



Reviewing the Literature on Central Banks after the 2008 and COVID Crises: Amid Accountability and Independence

Pierluigi de Rogatis*

Department of Government and Economics, University of Essex, Colchester, United Kingdom

ABSTRACT

This article provides a brief but comprehensive analysis and literature review of Central Banks (CBs) role in political and economic policies. The paper argues that the COVID-19 pandemic has changed perceptions of CBs' function, and the traditional custodianship of low inflation and price stability is under pressure. The article highlights how CBs in developed countries such as the ECB, Fed, and the bank of England have taken unprecedented measures in response to the pandemic, leading to higher inflation levels than in the past 30 years. The article also addresses the concerns raised about the expansion of CB powers, such as legitimacy, accountability, and self-empowerment. The research also highlights the debate about the role of CBs in ensuring price stability, sustainable growth, and maximum employment. The article concludes by emphasizing the need for a comprehensive review of the role of CBs in shaping policy environments that improve society's well-being.

Keywords: Central banks; Accountability; Central Bank Independence (CBI); Global financial crisis; COVID-19

INTRODUCTION

Some of the literature on Central Banks (CBs) and their role in the economy is drastically changing since the global financial crisis and after COVID-19 [1]. Indeed, CBs had to step up to save economies from severe recessions with expansionary monetary policies, ignoring their responsibility to ensure price stability and becoming guardians of their economies [2]. This article provides an insightful analysis of the role of Central Banks (CBs) in political and economic policies. It argues that the COVID-19 pandemic has changed perceptions of CBs' function and that the traditional custodianship of low inflation and price stability is under pressure [3]. Further, it highlights how CBs in developed countries, like the ECB, fed, and the bank of England, have taken unprecedented measures in response to the pandemic, leading to inflation levels higher than in the last 30 years in the EU and the UK, and since world war I in the US.

The price stability framework is part of the overarching mission but does not exhaust it. During the 2008 and pandemic crises, QE resulted in the fed's balance sheet growing to 33% of annual

US GDP by the beginning of 2021; the bank of England's, 43% of annual UK GDP; the ECB's, 60% of annual Eurozone GDP [4]. Fischer, et al., argues that these "unprecedented actions of central banks to stabilize markets and offer generous support to their economies played a crucial role in halting the downward spiral of markets, lessening the pandemic driven losses of businesses, and jumpstarting the economic recovery [5-9]. With the financial crises of the past years, however, the expansion of CB powers lifted concerns regarding legitimacy, accountability, self-empowerment with critiques from populist parties, academics, and civil society groups. Further, the exceptional policies executed by countries in response to the COVID-19 pandemic fueled a discussion on how CB financing of government debt might increase the risk of fiscal dominance and contravene the principle of Central Bank Independence (CBI).

Therefore, a review of the literature on CB evolution is significant because providing insights into the historical development of CBs, their role in the economy, and the various challenges they have faced and overcome [10]. This information can help to inform policy decisions and guide the future

Correspondence to: Pierluigi de Rogatis, Department of Government and Economics, University of Essex, Colchester, United Kingdom, Tel: +44 (0) 07518438797; E-mail: pd21116@essex.ac.uk

Received: 08-Feb-2023, Manuscript No. IJAR-23-19819; **Editor assigned:** 10-Feb-2023, PreQC No. IJAR-23-19819 (PQ); **Reviewed:** 24-Feb-2023, QC No. IJAR-23-19819; **Revised:** 12-May-2023, Manuscript No. IJAR-23-19819 (R); **Published:** 19-May-2023, DOI: 10.35248/2472-114X.23.11.333

Citation: de Rogatis P (2023) Reviewing the Literature on Central Banks after the 2008 and COVID Crises: Amid Accountability and Independence. Int J Account Res. 11:333.

Copyright: © 2023 de Rogatis P. This is an open access article distributed under the terms of the Creative Commons Attribution License, which permits unrestricted use, distribution, and reproduction in any medium, provided the original author and source are credited.

direction of CBs. Additionally a review can identify gaps in the research and inform future research directions. It also provides a comprehensive understanding of the various theories, models, and best practices in the field, which can be particularly valuable for policymakers and academics [11].

LITERATURE REVIEW

Inflation or employment fighters?

Interestingly, Baerg and Lowe focus on the individual interests and activities that explain the different behavior in monetary policies, discovering that inflation levels and interest rates are related to the share of inflation talks and that representative inside monetary committees are sensitive to their region's economic performance when implementing their policies [12].

