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(Article begins on next page)

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Governing Money

Central Banks in International and Comparative Political Economy

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Abstract

Central banks are among the most influential decision-makers in domestic political economies. In order to understand the power that central banks command, this chapter pursues a twofold objectives. First, the chapter situates the study of central banks and monetary policy in IPE and CPE. In particular, the chapter shows that, while the study of central banks in the two disciplines has generally mapped the traditional division of labour between them, with the IPE more focussed on global factors and CPE focussed on domestic ones, both IPE and CPE have significantly contributed to shedding light on the *politics* behind central banks and monetary policy. Second, the chapter showcases that the political nature of central banks is not static but evolves over time. In particular, the chapter traces the institutional trajectory of central banks from a historical era (1980-2007) where the distributive consequences of monetary policy were largely hidden behind legal independence and the narrowing of central banks' goal to price stability to an era (2008-present) where the scope of monetary policy has expanded and its consequences have become highly visible and contested.

Keywords: Central banks; Monetary policy; Depoliticization; Politicization; Independence

1. Introduction

Central banks are among the most influential decision-makers in domestic political economies. By affecting key variables such as output, inflation, and employment, central banks indeed command enormous power over economic and societal well-being. The power assigned to central banks becomes even more discernable during financial and economic crises. As the historical record of the 2008 and 2020 crises attests, central banks' interventions in financial markets were not only crucial for managing the crises and mitigating their recessionary aftermath but also functioned as distributive decisions that not rarely worsened the inequality present in domestic societies. The recent historical period was thus a moment when central banks critically affected the course of history in advanced capitalist economies and beyond them, given the influence that the central banks of high-income countries have in global markets. This global influence has become plain to see with the return of inflation at the end of 2021. The largely synchronized tightening of monetary policy across central banks in high-income countries has translated into a generalized slowdown in global economic activity.

Given the consequential global and domestic effects of monetary policy, central banks have been the object of investigation in both International Political Economy (IPE) and Comparative Political Economy (CPE). Among others, the study of central banks has helped shed light on important debates regarding the rise of financial globalization (Helleiner 1994), economic cooperation (McNamara 1998), policy diffusion (Ban 2016, Johnson 2016), power and conflict in economic policymaking (Hall 2008). As a whole, the institutional trajectory of central banks has often been regarded as a foil to get at the macroeconomic regime that had been dominant in most capitalist economies since the 1980s (Moschella 2024).

The purpose of this chapter is twofold. First, the chapter situates the study of central banks and monetary policy in IPE and CPE. In particular, the chapter shows that, while the study of central banks in the two disciplines has generally mapped the traditional division of labour between them, with the IPE more focussed on global factors and CPE focussed on domestic ones, both IPE and CPE have significantly contributed to shedding light on the *politics* behind central banks and monetary policy. In particular, both disciplines have shed light on how central banks are far from being neutral technocratic institutions but political institutions

(Moschella 2024), namely institutions whose decisions have profound distributive consequences across society and whose institutional design and decisions reflect the influence of dominant societal groups (Kirshner 2001). The dominant group has usually been identified in the one made up of financial market actors. However, more recent scholarship has also shown that central banks navigate the pressures and expectations of different societal groups, including elected policymakers and citizens, as discussed below.

Second, the chapter showcases that the political nature of central banks is not static but evolves over time. In particular, the chapter traces the institutional trajectory of central banks from the 1980s till present. In doing so, the chapter illustrates how central banks shifted from a historical era (1980-2007) where the distributive consequences of monetary policy were largely hidden behind legal independence and the narrowing of central banks' goal to price stability to an era (2008-present) where the consequences of monetary policy have become highly visible. This visibility has been largely a function of the expansion of central banks' mandate to include financial stability, employment, and even the fight against climate change. The expansion of central banks' mandate, in turn, has elicited increased politicization of monetary policy, meaning its salience and contestation in the public arena.

In advancing these arguments, the analysis that follows largely tracks the experience of monetary authorities in high-income countries, with specific examples of the US Federal Reserve (Fed) and the European Central Bank (ECB). This analytical choice is not meant to underplay the challenges and trends that have been taking place in emerging and low-income countries. Given the chapter's goals, however, the focus on the central banks in high-income countries is of particular importance. As will be discussed at greater length below, the historical development of central banking since the 1980s has been largely modelled on the experience of high-income countries and, in particular, on the experience of the United States in fighting the Great Inflation. Furthermore, central banks in high-income countries have often set the standards for policymakers in other countries to follow (Johnson 2016), and their policy decisions rarely leave unaffected central banks' tasks in emerging and low-income countries.

