ELRR

Article

Central bank independence: A social economic and democratic critique

The Economic and Labour Relations Review
24(1) 32–50
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DOI: 10.1177/1035304612474217
elrr.sagepub.com

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Abstract

The advent of quantitative easing by the world's major central banks invites renewed questions about the meaning and role of central bank independence in an age of economic crisis. This article draws together insights from economic sociology, history and democratic theory to engage in further discussion about the proper role of central banks in democratic society. We stress some related themes. Our brief history of central banks aims to show how these banks have always been embedded in economic and political coalitions and conflicts, therefore qualifying the term independence; our study also aims to show that in satisficing between conflicting tasks, central banks need to maintain a balance between cognitive competences and normative expectations. Independence is better understood as a form of dependence on the coalition of interests that supported the financial climate prevailing before the global crisis of 2008, one of low wage-price inflation, high borrowing and debt, and loss of prudential control. We argue that independence amounts to a form of re-privatisation of central banks, and that they are increasingly suborned to the pressures of financial markets. At the same time, asset price inflation has sacrificed growth and employment and therefore prolongs the crisis. The economic measures now demanded by the financial crisis prompt new doubts about the independent central bank experiment, potentially in favour of the *ex ante* model of governmental oversight of central banks.

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https://doi.org/10.1177/1035304612474217 Published online by Cambridge University Press

JEL Codes: E52, E58, G28, H50

Keywords
Central bank independence, central bank principles, democratic mandate and institutional design, monetary and fiscal policy, social economics

Introduction

Central banks (CBs) are public institutions whose system-integrating function is to operate as the interface between public currency and private credit. Their centrality is defined by their role in intervening between the competing demands of creditors and debtors where those demands are denominated in a national currency whose stable value a CB must try to maintain. As public institutions, they are given statutory powers by legislatures to perform these tasks. This article looks at how democratic legislatures have, since the 1990s, redefined the remits of CBs, and in particular, how they came to give up direct controls over CBs in favour of awarding them 'independent' powers. Our argument is that CBs cannot be freed from the contradictory demands and expectations that are placed upon them, and that 'operational' independence has turned out to be a form of re-privatisation of CBs where accountability to the public sphere has been replaced or modified by implicit subordination to commercial financial institutions. The situation is now dire (November 2012) as CBs improvise policies that have moved far beyond this previous 'independent' remit. We argue that both the democratic accountability of CBs (historically, a relatively brief interlude) and their statutory functions are in urgent need of reconsideration and that present crisis-driven events may prompt new pressure for governmental control of CBs.[1]

Conceptualising CBs

CBs can never escape the conflicts that have always existed in modern capitalist societies, particularly following, first, the internationalisation and then the globalisation of economic activity. Hence, when we speak in this article of their system-integrating functions, while this is a widely held assumption, it turns out to be very difficult to achieve. What actually occurs is *interface*, which, as an explanatory concept, is more to the point. In a technological sense, an interface has to have certain properties to enable it to function and survive the movement of different planes and forces. For example, the membranes in the human shoulder sheathe a number of muscles, which cross over each other and pull in different directions. The membrane is an interface that allows muscle groups to slide over and past one another. The body continuously maintains the membrane in a healthy condition, though when these membranes deteriorate, complete loss of shoulder function can occur.

By analogy, a CB can be seen as performing an interface function. CBs have a number of capabilities, which they have to exert to the maximum if they are to be successful, and an interface, technologically, is aggressive in its interaction. Nevertheless, far greater economic forces – of government, industry and consumer spending and borrowing, private bank money creation and international currency fluctuations – pull and push in

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different directions, however much a CB might seek to control and guide that economic activity.

Sociologically, the analogy is Durkheimian with its normative stress on functionality and the imperative of an empowered state institution to 'satisfice' between competing interests and demands. As such, it is a normative ideal that has the capacity to frame the thinking and policies of democratic legislatures. It is argued that institutions effective for a rational modernity need to be designed and able to realise, in their functioning, a balance between the cognitive demands of coping with complexity and the need to embody a normativity with a sense of equity that seeks to restrain major disparities developing in the economy. This may not achieve the standards of Durkheim's 'normal division of labour' (Whimster, 2007a: 60–63), but as institutions, CBs should be designed to have such an awareness.

The second sociological approach that we propose to use is social economics in its Weberian guise. It assumes from the outset that all economic relationships within modern capitalist societies are conflictual. Weber did not belong to the Smithian optimisation lineage of economic thought that saw both parties in an economic transaction as potentially able to benefit. For Weber, the increasing marketisation of the world (a process of *Vergesellschaftung*), while leading to an unprecedented spurt in economic power and capacity, was based on one party always trying to extract advantage from the other party in any transaction. Therefore, there is no initial reason to assume that CBs are placed above the fray of economic transactions – indeed, as we indicate below, CBs invariably take sides in the underlying and ineradicable conflict between groups, classes and interests. Writing as a national-imperialist, Weber demanded in his social economics that banks act for the furtherance of the interests and prestige of the nation. This meant facing down reactionary class (agrarian) interests, and intellectually, it involved abandoning misplaced and erroneous theories of money and credit (Weber, 2000: 58–59). Therefore, he championed one of the early theorists of credit-money, G. F. Knapp (Weber, 1968: 164–193).

