

# Central banks in the political crossfire: a historical review

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Columbia University

October 2019



## **Perplexing time for central bankers:**

Finely balanced moment in the business cycle.

Ongoing adjustment in the financial system in wake of 2008.

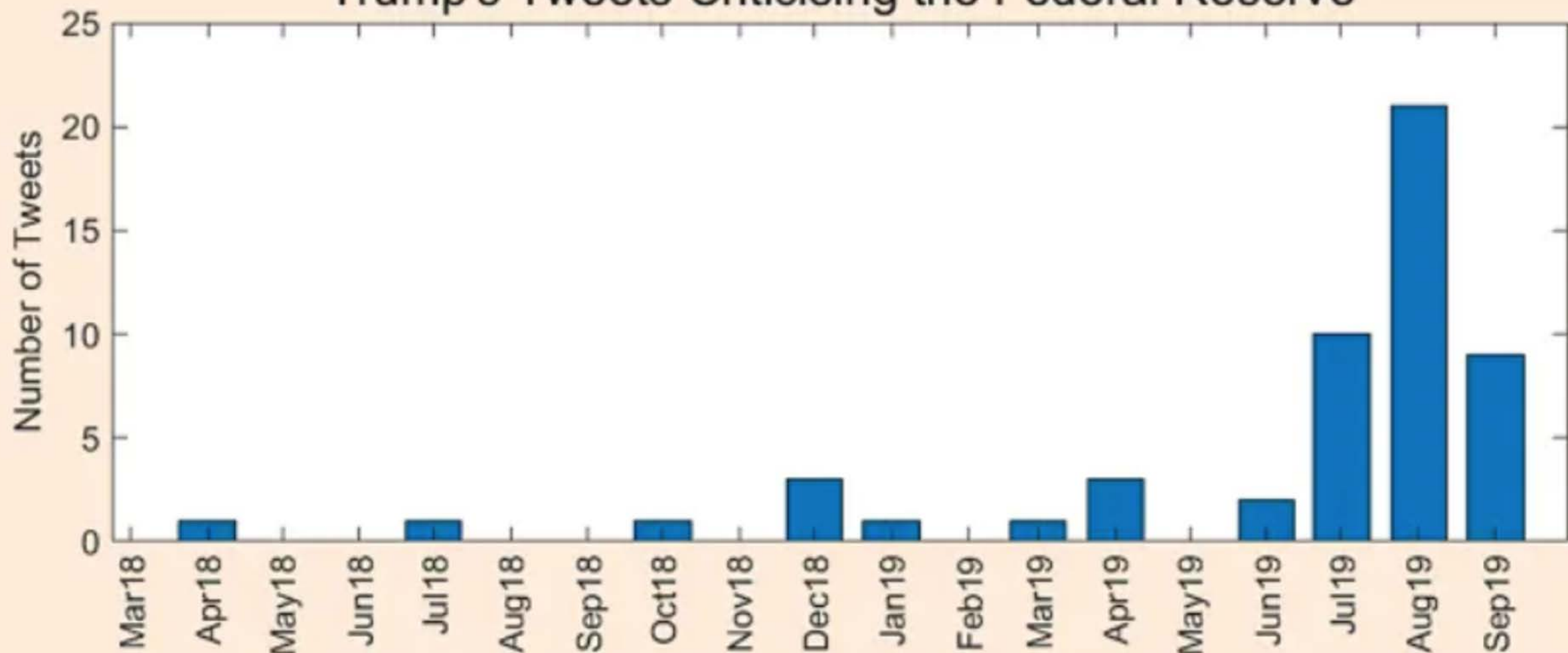
Not obvious that central bank balance sheets will ever return to normality.

Large parts of fixed-income sliding into negative yield.

Surprising technical disturbances in money markets.

In the eurozone, unresolved structural.

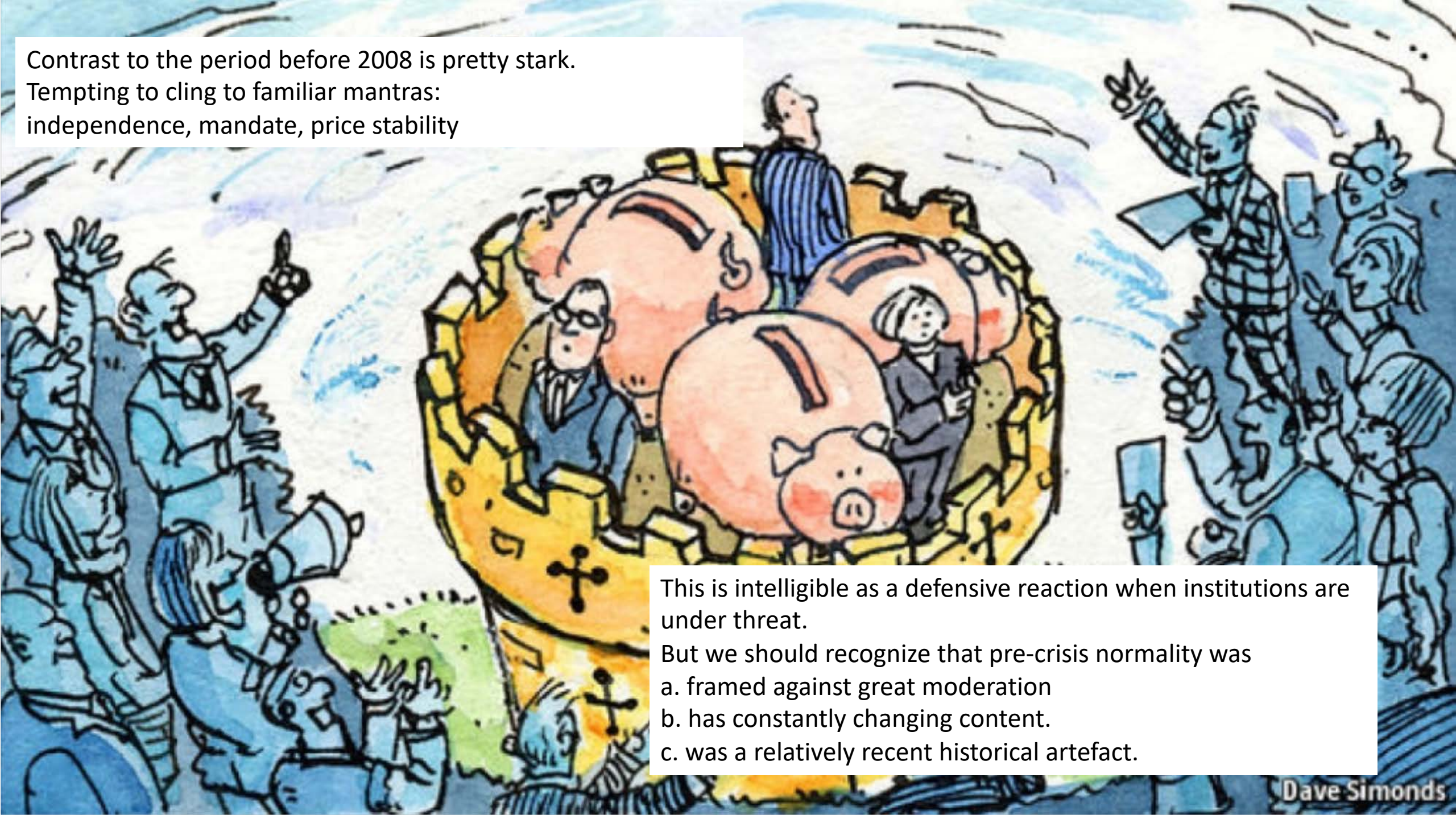
## Trump's Tweets Criticising the Federal Reserve



*Note: Tweets are collected from [Trumptwitterarchive.com](http://Trumptwitterarchive.com). Tweets are selected if they contain the key words 'Federal Reserve', 'Fed', 'interest rate' or 'Powell', and if they also contain direct comments or criticisms of the Fed policies.*

*Source: Fulcrum Asset Management.*

Contrast to the period before 2008 is pretty stark.  
Tempting to cling to familiar mantras:  
independence, mandate, price stability



This is intelligible as a defensive reaction when institutions are under threat.