The chapter is organized as follows. First, the chapter reviews the literature on central banks and monetary policy in IPE and CPE. In particular, the next section will discuss both the distinctive focus of each field and the similar emphasis on the political nature of central banks and monetary policy. Second, the chapter traces the

institutional trajectory of central banks in macroeconomic management from the 1980s onward. Specifically, the analysis distinguishes between two historical periods: first, the 1980-2007 period, when monetary policy was narrowed down to the achievement of the price stability objective, and second, the post-2008 period, when central banking was significantly expanded and politicized. Finally, section 3 concludes by reflecting on the trajectory of central banks and the challenges they confront in maintaining macroeconomic stability.

2. Central Banks and Monetary Policy in IPE and CPE

Central banks and monetary policy have been the object of investigation in both International and Comparative Political Economy, although with different emphases that reflect the traditional concerns and repartition of responsibility between the two disciplines.

Given its primary concern with the intersection of politics and economics in the international arena, IPE scholarship has predominately focused on the global and transnational dimensions of central banking. When studying central banks and monetary policy, International Political Economy has thus provided insights into how central banks and monetary policy shape (and are shaped by) global economic forces and power dynamics among states, especially in an increasingly financially interconnected world. In doing so, IPE scholars have drawn attention to the broader convergence in central banks' practices on how to conduct macroeconomic management that has taken place around the world.

Within this overall orientation, there are at least three major strands of literature on central banks and monetary policy in IPE. First, IPE scholars have analyzed how the structure and dynamics of the global monetary system, including the role of central banks in managing international financial flows, affect the distribution of power among countries and the role of hegemonic powers in shaping the international monetary system. This research stream includes analyzing how dominant currencies and their central banks' guardians, such as the US Fed and the dollar, influence global financial markets (Ba 2021, Schwartz 2015), as well as the evolution of the global financial system at large (Helleiner 1994). A related research stream here has been that of exploring how central banks coordinate monetary policies and engage in international cooperation to address common challenges such as exchange rate volatility, inflation, and financial instability (Broz 2015, McDowell

2018). This has also involved examining the role of central banks' cooperation in international fora like the IMF (Pauly 1997) as well as the exercise of monetary power in global politics (Kirshner 1995). The study of cooperation and conflict among central banks has also regarded the regions where monetary integration has occurred, such as the European Union with the euro. In these settings, IPE scholars have examined the role of central banks in driving monetary integration (McNamara 1998), as well as the challenges of coordinating monetary policy across diverse economies (Braun et al. 2024).

Second, the study of central banks in IPE has focussed on the impact of capital flows and financial globalization on central banks and monetary and exchange rate policy. This includes analyzing the policy and political challenges posed by capital mobility, financial crises, and the integration of domestic financial markets into the global economy in both low and high-income countries (e.g., Barta et al. 2024, Steinberg 2015).

Third, the study of central banks in IPE has focussed on the global and transnational dimensions of central banking and, in particular, on the importance of knowledge as the key driver of central bankers' behavior and their convergence around the alleged depoliticization of monetary policy (Best 2022). Over the past decades, it has become common among IPE scholars to posit the existence of a distinct central bank epistemic community that transcends national borders (c.f. Baker 2006, Johnson 2015, Marcussen 2006, McNamara 1998). Johnson (2016) for instance, describes them as a kind of a special priesthood. For Tsingou (2014, 266), central bankers are members of a transnational 'club' whose members are "held together by elite peer recognition, common and mutually reinforcing interests, and an ambition to provide global public goods in line with values its members consider honorable". The diffusion of monetary rules, the numerous interactions among central bankers in transnational fora and the similarities in their educational and professional backgrounds are all factors that IPE scholars have commonly used to explain the growing convergence among central banking practices on how to conduct macroeconomic management around the world. As Marcussen puts it, "An archetypical central bank governor has been studying economics and he has therefore also learned to understand and apply the established terminology and methods within this particular discipline. ... This means that, theoretically and socially, they have the same reference points" (Marcussen 2006, 189) – where these reference points refer to the widely spread embrace of neoliberalism (Ban 2016, Grabel 2003, McNamara 1998) which, in turn, lead to the alleged presumption of

monetary policy as a scientific exercise where politics is allegedly left out of the picture (as discussed more in Section 3.1 below).

