Political Independence and Technical Independence of Central Banks: A Crucial Distinction for European Monetary and Banking Union

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Abstract

European economic history of the 19th and 20th centuries provides several examples of monetary unions, that is to say, mergers into a single monetary administrations of several previously distinct monetary areas. Comparison of these processes with the on-going trend of European monetary union shows that there are significant differences and less important similarities. Even so, such a comparison provides fruitful insights on the main problems that the process of European monetary union must face. One of these problems is the role of central banking, and the question of central banking independence. Current literature on the subject usually presents a holistic definition of the concept and links it to the goal of preservation of monetary stability. However, for historical and analytical reasons, a distinction should be made between political independence and technical independence of a central bank. Whenever the political decision-makers set some goal for the central bank, the central bank cannot be considered as politically independent. Whenever the central bank is allowed to pursue its goals, however chosen, without government interference, the central bank can be considered technically independent. Historical analysis shows that central banks are not usually politically independent, but became technically independent during the 20th century. The preservation of this distinction appears as a crucial element for a successful European monetary and banking union in the 21st century.

Key words: central bank independence; European monetary and banking union.
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1. Introduction

European economic history of the 19th and 20th centuries provides several examples of monetary unions, that is to say, mergers into a single monetary area of several previously distinct monetary spaces. Section 2 compares these monetary unions with the on-going process of European monetary union and concludes that there are significant differences and less important similarities. Anyway, such a comparison provides fruitful insights on the main problems that the process of European monetary union must face. One of these problems is the role of central banking, and the question of central banking independence. Section 3 discusses the concept of independence of central banks, and argues that distinction between political independence and technical independence is a crucial one. Sections 4 and 5 analyse the historical evolution, respectively, of political independence and technical independence. It becomes clear that central banks are not usually politically independent, but became technically independent during the 20th century. The conclusion elaborates on the point that preservation of this distinction appears as a crucial element for a successful European monetary and banking union in the 21st century.

2. What is new about European monetary union?

The 19th and 20th centuries witnessed a significant number of processes of monetary union among European countries. The most important were, by chronological order:

1) The Italian monetary unification, 1859-1862

The Italian monetary unification was a result of its political unification. The campaign of 1859, during which France and Piedmont-Sardinia defeated Austria, united the states of Piedmont-Sardinia, Parma, Modena and Tuscany, the ex-Austrian province of Lombardy and the ex-papal province of Romagna into the kingdom of Upper Italy (which lost Nice and Savoy to France as the price of its alliance).

The campaign of 1860 united the kingdom of Upper Italy, the kingdom of Two Sicilies (Sicily and Naples) and the ex-papal provinces of Marche and Umbria into the kingdom of Italy. As the leading force of political unification, Piedmont-Sardinia provided the new kingdom with its monetary system: as soon as a new territory was annexed, the local monetary unit disappeared and local coins were given legal values in the framework of the Piedmontese monetary system, according to their gold or silver content, or to their previous value as subsidiary money. The Law of 24 August 1862 that transformed the Piedmontese lira into the Italian lira just confirmed this state of things, and provided measures to replace the old coins by new coins. The Italian monetary system was later extended to other territories annexed by Italy – Venetia in 1867, Latium in 1870, Trentino and Istria in 1919, Dalmatia and the Ionian Islands in 1941 (Istria, Dalmatia and the Ionian Islands were later lost in 1945 to Yugoslavia and Greece) – and to the formally independent states of San Marino and the Vatican City.

The Italian monetary unification did not immediately imply the existence of a single issuing bank. The Bank of Italy was created only in 1893, through the merger of four issuing banks, the National Bank of the Kingdom of Italy (which was the former National Bank of the Sardinian States and had previously absorbed two other issuing banks, the Bank of Parma and the Bank of Bologna), the National Tuscan Bank, the Tuscan Bank of Credit and the Roman Bank, and only during the 1920s did the Bank of Italy become the only issuing bank of the country, when the issues of the Bank of Naples and the Bank of Sicily were discontinued[1].

2) The Latin Union, 1866-1914

The Latin Union was an attempt to introduce a common monetary unit and a partially-common monetary circulation among France, Belgium, Italy and Switzerland, later joined formally by Greece (1868) and Romania (1889), and informally by the Church

[1] On the Italian monetary unification, see Zamagni (1993).

States (until they were annexed by Italy) and Spain (1868), and by Bulgaria, Serbia and Montenegro (1889).

This did not lead to a true monetary unification, because there was no common banknote issue and no common issuing bank. Thus, the common monetary unit was really not more than the existence of 1:1 fixed exchange rates among the various monetary units. As might be expected, such fixed exchange rates were revoked as soon as goals contradictory with respect to monetary agreements became priority. This happened with the outbreak of the First World War[2].

