed via the *open promulgation and debate* of systematic policy (rules) rather than the accretion of adjudicatory precedent. Whereas the elected executive branch

[9] This is not just true of the common-law system of binding precedent. In civil-law systems, precedent operates as 'soft law' under a principle of 'jurisprudence constante', ie an interpretation or doctrine clearly determinative of a series of core cases. This may be especially prevalent in public law. Fon, Vincy and Francesco Parisi, "Judicial Precedents in Civil Law Systems: A Dynamic Analysis." *International Review of Law and Economics* 26 (2006): 519-535.

[10] Friendly, Henry J. *The Federal Administrative Agencies: The Need for Better Definition of Standards*. Cambridge, MA: Harvard University Press, 1962. The effect was to introduce more formal codification into the regulatory policy of common-law jurisdictions.

and agencies of all kinds, independent or not, can, like elected legislators, consult on their planned policies, courts do not (and cannot) consult the public on their principles and precedents. Judicial law-making --- very obviously in the common-law tradition but also in the role of non-binding precedent in civil-law jurisdictions --- is in its essence incrementalist, developing and refining principles through a stream of individual cases, each with their own specific circumstances but linked by common threads that gradually emerge and which judges discern and enunciate.

Moreover, in some fields we want our regulatory policymakers to explain and defend their policies publicly and to the legislature, whereas we do not want our judges to be compelled to explain themselves to legislators.

In summary, given our democratic values of participation and accountability, regulatory policy-making by the executive branch is preferable where society desires consultation on the evolution of a systematic public policy, and wants to keep both the regime and the exercise of delegated power under public review.[11]

But that argument does not make a case for regulatory rule-making occurring beyond the day-to-day control of the elected executive branch. In fact, the writing of legally binding rules is typically regarded as a legislative function that, in a democtacy, requires not independence from but the active involvement of (or oversight by) elected representatives.[12]

In consequence, the notion of regulatory law-making seems less obviously to confront our political values where the regulator is under the day-to-day control of elected politicians. And a little bit less of a problem where elected politicians at least retain levers that give them real influence over regulatory

[11] At a high level of generality, my argument fits broadly with the principled limits on judicial law-making advanced in Bingham, Tom. *The Business of Judging: Selected Essays and Speeches: 1985-1999*. Oxford: Oxford University Press, 2000, Ch. I(2). In particular, Bingham argues that judges should not make law where "(2)… amendment calls for…research and consultation…; (3)…there is no consensus within the community"; [and] (5) … the issue arises in a field far removed from ordinary judicial experience" [a principle of inter-institutional respect], pp.31-32. My thanks to Lord Justice Gross for pointing me towards this essay.

[12] See, for example, Verkuil, Paul R. "The Purposes and Limits of Independent Agencies." *Duke Law Journal*, 1988: 257-279; and Stack, Kevin M. "Agency Independence after PCAOB." *Cardozo Law Review* 32, no. 6 (2011): 2391–420.

policy. Such agencies fit with the standard analysis of principal/agent relationships. They must, when making decisions, either consult their principal or ruminate on what their principal wants (or would want if in possession of the same information and expertise).

By contrast, what we call independent agencies are largely insulated from the day-to-day politics of both the executive branch and the legislature, because their policymakers have job security, control over their policy instruments, and some autonomy in determining the organisation's budget.[13] That is a reasonable description of many modern central banks, and of some regulatory bodies. They can be thought of as *trustees*: free to set and deploy their delegated powers in unpopular ways so long as they are true to their legislated mandate.

The centrality of credible commitment

The warrant for such *delegation-with-insulation* is, I want to argue, the welfare benefits that can be obtained by enhancing the credibly of the delegated policy goal: credible commitment.[14]

This problem --- of making promises that will be believed --- crops up across much of government. It arises wherever the effectiveness of a policy choice today depends on others' actions and, in particular, their expectations of future policy. If people act on an expectation that a promise could be broken, it can prove too costly for government to stick to its promise. For example, by living in the floodplain households might force government to break a pledge not to build expensive infrastructure preventing floods. Symmetrically, if a

[13] Misleadingly, the US typically applies the term "independent agency" to a government body whose leaders the President cannot sack on a whim. Since many such agencies are under the continuing influence of Congress (eg Securities and Exchange Commission) but others are not (Federal Reserve), the US has ended up with a rather impoverished (albeit voluminous) debate on the warrant for agency independence.

[14] Alesina, Alberto, and Guido Tabellini. "Bureaucrats or Politicians? Part I: A Single Policy Task." *American Economic Review* 97, no. 1 (2007): 169–79. In Europe, Majone, Giandomenico, "Temporal Consistency and Policy Credibility: Why Democracies Need Non-Majoritarian Institutions." European University Institute, Working Paper RSC No 96/57 (1996).

monetary authority is liable to exploit price stability to generate more economic activity in the short run, households and firms will factor that into wage- and price-setting, leading to permanently higher inflation. The expectation of a broken promise becomes self-fulfilling.

But if, in principle, institutional devices could overcome these problems, the question at the heart of this lecture is how they can possibly be squared with democracy.

Part 3: Reconciling commitment devices with democracy

The idea of commitment devices is hardly foreign to our constitutional history. As far back as the 16th century, French political theorist Jean Bodin, famous for his advocacy of a strong sovereign, held that a wise sovereign would buttress and enhance his/her powers by tying their hands in various ways, such as ruling within the law and in line with established custom.[15] But the monarch's motives are almost as self-regarding as those of Odysseus when he orders his crew to tie him to the mast but plug their own ears so that he, but not they, can hear the music of the sirens.[16]

Surely, the advent of democracy alters the normative calculus. The benefits of commitment can no longer accrue solely to a ruler or ruling elite, but must be held in common. Indeed, the 'democratic deficit' that some argue contaminates delegation to independent agencies, and therefore their authority, is typically seen as arising because policy making is removed from the people's accountable elected representatives. If democracy gives the people the right of to change their minds about what they want (ends) and

[15] Holmes, Stephen. *Passions and Constraint: On the Theory of Liberal Democracy*. Chicago, IL: University of Chicago Press, 1995, chapter 4.

