SEPARATION OF POWERS AND THE MACROECONOMIC CONSTITUTION

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ABSTRACT

The rise of independent institutions, especially central banks, and the heightened interest in the interplay between the three main macroeconomic policies – monetary, fiscal, and financial – call for the rethinking of modern macroeconomic constitutions and their institutional architecture.

The paper briefly analyses the main institutional processes of coordination of such macroeconomic activities: the market process, the adjudication/judicial process, and the political process, i.e. the electoral-representative with more or less delegation to independents. It concludes for an hybrid of private and public functions, with some intervention of all institutional alternatives, a crucial role of public powers, and an increasing role for (political and) independent institutions.

The core of this paper is focused on the distribution of macroeconomic powers, both functionally and institutionally. It examines and applies the constitutional doctrine of separation of powers to the macroeconomic constitution and its three main policies.

The functional analysis discusses the interactions and interdependences between internal and external monetary, fiscal, and financial policies, and how they can better be framed to deliver a superior macroeconomic policy mix.

It rejects both the alternatives of concentration of macroeconomic powers in the hands of a political majority and of strict separation of all macroeconomic powers. Instead, it defends a middle way of partial and balanced separation of powers which is compatible with interactions and without subordination.

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1. INTRODUCTION

The rise of independent institutions such as central banks, financial supervisors, and independent fiscal institutions, and the relations between separated monetary, financial and fiscal policies became, over the last decades, crucial traits of the architecture of macroeconomic governance and constitution.

They reflect the application of the doctrine of separation of powers in the field of macroeconomic policy.

Independent central banks (ICBs), for instance, are institutions in the thicker sense[2] that emerged due to a combination of historical factors such as collective traumas, exit from political gridlocks, and the force of concrete entrepreneurial leaderships, of compromises between ideas and/or interests, and of strategic behavior of power players[3].

ICBs are not inevitable; the world survived without them for a very long time, and it is unlikely that this is the "end of history" for central banking[4].

Imperfect as all institutional alternatives, their existence and power depend on their acceptance (legitimacy) by their respective polity, and their structure and process are framed and shaped by the constitutional regime deliberated and/or experienced by this polity.

Certain macroeconomic policies are only delegated to a specialized independent institution if there is a prior constitutional choice to separate public powers. There is no ICB in regimes with a full concentration of powers in the hands of one single ruler (elected or not), or with the assignment of all macroeconomic policies to a unique, general political branch.

However, almost all advanced economies' constitutions are defined by a balance between liberal and democratic values and institutions, where the separation of powers and the independence of (at least) the judicial branch are quintessential. The very idea of constitutionalism relies on such balance[5].

The liberal democratic project is by nature one embracing interdependences, tensions between powers, between effective power and its constraint, between cooperation, autonomy, and concentration. It is a project of moderation as much as equality, inclusion,

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[2] (KOMESAR, 1994), (GUY PETERS, 2019: 23, 147, 157), (MARCH & OLSEN, 2011: 159), (RAWLS, 1971: 55), (NORTH, 1990: 3-5), (NORTH, 2005: 48-49), (WALDRON, 2016: 1-7).

[3] (KETTL, 1986), (JAMES, 2012), (CONTI-BROWN, 2016), (BRUNNERMEIER, JAMES & LANDAU, 2016), (BINDER & SPINDEL, 2018), (HERGER, 2019).

[4] (STRACCA, 2019: 10, 16).

[5] (VILE, 1998: 8), (LEVINSON, 2016: 33, defining constitutionalism as "the project of creating, allocating, and constraining state power").

and tolerance. It requires compromises on principles, processes, and institutions rather than totalitarian or pure arrangements. Per these balances, the best of the majoritarian mode must live along with a meaningful role for non-majoritarian institutions, where the ICB fits neatly.

The constitution of European integration is also the embodiment of compromise, of vertical and horizontal separations (and balances) between national and supranational (even if intergovernmental) institutions and powers, and political and independent institutions and processes[6].

The asymmetry and incompleteness of the EMU only make its tensions and balances more delicate and complex. A strong and constitutionalized, independent ECB easily finds its way into it, as it grows old and entrenched in European societies along with its single currency.

If the system of (balanced) separation of powers is well established in liberal democratic constitutions in general and in the constitution of European integration, the distribution of macroeconomic powers and functions is less studied and consensual.

Therefore, this paper discusses whether macroeconomic constitutions of liberal democracies prefer concentration or separation of macroeconomic powers and, in the latter case, what kind of separation – strict or balanced – they endorse.

2. MACROECONOMIC CONSTITUTION

The macroeconomic constitution is a subset of the (economic) constitution that establishes the institutional framework – rules, organizations, and principles – governing the three essential macroeconomic policies.

It encompasses the *monetary constitution,* including both domestic and international monetary arrangements[7], the *fiscal constitution*, and the *financial/credit institutional frameworks* that include macroprudential, microprudential, and crisis management policies

[6] (LENAERTS, 2021, noting that since the *Meroni* case of 1958, the CJEU referred to the "balance of powers" as a "characteristic of the institutional structure of the Community").

[7] (BUCHANAN, 1962), (DAM, 1977: 272-5), (FRIEDMAN, 1982: 99), (VANBERG, 2011: 6-8, citing BÖHM, EUCKEN, GROßMANN-DOERTH, 1989), (TUORI, 2015: 178). (CANOTILHO, 2003: 345) and (SANTOS, GONÇALVES & MARQUES, 2004:31-33) including economic fundamental rights in the economic constitution.

such as LOLR, resolution, deposit-insurance policies[8]. But it does not necessarily include all policy fields with macroeconomic relevance[9].

Macroeconomic constitutions of advanced liberal democracies, in a substantive sense[10], display a core of five overarching *balancing ideas* that embody five compromises: (i) *non-autarkic sovereignty*, i.e., preservation of sovereign authority in macroeconomic fields, but open to integration and internalization of spillovers in an interdependent world; (ii) a set of substantive principles where the *stability culture* is paramount in the triple dimension of price, financial and economic stability; (iii) a complementary *mix of public and private roles and processes* in all those macroeconomic functions; (iv) the structure of public interventions as *hybrids of rules and discretion*, the latter being exercised by *varying combinations of political and independent institutions*; and finally, (v) the choice for *separation of macroeconomic powers*.

It is a *balanced* macroeconomic constitution in the sense of *embodying compromises* between diverse and often conflicting solutions, *with elasticity and flexibility* to accommodate different (reasonable) ideas, economic theories and societal preferences, distinct states of the world, and domestic idiosyncrasies in terms of political and electoral systems, political cultures, administrative and legal systems, and models of central banking.

It is also balanced in the sense of *limitation of powers* through a model of separation and the mobilization of non-majoritarian institutions that divide and share power with majoritarian political institutions.

This paper focuses on the fifth idea – the separation of macroeconomic powers.

However, before dedicating the remaining sections to that idea, a reference is due to the (logically prior) choice of the institutional process to coordinate the provision and organization of the macroeconomic activities. It will briefly elaborate on the third constitutional idea that all the those macroeconomic functions are organized under a mix of public and private roles and processes.

3. A Mix of Institutional Processes

[8] (Tuori, 2015: 185, on the dual focus of the macroeconomic constitution on monetary and fiscal policies).

[9] Other fields of macroeconomic relevance: trade policy, competition and state aids and even sectoral regulation (Listokin, 2017, and Listokin, 2019), (Masur & Posner, 2017), (Menand, 2022).

[10] On the debate whether and how the monetary, fiscal, and financial frameworks should be *formally* enshrined in legal texts of supra-ordinated constitutional level (Brennan & Buchanan, 1981: 64), (Bernholz, 1986: 480, 49-8), (Buchanan, 2010), (Horwitz, 2011). Differently (Musgrave & Musgrave, 1989).

The main theoretical alternatives of coordination and provision of macroeconomic activities are the *market process*, the *adjudication process,* and *political process* (i.e. the electoral-representative process, possibly with some with a significant degree of delegation to independent political institutions[11]).

The market process has been discussed at length by the literatures on monetary sovereignty vs private currency competition (domestic and international), on fixed/pegged vs. flexible exchange rates regimes, on financial regulation vs deregulation and decentralized financing, and on public vs market-based payment systems. [12]

The basic underlying idea is that monetary and financial activities are extremely complex and technical and their governance requires such levels of knowledge and professional competence that are unlikely in centralized management[13].

The defense of market provision through full competition of private monies is grounded on the belief that forbidding private money provision is an unnecessary violation of freedom of enterprise, under the expectation that concerns with reputation and trust in the currency, and stable rates of inflation discipline private issuers.

Furthermore, market process mobilizes a multitude of decentralized market actors that would increase innovation and the services provided, would have knowledge advantages over central planners, and would avoid failures of the state and of the political process such as political transaction costs and inefficiencies, political cycling, arbitrariness, and agency problems stemming from shirking, rent seeking, and capture.

However, serious market failures have been theoretically and empirically identified in the (unregulated) competition of private monies and provision of financial services.

Fully private money lacks flexibility and it has a dynamic instability problem as the money supply expands too rapidly in "fair weather" and contracts too sharply in "foul weather", lacks fiscal anchor, and its ancillary stabilizing elements have problems of their own (metals and other commodity are too rigid; the so called stable digital coins lack convertibility).

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[11] (Leitão Amaro, 2023, explaining that modern central banks are political and independent).

[12] (Lerner, 1947), (Hayek, 1976), (Friedman & Schwartz, 1987), (Lastra, 2015), (White, 2016 and 2023), (Stracca, 2019), (Herger, 2019), (Selgin, 2021).

[13] (Stracca, 2019: 121, noting that central planners "do not have enough information to decide on the optimal allocation of scarce resources and they do not know the underlying determinants of the macroeconomic variables they care for, even if they are well intentioned (not to be taken for granted), (Guisinger et al, 2022, questioning the advantage of Fed vs Markets in forecasting inflation).

Market based provision might be more inefficient as it tends to hinder the development of a uniform means of payment that would bring efficiency gains from network effects, commitment-stability gains, and reduced transaction costs.

Furthermore, there is scant empirical evidence of success of competitive monies. In the past century domestically competition of money became rare, subsisting only in the form of competition of government monies when the national currency is poorly managed and loses trust. In contrast with certain claims of success of a circumscribed experience of private monies competition in Scotland, the American experience of "free banking" in the 19th century has generally been associated with great financial instability, and described sarcastically as wildcat banking.

The greater flexibility and deregulation in international exchange rate (post-Bretton Woods) and financial markets and banking activities (mid-1980s until 2007) have deserved mixed appraisals and frequent blaming for the GFC.

Finally, if any private currency manages to beat the competition it creates monopolization and excessive concentration of power in the hands of the successful private banker.

Market-based processes are decentralized, are not structured to deal with concerns of procedural and substantive democratic justice, and the power of participants and the consideration of the interests of non-participants are highly skewed.

The historical trend has been towards hybrid models of public and private governance and provision of money and credit, where public powers, particularly independent central banks, have decisive roles across the various policy dimensions.

The current prevailing monetary regime is an hybrid two-tiered regime of public created outside money or monetary base[14], and of privately created inside money[15] through

[14] It typically includes currency (notes and coins) circulating in the public or physically held in the vaults of commercial banks, and reserves held in the central bank. When created, tokenized or account-based CBDC will add to this category.