3) The German monetary unification, 1873

Technically, the German monetary unification of the 19th century was a piecemeal process. This was a consequence of the similarly step-by-step pace of the political and economic unification of the country. From a monetary point of view, almost all states of the German Confederation gradually adopted a common silver standard divided into four currency zones: the 1837 Munich Convention unified the currencies of nine states (Baden, Bavaria, Frankfurt, Hesse-Darmstadt, Hohenzollern-Hechingen, Hohenzollern-Sigmarigen, Nassau, Saxe-Meiningen, and Würtemberg) as the silver gulden; the 1838 Dresden Convention unified the currencies of eighteen states (Anhalt-Bernburg, Anhalt-Dessau, Anhalt-Köthen, Hesse-Homburg, Hesse-Kassel, Lippe-Detmold, Mecklemburg-Schwerin, Prussia, Reuß-Gera, Reuß-Greiz, Reuß-Schleiz, Saxony, Schwarzburg-Rudolstadt, Schwarzburg-Sondershausen, Saxe-Altenburg, Saxe-Coburg-Gotha, Saxe-Weimar, and Waldeck) as the silver thaler; the silver thaler was later adopted as their currency by Brunswick, Schaumburg-Lippe and Luxembourg (1842), Hanover and Oldenburg (1854) and Mecklemburg-Streliz (1867); an 1852 convention formally confirmed a monetary union between Austria and Liechtenstein, already existing in practice; Hamburg and Lübeck shared the silver mark as their currency. By the late 1860s, only one member of the German Confederation, Bremen, remained outside

[2] On the Latin Union, see Flandreau (1995) and Flandreau (2000).

this pan-German silver standard, maintaining a gold standard instead.

The political unification of 'small' Germany (Germany without Austria, and also Liechtenstein and Luxembourg) in 1871, quickly led to the Law of 4 December 1871, which created a German monetary unit, the new silver mark; to the Law of 9 July 1873, which extended the use of the mark to the whole German Empire, including in the German monetary union the Hanseatic cities of Bremen and Hamburg, hitherto excluded; and to the Laws of 14 March and 22 September 1875, which created a central issuing bank for the Empire, the Reichsbank, based on the previous Prussian issuing bank, regulating and limiting the issues of the other thirty two issuing banks of the Empire. Meanwhile, the German Empire had made the transition from silver standard to gold standard, but only the Law of 1 July 1909 formalized such transition. Thereafter, the German monetary union followed the ups and downs of the German national state[3].

4) The Scandinavian Union, 1875-1914

The Scandinavian Union was an attempt to introduce a common monetary unit and a partially common monetary circulation between Denmark (including the Faroe Islands, Iceland and Greenland), Norway and Sweden.

The process was quite similar to the Latin Union mentioned above, and comments similar to those presented above for that case might apply, *mutatis mutandis*[4].

5) The Yugoslavian monetary unification, 1913-1920

Yugoslavia was built partly after the Balkan wars that preceded the First World War (annexation of Macedonia by Serbia), partly after the First World War (merger of former independent states of Serbia and Montenegro and annexation of the southern provinces of the Austria-Hungary Empire – Bosnia-Herzegovina, Croatia, Dal-

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[3] On the 19th century German monetary unification, see Deutsche Bundesbank (1976) and Valério (2012a).
[4] On the Scandinavian monetary union, see Henriksen, Kaergård (1995).

matia, Slovenia, and Vojvodina). From a political and monetary perspective, the process had many analogies to the one of Italian unification roughly half a century earlier: Serbia provided the political impulse and the monetary framework for unification, the Serbian dinar being transformed into the Yugoslavian dinar, and the National Bank of Serbia being transformed into the National Bank of Yugoslavia at the pace of political unification.

6) The Polish monetary unification, 1917-1924

Poland was rebuilt from territories belonging to the Austrian, German and Russian empires (which had partitioned Poland in the late-18th century) after the First World War. This was a politically complicated process, because of the difficult fixing of borders (especially with Germany, as the partition of Silesia, the existence of the so-called corridor and the Free City of Danzig remained informally open issues until the Second World War, and with Russia, as a consequence of the expansion of Poland east of the so-called Curzon line), and monetarily, because of the need to replace three different currencies that remained in existence elsewhere by a single new currency. Firstly, there was an attempt to create a Polish marka, pegged to the German mark, and an issuing bank, the Polish Bank of Credit, but hyperinflation swept away the new currency. Thus, there was need to replace it by the new Polish zloty, and to create a new issuing bank, the Bank of Poland, in 1924[5].