[16] Elster, Jon. *Ulysses and the Sirens: Studies in Rationality and Irrationality*. Cambridge: Cambridge University Press, 1979. A somewhat more apt exemplar of political self-binding appears in the same story, but stuck back at home on Ithaca. Penelope created an elaborate device to shield herself from the short-term rewards of taking a new husband during Odysseus' long absence, thereby preserving the integrity of the kingdom and the longer-run welfare of its people.

about how to go about obtaining what they want (means), commitment devices seem to be out of order. They are anti-democratic or, as Americans might put it, counter-majoritarian, a term coined half a century ago by legal theorist Alexander Bickell to characterise the challenge presented by a supreme constitutional court that can strike out acts of the elected legislature.[17]

There appears to be a paradox here. On the one hand, delegation is designed to help the democratic state deliver better results by sticking to the people's purposes: in that sense credible commitment is enabling of democratically generated purposes. On the other hand, the people have to remain free to change their purposes. The resolution has to be either that there are some commitment problems where democracy, as ordinarily understood, should be suspended or, alternatively, that institutional technology designed to enable credible commitment cannot be absolute.

The independent judiciary as a commitment device

We can find some illumination from the independent judiciary's role as both impartial adjudicators and unelected law-makers.

As citizens, we want to be assured that the law will be applied consistently to different cases in the interests of *fairness*. This too is a question of commitment: to *cross-sectional consistency* rather than the dynamic consistency intrinsic to the monetary-policy problem.[18] It does not turn on the regime itself delivering substantive justice in everyone's eyes, but rather on everyone being confident that, within the terms of the law, they (groups as well as individuals) will be treated in the same way: according to the same criteria, with their particular circumstances having a systematic effect rather

[17] Bickel, Alexander M. *The Least Dangerous Branch: The Supreme Court at the Bar of Politics*. 2nd ed. New Haven, CT: Yale University Press, 1986.

[18] Cross-sectional and dynamic consistency are not divorced. Fairness and impartiality in legal adjudication has instrumental value by increasing predictability, thereby reducing costs of uncertainty for individuals and businesses. These are amongst values associated with the rule of law.

than an arbitrary effect on policy choices. It provides a normative justification for delegating the adjudication of legal disputes to an independent judiciary.

Imagine a world without that separation of functions. If someone said, "I promise not to take my interests (and goals) as a legislator into account when adjudicating specific cases", we would doubt either their sincerity or their capacity to keep their promise. It would not be a credible commitment.

An independent judiciary helps to solve the commitment problem because their standing (even their sense of identity) rests, in significant degree, on maintaining a reputation for impartiality among their professional group and the wider public. In the jargon, they face "audience costs" if they are not seen to exercise their judicial powers impartially.

Law itself is a commitment device

In fact, law itself can, and I believe should, be thought of as a commitment device. Otherwise, government officials could turn up for work each morning and shift policy about, this way or that, however they chose. Some of the more formalist values of the rule law --- generality, transparency, predictability, avoiding capricious change, and the promulgated law actually being the law enforced, and so on[19] --- are attributes we should associate with seeking to make credible a commitment to maintain a stable policy generated through stable processes (law making).

Thus, legislated law is open to change only via formal amendment or repeal, and so exposed to attendant audience costs if those procedures are set aside. Up to a point, the same can be said of judge-made law, since the demands of precedent and giving reasons create audience costs for rogue judges amongst the community of lawyers.

[19] Fuller, Lon L. *The Morality of Law*. Revised edition. New Haven, CT: Yale University Press, 1969.

Commitment and democracy's rules of the game

Those, however, are both liberal institutions and ideas: law, adjudicated and applied by an independent judiciary. They show that, intrinsically, institutionalized commitment devices are not deeply alien to *constitutional* democracy. But what about the democratic part of liberal democracy?

Compared with Bodin's world, modern constitutionalism delivers a degree of symmetry. Politicians (parties, elites) continue to embrace arrangements that tie the hands of government somewhat. Meanwhile, the people allow themselves to be bound by acquiescing in general elections being held only infrequently, reducing their popular power.

Left intact across that leap of time is a distinction between the 'rules of the game' *for* politics (constitutional norms and conventions) and public policies determined *by* or *within* politics. The former cannot be subject to continuous or capricious change without the consequent uncertainty undermining the practice of politics as a means of addressing the problems and challenges of living together in political communities. A degree of collective-self-binding around the modalities of government is necessary for democracy to have any meaning, including preserving it for tomorrow. This was a point powerfully made by James Madison in response to Thomas Jefferson's hankering after a new US constitutional convention every 20 years or so, one for each new generation.[20]

Even within those meta rules of political procedure and conduct, there is an important distinction between mechanical rules and rules requiring interpretation. While there are certainly examples of the former, such as the US Constitution's provisions that a presidential term lasts four years and that no person may serve more than two terms, many rules of democratic and

[20] Although it seems doubtful that Jefferson would have thought it legitimate for a future US generation to reintroduce monarchy. Madison's debates with Jefferson, Thomas Paine and others on constitutional commitments are summarized in chapter 5 of Holmes, *Passions*, "Precommitment and the Paradox of Democracy."

legislative procedure involve interpretation or judgment in their application, requiring a second-order rule determining, mechanically, who has the final say. The overriding goal and norm is that those interpretations-cum-applications remain highly stable, while not necessarily being immutable.

The arguments for stability are different when we turn to what is decided *within* politics, such as, for example, some substantive legal rights and the outputs of the security, services, fiscal and regulatory arms of the state. If one purpose of democratic politics is to allow for collective *choice,* that includes making choices on what, if anything, to put beyond simple majoritarian processes and what to leave as part of ordinary politics.[21]

On that line of thought, we might see the following hierarchy of candidates for binding commitment:

1) Mechanical rules on the structure/procedures of politics
2) Institutions for applying interpretative rules on the structure/procedures of democratic politics and government
3) Institutions for applying interpretative rules on any 'fundamental' or 'basic' rights beyond democratic political rights
4) Institutions for adjudicating legal cases under (and with the final word on the meaning of) the ordinary law
5) Public-policy commitments.

Together, the first four categories show that embedding institutions as a commitment device is not alien to democracy, *per se*. Political communities seek stability in (1) and (2) because they structure politics itself; in (3) as a commitment to certain liberal values; and in (4) as part of a commitment to fair adjudication in the application of the law. All four categories might seem fundamentally different *in kind* from (5), concerning, as they do, the institutionalization of constraints on democratic power according to the values of the rule of law, liberalism, and constitutionalism.