Weberian social economics also seeks to de-intellectualise the abstract dilemmas posed by economists. For example, Galbraith (1975: 213) and Kindleberger (1989: 197) have both argued that CBs are limited in their influence. They cannot pick the timing of an intervention – expressed flippantly by the Federal Reserve Chair McChesney Martin as taking away the punchbowl before the party becomes a riot – nor can they effectively restore a deflated economy. CBs are, however, forced into making decisions – they interface between conflicting interests, and there is nothing abstract about this, as the thinking and decisions of CBs impact on whichever interest or group that will either suffer or gain financially and economically. Social economics also takes a harder look at the sociology of ideas: why do CBs adopt specific intellectual positions, given the configuration of interests; this involves more analysis than Keynes's quip about practical men being under the influence of outdated ideas (Keynes, 1936 [1964]: 383). Social economics asks, rather, why a CB tends to one position rather than another, so favouring one group as opposed to another. This is the position that Max Weber painstakingly explained in his 'Objectivity' essay, where he dissects the myriad of opposed interests contained in the phrase 'agrarian interests' (Weber, 2012: 133–137). The social scientist's task is to analyse and point out the advantages and disadvantages of a particular economic policy.

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Weber famously pointed out that productivity is not a neutral economic concept. Its pursuit favours profitability at the cost of employment skills and loss of artisanal culture, and in Weber's day, this led to a heated, even though not always democratic, debate (Weber, 2012: 358–361). The same applies, as we have seen, to CBs, and social economics rejects the notion that any one economic theory resolves all contradictory claims and conflicting interests.

The challenge of progressive democratic thinking today (to our mind) is how to advance policies for the much more porous national entity within the framework of the global age (Albrow, 1996). With specific regard to CBs, this means considering their role within the currency areas for which they are nominally responsible (all of which goes beyond the scope of this article, but nevertheless remains fundamental).

The partisan CB

Shoulders have, of course, evolved pretty successfully, whereas CBs are subject to changing social relations. Some economists hold to an evolutionary account of CBs, therefore dubiously anticipating by virtue of process what has to be ascertained in fact as progress. Thus, Capie et al. wrote in 1994,

> If the fundamental evolutionary criterion of success is that an organisation [here central bank] should reproduce and multiply over the world, and successfully mutate to meet the emerging challenges of time, then central banks have been conspicuously successful. (p. 91)

In this 'last stage of history' (1990 onwards), the functions and operation of CBs can be reduced to technical competences, devoid of the old politics and the old mistakes. Instead, this article sides with the view that CBs are not 'independent' in the fundamental sense that they only exist in historical contexts of alliances with major – conflicting – social groups, corporations, treasuries and political elites. When they started, they were privately owned but, although behaving much like other early banks, were in an exclusive alliance with the Sovereign. Indeed, they were a 'central' part of the creation of capitalist money. This was new 'money' sui generis, and Geoffrey Ingham (2011) shows that it joins 'the power and security of the state with the ability of the commercial banks to produce credit-money' (p. 72). CBs manage this 'conversion' – their interface role – in shifting alliances and implicit contracts.

Mystique and misunderstanding surround the functioning of CBs, or what Paul Volcker calls the 'magic power' conferred on CBs of creating money (Capie et al., 1994: 344). The creation of money, seemingly out of nowhere, *is* an intellectual challenge to understand (with bankers' favourite 'art not science' view (Pixley, 2012) also blurring the lines of democratic accountability). A CB makes loans to the state, so when the Bank of England (BoE) was formed by a group of private investors in 1694, it lent £1.2m to William III, who was desperate to build a new navy after the old one had been sunk. Prior to that, the Stuarts had defaulted, whereas the increased powers of parliament over the sovereign and its ability to enforce taxation (on imports) provided the foundation for 'the deal' between Parliament and the City. This conferred on the BoE the right to transfer government borrowing into money loaned on (Galbraith, 1975: 31; Ingham, 2004: ch. 7).

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To Max Weber (1927), it was an alliance: 'mobile capital' would dictate the 'conditions' of assisting states to power (pp. 264–265, 337).[2]

In one respect, to probe the mysteries, a CB is like any other bank. The BoE's initial deposit (of £1.2m) is lent out and becomes an asset on its books. It is an asset because it earns interest on the loan (and on re-lending the 'deposit'): this is the institution of the deposit-creating loan. The state or crown writes cheques for its purchases (of a new navy or whatever), and the CB agrees to accept the cheques. The magical wonder of a *CB* is that a cheque from the government is a high-quality IOU. On the note is written that the government promises to pay the bearer the denominated sum. In this way, money is created. The nascent government debt, which over time became the national or sovereign debt, is a CB asset, which in turn is loaned out at interest to ordinary banks or to tide them over their liquidity (currency) shortfalls. Any ordinary bank loan to a client ends up as a deposit in a bank and loaned on through the banking system 'as a whole', therefore creating a kind of multiplier effect, as the private banking sector becomes the engine of credit creation with CBs eventually taking on a control rather than initiation role. Schumpeter (1954) stressed the major role of the 'deposit-creating bank' in 'financing investment *without any previous saving up of the sums thus lent*' (emphasis in the original, pp. 1113–1115). As he puts it, bankers are not like commodity producers, since no commodity can be both a claim to a thing and 'serve the same purpose as the thing itself: you cannot ride on a claim to a horse, but you can pay with a claim to money' (p. 321).