[15] Inside money may be broadly defined as "an asset backed by any form of private credit that circulates as a medium of exchange" (LAGOS, 2006). For the conduct of monetary policy central banks adopt a narrow definition and measure of the money stock, that includes currency in circulation and certain bank deposits in M1 aggregates – for the US Fed, demand deposits and other checkable deposits; for the ECB, overnight deposits – and also some other less liquid financial assets in M2 and M3 – for the US Fed, includes also savings deposits, small-denomination time deposits, and retail money funds, while for the ECB, M2 includes M1 and certain time-deposits (maturity of up to two years or at notice of up to three months) and M3 includes also repurchase agreements, money market fund shares/units and debt securities with a maturity of up to two years (US Federal Reserve and ECB websites), (LASTRA, 2015: 13), (MISHKIN, 2016: 102-105).

fractional-reserve banking[16]. Nowadays, money is overwhelmingly electronic and created by the private sector[17], and for the time being "the general public typically holds only one form of central-bank-issued money, namely cash"[18]. Public authorities discipline or influence this private money creation through monetary and financial policies[19], with an increasing challenge from quasi-money instruments issued by non-banks - unchartered and less-regulated financial institutions such as hedge funds, brokerage firms, and money market mutual funds[20].

The external monetary policy regime is also a public-private hybrid. In countries with flexible exchange rates and free capital flows regimes the market-process component is even more preponderant, as "the exchange rate is left to be decided by the daily flux of trillions of dollars in the foreign-exchange markets"[21].

However, national authorities did not surrender all powers to intervene in and control exchange rates and capital balances, flows and shocks. In the standard view for flexible rates regimes, that control of external monetary conditions is *indirect,* through internal monetary policy, thus enabling an independent (or sovereign) monetary policy according to the MUNDELL-FLEMMING trilemma[22].

However, this indirect control paradigm implied in the MUNDELL-FLEMMING trilemma had been challenged by the rise of globalization, openness and integration of trade and financial flows and markets, which increased interdependences, with spill overs and spill backs also on

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[16] (MANKIW, 2001: 117, defining fractional-reserve banking as "a banking system in which banks hold only a fraction of deposits in as reserves" per a reserve ratio).

[17] Private sector money dwarfs the amount of public sector money – i.e. currency – in circulation. (MERSCH, 2018) In November 2017, euro notes and coins in circulation amounted to €1.1 trillion, compared with the €17.5 trillion deposited by euro area residents with MFIs.

[18] (NIEPELT, 2018, noting that under the current monetary arrangement access to electronic central bank money ("reserves") is generally restricted to banks).

[19] (CLAEYS, DEMERTZIS & EFSTATHIOU, 2018: 10, noting that "today, the money stock that is created by private banks is ultimately influenced, but not fully controlled, by the central bank"), (MERSCH, 2018, alerting that private sector money is not truly independent).

[20] The role, lighter discipline and risks of these financial institutions also known as "shadow banks", and their quasi-money instruments, have been questioned (RICKS, 2016), (VAN'T KLOOSTER, 2020: 6).

[21] (TOOZE, 2020, in a dollar focused analysis), (COTTIER & SATRAGNO, 2014: 412), (U.S. DEPARTMENT OF THE TREASURY, 2020: 1). In their new agreement replacing NAFTA, the USA, Mexico and Canada committed to "achieve and maintain a market-determined exchange rate regime" (arts. 33.2.2. and 33.4.2.(c) of the new Agreement between the United States of America, Mexico and Canada of 2020).

[22] (MUNDELL, 2001, writing that "when a country opts for fixed exchange rates…it sacrifices policy sovereignty in the field of money").

countries with flexible exchange rates and open capital accounts[23]. Under this novel view, monetary sovereignty and internal monetary policy cannot be that fully autonomous and sufficient, and some sort of capital controls or foreign exchange rate interventions is also required on occasion[24], i.e. involving some *direct* public intervention or an hybrid of both. Such interventions may be only oral, or actual (even if secret) open market spot or forward transactions, reciprocal currency arrangements, or standing currency liquidity swaps[25]. Peripheral and center countries are in different situations, but none is immune to interdependences, so none can leave its currency, entirely and at all times, at the mercy of the unfettered vagaries of foreign exchange markets.

Furthermore, financial policies governing the financial system and credit activities are also a case of a mix of private and public processes. On the one hand, national and international financial markets encompassing advanced economies are essentially liberalized and actors mostly private. Moreover, public agents participating in those markets (central banks, state-owned commercial banks or financial institutions, agencies and treasuries) resort heavily to market tools, such as the central banks' open market operations or sovereign debt issuances[26].

On the other hand, the credit and financial sector is one of the most regulated and supervised of all market activities[27]. Public authorities control access (charters and licensing), regulate with minutia financial institutions and activities, supervise them macro- and micro-prudentially, develop insurance mechanisms, including deposit-insurance

[23] (CARNEY, 2019).

[24] (CARNEY, 2019, alerting for the interconnectedness and destabilizing asymmetry in the international monetary system facilitate foreign shocks on emerging markets), (KRUGMAN, OBSTFELD, MELITZ, 2015: 615-18, arguing that financial globalization challenged the purported benefits of a floating rates), (EICHENGREEN, 2016: 35-6, finding that monetary policy independence decreased in advanced economies, particularly in the period 2000-2013, in tandem with the movement toward greater financial openness).

[25] Furthermore, national authorities hold foreign currency reserves whose security, liquidity and highest rate of return they seek through a host of other operations (*e.g.* outright purchases and sales, agreements for repurchase and resale, managing balances in time and other deposit accounts at foreign institutions). (FOMC, Authorization for Foreign Currency Operations, 2020). The time, scale and scope distinguish these *management operations* from the other market interventions.

[26] Not that these public actors participate with the same purposes and conditions of private actors. The public interest is expected to justify their participation in situations and terms that private self-interested agents would not. The sovereign-backing and the money creation powers of central banks give them superior competitive conditions of an unlevelled playing field.

[27] The McLaughlin-Sherouse List of the 10 most-regulated Industries of 2014 in the USA includes both two types of financial services industries: nondepository credit intermediation and depository credit intermediation (MERCATUS CENTER, 2016).

schemes and lender of last resort functions, and create and run special resolution procedures for failing banks[28].

With the increasing financial globalization efforts to harmonize financial regulation and supervision have intensified internationally, specially under the auspices of the BIS and its Basel Committee, and regionally in Europe with Banking Union and the European System of Financial Supervision.

The pendulum between market and public processes, deregulation and regulation, as swung across history. After almost 3 decades of some deregulation (1980s-2007), the period since the GFC has been dominated by the concern with financial stability, and the revamp of regulation and supervision institutions and processes. The experience of the Pandemic Crisis suggests that such regulatory reforms were necessary and beneficial, even if not sufficient. The financial sector weathered the pandemic without major breakdowns, although the support from monetary and fiscal authorities have also been decisive.

Amongst credit and financial intermediation activities, banking is one of the most affected by that intensive public intervention[29].

However, there is one segment of the financial sector where the balance between market and public processes leans much more to the former, in terms that have been increasingly questioned[30]. In recent decades there was an explosion in the absolute and relative size of the so-called non-banks or shadow banking, which remain largely afoul from public chartering, regulatory, supervision and insurance obligations and intervention. However, systemic importance became so significant and growing (more in the USA but increasingly internationally), that in the recent past the Fed felt the need to go into their rescue, throwing public lifelines of liquidity and acting as a their market-maker of last resort.

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[28] For overviews of financial regulation and supervision, in the USA (BARR ET AL., 2018), for Europe (LASTRA, 2015).

[29] Banking has more relative importance in credit provision in Europe, than in the USA, where the source of financing is more diversified and less banking-dependent (even though, the repeal of the Glass-Steagall Act in 1999 in the USA which imposed the separation of commercial and investment banking, fostered the indirect control of non-banking credit by large banking conglomerates).

[30] There are other activities in the large financial sector that are also subject to high levels of regulation, such as insurance and pensions, securities firms and exchange markets, and consumer finance. (BARR, ET. AL., 2018: 11-32, distinguish financial services by the following partly overlapping and interconnected categories of institutions or activities: insured depository institutions, insurance companies, securities firms and exchange and other trading markets, consumer finance, payment systems, mutual funds and other investment vehicles, derivatives, and shadow banking. The latter group includes securitization, mortgage markets, money market funds, short-term wholesale funding).

Naturally, such systemic importance and public rescues triggered claims for the public regulation of these non-banks.[31]

On the other hand, the recent wave of digital revolution, with the emergence of distributed ledger technologies, private cryptocurrencies, stablecoins and payment systems, and of decentralized financing inspired new promises for market-based money and credit.

Under pressure, central banks reacted strongly with initiatives to launch CBDCs, to regulate private digital currencies and decentralized finance, and to upgrade payment systems under their purview.

The (digital) future of money and finance is open and uncertain.

This is not the end of history for the institutional architecture of money, payments and credit. Central banks and the current model of hybrid fiat money and financial governance are not inevitable, and "the world has survived without central banks for a very long time… [F]or most of history, including modern history, there was no central bank and especially no central bank in the modern sense" whose liabilities are the final means of payment[32].

Nonetheless, the recent volatility in the markets for cryptocurrencies and stablecoins suggests that existent solutions are not yet prepared to prevail.

As to the Adjudication Process, it would mean that Courts and their judicial process would make the ultimate calls on monetary or financial policies, which normatively questionable on two accounts.

Firstly, the structural features of the judicial process are comparatively inadequate for policymaking in general, and for the ordinary governance of this type of complex and technical macroeconomic policies in particular.

Courts' passive interventions and decision-making rely on others to initiate the resolution of social issues.

Generalist judges are specialized in legal methodologies but their expertise in complex macroeconomic fields is insignificant compared to central bankers.

Their a formalistic adversarial process, case-by-case determination and relatively limited physical and human resources are worse than ICBs in terms of competence, scale, expediency and information gathering capability for the purposes of macroeconomic decision-making.

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[31] (SISSOKO, 2021).

[32] (STRACCA, 2018: 9-10).

The comparatively high costs of access and litigation disincentivize participation by dispersed low per capita stakes. As many monetary and financial policy choices involve either uniform low stakes distribution (as with public goods), or a skewed distribution with concentrated high per capita stakes on one side (for instance, of the supervised or assisted financial institutions, of the issuers of eligible collateral for monetary policy operations, or of the holders of financial assets or liabilities specially affected by monetary policies), and dispersed low per capita stakes on the other (*e.g.* current or future taxpayers sharing the cost), the adjudicative procedure seems more prone to bias and less efficiency-enhancing than both the central banking and the political process[33].

Furthermore, of all public powers courts are the most insulated from the political process. Theoretically that would make them even more time-consistent than independent central banks, but they are relatively inept to exercise discretion in policymaking. Not only because they lack the technical specialization, but also are excessively detached from some meaningful democratic control.

Most ex ante and ex post democratic controls over central banks[34] are not available for courts. The coordination of actions between courts and political branches exists but is much more tenuous and suspicious. Therefore, judicial independence is excessive when compared to CBI, especially in its pluralistic model[35], in terms of democratic normative standards required to governing macroeconomic policies.

Secondly, the governance of money through the adjudication process would have to rely on a system of Rigid Rules that Courts would be entrusted with implementing, enforcing and eventually adjust[36].

However, as demonstrated by the rules vs discretion literature, regimes of rigid rules, such as the historical commodity standards or the theoretical monetary rules, lack the indispensable flexibility and efficiency, which led to their general abandonment and replacement for discretionary regimes.

Prima facie a rigid rules-based process is dominated by the classic (electoral-representative) Political Process, by the political Legislature that sets the rigid rules, with a meaningless role

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[33] (KOMESAR, 1994: 123-150).