[21] A broadly similar point is made in Waldron, Jeremy. *Law and Disagreement*. New York: Oxford University Press, 1999, chapter 12.

Commitment and democratic public policy

It would seem odd, however, to hold that even where the elected assembly stays within those constraints, it should not be free to put obstacles in its *own* way so long as those obstacles are not insuperable and do not violate a constitutional democracy's deepest political values.

Yet, that is the argument advanced by some US legal scholars: that Congress should not be permitted to create independent agencies or delegate rule-making powers.[22] Never mind fringe opinion, in Germany the Basic Law itself, which unusually among advanced-economy constitutions makes explicit provision for the administrative state, effectively stipulates that all domestic-law agencies must be, and so are, subordinate to the relevant minister.[23]

But my question is not whether, as a matter of law, independent agencies are Constitutional in any particular jurisdiction, but whether they could be squared with the constitutionalist values that the major democracies share. More specifically, we need to ask whether the values of constitutional democracy are violated if one generation of elected legislators seeks to raise the costs of their successors (or, indeed, their future selves) departing from their preferred policy. The argument that there need not be a violation turns on what could seem paradoxical. On the one hand, for some people the warrant of democracy lies in its capacity to produce better outcomes for public welfare. On the other hand, the very structure of representative democracy has inscribed into it a risk that elected politicians deliberately deliver poorer results than they had promised when standing for election.

[22] For example, Epstein, Richard A, "Why the Modern Administrative State is Inconsistent with the Rule of Law." NYU Journal of Law and Liberty 3 (2008); 491-515. Hamburger, Philip, *Is Administrative Law Unlawful*, Chicago and London: University of Chicago Press, 2014.

[23] Generally, every decision by a public authority must be capable of being traced back to the public through a 'chain of legitimacy', with legislation having to lay down the "content, purpose and scope" of any powers conferred on the executive (Article 80.1). More specifically, in common with the core civil service, each agency is formally subject to one or both of two types of ministerial oversight and override, which are broadly equivalent to the English-American *vires* and substantive merits. *Rechtsaufsicht* and *Fachaufsicht*. As I understand it, the financial regulator (Bafin) is subject to both; the cartel office (Bundeskartellamt) only to Rechtsaufsicht.

For example, if we hate credit booms after they have burst, that is often forgotten when only a few years later easy credit and rising property prices once again lure us back into debt. It is a brave, and so rare, politician who puts their re-election prospects at risk by taking away the punch bowl while the party is swinging away. We, citizens, are unavoidably exposed to the risk of our representatives' responsiveness to our preferences morphing into an endemic short-termism that depletes our aggregate welfare.

That being so, we need to escape from thinking that the hazards of our system of government are confined to (a) extra-legal measures that can be remedied via the courts and (b) policy failures that can be remedied via the ballot box. Neither of those checks and balances can suffice where all political parties competing to govern have incentives to renege on a substantive promise (for example, low inflation) and, further, the social costs of their doing so are long-lasting (because they become embedded in people's expectations and behaviour). Those are serious *misuses* of power.

Seen thus, the key question about public-policy regimes is *not* whether goods like price stability, financial stability, the protection of investors or environmental protection should be regarded as (almost) unqualified rights ranking with, for example, the right to vote in free and fair elections or any right to free speech. Nor is formal constitutional codification the only way of embedding a policy regime. Other, lesser commitment devices are available.

In fact, representative democracy gives our politicians a menu of devices for making their breaking promises more or less visible, and more or less costly to themselves. Elected legislators can seek to bind themselves by legislating in ways that create heightened audience costs if policy departs from what was promised. Legislating the objective helps. Delegating to an independent agency rather than to the civil service (or to an executive agency beholden to ministers) ratchets up the transparency of attempts to alter the course of policy for short term electoral gain. While the institution of the civil service is itself a commitment device --- to the integrity of the administration of policy --- it is not, and is not meant to be, a device for committing to a stable policy.

Delegating to independent agencies is, in short, a mechanism for elected representatives to safeguard those areas of policy where they wish to secure a public good but recognize that they cannot commit to doing so if they retain *ongoing* control. Instead, by appointing an unelected trustee with a *monitorable mandate*, parliamentarians can seek to generate a normative public expectation that the agency will stick to the mandate rather than seek to improve upon (or otherwise depart from) it. The mechanism is not idealistic, but to harness the self-regard of technocratic policy makers. Whereas elected politicians will nearly always prioritise whatever short-term measures help get them re-elected, technocrats are highly sensitive to their professional reputation and standing.[24]

By using ordinary legislation to delegate a clear mission to an independent agency, elected legislators specify and retain ultimate control over a policy regime (because, formally, it can be amended or repealed) while putting obstacles in their own path: exposing themselves to the political costs of over-riding or repealing a policy regime which they made a public fuss about insulating. This will work as a commitment device only where it is also normatively warranted, which includes retaining broad acceptance across the political community. Without that, the audience costs of the legislators reneging (by repealing or gutting the legislation) or of the agency's policymakers going rogue (by pursuing a different objective) do not kick in. Under modern democracy, credibility and legitimacy come bundled together, and the key ingredient is transparency: being able to observe the legislators' formal acts, the agency's exercise of its delegated powers.

IAs as rule-writers: legislative self-binding

We can now revisit the question of whether or not independent rule-writing regulators violate our democratic values. The grounds for credibly committing

[24] This is the mechanism posited in the model of Alesina and Tabellini, *op cit*. In practice, it depends on a series of conditions prevailing in a political community, including especially the availability of public esteem. This is a descendent of the republican idea of honour: see Pettit, Philip. "The Cunning of Trust." *Philosophy and Public Affairs* 24, no. 3 (summer 1995): 202–25.

to impartial adjudication of disputes via the institution of an independent judiciary are provided by the fundamental value of avoiding *abuses* of power. I have argued that, in democracies, we might also sometimes want to guard against *misuses* of power; ie, the deployment of power in ways that are not illegal but profoundly let down the public, leaving them less well-off and exposed to avoidable risks.

While, for economists, the classic time-inconsistency problems might be price stability and utility regulation, the underlying problem of making credible commitments can infect the legislative process itself.