A further institutional feature appeared when the government created a bond market to avoid borrowing from one entity at the exorbitant discount (interest rate) charged by the BoE. The British Treasury realised that 'the national debt could be made in effect self-liquidating and long-term'. New bond issues were placed on the market 'to pay for old bonds that were due to be paid' (Braithwaite and Drahos, 2000: 143–144, 172). These state debt–CB models were later copied, first in Europe, because the UK government gained such fabulous amounts of war finance (and kept winning wars), and then in America, where Alexander Hamilton won a bitter debate against Jefferson and the interests of small farmers.

Without getting too technical, there are three kinds of modern transferable IOUs: First is banknotes, that is, currency; second are other higher value bills of exchange that have a temporal life of months and third are government bonds whose redemption period can be short to long (months to years). Currency represents instant liquidity, and bills of exchange are uncashed IOUs, which can be monetised if presented at a CB. Wholesale and international money markets swap bills of exchange and bonds, and the banks and brokers who swap them earn money by offering them at a discount of their final redeemable value. A CB is literally central to the monetisation of bills of exchange. It offers a price at which it will buy bills of exchange and bonds (and this results in commercial banks realising more cash/liquidity), just as it puts a price on those bills of exchange it possesses for sale to commercial banks (therefore increasing their reserves). This came to be known as an open market operation, and it is the mechanism through which a CB attempts to control the amount of liquidity in the banking system (and therefore economy).

CBs cannot meet all the conflicting demands of government, the economy, commercial banks, the wholesale money markets and its own treasury; they have to learn the art

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of satisficing those demands with an acute sense of timing and proportion. CBs were also granted the statutory power to issue banking licences to commercial banks, and only those with a licence could obtain liquidity from the CB.

William III's navy programme kick-started economic growth in the 18th century not simply through fiscal defence spending but also by creating a general credit and banking system. Some 100 years later, Alexander Hamilton, as Treasurer to the new republic of the United States, had noted the win–win situation from which the British crown had benefited. It was no longer in debt servitude to one private bank, to which it paid exorbitant interest. Interest paid was lower and was made sustainable through (nationalised) taxation, and the prosperity of Great Britain stood out in comparison to other nations.[3] Hamilton joined the long and fractious debate (that related directly to particularist interests) on how America could found its own CB within the bounds of legitimate constitutional ends (Spiegel, 1987: 587).

The emergence of CB-administered currency offers clear public benefits. However, many economic textbooks portray money as neutral. Money is a transferable IOU – a debt – that achieves general circulation (and fosters capitalist dynamism) insofar as its creditworthiness is perceived as sound. Money therefore also involves a sociological relationship between creditors and debtors, which in a market situation for Max Weber (1968) is characterised by conflict (pp. 91–93). Each side, creditor and debtor, has opposed interests. The creditor wants to extract as high a price for loans, and the debtor wants to reduce the cost of loans, which in a centralised money system is worked out through a country's system of taxation and its CB. At times of patriotism, creditors will loan at low nominal interest rates, for example, war loans, whereas at times of crisis, creditors demand high nominal rates of interest and low inflation, for example, today's bondholders of government debt. The CB mediates this tension according to its own viewpoint and decisions, and this will vary according to the different coalitions of interests. It has to be remembered that until the 1920s, nearly all CBs were privately constituted banks (Ahamed, 2009: 11, 13). They had their own interest to pursue, usually in alliance with the wider financial community – a Wall Street or the City of London.

The Bank Charter Act of 1844 gave the BoE, anew, the sole authority (in London) of issuing banknotes, and as Charles Goodhart (1987) notes, it acted as an 'ordinary, profit maximising commercial bank' (p. 386). Joint-stock banks complained with justification that the BoE enjoyed free credit (because it created credit on its own account), whereas private banks had to pay for their deposits: 'The time is already arriving, if it has not already arrived, when the Bank of England must choose whether to be the banker for the government or a commercial bank. It cannot be both', wrote a Leeds banker in 1896 (quoted in Kynaston, 2011: 174).

The Bank Charter Act of 1844 severely limited the creation of credit by the BoE. The expansion of credit, by statute, had to be fixed to the reserves of gold. Therefore, when there was an expansion of economic activity and a greater use and need of credit, the BoE had to raise the discount rate. This had the effect of holders of bullion exchanging that for government bonds at its new, higher discount rate. The value of sterling remained fixed against the price of gold – the gold standard – and what it meant in this period was that any domestic economic expansion tended to be

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deflated. This placed the BoE and the City in opposition to industry and employment. Governors of the BoE were adamant that the gold standard be upheld, since in this period of Empire, the whole world trusted the City of London as the place where any bond could be exchanged, that is, London traded on its reputation for liquidity and calculable rate of exchange. No other national or sectoral economic goal was allowed to intervene. This is highlighted by the conflict between the interests of the joint-stock banks, which wanted to do as much commercial business domestically as possible, and the board of the BoE composed of merchants with not one commercial banker (Ingham, 1984; Kynaston, 2011: 158–160). The interests of an international City of London took precedence over industry – a conflict that remains to this day in the United Kingdom. Will Hutton (1995) argued about the BoE in the 1990s:

> It is thus a public body in name, but its overweening objective is to further – as it would say – the smooth running of a financial system whose sense of the public interest is extremely tenuous. The more liquid and broad the markets the better. When it needs to, the Bank looks for theories that justify its instinctive institutional preoccupation – and there is no better tool than classical economics. (p. 145)

The return to the gold standard after World War I marked the nadir of unenlightened CB policy. The Bank defended the Empire and the City of London's role as the financial headquarters (HQ) to the world, and so against the rival power of America and Wall Street. This policy was pursued with rigour in opposition to the extreme scepticism of the Chancellor of the Exchequer, Winston Churchill, who wrote to the BoE's controller of Treasury, Dr Otto Niemeyer:

> The Governor [of the BoE, Montagu Norman] shows himself perfectly happy in the spectacle of Britain possessing the finest credit in the world simultaneously with a million and a quarter unemployed. Obviously if these million and a quarter were usefully and economically employed, they would produce at least £100 a year ahead, instead of costing up at least £50 a head in doles. (Jenkins, 2001: 399)

Norman represented the consensus in the bank, the government and civil service that a return to the gold standard was the opinion 'of educated and reasonable men' and he carried the day. Roy Jenkins (2001) notes, 'An irony was that by upvaluing the pound Churchill threw a destructive spanner into the works of Baldwin's [the Prime Minister] industrial policy …' (p. 401). The traditional export trades of cotton, shipbuilding, steel and coal all suffered as a result. The government was forced into savage deflationary measures that included cutting the dole by 10% and in the dominions, the effects of the BoE's calling in debts were even more disastrous and as bitter.[4] Politicians of all parties – Churchill and Lloyd George – never relented in their hostility towards Montagu Norman and the BoE. The futile gold standard policy was lifted, unannounced, in 1931. Until 2008, this stands as the most notorious case of the bank pursuing one interest, mainly its own and the City of London's, against the interests of industry, commercial banks, employment and citizens.

https://doi.org/10.1177/1035304612474217 Published online by Cambridge University Press

CBs and the democratic mandate

This highly selective commentary illustrates the unpredictable but inevitable conflicts in money and CBs' mediating, but partisan, roles. Many CBs were established in an anti-democratic culture before the era of universal franchise, but the exigencies of the Great Depression in the 1930s placed them under the control of Treasuries in the democratic states (Goodman, 1991; Ingham, 1984: 170–172). In the United States under Roosevelt, it led to a reformed Fed; democratic wartime governments took powers over CBs, and many required, post war, a full-employment remit of CBs, as seen in the United Kingdom in the implicit mandate contained in the Radcliffe Report of 1959 (Dow, in press).

The period from the 1930s until the period of unpegged exchange rates and vast international capital flows, which started in the 1970s and intensified thereafter, represents therefore an era of greater democratic accountability. CBs were no longer privately run institutions whose main interest was the private banking industry. Instead, they were in dialogue with government treasuries, which in the post-1945 world were committed to rebuilding shattered economies – in short, to investment, growth, full employment and social welfare. It is facile to refer, as Montagu Norman did and some banking economists still do, to the 'nationalisation' of the CB. What happened then, as unfortunately now, is that democratic governments had to underwrite through taxation and austerity measures highly indebted national economies.

The tasks of CBs were multiple and, since these have mostly been consigned to 'pre-history' by the 'one task' independent CB movement, we need, briefly, to restate what they were: stabilising the value of the national currency both domestically and externally; ensuring the good functioning of the payment systems in domestic banking and its relation to foreign transactions; maintenance of the stability of the banking system and, if required, acting as lender of last resort and handling the government's sale of debt as well as its purchases, and therefore open market operations that directly affect interest rates and the control of credit in the economy (Davies and Green, 2010: 12). Within the institution of the CB, like the BoE prior to the 1990s, there would be dedicated departments that undertook foreign exchange transactions (on behalf of government and the CB's own account), credit control in the private banking and finance institutions (Ryan-Collins et al., 2011), and banking regulation and supervision with the sanction of withdrawing a bank or finance house's licence, and a government debt office (gilts). These were specialist tasks, and CBs developed the expertise and operational discretion, which in the case of buying and selling debt or currency required a keen sense of timing and time maturation of debt. To this extent, a CB was semi-autonomous. However, clearly, a CB could not be independent of government economic policy, since an expansionary fiscal policy, or a tightening monetary policy, or currency re- or devaluations had immediate consequences for the CB. Likewise, a CB could hardly move its discount rate in a direction contrary to government economic policy.

Functional differentiation within a CB operated in liaison with democratic governments, which were obligated to their electorates to keep unemployment at what was politically normalised at around 2% as well as delivering increasing prosperity through growth and investment. Government economic policy pursued this through both monetary and fiscal policies (Kriesler, 2009; Pixley, 1993; Wilson and McCarthy, 2012).

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Governments also faced the considerable discipline of maintaining the parity of the currency in an era of fixed and pegged exchange rates. Government finance departments could get out of line with CBs, and vice versa, but both lived under and operated within the expectations of a democratic mandate, which in the 1950s and 1960s was to an extent bipartisan across political parties.