But we should recognize that pre-crisis normality was

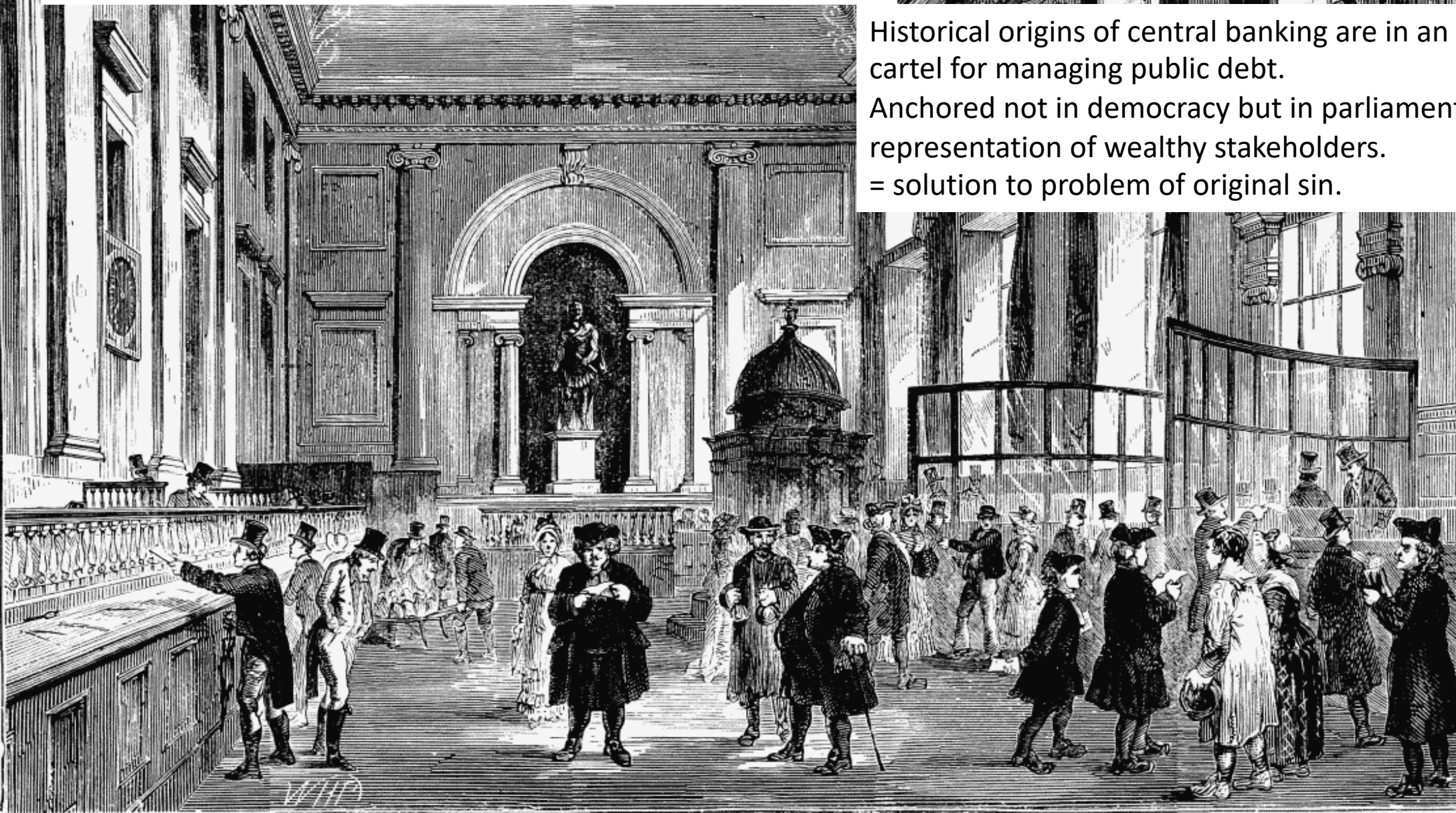
a. framed against great moderation

b. has constantly changing content.

c. was a relatively recent historical artefact.

1668 Swedish Riksbank aka Bank of the Estates  
1694 Bank of England

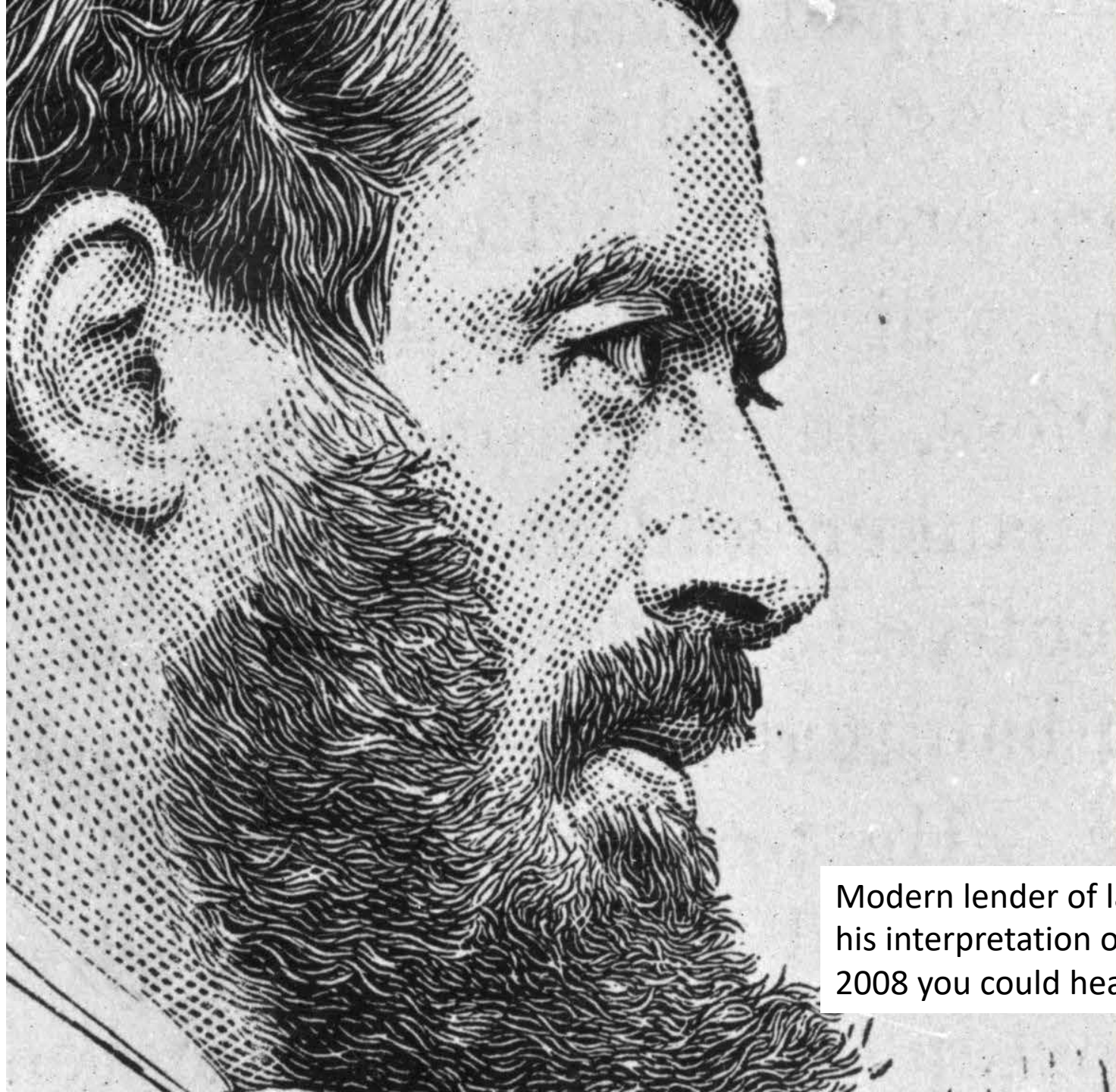
Historical origins of central banking are in an elite creditor cartel for managing public debt.  
Anchored not in democracy but in parliamentary representation of wealthy stakeholders.  
= solution to problem of original sin.



A key test was the historic deflation of the post Napoleonic period.



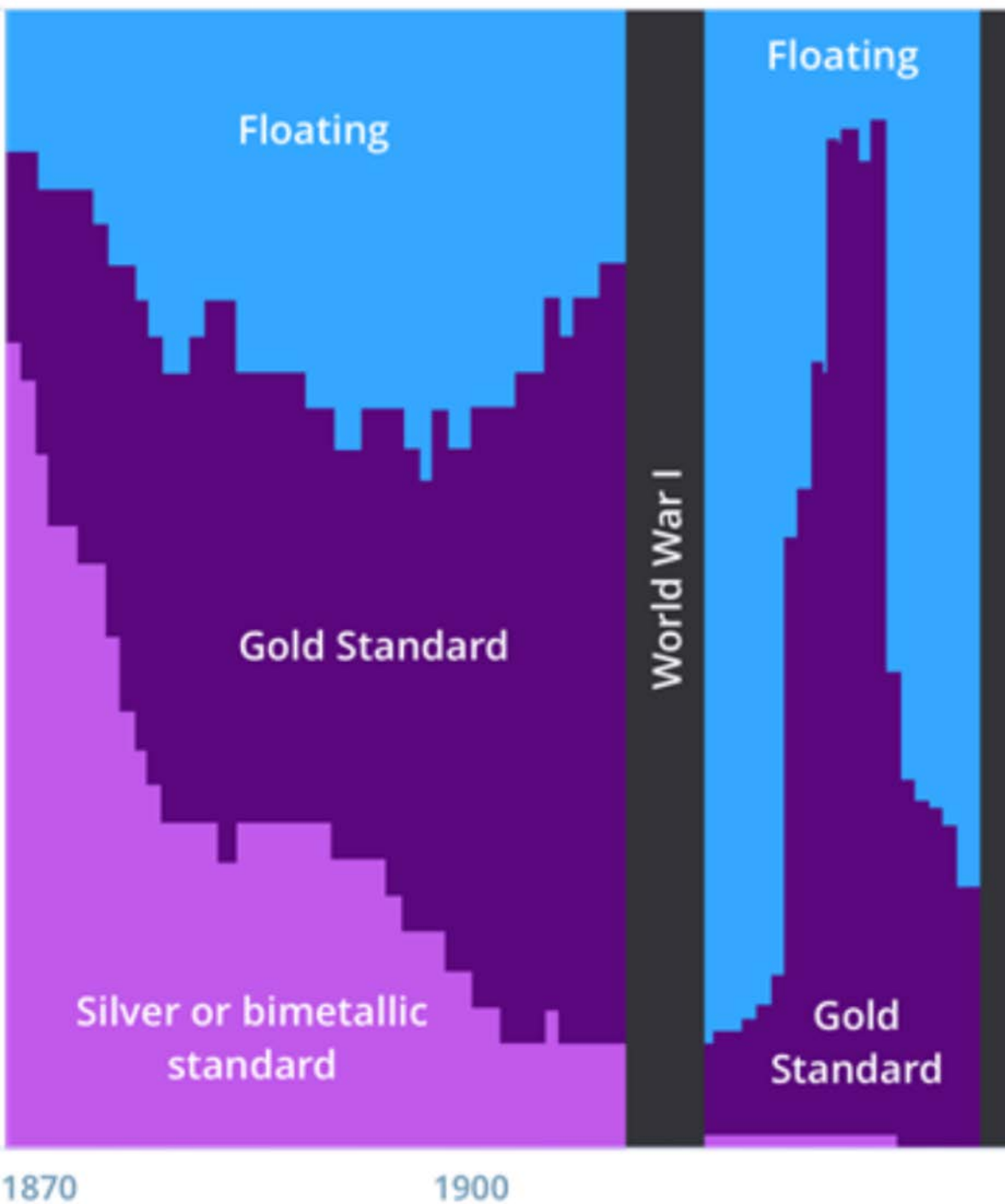
*St. Peter's Field, Manchester, sixteenth day of August, 1819*



“To avert panic, central banks should lend early and freely, to solvent firms, against good collateral, and at high rates”

WALTER BAGEHOT

Modern lender of last resort goes back to Bagehot (1873) and his interpretation of the global financial crisis of 1859. Even in 2008 you could hear Bernanke and co citing Bagehot.



