Gordon Unbound: 
The Heresthetic of Central Bank Independence in Britain

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Abstract

This article combines theory and historical narratives to shed new light on the politics surrounding the making of central bank independence in contemporary Britain. Its central argument is that Gordon Brown’s decision to rewrite the British monetary constitution in May 1997 constituted an act of political manipulation in a Rikerian sense. The institutional change involved can be conceptualized as a heresthetic move, that is, structuring the process of the political game so you can win. The incoming government removed a difficult issue from the realm of party politics in order to signal competence and enforce internal discipline in the context of a government that was moving toward the right. But building on Elster’s constraint theory, the paper argues that the institutional reform was not a case of self-binding in an intentional sense. Rather, Brown adopted a precommitment strategy that was aimed at binding others, including members of his government. The reform had dual consequences: it was not only constraining, it was also enabling. The institutionalization of discipline enabled New Labour to achieve key economic and political goals. By revisiting the political rationality of precommitment, this paper questions the dominant credibility story underlying the choice of monetary and fiscal institutions.
‘The world has turned upside down. A Labour Government is elected and the new Chancellor's first move is to hand over control of macroeconomic policy to the Bank of England.’

The Times, 7 May 1997

‘One good way to understand the development of institutions is to analyze crucial turning points when people consciously try to change the way the institutions work.’


Introduction

This paper looks at the politics surrounding a pivotal change in the rules of the game governing British political economy. On 6 May 1997, the newly elected Labour government surprised friends and foes by announcing that the power to set interest rates would be transferred from the Treasury to the Bank of England. Giving the Bank operational responsibility for setting interest rates should be seen as a seminal event. This momentous change in the ‘constitution of economic policy’ was regarded by Tony Blair as ‘the biggest decision in economic policy-making since the war’. Many commentators went further and argued that the move was ‘the most significant shake-up at the Bank of England in its 300-year history’. In hindsight, one might argue that central bank independence (CBI) in Britain was simply an idea whose time has come. Yet the paradox is that at the time nobody saw it coming. Although New Labour had signalled financial reform in its election manifesto, the issue was barely mentioned during the campaign. Indeed, ‘Brown got through fifty interviews and press conferences during the campaign without being seriously questioned over his plans for the Bank of England’. Even the most perceptive journalists were astonished by Brown’s bold and unexpected move. According to the Financial Times:

‘Labour’s election manifesto had seemed to suggest this momentous change in the conduct of economic policy was on a fairly distant horizon’.

The adoption of central bank independence in Britain poses an explanatory puzzle: if independence is supposed to enable a central bank to resist pressures from elected politicians, why might those politicians have an incentive to establish independent

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2 The Times, 7 May 1997.
central banks in the first place? Britain is a crucial empirical case for interpreting competing theories of monetary governance. As Michael King shows, this institutional change does not sit well with theories based on structural changes in the global financial system, economic competition among states, or external coercion by international financial institutions. More critically, this case defies the expectations of the partisan literature. This sweeping institutional reform was introduced by the Labour Party, which had nationalised the Bank in 1946, and whose constituents are not likely to prefer price stability over job creation. The Conservatives, the party representing business and financial interests, had resisted several attempts to introduce central bank independence in the period 1988-1997. This rapid constitutional transformation cannot be easily explained on the basis of existing theory such as North’s notion of ‘relative price shocks’ or Schofield’s concept of ‘belief cascades’.

The aim of this article is to provide a political economy account of the origins of central bank independence in Britain. As a point of departure, I assume that to remove monetary policy from the political sphere is a political act. Given this assumption, this article stresses the strategic nature of institutional creation and assesses the role of political entrepreneurs in the process of institution-building. In particular, I will claim that William Riker’s notion of heresthetic is a useful analytical tool for understanding the logic of institutional formation. I will focus on two mechanisms which I suggest were at work in the thinking of the ‘founding fathers’.

First, building on Jon Elster’s reformulation of his original thesis on ‘Ulysses and the Sirens’, I will argue that precommitment strategies are about binding others rather than being acts of self-binding. Second, I will contend that institutional commitments

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11 Following the convention in constitutional political economy, founding fathers refer to the core group of people playing a central role in the process of institutional framing.

fulfil not only constraining functions, but also enabling ones. By revisiting the political rationality of precommitment, I will shed new light on the credibility story underpinning the making of CBI in Britain. My account challenges economic narratives based on the idea of self-binding and complements political narratives constructed around the influence of epistemic communities and the benefits of depoliticization.

The paper proceeds by setting out an analytical narrative of Gordon Brown’s decision to grant operational independence to the Bank of England. An analytic narrative seeks to convert descriptive historical accounts into analytical ones by using theoretically relevant language. Its basic methodological assumption is that ‘theory linked to data is more powerful than either data or theory alone’. The data come from the abundant secondary literature on New Labour’s policies and politics. In line with McLean’s advice, the paper engages with the trade of the historian and analyses parliamentary debates, politicians’ biographies and memoirs, hundreds of newspaper articles and media reports, and a wealth of lectures and policy speeches given by the key actors involved in the process. But satisfactory answers to complex empirical puzzles depend not only on the evidence available, but also on what we bring into the analysis. Theory should guide empirical explorations.

Case studies are not always good for testing theories. However, they are good for uncovering missing mechanisms, developing new ideas, and dealing with causal complexity. This case study aims to contribute to the comparative literature on the political economy of monetary institutions. Econometric studies do not reach a

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consensus regarding the factors that determine the choice of monetary institutions, and cannot resolve disagreement about the precise processes by which politics affects the choice of these institutions.\textsuperscript{19} Theories of institutional change are still underdeveloped, and game-theoretic models of credibility are too abstract for dealing with the nuances of historical situations. Happily, there is a rich variety of sources for New Labour’s economic project, including the early move towards Bank independence. To date, few of these narratives have sought to draw implications from their observations of political behaviour. An analytically informed analysis of a seminal episode of institutional development may therefore have both empirical and theoretical value.

This article proceeds as follows. The first section reviews political economy theories of central bank independence, seeking to identify the puzzles of the British case. The second presents the theoretical framework of this paper, drawing ideas from the works of Elster and Riker. The third section discusses the economic and political context of the institutional reform. The fourth section offers an analytical narrative of the origins of central bank independence in Britain. Key findings and implications of this research are summarized in the conclusion.

\textsuperscript{19} Bernhard et al., ‘The Political Economy of Monetary Institutions’, p. 28.
Britain’s puzzling road to central bank independence

What explains the choice of monetary institutions in general and independent central banks in particular? An established literature has looked at the costs and benefits of alternative monetary regimes from an economic perspective. The starting point of this approach is the macroeconomics of time-inconsistency. Time-inconsistency models point to the welfare losses that arise when a policy announced for some future period is no longer optimal when it is time to implement the policy. Economists have proposed institutional responses to the credible-commitment problem of time-inconsistent plans. Following Kydland and Prescott, some scholars have advocated ‘rules rather than discretion’ in the governance of monetary affairs. Others have observed that ‘credibility may be achieved by delegating powers to suitably designed institutions’. For example, Giavazzi and Pagano discussed the advantages of handing over power to a conservative foreign bank. In the same line, Rogoff argued that the right incentives could be generated by setting up an independent central bank that is staffed with inflation-averse officials.

It is often assumed that there is a strong economic case for insulating central banks from the influence of elected politicians. However, Kathleen McNamara argues that this conventional wisdom should not be taken for granted. On the one hand, some studies have found that high central bank independence (CBI) is correlated with low-

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25 McNamara, Rational Fictions.
inflation performance, often at no costs in terms of output stabilization.\textsuperscript{26} On the other hand, other scholars have shown that the apparent correlation between CBI and low inflation is not causal.\textsuperscript{27} In fact, it is highly sensitive to measures of independence, the time period chosen, and especially to the countries included in the sample.\textsuperscript{28} But even assuming that there is a strong economic case for choosing an independent central bank, the political logic of delegation remains a paradox. If independent central banks did nothing but limit the ability of governments to manipulate monetary policy for their own short-term gain, governments would never choose an independent central bank.\textsuperscript{29} Delegation may be a way to achieving credible commitments.\textsuperscript{30} But the core question remains: ‘why did the same politicians who always preferred to have their hands on the monetary lever, suddenly opt to delegate such far-reaching powers to an independent technocratic institution?’\textsuperscript{31} A body of research has exposed the limitations of the economic approach. This literature questions the apolitical nature of traditional optimal currency area and time-inconsistency models, which rely on the unwarranted assumption that monetary choices are made by benevolent social planners motivated by welfare considerations. By neglecting the role of politics, the argument goes, approaches that focus solely on countries’ structures or expected economic performance have little explanatory power to account for the observed pattern of currency arrangements.\textsuperscript{32} Hence, a theory of monetary institutions should incorporate the ‘political incentives and constraints that


\textsuperscript{29} McNamara, \textit{Rational Fictions}, p. 7.