In March 2020, as a reaction to the pandemic, the ECB council established another considerable asset purchase program, the Pandemic Emergency Purchase Program (PEPP), acquiring European sovereign bonds [13]. Collected bonds in the euro system balance sheets reached 3.2 trillion euros at the end of 2020, and assets progressively deviated from the ECB capital key, unbalancing toward high-debt countries. Various elements of the new pandemic-induced monetary instruments point to hidden transfers. With the new asset purchases under PEPP, the ECB has deserted several earlier protections against excessive exposure to high debt countries. The ECB council lowered the credit quality standards for eligible securities, admitting previously excluded Greek sovereign bonds [14]. Moreover, Heinemann, et al., also discussed that hidden transfers are becoming an integral part of the European monetary strategy, like the ECB's new asset purchases, funding of the recovery plan, and an international treaty on the EU's resource system. However, holding risky assets could be problematic for a CB. Indeed, there is a debate about the limit to which CBs should care about losses and whether a CB's capital is relevant for monetary policy [15]. But shortfalls would be a political problem, harming CBs' reputation as institutions and the individuals in charge. Therefore, credibility is essential for CBs, and research recommends that pledging to keep interest rates low after a financial crisis remains the desirable policy.

Fischer pointed out that many advanced economy CBs seek to ensure price stability, sustainable growth, and maximum employment [16]. However, new literature proposes their mandate expansion since the history of CBs demonstrates that their role changes over time, suggesting CBs use monetary and financial instruments to build policy environments that improve society's well-being. This expansion still holds the narrow price stability approach while granting flexibility and adaptation to future challenges. Besides, Kolf pointed out that the need for large scale coordinated global monetary policy has only grown more urgent, with their activities focused on protecting economies from the pandemic and environmental crises [17]. For instance, research indicates that a significant reaction to output and a weak reply to inflation is the best option and that welfare gains from output stabilization are substantial while welfare losses from permanent consumption falls should be considered. By contrast, Rogoff agrees that the low inflation

standard in advanced economies is, indeed, questionable but that the argument for independent CBs with a focus on inflation stabilization rests solid, suggesting CBs search for new ways to renovate their effectiveness and not turn into subordinate associates in debt management [18].

Are central banks still independent?

Recently, Mabbett and Schelkle explored the institutional process of creating CBs and how the relationship between CBs and governments changes based on veto players in a political system. They contended that CBs in systems with many veto players operate under more restrictions than with fewer veto actors, but that CBs willingly accept these restrictions to protect their monetary power and limit the extent to which financial market panic can force their hands. They are not alone in identifying CBs as political entities necessitating political science methodologies and economic frameworks to understand them [19]. Besides, around 10% of CBs encounter political pressure or government interference yearly, and 39% faced it between 2010 and 2018, almost always for easing monetary policies. Political pressure on CBs is a global phenomenon in both developed and developing economies, more likely to come from left-wing or nationalist governments or countries with a weak rule of law and electoral competition, leading to higher and more persistent inflation. Besides, a recent survey discovered that 72% of scholars and 31% of CBs think that CBs received condemnation for crossing the line into the political realm after the 2008 crisis and added that crossing the line in one direction invites reciprocal crossings in the opposite direction, to wit, political interference with monetary policy [20].

DISCUSSION

States intentionally devised an independent CB with few accountability mechanisms to guard its reputation. The accountability against independence debate is particularly acute because it impacts monetary stability and efficiency. Some researchers argued that political pressure derives from the distributional consequences of monetary policies in national economies. Further, CBs have been delegated broader abilities and assignments, including for financial stability, raising multiple concerns about their legitimacy and accountability in front of the political system and public opinion. For example, many governments have intensified the CBs' involvement in banking and financial sector supervision after the financial crisis. However, there is a trade-off between independence and accountability, with expanded accountability through better responsiveness and communication but demands better controllability and liability dismissed to preserve independence. Besides, recent studies on the politicization of EU institutions and the transformation of ECB accountability practices claim that there is this trade off. Most of these studies, nevertheless, equate accountability with transparency. Further, the empowerment of European institutions over the past decades raised concerns about their democratic deficit and lack of accountability. During the euro crisis, the ECB's decision to implement political measures to rescue the euro, launching the outright monetary transactions program to buy sovereign debt,

led to divisive discussions on whether the ECB had exceeded its mandate with concerns about a lack of accountability. Some scholars argue that the ECB has battled tensions between greater transparency and secrecy since its foundation. The question of how CBs can be held liable by outsiders has to turn out to be crucial.

Partisan and political studies argue that a new political actor is particularly active in the fight against CB's independence and autonomy in monetary policies. The recent emergence of populist parties has created, once again, a new fervent political interest and debate on monetary policy and the role of CBs. Indeed, Goodhart, Lastra and Agur argue that populist movements and nationalist politics, such as those flourishing after the global financial crisis, erode support for CBI. The erosion of public support for CBI may enable politicians to pressure CBs more blatantly without concern of public reprisal. For example, the negative and statistically significant importance of the populism proxy confirms the idea that populist waves may undermine CBI.

CONCLUSION

The role of CBs has undergone significant changes since the 2008 crisis and the COVID-19 pandemic. CBs have taken unprecedented measures, resulting in an expansion of their powers and an increased focus on the role of monetary policy in stabilizing economies. However, this expansion has also raised concerns about legitimacy, accountability, and CBI. The ECB, fed, and bank of England's balance sheets grew to 33%, 43%, and 60% of GDP, respectively. The ECB's PEPP has resulted in hidden transfers and raised questions about the limit of CBs holding risky assets. Recent literature suggests that individual interests and activities play a role in the behavior of monetary policies. CBs are considered essential to ensuring price stability and sustainable growth, but the need for large scale coordinated global monetary policy has become more urgent. Some literature proposes expanding CBs' mandates to improve society's well-being, while others argue for the importance of maintaining credibility by pledging to keep inflation low.