7) The monetary union between Belgium and Luxembourg, 1921

Luxembourg did not join the German Empire in 1871, and lived until the First World War in a confortable frontier regime between the German monetary union and the Latin Union. The monetary upheavals of the war and immediate post-war years destroyed that situation. In such a context, the monetary union between Belgium and Luxembourg may be considered an attempt by the Luxembourg authorities to recover a degree of monetary stability that the country

[5] On the Polish monetary unification, see Landau (2003).

was unable to achieve by itself without being committed to an overwhelming neighbour (it may be added that, anyway, neither France, nor Germany presented at the time a truly stable monetary regime). As the union achieved its goals, it was maintained until both countries joined the European monetary union in 1999 (except for fresh transitory upheavals resulting from German occupation during the Second World War)[6].

8) The monetary union between Switzerland and Liechtenstein, 1924

The monetary union between Switzerland and Liechtenstein may be considered a side consequence of the collapse of the Austria-Hungary Empire and its monetary system in the wake of the First World War. Similarly to Luxembourg, Liechtenstein looked for monetary stability from the other neighbour of the country and the success of the move ensured its survival until the present.

9) The German monetary unification, 1990

The German monetary unification of 1990 may be considered part of the German political unification that quickly followed the collapse of Soviet hegemony over Central and Eastern Europe in 1989. The process was made under the supervision of foreign powers (still the occupying powers in the wake of the Second World War) and under the threat of a possible Soviet revival (as a matter of fact the Soviet Union collapsed only fifteen months after German political unification, but this was not foreseeable for sure in 1990). Thus, special care had to be taken about respecting foreign interests and getting full support from German public opinion. As a consequence, conversion of the East German mark into the West German mark (that simply became the German mark) was not made at the market exchange rate, but at an artificially overvalued exchange rate. This was partially compensated by some reductions of the money

[6] On the monetary union between Belgium and Luxembourg, see Van der Wee, Tavernier (1975).

stock of East Germany, but certainly had an overall inflationary effect. Such procedure is, of course, technically perverse, but was needed because of political reasons – it was one of the measures taken to get full support from German public opinion. Of course, the Bundesbank, the central bank the Federal Republic of Germany, played a crucial role in the process and became the central bank of the new unified Germany[7].

10) The European monetary union, 1999 …

The European monetary union had what may be called a false start between 1969 (Hague Summit, which created the Werner Committee, whose Report, presented in 1970 and approved in 1971 by the Council of Ministers of the European Communities, called for the implementation of the monetary union during the 1970s) and 1973 (creation of the European Monetary Cooperation Fund, and fading out of the process into what became known as the European monetary serpent, later upgraded into the European monetary system, its exchange-rate mechanism and the European currency unit — ecu — in 1979). The real start was the creation of the Delors Committee in 1988, the presentation of its Report in 1989 and its approval by the European Council in the same year. According to the Report, the European monetary union should go through three phases:

1. The first one, starting on 1 July 1990, should involve the access of all member states of the European Community to the exchange-rate mechanism of the European Monetary System, the implementation of free capital movements among the member states, and free use of the ecu as an accounting unit and means of payment.
2. The second one, starting on 1 January 1994, should involve the creation of a European Monetary Institute, the implementation of independence of national central banks, banishing lending by central banks to public entities, and the coordination of monetary policies.

[7] On the 1990 German monetary unification, see Ritschl (2003) and Hunt (2008).

3. The third one, starting between 1 January 1996 and 1 January 1999, as soon as more than half of the member states of the European Community fulfilled the conditions to access, should involve the establishment of irrevocably fixed exchange rates among the monetary units of the member states, the existence of a single monetary policy conducted by the European System of Central Banks, the possible introduction of a common currency among the member states, a new European monetary system and exchange rate mechanism for countries unable to join the monetary union, and a coordination mechanism of fiscal policies among member states.

The European System of Central Banks should be formed by a European Central Bank (whose creation would be prepared during the second phase by the European Monetary Institute) and all central banks of member states of the European Community. However, full participation in the third phase, with irrevocably fixed exchange rates and participation in the definition of common monetary policy, should be restricted to countries fulfilling a set of nominal convergence criteria, namely:

a) Exchange-rate stability, checked by remaining during three years in the narrow fluctuation band of the exchange-rate mechanism of the European monetary system without central parity changes.
b) Absence of significant inflation, checked by an inflation rate not higher than the average of the three member states with lowest inflation plus 1.5 per cent.
c) Interest rates witnessing market confidence, checked by a long-term interest rate not higher than the average of the three member states with lowest inflation plus 2 per cent.
d) Consolidated public finances, checked by the absence of negative balances of public accounts higher than 3 per cent of gross domestic product and public debt higher than 60 per cent of gross domestic product.