Rudolf Stichweh (2012), as the first holder of the Dahrendorf chair at the University of Bonn, has recently reminded us that the institutions that constituted modernity emerged as a result of maintaining a balance between the cognitive and the normative. CBs testify to this. The cognitive achievement is of a high order in, say, Bagehot, Hamilton and Keynes, and many intelligent men held to viewpoints that proved catastrophic – with the present as no exception. Moreover, the everyday specialist activities of the CB testify to cognitive skills built up over decades. The normative impulse is crucial to propel CBs from a particularistic perspective to becoming an institution for the common good. This is most importantly instanced by keeping the currency sound and stable, and keeping the payment system secure. It was an accepted maxim that money – a time-sensitive exchange between credit and debt – is based on trust, the paramount normative value underpinning the whole financial system. Banking regulation and stability – or keeping bankers honest – is another normative essential. Commenting on the 1960s, neo-institutionalist analysts like John W. Meyer were able to recommend that good institutional design could be exported, a successful of example of which was the university. Therefore, in the early 1940s, there was a *schwärmerei* for constructing a normative world order (Dennaoui, 2010: 349–359; Meyer, 2005: 107–108). The creation in the period before and after 1945 of CBs in many countries of the world (Capie et al., 1994) is part of that normative impulse as well as the competence to export an institutional design.

However, since 2007–2008, we have experienced a grotesque amnesia about these normative and cognitive accomplishments. In September 2008, the international payment systems came within hours of shutting down, which would have been followed by probable anarchy on the streets and economic dislocation (Skidelsky, 2009: 9–10). Central bankers, like the BoE, temporarily forgot in 2007 their role as lender of last resort, which prompted bank runs and loss of public confidence. Banking regulation has been consistently lax since 'principles-based' self-regulation was introduced following the de-regulation of banking and finance in the mid-1980s, and in effect amounted to the abandonment of this task. Prime Ministers Blair and then Brown, like previous Conservative leaders, gave public utterances that the regulatory authorities should have a 'light touch', and this represented a politicisation of regulatory agencies (Budd and Whimster, 1992; Parry, 2009: 109–131).

Following the dire crisis, major CBs turned to quantitative easing. It is a form of monetisation of government debt. It is justified in times of economic emergency, but it was not part of the independence remit of CBs, and could only operate before that with the guarantee of citizen taxation. Interest rate setting, which became the only task of the CBs under independence, belonged as it now turns out, to the truly independent financial markets, which manipulated the interbank lending rate (Libor). CBs were presiding over an instrument over which they had only part control. Whether they actually thought interest rates still governed the price of capital in relation to future investment returns or realised that interest rates now related to the future speculative profits and losses in the

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trillion dollar industry of trading in financial instruments (that were referenced to Libor: e.g. Plender, 2012: 20) has yet to be revealed. Bank insolvency, consequent upon, in part, lax supervision, has meant that whole economies, as in Iceland, Ireland, and the United Kingdom, have become burdened with bad debts, with only the guarantee of citizen taxation maintaining the creditworthiness for consequent massive government borrowing, now required to rectify the accumulated delinquencies of banking.

We write before a complete audit of the role of CBs and private banks has been published, though in this respect, the United States is very much ahead of the authorities in the United Kingdom (Pixley, 2012). However, a clear line of inquiry for future research and policy deliberation is whether the loss of normativity in CBs was the adequate cause for cognitive dysfunction. In other words, did the granting of independence signal a loss of normative responsibility and the atrophy of cognitive skills? To answer this question, we turn to the reasons, manifest and latent, behind the move to CB independence.

The independence movement

When in this article we refer to the technocratic CB and its vulnerability to capture by the values and interests of finance, what is occurring is the loss of symmetry between the cognitive and the normative. What we first consider is the intellectual case for independence that became the new vogue in the 1990s. In the previous decade, leading orthodox economists such as Gordon, Barro and Rogoff had started to turn their theoretical and mathematical firepower in the direction of formally defending CB independence (Debelle and Fischer, 1994: 198). However, the face-value justification for making CBs independent was empirical research, first published only in 1988 with follow-up studies in the early 1990s, that demonstrated a statistically significant correlation between countries that had low inflation rates and had constituted their banks as independent (Walsh, 2008: 728).

Independence is most directly defined according to two criteria: either government denies itself influence on policy (goal independence), or government grants CBs freedom to determine which instruments it will use to meet policy goals that are specified by government (instrument or operational independence). The latter is the usual case, so that in 1997, the BoE was given an inflation target to meet. The Federal Reserve of the United States by charter has to aim at maximum employment, stable prices and moderate long-term interest rates. The European Central Bank (ECB) has its primary goal set by Article 105 of the Maastricht Treaty as price stability, but it also has to support a high level of employment as well as stable and non-inflationary growth as stipulated in Article 2 of the European Community. The remit of the Federal Reserve stands out as more comprehensive – although it is criticised for its vagueness, which effectively gives it ‘goal independence’ (Debelle and Fischer, 1994: 217).