Whereas IPE mostly focuses on the global dimension of political economy interactions, Comparative Political Economy examines the interplay between politics and economics across different countries. In studying central banks and monetary policy, CPE thereby focuses on how political institutions, domestic structures, and ideologies shape monetary policy decisions and outcomes. Building from these premises and in contrast to IPE, CPE scholars have tended to emphasize divergence between the institutional design of central banks and monetary practices. Similarly, CPE has stressed the persistence of distinctive domestic patterns and trends, despite common global forces.

It is possible to single out at least two major sets of issues that CPE scholarship on central banks and monetary policy has been particularly interested in investigating. First, CPE scholars have been interested in questions of institutional design and, in particular, in explaining the difference in the degree of legal independence and monetary mandates across countries. In this vein, CPE scholars have analyzed how the institutional design of central banks varies across countries and how these differences influence monetary policy decisions. Studies in this research stream include those examining the domestic political factors that affect the degree of central bank independence, the mandates given to central banks by governments or legislatures, and the credibility of monetary policy (Goodman 1991, Keefer and Stasavage 2002, Keefer and Stasavage 2003). Scholars within CPE have also been keen on exploring how ideological differences among political actors shape attitudes toward monetary policy. For example, left-wing parties may prioritize policies aimed at reducing unemployment, while right-wing parties may prioritize price stability (Hibbs 1977).

Second, CPE scholarship has been interested in examining the variety of monetary policy outcomes, such as inflation, unemployment, economic growth, and income distribution. This research stream includes analyses that have assessed how different political economy structures, affect the effectiveness of monetary policy in achieving its goals. For instance, Hall and Franzese (1998) show that central banks' capacity to deflate is conditional on a broader set of institutional conditions, including, most notably, the organization of wage bargaining: where wage bargaining is more coordinated, the monetary policy of an independent central bank is more effective by lowering the long-run rate of inflation at relatively low unemployment costs. The consequences of disinflation are instead harsher in non-

coordinated market economies. Similarly, more recent analyses connect different components of central banking (not just monetary policy but also exchange rate policy and financial stability) to the characteristics of different growth models (Baccaro et al. 2022, Wansleben 2024).

Thus far, I have argued that IPE and CPE scholarships have focussed on distinctive questions that reflect their traditional research interests and focus. Despite the distinctive emphasis, one of the major contact points between IPE and CPE lies in the analysis of central banks as *political* institutions (Moschella 2024). That is to say, both disciplines converge in the recognition that "all monetary phenomena are fundamentally political" (Kirshner 2001, 42) and that central banks and their monetary policies reflect the outcome of political conflicts and ideological struggles.[1]

The view of central banks and monetary policy as 'political' stems from the basic observation that the power that central banks command makes winners and losers. In other words, monetary policy is always distributive. That is, even the conventional policy of lowering (or raising) interest rates entails distributive effects. For instance, when a central bank raises interest rates to restrain demand, there are typically some costs to debtors and some gains to savers. In other words, there is always somebody who benefits more than others.

Given the distributive effects of monetary policy, scholars working in political economy regard the institutional features of central banks (including their independence) and their decision (whether to support or restrain aggregate demand) as fundamentally political because they crystallize the outcome of the conflict among competing societal interests. From this perspective, for instance, the monetary regime that prevailed from the late 1980s, with the prioritization of low inflation as the ultimate economic objective to be pursued, provides evidence of a distinct political outcome: the victory of a "deflationary bloc" led by financial interests (Feygin 2021). A similar reasoning applies to central bank independence. The fact that monetary policy decisions have been almost universally delegated to independent central banks is ultimately the reflection of the institutional victory of both a distinct neoliberal ideology and the particular (financial interests) groups that benefit from the policies that this ideology recommends (Grabel 2003, see also McNamara 2002). Importantly, these groups have lent the necessary political

[1] See also the contributions in Kirshner, 2003.

support for the new regime to be *credible* and thus to be *reproduced* over time (Grabel 2003).

The importance of financial markets as the dominant constituency central banks relate to can also be found in recent analyses of central banks' responses to the crisis period that started in 2008, according to which central banks have ultimately served financial interests rather than general societal interests (Dietsch et al. 2018, Jacobs and King 2016), also in reflection of the key infrastructural power that financial markets possess in highly financialized economies (Braun 2020).