International monetary affairs began to take on a modern form with the formation of the international gold standard from 1871. It is a conservative international framework that constrains monetary policy. It also makes central banks into key managers of reserves and triggers tough deflation of the 1870s.

-> Modern monetary economics emerged as effort to make sense of this.



**Table 1**  
**The Origins of Central Banks**

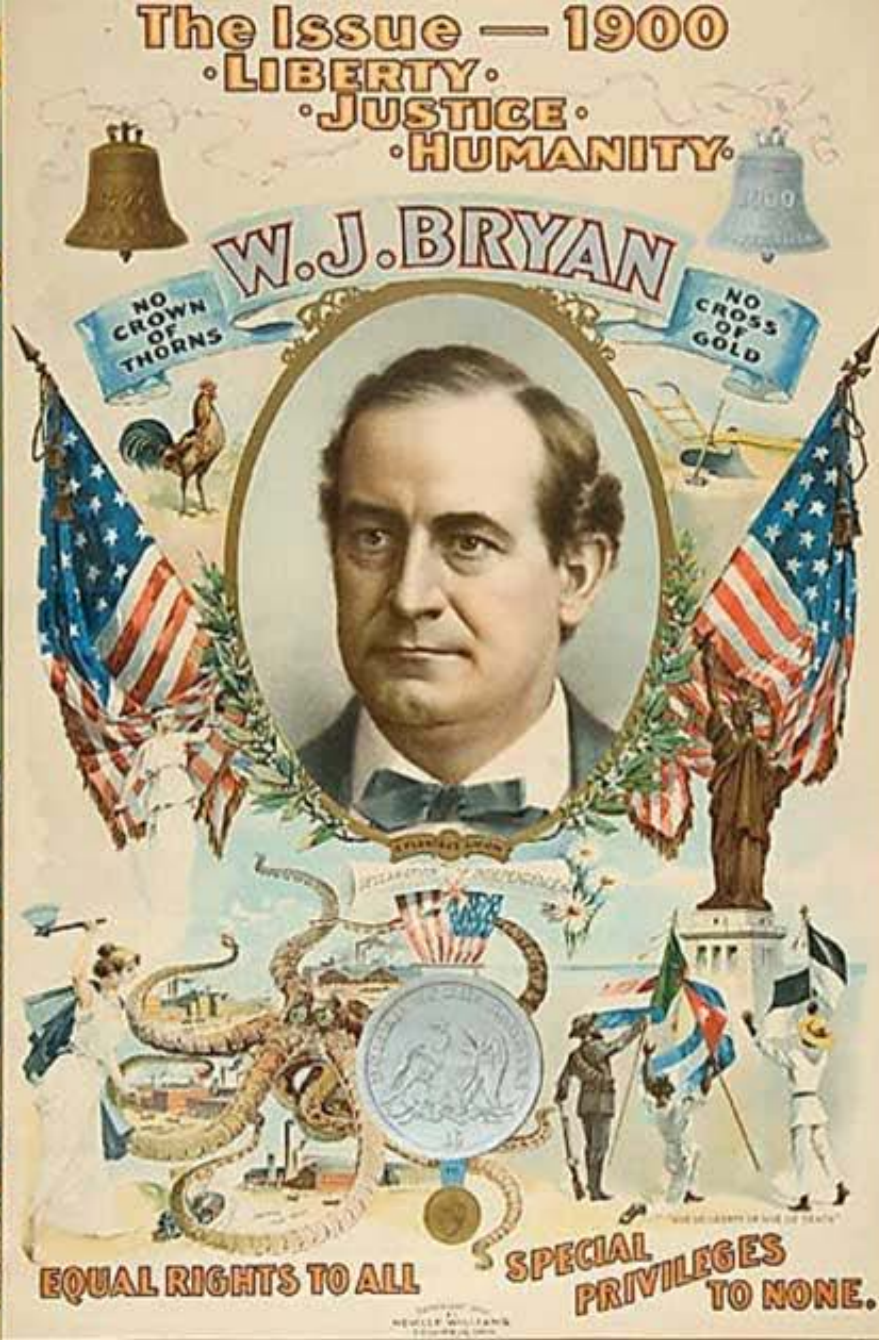
Year	Country	Name	Motivation
1668	Sweden	Bank of the Estates of the Realm. Forerunner of the Riksbank	Finance war and the consequences of excessive inflation
1694	UK	Bank of England	Finance war, debt management, and banker to the government
1800	France	Banque de France	Manage public debt, issue notes, : note issue, improve state revenue (seigniorage)
1816	Norway	Bank of Norway	Economic crisis in neighboring Denmark prompts monetary reform (note issue, lending)
1876	Germany	Reichsbank. Forerunner of Bundesbank	Consolidation of previous note issuing authorities following unification, upholds Gold Standard, under government management
1882	Japan	Bank of Japan	Part of modernization of Meiji regime, reserves management, vehicle to promote industrialization
1893	Italy	Banca d'Italia	Consolidation of previous note issuing authorities following unification and a banking crisis
1907	Switzerland	Swiss National Bank	Centralization and standardization of note issue, banker for the government and custodian of reserves
1913	USA	Federal Reserve System	Creation of lender of last resort and other banking related functions
1934	Canada	Bank of Canada	Lender of last resort

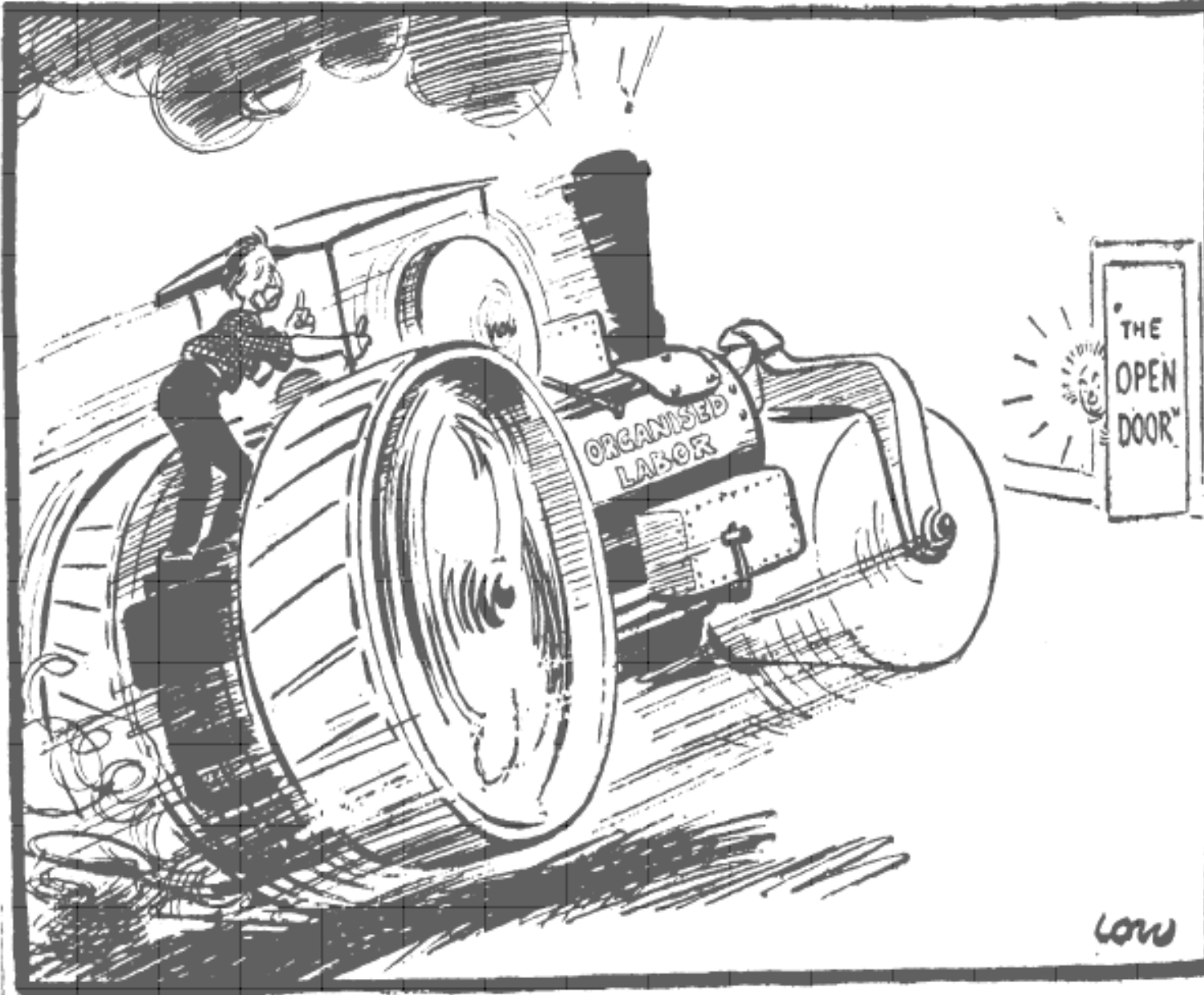
Source: Adapted, updated, and expanded from Siklos (2002), Table 1.2. Several of the central banks in our sample have posted historical time series but they do not always include prices or real economic information (e.g., the Swiss National Bank's Historical time series: [http://www.snb.ch/en/i/about/stat/statrep/statpubdis/id/statpub\\_histz\\_arch#t3](http://www.snb.ch/en/i/about/stat/statrep/statpubdis/id/statpub_histz_arch#t3)).

Key nodes in modern network of central banking are founded in late 19<sup>th</sup> century.

First modern central bank is the Fed created in 1913.

Why first modern? Because it is a central bank created to manage monetary policy under democratic conditions.