The monetary union process started on schedule and its rules were reproduced in the 1992 Treaty of Maastricht that created the

European Union, together with an opting-out clause for Great Britain, extended to Denmark when the Treaty was revised as a response to its rejection in a referendum in that country. The statutes of the European System of Central Banks and of its pivotal element, the European Central Bank, were appended to the Treaty. Price stability, considered a crucial element of the background of stable economic growth in the long run, was set as the priority goal of monetary policy to be pursued by the European Central Bank. Economic growth appeared as a fundamental long-term goal, but not as a short-term priority. In order to carry out this mission, the European Central Bank was awarded full technical independence.

By 1992, the first phase of the European monetary union process seemed to be carried out with almost full success, as all member states, with the exception of Greece, participated in the exchange-rate mechanism of the European monetary system (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg and the Netherlands in the ± 2.5 per cent narrow fluctuation band; Great Britain, Portugal and Spain remained in the large ± 6 per cent fluctuation band) and had established free capital movements. However, in September 1992, speculative movements against several currencies of the European monetary system triggered an exchange crisis. As a consequence, Great Britain and Italy left the exchange-rate mechanism, and several parity realignments were needed, until a general enlargement of fluctuation margins to a very large ± 15 per cent fluctuation band in August 1993 restored stability.

In spite of these upheavals, the second phase of the European monetary union process went on smoothly, and in 1995 the European Council decided that the third phase would involve a single currency (not only irrevocably fixed exchange rates) that would be called the euro (not ecu).

However, the earliest deadline for the start of the third phase was missed, because only Luxembourg among member states fulfilled the criteria to enter it, and only in 1998 did a majority of member states qualify. Thus, the third phase had to start at the last date initially scheduled (1 January 1999), by then with eleven member

states (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain) qualifying, in a rather lenient application of the rules (to maximize the gains from the reduction of transactions costs by maximizing the extension of the single currency zone). Denmark and Great Britain remained outside, profiting from the opt-out clause, Greece, because it clearly did not fulfil the accession criteria, and Sweden in an informal opt-out situation tacitly accepted by the other member states (even to the point of turning a blind eye to a referendum in 2003 that decided not to join the single currency in clear violation of former commitments).

The fact that some member states remained outside the monetary union called for a new European monetary system, differing from the first because the reference unit was no longer an accounting unit computed from a weighted average of the currencies of participating countries (the ecu), but the currency of the main monetary zone of the system (the euro).

Between 1999 and 2001, the European monetary union functioned only at the level of the accounting unit, while distinct circulating media went on being used in the various participating countries. At the beginning of 2002, euro coins and banknotes were put in circulation, and quickly replaced the previous coins and banknotes according to schedule. In theory, the rules of free establishment and competition should have ensured a smooth banking union; however, national regulations kept the previous national banking systems partially isolated, especially for small and medium economic agents[8].

The last element of the monetary union plan was coordination of fiscal policies of member states, to circumvent the fact that the bulk of fiscal activity remained at a decentralized level and was not carried out at the same geographical level as monetary policy (as usually happens in national economies). The Stability and Growth Pact agreed for that purpose called for the balancing of public ac-

[8] On the absence of a European banking union and its consequences for monetary policy, see Goodhart, Lee (2013) and Goodhart (2014).

counts of member states along the business cycles and maintaining the limits to public accounts deficits and public debt included in the accession criteria to the monetary union. Respect for the Pact was far from complete during the first decade of the monetary union, and almost collapsed with the financial crisis of the end of the first decade of the 21st century and the awkward attempt to use fiscal stimuli to economic activity in its wake. Several member countries faced huge hikes in public-accounts deficits and interest rates, either as a consequence of structural twin external plus public deficits (the case of Greece, Portugal, and partially Spain), or because of the need to bail out banks weakened by excessive speculation (the case of Ireland, Cyprus and partially Spain). A European mechanism to support financial stability of member states had to be improvised (with the help of the International Monetary Fund), with mixed results (by mid-second decade of the 21st century, Ireland had regained financial stability, Portugal, Spain and Cyprus presented some signs of improvement, Greece remained in deep trouble). On the other hand, a reinforced intergovernmental treaty on stability, coordination and governance in the economic and monetary union to limit negative balances of public accounts and public indebtedness was agreed among European Union members, but the Czech Republic and Great Britain refused to sign and compliance with its rules in the early years after its coming into force may be considered meagre.

Meanwhile, the European monetary union was enlarged in 2001 to Greece, in 2006 to Slovenia, in 2008 to Cyprus and Malta, in 2009 to Slovakia, in 2014 to Estonia and in 2015 to Latvia, as well as comprising formally Monaco, San Marino and the Vatican City and informally Andorra (which already shared some of the currencies replaced by the euro). The euro is also used as currency by Kosovo, Montenegro and, together with the Turkish lira, by the Turkish Republic of Northern Cyprus. On the other hand, Bulgaria, Croatia, the Czech Republic, Denmark, Great Britain, Hungary, Lithuania, Poland, Romania and Sweden among European Union members remain outside the monetary union, either using formal or informal opt-out rules, or because they still do not fulfil the criteria for acces-

sion. It is clear that most of them do not intend to join in the foreseeable future[9].