\textsuperscript{31} Majone, \textit{Public Policy and Administration}, p. 617.

shape governments’ decisions on monetary institutions’ and acknowledge the fact that ‘monetary phenomena are always and everywhere political’.}

Political economy accounts of variations in central bank independence can be divided into five groups of explanations. Firstly, institutional explanations claim that independent central banks tend to emerge in countries with a federal form of government and/or many veto players. Secondly, distributional or partisan explanations contend that central banks should be more independent in countries where anti-inflationary social interests are powerful, and that conservative parties, more concerned about inflation than unemployment and redistribution, should be more likely to support the institutionalization of price stability. However, an alternative and more counterintuitive partisan argument is that left-wing parties lacking anti-inflation credibility may choose CBI to signal a commitment to responsible economic policies. Thirdly, international ideational accounts suggest that, in the context of increasing economic openness and capital mobility, national politicians have been forced to grant CBI in order to achieve market confidence by reassuring international financial markets. According to this logic, the growing popularity of this regime is rooted in a process of social diffusion of (appropriate) organizational models led by influential epistemic communities. Fourthly, strategic explanations argue that political actors establish monetary commitments to lock in the policy preferences of the enacting coalition, address the problem of political

33 Bernhard et al., The Political Economy of Monetary Institutions, p. 18.
34 Jonathan Kirshner, Monetary Orders, p. 3.
39 McNamara, Rational Fictions, p. 61.
survival, or to make it possible to shift the blame when something goes wrong. Finally, integrative approaches to the politics of central banking examine the interaction of international, national and micro-institutional incentives.

The British case appears to defy conventional theories regarding the adoption of central bank independence. To start with, governments of unitary countries with few veto players have little incentives to support a politically independent central bank. This case also contradicts partisan and interest-group explanations. While the Labour Party surprisingly instigated this flagship neo-liberal reform in 1997, the powerful City of London, which was meant to be among the key winners of this institutional change, did not take the lead in the constitution-making process. Given that decisions over interest rates were bound to have significant distributive effects, it is also striking that neither the business community nor the Bank of England itself actively lobbied for independence. Finally, the British experience is not consistent with the most popular strategic argument, which contends that monetary commitments are used to constrain future governments.

At first glance, this case offers support to the hypothesis that politicians hand over policy tools to signal credibility to financial markets. Yet even though the binding implications of open markets featured strongly in the way the founding fathers perceived their own interests, the British road to independence was dominated by domestic considerations. King argues that while the diffusion of ideas through epistemic communities is the key mechanism explaining central bank reform in Britain, ‘policy failure and paradigm innovation are insufficient conditions for the

42 Cukierman, Central Bank Strategy, Credibility and Independence; Elster, Ulysses Unbound.
45 Mark Hallerberg, ‘Veto Players and the Choice of Monetary Institutions’, p. 95.
adoption of new ideas by politicians’.

Politicians’ incentives for adopting ideas have to be accounted for. King’s argument is that ‘Bank of England independence provided electoral gains for New Labour by making the party more attractive to voters. In particular, this policy was designed to win the support of homeowners that represent the median voter in the British context’. King’s account is compelling, but it is not without problems. Had electoral considerations been central, the decision would have been taken before the election, not after. Moreover, the process of policy learning was less than straightforward. Ed Balls, for many the real intellectual father of the reform, used to believe that an independent central bank was the right instrument for ‘escaping’ rather than strengthening monetarism.

The move towards central bank independence was entirely consistent with one of the defining governing strategies of the Blair government, the politics of depoliticization. In a path-breaking work, Peter Burnham claimed that by granting operational independence in the area of monetary policy to the Bank of England, New Labour could off-load responsibility for unpopular policies and enhance its much-needed governing competence in the eyes of both markets and voters. Burnham correctly assumes that depoliticization is an intensely political process. He is also right in underlining the role of economic competence. However, our argument is that the founding fathers were more interested in enforcing governing competence through time than in signalling economic responsibility. At the same time, it is likely that the blame avoidance argument has been overstated. Some scholars suggest that, given the British constitutional settlement, trying to shift the blame through policy delegation is not always the best strategy.

There is little evidence suggesting that blame avoidance was a key motivation influencing this institutional change. King argues that ‘the British case supports the hypothesis that an epistemic community of monetary experts has the ability to influence policy if they can convince a key

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47 King, *Epistemic Communities and the Diffusion of Ideas*, p. 115.
48 King, *Epistemic Communities and the Diffusion of Ideas*, p. 115.
49 According to Peston, ‘the young Balls deserves as much credit—probably more—than anyone else for the creation of the modern Bank of England’, Peston, *Brown’s Britain*, p. 118.
52 Elgie and Thompson, *The Politics of Central Banks*. 
politician to champion this reform’.\(^{53}\) This implies that the incentives of those key politicians, the constitution-makers, should be at the centre of the analysis. Was the Bank of England reform really about signalling economic competence and appealing to the median voter? Was it really about shifting the blame for unpopular decisions? To what extent were the founding father constrained by the actions and expectations of influential epistemic communities? In short, what were the microfoundations of this radical institutional change?

These reflections suggest that the political economy of monetary governance has a critical analytical gap, namely its isolation from the rich theoretical literature on institutions. It is striking, for example, that most scholars writing about the political economy of monetary institutions and the politics of central banking in Britain in particular make practically no reference to the works of leading political economists such as Douglass North and William Riker.\(^ {54}\) In the next section, I will draw some lessons from the political of institutions research tradition.

**Analytical tools: heresthetic and constraint theory**

‘The key for understanding the process of change is the intentionality of the players enacting institutional change and their comprehension of the issues’

Douglass North, *Understanding the Process of Economic Change*, p. 3

Why do institutions emerge? Rational-choice scholars conceptualize institutions as negotiated solutions to problems of coordination and cooperation.\(^ {55}\) But we should not neglect an important part of the story: political institutions are also weapons of coercion and redistribution. They are the structural means by which political winners pursue their own interests, often at great expense to political losers.\(^ {56}\) Institutions are not usually created to be socially efficient; they are created ‘to serve the interests of

\(^{53}\) King, *Epistemic Communities and the Diffusion of Ideas*, p. 113, emphasis added.

\(^{54}\) Similarly, mentions to the works of Schofield, Shaple, Tsebelis and Weingast are exceptional.


those with bargaining power to create new rules’. Moreover, they are products of ‘struggles among unequal actors’. If institutions have distributional effects, the ‘politics of structural choice’ should be rigorously investigated. If there is a systematic relationship between institutions and outcomes, a political actor ‘may operate on the cause in order to modify its effects’. In this context, the politics of institutional change can be analysed from the perspective of heresthetic.

**Heresthetic**

‘Heresthetic…may not happen as often as Riker claims, but when it does, it matters’

Iain McLean, *Rational Choice and British Politics*, p. 556

Heresthetic is the art of political manipulation. It is about ‘structuring the world so you can win’. This concept is used in electoral politics to describe the strategy of bringing about a new alternative to divide an existing majority, upsetting the prevailing equilibrium. As a case in point, Abraham Lincoln famously split and then defeated a solid Democratic majority by introducing a new dimension of political competition, that is, slavery. Political scientists mainly focus on the way electoral equilibria are broken by increasing or fixing dimensionality. But Riker’s lessons are more general. Skilful herestheticians outmanoeuvred political adversaries by redefining political situations, reframing policy alternatives, manipulating agendas, voting strategically, and changing the process by which collective decisions are taken. Indeed, heresthetic is essentially ‘the art of constructing choice situations so as to be able to manipulate outcomes’. In Riker’s words, it is about:

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59 Moe, *Political Institutions*.


‘Setting up situations...in such a way that even those who do not wish to do so are compelled by the structure of the situation to support the heresthestician’s purpose’. 64

One of the key arguments of this paper is that heresthetic is also about the strategic manipulation of institutions. Social decisions are made by aggregating the opinions of relevant people. New institutionalism contends that social outcomes depend as much on the procedure of aggregation as on the tastes of participants. If institutions mediate the relationship between preferences and outcomes, it is always possible to manipulate outcomes by redesigning institutions. In this context, the logic of heresthetic can inform the politics of institutional change. 65 In certain moments of history, the introduction (or elimination) of dimensions involves the manipulation of institutional structures, as actors struggle to shape the mechanisms transforming preferences into outcomes in order to prevail in future political contests. Hence, heresthetical manoeuvres are a source of institutional change. However, while some politicians are strong on heresthetic, others not. 66 We will see that this issue played a key role in explaining the evolution of bank independence in Britain.

The concept of heresthetic is also a reminder that political agency matters in the process of institutional change. One way of incorporating agents into a model of institutional origins is to look at the behaviour of ‘political entrepreneurs’, who engage in institution building to make profits. 67 Transforming institutions is costly though. Political entrepreneurs must invest time and energy in the design of institutions from which they seek to secure political gains. In the reminder of this section, we will discuss two types of motivations: (1) the notion of binding others and (2) the enabling functions of institutional precommitments.