[34] (LEITÃO AMARO, 2023, describing such ex-ante and ex-post democratic controls of the classic political branches over independent central banks).

[35] (LEITÃO AMARO, 2023, proposing a novel pluralistic model of CBI).

[36] (KOMESAR, 1994), (SCICLUNA, 2014: 564).

for an implementation by a politically dependent executive that is supposed to be strictly mechanic. The idea there is to circumscribe political centralized policymaking to rare moments of high-salient deliberation (and self-commitment) to the most objective and mechanical Monetary Rules that is possible, which would allow for the maximization of the epistemological advantages of democracy, mobilizing expert advice, while minimizing the opportunities for technical errors, political manipulation and abuse of power.

The choice of a commodity-standard would be the simplest[37], while the design of mechanical rules for fiat-issue would be more technical and complex than approving a commodity standard, but both try to put monetary policy on "automatic" mode, reducing room for that discretion allegedly more prone to errors and political manipulation.

However, such processes have structural fragilities: the risks of dynamic ignorance (discounted or unpredicted evolutions challenging the knowledge that based that rigid rulemaking), and the shortcomings of rigid rules in terms of lack of elasticity and flexibility, but they believed that the dangers of micro-management errors and political manipulation were greater.

In fact, a regime of seriously rigid rules and reduction of discretion transfers the ultimate power to interpret, adjust and enforce such rules to the Courts.

Courts have shown self-awareness of their structural inferiority to adjudicate complex and technical macroeconomic issues, and their unwillingness to be central forces driving monetary and financial policies by repeating their deference and other techniques of self-restraint in the judicial review of those policies.

The comparative superiority of CBI over market and judicial processes does not exclude some intervention and role of those processes.

Money, payments and finance have hybrid governances, with complementary roles of public and private processes, combining decentralized decisions and beneficial interventions of independent central banks.

Courts too are not excluded from the macroeconomic fields. They exercise important, albeit limited, judicial accountability of central banks, in which check the legal substantive and procedural limits of delegated discretion. Their judicial review tends to be more intrusive where regulatory and supervisory actions violate individual rights.

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[37] (ALLYN YOUNG, 1925: 292, accepting that "gold standard, by [the stability provision] test, is far from ideal.).

Finally, fiscal activity is by nature a public political process, that concerns the funding and spending of the public sector. Modern fiscal policy is decided, organized and largely implemented by public political authorities.

It has been recognized that private sector behavior and (foreign exchange and sovereign bonds'[38]) market discipline are relevant for, and do actively constraint, the design and implementation of both sides of public financing and spending[39].

Credit rating agencies have been defined as gatekeepers of fiscal policy[40], with a very small number of them worldwide centralizing information and assessment of fiscal decisions and performance, being tacitly delegated "safety judgments by financial regulators"[41] and assisting (if not substituting for) decentralized market judgements.

ALESINA & PASSALACQUA's "radical" proposal" for an explicit delegation "to a respected private institution [of] the task of verifying the accuracy and transparency of the budget process"[42], seems even less democratically tenable.

However, fiscal policy is still thought of as a public political process, in the sense that are political authorities representing the consenting polity that make options on the amounts, balance and composition of revenue and spending of the public sector, taking into account such reactions of private agents. If confronted with shocks that tighten the budget constraint, cause severe budget shortfall, dry up sovereign liquidity or cause a solvency crisis, public authorities still have - in theory, at least in the short term and assuming the state maintains its coercive power - the power to decide on the trade-offs between increasing taxation, cutting spending, inducing private saving on sovereign debt through

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[38] (GASPAR, 2020).

[39] (MUSGRAVE & MUSGRAVE, 1989: 4, declaring that "[n]ot only do the effects of expenditure and tax policies depend upon the reaction of the private sector, but the need for fiscal measures is determined by how the private sector would perform in their absence"). Government debt also impacts – at least intertemporally – the effort and expectations of that taxpaying private sector, and it is subject to the discipline of the foreign and/or domestic credit markets, whose participants are mostly private sector agents (at least in normal times). Nonetheless, the process of fiscal policy is essentially public. Ordoliberal views emphasize the combined role of rigid rules and market discipline of fiscal policy. (EYRAU, GASPAR & POGHOSYAN, 2017: 29-30).

[40] (VINEY & POOLE, 2019: 468, noting how ratings agencies are fiscal gatekeepers with hard sanction powers that public independent financial institutions lack, as they can increase or decrease the cost of borrowing through a revision of the institution's credit rating), (HAANUSCH & VALEER, 2013).

[41] (WHITE, 2010, questioning the delegation to three credit rating agencies -- Moody's, Standard & Poor's, and Fitch – that came to the center of the U.S. financial markets).

[42] (ALESINA & PASSALACQUA, 2015: 50).

financial repression, monetary financing, inflation tax, and debt repudiation, default or restructuring.

Most or all of these options have legal, political and economic limits, with possible self-defeating consequences in the short and/or long run. With public debt currently in colossal levels in relative terms to the size of economies and their sovereigns' fiscal capacities, such limits are particularly visible.

When *market discipline* becomes *financial dominance* it can be asked whether those decisions on how much the state is to collect in revenue or is authorized to spend, are not *de facto* gravitating from the realm of the *public political process*, towards the *market process* and the decentralized decisions of so many agents purchasing sovereign debt or other assets.

4. The Separation of Powers Doctrine

In constitutional or liberal democracies, separation of powers is a fundamental doctrine of organization and limitation of government and its powers.

Substantive separation serves the core values of liberty and efficiency/effectiveness, and ultimately democracy, through two principles: *limited government*, by bringing it under control and placing limits on the exercise of its power to prevent tyranny, protect fundamental rights, build consensus, and promote moderation and deliberation[43]; and *functional specialization*, by assigning public powers to those bodies best suited to exercise them[44].

It demands the division of power among government institutions, but also democratic interests, groups of society, or any form of factual power[45].

Critics of the doctrine or its practical implementation accuse it of undermining the majoritarian will and not accounting well for democracy (counter-majoritarian difficulty), compromising the force and effectiveness of unitary executives, favoring concentrated

[43] (Montesquieu, 2015), (The Federalist Papers, nr. 47), (Vile, 1998), (Levinson, 2016, 108-9).

[44] On the "functional separation view" (Barber, 2001), (Waldron, 2016). Defending the combination of limitation and functional specialization (Ackerman, 2000: 639,685), (Canotilho, 2003: 250), (Metzger, 2009: 428, arguing that the SCOTUS combined the two justifications), (Levinson, 2011) and (Voigt, Gutman, Feld, 2018: 4).

[45] (Levinson, 2016), (Michaels, 2015), (Canotilho, 2003, 556).

minorities bias and a status quo bias, perpetuating inequalities, and having a tendency towards gridlock and inefficacious governance[46].

However, the dominant doctrine is "[n]either a complete separation or a complete fusion of the functions of government, nor of the procedures which are used to implement these functions, [and it] is acceptable to men who wish to see an effective yet controlled used of the power of governments"[47].

4.1. A BALANCED SEPARATION OF INTERDEPENDENT POWERS

A pure separation model would require *strict separation of functions*, *institutions*, and *people*, diffusing authority among different autonomous centers of power that develop certain institutional interests, and with distinct agencies being assigned different functions and having distinct membership[48].

Yet, the model for constitutional democracy is one of *partial* or *balanced* separation, with mutual checks between government institutions.

It warrants not absolute independence of functions or institutions but their interdependence[49], allowing for some overlap of functions, a degree of interference, and their inevitable and *desired* friction[50]. The purpose of the separation of powers "was not to avoid friction, but by means of the inevitable friction incident to the distribution of the governmental powers among three departments, to save the people from autocracy"[51].

Under this doctrine, "no one institution has absolute autonomy"[52], but a combination of *resolving* (*statuer)* and *rejecting* (*empêcher*) powers in MONTESQUIEU's language[53].

Envisaging a structural differentiation[54] with parity or non-subordination between powers[55], it protects the functions' essential core[56] and seeks to prevent "undue or injurious

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[46] (ROUSSEAU is the historical reference here). Critically (FABRINNI, 2003 citing DAHL). (LEVINSON, 2016, 108-9).

[47] (VILE, 1998: 362).

[48] (VILE, 1998: 16-8).

[49] (KAGAN, dissent *Seila Law LLC v. Consumer Financial Protection Bureau* (2020), recalling that every branch of government "supports and is supported, regulates and is regulated, by the rest", and that the drafters of the Constitution opted against keeping the branches of government "absolutely separate and distinct". Instead, the branches have "common link[s] of connection [and] dependence"), (CANOTILHO, 2003: 557-8).

[50] (KAUFMAN, 1980: 689), (STONE SWEET, 2000, 129, arguing that the overlap in functions is the norm), (BARBER, 2001).

[51] (BRANDEIS' dissent in SCOTUS decision in *Myers v. U.S.* 272 U.S. 52 (1926)).

[52] (BARBER, 2001), (VILE, 1998: 368, writing that "no single structure should be solely responsible for one" of the functions), (CANOTILHO, 2003: 557-8).

[53] (MONTESQUIEU: 310).

intrusion"[57], the "encroachment or aggrandizement of one branch at the expense of another"[58], even though the meaning of *undue* is contested[59].

Thus, under this balanced principle, powers are separated, but simultaneously they are blended, intermixed[60] for *mutual control* and *coordination*, for the sake of liberty and unity and effectiveness of government[61].

It "combines MONTESQUIEU's functional separation and differentiation ... with mixed government logic, giving the branches a set of 'checks and balances' over one another, preventing unilateral action, and requiring cooperation to accomplish the tasks of governance"[62].

This system of checks and balances with internal and external controls[63] involves "continuous communication and incessant negotiation between the powers"[64].

The past two and a half centuries of constitutional, political, and administrative evolution have only reinforced such balancing of mutual control and coordination, departing further from the stricter formulations of vertical and horizontal separation of powers[65].

4.2. BEYOND THE CLASSIC TRIPARTITE SEPARATION

The classic tripartite model of horizontal separation of legislative, executive, and judicial powers has been questioned and sentenced[66], additional branches have been copiously

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[54] (KAUFMAN, 1980: 689), (STONE SWEET, 2000, 129).

[55] (MORGADO, 2015: 86), but (KATYAL, 2006: 2316-8, 2348, confronting that ideal of parity with the reality of an "executive that subsumes much of the tripartite structure of government", while "legislative abdication is the reigning modus operandi" and "judicial checking is bound to fail").

[56] (CANOTILHO, 2003: 557-8), (OTERO, 2010: 12), (MORAIS, 2008: 40), (KAUFMAN, 1980: 690-1).

[57] (KAUFMAN, 1980: 689).

[58] (MANNING, 2011: 1943), (*Mistretta v. United States*, 488 U.S. 361, 386 (1989)), (WHITE's dissent in SCOTUS case *Bowsher v. Synar)*.

[59] (SCALIA's dissent in SCOTUS case *Morrison v. Olson*). Critically (Strauss, 1986: 526).

[60] (THE FEDERALIST PAPERS, nr. 47 and 48), (VILE, 1998), (KAUFMAN, 1980: 689), (METZGER, 2009: 428), (MANNING, 2011: 1945).

[61] (VILE, 1998: 417).

[62] (LEVINSON, 2016: 95). Even (MONTESQUIEU: 314, acknowledged coordination, arguing that powers "are forced to move, but still in concert").

[63] (VILE, 1998: 20).