Imagine, as if we need to, that there has been a major financial crisis and, further, that there is very broad support for a major overhaul of the regulatory regime. Imagine too that this is going to take some years to develop: not because legislators have other current priorities but rather because, even though the broad direction of and standard for policy has been determined, a huge amount of thinking is needed on the detail. The expected length of the process is not driven by legislators' incentives or their lack of technical expertise but by the underlying substance. It would take anybody years (as, indeed, it has). Because it will take years, legislators worry about whether their resolve, and that of their backers or the public at large, will hold as memories of crisis fade and the short-term lure of easy credit and asset-price inflation reasserts itself. Conscious of that risk --- that their preferences will buckle and bend[25] --- the legislators decide to bind themselves to the mast by delegating to an independent agency the job of filling in the detail of the reformed regime.

Compared with standard explanations offered by political scientists, this is not a case of legislators seeking to shift blame, being inexpert, lazy or time-constrained. It is a case of legislators trying to commit to their *own* high policy.

[25] The time-inconsistency literature assumes stable preferences. While analytically useful, this has blunted the value of exploring the problem of preferences that shift against one's better judgment: weakness of the will (akrasia).

Crucially, they have not tightly bound their successors (or their future selves), because they cannot. But they have established a structure that makes any such backtracking more visible --- to commentators, the public, and the world. Under the delegated structure, future legislators must pass legislation to override the independent agency's rules, amend its mandate or abolish it altogether. Each requires only ordinary legislation, and is well within their constitutional rights, but each is highly visible and so can increase the political costs of bending to special interests or yielding to transient temptations.

What, though, are the pre-conditions for delegating to independent agencies other than the desire to employ a commitment device? Here I begin to return to central banking, where my eventual purpose is to show that democratically warranted pre-conditions for bestowing great power on independent agencies are not completely satisfied by the ECB.

Part 4: Delegation principles for independent agencies

The key output of *Unelected Power* was a set of concrete precepts, proposed as political or constitutional norms for healthy constitutional democracies, constraining the delegation of discretionary power to central banks and other independent agencies that, formally, are highly insulated from both elected branches. They were arrived at through an attempt to take seriously the values of the rule of law, constitutionalism, and democracy.

This means not only the liberal values policed by the modern judiciary, but also our republican values. Most obviously, if the instrumental purpose of delegation to trustee-agencies is to help the democratic state deliver better results by sticking to the people's settled purposes, then *the people's* purposes

had better be known, and determined by some process that has deep legitimacy. That is exactly the role of democracy's procedures.[26]

To summarize just a few of the *Principles for Delegation*:

1) Above all, such independent agencies should have clear, monitorable objectives.
2) They should not be given mandates that entail making big distributional *choices* or big value judgments on behalf of society
3) They should make policy in committees, comprising members with long, staggered terms (which they are expected to serve), and operating via one person-one vote
4) Their policy choices should not interfere with individual citizens more than warranted to achieve their statutory purpose (proportionality)
5) The provisions of such delegations should, in the usual course of things, be laid down in ordinary legislation, and only after wide public debate and subsequently embedded through ongoing public familiarity and support
6) Governments and legislatures should articulate in advance, and preferably in law, how (if at all) an independent agency's powers to intervene in an emergency would be extended, but any such extensions should not compromise the integrity and political insulation of its core mission
7) There should be sufficient transparency to enable the stewardship of delegated policymaker and, separately, the design of the regime itself to be monitored and debated by elected representatives. In particular,
    - The agency should publish principles for how it plans to exercise discretion within its boundaries
    - It should publish data that enables *ex post* evaluation of its performance, and research on the regime

[26] Here, my argument coincides with recent neo-republican political theory, notably in Pettit, Philip. *On the People's Terms: A Republican Theory and Model of Democracy*, New York: Cambridge University Press, 2012, summary points 19 and 20, p.306.

8) An independent agency should be given *multiple missions* only if:
    - they are intrinsically connected, each faces a problem of credible commitment, and combining them under one roof will deliver materially better results.
    - each mission has its own monitorable objectives and constraints
    - each mission is the responsibility of a distinct policy body within the agency, with a majority of members of each body serving on only that body and a minority serving on all of them.

9) The legislature should have the capacity, through its committee system, properly to oversee each independent agency's stewardship and, separately, whether the regime is working adequately.
10) The agency should be independent of any industry it regulates.

And beyond the parameters of the formal regime, an ethic of self-restraint should be encouraged and fostered.

Of these, (8) will be especially important for our discussion of central banks (Part 5), and so to where we end up on the ECB and the Single Supervisory Mechanism (SSM) (Part 6), but some more general points need to be made first about the role of the courts in invigilating this area of public law.

Statutory interpretation

Since such trustee-type independent agencies exist as a means to commit to a well-articulated public policy purpose and objective, their statutory powers should be interpreted, by the courts, and so by independent agencies themselves, purposively (and where an ostensibly clear objective leaves ambiguity, with the overall grain of the statutory scheme). That is because the legitimacy of the delegation depends on the intention of credibly committing to a legislated purpose and on constraints that, accordingly, bind the agency to that purpose.[27]

[27] I have in mind something like the following. Say a statute empowers an agency to make rules requiring 'prudent conduct' of banks, and that the overall purpose of the statute is financial stability, defined as the

This norm of statutory interpretation would mean that an agency should desist if a proposed measure might at a stretch be within the law on a textualist analysis of the statute but could not reasonably be viewed as aimed at pursuing the agency's statutory purpose.

Standards of judicial review

I want to argue that compliance with these principles for delegation should influence the intensity of judicial review of independent agency decisions and actions. Specifically, I believe that the intensity of judicial review of independent-agency decisions and actions should increase with the extent to which the delegated policy regime falls short of the *Principles* (entailing a democratic deficit) and also with how far the challenged actions cut across liberal freedoms. Thus:

	Principles-compliant	*Principles-deficit*
No 'basic rights' at stake	Thin review: Eg, not unreasonable	Less thin review: Eg, clearly reasonable
'Basic rights' at stake	Thicker review: Eg, proportionality	Thick review: Eg, proportionality and merits

A *Principles*-compliant independent agency with multiple instruments would (a) be constrained by the law (courts) to choose the instrument least invasive of individuals' freedom (taking into account any legal rights furthered by the

preservation of core financial services in the face of a shock up to a specified size (see Part IV). Then when issuing rules defining prudent conduct, 'prudent conduct' should be interpreted to mean conduct material to preserving stability as defined, not that would help to protect investors or make the economy dynamic or would deliver a rationally assessed risk-adjusted return. This approach echoes the 1950s' US Legal Process School of Hart and Sacks but distinguishing between different kinds of administrative-agency regime according to their general purpose (commitment, exploration/experimentation, delegated politicised decision-taking).

action), but would (b) face a lower test (unreasonableness or irrationality) in determining whether that action was needed to achieve its statutory objective and in calibrating the instrument employed. While the former amounts to a 'check' (and could give courts an incentive to unearth new rights), the latter reflects the value of institutional 'balance', with the courts respecting the mandate given to the independent agency (and not judges) by democratically elected legislators (and perhaps respecting the agency itself if it was an equally ranking branch of government).