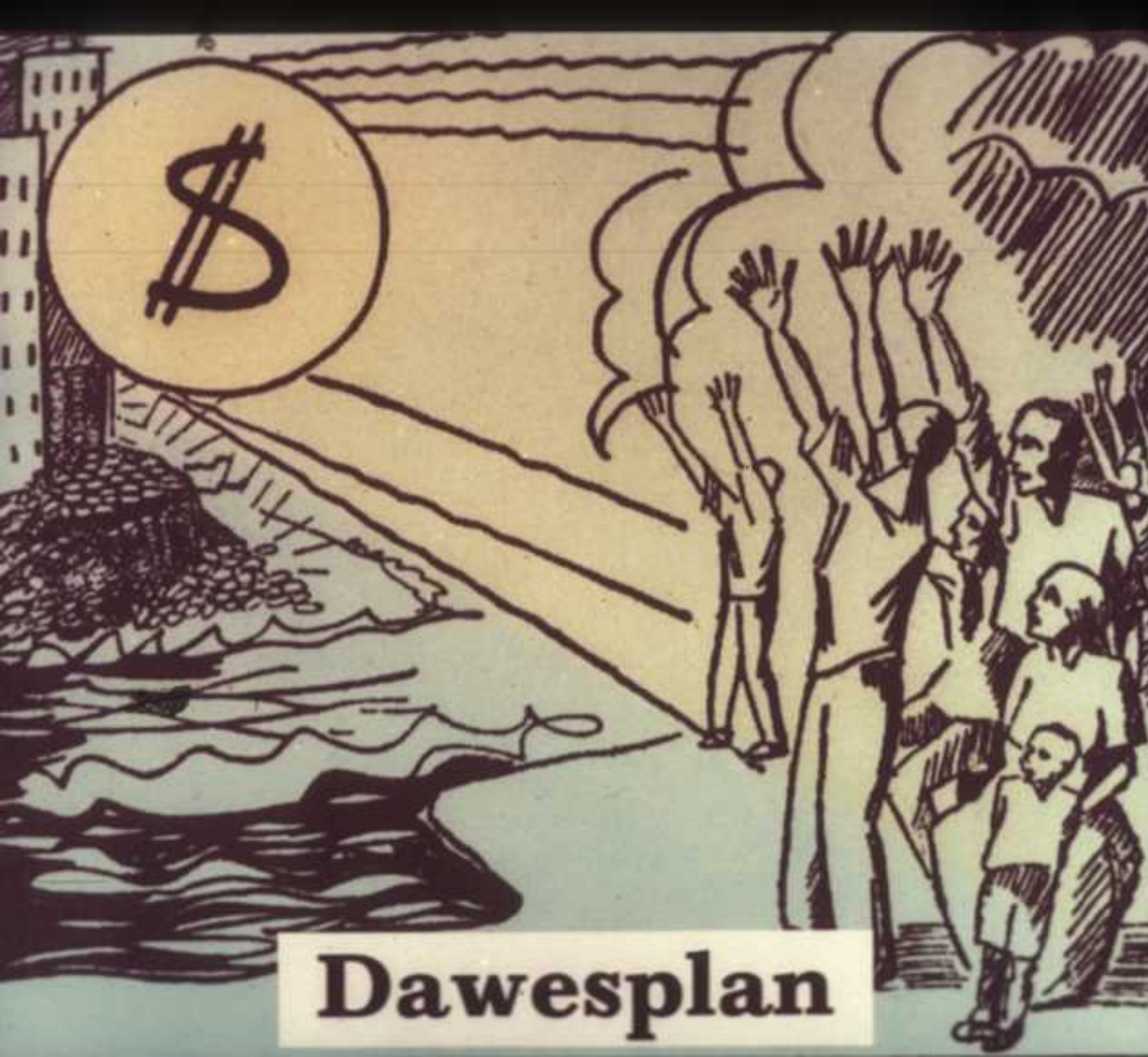


The Runaway Steamroller.

Aftermath of World War I saw central banks for the first time contending with 20<sup>th</sup>-century forces of class conflict and organized labour.

Tempting to think of socialist parties as big spenders. But in fact historically it is militarists who have been far larger.





Gold standard of 1920s was effort not just at economic but at political and geopolitical stabilization.

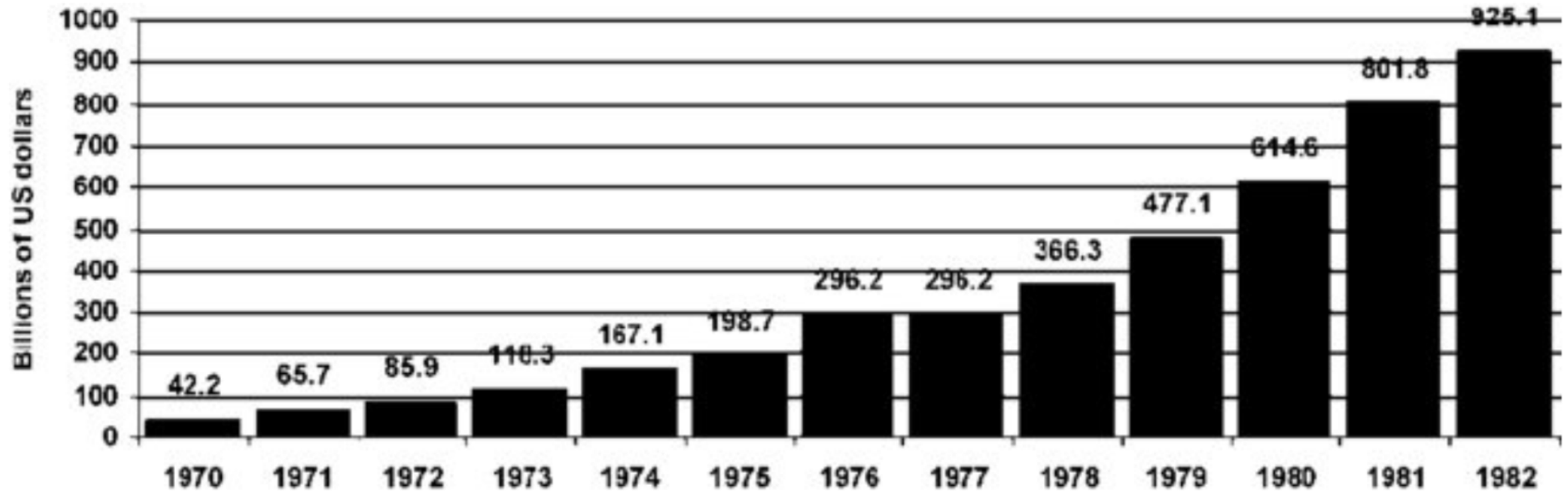


Adolf Hitler and central banker Hjalmar Schacht at the ceremony to lay the foundation stone for the new German central bank (Reichsbank) in 1934



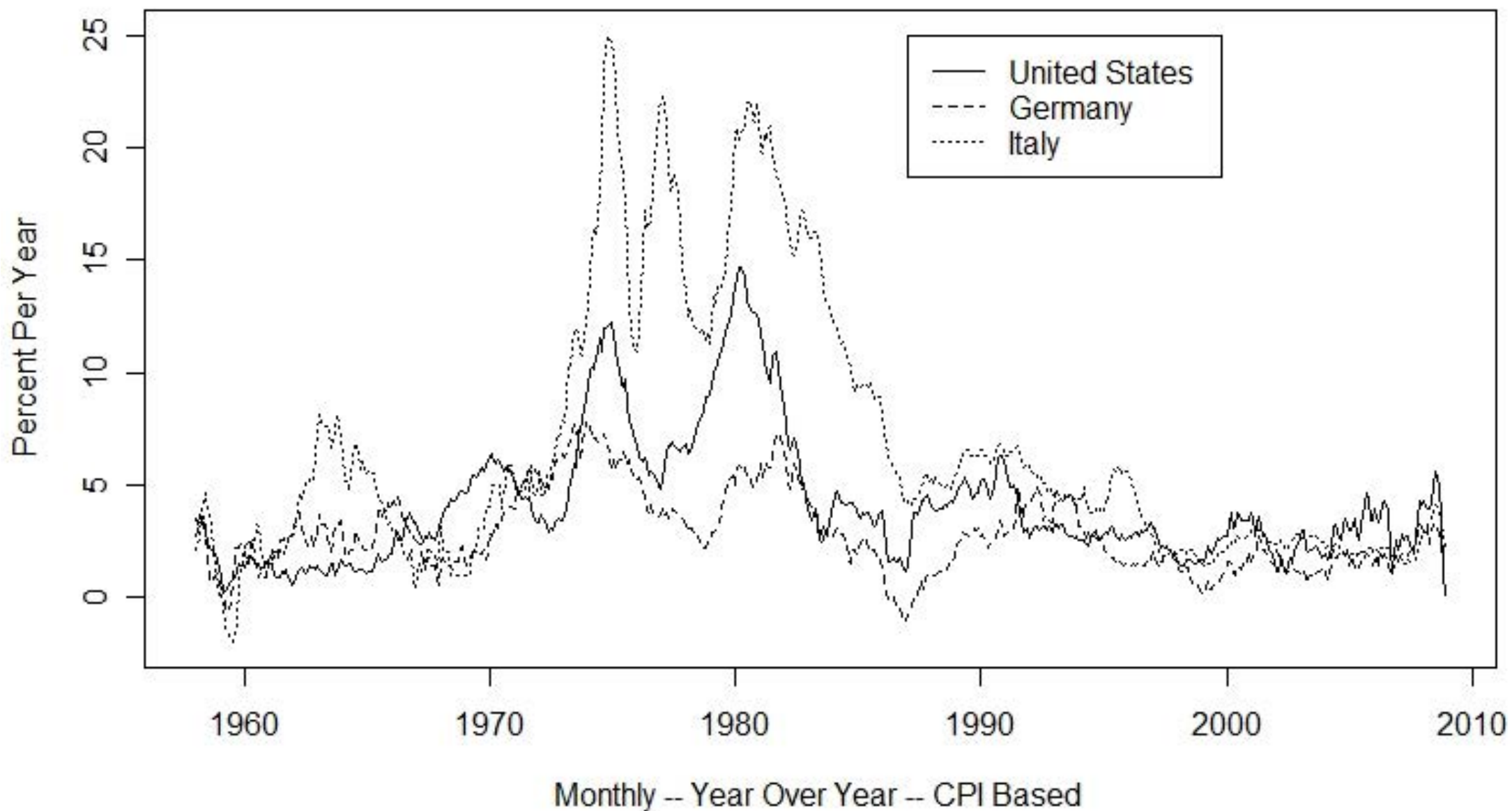
After the crises of the interwar period, the era of Bretton Woods was one of “boring banking” and “financial repression”.