[64] (MORGADO, 2015: 86-7).

[65] Federalism and decentralization were the classic forms of vertical separation. The European integration, with its so-called multi-level governance, incomplete integration, ambiguous subsidiarity and pluralistic claims to sovereignty, provided the starkest challenge to the traditional models of rigid vertical separation of powers.

[66] (BARBER, 2001: 69-70).

suggested[67], and new or reorganized horizontal/functional separations have been proposed[68] to deal with the explosion of discretionary decision-making, administrative rulemaking and adjudication, of supranational governance, institutional specialization, and mass politics.

Even if there is some exaggeration in the assertions that the "legislative abdicated" and "judicial checking is bound to fail"[69], the 20th-century integrative tendency of power[70], the unrivaled expansion of the Executive and the increased decisiveness of party and interest-group politics motivated the acknowledgment that both "external relations between the branches"[71] and external control of government by the people are necessary but might not be sufficient[72].

Literature traditionally distinguishes external and internal separation, where the former occurs between branch-functions of government and the latter between actors within the same branch-function[73].

As surrogate or complement to external separation[74], internal control-through-separation grew in various directions, often combined through (i) functionally specialized fragmentation of the structure of government by creating distinct agencies or internal segregation within agencies[75]; (ii) insulation from partisan and electoral politics by diluting powers among independent agencies; and (iii) other procedural or organic mechanisms that add inputs[76].

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[67] Governmental institutions such as independent administrative agencies or societal actors such as the media or sectional interest groups have been proposed as "fourth branches". (ACKERMAN, 2000: 723, proposing the creation of an integrity branch and a regulatory branch), (VIBERT, 2007, suggesting a new unelected branch dedicated to "information-knowledge-evidence gathering, management and provision").

[68] (VILE, 1997: 17), (CANOTILHO, 2003, 562), (MICHAELS, 2015, identifying the rise of secondary, administrative separation of powers).

[69] (KATYAL, 2006).

[70] (VILE, 1998, describing the integrative tendency of power along the hierarchical principle and co-ordination function, with relative erosion of the Legislature, prominence of the Executive and its leader, and expansion of the welfare state).

[71] (METZGER, 2009: 437-9).

[72] (VILE, 1998: 362-5), (ACKERMAN, 2000: 687).

[73] (LEVINSON, 2016), (MICHAELS, 2015), (METZGER, 2009).

[74] (KATYAL, 2006: 2348, defending that the first-best concept of "Legislature v. Executive" checks and balances must be updated with second-best "Executive v. Executive" divisions), (VILE, 1998), (METZGER, 2009: 439-444), (LEVINSON, 2016: 110).

[75] (METZGER, 2009).

[76] Collegiality, procedural fairness and due process aspects in administrative procedure, career protections for the civil service, mandatory review of government action by different agencies, reporting requirements to Congress, and creation of an impartial decision-maker to resolve inter-agency conflicts (VILE, 1998), (KATYAL, 2006: 2316-8).

Internal separation exists in all constitutional branches[77], but with the 20th-century rise of the welfare and administrative state, it became more salient in the executive branch.

The first degree was the development of professional bureaucracy, which creates *institutional* and *personal* internal separation, with one political executive (president, prime minister, and their cabinets) served by a united, professional civil service[78].

In higher degrees of fragmentation, specialized functions are distributed to different agencies within the same branch, including independent agencies insulated from political bodies. Such internal separation is also *functional*, in a double sense, of distribution per policy areas and/or per types of tasks (such as information-gathering, legal services, administrative police, internal audit, etc.).

Internal separation is no silver bullet, though[79]. In contexts such as strong executive leadership, overwhelming majorities, or moments of crisis, it might become a parchment barrier. They do not dispense with external separation.

On the other hand, functionally specialized fragmentation should not turn a limited government into a paralyzed one. The ideals of neutrality and impartiality behind independent agencies are confronted with positive and normative limitations and challenges[80].

4.3. IDEAL INSTITUTIONAL ARCHITECTURE?

"There is no natural set of state institutions which exists before the state," "no natural division of power between ... institutions of the state", and no theoretical archetype of a concrete separation of powers[81].

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[77] The legislative branch has internal separation, the most visible being bicameralism and the multiplicity of parliamentary committees. The judicial branch has both a vertical separation with a segmented hierarchy of autonomous courts and a horizontal separation through substantive (specialized) or territorial jurisdictions. Similarly (METZGER, 2009: 428, noting that "internal measures are present in all the branches").

[78] (LEVINSON, 2016: 94, suggesting "the idea of separating qualitatively different powers is entirely different from the mixed government idea of creating concurrent or shared powers among competing groups as a barrier to unilateral decisionmaking or domination…mixed government could be accomplished by representing the major interests in a single, omnipotent branch, with no need for separating governmental powers into multiple branches").

[79] (METZGER, 2009), (KATYAL, 2006: 2316-8).

[80] (THE FEDERALIST PAPERS, nr. 51), (VILE, 1998: 365), (ACKERMAN, 2000: 698).

[81] (BARBER, 2001: 61), (BAMFORTH, 2007: 178-180), (MORAIS, 2008: 40), (TUCKER, 2018: 486-7, rejecting pure realms of certain policies, or Natural Law or Positive Economics' answers to which Institution of the State ought to control each tool).

Each polity must deliberate under a host of dynamic, idiosyncratic contexts and positive factors – e.g., historical, political, legal, cultural, and economic – to reach what can only be a compromise for their specific system of separation of powers, often instrumental to higher, unsettled/unsettleable normative ends.

Yet, the impossibility of an ideal and universalizable model should not be confused with relativism[82].

In modern liberal democracies, the nuances of normative theories seeking "to attribute the correct function to the correct institution to serve better the purposes for which collective action is undertaken"[83] and the specificity of each country's balancing compromise ought to fall within a *substantive doctrine of balanced separation of powers*.

This doctrine foresees a system with external and internal separation of powers at the service of limitation of government and functional specialization, where separation is neither complete nor strict but partial and balanced, with interdependence rather than absolute independence allowing for mutual control and limited intervention on each other's functional realms. Such a system welcomes certain coordination, while rejecting dominance and protecting the essential core of each institution. Independence, as insulation from politics and other factual powers and aspiration to neutrality is instrumental to and allied with such balanced separation.

5. Two Questions About Separation in Macroeconomic Constitutions

Descending now to the segment on the macroeconomic constitution, two questions emerge: one about functional separation, on whether the three main macroeconomic policies should be concentrated or separated (for at least some of their functions); the other about institutional and personal separation, on how each of those policies is distributed across branches of government.

The first question is addressed in the remaining sections of this paper. The second is introduced in the present section and developed elsewhere[84].

The classic model of CBI assumes both a strict separation of macro policies, particularly between fiscal and monetary policies and a certain model of distribution within each policy

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[82] (Barber, 2001: 61).

[83] (Komesar, 1994), (Vile, 1998: 380-3), (Ackermann, 2000: 639), (Barber, 2001: 61-73).

[84] (Leitão Amaro, 2023, proposing a new pluralistic model of central bank independence).

where fiscal would be kept almost entirely in the hands of elected political branches. In contrast, monetary and (arguably) financial policies would be delegated mainly to independent institutions because of a primary intervention of elected political branches that would (clearly and completely) establish and structure the institution and its mandate.

The judicial branch has a limited and deferential role in controlling the delegation's boundaries.

However, a realistic, comprehensive, updated description of modern macroeconomic constitutions offers a more complex picture.

Policies are more interdependent and in need of coordination domestically and across borders. Political branches are scanter in defining the mandate delegated to independent institutions, but also more potent in controlling the delegation than the traditional tale. Independent institutions go beyond a purely executive function of implementing policies that would have been primarily decided elsewhere. Checks and balances countervail functional separation.

The macroeconomic constitution is just one of many domains where powerful independent or autonomous institutions have emerged.

Independent courts administer justice through the adjudication process. A professional military with a great deal of autonomy from civil (political) government partially governs defense. Microeconomic regulation and supervision of relevant markets – e.g., media and communications, elections, energy, water, transportation, various financial services, and competition across the economy – have been assigned to independent administrative agencies.

After centuries of conflicts and wars, religion broke away from state control to become governed mainly by market processes, with some of its large operators organized under powerful, non-state hierarchies.

Macroeconomic governance, too, became a fertile ground for the rise of independent institutions that depart from the classic tripartite model of separation of powers. It is more established in monetary policy, gained ground in financial policies, and is emerging with independent fiscal institutions' (still limited) development.

From the perspective of external separation, all macroeconomic policies involve some potential intervention of all the branch-functions traditionally distributed among the three classic constitutional branches, the Legislative, Executive, and Judicial[85].

Across advanced economies, there are multiple variations of compromises of external separation of macroeconomic powers: between executive dominance and ultimate legislative authority, between the former's discretion and constraining legislated rules and judicial review, and between the executive's political and independent forms.

Such compromises have evolved across time. In fiscal policy, decades of (political) executive dominance have more recently led to parliamentarian efforts to reassert power, often in tandem with the (still timid) emergence of independent fiscal institutions. In monetary policy, the evident rise of ICBs has not prevented heightened levels of coordination with political authorities, in different capacities, especially since the Global Financial Crisis (GFC). Financial policy is probably the most prone to and fertile in judicial intervention, particularly regarding microprudential supervision, resolution, and insurance measures. Still, rulemaking and deference to discretion are also relevant there.

Additionally, the rise of international cooperation and supranational integration has shifted power abroad or above and affected the internal distribution of powers. While it hollows some domestic powers, it also strengthens the relative role of domestic institutions with better seats at the leading international tables. Political or independent institutions may take advantage of their unitary, specialized, and more agile structure and functioning and use the opacity and distance of inter-/supranational decision-making to shield their interventions from other domestic branches.

Internal separation of macroeconomic powers has also grown, particularly at the executive level.

Fiscal policy is still dominated by political executives in constant struggle with legislatures, but also with decisive roles of subordinated, professional bureaucracies such as tax, budget, social security and debt management offices, public investment banks, and increasing, albeit still ancillary tasks entrusted to independent fiscal institutions. Various countries or regions have significant degrees of vertical separation through fiscal federalism or decentralization.

[85] (VILE, 1998: 17).

Monetary policy is generally assigned to ICBs, who also cumulate various objectives, numerous instruments, and multiple other functions such as government's fiscal agent, sovereign debt and foreign reserves manager, executor of (politically oriented) external monetary policy, guardian and operator of the payment system[86], information and statistics provider, and a financial stability mandate with macro-, microprudential and resolution functions.

Financial policies are spread through often distinct macroprudential, supervisory, resolution and deposit-insurance authorities with varying degrees of executive and central banks' involvement and integration (and sometimes without separation of persons)[87]. There are also relevant functions of consumer protection and regulation and supervision of capital markets, insurance, and pension funds.

Post-GFC reforms moved in the direction of regrouping various financial powers under the control of ICBs. In the UK, 2009 and 2012 laws made the BoE the country's resolution, macroprudential, and prudential supervision authority. The creation of the EU's Banking Union put the novel Single Supervisory Mechanism (SRM) under ECB leadership. The Fed also augmented its supervision powers and involvement in macroprudential policy.

The general trend seems to be towards making financial policies increasingly a "dance of two" institutions, political executives and ICBs, which leads to the other question of whether and how the three macro policies should be functionally separated.