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66 McLean, *Rational Choice and British Politics*.
From self-binding to binding others

‘In politics, people never try to bind themselves, only to bind others’
Jon Elster, *Ulysses Unbound*

The idea of *self-binding* is omnipresent in the credibility-based narratives explaining the choice of monetary arrangements. Several scholars have employed the metaphors of tying one’s hands and burning own ships to describe the pre-commitment options available for achieving credibility in strategic interaction.\(^{68}\) These metaphors have been widely applied to account for the evolution of fiscal and monetary commitments.\(^{69}\) Correspondingly, Ulysses’ self-binding logic is often used to explain the rise of independent central banking. As one expert put it:

‘Perhaps the principal reason why central banks are given independence from elected politicians is that the political process is apt to be too shortsighted. Knowing this, politicians willingly and wisely cede day-to-day authority over monetary policy to a group of independent central bankers who are told to keep inflation in check…The reasoning is the same as Ulysses’: He knew he would get better long-run results by tying himself to the mast, even though he wouldn’t always feel very good about it in the short run!’\(^ {70}\)

The abusive use of the self-binding rhetoric leads to misleading interpretations of the political logic of institutional solutions to problems of credible commitment. Moreover, scholars writing on monetary commitments seem to be unaware of Elster’s important U-turn on the rationale of self-binding. In *Ulysses Unbound*, he explicitly revisits and reformulates some of the key arguments of his influential *Ulysses and the Sirens*. In particular, he argues that: ‘the transfer of concepts used to study individuals to the behaviour of collectivities, as if these were individuals writ large, can be very misleading’. For one thing, `*constitutions may bind others rather than being acts of self-binding*’.\(^ {71}\) By removing the assumption that governments are unitary actors, Elster now claims that precommitment devices, like granting central bank independence, are not self-binding in an *intentional* sense. On the contrary, many


\(^{70}\) Blinder, *Central Banking in Theory and Practice*, pp. 56-61, emphasis added.

\(^{71}\) Elster, *Ulysses Unbound*, p. 92, emphasis added.
alleged cases of self-binding institutions turn out, on a closer inspection, to confirm the dictum that in politics ‘people want to bind others, not themselves’.72

More formally, Elster shows that self-binding entails the following four analytical options: (1) An agent A binds the same agent A (of course, most of the times A needs assistance from B to bind himself); (2) An agent B imposes a constraint on an agent A because A has asked him to do so; (3) An agent B binds A because B believe that A would have asked to be bound had he known all the facts about the case and been capable of making an informed decision; and (4) A person bind himself merely for the purpose of creating a constraint that will also limit the freedom action of others.73

It is the last of these options that provides the most useful framework for understanding the Britain’s path to independence. By strategically delegating power, Gordon Brown did not want to bind himself. Instead, the institutional choice was meant to constrain potential challengers while simultaneously increasing the capacity of the Treasury to control other departments’ plans, enabling Brown to play a more powerful role than any previous Chancellor.

**Enabling political institutions**

‘Common sense suggests that it is always preferable to have more options than fewer…very often common sense fails… Sometimes it is simply the case that less is more; people may benefit from being constrained.’

Jon Elster, *Ulysses Unbound*

By reading too much into the self-binding metaphor, most works on credibility overestimate the constraining dimension of institutional commitments. Institutional constraints are not only about limiting power. Indeed, the democratic paradox of constitutional pre-commitment is that constraints can be power-enhancing. As James Madison famously claimed, constraints can promote freedom. In this context, Stephen Holmes argues that ‘precommitments are not disabling, but enabling’.74 In Douglass North’s terms, institutions reduce the transaction costs of certain exchanges by increasing the costs of engaging in certain forms of (undesirable) behaviour.

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This dialectic relationship between the constraining and enabling features of government commitments refers to Thomas Schelling’s classic thesis: in strategic bargaining ‘weakness is often strength’. This enabling function reinforces the benefit-side of the ruler’s equation. Herestheticians are not seduced by discipline per se, but rather by the profits attached to the institutionalisation of discipline.

Some classic works on political economy support the proposition that less is more in the creation of commitments through institutions. For example, North and Weingast show that a ‘fiscal boom’ was one of the outcomes of the constitutional reforms that took place during the Britain’s Glorious Revolution. Hilton Root’s research on France’s historical political economy also emphasises the enabling implications of tying one’s hands. He wrote: ‘the King supported the expansion of corporate society because corporate institutions enabled him to obtain credit’. We will see below that the logic of enabling political institutions can also inform the evolution of Gordon Brown’s prudence. In a curious way, the strategy of constrained discretion ended up liberating rather than binding the Treasury. The government was able to exploit unprecedented political and financial opportunities, creating the conditions for significant increases in government spending.

**The context of institutional choice**

The overriding aim of central bank independence is to induce low and stable levels of inflation. British inflationary history has been problematic. During the so-called post-war settlement, governments put the emphasis on demand management through fiscal means with monetary policy performing a subordinate, supporting role. The stagflation of the mid-1970s dislocated this framework. Inflation reached record levels in 1975, as Britain was particularly hit by the dismantling of the Bretton Woods system and oil crisis. The dramatic failure of traditional income policies to provide an adequate response to the new reality, epitomized in the IMF crisis of 1976 and the winter of discontent of 1978/9, brought about a ‘new politics’ and a ‘new

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76 Douglass North and Barry Weingast, ‘Constitutions and Commitments’.
77 Hilton Root, ‘Tying the King’s Hands’, p. 241.
policy paradigm’. In the context of the Thatcher revolution, the conquest of inflation – rather than unemployment – became the government’s new priority. Inflation was eventually controlled, helped by structural changes. However, endless disputes over monetary and exchange-rate policy (e.g. the quarrel between fixers and floaters) were one of the dominant features of the Conservative years. In the event, the ERM crisis of 1992 raised serious questions about both the consistency and appropriateness of Britain’s monetary framework.

It is certainly tempting to explain the origins of central bank independence in Britain as the predictable outcome of its traumatic monetary history and politics of economic decline. However, this conclusion would be misleading. The shock in relative prices of the mid-1970s critically challenged the core beliefs underpinning the post-war British model of political economy. This belief cascade in turn led to a radical change in the institutional foundations of economic policy. Actually, Britain experienced a ‘movement from a Keynesian mode of policymaking to one based on monetarist economic theory’. It should be pointed out though that CBI was one among a range of monetary commitments that might have been consistent with monetarism and the rational-expectations revolution. And indeed the Conservatives sought alternative mechanisms to anchor their anti-inflation strategy, including money supply limits, external commitments and inflation targets. The founding fathers were also aware of the available options. In the words of Ed Balls, economic adviser to Gordon Brown:

‘Of course, there is more than one route to stability for countries and regions – and different successful models of central bank independence – depending on their history, institutions and track record’.

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This argument also applies to the role of globalization. Many authors stress the importance of the processes of Europeanization and internationalization for explaining New Labour’s policy formation.\(^{85}\) It is probably true that globalization has created constrains on autonomous and discretionary economic policy,\(^{86}\) on the one hand, and incentives for delegation in the name of credibility, on the other. It is also probably true that New Labour’s leaders consciously sought to adapt to the pressures imposed by economic integration, financial liberalization and heightened capital mobility.\(^{87}\) However, it should be noted again that alternative institutional configurations, other than central bank independence, might have been consistent with the imperatives of globalization.

Political economists largely focus on changes in economic relative prices to explain the emergence of fiscal and monetary rules. But political relative prices are important as well. New Labour faced powerful political incentives, both electoral and coalitional, to endorse the main tenets of the neo-liberal consensus in an attempt to recapture the political centre of British politics.\(^{88}\) Colin Hay shows that economic policy in general and monetary policy in particular were key elements of New Labour’s reckless ‘politics of accommodation’.\(^{89}\) Labour had to overcome the problem of being seen as the party of devaluation, inflation and high taxation.\(^{90}\) In a bid to signal that the party had learned the hard lessons of the past, its 1997 manifesto committed to macroeconomic stability, control of inflation and fiscal prudence.


\(^{87}\) Colin Hay, *The Political Economy of New Labour*.


\(^{89}\) Hay, *The Political Economy of New Labour*.

\(^{90}\) Lee, *Best for Britain?*
Critically, Labour proposed ‘a robust and stable framework of monetary and fiscal discipline’.\(^{91}\)

The adoption of central bank independence in Britain cannot be fully explained by looking only at the economic and political underpinnings of New Labour, as most analysts implicitly do. At most, the structure of incentives described above affected the rational-choice calculations of the institutional framers by providing the context of decision. Those factors might have made possible a range of feasible options. They are hardly the essence of decision. Important puzzles remain. Why didn’t CBI, one of the flagship institutions of neo-liberalism, emerge during the height of conservative hegemony? Why didn’t this radical institutional change coincide with the rise of financial interests and the monetarist paradigm? If Blair and Brown wanted to use CBI to signal competence through repositioning, why didn’t they announce this radical reform before the election? In order to answer these questions, we should focus on the beliefs and motivations of the founding fathers.

**Bank of England reform as heresthetic**

‘The power to constrain an adversary may depend on the power to bind oneself…freedom may be freedom to capitulate, and to burn bridges behind one may suffice to undo an opponent’.

Thomas Schelling, *The Strategy of Conflict*, p. 22

**Evolution? No, heresthetic!**

‘My intention is to lock into our policy making system a commitment to consistently low inflation in the long term.’