Meanwhile, for a non-compliant independent agency, enjoying insulation from politics without appropriate constraints coded into the delegated regime, more intense judicial review would give them (and conceivably legislators) incentives to remedy the regime's flaws (assessed against our democratic values).

So, unlike some others, I am not distinguishing between different types of policy activity *per se* --- for example, between the monetary policy decisions and prudential stability decisions of a multiple-mission central bank.[28] Instead, the stress is on democratic pedigree, and types of effect. Thus, faced with a potentially destabilizing credit boom, a multiple-mission central bank would not be incentivised to turn immediately to monetary-policy measures simply because more intense judicial scrutiny would apply to regulatory interventions, since each type of measure would, instead, face the same broad standard (of not being unreasonable or irrational).

The Principles for Delegation as constitutionalist social norms

We can think of constitutionalism as establishing "a set of rules that determine how a practice or institution is organized and run".[29] In that sense, the

[28] This seems broadly consistent with Goldmann, Matthias. "Adjudicating Economics? Central Bank Independence and the Appropriate Standard of Judicial Review." *German Law Journal*, Vol. 15(2), 2014: 266-280.

[29] Bellamy, Richard. "Constitutional Democracy." In *The Encyclopedia of Political Thought*, edited by Michael T. Gibbons. Chichester: Wiley-Blackwell.

Principles for Delegation are putative *norms* guiding the structure and operation of part of the administrative state, regulating the distribution of day-to-day power between elected politicians and unelected state technocrats, and helping to condition the legal relationship between citizen and state in a general, overarching manner. The *Principles* offer themselves, in other words, as a standard against which legislative efforts can be assessed and held accountable.

This does not mean that, to gain traction, the *Principles* must always and everywhere be incorporated into a legal constitution (whether codified or not), so that they are justiciable. They might amount to a convention, living in the space between law and quotidian politics, at first underpinned by political and social sanctions rather than the courts (but possibly later partly respected by legal doctrine).[30] In other words, to make a difference they would at least need to amount to a 'political norm', accepted by and, hence, commanding allegiance amongst the core officers of the main branches of the state, and supported and informally enforced by a critical mass of outside commentators.[31]

Where a polity's constitutional provisions are codified, it also has the option of specifying that some specific public-policy commitment devices may or must exist, and of entrenching some of the constraints on them (purposes, powers, limits, etc). Here we have another way in which constitutionalism could embrace different degrees of entrenchment for institutionalised commitment technology. In terms of our democratic values, however, the more that is formally entrenched, the more important it is that there exist workable processes for the constitution to be formally amended rather than reconfiguration relying, in practice, upon shifting judicial interpretations.

[30] On conventions, see Barber, N. W. *The Constitutional State*. Oxford: Oxford University Press, 2010, chapters 5 and 6. More generally on non-justiciable constitutionalism, Bellamy, Richard. *Political Constitutionalism: A Republican Defence of the Constitutionality of Democracy*. Cambridge: Cambridge University Press, 2007.
[31] This is akin to the explication of the UK's norm of parliamentary supremacy in Goldsworthy, Jeffrey. *Parliamentary Sovereignty: Contemporary Debates*. Cambridge: Cambridge University Press, 2010.

Part 5: Independent central banks are a special case

Equipped with that general framework for independent agencies, we can return to central banking. On the one hand, everything said so far applies to them. Analytically, the necessity of institutional designs being able harness audience costs in a democrat setting were the missing ingredient in monetary economists' time-inconsistency theories.[32] Normatively, the *Principles for Delegation* should govern them, meaning all of their functions.

On the other hand, however, it turns out that they are also somewhat special given our constitutionalist values.

Monetary independence as a corollary of the high-level separation of powers

One of the decisiveness steps towards our modern system of democratic governance was insistence that representative assemblies formally approve a king's desire to levy extra taxes. That separation of powers would be undermined if the executive government could use a power to print money as a substitute for legalized taxation. If the executive branch controlled the money-creation power, it would at very least be able to defer its need to go to the legislature for extra 'supply', and at worst could inflate away the real burden of its debts to reduce the amount of taxation requiring Parliamentary

[32] At the conjuncture of economics and political science, I think the papers that get closest to this (and, also, to how many central bankers conceive of modern monetary regimes) are Susanne Lohmann, "Reputational versus institutional solutions to the time-consistency problem in monetary policy." In *Positive Political Economy: Theory and Evidence*, edited by Sylvester C. W. Eijffinger and Harry P. Huizinga. Cambridge: Cambridge University Press, 1998; and "Why Do Institutions Matter? An Audience-Cost Theory of Institutional Commitment." *Governance* 16, no. 1 (2003): 95–110. The audience-cost theory is subjected to some empirical testing in Broz, J. Lawrence. "Political System Transparency and Monetary-Commitment Regimes." *International Organization* 56, no. 4 (2002): 861–87.

or Congressional sanction. In other words, it could usurp the legislature's prerogatives.

If, as we argued earlier, something like the old gold standard is not viable under full-franchise democracy, the solution is to delegate the management of the currency's value to an agency designed so as to be immune from the necessities and temptations of short-term popularity.

Seen thus, an independent monetary authority is a *means* to underpinning the separation of powers once the step to adopt fiat money has been taken. The regime is *derivative* of the higher-level constitutional structure and the values behind it.