The statistical methodology of the research highlighting the achievements of independence has been questioned – too few cases and invalid causal inferences in a more complex multi-causal environment (Walsh, 2008: 730). Prima facie, unless oil price hikes in the 1970s and other determining factors like technology and productivity increases, cheaper energy and global labour competition in the 1990s are removed as exogenous causes, then the research has less plausibility. When CBs appear to have contributed to low inflation,

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these achievements have come at a known sacrifice: the Bundesbank produced two longer and deeper recessions (e.g. 1981) than the one created by Volcker's Fed in the United States (1980), so it is surprising (in a cognitive sense) that its model was so revered for creating a 'free lunch' (according to Debelle and Fischer, 1994: 201–206).[5] Indeed, the output and employment costs of the policy bias (Forder, 2001) in favour of low inflation have been seldom researched when compared with studies of independent CBs on inflation. One of the few studies to attempt this by Down (2004) states: 'Probably the most striking result to emerge … is the robust relationship between CBI and the unemployment and output costs of inflations … the relative inflation aversion of policy makers appears to increase the cost they are willing to impose on society to reduce inflation' (p. 430).

What is striking – at least in the academic literature – is that the independence movement gained ground in the 1990s on the insubstantial basis of a few studies. Behind this move, however, was the general pushback in economics and economic policy against the control of aggregate demand through Keynesian fiscal policies. Economic actors, so the new monetarism argued, come to anticipate the fiscal stimulus, which then has the result of increasing the rate of inflation. Monetary policy solutions were regarded, by defenders, as a *depoliticisation* of economic policy, and it was in this climate that the idea of the 'independent' CB arose. Independence coincided with ever more freedom for financialisation. Finance managers not 'owners' (as alleged in the 'democratising of credit and assets' rhetoric) became *the* influential and politically ascendant economic actors, and the accompanying freedom from constraint appeared like a utopian escape from an alleged 'financial repression'. At the height of the fervour, expanding finance promised a way of generating growth and wealth that bypassed democratic and redistributive pressures implicated in Keynesian growth strategies. In addition, in a context of double-digit wage-price inflation, the political debate that 'won' in the 1970s stressed social-democratic fiscal controls as the 'road to serfdom' (for financiers) and how trade unions were destroying the value of pensioners' savings (Pixley, 2012: 244–250). The rise in bank competition imposed primarily by the US and UK governments, and the contradiction in the loss of CB supervision *versus* retaining lender of last resort, seemed to distance CBs from what had been one of their core concerns: the control of private money creation.[6]

Turning briefly to the record of the CB independence, what stands out is the attainment (fortuitously or otherwise) of their remit of price stability in terms of measured indices and their indifference to all other concerns (see Alesina and Gatti, 1995; Franzese, 1999; Klomp and De Haan, 2010). We also need to remember the context of the 1970s and the sort of lessons bankers and monetarists drew from that decade. Social-democratic governments and their CBs were faced with a series of intractable issues when President Nixon and his Treasury Secretary abandoned Bretton Woods in 1971, an event followed soon after by the oil price hikes and their effects on the cost of living and industrial costs. Wolfgang Streeck (2011) and Hirsch and Goldthorpe (1978) have argued that nominal wages were allowed to rise as a form of compensation for fairer welfare states more responsive to democratic demands.

The 1970s also started the experimentation, continuing to the present, of 'easy credit' – for example, the 'Barber boom' in the United Kingdom – as a way of maintaining effective demand once low inflation gained priority over full-employment goals. Independence for CBs seemed a way of immunising politicians against pressures for job

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creation. In freeing up credit and lowering inflation, it was argued, growth could be sustained in a new way. However, Debelle and Fischer (1994) and Ian Down (2004) show that independence (per se) fosters wage-price inflation 'hawks', that is continually 'pre-emptive', which leads to loss of output and a higher 'sacrifice ratio' in unemployment: no 'free lunch'. At the same time there was a tremendous asset-price and credit inflation. We simply note in the United Kingdom, private money creation (bank assets) rose from 50% before the 1970s to 600% of gross domestic product (GDP) by 2007, and to 100% in the United States (Alessandri and Haldane, 2009; Haldane, 2010). After 2008 came strong and widespread deflation, unemployment and further underemployment. Independence remains the norm. In the sense that CBs became dependent on 'markets', disinterested in 'output' and rejected a norm of full employment, we suggest that a new form of privatisation of these statutory institutions took place. This stands in contrast to the rule and accountability to social-democratic treasuries in the period up to the 1970s.

Independent CBs, once institutionalised, appeared to act against the major interests of the old order – fiscal agencies and manufacturers. Political scientists implicate independent central banking as a direct cause of unemployment from the Netherlands to the United States, with serious exceptions (e.g. Kurzer, 1988). One exception is that relationship banking (in Germany, notably) meant that big business and labour unions were less excluded from money's heartland in Europe, than in the United Kingdom or United States (Kurzer, 1988: 30). According to Kurzer, 'when financial institutions have vested interests in manufacturing, as in Germany, the central bank will be less opposed to fiscal expansion and relaxed monetary policies'. (See two views in Debelle and Fischer, 1994: 201.) However, the informal relations of a CB are partly dependent on the strength of the financial sector (Kurzer, 1988: 28–29).

