The Political Economy of

Monetary Sovereignty in the Era of Modern Money

Moving towards a Flexible Synthesis of Post Keynesian Economics and Critical GPE

Konsta Aamos Kotilainen

University of Helsinki
Faculty of Social Sciences
Political Science/World Politics
Master’s Thesis
May 2016
This thesis investigates the political economy of monetary sovereignty in the post-Bretton Woods era of monetary governance. It examines whether monetary sovereignty matters for the macroeconomic policy space of contemporary states. It asks further whether monetary sovereignty ought to matter in the present global age. According to the standard view in the field of Global Political Economy, the current policy space of states is very narrow compared to the Bretton Woods period. In contrast to this position, however, the chartalist Post Keynesians argue that the recent decades in fact have seen a strengthening of the monetary sovereignty of states. Because the chartalists do seem to make an impeccable argument, it appears paradoxical that there nevertheless has been a recent tendency towards homogenous, slow-growth economic policies in the majority of states.

This apparent paradox is resolved in thesis by reconciling these contradictory-looking positions: while monetary sovereignty has generally strengthened, the possibilities of states to exercise it often have not. Given this predicament, a possible way to enable the conduct of experimental macroeconomic policies in the future is proposed. The approach of the study is informed by a realist philosophy of science. Hypotheses of Post Keynesian economics and Global Political Economy are tested and revised in the spirit of iconic modelling. It is suggested that a realist approach provides a solid basis for moving towards a flexible theoretical synthesis capable of illuminating the political economy of monetary sovereignty from both explanatory and normative point of views.

Several arguments are put forward. First, the Global Political Economy literature on the macroeconomic policy space of contemporary states has largely failed to integrate the core and valid insights of the chartalist economics. The strengthened monetary sovereignty matters for the ability of many states to conduct progressive economic policies. Second, while the chartalists are correct about the economics of monetary sovereignty, several monetary sovereignty-undermining processes and institutional developments of the post-Bretton Woods macroeconomic governance regime often tend to trump the practical potentials and theoretical considerations of Chartalism.

Third, because the neo-Gramscian approach helps to illuminate the constitutionalization of the present consensus on macroeconomic policy – a process that is shown to constrain the possibility of many states to exercise their monetary sovereignty –, it can fruitfully supplement chartalist economics of monetary sovereignty. The neo-Gramscian view on the nature of these processes, however, has to be revised and updated to make it consistent with the Post Keynesian framework underpinning chartalism. Fourth, it is argued that the current consensus view of macroeconomic policy has failed and is likely to be replaced by an alternative set of governance ideas in the near future. It is suggested that in order to exercise monetary sovereignty effectively and in a way that contributes to transformative and cosmopolitan democracy, nation states may not be the optimal entities to exercise monetary sovereignty in the future. A chartalist case for the supranational exercise of monetary sovereignty is put forward.
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The Modern Money Era and the Economic Policy Space of Contemporary States

While the generally accepted view among political economists (Blyth 2013; Rodrik 2011, 204-205; Ruggie 1982) is that the post-World War II Bretton Woods arrangement provided governments with considerable policy space to pursue their preferred models of economic and social policies that has over time evaporated, not everyone agrees. According to the increasingly influential monetary theory of the chartalist Post Keynesians¹, the post-Bretton Woods monetary system of flexible exchange rates in principle gives more – and certainly not less – policy space to “monetary sovereign” states to experiment with different policies than the post-war Bretton Woods era ever did. Indeed, given the chartalist conception of “monetary sovereignty”, states under the Bretton Woods arrangement did not qualify as full monetary sovereigns. This thesis scrutinizes what has happened to the possibility of exercising monetary sovereignty in the post-Bretton Woods system of monetary governance. It asks whether monetary sovereignty matters for contemporary states as well as whether it should matter. The goal is to reconcile and develop views of political economists and Post Keynesian economists in order to move towards a flexible synthesis that is capable of shedding light on the fundamental themes of the political economy of monetary sovereignty.

The chartalists point out that in the Bretton Woods system the pegging of national currencies to the US dollar (which itself was pegged to gold) effectively meant that central banks’ monetary policies were restricted to the protection of the exchange rates of their currencies (Sardoni & Wray 2007; Wray 2012, 148–186). In particular, those governments with external deficits “were forced to continually deflate their domestic economies, because monetary policy had to defend the exchange rate” (Mitchell 2009, 9). In these circumstances, fiscal policies “had to be passive to avoid the stop-go growth patterns that were common” (ibid., 9). Interestingly, as the chartalists continue, these constraints on policy space do not hold in the current monetary arrangement for the majority of countries who typically do not take far-going action to manage the external value of their currencies. Because they do not have to worry about a peg, these countries

are free, first of all, to pursue their domestic monetary policy goals. In other words, they are able to “set the rate of interest (e.g. the interbank rate) as an exogenous policy datum” (Juniper et al. 2014, 289; see also Moore 1988). Secondly, and even more crucially, the ability of these states to conduct fiscal policy has greatly increased under the current arrangement. Currency issuing states that allow their exchange rates to float do not in fact face a literal budget constraint when they spend in their own currencies. Moreover, they are in a position to decide how much interest they pay to the holders of their bonds. (Kelton 2011; Wray 2012.) In the chartalist literature, those states that do enjoy such monetary and fiscal policy independence are commonly referred to as monetary sovereigns.