Gordon Brown, ‘Remit for the Monetary Policy Committee’

Actors maximize their goals by either changing their strategies under giving rules or by changing the institutions that transform their strategies into outcomes. Most of the time they do the former, but they may occasionally do the latter. They attempt to shape political outcomes by manipulating the rules of the game. As the many examples included in Iain McLean’s *Rational Choice and British Politics* show:

‘Once in a while there comes a politician who sees further than the others. Such a politician can see opportunities where others do not, in opening up or closing down political dimensions. This may lead to the enactment of radical and unexpected policies. It may turn a

persistently losing coalition into a winning coalition. It may save a party whose social base is eroding. It may protect a party from overstretch’. 92

Institutional reform is always an outcome of both evolution and design, a complex interaction of continuity and change, a blend of the old and the new. The making of central bank independence in Britain was not an exception. For some, it was a bold and radical reformulation of the monetary constitution. For others, it was simply the consolidation of the monetary arrangements introduced by Lamont following the ERM fiasco of 1992. In a lecture given to mark the first ten years of the Bank of England’s Monetary Policy Committee, Mervyn King, in his capacity of Governor of the Bank of England, played around the ambiguity between evolution and design as he claimed that,

‘although the announcement in 1997 of independence for the Bank of England was a bolt from the blue, it was a long time in the making’. 93

However, in the very same paragraph King added that ‘granting independence to the Bank of England was the dramatic constitutional change that convinced financial markets of the United Kingdom’s conversion to stability as the basis of macroeconomic policy’ and that the decision was ‘both unexpected and far-reaching’. In another lecture given in 1999, King argued that ‘the Monetary Policy Committee has broken new ground in British constitutional history. In its three hundred year history probably no change has been as significant as operational independence and the creation of the Monetary Policy Committee’. 94 According to Eddie George, this sweeping reform transformed the old Bank of England into the ‘The New Lady of Threadneedle Street’. 95 Detailed analysis of yield curves on UK government bonds also showed that Brown’s announcement on 6 May 1997 was ‘a complete surprise to the financial markets’. 96 It is evident that the key players perceived this reform as a turning point, a radical departure from existing practices and traditions.

92 McLean, Rational Choice and British Politics, p. 231.
Evolutionary accounts of the politics of central bank independence in Britain suggest that this was simply an idea whose time had come. But Brown’s largely unforeseen decision to move swiftly towards granting operational independence to the Bank of England was nevertheless hailed as ‘an audacious stroke’, ‘a political masterstroke’, a ‘revolutionary move’, ‘a pre-emptive and brilliantly orchestrated manoeuvre’. The always well-informed Andrew Rawnsley argued that ‘expert and inexpert opinion agreed that Brown had pulled off an astonishing coup de théâtre and a strategic masterstroke’. This pivotal decision, not mentioned explicitly in the party manifesto, was announced only five days after the election. More tellingly, Brown deliberatively waited until the eve of polling day to discuss with Blair his intention to go for an early announcement of CBI. According to Rawnsley, this was partly tactics: ‘it would give Blair little time to consult others who might be cool about the idea.’ It was both striking and illuminating that this decision – for many the biggest change in economic policymaking since the war – was not discussed in the Cabinet, let alone referred to a formal consultation process. As Brown thought that making the move quickly was essential, the project was presented to Eddie George on a take-or-leave-it basis. This ‘great political coup’ had all the fingerprints of heresthetic.

Iain McLean argued that the decisions to cede control over interest rates and to establish the golden rule to borrow only for government’s capital spending were indeed ‘heresthetic moves’. He suggested that the key motive behind the move was to avoid the blame when the economy goes wrong. The depoliticization literature has also assumed that New Labour surrendered control over monetary policy to evade...
responsibility for unpopular decisions such as interest rate increases.\textsuperscript{105} Indeed, this motivation of avoiding the blame loomed large in both media analyses and parliamentary debates. And as might be expected, it was one of the preferred lines of argument used by Conservative MPs in the House of Commons. As Mr Lilley put it:

‘the Bill is yet another example of the Government’s desire to remove power from the House and from elected representatives and give it away to appointed officials. They want to escape the blame for difficult decisions’.\textsuperscript{106}

Blame avoidance might have been one of the motives of the group around Gordon Brown. However, the strategic implications of the decision to surrender key tools for managing the economy were much broader. Heresthetic is about restructuring games to achieve political ends. Brown sought to reconstruct British political system by manipulating the institutions of economic decision-making. By removing monetary policy from the realm of party competition (fixing dimensionality in Riker’s analytics), Brown could achieve vital strategic aims. For one thing, he was able to consolidate his reputation for economic competence by sending the ultimate signal to the markets. For another, he bought a powerful institutional insurance for enforcing internal discipline and policy cohesiveness in the context of a coalition of groups within the Labour Party that was moving towards the right.

It is widely accepted that Brown moved promptly towards independence in order to reassure markets about New Labour’s modern and business-friendly economic framework. This idea was surely in the mind of the founding fathers, who certainly use independence to signal a decisive break with the ‘old dogmas of the past’.\textsuperscript{107} But this strategic decision was not only about signalling change; it was mainly about enforcing change over time. Essentially, the institutional change aimed at reshaping the structure of the political economy game. The real objective was to enforce a new paradigm of economic policy. In his 2005 Mansion House speech, Brown said: ‘in the 1950s Britain managed decline, then in the 1960s we mismanaged decline and then in the 1970s we declined to manage. And our stop- go history is now legendary - so much part of our psychology that it was essential in 1997 to start a new chapter by

\textsuperscript{105} Burnham, \textit{New Labour and the Politics of Depoliticisation}.
\textsuperscript{106} House of Commons, \textit{Hansard}, 11/11/97.
making the Bank of England independent’. In the same spirit, Balls admitted that the early move to independence provided,

‘a unique opportunity to reshape the objectives, institutions and practice of British macroeconomic policy’.

William Keegan concluded his insightful chapter on the Bank of England reform with the following words: ‘the battleground simply moved’. This is precisely what heresthetic is all about; it is about reframing the rules of decision-making, and by implication, shifting the parameters of political competition. By changing dimensionality, the institutional framers sought to induce a more consensual approach to economic policy-making, attacking the roots of the pervasive conflicts of the past. Constitutional change was not only concerned with credibility, but also with legitimacy. According to Balls, ‘the new framework had to be capable of rebuilding and entrenching public support and establishing a new cross-party political and parliamentary consensus for long-term stability – a new consensus about goals and a new consensus about the institutional arrangements needed to deliver those goals’.

Brown believed that institutionalizing a new consensus was needed for moving beyond the ‘endless and sterile divisions between capital and labour, between state and market and between public and private sectors’.

Gordon Brown is not a typical heresthetician. Political entrepreneurs, who are active in the game of framing institutions, are usually people who strongly believe in the political power and the mediating role of institutions. Brown’s policies did not seem to be informed by the institutions-do-matter mantra. Actually, Brown’s interest in heresthetic comes from a different source, namely his ability and propensity to ‘think and act strategically’. As Keegan put it, ‘the MPC episode brought out Brown’s strategic and long-term approach’. Other commentators point out that the Chancellor was determined to make Labour’s conversion irreversible. Stephen argues that ‘if a single, overriding, feature defined the economic policy of the first Blair

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110 Keegan, The Prudence of Mr Gordon Brown, p. 171.
113 Robert Peston, Brown’s Britain, p. 91.
government, it was the Chancellor’s construction of permanent monetary and fiscal frameworks to keep it in the path of virtue’.¹¹⁵ In Brown’s own words:

‘Improving the institutional arrangements for economic policy will be accorded a high priority by the government in order to deliver long term economic stability and rising prosperity’.¹¹⁶

In hindsight, it appears that Brown had clear incentives to alter the dimensionality of the economic policy game by shifting decision-making power from Whitehall to the Square Mile. But this begs the further question as to why this did not happen before? An article in the Financial Times nicely captured the reaction of the City. It stated: ‘Mr Gordon Brown’s decision to give the Bank of England operational autonomy may have been unexpected. But it is welcome. It should have been taken by the Tories’.¹¹⁷ And indeed this radical institutional change should have been championed by the Conservatives in the name of sound money, financial stability and wage restraint. The Tories could have also delivered a pre-emptive strike and moved strategically towards independence just before leaving office. This would have locked in the interests of the Conservative coalition, just as Pinochet did in order to constrain the Chilean democratic transition. Intriguingly, they failed to do so. Why?