While financial markets are certainly a key constituency for central banks, recent analyses of central banks and monetary policy have also shed light on the multiple societal groups that shape central banks' decisions by diverse channels. These groups include political audiences (both political principals such as governments and legislatures) and citizens (Moschella 2024, Moschella et al. 2020) as well as monetary and financial experts (Ban and Patenaude 2019, Thiemann et al. 2021). These groups can exert as much influence on central banks' decisions as financial markets are under specific conditions, including crisis conditions, and when the central banks search for prestige and reputation to cement their role in domestic societies.

In short, central banks and monetary policy decisions have been an important object of investigation in both IPE and CPE scholarships. While each scholarship has focused on distinctive questions and from a distinctive vantage point, the common ground has been in the identification of the political nature of central banks. It is the conflict of interests among competing groups that has ultimately shaped the institutional trajectory of central banks and their monetary policy decisions. In what follows, I zoom on exactly this institutional trajectory. In particular, I show how the role of central banks in macroeconomic management is not fixed but subject to continuous political renegotiations.

3. The institutional trajectory of central banks as political institutions[2]

Ever since the 17th century, when the first central banks were established in Sweden and later in England, central banks have not been static institutions. Rather, "the central bank is a body that has developed over time, progressively acquiring new and increasingly complex functions, duties and features, establishing more and more

[2] The institutional trajectory presented in this section draws from the analysis in Moschella (2024).

intricate and delicate relations with the rest of the banking and financial system and with the political system and the economy in general." (Cipolla 1989) In particular, at different points in time, central banks have usually placed more weight on different policy objectives, including price stability, financial stability, and economic stabilization (Goodhart 2010).[3] Their relationship with domestic governments has also taken on differing forms over time, with central banks operating under varying degrees of political control. For instance, whereas the first central banks were chartered as clearing houses for commerce and buyers of government debt, those created at the turn of the 20th century came to prioritize price and financial stability, especially under the framework of the gold standard. In the aftermath of World War II, government control over central banks' policies significantly increased. At the same time, central banks' role in stabilization policy became much more prominent, with policy priorities shifting to high employment.

The role of central banks changed dramatically in the 1970s and, in particularly, since the 1980s following the macroeconomic period known as the Great Inflation. In particular, in the wake of the battle against inflation, central banks departed from their post-World War II role in supporting employment and economic activity, to a much narrower role as the guardian of price stability, which came to be regarded as the most important contribution that monetary authorities could make to achieve macroeconomic stability.

3.1 The rise of inflation-focussed and politically-neutral central banks

The origins of the shift in the role that central banks play in domestic macroeconomic regime can be largely traced back to the so-called Volcker shock, that is the painful disinflation brought about by the US Fed Chairman Paul Volcker at the beginning of the 1980s. At that time, the scourge that confronted economic policymakers was that of rising prices and growing unemployment. In the United States, for instance, between 1964 and 1974, inflation rose from 1 percent to over 12 percent, and unemployment rose from 5 percent to over 7 percent. By the summer of 1980, inflation was near 14.5 percent, and unemployment was over 7.5 percent (Bryan 2013). Then, Paul Volcker became the head of the US Fed, which delivered a

[3] On the historical evolution of central banks and central banking features see, among the others, Bordo, 2007, Ugolini, 2017, Siklos, 2002, Bordo and Siklos, 2017.

shock to the US economy that eventually broke the bone of inflation; however, this shock came at the cost of high unemployment and a deep recession.

Volcker's success in taming an extended period of inflation is probably the most influential episode in the development of modern central banks. Indeed, Volcker came to epitomize a distinct view of central banks' mission, namely, the view according to which "central banks can and should use monetary policy to maintain *low* inflation over time." (Goodfriend 2005, 250 emphasis added)

The development of central banks as the institutional guardians of low and stable inflation was supported by concomitant developments in macroeconomic theory. In particular, the lessons the international academic and policy community drew from the Great Inflation invalidated the supposed long-term trade-off between inflation and unemployment that had guided monetary policy since the aftermath of WWII, as theorized by the Phillips curve. The notion that the economy gravitates to some natural rate of unemployment in the long run—no matter what the rate of inflation is—became the new standard in macroeconomic thinking (Mishkin 2007, 5-6).