In the Eurozone, the mosaic is even more complex, with an incomplete and asymmetric EMU with one central bank but 20 national fiscal authorities[88], and a hybrid macro- and microprudential architecture with only partial integration and still significant national competences. This makes their relations, competition, and coordination more difficult, with different states of national economies that complicate the design of one optimal policy and facilitate free-ride and uncooperative strategies[89].

6. FROM DIFFERENTIATION TO INTERDEPENDENCE

6.1. DISTINGUISHING POLICIES BY THE CORE

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[86] (BLINDER, 2016).

[87] It is common that boards and staff of macroprudential authorities, financial supervisors and resolution authorities include persons from the finance ministry or the central bank.

[88] (ORPHANIDES, 2018: 462).

[89] (DRAGHI, 2016).

The distinction between macroeconomic policies "is rarely, if ever, made clear by economists of any ilk. It has been taken for granted that we just know the difference"[90].

Theoretically, it could be based *on the institutions* (who is acting)[91] and/or *on the functions* in the sense of the tasks, instruments, objectives, or the effects of each policy[92].

A recent intense judicial dialogue between the CJEU and the German Constitutional Court (GCC) (*Pringle*, *Gauweiler,* and *Weiss* cases) has addressed the question of drawing the boundaries of legal competences. While the German court focused on the effects generated by the policies, the EU Court affirmed a functionalist view that distinguishes policies according to the *tools/instruments employed and objectives pursued,* discounting indirect effects that go beyond the statutory objectives of the policy.

A functionalist approximation describes the monetary policy as "involv[ing] changes in the provision of the monetary base"[93] through conventional and unconventional policies on interest rates manipulation, reserve requirements, collateral policy, market operations on public and private financial assets (for liquidity or long-term yield control), targeted long-term loans, inflation targeting, and forward guidance to manage agents' expectations.

"Fiscal policy, in contrast, involves changes in taxation and government expenditure" with allocation, redistribution, and stabilization functions [94].

Financial policy(ies) involves intervention in the conditions of financial intermediation and the financial system, either systemically through macroprudential policy or on an individual basis using microprudential policies of regulation and supervision, insurance, and resolution of financial institutions.

However, this functional differentiation cannot be too rigid or clear-cut in any of the dimensions of instruments, objectives, or effects.

First, policy instruments and tasks evolve with time. They change, are created anew, or disappear, blurring the boundaries of the functionality of each policy and authority.

The post-GFC new style of central banking offers plenty of examples of such innovations: unconventional monetary policies, interventions where central banks have "gone direct and

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[90] (LONERGAN, 2016).

[91] (TUCKER, 2018: 486-7, arguing that differentiation is conventional, based on "choices about how to separate what is controlled by, respectively, elected and unelected policymakers").

[92] (LONERGAN, 2016), (GOODFRIEND, 2001), (LANE, 2021).

[93] (LONERGAN, 2016).

[94] (LONERGAN, 2016), (MUSGRAVE & MUSGRAVE, 1989), (GOODFRIEND, 2001).

targeted" contrary to traditional conceptions of a blunt tool, and where they purchased large swathes of sovereign debt (even more than the annual net issuance in some countries during the pandemic[95]) while denying engaging in monetary financing and debt monetization.

A more traditional example is the involvement of central banks in liquidity provision and credit conditions. Since the 19th century, following THORNTON and BAGEHOT, it has been consensual that in emergencies, central banking involves the provision of liquidity to banks as lender of last resort (LOLR) to offset shocks to the aggregate demand of central bank base money[96]. The rationale is that in fractional reserve banking, central banks are in the unique position of producer of the economy's final settlement asset. Through their intervention, they can preserve the transmission (via the financial intermediation channel) of monetary policy and, finally, price stability and prevent the high social costs of allowing banks to collapse[97].

Less obvious, though, is whether central banks should also be market makers of last resort (MMLR) by extending liquidity to non-banks who generate, without a backstop, enormous amounts of money-substitutes[98], or whether they should engage in liquidity and credit facilitation to which they offered the justification that warranting "favorable financing conditions" in periods of emergency is an intermediate objective to purse price stability[99].

The objection is that deciding who gets money is not a monetary function but a distinct credit policy function that should not be exercised by central banks[100]. Even if pursued through monetary policy instruments, "all lender of last resort operations are ultimately fiscal".[101]

Second, while functions and objectives are deeply connected, they are conceptually different, with the latter being ascribed to each function by each polity in time. If price and financial stability have become assumed as teleological components of monetary and financial policies, those same policies have also been assigned other objectives such as

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[95] For example, Italy in 2020-21.

[96] (FISHER, 2016), (GOODFRIEND, 2001).

[97] (TUCKER, 2018: 487).

[98] (MEHRLING, 2011), (BERNANKE & YELLEN, 2020).

[99] (POWELL, June 2020), (LANE, 2021), (TUCKER, Cato Conference, 2020), (MASON, Cato Conference, 2020).

[100] (GOODFRIEND, 2001), (MENAND, Cato Conference, 2021).

[101] (REIS, The Second Decade, 2019: 139-140).

economic stabilization more generally, maximum employment, and support of other government policies.

Third, the formal assignment does not prevent the use of instruments of one policy to purposedly or inadvertently affect the objectives legally ascribed to other policies. Policies have multiple effects, including spillovers on and from other policies.

However, even if macroeconomic policies have significant interaction and interdependences, their distinction is still meaningful. For instance, "all monetary policy has fiscal effects, but a fiscal effect is not a fiscal policy" and "policies which have fiscal effects are not necessarily fiscal policy"[102].

A perfect clear-cut division of functions and their effects would be artificial, unrealistic, and undesirable.[103]

The analytical differentiation and legal distribution of policies should seek the differentiation of each function's core.

As in the general doctrine of separation of powers, what is relevant is the preservation of the integrity of that *core* while acknowledging some overlap and interdependence of functions and mutual interference of effects.

6.2. INTERACTIONS AND INTERDEPENDENCIES OF MACROECONOMIC POLICIES

The idea that, at all times and states, the three macroeconomic policies might be governed with absolute indifference, independence, and no interference in the decisions and operation of the other macroeconomic policies, is untenable.

While most policymakers and academics ignored such interactions and interdependencies during the Great Moderation[104], the period since the GFC has made them inescapable.

They matter from two perspectives: first, the effects each policy has on the others, their operation, and assigned objectives; and second, their joint impact on the aggregate macroeconomic policy mix.

6.2.1. EFFECTS ON OTHER POLICIES

[102](LONERGAN, 2016), (DRAGHI, 2016), (TUCKER, 2018: 78, noting that a monetary Clausewitz might have said, "all central bank interventions in markets are an extension of fiscal policy").

[103] (ALESINA & PASSALACQUA, 2015: 56).

[104] (REIS, 2017: 1).

Macroeconomic policies interact and are interdependent in the sense that the conditions and control of one are effectively or potentially affected by the other policies and their respective actions and effects.

Amongst macroeconomic policies, such interactions can take various forms and degrees of interference: from (i) indirect spillovers and footprints to (ii) strategic interaction; (iii) deontic interferences; (iv) imposition of conditionality; and (v) general policy dominance.

First, spillovers and footprints would be those effects caused by the exercise of statutory powers of a policy in the room for maneuver or transmission of the other. In certain circumstances, they might alleviate or constrain the other's policy space, thus becoming a source of discipline or laxity[105].

Spillovers and interdependences are endemic features of life and decision-making in societies, including for state powers.

Literature has devoted efforts to map the bilateral interactions between fiscal, monetary, and macroprudential policies.

Starting with fiscal-monetary interaction, REIS concluded that "[c]entral banks affect the resources available to fiscal authorities through the impact of their policies on the public debt, as well as through their income, their mix of assets, their liabilities, and their own solvency"[106].

He describes five direct channels[107]: (i) *inflation*, as central banks can use their control over nominal interest rates and inflation to inflate away the real value of public debt[108]; (ii) *seigniorage* profits generated by central bank's provision of liquidity services to the community, that are transferred to the government as revenues[109]; (iii) *interest-paying reserves issued by the central bank,* that banks could otherwise use to finance government to pay its bills; (iv) *income risks and central bank insolvency,* that if materialize generate negative real remittance to the Treasury, and in the extreme, involve recapitalization through fiscal backstop[110]; and (v) *fiscal redistribution* across fiscal entities within the monetary

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105 (SARGENT & WALLACE, 1981, 6).

106 (REIS, 2017: 6).

107 The Author adds three indirect channels: real interest rate, the reaction of the fiscal authority, and recovery rates on the public debt (REIS, 2017: 9).

108 (REIS, 2017: 8), (REIS, 2020).

109 (REIS, 2017: 8), (SARGENT & WALLACE, 1981), (BUITER, 2020).

110 (REIS, 2017: 4, 20-22), (BARTSCH, ET AL, 2020: 14).

union that the common central bank can affect via the allocation of dividends and income among national central banks (NCBs) or via assets and reserves if permanent[111].

The relevance of these effects on the fiscal burden is state- and time-dependent. REIS suggests that in normal times central banks can indeed generate fiscal resources and alleviate the fiscal burden, but with a small effect and potentially prompting bad side effects on long-term financing costs through inflation risk premia, hyperinflations, contractions in credit, and lower output. In a world with huge public and private debt, the fiscal footprint of monetary policy increases greatly, risking fiscal dominance and potentially more inflation.[112]

In a fiscal crisis, the Author notes, it is appealing to use a mix of inflation, seigniorage, QE, and financial repression. But if the crisis is both fiscal and financial, the liquidity provision through the LOLR function, which is ultimately fiscal, takes prominence, and "the strict separation of monetary and fiscal policy is neither possible nor desirable"[113].

Focusing specifically on the EMU, SINN has argued that the ECB entered fiscal territory with an intervention spiral of unprecedented dimensions since the GFC, four of which constitute policies that, at least in part, can be seen as fiscal, namely asset purchase programs such as the SMP, OMT, and APP, and what the Author calls "local money creation" by allowing NCBs to issue ELAs, non-monetary policy assets within limits fixed in the Agreement on Net Financial Assets, and also Target balances in consequence of collateral policy[114].

Fiscal policy can also interfere with the monetary policy burden and the fulfillment of its objective of price stability through various channels: (i) fiscal indiscipline may raise inflation and inflation expectations, especially if associated with a lack of credible monetary commitment; (ii) the decision of the fiscal authority on providing or not a fiscal backstop to potential losses on the central bank's large balance sheet, or even the uncertainty about it, might mean central banks refrain from intervening actively and reduce the respective credibility, thereby risking the loss of control over inflation; (iii) the asymmetric nature of the EMU, with a single monetary policy, but heterogenous inflation conditions across regions and multiple fiscal authorities, gives way for national fiscal authorities to free-ride or

[111] (REIS, 2017).

[112] (REIS, 2019), (REIS, Discussion, 2020: 110), (SIMS, 2016: 9).

[113] (REIS, 2019: 138-40), (ORPHANIDES, 2018: 450).

[114] (SINN, 2019).

effectively impact domestic inflation conditions that a unitary monetary policy cannot tackle[115].

Macroprudential and fiscal policies also interact, and they may be aligned, conflict, or feed off each other's actions to amplify shocks[116].