Paths not taken

In the period 1988–1997, the Conservative governments of Thatcher and Major seriously considered but eventually rejected a number of proposals for central bank independence.¹¹⁸ On November 1988, Chancellor Lawson sent a memo to Prime Minister Thatcher, proposing an independent Bank of England. The PM and the Chancellor had famously clashed over interest rates. In her memoirs, Mrs. Thatcher recalled: ‘I was always more sensitive to the political implications of interest rates rises – particularly their timing…Prime Ministers have to be. I was also acutely conscious of what interest rate changes meant for those with mortgages… I was cautious about putting up interest rates unless it was necessary’.¹¹⁹ In this context, Lawson contended that independence would strengthen the use of monetary policy to

¹¹⁷ Financial Times, 7 May 1997, emphasis added.
¹¹⁹ Thatcher, The Downing Street Years, p. 698.
fight inflation, making the commitment to stable prices a permanent feature of British
economic policy. He also argued that the change would enhance government’s ability
to resist electoral pressures. Interestingly, he also pointed out strategic considerations:
‘I was anxious above all to entrench our counterinflationary commitment and policies against
the vagaries of future governments, possibly of a different political complexion’.\(^\text{120}\)

The proposal was turned down by Mrs. Thatcher, who believed that monetary policy,
interest rates and the value of the pound were not technical affairs; they were rather at
the heart of economic policy, if not quintessential to democratic politics.\(^\text{121}\)
Paradoxically, heresthetic considerations were probably behind her decision. She
might have calculated that removing monetary issues from party political competition
was bound to benefit Labour. According to Peston, a senior official of that
government confessed that ‘she recognized that such a move would reduce the
electorate’s fear of a Labour government’.\(^\text{122}\) A deliberate ‘non-decision’ of this sort
was probably one of the motivations. However, cognitive considerations played a
crucial role as well. Would-be institutional reformers should be confident about the
political power of institutions. Margaret Thatcher did not seem to share this belief. In
her own words:

‘My reaction was dismissive…I do not believe that changing well-tried institutional
arrangements generally provides solutions to underlying political problems –and the control
of inflation is ultimately a political problem’.\(^\text{123}\)

Chancellor Lamont and Prime Minister Major also clashed over monetary policy.
Major wished to see interest rates ‘as low as possible, but my frustration was with
delays in implementing cuts that were to be taken’.\(^\text{124}\) Following his predecessor,
Lamont also proposed making the Bank of England independent.\(^\text{125}\) But Major, like
Thatcher, also rejected the move. Major recalled: ‘Norman…wanted to grant
independence to the Bank of England. I disliked this proposal on democratic grounds,
believing that the person responsible for monetary policy should be answerable for it
in the House of Commons. I also feared that the culture of an independent bank
would ensure that interest rates went up rapidly but fell only slowly’.\(^\text{126}\) Again,

\(^{120}\) Lawson, *The View from No. 11*, p. 871.
\(^{121}\) Thatcher, *The Downing Street Years*.
\(^{122}\) Peston, *Brown’s Britain*, p. 144.
\(^{123}\) Thatcher, *The Downing Street Years*, p. 706-7.
\(^{125}\) Lamont, *In Office*, p. 325.
Major stated that: ‘Like Norman, he [Ken Clarke] favoured an independent Bank of England, but,
dimensionality seemed to be an issue. According to Lamont, one of the reasons why Major objected to CBI was because ‘people were frightened how Labour would handle monetary policy and he didn’t want to remove that fear’. Lamont launched a futile counterattack:

‘I said there were some indications that Labour might move in the direction of independence, but the PM wouldn’t budge. Reluctantly I had to forget the idea’ (Lamont 1999: 325).

The Conservatives were trapped in a strategic conundrum. While some key players (notably Lawson and Lamont) were persuaded about the potential gains of central bank independence, other players (notably Thatcher and Major) failed to see the benefits of removing monetary policy from the space of political competition. A further dimensionality problem undermined the position of the advocates of reform. Many observers viewed central bank independence as a step towards Europe, always a divisive issue within the Conservative coalition.

This analysis of the paths not taken stresses the role of Tony Blair as a founding father of central bank independence. The conventional wisdom is that the decision was Brown’s and that Blair was simply notified of the change, rather than seriously contributing to it. However, the incoming Prime Minister could have emulated its predecessor and vetoed the proposal. By acquiescing to Brown’s strategy, he played a key role in the process of institutional formation. According to Rawnsley, Blair liked the boldness of the plan and enthused by the political dividend of winning the instant approval of the City. The reform was also consistent with many of Blair’s declared aims: appealing to the radical centre, disciplining the Labour party through modernization, and strengthening the centre of government.

This discussion reveals the limitations of evolutionary accounts of institutions based on relative price shocks or policy learning. There is a tendency to see bank independence as the end of a continuum that started with the 1992 ERM debacle. Yet nothing was inevitable. As Peston argues: ‘if the Tories had won the 1997 election,

cheerfully noting that there was ‘not a snowball’s chance in Hades’ that I would agree, he merely chipped away at me by adding to the Bank’s authority without conceding full independence’ (682).

And indeed the idea that central bank independence would be a step towards EMU was an important theme in media reports during May 1997.

Peston, Brown’s Britain, p. 68. See also Keegan, The Prudence of Mr Gordon Brown.

Rawnsley, Servants of the People, p. 31.

they would not have given independence to the Bank’. The making of central bank independence in Britain stresses that, using Douglass North’s language, institutional change requires both intentionality and comprehension of the issues. The evolution of relative price shocks and ideas created opportunities for change. But crucially, those opportunities were seized by the decisive action of a group of strategically-oriented politicians. On the other hand, some groups that would eventually profit from the institutionalization of discipline failed to take decisive steps to promote change, probably because they did not perceive the ultimate benefits of the reform.

The following anecdote highlights the importance of intentionality. Having made the decision about Bank of England reform very soon after the election, Brown, who had only quite recently been converted to the independence cause, called Lamont to reveal his plans. When Lamont picked up the phone, he heard Brown saying: ‘we have decided to take your advice’. Lamont commented that ‘it wasn’t my advice of course, it was their own decision’. He probably felt intellectually satisfied, but politically outplayed. The Conservatives enforced the monetarist paradigm in Britain, but ironically failed to deliver one of its flagship institutions. Ultimately, they were outmanoeuvred by their political opponents. By deciding to play the CBI card, New Labour unambiguously signalled their competence on issues of economic management and thereby radically reshaped the structure of the economic policy game.

The parliamentary debate over the 1998 Bank of England Act suggests that Brown’s bid to manipulate dimensionality was successful. The Conservatives looked disconcerted. Mr. Lilley claimed that: ‘controlling inflation by interest policy is a technical matter than cannot simply be handed over to a group of experts. It involves considerable discretion, and that discretion affects people’s livelihoods, their jobs, the value of their savings, the viability of their businesses and the burden of their debts’. Former Chancellor Ken Clarke argued that ‘hitting the inflation target can

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133 Brown’s determination to implement this reform was reinforced by a conversation he had with the Chairman of the US Federal Reserve, Alan Greenspan, on 20 February 1997. See Peston, Brown’s Britain, p. 128. On the role of Greenspan, see Keegan, The Prudence of Mr Gordon Brown, p. 156.
134 Lamont, In Office, p. 326, emphasis added.
be damaging to the levels of unemployment and growth’.\textsuperscript{136} Clifton-Brown complained that ‘bankers are always cautious. The proposal is therefore likely to be deflationary’.\textsuperscript{137} Surreally, the Tories were favouring discretion and concerned about the implications of the reform for growth and unemployment. The heresthetic manoeuvre definitively turned the world upside down.\textsuperscript{138}

In order to maximize support, herestheticians engage in the ‘strategic use of rhetoric’.\textsuperscript{139} This proved to be the case during the Bank of England reform. While most nonpartisan commentators cited the experiences of New Zealand, the US and above all Germany to illustrate the potential payoffs of independence, Brown preferred to frame the reform as ‘a British solution to meet British needs’.\textsuperscript{140} He also claimed that ‘this is a long-term policy for long-term prosperity’\textsuperscript{141} and that ‘the new monetary arrangements will form part of our wider strategy to improve the performance of the British economy in the long term’.\textsuperscript{142} So much for the long term.

As Lord Keynes reminded us, in the long run we are all dead. What about the short-term gains of this institutional reform? Herestheticians would prefer not openly talk about them. But they are vitally important nonetheless.

\textbf{Gordon Unbound: the politics of self-binding revisited}

\textbf{Self-binding? No, binding others!}

‘I am cutting the politicians and the politics out of setting interest rates’
\begin{flushright}
Gordon Brown, The Sun, 7 May 1997
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Economists tend to emphasise the welfare gains of institutional precommitments. However, they rarely discuss the political rationale of voluntary self-binding. Why, and under which conditions, a self-interested politician willingly sacrifices freedom

\textsuperscript{136} House of Commons, Hansard, 11 Nov 1997. 
\textsuperscript{137} House of Commons, Hansard, 11 Nov 1997. 
\textsuperscript{138} The Tories sought to limit the damage by claiming that independence was the first step towards EMU. According to a Conservative MP: ‘The fourth, and in many ways most important, reason for the change is to prepare the way for Britain to enter a single European currency managed by a European central bank that will be wholly independent of any form of democratic control’. Sir Tapsell, House of Commons, Hansard, 11 Nov 1997. 
\textsuperscript{141} Brown, ‘The Chancellor’s Statement to the House of Commons on the Bank of England’. 
\textsuperscript{142} Gordon Brown, 7/5/1997.
of action in favour of technocratic institutions? Politicians adopt precommitment strategies only if they can realize effective political profits.

Gordon Brown and his advisers claimed that the new institutional arrangements would enhance significantly the ‘credibility of UK monetary policy’. Credibility is an elusive concept though. It is partly about promoting macroeconomic consistency by realigning inter-temporal incentives. But credibility also has important political dimensions. After all, the strategy of Ulysses applied to the design of monetary institutions is ‘to entrust economic policy to persons that will not be tempted by the Sirens of partisan politics’. This means that the pressures undermining the credibility of economic policies stem from the dynamics of public opinion and the demands of intra-party coalition-building. Governments are not unitary actors. And they are constantly faced with severe common-pool resource problems.