The Fiscal Shield: barring monetary financing of government

This view provides a double-headed constitutional basis for a rule that the central bank should not provide 'monetary financing' to government. On the one hand, if the executive government could demand central bank financing, it would have access to the inflation tax by the back door, and the commitment to stability would lack credibility. A bar on such demands can be thought of as a central bank's *Fiscal Shield*. On the other hand, if the central bank could lend directly to government on its own discretion, unconstrained by its stability objective, it would be able to choose whether or not a financially stretched government survived, making it a master rather than a trustee. Both elements of a 'no monetary financing' draw on the republican value of non-domination.

The Fiscal Carve Out

Since central banks take risk and their actions can have distributive effects, the Shield this needs to be combined with a *Fiscal Carve-Out* that constrains their

discretion in managing their balance sheets.[33] The details might differ from jurisdiction to jurisdiction, but each would need to cover: the kind of assets the central bank can lend against; the kind of assets it can buy, in what circumstances, for which of its purposes, and whether those operations are ever subject to consultation with the executive government or legislature; how losses will be covered by the fiscal authority, and how they will be communicated to government and legislature.

This does not mean that either the legislature or executive government must list or approve every security that the central bank may lend against or buy outright. A *Fiscal Carve-Out* might reasonably be cast in terms of general criteria (or standards), leaving the detailed fleshing-out of the regime to the technical expertise of the central bank.

Monetary authorities in the regulatory state

The constitutional argument for central bank independence applies only to monetary policy, with its latent power of taxation. It does not apply to the other responsibilities a central bank may have, notably regulatory policy and prudential supervision.

What's more, a central bank with both monetary powers and regulatory powers risks being an over-mighty citizen. And, yet, as Paul Volcker so rightly said with tragic foresight:[34]

> *"I insist that neither monetary policy nor the financial system will be well served if a central bank loses interest in, or influence over, the financial system."*

[33] Marvin Goodfriend called for something like this as long ago as 1994: "Why We Need an 'Accord' for Federal Reserve Credit Policy: A Note." *Journal of Money, Credit and Banking* 26, no. 3 (1994): 572–80. While Goodfriend and I might draw the lines in slightly different places, we agree on the significance of the high-level political economy issues.

[34] Volcker, Paul. "The Triumph of Central Banking?" The 1990 Per Jacobsson Lecture, Per Jacobsson Foundation, 1990.

Why should that be so? The reason is elemental. The central bank must accomodate sudden jumps in demand for its money (the economy's ultimate liquid, safe asset) if it is to avoid inadvertent restraint on economic activity. The most dramatic such jumps in demand come in the form of runs on banks. When the central bank acts as the lender of last resort, it is therefore both stabilizing the private part of the monetary system (banking), and ensuring that the liquidity crunch does not interfere with the course of monetary policy. It should not be surprising that these two ends are conterminous: our societies have accepted monetary arrangements that truly comprise a *system*, in which most of the money used in the economy is privately issued but accepted as such only because it can be exchanged for central bank money.

This has dramatic effects on where and when the central bank crops up in a country's economic life. As LOLR, it is pretty well certain to find itself at the scene of a financial disaster. That being so, central banks have an interest in being able to influence the system's regulation and supervision. At the most basic level, when they lend, they want to get their money back! They need to be able to judge which banks (and possibly near-banks) should get access to liquidity, and on what terms.

Even opponents of 'broad central banking' generally accept that, as the lender of last resort, the central bank cannot avoid inspecting banks which want to borrow. Events in the UK in 2007 demonstrated that doing so from a standing-start is hazardous for society. A central bank must be in a position to track the health of individual banks during peacetime if it is to be equipped to act as the liquidity cavalry; and if it is to be able to judge how its monetary decisions will be transmitted to the economy.

In some jurisdictions, for example Germany and Japan, this is reflected in a set-up where the central bank conducts inspections of banks, but does not take *formal* regulatory decisions. There might be cultural specificities here. Sitting next to him at dinner, I once asked former Bundesbank President Helmut Schlesinger why he publically maintained that central banks should not be the bank supervisor when, as a matter of fact, many of the German central bank's

staff were engaged on bank supervision. The response was that the central bank was not *formally* responsible or accountable, so banking problems would not infect the Bundesbank's reputation and standing as a monetary authority. This is problematic held against the light of modern democratic constitutionalism. We should not try to hide the reality of power.[35]

In summary, we should think of *monetary system* stability as having two components:

- stability in the value of central bank money in terms of goods and services; and also
- stability of private-banking system deposit money in terms of central bank money.[36]

Central banks cannot sensibly be excluded (or exclude themselves) from the second leg. But *if* they are involved materially in supervision, whether alongside other agencies or not, our political values demand that their role should be formalized, through a legislated mandate, objective, and powers.

In line with the *Principles for Delegation*, their remit should be to deliver a monitorable objective, which elsewhere I have argued should be framed as a "standard for resilience".[37]

A fourth branch?

My discussion of independent agencies in general and central banks in particular should bring some reassurance on the biggest complaint lodged by the opponents of monetary independence. Provided that central banks are

[35] On Bafin's routine reliance on Buba supervision: section 7(2) of Banking Act. For a recent, and I think healthily open, discussion of Buba's active role: Dombret, Andreas. "What is 'Good Regulation'?" Speech at the Bundesbank Symposium "Banking Supervision in Dialogue?", Frankfurt, 9 July 2014.

[36] To be clear, the second leg absolutely does not entail that no banking institutions can be allowed to fail; only that the monetary liabilities of distressed firms must be transferable into claims on other, healthy deposit-taking firms or otherwise mutualized so that payments services are not interrupted.

[37] See *Unelected Power*, chapter 21; and *The Design and Governance of Financial Stability Regimes: A Common Resource Problem That Challenges Technical Know-How, Democratic Accountability and International Coordination*. CIGI Essays on International Finance, volume 3. Waterloo, ON: CIGI, 2016.

established by and operate under under legislated regimes that comply with my proposed *Principles for Delegation*, they are not, inherently or formally or in practice, a new fourth branch of government that ranks alongside the canonical three branches. That is because *Principles*-compliant central banks are subordinate, in different ways, to each of the higher-level branches of the state: delegation of statutory powers (legislature), nomination or appointment of agency leadership (executive), adjudication of disputes under the law (courts).

In fact, the greater issue is whether or not there should be a formal constitutional bar on the legislature turning on the inflation tax (ie permanently monetising the debt). Such a capability can live alongside an independent central bank provided people think it is very unlikely to be switched on (and so monetary independence switched off).