REIS has also observed four channels through which macroprudential policy may have a fiscal footprint: (i) the *demand for government bonds*, which is augmented by tightening macroprudential policy, i.e., forcing banks to increase their holdings of safe assets, which raises their price, and consequently makes rolling over the public debt easier, thus alleviating the fiscal burden[117]; (ii) *the seigniorage channel*, where tighter macroprudential regulation lowers the return earned on bonds relative to the return earned on reserves, decreasing the net profits of the central bank, and thereby imposing more fiscal constraint[118]; (iii) the effect on *bailout costs*, with tighter macro-prudential policies preventing financial crises, or alleviating their fiscal costs when they occur, thus relaxing the fiscal constraint[119]; (iv) the impact via *fiscal surpluses*, as tighter macroprudential policy reduces bank credit and lending, investment, real activity, and so tax revenues and fiscal surpluses. The diabolic loop between sovereigns and banks aggravates the process[120].

As these channels have countervailing effects, their net aggregate impact is state-dependent, depending on whether there is some financial and/or fiscal crisis in sight or none. In any case, even an independent macroprudential authority focused on avoiding a financial crisis can no longer operate by ignoring its fiscal footprint[121].

Finally, there is also a close interaction between macroprudential and monetary policy, as both rely substantially on the transmission channel of banking and financial intermediation. Macroprudential policy can have significant impacts on central banks and their control of monetary policy: on their net profits and solvency, especially with such large balance sheets, and through banks' capital constraints that affect the bank lending channel and the

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115 (SIMS, 2016), (REIS, 2017), (BARTSCH ET AL, 2020: 14).

116 (REIS, Macro Prudential, 2020).

117 (REIS, *idem*, 2020).

118 (REIS, *idem*, 2020, describing it as a relatively small and less significant effect).

119 (BRUNNERMEIER, 2016), (REIS, *idem*, 2020).

120 (REIS, *idem*, 2020), (REIS, Discussion, 2018: 331-3).

121 (REIS, Macro-prudential, 2020).

effectiveness of the central bank as a LOLR[122]. Concerning asset prices and financial crises, macroprudential policy "constitutes the main line of defense" against financial excesses, tackling unwanted side-effects in certain areas or markets, and creating space for monetary policy authorities to manage demand and follow their price-stability mandate[123].

Second, being aware of such interdependencies, macroeconomic policymakers engage in a strategic game with each other.

It can be a non-cooperative game, where policy decisions are independent but consider the other[124]. Albeit sub-optimal, such a non-cooperation game, which SARGENT & WALLACE called a "game of chicken" between fiscal and monetary policy, is a Nash equilibrium when authorities' preferences cannot be chosen in advance and coordinated. If they can, or through institutional design, coordination is possible[125].

Who moves first might be decisive, although strategizing for this game is difficult due to uncertainty, the policymakers' preferences and targets, their constraints such as fiscal or monetary rules or other institutional commitments, their discretion, the level of coordination between policymakers, the order of moves, and the plurality of authorities, only made more complicated in the EMU with its one central bank, but various national fiscal authorities[126].

Third, there are deontic interferences amongst macro policymakers when they use speeches or other discursive forms to express preferences about the policies under another's authority. For instance, when political officials make public pronouncements on the conduct and stance of monetary policy, or when central bankers deliver speeches and press conferences, or write letters[127], appealing for fiscal policymakers to do more (or less) and follow a certain policy course[128].

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[122] (ACHARYA ET AL., 2019).

[123] (EL-ERIAN: 2015: 129-30), (CUNLIFFE), (SIGNORINI, 2019).

[124] (ALCIDI & THIRION, 2016), (DIXIT, 2001), (DIXIT & LAMBERTINI, 2001), (ALESINA & TABELLINI), (DIESSNER & LISI, 2019: 5), (BARTHELEMY & PLANTIN, 2019).

[125] (SARGENT & WALLLACE, 1981: 6), (DIXIT & LAMBERTINI, 2001), (ALCIDI & THIRION, 2016), (KIRSANOVA, MACHADO & RIBEIRO, 2018).

[126] (DIXIT, 2001), (DIXIT & LAMBERTINI, 2001 and 2003), (FORESTI, 2017), (BARTHELEMY & PLANTIN, 2019).

[127] The 2010-11 confidential letters to the heads of governments of Ireland, Spain and Italy co-signed by the ECB and their respective NCBs "calling for the adoption of reforms as well as 'bold measures to ensuring the sustainability of public finances'"(DIESSNER & LISI, 2019: 12).

[128] The BIS database of leading central bankers' speeches after the GFC includes dozens of appeals for fiscal action and structural reforms by governments.

Such interventions may be perceived as signaling the policy course of the speaking authority, as engaging in a form of monetary-fiscal coordination[129], or as efforts to influence and interfere beyond the policy's remit[130]. The more specific the policy "advice", the more it looks like encroachment. The more divisive the issue, the more problematic the interference.

Fourth, conditionality is an express and formally leveraged form of interference that occurs when a certain authority explicitly attaches to some measure supportive of another macroeconomic authority, some condition that steers the latter's decisions and policy course.

Notorious examples are the ECB prescribing fiscal policy reforms as condition of financial assistance to member states (Troika, OMT, and other programs). Or else when central banks design "the settings of its unconventional monetary policies with a view to their impact on governments' fiscal behavior"[131] or tweak the collateral policy on sovereign bonds to reflect their views on certain countries' fiscal policy and performance.

Conditionality would also exist if a fiscal authority attached its preference for monetary policy as a condition for deploying a fiscal backstop to the balance sheet or to a specific central bank emergency facility.

Fifth, the extreme form of interdependence between macroeconomic policies occurs when the footprint of one becomes dominant over another, changing the nature of the problem into one of illegitimate interference or encroachment.

Policy dominance is an economic concept that expresses the relation between two policy fields where *de facto* conditions generate an *informal* subordination of one policy to the other, irrespective of any *formal* powers to dictate the former's terms. It means that the subordinated policy would be materially constrained in its room for maneuver or impaired in pursuing its assigned objectives by the choices and footprint conditions created by the course of the dominating policy.

In abstract, all three policies can achieve a position of dominance: fiscal, monetary, or financial dominance.

129 (EICHENGREEN, 2020).

130 (DIESSNER & LISI, 2019: 5).

131 (DIESSNER & LISI, 2019: 2), (SINN, 2019).

Fiscal dominance occurs when fiscal authorities adopt a policy course that defies their budget constraint or debt sustainability, forcing monetary and/or financial authorities to alleviate that fiscal burden, namely through monetary financing or financial repression, respectively, in terms that jeopardize the latter's primary goals (e.g., price and financial stability).

Monetary dominance means that price stability is, in practice, the overarching macroeconomic objective. Monetary authorities do not let the needs of the fiscal authorities influence monetary policy. They can independently achieve their price stability mandates and will adjust their policy stance to prevent a persistent imbalance between aggregate demand and supply.

Conversely, fiscal and financial policies would be formally and materially constrained in their room for maneuver, namely governments being "always solvent conditional on monetary policy following its own objectives", if needed adopting a subordinated or "passive fiscal policy"[132].

Financial dominance is "defined as the ex-ante behavior of the financial sector, which out of fear that losses will be pushed onto it, purposely stays (or even becomes) undercapitalized". This increases risks and volatility that might force the fiscal or monetary authority away from its otherwise preferred policy course (or impair its effects), namely by delaying or adjusting actions or injecting taxpayers' funds or liquidity in order to absorb financial losses, backstop crucial parts of the financial system or stabilize financial conditions[133].

If interdependences become one of those policy dominances, legal boundaries and divisions of functions, including institutional protections such as central bank independence (CBI), would become "parchment barriers". Even if they resist *de jure*, they would be *de facto* jeopardized[134].

6.2.2. EFFECTS IN THE MIX

While each macroeconomic policy is framed with certain statutory objectives in sight and has direct and indirect effects on those and other variables and societal goals beyond the corresponding mandate, the outcomes of all those variables and objectives, including

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[132] (LEEPER, 1991).

[133] (BRUNNERMEIER, 2016), (BIS, 2022).

[134] (MADISON, Letter to Thomas Jefferson, 1788), (THE FEDERALIST PAPERS nr. 48), (DIESSNER & LISI, 2019: 4), (WALSH, 2011: 19).

economic stabilization, are determined by the *mix of macroeconomic policies*, made of the sum of their in(ter)dependent and interconnected contributions[135].

As historically proven, various mixes of macroeconomic policies may deliver the same (or very different) results and levels of aggregate demand[136].

In terms of their contribution within the mix, policies can be contrarians (off-setting), substitutes, or complements; or congruent, divergent, destabilizing, or neutral as a result of independent decisions or of explicit coordination[137].

There is no one *a priori*, universally optimal policy mix.

Whether congruence is optimal depends on the circumstances, on the economic theory of preference, on the time horizon, and, if there is a crisis, on the type of shock[138].

In some states of the world, it may be sufficient that they act as substitutes (as argued during the Great Moderation), while in others, such as crises and the low-low conditions, they should better act as complements, as strong complementarities reinforce the policies' impact[139].

However, congruence is historically rare[140]. Even in crises that call for it, it is not guaranteed, as observed in the Eurocrisis. In normal times, fiscal-monetary coordination is more the exception than the rule, supported by the argument that in such normal conditions, the autonomous and non-dominated focus on the objectives specific to the policy is more beneficial. Therefore, macroeconomic policies typically act independently in a non-cooperative game, even though congruence is still possible without formal coordination[141].

Interactions tend to rise in emergencies, which demand expediency and effectiveness in public intervention, which is not an oddity of macroeconomic powers, but a feature common to the overall structure of state powers. Wars, crises, and situations of special

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135 (BLINDER, 2002: 399-401), (SIMS, 2016: 4-5), (BARTSCH ET AL., 2020: 17), (AFONSO ET AL., 2019).

136 (MUSGRAVE & MUSGRAVE, 1989: 510), (BLINDER, 2002: 399-401), (MAVROMATIS, 2020, 327-378, with an historical brief of fiscal-monetary mixes).

137 (BARTSCH ET AL., 2020: 17, 21-2), (MUSGRAVE & MUSGRAVE, 1989: 510), (GALHAU, 2020).

138 (MUSGRAVE & MUSGRAVE, 1989: 510-11), (BUTI ET AL., 2001), (REIS, DISCUSSION, 2020: 109), (BARTSCH ET AL., 2020), [Sissoko, 2021).

139 (REHN, 2019), (SCHNABEL, 2020), (BARTSCH ET AL., 2020), (FIELDER ET AL., 2020: 9).

140 (BARTSCH ET AL., 2020).

141 (WYPLOSZ, 2020: 89), (SVENSSON, 2018), (GALHAU, 2021).

urgency have historically led to more executive dominance and discretion and more legislative and judicial deference and self-restraint[142].

Moreover, interdependencies are more decisive when policies are closer to their limits of sustainability and effectiveness, even though such limits are far from fixed but highly state-dependent and susceptible to policy innovations[143].

Their interaction and relative roles within the mix and their normative acceptability are dynamic over time and state-dependent[144]. Transformations such as the fall in real interest rates to the vicinity of monetary policy's effective lower bound, the explosion of debt stocks and of central banks' balance sheets, and their combination with conditions of low growth and high inflation increase the challenges for the policy mix.

This host of interactions and interferences between macroeconomic policies provoke diverse positive and normative appreciations, from the acknowledgment of their inevitability to their tolerance or support as beneficial exercises of coordination or mutual check or their rejection as unacceptable encroachments in the other policies and institutional aggrandizement.

Both monolithic concentration and strict separation of policies seem too rigid a framework to deal with such dynamic interdependence of policies, objectives, and effects.

7. The Middle Way between Concentration and Separation of Macro Policies

The option is not binary, however. There is a continuum of theoretical possibilities between the extremes of maximum concentration and the strictest separation of macroeconomic functions, institutions, and persons.