It is useful to classify the processes of monetary union among European countries during the 19th and 20th centuries that have just been quickly summarized, according to three main criteria[10].

The first criterion is a technical one and involves the distinction between:

a) Monetary unions that remained at the stage of irrevocably fixed exchange rates.
b) Monetary unions that went to the point of replacing several currencies by a single currency.

The Latin Union and the Scandinavian Union belong to the first type. All other processes belong to the second type. As already suggested, it is possible to argue that the first type is an imperfect monetary union, because it is easily dissolved; and, as a matter of fact, both monetary unions of this imperfect type created in Europe during the 19th and 20th centuries disappeared as soon as a major challenge undermined their usefulness.

The second criterion is a political one and involves the distinction between:

a) Monetary unions that were linked to the preservation of political independence of member countries.
b) Monetary unions that were linked to (usually that were the consequence of) political unions among member countries.

The Latin Union, the Scandinavian Union, the monetary union between Belgium and Luxembourg, the monetary union between Switzerland and Liechtenstein, and the European monetary union belong to the first type. The Italian, 19th century German, Yugoslavian, Polish and 1990 German monetary unifications belong to the second type.

Unsurprisingly, monetary unions linked to political unions pro-

[9] On the on-going European monetary union, see De Grauwe (2003), Wyplosz (2008), Binder, Wieland (2008), Mayes (2011), De Grauwe (2011) and Gaspar, Issing (2011).
[10] On monetary unions in general, see Rose (2008).

ved more stable (although dependent upon the political processes that supported them). It may be added that the same happened with asymmetrical monetary unions, such as the monetary union between Belgium and Luxembourg and the monetary union between Switzerland and Liechtenstein, where a small partner looked for monetary stability through its association to a larger partner. The Latin Union and the Scandinavian Union, which lacked a clear and formal hegemon proved unstable. Whether the European monetary union, which also lacks the political union cement (at least for the time being) and a clear and formal hegemon (in spite of the undoubted predominant role of Germany), will be able to survive in the long-run or not is certainly an interesting open case in the context of this distinction[11].

The third criterion is again a technical one and involves the distinction between:

a) Monetary unions in the framework of commodity monetary systems.
b) Monetary unions in the framework of conventional monetary systems.

All monetary unions before the First World War were made in the framework of commodity monetary systems (silver standard, bimetallism, or gold standard); monetary unions made immediately after the First World War were made in the framework of an ideal commodity monetary system (gold standard) and practical conventional monetary systems; the German monetary union of 1990 and the European monetary union were made in the framework of conventional monetary systems. This has no significant consequences for the stability of the monetary unions, but certainly affects the way monetary unions proceed.

As a matter of fact, commodity monetary systems based on the definition of the accounting unit in terms of a given commodity (usually silver, gold, or both) and giving full legal tender only to

[11] On the question of hegemony in the framework of monetary systems, see Llevellyn, Presley (1995).

coins with intrinsic value can technically be merged just by redefining the accounting unit and possibly minting different coins of the standard commodity. Of course, as banknotes gradually became the effective main means of payment, issuing banks began to play an important role in monetary life; however, such a role consisted mainly in ensuring the convertibility of banknotes. The situation is completely different in conventional monetary systems based on a purely conventional definition of the accounting unit and the value of means of payments. Central banks, issuers of the full legal tender means of payments (banknotes and credit that form the monetary base, as coins declined to the role of appointment money), become the key players of monetary life (together with the banking system they are supposed to supervise and, on occasion, to save from disrupting the whole of economic life). This is why the question of independence of central banks acquires a crucial importance in conventional monetary systems, such as the one that provides the framework for the European monetary union.

3. Political independence and technical independence of central banks

This leads to the crucial question: what is an independent central bank? Current literature on the subject usually presents a holistic definition of the concept and links it to the goal of preservation of monetary stability. In other words, an independent central bank is conceived as one that is free from government interference; and it is supposed that the absence of government interference implies that preservation of monetary (often understood just as price) stability is naturally adopted as the main (perhaps even sole) goal of central bank action (while government interference is supposed to pursue as a rule other goals, such as to stimulate economic activity and reduce unemployment)[12].

[12] On the question of central bank independence, see Capie (2003) and Walsh (2008).

It is possible to argue that such a definition is formally defective because:

1) The concept of independence should not be linked to a specific goal.
2) Interference may come from organisations other than the government.