The ECB and the Euro is an extreme example of a flawed design. Considering the above criteria, the ECB (a) is not supervisory, (b) does not lend directly to government, (c) makes limited interventions in markets (until 2007) and (d) it depleted the reserves of the national CBs without providing member countries with the protection normally expected of a CB (Davies and Green, 2010: 142–148). The ECB was set up for political reasons, which is not the same as Stichweh's normative role, and the ECB was launched into the world with limited powers, so it was a cognitive failure. Although it is the *outlier case*, it lays bare the sociological and democratic issues involved in independent CBs. Amid attempts to depoliticise money via independent CBs, the ECB's rules demarcate, if not replicate, the informal types of relations of *independent* CBs. Europe has no 'overarching political sovereignty' (Ingham, 2004: 195) from which the ECB would be independent, and indeed, its remit is set by treaty (and difficult to change).

The Euro is 'pure-private' money: no individual state can borrow from the ECB (unlike sovereign states from their CB – a point in need of further examination with independent CBs), and therefore, 'budget deficits must be financed directly in the money market' like private corporations (Ingham, 2004: 190–191). The difference is that sovereign states have compulsory taxation: taxpayers are involuntary debtors. Both Ingham and Goodhart ask, 'why did these European states agree to surrender their monetary sovereignty?' Ingham cites Weber, 'for money to be money, it has to be scarce and an autonomous weapon in the economic battle'. However, it is a near monopoly dominance by capitalist

https://doi.org/10.1177/1035304612474217 Published online by Cambridge University Press

money now. In contrast, money's infrastructural (collective) power and its utility aspect have been enfeebled. As Alain Parguez (1999) puts it, the Euro was a 'bold' plan to create the *soundest and strongest currency* in the world. However, that required convincing global financial investors of 'zero expected inflation' through preventing wage inflation, taken as the sole cause of inflation by the ECB. Although this regime is harsher than even the policy of defending a non-accelerating inflation rate of unemployment (NAIRU), the further requirement is that no member state is allowed to interfere in the process of money creation, and the ECB is forbidden to create money. Member states are 'obliged to finance their deficits by selling bonds to commercial banks' and other bond buyers. As Parguez (1999) says, the 'ECB should even abstain from acquiring these bonds if it could be an indirect way of financing government deficits' (pp. 63–66). In 2012, the ECB version of quantitative easing appears to propose exactly that, but so belatedly that deficits had become higher. Parguez (1999) continues on this dismal pursuit of 'pure' independence:

> At last, any connection between the Treasury and the Central Bank should disappear. Members will have no checking account at the Central Bank. This last aspect of the prohibition should prevent states from creating money in the short run to match the discrepancies between flows of expenditure and flows of taxes. They should always spend what they have already received as taxes. (p. 66)

This overturns the whole meaning of money as a promise into the future depending on new wealth being created by business firms and, in this case, the ability of governments to tax *more* citizens and firms *later*. Under the Eurozone depression created since 2008, and worse, having kept unemployment and fiscal austerity high and economic activity low since the ECB's inception, current taxes were already low *before* the speculative attacks and depression. The ECB kept monetary policy tight, ruinously for the very countries now blamed for fecklessness (Baker and Schmitt, 1999: 12). Ahamed (2012: 9) suggests that where France, then the major European creditor, could have engaged in debt forgiveness to Germany in the 1920s, so too could Germany in the 2010s. The Euro was a vision of money as 'pure hoarding' (Parguez, 1999: 68).

Low inflation, whether set by democratic governments or by CB independence, has had huge social and employment costs. Moreover, behind closed doors by 1996, Greenspan explained that to the extent that wage-price inflation is controlled, asset-price inflation 'goes through the roof'. He agreed that raising margin loan equity (a specific Fed control) would stop it, but to Congress, he claimed that such a move would hurt modest 'investors' (Pixley, 2012: 161–162). Greenspan (1996) also said, 'Clearly, sustained low inflation implies less uncertainty about the future, and lower risk premiums imply higher prices of stocks and other earning assets'. Our question is which groups enjoyed this apparently reduced 'time inconsistency'.

The challenge of CB independence for democratic politics

The problems of democratic accountability and CB conduct have been noted by critics for some time. For example, in 1994, Paul Volcker noted at a conference at the BoE tercentenary when the brave new world of independence was being mooted,

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> Charles Goodhart made the analytic point earlier today that if price stability were the only objective of monetary policy, we would do well without having central banks, which, after all, have been given the magic power of creating money – and by corollary the possibility of too much money. I am not about to support the idea of abandoning central banks, but a certain degree of modesty seems to me appropriate, and I would conclude that it is not monetary policy alone that will seize the holy grail at acceptable cost. Instead I join Alexandre Lamfalussy in emphasising that fiscal policy, labour markets, social policies, and other difficult questions inextricably tied up with the political process remain relevant. To put the point starkly, whatever the formal independence of a central bank, it's a broad mix of policies, ideally a suitable co-ordination of policy, that will count. (Volcker in Capie et al., 1994: 343–344)

In addition, in 1998, Joseph Stiglitz went further, suggesting that an independent monetary policy would reduce democratic control over the economy altogether:

> The most fundamental is a matter of democratic philosophy. Monetary policy is a key determinant of the economy's macroeconomic performance. The elected government is inevitably held accountable for that performance, … yet, especially as fiscal policy becomes constrained by budget stringency and it will be even more constrained in Europe with the agreements underlying the monetary unification, … monetary policy is the main instrument for affecting macroeconomic performance. That this key determinant of what happens to society – this key collective action – should be so removed from control of the democratically elected officials should at least raise questions. (p. 216)

Underlying the current disorders are no mere technical questions. They are political and sociological ones. The argument for democratic controls through the legislature – and this involves the institutional design of CBs – rests on the principle that the core functions of a CB are to protect the common good. Money has the potential to be a dynamic force and utility. Maintaining its value, stability and availability is paramount to employment and economic activity, so too is maintaining the stability of the banking system. Normativity matters.