7.1. Concentration In a Benevolent Centralized planner

One option would be to put all macroeconomic policies under the unified control of one benevolent social planner who would choose the "optimal" policy mix, deliver the various macroeconomic objectives and internally coordinate policy functions.

Beyond the classic Rousseauian argument that a "democratic", centralized authority would be more faithful to the general will expressed by the political majority, there are arguments for effectiveness and efficiency.

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[142] (Waldron, 2016: 67), (Locke, §160), (Morgado, 2012: LXXVII).

[143] (Bartsch et al., 2020: 80), (Reis, 2019), (Brunnermeier, 2016).

[144] (Bernanke, 2003), (McCulley & Pozsar, 2013: 30), (Reis, Two decades, 2019: 138), (Alpanda, Granziera and Zubairy, 2019).

Concentration would increase the might and expediency of macroeconomic policymaking and enable internal coordination and adjudication of trade-offs that would facilitate congruence and complementarity or substitutability within the mix. Furthermore, it would reduce the number of independent public powers and their frictions and avoid turf wars between multiple agencies and conflicting regulatory approaches[145].

Experiences of closed cooperative coordination in response to the crises of the century and the combination of fiscal activism and expansionist "new style central banking"[146] left some wondering whether it still makes sense to talk of separation of macroeconomic powers. However, such an idea of concentration raises the same fundamental objections that justify the general doctrine of separation of powers.

Here it would (i) concentrate too much macroeconomic power in the hands of a single body or instant majority; (ii) risk abuses and tyranny; (iii) rely on delusional beliefs in the benevolence and omniscience of centralized social planners; (iv) eliminate the constraints and incentives for functional specialization and the benefits thereof; (v) compromise the credibility of the commitment and consistency of policymakers to the various, often conflicting macroeconomic objectives; (vi) facilitate dominance (the one that *in casu* caters better to the interests of the instant majority or governing elite); and (vii) jeopardize parliamentary primacy over fiscal policy by allowing the government to manipulate monetary policy to escape legislative authorization of taxation and debt[147].

Welfare and liberal democratic values manifested in the ideals of limited government, and functional specialization would be compromised, at least in the long run.

7.2. STRICT, FUNCTIONALIST SEPARATION

The academic and institutional response that prevailed from the 1970s was the opposite extreme: strict, functionalist separation of macroeconomic powers, particularly between fiscal and monetary policies.

This approach puts all chips on functional specialization and the belief that the most effective way of delivering each macroeconomic policy objective *per se* is to assign it to a separate/independent policy instrument (and authority).

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[145] (BARR, 2015: 121).

[146] (HALL & REIS, 2015), (REIS, 2021).

[147] GERMAN CONSTITUTIONAL COURT preliminary questions to the CJEU in the *Gauweiler* and *Weiss* cases. (TUCKER, 2018: 486).

It feeds on the Tinbergen Rule that to successfully achieve nn independent policy targets, at least the same number of independent policy instruments are required[148]. It was typically based on a ranking of preferences on macroeconomic objectives where price stability was paramount and demanded monetary dominance[149].

Functionalist separation promises maximum loyalty to the designated objective and immunity to distraction by a multiplicity of objectives and functions and by the need to coordinate and trade them off. It suspects all forms of interdependencies and assumes that risks of deviating dominances or suboptimal internal coordination are greater than the potential benefits of macroeconomic coordination.

It rejects the tyranny of a single political macroeconomic policymaker whose power it seeks to limit but also an overreliance on an activist central bank that sees itself as an "all-purpose manager of macroeconomic cycles"[150].

This view associates *functional* with *institutional* separation under an "assignment consensus"[151] where monetary policy is governed through a framework of strict CBI, for those reasons and others used to justify firm insulation from partisan electoral politics.

If strict, functionalist separation seemed acceptable in certain states of the world, such as the Great Moderation, it is positively untenable in several others, facing normative objections and opposition from societies simply not willing to bear the corresponding costs.

7.3. THE MIDDLE WAY: BALANCED SEPARATION

The better alternative for multiple states of the world is the *balanced separation* of functions and authorities that combines the advantages of limited government and functional specialization with the benefits of mutual checks and balances, structured coordination, and managed interdependencies that improve the macroeconomic policy mix.

This Madisonian separation shares with the functionalist separation the basic tenets of limitation of government and functional specialization.

Both emphasize the need to divide functions (and to distribute them per different institutions and persons) to limit and dilute power, prevent abuse and tyranny, and mitigate the risks that all mighty macroeconomic functions push in the same erroneous direction.

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148 (TINBERGEN, 1956).

149 (SCHNABEL, 2021).

150 (MENAND, 2022).

151 (KIRSANOVA, LEITH & WREN-LEWIS, 2009), (WREN-LEWIS, 2020).

In that sense, both views reject the overreliance either on a political macroeconomic planner or on an overmighty central bank, overburdened as the "only game in town".

They also share the importance of structuring policies with a degree of functional specialization so that each policy and its instruments are more driven to the effective delivery of the respective macroeconomic objectives.

Both accommodate a normative approach that seeks the distribution of powers according to the characteristics of each function and instrument and the comparative advantages of each institution.

It seems better than a purely positivist/conventional approach that believes that such distribution of functions is merely a matter of convention or design choice, without "pure realms of certain policy" nor "natural Law or positive Economics answering to which institution of the state should control each tool"[152]. Even a pure proceduralist variation, simply requiring that such convention is open, comprehensible, and enforceable, is insufficient.

Yet, the balanced separation departs from the functionalist in various dimensions, demonstrating that separation and specialization are not absolute but partial.

First, balanced separation welcomes checks and balances, certain mutual interferences, and control as a supplemental technique to limit government. It does not envisage a completely independent exercise of each policy function.

Second, its functional specialization does not demand watertight boundaries but the integrity of a functional core, which means autonomous decision-making by a distinct process: fiscal policy through the traditional electoral and partisan game and monetary policy by the art and science of central banking.

Third, the dilution of power cannot degenerate into hyper-fragmentation of functions and institutions. On the one hand, to warrant serious mutual control, a powerful political executive authority should be matched by another robust macroeconomic institution rather than a multiplicity of minions that would not withstand executive domination[153].

On the other hand, the rationales of efficiency and effectiveness underlying functional specialization are compromised by excessive fragmentation that would increase: (i) the informational and operational costs from agency competition; (ii) costly coordination failures

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[152] (TUCKER, 2018: 486-7).

[153] (MAJONE, 1996: 299).

as policymakers may not have the same goals or the same preferences over the various goals, or face different constraints [154]; (iii) the dissipation of institutional capabilities (graver in countries with more limited human, knowledge and financial resources); and (iv) costs of transition towards multiple agencies.

Furthermore, excessive fragmentation multiplies the points of entry for partisan and interest group pressure while diluting each point's relative robustness and resistance capability to such pressures.

Path dependence, institutionally entrenched group, party, or bureaucratic interests, and pervasive inertia add positive or political economy explanations against excessive separations.

These problems recommend caution on the degree of division of functions and institutions to preserve the accumulation of a certain level of functional, institutional, and epistemic capacity. This gives normative support to the recent formation of macroeconomic twin peaks: executives and central banks.

Fourth, it requires a more balanced view of interdependencies, interactions, and coordination of macroeconomic policies.

On the one hand, these interactions and coordination are suspicious and, in many cases, must be rejected. Effective differentiation is important, and "undue interferences" should be outlawed, namely when they manifest policy dominance and institutional aggrandizement.

Certain tools and techniques are prime suspects, namely monetary financing[155] and bailouts, financial repression, policies on central bank remittances, fiscal backstops and recapitalization of monetary authorities, provision of liquidity and last resort roles, accumulation of massive stocks of fiscal or monetary liabilities (e.g., sovereign debt, central bank balance sheets), and *ex-ante* negotiation or subordinated orientation of policies.

On the other hand, policy interdependencies and interactions, and strategic behaviors are inevitable and have relevant dimensions that should be exploited instead of ignored.

Structured (and constrained) coordination may facilitate effective macroeconomic government and optimal policy mix, especially during shocks and crises of all sorts.

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[154] (BARTSCH ET AL., 2020: 26-7).

[155] (GABOR, 2021, distinguishing subordinated monetary financing from a non-subordinated shadow regime).

Congruence, complementarity, and even substitutability of macro policies offer opportunities for coordination gains that should not be wasted and might prevent economic and social costs (stemming from uncooperative games) that no society wants to tolerate.

It should be "coordination without subordination", *concert in parity*, not necessarily cooperative, where each policy and authority maintain autonomous decision-making and objectives. Macroeconomic government should be structured between "a single undifferentiated monolithic structure" and "an accidental agglomeration of purely pragmatic relationships"[156].

A substantive doctrine of balanced separation of powers adopts a differential approach from the strict functionalist separation, accepting limited separation and a certain degree of coordination (when beneficial), valuing mutual checks and balances while rejecting interferences and dominances that offend the functional core of each macroeconomic power.

Finally, under this doctrine, functional separation requires institutional separation, i.e., allocation of policies to distinct institutions with different mandates and decision-making processes.

8. Evolution of the Separation of Macroeconomic Powers

Three stylized periods or phases can be distinguished in the history of the separation of macroeconomic policies: until the 1970s United Macroeconomic Governance (which includes the first and second stage of central banking) prevailed; the 1970s until 2008 was the period of Strict Separation of Macroeconomic Government; and since 2008 there has been a period of New Balanced Separation[157].

8.1. Period of United Macroeconomic Governance

Until the 1970s, macroeconomic governance was largely united under the political executive's control, with two sub-phases, before and after the Great Depression of the 1930s.

[156] Adapting (Vile, 1998: 11).

[157] (Goodhart, 2010). (McCulley & Pozsar, 2013: 30, on a different US-focused division in three epochs: "arranged marriage" from 1913 to 1951, marked by fiscal activism and monetary subordination; "divorce" from 1951 to 1978 characterized by fiscal activism and monetary independence; and "estrangement" from 1978 to 2008 characterized fiscal passivism and monetary "supremacy"). This view exaggerates the immediate importance of the Treasury-Fed Accord, which came alive only with Volcker's Fed (Conti-Brown, 2020).

Until the 1930s, there was an incipient administrative and welfare state, and so fiscal necessities were more limited, except in war efforts. Monetary policy was highly constrained under gold (or bi-metallic) standards, and most countries did not even have a central bank, trusting both fiscal and monetary policy to the Executive. Of the few existing central banks, various were under private ownership with some public charter or legal assignment of the monopoly of banknote issuance. They were created basically with one or two of the following goals: ensuring financial stability in the country[158] and supporting the state's financing[159]. Before the existence of central banks, monetary policy was conducted by the Treasury[160].

After the Great Depression and until the 1970s, state and fiscal dominances were the strongest. Central banks became more state-dependent, state-owned originally or by nationalization, or subject to increased influence through tighter organic laws when they remained privately held.

Aside from some temporary returns to the gold standard, fiat money prevailed, with almost all countries joining the Bretton Woods system with fixed exchange rates pegged to the US dollar and, ultimately, gold, providing a simple monetary rule which significantly narrowed the room for monetary policy discretion and autonomy.

It was generally accepted that monetary and fiscal policies would work together, with fiscal policy having an important role to play in stabilizing output, while monetary policy was not that central[161]. The few significant monetary decisions concerned the return to the gold standard, realignments, and de-/revaluations within the Bretton Woods systems, and those were made by the Executive. Central banks were regarded as bureaucratic, politically dependent institutions – the institutional separation was, thus, only half-hearted.