This conclusion had important consequences for the development of central banks and their role in domestic societies. Indeed, absent a long-run trade-off between inflation and unemployment, the best contribution that central banks could make to economic activity in the long-run was to keep inflation low. That is, "the central banker has to be conservative, where conservativeness refers to the importance that he or she assigns to price stability in its relation to other macroeconomic objectives." (Masciandaro and Romelli 2015, 263)[4]

Building and sustaining an institutional image as a conservative, inflation-averse actor has oriented the practice of central banks for over three decades. As central banker officials explain it, "For a central bank, earning a reputation as a guardian of price stability is of paramount importance." (Rostagno et al. 2019, 39). In particular, central banks regard conservativeness as important for increasing the success of monetary policy and thus for justifying their independence (Hayo and Hefeker 2010, 185). Even when legal statutes have assigned central banks multiple policy goals, monetary authorities have often developed a clear policy hierarchy in which the price stability objective has pride of place. The case of the US Fed is an apt case in point; even though the Fed is assigned the "dual mandate" of seeking maximum employment and stable prices, the emphasis on which objective should be

[4] For the standard argument on the social benefits of a conservative central banker, see Rogoff, 1985.

paramount has shifted over time, with the former mandate being more paramount in the period before 2008 (Steelman 2011).

The primacy that central banks came to attribute to low and stable inflation had been underpinned by the widespread adoption of inflation-focused monetary frameworks. Since the late 1980s, central banks around the world have come to adhere to some form of inflation targeting to signal their commitment to fight inflation. Indeed, "inflation-targeting central banks have a single goal—low inflation; and they are normally given precise numerical targets by their governments" (Blinder 2004, 15). This means that central banks raise or lower interest rates based on above-target or below-target inflation, respectively. The primacy of price stability for central banks' role on macroeconomic management in this historical period can further be gleaned from the fact that in the precrisis period, even those central banks that did not consider themselves formal inflation targeters (including the US Fed and the European Central Bank) had nonetheless incorporated key features of the inflation-targeting regime in their monetary practice, 'including a numerical definition of price stability, a central role for communications about the economic outlook, and a willingness to accommodate short-run economic stabilization objectives *so long as these objectives do not jeopardize the primary goal of price stability*' (Bernanke 2011, emphasis added).

The key corollary of the refocusing of central banks' mission around the low inflation goal has been the 'depoliticization' of central banks and of their monetary decisions. That is to say, by narrowing central banks' activity on maintaining inflation low, central banks have sustained an institutional image as politically neutral institutions whose actions are almost exclusively driven by available economic information interpreted through the best macroeconomic knowledge. That is, central banks have been keen on projecting an image as technocratic, a-political institutions, where expertise trumps political discretion. As a former US central banker stated, "Over the last five decades, monetary economists have developed a set of basic scientific principles, derived from theory and empirical evidence, that now guide thinking at almost all central banks." (Mishkin 2007, 2). It is not by accident that references to "monetary science" have been abundant over the past decades, especially to distinguish the realm of monetary policy from the much messier and distributive area of fiscal policy.[5]

[5] In the words of a well-known study, "Monetary policy decisions tend to be based on systematic analysis of alternative policy choices and their associated macroeconomic impacts: this is science;" thus, a title-provoking article described monetary policy around a decade ago to clearly distinguish it from "fiscal alchemy" (Leeper, 2010).

The alleged distance between monetary policy and distributive policy has been further underpinned by the notion that money is *neutral*. That is, the mantra present in monetary economics had been that changes in the supply of money affect only prices and not the real economy. The implication was that "the idea that central banks achieve their narrow objective of price stability without much in the way of distributive consequences." (van 't Klooster and Fontan 2019, 5)

One way in which central banks signaled their neutrality was also by severing their relationship with fiscal authorities (Diessner and Lisi 2020). That is, central banks embraced the principle of monetary dominance, according to which monetary authorities pursue the price stability objective without being constrained by the government's fiscal needs. In other words, central banks were keen on projecting an institutional image aimed at signaling that deficit financing and debt-servicing issues played no role in monetary policy decisions, even at the risk of amplifying financial fluctuations (Bateman and van 't Klooster 2023). The idea of monetary financing, i.e., the financing fiscal deficits via money creation, thus came to be seen as "a mortal risk to hard-won central bank credibility." (Agur et al. 2022)