There are two competing arguments about the political dimension of credibility. On the one hand, Bernhard suggests that bank independence sought to increase cabinet stability by removing intra-party conflicts over monetary policy. On the other hand, King claims that the British case does not provide support to the coalitional hypothesis because ‘only a few leftists remained in the Labour party… [so] Blair and Brown did not fear a threat from Labour backbenchers against their policies’. In the light of the empirical evidence, Bernhard’s case carries greater weight. The heresthetic move was perceived by its proponents within the Labour Party as a political weapon for enforcing policy changes and party discipline in a coalition moving right. King’s position is not entirely consistent with the large scholarship on the cognitive and political underpinnings of New Labour. A consistent view emerges from this literature that Blair and Brown were obsessed with exorcising the past and strengthening the grip of the core executive. As Philip Stephens clearly put it:

‘The failure of his party’s past loomed large. Brown had seen too many Labour Chancellors lurch from profligate post-election boom to fatal pre-election bust. Stability, rules, discipline, prudence, transparency: the mantras were more than election slogans. They were the means by which the New Labour government would exorcise the past. The party, as Blair would often remind his colleagues, had never secured two full terms in office. It had founded

145 Bernhard, Banking on Reform.
146 King, Epistemic Communities and the Diffusion of Ideas, p. 112.
instead on the rocks of successive economic crises. Stafford Cripps in 1948, James Callaghan in 1967, Denis Healey in 1976- all had been humiliated by the financial markets. The sterling crises in those years had been symptom as much as a cause of the failure of self-discipline. Subsequent elections defeats were proof that the Labour way of governing had been bad politics as well as bad economics’.  

Since 1994, the architects of New Labour promoted radical programmatic, organizational and symbolic changes aimed at signalling an unmistakable break with the past. Moreover, they endorsed a reckless politics of accommodation, even at the risk of overshoting the position of the median voter. Notwithstanding its large parliamentary majority, the newly elected leaders wanted to avoid the fate suffered by past Labour governments. Andrew Rawnsley’s books show that Blair and Brown were obsessed with proving their competence by pleasing the markets and finding ways of enforcing internal discipline. This thinking shaped the politics of central bank independence. As Ed Balls confessed:

‘Establishing and retaining credibility is important for any central bank or government – but particularly for a new government from a political party which has been out of power for almost two decades and which has seen substantial changes in its party constitution and policy in a short space of years’.  

Self-binding is the dominant narrative in most accounts of bank independence in Britain. As an article put it, ‘by tying his hands to an independent monetary policy, Mr Brown should be able to avoid those perennial financial crises that have bedevilled previous Labour governments’. Tying his hands? Actually this was not an act of self-binding in an intentional sense. Moreover, this self-binding rhetoric is at odds with conventional views regarding Gordon Brown’s decision-making style. Brown had a determination to maximize his authority at the expense of others. This apparent paradox regarding Brown’s behaviour can be resolved by realising that governments are not unitary actors, but coalitions of conflicting interests and ideas. Once we move from the logic of individual to collective choice, precommitment strategies are about binding others, rather than acts of self-binding. By formally tying

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151 The Independent, 7 May 1997.
152 Stephens, The Treasury Under Labour, p. 188.
his hands, Brown really intended to bind others. \(^{153}\) Following Elster’s logic, he formally bound himself merely for the purpose of creating a constraint that would also limit the freedom of action of others.

Then, whose hands? The markets and the media supported the move because they fully understood that the reform aimed at binding politicians, including sectors of Brown’s own party. The Chancellor did not hide this intention. In several speeches, he argued that ‘interest rate decisions will be free from any political influence’ and that ‘we must remove the suspicion that short-term party political considerations are influencing the setting of interest rates’. \(^{154}\) In a speech at the CBI national conference, Brown pleased the audience by saying that: ‘the perception that monetary policy decisions have been dominated by short-term political considerations has grown. I believe we are agreed it is right to take these decisions out of politics, and to free them from short-term political pressures’. \(^{155}\) Stephens also highlights that ‘at the core of Brown’s approach was the conviction that Britain’s sad record of postwar economic mismanagement showed that politicians could not be trusted’. \(^{156}\)

Which politicians were targeted by the strategic move? The Sun pointed, maliciously, to Old Labour: ‘Brown’s brilliant bid to defy Lefties’. \(^{157}\) An article in The Guardian also argued that the reform ‘cuts the new government adrift of all the Old Labour expectations like public sector unions expecting favours. In future the chancellor will be able to say it’s not within his power to make special cases: the Bank rules’. \(^{158}\) In the same line, Mr Lilley claimed: ‘they want to remove any influence from Labour Back Benchers, whose demands for higher spending and laxer policy have wrecked every previous Labour Government’. \(^{159}\) Another Conservative MP stated:

‘The Chancellor and his senior colleagues must hope that the change will provide him with a defence against his Back Benchers, who will not be as cringing in their parliamentary behaviour as they have been so far. When things start to go wrong on the economic front, as undoubtedly they will in the nature of things, and when unemployment starts rising, as

\(^{153}\) It is also worth stressing that structural inflation (and hence interests rates) in major capitalist economies was much lower in the late 1990s. This means that the issue of who controls interests was less contentious than in the past. This factor might have also affected Brown’s decision. Balls sacrifices were actually trivial.
\(^{155}\) Gordon Brown, ‘Chancellor’s Speech at the CBI National Conference, 10 November 1997.
\(^{157}\) The Sun, 7 May 1997.
\(^{158}\) The Guardian, 7 May 1997.
\(^{159}\) House of Commons, Hansard, 11 November 1997.
undoubtedly it will at some point in the cycle, I hope that Labour Back Benchers will not allow themselves to be bought off with the excuse that the measures causing unemployment are not in the control of the Government but are the responsibility of the hard-hearted people on the Monetary Policy Committee of the Bank of England.  

Stories about left-leaning Labour MPs’ discontent over the reform attracted some attention, mainly during the debate of the Bank of England Act. In the House of Commons, Diane Abbott complained that: ‘It was remarkable to see a Labour government elected in triumph with the biggest majority since the war, within days…hand over one of the most important levers of economic policy to an unelected quango’. According to Mr Austin Mitchell, the institutional choice implied that:

‘The Government are now giving up power to an oligarchy whose interest point in the opposite direction of those of the people.’

The Old Labour issue has probably been overstated. The politics of interest rate setting in Britain is uniquely complex. We should remember that Thatcher and Major (not exactly Lefties), concerned about the reaction of small businesses and people with mortgages, were too willing to accommodate demands for lower interest rates. In the US and even in pro-stability Germany, politicians and central bankers have also engaged in fierce arguments about monetary policy. We should also remember that governments face pervasive collective action problems which compromise sound public finances. One journalist argued that ‘the chancellor has armed himself with a potent new reason to resist demands from spending ministers’. The intellectual master of the reform was fully aware of the importance of protecting the Chancellor from civil servants and other ministers. In his now famous *Euro-Monetarism*, Balls argued:

‘No one has mastered the art of boom-bust economics better than the British Treasury…Power to set monetary policy remains in the hands of government ministers and unaccountable Treasury civil servants who seem to be able to live on despite their errors, while hapless Chancellors take the blame’.

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162 On this important issue, see Elgie and Thompson, *The Politics of Central Banks*.
165 *The Economist*, 5 October 1997.
166 Balls, *Euro-Monetarism*, p. 16.
Brown not only faced pressures from party insiders and spending ministers, but also demands from interest groups. One of his biographers explained that ‘his study of twentieth-century had convinced him that good policies and ideas were often derailed by interests groups and the pressures of the moment…This conclusion permeated his entire strategy’.  

167 The group around Brown knew that pressures would not only be exerted by the unions, who tend to be the usual suspects. Business interests could also exert strong pressure on Chancellors. Richard Lambert, CBI’s Director General, repeatedly demanded the Bank of England to keep interest rates as low as possible to support economic activity.  

168 The new Chancellor had strong reasons for trying to bind vested interests through political manipulation. In doing so, he was also constraining the Tories, which would find it more difficult to strategically use their influence over market actors to bully the Labour government.

Interest group dynamics were also important because a commitment to increasing productivity was one of the pillars of New Labour’s political economy and CBI would be inextricably linked to the politics of wage bargaining.  

169 Euro-Monetarism provided an interesting discussion of Britain’s poor record of wage restraint. Balls argued that wage restraint should be a central element of a non-monetarist economic policy. He stated: ‘the independent central bank should pay, and state that is paying, particular attention to the rate average earnings inflation in setting monetary policy. If employers and workers ignore the public interest and push settlements higher, then the Bank would have to raise interest rates’.  

170 In his 1999 Mais Lecture, Brown outlined New Labour’s approach to industrial relations:

‘The Bank of England have to meet an inflation target of 2.5 per cent. The target has to be met. Unacceptably high wage rises will not therefore lead to higher inflation but higher interest rates. It is in no one’s interest if today’s pay rise threatens to become tomorrow’s mortgage rise. So wage responsibility - to rescue a useful phrase from a woeful context- is a price worth paying to achieve jobs now and prosperity in the long term. It is moderation for a purpose.’