Through central banks are centuries old, it is only in the 1970s that the global monetary system as we know it today comes into existence: fiat money, flexible exchange rates, zero capital controls, increasingly large-scale financial flows = system typified by Eurodollar market





**Figure 5. Inflation Rates -- United States, Germany and Italy**





The 1970s – after collapse of Bretton Woods and in face of surging inflation - is first moment when the Bundesbank model first comes into its own.

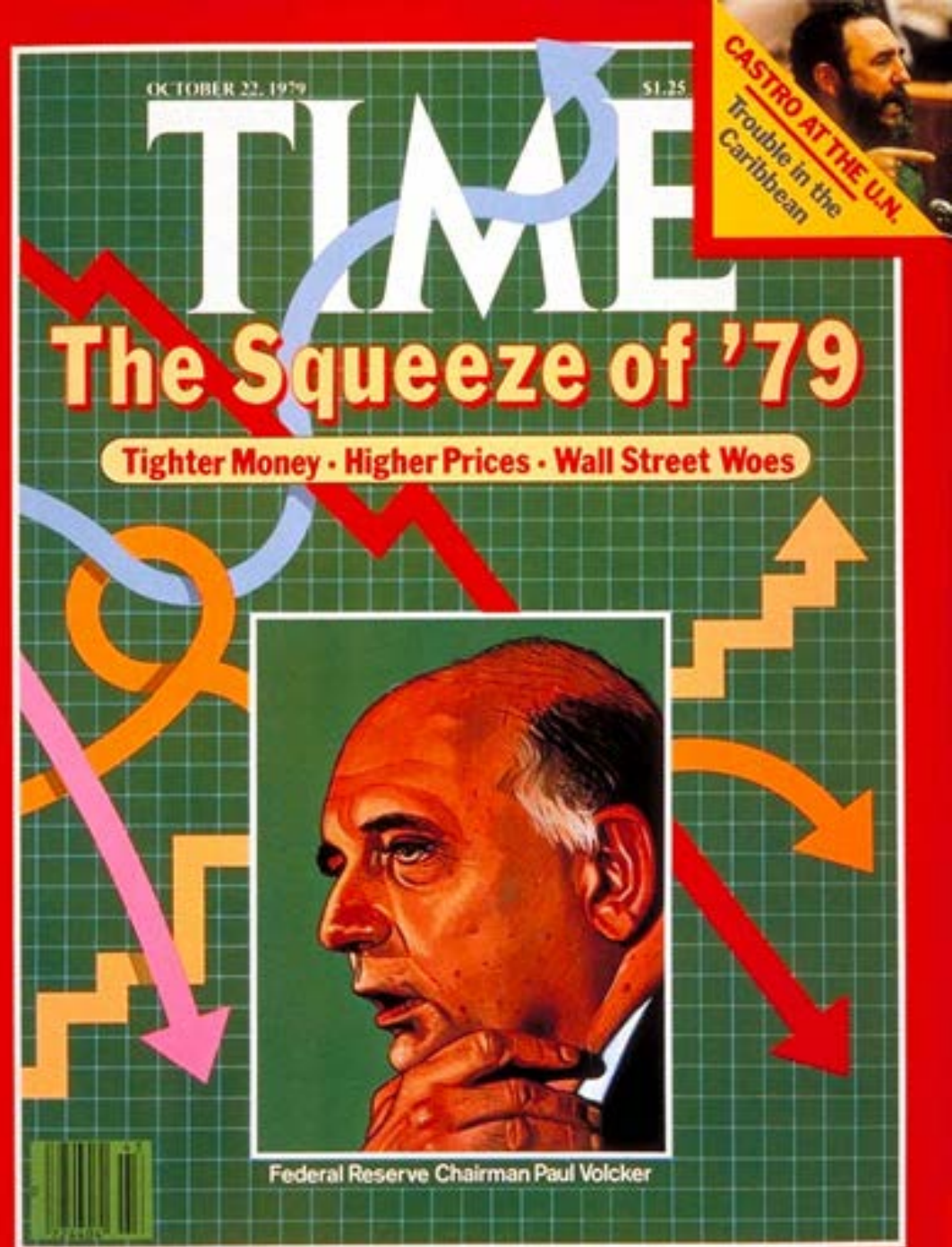
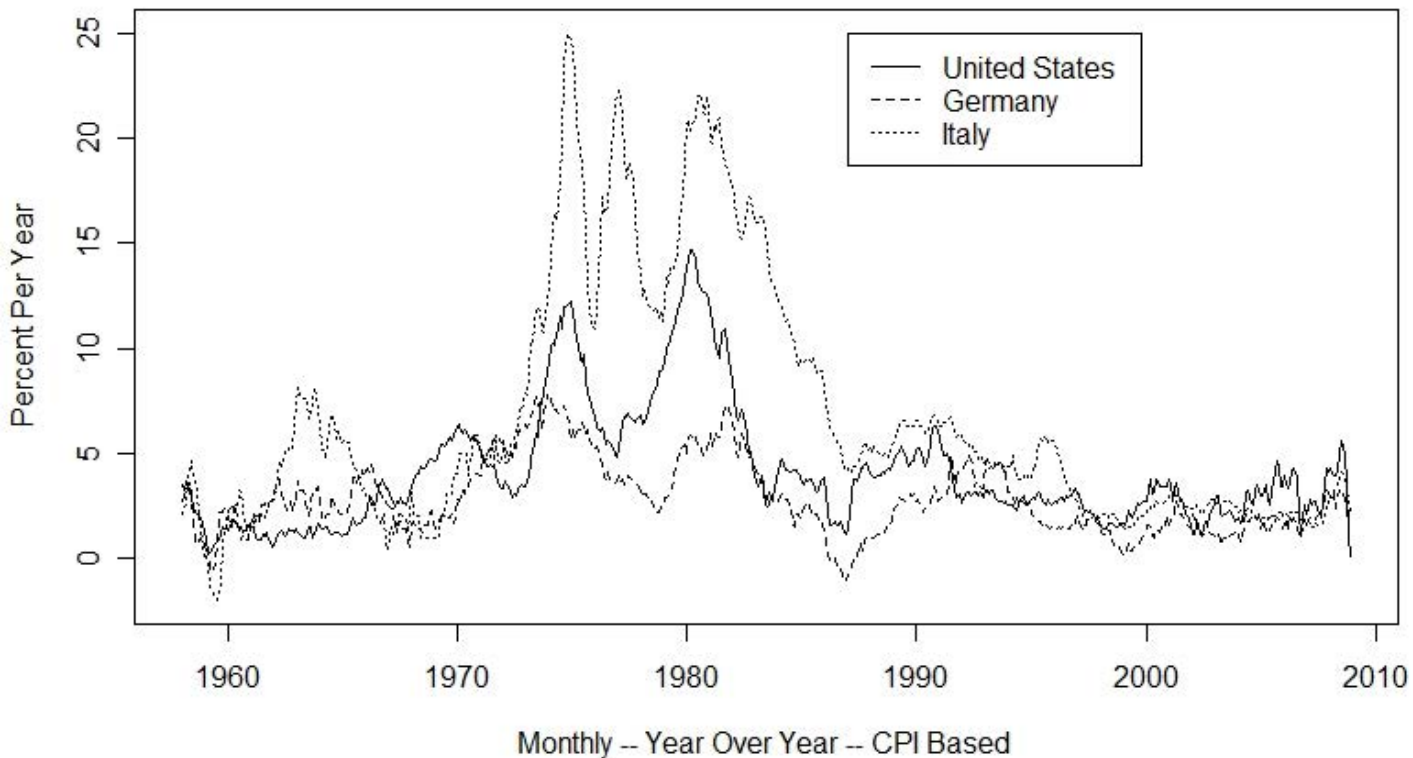
The Deutsche Bundesbank Act of July 26, 1957 gave birth to the present German central bank.

Shaped by Germany's traumatic experience and occupation comes into its own.

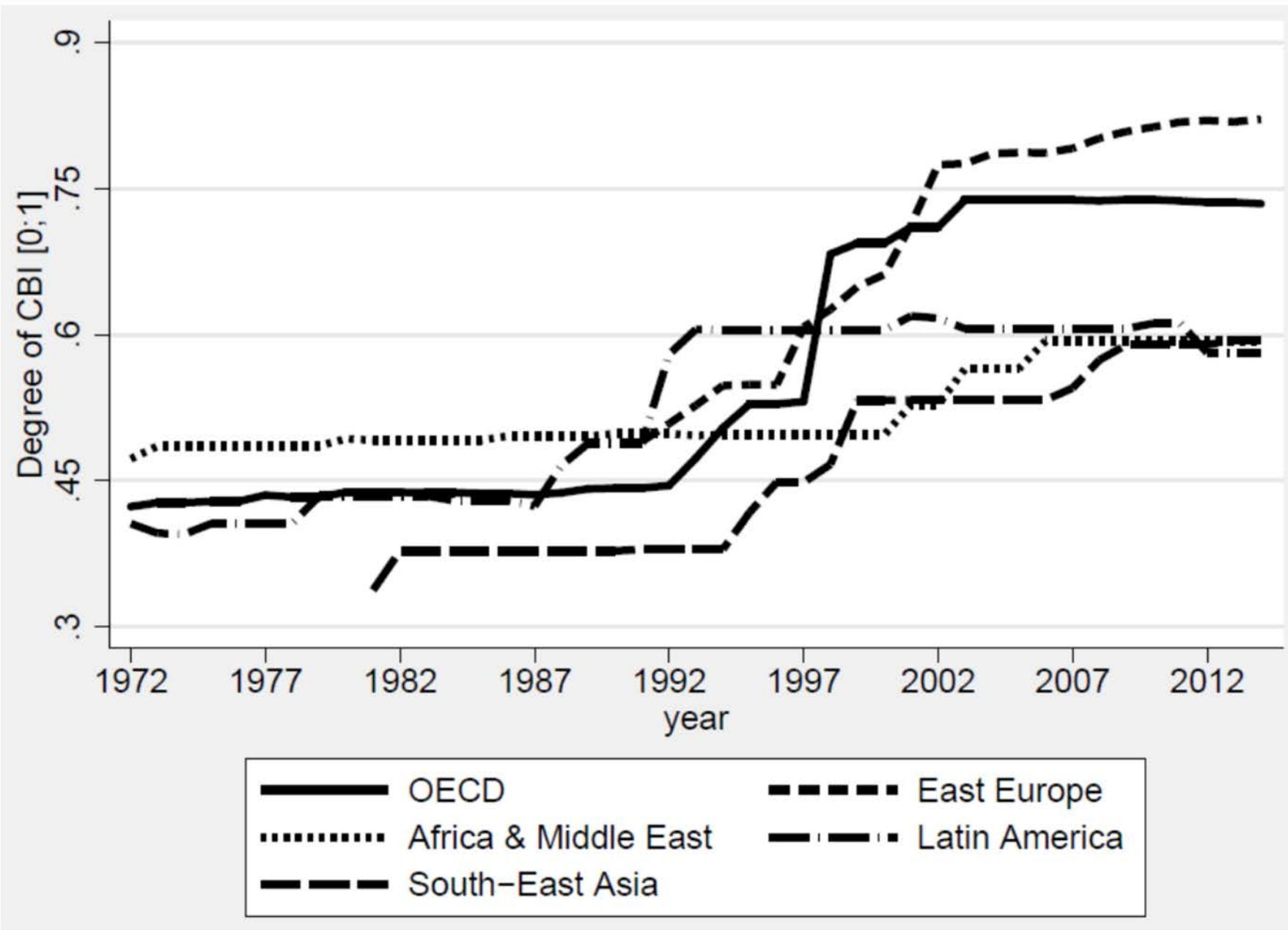
1973-74 Bundesbank becomes first central bank to adopt monetary targets.