The stabilization role of central banks around the narrow and neutral price stability objective was further cemented during the period of the Great Moderation, which is the period from the mid-1980s until 2007, characterized by low economic volatility and low inflation. the economic success of the Great Moderation was largely attributed to the conduct of monetary policy and, in particular, to the improved control of inflation. Although other factors have certainly contributed to the change in global inflation dynamics, including globalization and financial deregulation, the merits of monetary policy were elevated to center stage. In particular, the consensus view on the reasons why monetary policy was to be praised for the Great Moderation rested on the observation that 'monetary policy has been much more focused on achieving low inflation, and less on exploiting short-run output gains.' In doing so, central banks seemed to have achieved the holy grail of credibility (Cecchetti and Debelle 2004). [6] The crisis period that started in 2008 soon shook this rosy conclusion.

3.2 The expanding role of central banks and their overt politicization

[6] The importance of monetary policy to explain the success of the Great Moderation is also stressed in Blanchard and Simon, 2001, Bernanke, 2004.

If, until the early 2000s, the role of central banks had been narrowed down to the achievement of low inflation and central banking elevated to neutral institutions, the crisis period that started in 2008 led to a profound transformation in central banks and the way in which monetary policy is conducted. In particular, the role of monetary authorities in economic management has been expanded to include financial stability and social goals, from employment to the environment. Concomitantly, central banks have expanded the tools of monetary policy by resorting to balance sheet policy tools along with the traditional interest rate policy (for an analysis of these transformations, see Moschella 2024). The expansion of the mandate and tools of monetary policy has made the distributive consequences of monetary policy plain to see leading to increased politicization, that is, increased salience and contestation of central banks and their choices.

The origins of this shift lies in the decade long crisis period that started with the 2008 global financial crisis. Indeed, the crisis marked a critical turning point for the global economy. The dynamic, scale, and spread of the crisis led several commentators to compare it to the 1930s Great Depression and refer to its aftermath as the Great Recession.[7] Indeed, similar to the Great Depression, the financial sector was the epicenter of the shockwaves that threatened the stability of the global financial system and caused a decade of stagnant economic growth.

The economic consequences of the financial crisis were indeed dire. The year 2009 was witness to the largest economic contraction in seven decades. According to the IMF, 91 economies, making up a combined two-thirds of the global GDP, experienced a fall in output in 2009. The United States saw a 2.6 percent drop in GDP in 2009, the largest decline in the postwar era. In the European Union, the GDP decrease was 4.3 percent in the same year. Between the third quarter of 2008 and the first quarter of 2009, the economic downturn also spread rapidly to countries that were initially not affected by the financial and banking crisis. Emerging market economies saw a real output decline of approximately 4 percent. The economic effects of the financial crisis were not solely profound but also prolonged: output deviations from precrisis trends persisted over time.

The global economy was still healing from the 2008 crisis when the 2020 COVID crisis struck. The first chilling signs of the health emergency's dramatic economic costs came from the financial sector, bringing back memories of the previous 2008 crisis. As investors started fretting about the economic consequences of the inevitable confinement measures, the usual panic dynamic settled in: investors

[7] For instance, Temin, 2010, IMF, 2010, Khaler and Lake, 2013.

started selling assets and rushed into the safety of US Treasuries. The liquidity squeeze further exacerbated the pains of firms whose revenues were shrinking quickly. The surging US dollar, in turn, spread the pressure worldwide and especially to developing and emerging market countries that borrow in US dollars. In April 2020, IMF forecasts certified that the world was experiencing the worst economic crisis since the 1930s, a crisis far more profound than the preceding 2008 crisis (IMF 2020).

To respond to the recessionary consequences of the crisis period, the majority of advanced economies initially introduced sizable expansionary fiscal packages to help offset the effects of the 2008 financial shock, including via measures such as government guarantees of banking sector liabilities, purchases of toxic assets from banks, and capital injections. Austerity, however, progressively took over the initial fiscal support, perhaps due to both the financial underpinnings of the crisis and policymakers' ideational orientations favoring balanced budgets.