167 Keegan, The Prudence of Mr Gordon Brown, p. 245.
171 Balls, Euro-Monetarism, p. 23.
Constraining? No, enabling!

‘Central bank independence liberated the Treasury’

Ed Balls, *Delivering Economic Stability*

Binding others was clearly a powerful incentive in the calculation of the founding fathers. But the institutionalization of discipline involved other political benefits. According to Elster, precommitment is justified ‘because, rather than merely foreclosing options, it makes available possibilities which would otherwise lie beyond reach’.¹⁷³ This is Schelling’s old lesson: in bargaining, weakness is often strength. Robert Peston, in his authoritative *Brown’s Britain*, brilliantly captured this strategic dimension of the institutional move. He argues:

‘Brown’s eureka was to recognize that less is more, that to give up some responsibilities - notably the control of interest rates, but also important areas of financial regulation, such as oversight of insurance companies – would reinforce the powers that matter’.¹⁷⁴

Peston’s remarks refer to the paradox of institutional precommitment. As Holmes argues, a voluntary abdication of power can be power-enhancing. Self-binding institutions are not only constraining; they are also enabling.¹⁷⁵ Brown was not necessarily persuaded by the constraining, but he was surely keen on the enabling. Ironically, he bought some real freedom by sacrificing some formal powers. One effect of the reform was ‘to give Brown and the Treasury greater independence from Downing Street and far greater authority over other departments’.¹⁷⁶ As Lee put it, ‘by ceding responsibility for monetary policy to the Bank of England’s Monetary Policy Committee (MPC), the Treasury was given the space and opportunity to intervene, in a way unprecedented in peacetime, in economic and social policy. The creation of the MPC made possible the new developmental role for the Treasury’.¹⁷⁷

The empowerment of Brown’s Treasury through ‘constrained discretion’ was not only rhetorical.¹⁷⁸ It had real effects. One government official argued that

‘independence strengthened the Treasury’s hand more generally in respect of

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¹⁷⁴ Peston, *Brown’s Britain*, p. 76.
¹⁷⁵ Holmes, *Precommitment and the Paradox of Democracy*.
¹⁷⁶ Peston, *Brown’s Britain*, p. 76.
¹⁷⁷ Lee, *Best for Britain?*, p. 73.
economic policy, fiscal policy, public spending and the minimum wage. In the old
days, the Treasury sanction was not a credible threat. But suddenly we were in a
position where we could say: If you do that and it is perceived as imprudent, well the
Monetary Policy Committee might raise interest rates. It’s out of our hands'.\textsuperscript{179} In the
same line, Ed Balls observed that ‘far from weakening the ability of the Treasury to
ensure public spending discipline, the risk that the Monetary Policy Committee might
respond with a rate rise has proved a useful and effective deterrent to profligate
departmental proposals on more than one occasion’.\textsuperscript{180} One analyst put it this way:
‘previous Labour governments had felt captured by the Treasury, Brown captured the
Treasury’.\textsuperscript{181}

In the same vein, Rawnsley argues that Gordon Brown ‘was less interested in
operating the levers of macro-economic management than any previous incumbent in
the Treasury, and independence for the Bank would be both a confidence-building
marker with the markets and offer more freedom to devote himself to the structural,
social and employment reform that really engaged the new Chancellor’.\textsuperscript{182} Peston
also shows that ‘there have been other examples of Brown and the Treasury being
empowered by the imposition of rules or reforms that appeared to limit their own
freedom’ - notably the golden rules and the five tests for the single currency.\textsuperscript{183}
Herestheticians know that binding commitments can play positive roles, ultimately
enhancing policy capacity. Balls and O’Donnell clearly knew this too:
‘Central bank independence liberated the Treasury. Handing over the monthly process of
decision-making on interest rates…created the time, space and long-term credibility for the
Chancellor and senior Treasury management to concentrate on other levers of economic
policy and the Government’s wider economic objectives.’\textsuperscript{184}

We might risk falling into the functionalist trap, explaining the emergence of a given
institution on the basis of its results. However, some evidence suggests that Team
Brown fully understood \textit{ex ante} the strategic benefits of delegation. In his 1992
Fabian pamphlet, Ed Balls defended independence by emphasizing that a more
transparent, accountable and predictable monetary policy would enhance credibility,
meaning that ‘a Labour chancellor would be free to concentrate on many other

\textsuperscript{179} Cited in Peston, \textit{Brown’s Britain}, p. 77.
\textsuperscript{180} \textit{The Observer}, 8 August 2004.
\textsuperscript{181} Keegan, \textit{The Prudence of Mr Gordon Brown}, p. 247.
\textsuperscript{182} Rawnsley, \textit{Servants of the People}, p. 32.
\textsuperscript{183} Peston, \textit{Brown’s Britain}, p. 77.
\textsuperscript{184} Balls and O’Donnell, \textit{Reforming Britain’s Economic and Financial Policy}, p. 92.
aspects of policy’. According to one commentator, Ball’s explicit message to Brown was:

‘You should make the Bank independent. You should lose control in order to gain control’.

Remarkably, the founding fathers did not try to hide this fundamental dimension of institutional reform. On the contrary, they were unusually candid about the enabling implications of ‘making Labour credible’. It is often forgotten that Ball’s earlier writings aimed at denouncing the perils of a rigid rules-based approach to monetary policy. His central argument was that both the domestic and European brands of monetarism, which sought to link inflation expectations to intermediate monetary targets and to a one-size-fits-all German monetary policy respectively, were economically and politically misconceived. Both Brown and Ball rejected the simplistic idea that governments could achieve credibility by tying themselves to fixed monetary rules. They also contended that ‘the answer is not no rules, but the right rules’. Thus a post-monetarist path to stability should allow for both discretion and flexibility. As Brown repeatedly argued:

‘In an open economy the discretion necessary for effective economic policy is possible only within a framework that guarantees the public interest is met, one that commands public trust and market credibility.’

‘In the era of open capital markets, it is only within a credible framework that governments will command the trust to exercise the flexibility they require’.

Many commentators have failed to understand the cognitive and motivational nuances of this institutional choice. The institutional designers were not seeking to buy credibility by tying themselves to the mast of a strict binding commitment, as advocated by Giavazzi and Pagano. On the contrary, Ball was concerned with finding ways of ‘escaping the straitjacket of ERM and EMU’, including its deflationary effects. Similarly, they were not uncritically embracing the central tenets of neoliberalism. They were rather interested in building flexibility into the system. In a lecture in which he denounced the ‘failures of monetarism’ and the

185 Ed Balls, *Euro-Monetarism*.
192 See also Balls, ‘Open Macroeconomic in an Open Economy’; Balls, ‘Delivering Economic Stability’.
rigidity of the Stability and Growth Pact, Balls declared that a clear pre-commitment to credible institutional arrangements should ‘allow the necessary flexibility so that policy can respond in the short-term to surprise economic events’. Brown’s economic framework was less about constraining and more about enabling than is often assumed. Indeed, the constraining element of the much-discussed ‘constrained discretion’ concept was only incorporated by Balls following a suggestion made by Mervyn King. This is hardly surprising. While the central banker was interested in constraining politicians, the economist political operator was keen on buying flexibility through pre-commitment.

The enabling features of institutional commitment may be the key to understanding some of the tensions associated with Brown’s chancellorship. Earlier assessments of his policies put the emphasis on prudence. In its first term in office, New Labour broadly honoured its pre-election budget pledges and introduced the so-called golden rules establishing that over the economic cycle the government would only borrow to invest and that public debt would be held at a stable level. The enactment of CBI was also supposed to induce budget discipline. This new macroeconomic framework enforced tight budgets in the early years. However, over time the corset was loosened and then removed altogether. In History of Modern Britain, Andrew Marr remarks that ‘perhaps the most striking aspect of Brown’s running of the economy was the stark, dramatic shape of public spending. For his first two years he stuck fiercely to the promise he had made about continuing Conservative spending levels…Then there was an abrupt and dramatic shift and public spending soared, particularly on health…So there were the lean years followed by the fat years, famine then feast, squeeze then relax’. Fiscal policy was ‘tight in the first years of New Labour but loosened significantly in subsequent years’. This fiscal cycle led to the prudence for a purpose narrative. As one commentator put it:

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193 Balls, ‘Stability, Growth and UK Fiscal Policy’.
194 Balls, ‘Open Macroeconomics in an Open Economy’, p. 120.
199 Peston, Brown’s Britain. See also Stephens, The Treasury Under Labour.
Indeed, the early [fiscal and monetary] restraint was ‘to allow Brown, over time, to spend more than if he had splurged initially and then had been forced to tighten his belt, which had been the fate of his Labour predecessors at 11 Downing Street’.  

As in many other historical experiences, the institutionalization of monetary discipline involved a critical fiscal dimension. Opening financial opportunities was one of the cornerstones of the strategy of constrained discretion. As Ben Clift and Jim Tomlinson have lucidly argued, New Labour’s decisive pursuit of market credibility ‘was expressly concerned to create some space for fiscal activism’.  