Although these points are certainly valid, it must be acknowledged that their scope is limited because:

1) It is commonly acknowledged that monetary stability is a good thing, and it has been proved that usually the assignment to the central bank of the goal of monetary stability is the most efficient way to achieve simultaneously tolerable degrees of monetary stability and a stimulus to economic activity[13].
2) The most important political interference comes certainly from the government, although other interferences, especially those linked to the well-known phenomenon of capture of the regulator (central bank) by the regulated (banking and financial organisations in general) cannot be ignored.

The main problem with the usual definition of central bank independence is, however, an analytical one and relates to its holistic character. For historical and scientific reasons, we should distinguish between political independence, related to the choice of goals, and technical independence, related to the choice of instruments[14]. In other words:

1) A central bank should be considered politically independent when it can freely choose its goals.
2) A central bank cannot be considered politically independent when other institutions or political organs dictate its goals.
3) A central bank should be considered technically independent

[13] The pioneer contribution in this field is, of course, Mundell (1963).

[14] Similar distinctions between political independence and economic independence on one hand and between goal independence and instrument independence on the other hand were proposed, respectively, by Grilli, Masciandaro, Tabellini (1991), and Debelle, Fischer (1994). However, they are conceived in both cases as dimensions of the same concept, rather than distinct concepts.

when it can freely choose the instruments it uses to pursue its goals.

4) A central bank cannot be considered technically independent when other institutions or political organs dictate the instruments it uses to pursue its goals.

The distinction between political independence and technical independence of a central bank is important for two reasons: (i) it is possible that they do not coincide in practice; (ii) they have quite different implications for the activity of central banks. To substantiate these arguments, it is useful to present a brief overview of the evolution of political independence and technical independence of central banks since the formation of the contemporary world economy.

4. The avatars of political dependence: war and peace; Keynesianism and non-interventionism

There are two reasons why the possibility of a politically independent central bank should be considered implausible:

a) The role of central banks deals with a domain – money – that has been considered since its appearance as a prerogative of the state.
b) The origins of most central banks tied them closely to the political power since their beginnings, either because they were public issuing banks (for instance, in Prussia), or because they were private issuing banks that received privileges from the government in exchange for financial services (for instance, in England and France).

Contrary to this view, a somewhat mythical history of central banks is usually presented according to the following stages:

1) At the epoch of commodity (metallic) standard, especially the gold standard (late 19th and early 20th centuries), central banks were independent, because the convertibility rule implied that they preserved monetary stability.
2) Between 1914 and the 1970s, central banks lost their indepen-

dence, first because during world wars they were forced to finance government war expenditure regardless of the financial consequences, later because of the triumph of Keynesian doctrines that brought goals other than monetary stability, namely full employment, to priority status.

3) The last quarter of the 20th century witnessed the restoration of the independence of central banks, in the framework of the progress of new macroeconomic theories.

This periodization cannot be accepted unless the priority of the goal of monetary stability is taken as the criterion to identify central bank independence. As a matter of fact, if freedom of the central bank to choose the goals is used as criterion, periodization takes a completely different aspect.

1) The gold standard system that prevailed in the world economy at the earliest stages of its existence (late 19th and early 20th centuries) may be characterized as the realization of the classical ideal of a monetary system in which the means of payment consists of paper money that has exactly the same value as the metallic money it is supposed to represent[15]. This implied compliance with four main rules: (i) the accounting unit is defined as a certain amount of gold; (ii) the means of payment are comprised of gold coins with intrinsic value and fiduciary instruments convertible at par and at sight into gold (and of other coins that only play the role of appointment money); (iii) international movements of gold are free; (iv) switching of gold between monetary and non-monetary uses (coinage and melting of gold coins) is free.

According to the standard view, this implies that issuing banks are forced by the convertibility rule to pursue the goal of monetary stability, and that governments are unable to interfere and impose other goals to them. As a consequence, issuing banks are independent[16].

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[15] The classical presentation of this ideal is, of course, Ricardo (1816), especially Section 1.

[16] See, for instance, Meissner (2003) and Officer (2008).

However, according to several authors[17], the gold standard may better be characterized as "a contingent rule, or a rule with escape clauses" (*op. cit.*, p. 12). As Bordo and Schwartz put it: "specie convertibility could be suspended in the event of a well-understood, exogenously produced emergency, such as a war, on the understanding that after the emergency had safely passed convertibility would be restored at the original parity" (*op. cit.*, p. 12).

What they mean by such a contingent rule is clearly illustrated by the behaviour of the United States and France when facing the straints of the civil war and Franco-Prussian war, respectively. Convertibility was suspended during the war and immediate post-war years, and resumed as soon as circumstances allowed.