SCHWARTZ notes that even the more independent Fed "was hardly ever the sole authority in the government that had essential monetary powers", and from 1933 to 1941, the Fed was

[158] (BLINDER, 2016, recalling that "the involvement of central banks in preserving (if they could) or restoring (if they could not) financial stability dates back centuries").

[159] (ORPHANIDES, 2018: 449, arguing that "ensuring the smooth financing of the state was perhaps the single most important early reason for the founding of central banks"), (SISSOKO, 2021).

[160] (SCHWARTZ, 2009: 5).

[161] (PHILLIPS, 2017), (JAMES, 2012: 269).

passive, and the Treasury predominantly took over monetary powers and engaged in open market operations of buying and selling securities"[162].

Moreover, central banks were expected or required to financially support governmental policies (war and monetary financing, and supporting development, namely through exporting credits).

It has been well documented that during this first period of United Macroeconomic Governance, there were recurrent experiences of monetary financing of the state in various guises[163]. While some experiences were positively assessed[164], many turned (very) sour, either generating periods of painful and traumatizing hyperinflation or finally leading to the 1970s stagflation, the demise of the Bretton Woods monetary system, and a turn of the tides in theoretical, institutional and policy consensus[165].

The concept and concern with the mix of fiscal and monetary policies and their functional and institutional separation emerged gradually after WWII, on the tails of TINBERGEN's intellectual contribution[166]. But it was only after the 1970s that the paradigm really changed. Even though the widespread triumph of CBI is a defining feature and innovation of the second period of Stricter Separation of Macroeconomic Government, the "true story of central bank independence is much older", starting with "three tools" that have been applied to achieve some autonomy "since the 15th century"[167].

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[162] (SCHWARTZ, 2009: 5).

[163] (RYAN-COLLINS & VAN LERVEN, 2018, describing various guises of monetary financing between 1930 and 1970: indirect monetary financing, monetization of debt, central bank advances to government, "*devolved monetary financing"* of public development banks, and *financial repression* when private banks are required to extend credit to governments), (GABOR, 2021).

[164] (LAWSON & FELDBERG, 2020: 15, defending as positive experiences France during and post-WWI, and Japan during the Great Depression, allegedly due to the credibility of their central banks and effective efforts to curtail excessive spending and depreciation after they were on the road to recovery), (RYAN-COLLINS & VAN LERVEN, 2018).

[165] (LAWSON & FELDBERG, 2020, indicating the hyperinflation disasters of Germany, Austria, and Poland after WWI, and more recently Zimbabwe in the 2000s and Turkey in the 1990s). Venezuela is another recent example.

[166] (TINBERGEN, 1956), (BARTSCH ET AL., 2020: 17). Or later in the 1980s-1990s (ALCIDI & THIRION, 2016), (CANZONERI, CUMBY, & DIBA, 2002: 334).

[167] (BINDSEIL, 2020, identifying: (i) explicit limitations, or prohibitions of central bank credit to the public sector – city of Barcelona in 1412, establishing acts of the Venetian Banco di Rialto in 1587, the Bank of Amsterdam, and the Swedish Riksbank in 1668, and the USA bill of 1791 establishing the Bank of the United States; (ii) relative institutional independence within the public sector – charter of the Hamburger Bank of 1619, and the Swedish Riksbank; (iii) private ownership, pioneered by the Genovese Casa di San Giorgio and the Bank of England, and later followed by many others created up to the 20th century).

In 1824 RICARDO suggested the creation of an ICB to avoid abuse of the issuance of money[168]; in the 1920s, there was institutional and theoretical support for CBI[169], and both the British and the German central banks were deemed to be quite independent operationally[170].

The latter political insulation was firmly established when constituted as Bundesbank in 1957. The US Fed consolidated its independence in a series of episodes throughout the 20th century, specifically the 1934-35 legislative reforms and the Fed-Treasury Accord of 1951, but these only "came alive" in the early 1980s under VOLCKER's Fed[171].

8.2. STRICT(ER) SEPARATION PERIOD

A combination of factors caused a dramatic change in the framework and the deliberate breakup of the *United Macroeconomic Government* in the last three decades of the 20th century.[172] The 1970s experienced stagflation (low growth, high unemployment, and high inflation) for various reasons, including the oil crisis and decades of the procyclical policy mix. The demise of the Bretton Woods international monetary system moved most advanced countries to the flexible exchange rates systems where internal monetary policy was expected to have more autonomy and potency.

Macroeconomic theory was taken up by the rational expectations revolution favoring the separation, constraints, and credible commitment on monetary and fiscal policy (eventually leading to CBI), the prevalent conviction that monetary policy alone could achieve economic stabilization, primacy of the price stability objective, a serious concern with the faults of fiscal policymaking and the possibility of (a dominant) monetary policy accommodating such excesses[173].

The 1970s led to a new period of Strict Separation of Macroeconomic Government under a consensus assignment[174]. This was essentially characterized by strict functional and institutional specialization and separation of monetary and fiscal policy and authorities, with

168 (RICARDO, 1824), (ORPHANIDES, 2018: 449-50).

169 (VALE, 2021, citing KISCH & ELKIN, 1928, as "the first systematic and elaborate formulation of a doctrine of CBI").

170 (JAMES, 2012: 269), (MEE, 2019).

171 (CONTI-BROWN, 2020), (BINDER & SPINDEL, 2017), (CONTI-BROWN, 2016).

172 (JAMES, 2012: 20).

173 (BARRO, 1976), (KYDLAND & PRESCOTT, 1977), (SARGENT & WALLACE, 1981). For summaries on the evolution of macroeconomic theory (BARTSCH ET AL., 2020), (PHILLIPS, 2017), (ALCIDI & THIRION, 2016).

174 (KIRSANOVA, LEITH, WREN-LEWIS, 2009).

a widespread triumph of CBI, monetary dominance, or primacy[175] or at least refusal of fiscal dominance, based on the creed of the practical sufficiency of monetary policy for stabilization.[176]

This view was operationalized through *independent institutions* and *rigid rules* such as monetary rules/anchors, fiscal discipline, and limitations of monetary financing, which together would constrain policymakers and prevent spillovers to other macroeconomic policies.[177]

On the other hand, this was a transformative period for government debt financing, with the expansion of public sectors snowballing the financing needs, the deregulation of the financial system, the end of financial repression disincentivizing private sector finance and the opening of the external capital accounts providing governments with a new source of deficit financing but also with the risk of a sudden stop or reversal.[178]

Despite the increasing fiscal pressures, central banks succeeded in upholding their independence from fiscal authorities and the societal commitments to price stability. There was barely any public pressure from fiscal authorities for monetary policy to generate more seigniorage revenues or to rebate more net income to the national Treasuries.[179]

Still, central banks were never restricted to monetary policy, let alone to a unique policy instrument, even at the apex of the Stricter Separation period. Almost all central banks kept some non-monetary policy functions (including those not so independent such as external monetary policy or fiscal agency for governments), were entrusted with more than one objective (even when price stability was assigned lexicographic priority), and used more than one instrument, leaving reality always distant from the pure versions of the strictest of separations.

Finally, this period's functional and institutional separation was *narrowly* focused on monetary and fiscal policies and authorities while disregarding financial stability and the regulation and supervision of the financial sector[180].

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[175] (Draghi, Farewell speech, 2019), (Skidelski, 2018: 200), (Fiedler, Gern & Stolzenburg, 2020: 21), (Schnabel, The shadow, 2021).

[176] (Wyplosz, 2002: 11-13).

[177] (Wren-Lewis, 2020).

[178] (Phillips, 2017).

[179] Generalizing Reis' point on the first decade of the euro (Reis, Twenty Years, 2019: 138-9).

[180] (James, 2012: 20), (Brunnermeier, 2016: 11).

The short-run coincidence between financial deregulation and the Great Moderation experienced in a significant part of this period fueled the illusion that stability had been conquered and cycles tamed. The GFC came to expose the mistake of such "financial oblivion" whose correction was one of the fundamental aspects of the incoming evolution.

8.3. PERIOD OF NEW BALANCED SEPARATION

The GFC opened the shift to a new period of assumed Balanced Separation of Macroeconomic Powers, marked by transformations in the macroeconomic context and institutional architecture[181] and three defining aspects: (i) the consolidation of the third leg of the macroeconomic framework corresponding to the policy, objective and institutions of financial stability; (ii) (the acknowledgment of) an increased level of interdependencies, interactions and coordination between macroeconomic policies and authorities that challenged the traditional boundaries of separation and the tenets of strict separation views; and (iii) the robustness of the functional and institutional separation between the core of fiscal and monetary policies, and the endurance of CBI.

Firstly, with the assertion of the financial leg of the policy mix in complement to the old pair of macro policies, macroeconomic separation became tripartite and, thereby, a more balanced stool.

Financial frictions and risks regained attention, legal reforms consolidated financial stability as the primary objective (often in unranked parallel with price stability), and a comprehensive gamut of financial policies developed in functional separation, e.g., macro- and micro-prudential regulation and supervision, resolution, deposit insurance.

Institutional bodies were created or transformed, but the *institutional* separation is still maturing, with architectural hesitations between some connection to the political power over the purse, complete autonomy, or some internal segregation within central banks (more pertinent when their balances grew so large, but in turn fostering internal conflicts of interest within such multi-hat central banks)[182].

Second, the combination of activist new style central banking with bouts of fiscal and financial policy interventionism in reaction to crises intervaled with periods of low growth

[181] (LEITÃO AMARO, 2023).

[182] (REIS, 2020: 3).

exposed and multiplied the interdependencies, interferences, and coordination between the three macroeconomic policies and respective authorities.

The nature of such interactions and the policy mix varied significantly across the period. There were periods of congruence and complementarity of policies, and cooperative coordination of authorities at domestic and international levels, namely for stabilization and stimulation during the pandemic and periods of the GFC. But there were other periods of substitution, incongruence, and even opposing policy stances, namely during the Eurocrisis, low growth transitions, and post-pandemic inflation.

Concomitantly, macroeconomic theory has also gone into flux, grappling with those new contexts that exposed its state-dependency and stimulated the rethinking of theoretical prescriptions and the limitations, boundaries, and optimal interaction between macroeconomic policies.

The post-pandemic inflation burst might have cooled theoretical heretics and buried more heterodox views, such as the so-called Modern Monetary Theory[183] and claims that functional separation was bound to disappear[184]. However, the theoretical dust still needs to settle.

Third, even though those transformations challenged and blurred the traditional boundaries of macroeconomic policies[185], the core of their functional and institutional separation essentially held and expanded to financial policies.

Contrary to visions of a return to a united macroeconomic government[186] and the end of CBI, a new comprehension of a *balanced separation* of macroeconomic powers emerged. CBI withstood or grew even more robust, and the specter of fiscal or financial dominance has not (yet) prevailed.[187]

This partial and balanced separation is compatible with certain degrees and forms of coordination and interaction, which do not entail subordination if supported by an

183 (KELTON, 2020).

184 (MURAU, 2021).

185 (BARTSCH ET AL., 2020).

186 (JAMES, 2020).

187 (REIS, Twenty Years, 2019: 138-9), (SCHNABEL, The shadow, 2021).

institutional framework with robustness, credibility, and flexibility to preserve the integrity of each policy process while delivering the best policy mix[188].

An important part of the effort to build such superior institutional architecture is the reconstruction of the concept and framework of CBI, substituting a novel model of pluralistic independence for the traditional version of CBI.

[188] (LAWSON & FELDBERG, 2020: 4).

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