The mechanism was the following: as potential owners of government bonds thought inflation would be lower, they started paying more for government debt, freeing up the Chancellor to spend more while keeping taxes down. This implies that, by strengthening monetary and fiscal governance, New Labour ended up creating conditions for a huge increase in education and health spending. Again, this is not a functionalist speculation. A Labour MP made the following point in the parliamentary debate:

‘Gavyn Davis, the chief economist at Goldman Sachs, has estimated that, if yields on long bonds fall eventually by a full point, the Government’s funding costs will be reduced by about 3.5 million. The sum could be invested in the economy and could be used for extra public spending. A fall in bond yields would also reduce the cost of investment for private investment for private investors, and hence boost the economy in that way’.

Back in May 1997, most analysts assumed that an independent central bank implied a more prudent fiscal policy. As one newspaper remarked: ‘the chancellor is more likely to follow a sensible fiscal policy if he has good reason to expect monetary policy will not accommodate it than if he can make it do so’. However, the Bank of England reform ended up giving Brown ‘more freedom to tax and spend’. In the context of enhanced credibility, both public and private borrowing soared, compromising financial sustainability. Eventually, New Labour policies came full circle, from prudence to increasing public and private imprudence. The paradox of constitutional commitments squares the prudence and the prudence-for-a-purpose

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202 This important point was suggested to the author by Hugh Ward.
204 Financial Times, 7 May 1997; The Times, 7 May 1997; The Independent, 7 May 1997.
206 Lee, Best for Britain?, p.70.
narratives. It has been suggested that Brown was able to be a real socialist because he previously won the confidence of the financial markets. In the logic of heresthetic, he could afford to do it because he previously reshaped the structure of the political game by manipulating the monetary constitution. But prudence for a purpose was not an unintended consequence of the institutional move. It was the natural implication of the successful implementation of an enabling precommitment strategy. As Brown once claimed: ‘this extra public spending comes not at the expense of prudence but because of our prudence’. Gordon was not bound, but unbound!

To sum it up, the making of central bank independence in Britain was underpinned by typical New Labour strategic thinking. The attempt to institutionalize a ‘post-monetarist approach to economic policy’ was based on a peculiar reading of the evolution of economic ideas and changes in the world economy. It was also based on an explicit attempt to move beyond ‘the old methods of old left or old right’, squaring the circle between the seemingly irreconcilable Friedman and Keynes. In this framework, achieving credibility and stability were not aims, but only means to an end. Gordon Brown repeatedly argued that central bank independence was not the government’s main objective. Tellingly, he began his Mais Lecture by saying: ‘my first words from the Treasury, as I became Chancellor and announced the independence of the Bank of England, were to reaffirm, for this Government, our commitment to the goal first set out in 1944 of high and stable levels of growth and employment’. In other words, traditional values in a modern setting.

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207 Peston, Brown’s Britain, p. 149.
212 Clift and Tomlinson, Credible Keynesianism?.

Conclusions and implications

‘Looking at historical situations or tempering formal models through empirical analysis is the best way to understand ourselves and the world in which we live.’
Norman Schofield, ‘Constitutional Political Economy’, p. 299

This article combines theory and historical narratives to explain a seminal constitutional change in contemporary Britain. The main argument is that Gordon Brown’s surprise decision to change the British monetary constitution in 1997 was an act of political manipulation in a Rikerian sense. Conceptualizing the Bank of England reform as a heresthetic move throws new light on the motivations of New Labour. The political strategists deliberately removed an unpleasant issue from party politics in order to signal governing competence and enforce a new model of political economy. But we have observed that the institutional choice was not self-binding in an intentional sense. Indeed, Brown adopted a pre-commitment strategy to bind others, including members of his own government and powerful interest groups. Similarly, the reform was not driven by the logic of constraining. On the contrary, the institutionalization of discipline sought to achieve in-built flexibility through constrained discretion, enabling the Chancellor to achieve important economic and political goals. All these findings are well grounded in extant empirical evidence to date; but they are also subject to revision in the light of alternative interpretations of available evidence or the emergence of new evidence.214

Theories of endogenous institutions are still underdeveloped,215 probably because there is an element of contingency regarding the sufficient causes of rapid change.216 Yet we can still identify patterns of political behaviour through the study of crucial instances of institutional development. This research confirms that there should not be a distinction between in-period choices (choices given rules) and constitutional choices (choices about the rules) as far as politicians’ motivations are concerned. The

214 As a case in point, the publication of Blair’s memoir has activated a fresh debate about the paternity of the Bank of England reform. See, ‘Blair, Brown or Balls?’ Left Next Blog, 1 September 2010. Following Garnett, we believe that the uniquely rich collection of diaries and memoirs by the participants of the New Labour project should receive more attention from academics. Mark Garnett, ‘New Labour’s Literary Legacy’, British Politics, 5 (2010): 315-336.
idea of a ‘pristine design stage’ is a myth. If anything, incentives for political manipulation are higher during constitutional moments. Politicians can obtain substantive benefits by manipulating the mechanisms transforming preferences into outcomes. This implies that the concept of heresthetic has leverage beyond the sphere of electoral competition. This concept crucially induces us to focus on the intentions and beliefs of a small group of strategic-oriented politicians who consciously seek to profit from reshaping the structure of political games. Decisions over interest rates have massive distributive implications, not least in Britain. In this context, it is striking that the main proponents of price stability did not manage to make the Bank of England independent during the Conservative era. This further confirms that policy suppliers have a great deal of influence in the constitution-making process.

This article speaks to current debates about institutions and credibility, central bank independence, and the relationship between monetary and fiscal governance. The dominant story about the merits of self-binding and the credibility gains from depoliticizing monetary commitments may risk obscuring the politics of institutional change. Self-binding is a strategic hook aimed at outmanoeuvring adversaries. Politicians design institutionally binding credible commitments in order to bind others rather than themselves. Insofar as commentators have recognized the power of argument about e binding others, it tends to be made with reference future governments. This research suggests that binding others is also a strategic option to enforce the cohesiveness of ruling coalitions in a transition context. In the British case, Brown surrendered key policy tools with the objective of creating a constraint that would limit the freedom of potential challengers. Institutionalized commitments are also power-enhancing. Politicians, even the Gordon Browns of this world, are not interested in self-discipline, but in the political profits associated with the institutionalization of discipline. These two motivations – binding others and enabling – may help us understand why politicians delegate power to technocratic institutions, complementing explanations based on epistemic communities and depoliticization.

Greater central bank independence has emerged in the last decades as the paradigm of good economic governance. This monetary consensus should not be taken for granted though. Both the theoretical and empirical cases for independence are not uncontroversial. Works documenting an apparent association between CBI and low inflation are still undermined by causality issues, measurement errors, omitted-variable biases and sampling problems. More importantly, the effects of central bank independence on inflation may be contingent on countries’ underlying political and societal constraints. The new monetary orthodoxy entails significant ‘institutional paradoxes’. Finally, the logics of delegation and democratic accountability are not easily reconciled. These remaining uncertainties call for more in-depth and context-specific analysis of the evolution and implications of monetary institutions. This case study has shown that the cognitive and political underpinnings of central banking reforms are more nuanced than often suggested.

Economists assume that hard monetary commitments would enforce budget discipline. But history shows that institutional innovations aimed at controlling rulers’ discretion may induce financial revolutions which relax the existing budget constraints of private and public agents. In the worst case scenario, the politics of cheap money leads to a financial disaster. Examples are not in short supply. In Argentina, an ultra-hard monetary arrangement created the conditions for an unsustainable financial bubble which burst tragically in December 2001. In Greece, the combination of the single currency with independent national budget policies encouraged fiscal profligacy, leaving the country on the verge of financial collapse.


222 John Freeman, ‘Competing Commitments: Technocracy and Democracy in the Design of Monetary Institutions’, in Bernhard et al., *The Political Economy of Monetary Institutions*.

223 Daunton’s fascinating history of taxation in Britain is also full examples of rulers seeking to exploit the enabling properties of credible commitments. See especially Martin Daunton, *Trusting Leviathan: The Politics of Taxation in Britain*, 1799-1914 (Cambridge: Cambridge University Press, 2001).
In the UK, the conscious pursuit of credibility through constrained discretion facilitated fiscal activism and fuelled an unhealthy housing boom. The established thinking has typically argued that the problem was not the monetary frameworks, but too expansionary fiscal policies. Yet this article suggests that the softening of budget constraints were not unintended consequences, but intrinsic to the making of constitutional commitments. This argument may contribute to the debate about the contradictions and limits inherent in the New Labour project.

I wish to conclude by saying that the crucial anomalies brought about by the current financial crisis should ideally encourage a rethinking of the role of institutions on economic policy-making. Are monetary institutions really solving problems of credible commitment, or simply reallocating them? Is there an institutional fix to politics? What are the limits of using external commitments to induce domestic discipline? What is the role of institutional complementarities, including the interactions between monetary, fiscal and financial governance? All these issues must be seriously addressed in further research.

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224 Martin Feldstein, ‘Let Greece Take a Holyday from the Eurozone’, *The Financial Times*, 17 February 2010. This analysis can be replicated to other European countries, as EMU institutions have failed to enforce fiscal discipline on a sustainable basis. See Mark Hallerberg, Jurgen von Hagen and Rolf Strauch, *Fiscal Governance in Europe* (Cambridge: Cambridge University Press, 2009).

225 Clift and Tomlinson, *Credible Keynesianism?*