Returning, then, to Milton Friedman's complaint about the Federal Reserve to the US Congress, I want to suggest that when thinking about the parts of government insulated from day-to-day politics, we should not lump them all together. Instead, we should distinguish trustee-type agencies, even those demanded by the separation of powers, from those arms of the state whose purpose is to guard the rule of law and the democratic process. The high judiciary and, perhaps, some independent electoral commissions meet that description. But central banks are not *Guardians* of the high values, integrity or existence of the democratic rule-of-law state.

Part 6: the ECB's precarious position in an incomplete constitutional order

So, finally, we arrive at the ECB. Here, my general conceptualization and justification of the legitimacy of central banking stumbles. This is serious, and needs some unpacking. Here I will just scratch the surface.

Not a regular central bank

The most obvious difference about the ECB is that it is not established by ordinary legislation (passed by Council and Parliament) but through a treaty among the EU's many member states (each with their own ratification process, some involving referenda). In practice, the ECB's independence is a deeply entrenched as it possible to get.

But the differences between the ECB and its peers (the Fed, Bank of Japan, Bank of England, Swiss National Bank) are more profound than that. Unlike the central banks serving national or federal democracies, the euro area's central bank does not work alongside a counterpart fiscal authority elected by the people. Since a bank of issue has *latent* fiscal capability, establishing a common money entailed creating a fiscal instrument in a confederal polity *without* the familiar fiscal constitution of nation states. As if recognizing this, the architects of monetary union sought to constrain the ECB via a deeply entrenched constitutional duty, enshrined in the Treaty, to maintain price stability. On this view, ECB independence is still, normatively, a corollary of a higher-level constitution: only not, like the Fed or the Bank of England, in order to avoid a violation of the traditional separation of powers, but rather to avoid inadvertently creating a European fiscal authority with many degrees of freedom (for which, as yet, there is no constitutional sanction).

Consistent with that, the ECB was not established under the same Treaty provision (Article 7) as the Council, Parliament and Commission, signaling a different status. And substantively, seeking to substitute discipline for discretion, the Treaty enshrined a principle of 'no bail outs' for member states participating in the monetary union. When it came to pass, however, that proved mere parchment. While member-state governments had short-term incentives to sign up to 'discipline', they did not have more enduring incentives to abide by or enforce their agreement. So when the euro area faced an existential crisis, the lack of confederal fiscal capabilities left the ECB as the only institution which could keep the currency union from shattering. It

became the existential guarantor of the European Project itself. Not merely a mighty citizen, but *the* essential citizen: a *Guardian*, a lot more than a normal central bank.[38]

Both in terms of constitutional politics and quotidian politics, therefore, the ECB's greatest challenge is to navigate itself to the more modest and proper role of trustee.

It is hard to see how that can be accomplished without a deepening on the monetary union in ways that are unpalatable for some member states. For constitutionalists, the choice lies between living with an over mighty central bank (underpinning a fragile currency union through its quasi-fiscal powers) or, alternatively, returning technocracy to its proper place but within a deeper Economic Union built on incentive-compatible foundations.

But the ECB could encourage the Council to enter into a dialogue leading to some informal (non legally binding) codification of its crisis management plans, and the consultative procedures to be employed if ever the ECB again needs to act at the margin of its powers in novel and dramatic ways. **ADD:**

The single supervisory mechanism

By contrast, the prudential regime delegated to the ECB, the Single Supervisory Mechanism (SSM), is more capable of living up to the constraints of the *Principles for Delegation*. That is because it is established and guarded by the EU's legislative organs (Council and Parliament), who could therefore amend or repeal its terms. What's more, they create or formally approval most of the regulatory regime constraining bank balance sheets (capital requirements, and so on.

[38] Even, following the notorious Carl Schmitt, the true economic sovereign. Decency warning: anyone flirting with detaching the thoughts from the man might usefully read Lilla, Mark, *The Reckless Mind: Intellectuals in Politics*. New York: New York Review of Books, 2016, chapter 2.

All this is good, and increases the incentives of the European Parliament to hold the ECB accountable for its stewardship of the regime. In practice, however, the large size of the Parliament's Econ committee reduces its effectiveness as a source of forum for public debate and challenge.

The bigger question, however, is whether the SSM should be entrusted to the ECB at all. I have already laid out the bones of the case for central banks being formally delegated some prudential powers: simply, that they will inevitably be involved in prudential matters, and so it is a mistake --- more than a mistake, side-stepping our deep political values --- not to formalize that.

So why the ongoing debate? I cannot know how the legal arguments will be determined, but I do think that some features of Germany's Basic Law have created a distorting lens.

As I suggested earlier in this lecture, monetary policy is more or less alone in being exempted from the Basic Law's stipulation of ministerial control over executive policy making and implementation. Over the decades, this has given rise to a quite understandable reluctance to give the Bundesbank *de jure* responsibility for banking supervision. Doing so would mean either that the Bundesbank was not fully insulated from politics in *all* of its formal functions or, alternatively, or that the constitution needed changing.

But whatever the weight of the arguments for the current structure of domestic administration in Germany, they do not provide a basis for arguing that prudential supervision should not be combined with monetary policy in any jurisdiction, whatever the constitutional circumstances. To argue that central banks must never be responsible for prudential supervision, as some German officials occasionally attempt, would be to maintain that the German constitutional arrangements are optimal for all. One of my purposes in this lecture has been to bring into the open this basic driver of some commentary on the SSM.

I would suggest that it is more important to ensure that the SSM is insulated from both day-to-day politics and from the industry: ie, what, normatively, should be the conditions for the judiciary declaring the legality of the SSM?

One such pre-condition would be to stipulate that the national prudential authorities, which hold a majority of the votes on the SSM's board, should be independent of their national governments.

Another would be to stipulate that no member of the SSM board, or of the ECB Governing Council, may be a member of any non-governmental body that contains members of the private sector or funded by the private sector.

Conclusions

This lecture has explored how independent central banks can fit into a broader constitutionalist scheme for the structure and purposes of democratic government.

Our standard conceptions of the canonical three-branch state revolve around the people having a meaningful say in their governance; avoiding concentrations of power; placing checks on the illegal abuse of power; and ensuring impartial adjudication when the law is enforced against citizens. Many of the institutions of government --- an independent judiciary, law itself, a professional civil service --- are devices for committing to those political values.