From our point of view, this perspective means that, as a matter of fact, issuing banks were not politically independent. In what were considered normal times, the government assigned them the goal of monetary stability, by means of the legal convertibility rule. In exceptional circumstances, the government imposed them other priority goals, such as helping to win a war that for patriotic reasons was considered more important than monetary stability. Of course, it would be unconceivable that even the most conservative (in the sense of being attached to the monetary stability goal) central banker might refuse war loans to his government. Of course, when normal circumstances returned, normal goals regained their priority, and standard gold-standard rules resumed their validity.

2) Suspension of the gold standard by European countries at the beginning of the First World War conformed to this picture. The difference from the cases mentioned above was that resumption of convertibility at the old parities after the end of the conflict proved impossible, except for Great Britain, because there was not gold enough to sustain the credibility of the convertibility rule.

   In a certain sense, this was the end of the gold standard. Howe-

[17] See, for instance, Bordo, Schwartz (1996).

ver, a surrogate, the so-called gold-exchange standard, was still put in place during the 1920s. The trick to economize on the gold needed to sustain the credibility of the system was indirect convertibility for most currencies and direct convertibility only for three anchor currencies, the American dollar, the British pound sterling, and the French franc. Anyway, the gold-exchange system proved ephemeral, as it collapsed as a result of the Great Depression. The suspension of the convertibility of the pound (1931), the dollar (1933) and the franc (1936), and the gradual adoption of promotion of employment as a social goal as important as monetary stability opened a new era for central banks[18].

From our perspective, this did not increase or reduce the political independence of central banks. Such a political independence did not exist before and, of course, did not improve with the new course of events. There just was a change in priorities: stimulus to economic activity came to parallel monetary stability (and triumph in war continued to play its usual role, the only difference being that the world wars of the 20th century strained monetary stability to the point of failure, something 19th century wars did not do).

Anyway, monetary stability did not disappear from the list of goals of economic policy, and it should not be forgotten that the period of clear dominance of Keynesian ideas was also the period of the discipline of fixed exchange rates of the Bretton Woods system, a surrogate, as imperfect it might be, of gold-standard discipline.

The Bretton Woods system may be characterized as a surrogate of the gold-exchange standard of the inter-war period, designed to live with even less gold reserves. To economize gold reserves, the right to ask for direct convertibility was restricted to central banks, and the number of countries responsible for convertibility was reduced (in practice only the United States played the key role of the system, because the attempts of Great Britain to do the same failed).

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[18] It may be argued that this process transformed traditional issuing banks into modern central banks. On this process in the Mediterranean world, see Valério (2012b).

Of course, two goals (stimulus of economic activity plus monetary stability) need two instruments, and fiscal policy joined monetary policy in the toolbox of economic policy. At the same time, there was always the tendency to assign the goal of monetary stability mainly to the monetary instrument and the goal of stimulus of economic activity to the fiscal instrument, something Robert Mundell proved is usually the most efficient procedure.

3) Challenge of the intellectual dominance of Keynesianism under the form of the so-called second neoclassical synthesis by new macroeconomic schools, beginning with monetarism, and the inability of Keynesian economic policy to deal with the stagflation crisis of the mid-1970s, led to a new era of economic policy and central banking. Monetary stability regained its primacy among economic-policy goals, and central banks were confirmed in charge to attain such a goal. This is usually equated with regaining independence by central banks.

A closer look at the matter clearly refutes such a simplistic view. Let us consider, for instance, the case of the European Central Bank often considered as an achieved example of independent central bank. It is beyond doubt that the priority goal of monetary, especially price, stability was not a spontaneous choice of the governing board of the Bank; it was formulated and imposed on the Bank by the European governments, mainly through the Treaty of Maastricht. Moreover, even in formal terms, the Council of Ministers of Economy and Finance (Ecofin) retained the right to formulate the exchange-rate policy to be carried out by the European Central Bank.

It is true that the European Central Bank cannot receive instructions either from the European Union organs or from national governments; however, this rule concerns technical independence, not political independence. And it may be noticed that the European Central Bank remains subject to a possible order issued by the Court of Justice, as the threat of an accusation for disrespect of the Union Treaties recently reminded us.

On the other hand, it may be noticed that the last quarter of the 20th century and the early 21st century witnessed a general frame-

work of flexible exchange rates (of course, with intervention of monetary authorities in the exchange markets), coupled with a diluted hegemonic role of the dollar, and with attempts to build regional areas of intended fixed exchange rates that met varying success. This means that the automatic discipline imposed by fixed exchange-rate rule was weakened, and that monetary stability came to depend much more on the discretionary use of financial instruments, such as the money supply and the interest rate, by central banks.

5. The problems of technical independence: rules versus discretion

This brings us to the question of technical independence: is it possible to say that issuing or central banks limited by strict convertibility rules (as in the gold standard, gold-exchange standard and Bretton Woods system periods) were technically more independent than today's central banks, free from fixed-exchange rate rules?