Explaining the shift from expansionary to contractionary fiscal policy would deserve an analysis on its own (see Blyth 2013). What is relevant for the purpose of the present analysis is that, while fiscal authorities retrenched from macroeconomic management, central banks rose to the front line of addressing financial market dysfunctions and restoring the foundations necessary for sustained economic growth. They did so by expanding both the objectives and tools and monetary policy, as they had come to be crystallized in the preceding three decades. In particular, what emerged at the end of the crisis period was that, despite these differences, central banks converged on a set of policies, which came be labeled as 'unconventional', that marked a substantial deviation from the monetary orthodoxy that had been in place since the 1980s (Moschella 2024). Three major transformations have taken place in the understanding of the role of central banks in domestic societies.

First, central banks expanded their policy remit to include financial stability along with price stability as a way to ensure economic stability. As discussed in the previous section, before the crisis in 2007, the established view was that monetary policy should exclusively target price stability as the most important contribution to economic stabilization and that price stability was a sufficient condition to ensure financial stability. Specifically, it was widely believed that it was not monetary policy's purpose to address potential asset bubbles that could destabilize the financial system. The start of the 2008 crisis, however, tested the tenets of the pre-crisis monetary consensus. Importantly, the crisis revealed that the pre-crisis

monetary policy had fueled financial instability by creating fragilities across the financial system (Gabor and Ban 2016).[8] Furthermore, the crisis showed that financial stability was not guaranteed even when monetary policy (as measured by the criterion of price stability) was successful. In this context, the assumed separation between monetary and financial stability policy has been questioned and central banks have progressively elevated the maintenance of financial stability as coequal with their responsibilities for the management of monetary policy (see Thiemann 2023). An increasing number of governments have supported the shift by delegating overt and increased financial stability responsibility to central banks (Moschella and Pinto 2021).

Second, central banks blurred the line (and the distance) between monetary and fiscal policy. As discussed in the previous section, pre-2008, central banks have been keen on proving their political neutrality by claiming that their decisions did not have real distributional economic effects. Indeed, according to the notion of monetary neutrality, interest rate policy affects only nominal variables (i.e., price and inflation) and not real economic variables (i.e., employment and output) in the long run. One way in which central banks have signaled the distributional neutrality of their decisions has been the break-up of any form of explicit coordination with fiscal authorities. In particular, one of the key principles of independent central banks has become the view according to which governments' fiscal policies are exogenous. As a depoliticized institution, a central bank is merely concerned with its own monetary policymaking and not with the potential consequences of fiscal decisions. Monetary policy should simply not be enmeshed with governments' policy and the attendant distributional consequences. A decade of unconventional monetary policy, however, has questioned the pre-crisis monetary mantra. Indeed, since the start of the crisis period, monetary policy has basically supported public finances. That is, central banks have massively stepped in to lower government funding costs by way of asset purchases financed through the central banks' balance sheet. For instance, by the end of 2020, the four major central banks in the group of high-income countries (the BoE, the Fed, the ECB, and the BoJ) had ultimately bought more than half of the government debt issued since the start of the pandemic in February.

Third, central banks have been increasingly involved in the fight against climate change, further deviating from the narrow view of their mandate as focusing on price stability. Indeed, a growing number of central banks have pledged to

[8] Opinions diverge about the extent to which monetary policy contributed to the build-up of pre-crisis imbalances. For opposing view see, for instance, Ahrend et al (2008) and Bernanke (2007).

integrate climate change considerations into their policymaking criteria and have strengthened global collaboration in assessing climate risks (Deyris 2023, Di Leo et al. 2023)

The transformation in the role of central banks in domestic societies has been accompanied by important political consequences. In particular, the role of central banks and of their decisions has become increasingly politicized, meaning increasingly salient and contested in the public arena at least, in key high-income countries. Indeed, by enmeshing into measures with overt distributive consequences, including the ones pertaining which assets to buy in order to maintain financial stability, support government balance or help decarbonization, central banks could no longer hide behind the alleged generalized effects of interest rate policy decisions. The distributional impact of postcrisis monetary policy—or better yet, its increased visibility compared to precrisis policy—has made it difficult for central banks "to take shelter behind the claim to technocratic legitimacy." (Jones and Matthijs 2019, 138) Central banks and their policies so became increasingly contested.