-> establishes norm of price stability and low inflation as low-cost optimal policy

Figure 5. Inflation Rates -- United States, Germany and Italy



**Figure 3: Average degree of ECBI across regions**



1990s spread of central bank independence.

By 2011 9000 academic papers had been devoted to the topic.

COLOMBIA  
A survey after page 52

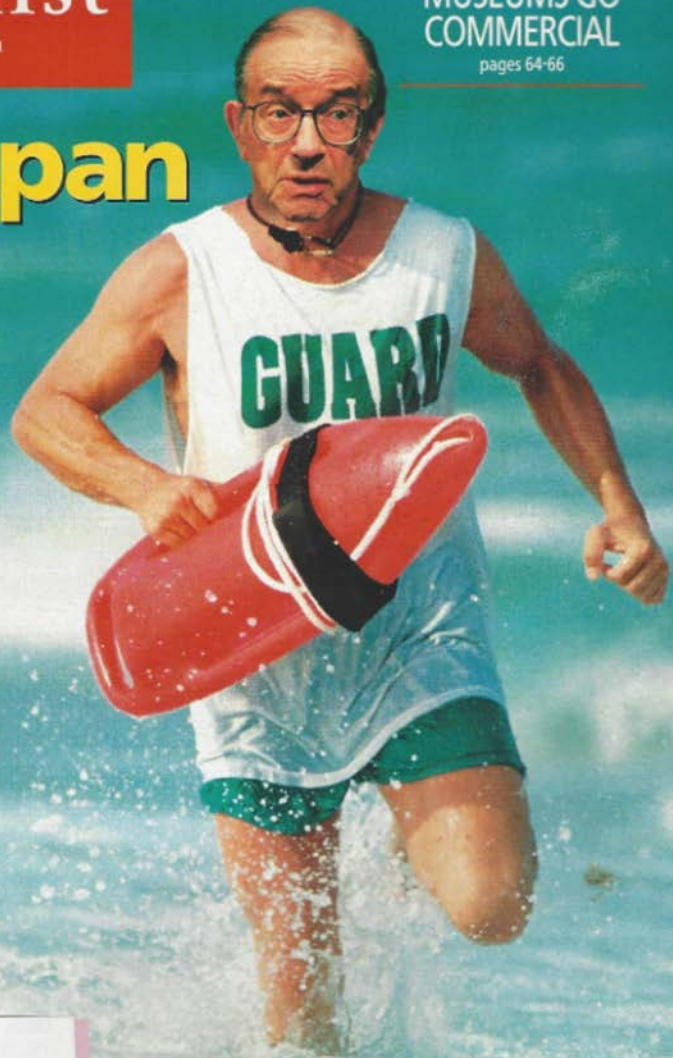
# The Economist

APRIL 21ST - 27TH 2001

FREE TRADE IN  
THE AMERICAS?  
pages 14 and 19-22

MUSEUMS GO  
COMMERCIAL  
pages 64-66

## Greenspan to the rescue



Canada	C\$4.95	Guyana	G\$17.50	Peru	S/22.80
Chile	Ch\$3,000	Jamaica	J\$170	UK	£2.70
Colombia	Col\$15,000	Mexico	Mex\$45	USA	US\$2.95
Ecuador	US\$2.00	Panama	US\$1.70	Venezuela	Bs3,250

FEBRUARY 25, 2001 \$2.50



The Clintons:  
Their Future

Who Wrote  
Shakespeare?