A negative answer to such a question leads to the idea that technical independence of central banks gradually increased during the 20th century. And such an idea may be reinforced by even a perfunctory consideration of the governing laws of the main issuing or central banks of the gold standard period.

a) In Britain the banking law of 1844 separated the issuing department from the commercial department of the Bank of England, and demanded full metallic backing of issuing beyond 14 million pounds. Thus, while the commercial activity of the Bank was free from government intervention, the issuing activity was subject to strict rules. The fact that the government eventually allowed the Bank transitory excess issues to overcome business crises (what may be interpreted as a special case of the gold standard contingency rule mentioned in section 3 above) enhances the idea that there was a significant government technical intervention in the issuing activity of the Bank of England.
b) In the cases of the Bank of France and the Bank of Prussia (which

later became the Bank of the German Empire) the same technique to limit the amount of banknotes issued was applied, that is to say, issuing needed full metallic backing beyond a given amount, and the same exceptions to the law in cases of grave crises were open. The main difference was the absence of strict separation between issuing and commercial activities of the issuing banks, what may be interpreted as a result of the fact that rediscount and even direct discount played an important role in the relations between the banks and the economic agents in general, which was much less prominent in Britain. As a consequence, government technical interference was able even to extend to the areas of interest rate and other policy instruments.

c) The American Federal Reserve System was a central bank of a very special type, created (very lately, 1913) by law, but formed as a voluntary association of commercial banks, with large scope in the choice of goals and instruments, that is to say rather independent, both politically and technically. Such a degree of independence has, however, often raised the question of efficacy, because of the possible contradiction between the goals pursued by the government and those of the central bank[19].

Anyway, it is possible to say that the main central banks of the gold standard period, at least in Europe, were neither politically nor technically independent.

From such a perspective, the Keynesian epoch brought more technical independence for central banks. As a matter of fact:

i) it banished from legislation most restrictions concerning detailed use of instruments by central banks.

ii) tt allowed central banks to act with much more discretion in pursuing fine-tuning management of short-term evolution of the economy.

Technical independence of central banks remained a characteristic of recent decades. Nowadays, few governments dare to impose

[19] On the American Federal Reserve System, see Friedman, Schwarz (1971).

action rules to central banks (which is completely different from imposing goals, as explained above)[20]. Thus, central bankers remain usually free to choose the instruments to reach the goals imposed to them. However, it became usual for central banks to announce self-imposed rules, as a means to reinforce policy credibility[21].

6. Conclusion

To sum up:

- Monetary and price stability is a good thing and independence is a beautiful word, but we should not accept uncritically the attempt of dominant doctrines to bind them together.
- It is important to distinguish in the analysis of the regime of central banks, political independence, concerning goals, from technical independence, concerning instruments.
- True political independence of central banks is almost impossible to achieve, the more so in democratic political regimes, where it would be obnoxious to accept the technocratic rule of central bankers over such a fundamental part of social life as monetary affairs.
- On the contrary, technical independence is, not only possible, but usual, after a historical evolution that tended to increase it during the 20th century.
- It seems that such a situation – political dependence plus technical independence – is the most desirable one and should be preserved, namely in the institutional framework of the European monetary union.

A few additional remarks on the last point must be added.

1) Political dependence of the European System of Central Banks,

[20] Of course, this excludes the cases in which currency boards replaced central banks: in these cases, strict rules have been imposed on action. In any case, such a trend did not reach highly-developed countries.

[21] On the topic of the evolution of the rules versus discretion question, see Goodhart (1978) and Mundell (1997).

and especially of the European Central Bank, upon the organs of the European Union should be preserved to avoid a technocratic drift of monetary policy and, above all, the capture of the regulator (central bank) by the regulated (banking system and financial system in general).

2) Technical independence of the European System of Central Banks, and especially of the European Central Bank should be preserved to avoid inefficient interference from political organs in the action of the central banks and, above all, the illegitimate imposition of unassumed goals disguised as technical measures.
3) The main challenge to complete the European monetary union is certainly fulfilment of the banking union, by means of standardization of supervision demands and suppression of disturbing particularisms. Such an evolution will certainly benefit from technical independence of the European System of Central Banks, and especially of the European Central Bank (with nothing to gain from political independence, which might be the basis to preserve special treatment to powerful players of the financial system).
4) Of course, one may desire changes in the political orientation of the European Union that might extend to banking and financial matters. However, once more, technical dependence or political independence of the European System of Central Banks, and especially of the European Central Bank, cannot ensure a positive evolution and may even contribute to the deterioration of the present situation from that point of view[22].

[22] Debates on the issues presented in the conclusion are, as might be expected, going on among the economic participants, especially in Europe. One of the main fora of these debates is certainly VoxEU.org, and a collection of many relevant statements may be found in Danielsson *et al.* (2015).

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