The article's analysis has several implications. Firstly, it highlights the importance of understanding the institutional process of creating CBs and the relationship between CBs and governments. Secondly, it highlights the significance of considering individual interests and activities when analyzing monetary policies. Finally, the article's analysis provides a political economy framework for understanding the impact of CBI on price stability and money growth rates. For academic literature, the paper contributes to the existing scholarship by critically reviewing and synthesizing existing research on the role of CBs. The recent literature analyzes the role of CBs in political and economic policies and how their responsibilities have changed. The increased powers of CBs during financial crises have raised concerns about legitimacy, accountability, and self-empowerment, leading to criticism from populist parties, academics, and civil society groups. There is now a need to review the traditional price stability framework considering these developments. For CBs, this article highlights the importance of considering the relationship between CBs and governments, the

influence of individual interests and activities, and the impact of CBI on price stability and money growth rates. CBs should recognize the need to adapt their policies and frameworks to the changing economic and political landscape. They should consider the concerns raised about their legitimacy, accountability, and self-empowerment and take steps to address these issues. CBs should also be mindful of the implications of their policies for the overall economic and political system and aim to strike a balance between price stability and other objectives. Policymakers should be aware of the changing role of CBs and the impact of the policies they implement. They should consider the implications of CBs' expanded powers for the legitimacy and accountability of these institutions. Additionally, policymakers should be mindful of the impact of CBs' policies on the overall economic and political system. For monetary policy, the article highlights the need to consider the relationship between fiscal and monetary authorities, the struggle between inflation hawks and doves in monetary committees, and the role of democracy in CBI. This result can inform monetary policy decision making and help policymakers better understand the implications of their actions for price stability and money growth rates. The impact of CBs' policies on the distribution of resources and the balance between price stability and other objectives will impact the economic and political system. Policymakers and CBs should be mindful of these implications and take steps to ensure that their policies contribute to the overall stability and well-being of the system.

REFERENCES

1. Agur I. Populism and central bank independence: Comment. *Open Econ Rev.* 2018;29(3):687-693.
2. Baerg N, Lowe W. A textual Taylor rule: Estimating central bank preferences combining topic and scaling methods. *Political Sci Res Methods.* 2020;8(1):106-122.
3. Best J. Rethinking central bank accountability in uncertain times. *Ethics Int Aff.* 2016;30(2):215-232.
4. Binder CC. Political pressure on central banks. *J Money Credit Bank.* 2021;53(4):715-744.
5. Blinder A, Ehrmann M, de Haan J, Jansen DJ. Necessity as the mother of invention: Monetary policy after the crisis. *Econ Policy.* 2017;32(92):707-755.
6. Bodea C, Hicks R. Price stability and central bank independence: Discipline, credibility, and democratic institutions. *Int Organ.* 2015;69(1):35-61.
7. Braun B. Central banking and the infrastructural power of finance: The case of ECB support for repo and securitization markets. *Socio Econ Rev.* 2020;18(2):395-418.
8. Braun B. Two sides of the same coin? Independence and accountability of the European central bank. 2017.
9. Buitter W, Rahbari E. The European central bank as lender of last resort for sovereigns in the Eurozone. *J Common Mkt Stud.* 2012;50:6-35.
10. Curtin D. Accountable independence of the European central bank: Seeing the logics of transparency. *Eur Law J.* 2017;23(1-2):28-44.
11. Diessner S, Lisi G. Masters of the masters of the universe? Monetary, fiscal and financial dominance in the Eurozone. *Socio Econ Rev.* 2020;18(2):315-335.

12. Dietsch P. Independent agencies, distribution, and legitimacy: The case of central banks. *Am Polit Sci Rev.* 2020;114(2):591-595.
13. Fernandez-Albertos J. The politics of central bank independence. *Annu Rev Polit Sci.* 2015;18:217-237.
14. Fontan C, Carre E, L Oeillet G. Theoretical perspectives on the new era of central banking. *Fr Polit.* 2018;16:453-470.
15. Gali J. The effects of a money-financed fiscal stimulus. *J Monet Econ.* 2020;115:1-9.
16. Goodhart C, Lastra R. Populism and central bank independence. *Open Econ Rev.* 2018;29:49-68.
17. Heinemann F. The political economy of euro area sovereign debt restructuring. *Const Polit Econ.* 2021;32(4):502-522.
18. Heldt EC, Herzog L. The limits of transparency: Expert knowledge and meaningful accountability in central banking. *Gov Oppos.* 2022;57(2):217-232.
19. Heldt EC, Mueller T. The (self)empowerment of the European central bank during the sovereign debt crisis. *J Eur Integr.* 2021;43(1):83-98.
20. Heldt EC, Müller T. Bringing independence and accountability together: Mission impossible for the European central bank?. *J Eur Integr.* 2022;44(6):837-853.