Indeed, central banks soon became the target of criticisms from across the political spectrum. At the more conservative end were those blaming central banks because of the alleged inflationary and currency debasement implications associated with the use of unconventional policies.[9] At the other more progressive end of spectrum, critics lashed at central banks because their unconventional policies had unduly redistributed wealth and ultimately led them into quasi-fiscal policy terrain that is not up to technocratic policymakers to encroach upon (Dietsch, Claveau et al. 2018, Jacobs and King 2021, Tucker 2018) The rise of populism, fueled by the social costs of the economic crises, has also added to the widespread politicization of central banks. In particular, an increasing number of politicians, most notably US President Donald Trump, have started making central banks the target of public criticisms mostly for their failure to support the real economy.[10]

In conclusion, following a decade of financial and economic crises, central banks moved away from orthodoxy by expanding both the goals and tools of

[9] A manifesto of these criticisms is provided in "Open Letter to Ben Bernanke." *Wall Street Journal.* 2010. https://www.wsj.com/articles/BL-REB-12460.

[10] Trump blasted the Fed on Twitter for "putting [the US] at a decided economic & physiological (sic) disadvantage" (Mar 13, 2020), called the Federal Reserve Board, among others, "pathetic, slow moving" (Mar 10, 2020), "derelict in its duties if it doesn't lower the Rate and even, ideally, stimulate" (Oct 29, 2019), and insulted them multiple times, calling them the "No Clue Fed" (Sep 29 and Aug 28, 2019) or "Boneheads" (Sep 11, 2019).

monetary policy. In particular, central banks have stepped into policy terrains that would have been simply anathema to any casual central banking observers just a decade ago, including financial stability, support for fiscal policy, and even climate change. Furthermore, central banks' responses to the new economic challenges have made the distributive consequences of monetary policies much more clearly visible than was previously the case for conventional interest rate policy. Against this backdrop, the contestation of central banks' policies and independence has increased. In other words, central banking has shifted from alleged depoliticization to unexpected politicization (Moschella 2024).

4. Conclusions

As already anticipated, central banks are among the most influential economic decision-makers whose decisions have profound domestic and global consequences. It is therefore not surprising that central banks, and specifically their mandate and policies, have been extensively investigated in both International and Comparative Political Economy.

The purpose of this chapter has been twofold. First, the chapter has reviewed both the IPE and CPE literature on central banks in order to shed light on the distinct questions and puzzles that political economy scholars have been keen on investigating. Furthermore, the chapter has highlighted the major commonality between IPE and CPE scholarships, namely the examination of central banks as *political*. That is to say, both IPE and CPE have stressed that central banks are institutions whose decisions have profound distributive consequences across society and whose institutional design and decisions reflect the outcome of a conflict of interests between different societal groups.

Second, the chapter examined the institutional trajectory of these important political institutions. In particular, the analysis has shown that the purpose of central banks and the conduct of monetary policy are not static but subject to continuous political renegotiation and interpretation. In doing so, the chapter traced a profound transformation in central banking from the 1980s till today. In particular, the chapter showed that, since the 1980s and for more than three decades, central banks have avoided claiming overt responsibility for financial stability or real economic objectives, including job creation. Their mantra was that monetary policy can influence only the level of inflation, while long-run employment and economic

growth are determined by structural policies. Monetary dominance was the other revered mantra: central banks jealously guarded their capacity to achieve their price stability mandates and vowed never to adjust monetary policy to take account of the government's fiscal actions. A decade of unconventional policies post-2008, however, has shaken the foundations of this monetary orthodoxy. Seen from today's perspective, central banks have become routinely enmeshed with financial stability, have often claimed responsibility for economic growth and social objectives, and blurred the boundaries of monetary dominance by working alongside fiscal policymakers to address pressing economic and social challenges.

The institutional trajectory of central banks is far from having been settled, though. At the time of writing, for instance, most central banks seemed keen on restoring the pre-crisis monetary regime by prioritizing the fight against inflationary forces regardless of the economic and social costs that tighter monetary policy implies. Indeed, with the return of inflationary forces by the end of 2021, basically all central banks in high-income countries have rolled back the monetary accommodation and set the stage for repeated interest rate rises.

While this evidence seems to point to a return to the old macroeconomic regime, the institutional transformations that have taken place in central banking are too profound to be dismissed without consequences. For instance, it is difficult to think that central banks' expanded mandate over the goals of financial stability or climate change could be unraveled in the face of renewed inflationary pressures. Furthermore, the increased politicization of central banking, as discussed in previous sections, raises the political stakes for central banks' monetary tightening. That is, the open question is whether central banks can afford to cause a painful recession or even a fiscal crisis in a context where politicization prevails and thus where central banks can become an easy target for public and political criticisms.

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