There is little foundation in democratic theory for independent CBs. As Claus Offe (1980) pointed out over two decades ago, 'Democratic politics is the bridge between the citizen and the state' in formal liberal democratic theory (p. 5). However, he adds, 'Behind the façade of parliamentary democracy, both political conflict and the resolution of policy issues increasingly takes place within organisational settings which are unknown to democratic theory' (p. 8). Although the post-war democratic settlement in our view was not a 'façade', we agree with Offe that governments '*rely increasingly upon criteria and standards of performance that are derived from other sources than the democratic political process*' (p. 8, emphasis in the original). The push for independent CBs fits this description closely.

In this vein, we endorse the criticism of the bureaucratic view, in which administrative and technocratic decisions are apparently not 'politics'. This is not possible, since administration cannot 'reduce' decisions about winners and losers to bureaucratic rules (Mannheim, 1936: 104). CBs were made independent by governments. CBs could skirt democratic politics and decide on losers according to rules, such as inflation targets. For

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the winners, CBs did little about the finance sector's gaming of any rules, in part because CBs had become part of the coalition of interests implicitly favouring finance and low inflation.

In extending Offe's insights, operational/instrumental independence, where the goal is the single task of price stability, inevitably leads to a technical mindset. Or as Willem Buiter (1999) sarcastically suggested, 'monetary policy is a cult whose high priests perform the sacred rites far from the prying eyes of the non-initiates' (quoted in Davies and Green, 2010: 161). This also leads to a technocratic notion of accountability: simple questions of who appoints the board members of CBs; should they publish their minutes; who do they report to and so on. However, we now inhabit a world where independence has been undermined by the financial crisis and where approximately 2% nominal inflation according to doctored indices is the least of many countries' worries. The world is returning to the situation *ex ante*. CBs will have to rediscover their old powers, competences and responsibilities in the enormous task of restoring the solvency of commercial banks; in exercising effective supervision to regain bank stability and in taking extraordinary measures to monetise private, commercial and government debt, and governments will need to reconsider whether the split between monetary and fiscal policy is still tenable.

Faced with this, the allure of independence, the prestige and mystique of the CB and the cult of the personality among their governors/chairs need a fundamental reassessment. The sacrifices being asked of tax-paying citizens and the damage being inflicted on their economic and social welfare mean that elected governments and their finance ministries will have to return to the old agreements and relationships with their CBs. In the public mind, bankers and economists have lost trust and therefore legitimacy, and this, we suggest, will lead to the reform of how CBs are constituted. The independence of the BoE was executed over a weekend in May 1997 without consultation or a White Paper (though such plans secretly existed beforehand). The ECB was created, as noted, from political expediency. Future reforms should incorporate a plurality of interests represented in the boards of CBs and a reworking of the relationship to finance departments and the elected government.

Although as sociologists we see no social coalitions forming that would foster renewed democratic control over the purposes of money creation, we believe it is worth defending the needs, which are volubly and continuously expressed by voters across the world, through a modest analysis of the current situation. CBs will always be in a social interface with conflicting interests and expressed needs. Democratic accountability, in our view, is important for stiffening CB's resolve (via institutional design) to manage and juggle, as fairly and competently as possible, the fundamental requirements of the stability of money and of putting money's creative powers to democratically desired social development for the world's commonwealth.

Acknowledgements

We wish to acknowledge the helpful advice from the anonymous referees and also wish to thank individuals, close to some of the processes involved, who gave us valuable advice.

https://doi.org/10.1177/1035304612474217 Published online by Cambridge University Press

Funding

This research received no specific grant from any funding agency in the public, commercial or not-for-profit sectors.

Notes

1. Our main examples, also selectively for this sociological argument, are the Bank of England and a brief mention of US Federal Reserve. We do not discuss the many crisis events since 2007 but focus on central banks' (CBs') institutional design and morphogenesis – how events cumulatively move an institution to a new structural form.
2. In other words, Weber (1927) says, 'loans came to be floated which appeal to the voluntary economic interests of the participants. The conduct of war by the state becomes a business operation of the possessing classes' (p. 280).
3. Independence of CBs is often defended on arguments that the Crown chartered the BoE to 'enhance' the credibility of its commitment to repay loans, and 'in so doing facilitate its efforts to raise new capital' (e.g. in Goodman, 1991: 330). That was at a time when the typical defaulter was a government not under democratic control (our focus).
4. For example, in Australia, where a version of a social-democratic state was, at the time, somewhat more established than in the United Kingdom.
5. Debelle and Fischer (1994) also note the more single minded a CB is in preserving the value of the currency, the more independent it is taken to be, and that this assumption is the usual basis of indices of CB independence (pp. 198–199).
6. Some central bankers opposed these changes, we briefly suggest later.

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https://doi.org/10.1177/1035304612474217 Published online by Cambridge University Press

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