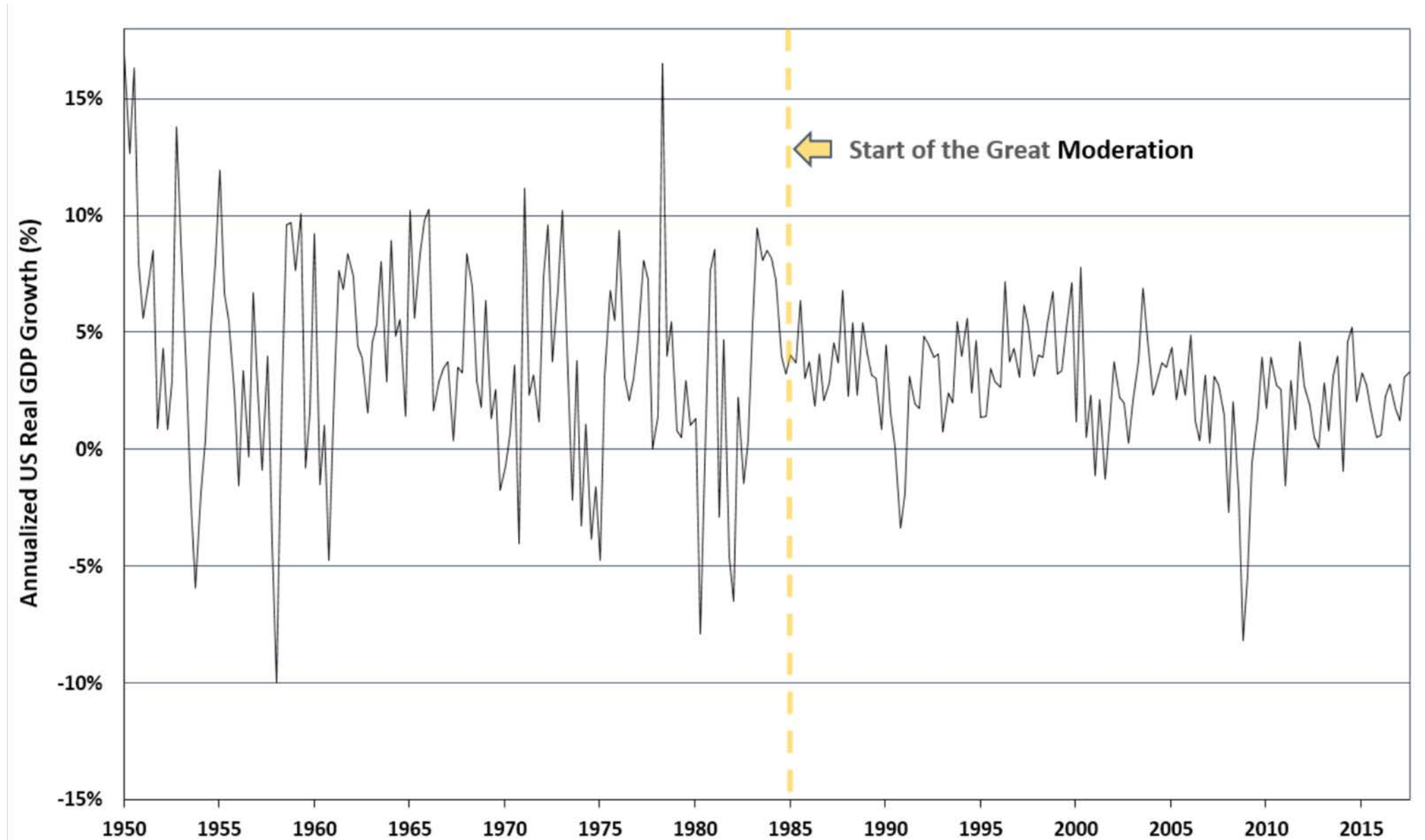
## THE COMMITTEE TO SAVE THE WORLD

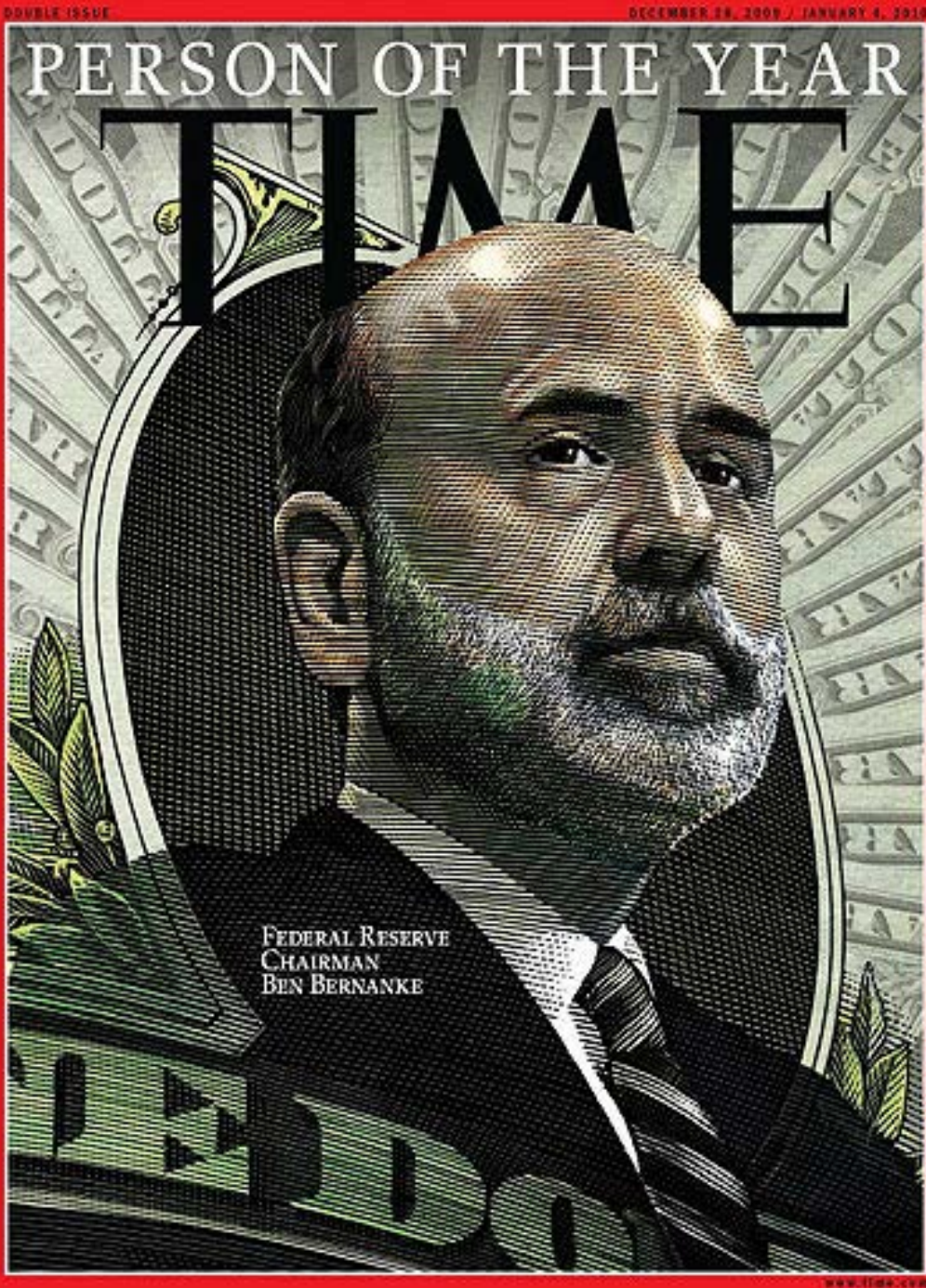
The inside story  
of how the  
Three Marketeers  
have prevented a  
global economic  
meltdown—so far

Rubin, Greenspan and Summers  
at the U.S. Treasury last Wednesday

www.time.com

# Great moderation: heroes or accidental beneficiaries?





The crisis of 2008 disrupts the great moderation.

The most dangerous crisis ever – Bernanke.

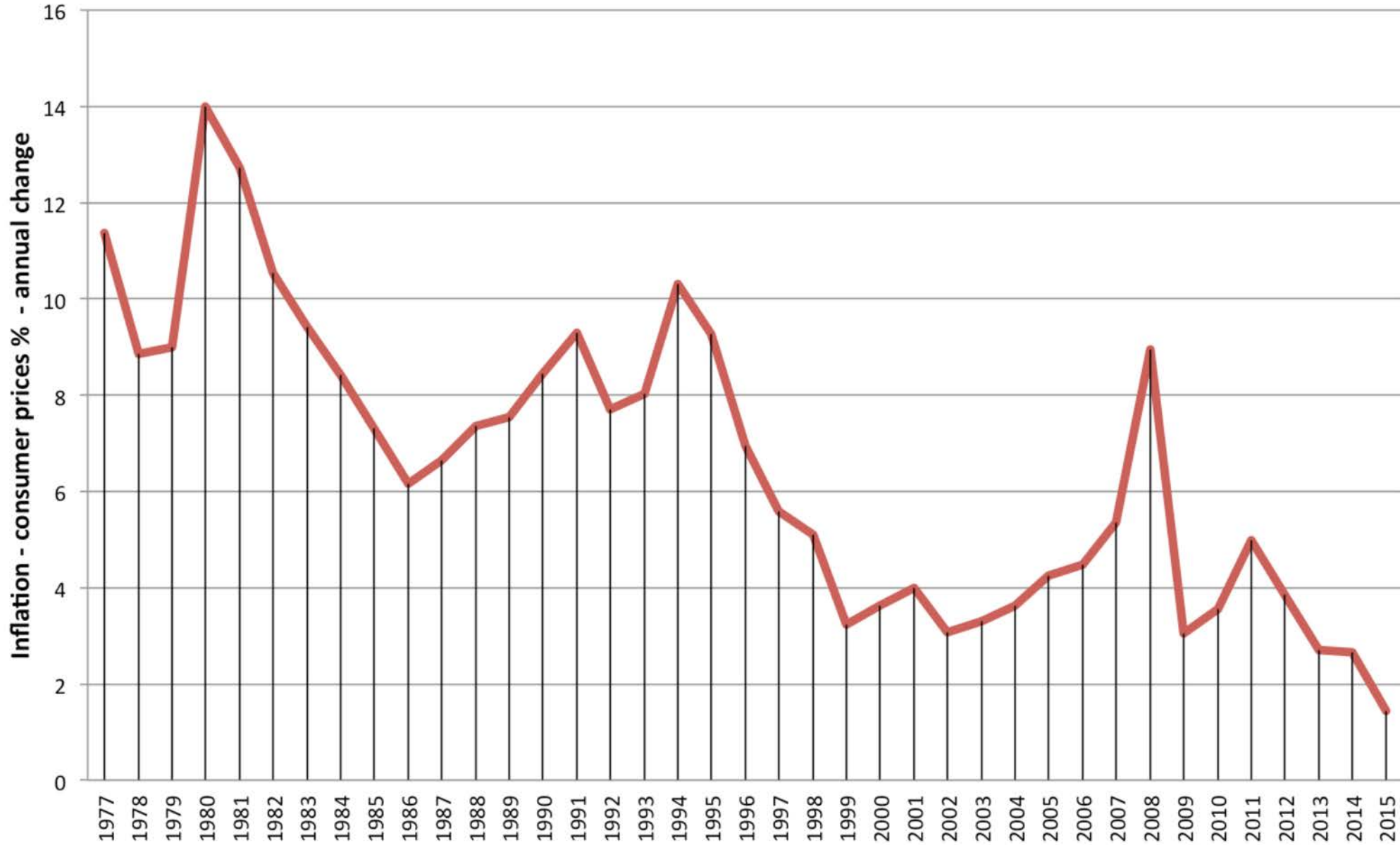
Vast expansion of both national and transnational action (liquidity swap lines)

Huge expansion in balance sheets.

QE

Macroprudentialism

# Global inflation rate





A photograph of Ben Bernanke, former Chairman of the Federal Reserve, speaking in profile. He is wearing a dark suit, white shirt, and red tie. Behind him is a large American flag and a red, textured background. Two white text boxes are overlaid on the image, containing quotes from Bernanke in 2015.

“[T]he increasing hostility of the Republicans to the Fed and to me personally troubled me, particularly since I had been appointed by a Republican president who had supported our actions during the crisis. I tried to listen carefully and accept thoughtful criticisms. But it seemed to me that the crisis had helped to radicalize large parts of the Republican Party,”  
Ben Bernanke 2015

“lost patience with Republicans’ susceptibility to the know-nothing-ism of the far right. I didn’t leave the Republican Party. I felt that the party left me.”  
Ben Bernanke 2015

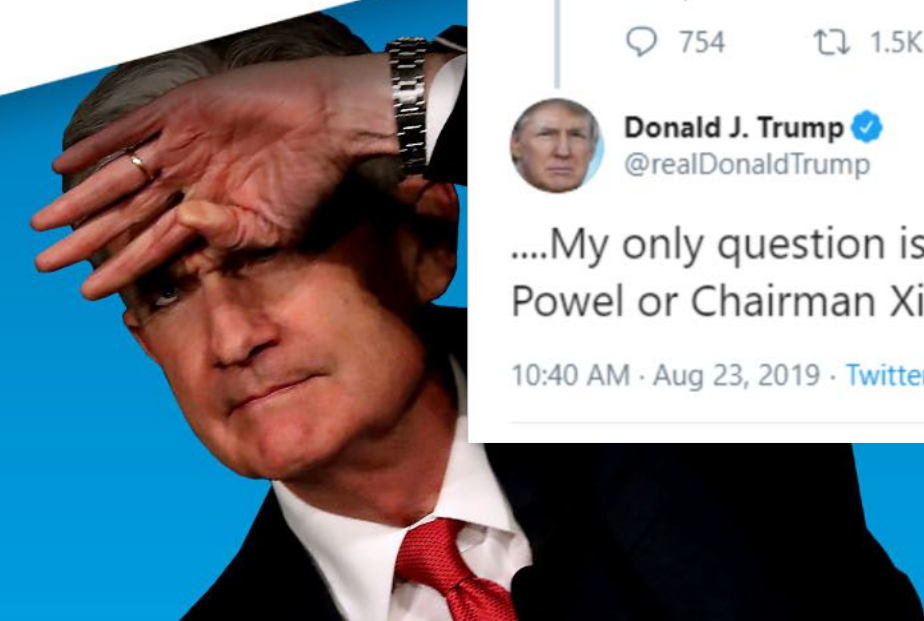
**Donald J. Trump** @realDonaldTrump  
Russia and China are playing a Devaluation game as the U.S. raises interest rates. Not acceptable!

**Donald J. Trump** @realDonaldTrump  
I hope the people over at the Fed will read today's Wall Street Journal Editorial before they make yet another mistake. Also, don't let the market become any more illiquid than it is. Stop with the 50 B's. Fed just go by me

**Donald J. Trump** @realDonaldTrump  
It is incredible that with a very strong dollar and virtually no inflation, the outside world is blowing up around us, Paris is burning and China way down, the Fed is even considering yet another interest rate hike. Take the Victory!