Staying within but elaborating on the value of commitment technology within constitutional democracy, I have suggested that modern constitutionalism ought also to clear a carefully delineated space for institutions designed to give

credibility to certain public policy commitments. The basic proposition is that a democratically elected legislature might, in certain limited circumstances, seek to raise the political costs (for both its current members and their successors) of later reneging on a public policy that commands wide support but is vulnerable to commitment problems. The enduring stability of a democratic republic is, thereby, pursued by enhancing the delivery of widely valued public goods.

The institutional means to that end is legislative delegation to independent agencies whose policy makers are insulated from day-to-day politics. Since that is a big step, the conditions for such delegation need careful enumeration. I call them the *Principles for Delegation* to independent agencies. Perhaps above all, such authorities should be set a clear objective that can be monitored: that way, we can tell whether they are in fact pursuing and delivering the people's legislated purposes. Such agencies can be thought of as trustees, and their statutory mandate as the trust deed.

This general approach involves getting away from debates about whether the administrative state as a whole is either illegal or must always be under ongoing ministerial control. Similarly, it side-steps suggestions that there is a distinct *Regulatory Branch* of government, which would entail accepting that a polity might not merely delegate regulatory powers via ordinary legislation that can be repealed but, more strongly, might alienate (that's to say, irrevocably transfer) the power to write legally binding rules to arm's length agencies.[39]

Much of the regulatory state does not warrant insulation from quotidian politics. Delegation to an agency with a bare mandate to "pursue the public interest" in a particular field, because legislators do not know or cannot agree what they want, is not the same kind of thing at all. Delegating such regimes to independent agencies would abdicate the legislature's responsibility to frame high policy, violating our democratic values.

[39] See, for example, Ackerman, Bruce, "The New Separation of Powers." *Harvard Law Review* 113, no. 3 (2000).

Within this general framework, I advanced four propositions about central banks. First, that they are trustees of the kind I am describing. Second, that in an economy with a fiat currency, monetary independence is a corollary of the higher level separation of powers that forms part of the basic architecture of constitutional democracy. Third, that in an economy with fractional-reserve banking, the central bank is unavoidably the lender of last resort --- liquidity reinsurer --- to the private part of the monetary system; and that in that guise --- the economic equivalent of the US cavalry --- it inevitably has a role in prudential policy and supervision. And fourth that our democratic constitutionalist values demand that that prudential function be formalised, including specifying a clear objective for banking system resilience that can be monitored rather than just taken on trust.

Constitutionally necessary but not an equal fourth branch

Although hugely powerful, such central banks do not stand alongside those arms of the state that act as guarantors of the basic fabric of liberal democracy. Instead they occupy an intermediate space in a hierarchy of institutions insulated from day-to-day politics:

a) *Trustee-type IAs* that are established in ordinary statutes to deliver credible commitment to a public policy purpose for purely consequentialist reasons. (For example, a regulator established to write rules to flesh out a standard for financial system resilience)
b) *Trustee-type* independent agencies that are not established by the constitution but are a corollary of the higher-level separation of powers (For example, independent monetary authorities)
c) *Guardian-type* agencies that are established by the constitution to preserve democracy and the rule of law generally. (Canonically, constitutional courts and, perhaps, some electoral commissions).

It seems hard to argue that trustee-type independent agencies in either the first or second category can comprise an equal 'fourth branch' of government, since the three canonical branches have decisive powers over them --- creation, purposes and powers (legislature), appointments (executive), and compliance with law (courts) --- but *not* vice versa. This is a world where, under the *Principles for Delegation*, the rules of the game for each trustee-like agency are set, monitored, and can be amended or repealed.

But the ECB is different

This account provides a framework for assessing the position of the European Central Bank: its functions and destiny. The ECB has delivered price stability in the euro area, and at an extraordinary moment of crisis acted alongside the world's other major central banks to prevent a repeat of the 1930s' Great Depression --- no mean achievement. But, through the lens of constitutionalism, it is not exactly like those other central banks. I offered the following observations:

(1) The ECB's existence is much more deeply entrenched than regular central banks
(2) Its independence is not a corollary of the separation of powers, because the euro area does not have a counterpart fiscal authority.
(3) In consequence, given the ECB has the same latent quasi-fiscal capabilities as any central bank, it has become the *de facto* existential guarantor or economic sovereign of the euro area
(4) The European Parliament's Econ committee is too big to conduct effective oversight of the ECB's stewardship of the monetary regime
(5) The political branches (Council and Parliament) should edge towards greater codification of the ECB's crisis repertoire, and the ECB should publish its contingency plans for extreme events.

(6) As the LOLR, the ECB has an inalienable interest in and needs some influence over the regulation and supervision of the euro area banking system
(7) The SSM is one decent way of helping to deliver that. *De facto* power without *de jure* responsibility, as with the Bundesbank's role in banking stability, is at odds with the values of constitutional democracy.
(8) No member of the ECB should also be a member of industry-sponsored or funded bodies.

None of this means, however, that the *Principles for Delegation* are irrelevant to the ECB. I will offer just two implications.

First, and perhaps most obviously, the ECB needs to help frame the objective of the SSM in a way that makes its prudential stewardship amenable to monitoring and debate, matching the transparency and monitorability of its inflation-targeting monetary-policy regime. This would require public consultation and debate

Second, within the spirit of political constitutionalism, where a measure was legal but there was good reason to believe that nothing remotely like it had been contemplated as serving the mandated purpose when the legislation was passed, our democratic values would put the ECB under a duty to seek some kind of blessing from current elected government officers. As an example, this would have entailed the ECB gaining support from the heads of government collectively when it introduced measures to stop the euro area itself falling apart a few years ago: the question being, "Do your governments want the monetary union to survive?"

Central banking in democratic society

Returning, finally then, to the four quotations on central banking with which I opened this lecture, the monetary function *is* elemental; in a fiat money

system with fractional-reserve private banking, independent central banks constrained by carefully designed mandates are better than the alternatives; they do not need to be a fourth branch or otherwise constitutionally objectionable; but their leaders and legislative overseers do need to strive to make this system of monetary governance less alienating.

That task of building broad-based legitimacy, while not easy in any democratic jurisdiction, is much less of a challenge for regular central banks than for the ECB, which will continue to occupy a problematic and precarious position in Europe's broader governance until the monetary union acquires much deeper economic and constitutional foundations.