**Donald J. Trump** @realDonaldTrump · 3m  
As usual, the Fed did NOTHING! It is incredible that they can "speak" without knowing or asking what I am doing, which will be announced shortly. We have a very strong dollar and a very weak Fed. I will work "brilliantly" with both, and the U.S. will do great...

**Donald J. Trump** @realDonaldTrump  
....My only question is, who is our bigger enemy, Jay Powel or Chairman Xi?



It is tempting to think of the economic policy dilemmas and the political problems as separate. But they are surely linked both in triggering and enabling conflict.

Faced with slow growth and resentment at inequality, economic nationalism is tempting.

Nationalism causes market stress. But a politician like Trump pays a minimal price for his aggression against the central bank in demanding looser policy.

Despite giant deficits, there is no risk of bond vigilante punishment.

There is no risk of inflation.

Furthermore given limp economic conditions. Many on the central bank and large cross section believe that he is right.

OPINION | COMMENTARY

# The Fed's Mandate Is Up to Congress and the President

Lawmakers in the past have broadened the central bank's goals, directing it to boost U.S. competitiveness.

By Judy Shelton

Sept. 16, 2019 6:39 pm ET



The Federal Reserve building in Washington, Aug. 22, 2018. PHOTO: CHRIS WATTIE/REUTERS

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## Economics

# The Fed Shouldn't Enable Donald Trump

The central bank should refuse to play along with an economic disaster in the making.

By [Bill Dudley](#)

August 27, 2019, 6:00 AM EDT

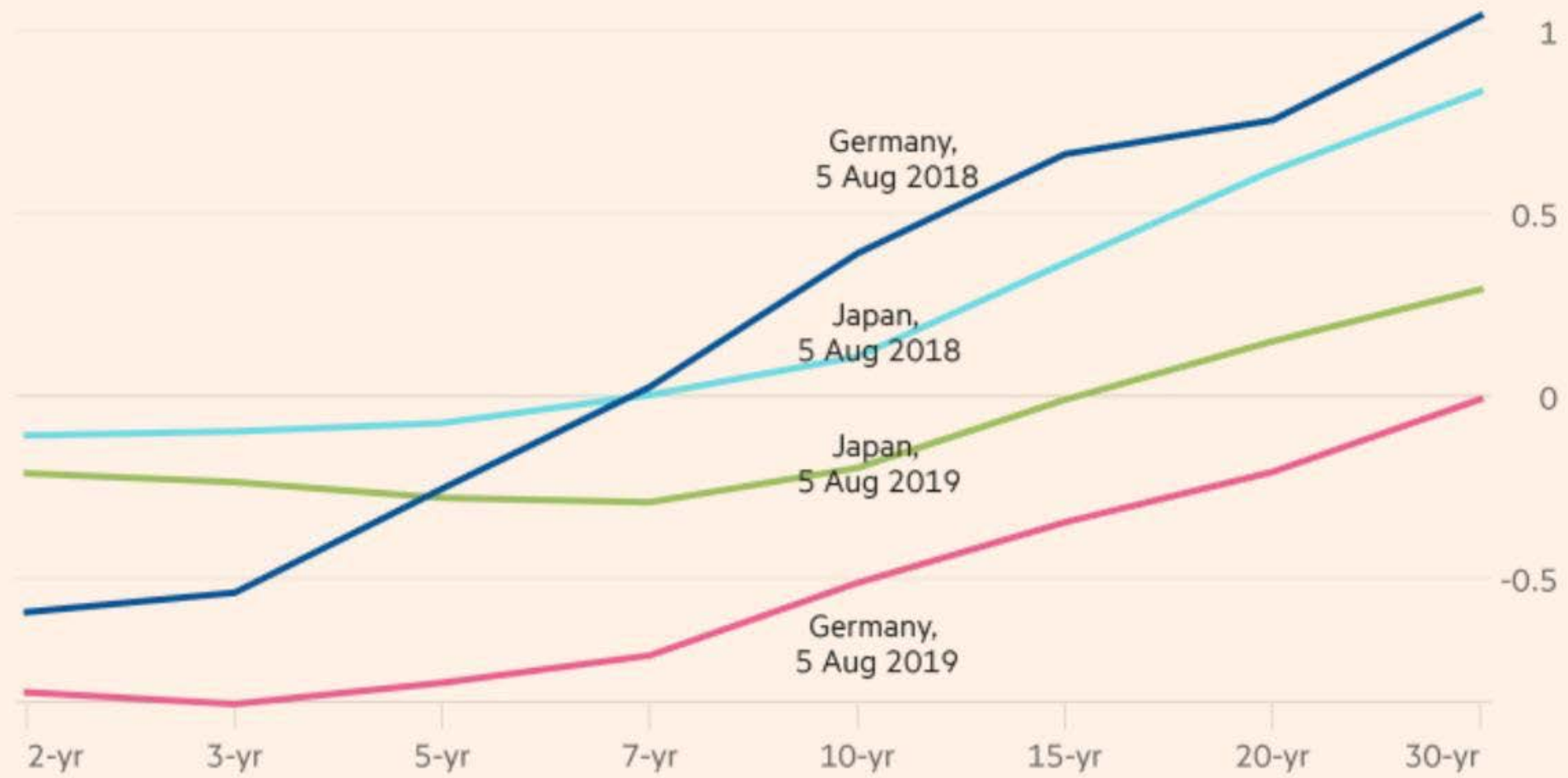


I understand and support Fed officials' desire to remain apolitical. But Trump's ongoing attacks on Powell and on the institution have made that untenable. Central bank officials face a choice: enable the Trump administration to continue down a disastrous path of trade war escalation, or send a clear signal that if the administration does so, the president, not the Fed, will bear the risks – including the risk of losing the next election.

There's even an argument that the election itself falls within the Fed's purview. After all, Trump's reelection arguably presents a threat to the U.S. and global economy, to the Fed's independence and its ability to achieve its employment and inflation objectives. If the goal of monetary policy is to achieve the best long-term economic outcome, then Fed officials should consider how their decisions will affect the political outcome in 2020.

# The entire German yield curve is now negative

German and Japanese government bond yield curves (by maturity, %)





German and Italian populism have opposite views on euro – too soft v. too hard – but a common enemy in the ECB.



**GELD-WAHNSINN**

# So saugt GRAF DRAGHILA unsere Konten leer

In seiner Amtszeit haben wir Milliarden verloren



# Deutschlands oberster Banker rechnet mit Graf Draghila ab

Seit Jahren saugt der EZB-Chef unsere Konten leer!

Die BILD-Fotomontage zeigt Mario Draghi als „Graf Dracule“

Jens Weidmann ist seit 2011 Bundesbankpräsident und Mitglied im EZB-Rat

Von KAI WEISE

**BILD:** Neue Anleihekäufe und noch höhere Strafzinsen für Banken. Halten auch Sie das für nötig?

**Jens Weidmann:** „Die Konjunktur hat sich abgekühlt – vor allem in Deutschland, aber auch sonst im Euroraum. Aber ein so weitreichendes Paket zur Lockerung der Geldpolitik wäre nicht nötig gewesen. Aus meiner Sicht ist der EZB-Rat damit über das Ziel hinausgeschossen. Denn die wirtschaftliche Lage ist nicht wirklich schlecht, die Löhne steigen deutlich, und die Gefahr dauerhaft sinkender Preise und Löhne ist auch nicht zu erkennen.“

**BILD:** Was bedeutet das jetzt für Sparer und Immobilienkäufer?

**Weidmann:** „Für die Bevölkerung heißt das: Wer bauen will, bekommt vielleicht günstigere Kredite. Sparer dagegen sind schlechter dran. Sie können zwar auf andere Weise profitieren, etwa durch einen sichereren Arbeitsplatz. Ganz allgemein wird es aber schwerer, für das Alter vorzusorgen, ohne mehr Risiko einzugehen. Das spüren Pensionisten und Lebensversicherer besonders.“

**BILD:** Müssen wir jetzt die Hoffnung auf Zinsen für...

**BILD:** Hat die Geldpolitik der EZB seit Ende der Finanzkrise Europa mehr genutzt oder mehr geschadet?

**Weidmann:** „Die entschlossene Reaktion der Geldpolitik auf die Finanzkrise war richtig, sie hat Schlimmeres verhindert. Mir war aber immer wichtig, dass die Geldpolitik nicht ins Schleppertau der Finanzpolitik gerät. Denn das gefährdet unsere Fähigkeit...

**Der BILD-Ombudsmann**

## Die Fälle Jatta und Metzelder

Zu der Berichterstattung über die Fußballstars Bakery Jatta und Christoph Metzelder erreichte mich eine Reihe von Briefen mit dem Tenor: „Beispiellose Hetzjagd“, so Leser Christian Schlatter zum Fall Jatta und „hochgradig unverantwortlich“, so nicht alle Fragen, die in diesem Zusammenhang aufkamen, geklärt. Aber der Fall ist abgeschlossen. Die Recherche und die darauf basierenden Veröffentlichungen waren gerechtfertigt.

★★★★  
Im Fall Metzelder, gegen

**BILD-Ombudsmann**  
Ernst Elitz

gekocht, und die Medien hätten sich dem Vorwurf ausgesetzt gesehen, wider besseres Wissen Informa-

PHOTO: AND GÖLLERMANN



# Memorandum on ECB Monetary Policy by Issing, Stark, Schlesinger

Bloomberg News

October 4, 2019, 4:31 AM EDT

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▶ 5:47

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## In this article

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The following is a memorandum on the European Central Bank's monetary policy published on Friday and signed by the people below. Jacques de Larosiere, a former governor of the Bank of France, shared their judgment. The text is reproduced in the original format of their statement.

- Herve Hannoun, former first deputy governor of the Bank of France
- Otmar Issing, former member of the ECB's Executive Board
- Klaus Liebscher, former governor of the Austrian central bank
- Helmut Schlesinger, former president of Germany's Bundesbank
- Juergen Stark, former member of the ECB's Executive Board
- Nout Wellink, former governor of the Dutch central bank

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