To avoid confusion, it is important to note that the chartalist definition of monetary sovereignty differs, in certain crucial respects, from the standard usage(s) in International or Global Political Economy. In the standard legalistic conception, each state’s monetary sovereignty “has long been understood to include an exclusive right to create and manage money” (Cohen 2008a, 3). In comparison, the chartalist definition of monetary sovereignty is less formal and more restrictive. It is less formal because it downplays the importance of legal tender laws and emphasizes that the practice of taxation drives the demand for modern state money (Forstater 2006; Wray 1998). This definition is more restrictive, too, because a state qualifies as being fully sovereign only if it (i) issues its own currency, (ii) spends in its currency, and (iii) floats its currency. If all three of these conditions are fulfilled, the state can claim to have an important degree of autonomy in both its monetary and fiscal policy. For Sardoni and Wray (2007) “both the gold standard and the Bretton Woods system of fixed but adjustable exchange rates were managed money systems” (ibid.,12). In contrast, “most developed countries now have fiat money systems – the dollar system in the United States, the yen system in Japan, and so on” (ibid., 12). Only those states that operate with modern fiat money systems thus count as monetary sovereigns.²

While the chartalist definition of monetary sovereignty is rather strict, most contemporary states are, even according to that definition, monetary sovereigns. In

² As a further important difference to the legal definition, the chartalist definition is consistent with the fact that a state is not the only institutions that creates money (broadly understood) within a given territory. However, state money is placed at the top of the so-called hierarchy of monies. (Wray 2012, 86.)
contrast, while states under the Bretton Woods were able to manage their peg within certain constraints, they did not enjoy full chartalist monetary sovereignty. Because of the privileges that (full) monetary sovereignty brings in its wake, the chartalists conclude that the post-Bretton Woods “modern money era”\(^3\) in principle allows for a wider spectrum of possible economic policy strategies between which to choose than did the Bretton Woods arrangement (Sardoni & Wray 2007).\(^4\) This spectrum of choices opens up new room for democratic decision-making (but only in those countries that are democratically governed, of course).

However, not only has the post-Bretton Woods era seen a convergence towards more uniform, “market-friendly” economic policies; this era has also provided only sluggish global economic growth and a very crisis-prone environment (Davidson 1999, 21–23; Lavoie & Stockhammer 2012; McCombie & Thirlwall 1999, 80–82). Unforeseen financial volatility has repeatedly erupted into numerous crises. Especially in the Global South, these crises have often been triggered by unbearable levels of external debt. In the North, the new wealth that has been produced has become concentrated within the finance world and the capital development of the economy has suffered (Mazzucato & Wray 2015; Panitch & Gindin 2012).

Because chartalists standardly suppose that monetary sovereignty can help countries independently to develop and pursue tailor-made, sustainable growth strategies (Tcherneva 2014, Wray 2012), the contrast between the promises and the outcomes of the modern money era do seem perplexing. If the chartalists are correct about the importance of monetary sovereignty (as they define the term) for economic policy space, a peculiar observation requires an explanation. Why do the majority of states in actual fact adopt more uniform – and less progressive – economic policies than they did during the Bretton Woods’ era, _despite_ the new policy space that the modern money era

\(^3\) The chartalists frequently employ the term “modern money” to highlight how different an institution money is in the current era than it used to in the past commodity standard regimes. Of course, “modern” chartal currencies themselves are thousands of years old, but the phrase “the era of modern money” in the sense used in this thesis refers exclusively to the Post-Bretton Woods era. (Wray 2012, 1998; Keynes 1930; Knapp 2012.)

\(^4\) Wray (2014, 8) explains how things have changed as follows: today the US uses a “chartalist, non-convertible, paper money—often called ‘flat money’ as do modern developed countries”. Referring to the pioneering work of Friedrich Knapp on state money, he adds, “This development came nearly three-quarters of a century after Knapp’s book was first published (1905) – when we finally abandoned Bretton Woods”.
has opened up for them to pursue various heterodox policy strategies? In other words, why does the new freedom that the monetary sovereigns enjoy not convert to more freedom and variance in economic policies, as one would logically expect? Why has the age of monetary sovereigns witnessed the exactly opposite development? I will attempt to resolve this “paradox” of the modern money era in Chapters 1–4. Furthermore, one then wonders whether monetary sovereignty should have a future in the contemporary global world. Are not all forms of sovereignty mere wreckage from earlier ages of kingdoms and nation states? Whether or not monetary sovereignty has increased, should we eventually not simply rid ourselves of it anyway and make way for cosmopolitan versions of monetary governance? Or, does there remain a way to reconcile supranational monetary governance and the exercise of monetary sovereignty? Even if only preliminary, these future-oriented questions are explored in Chapter 5.

By addressing these interrelated questions concerning the political economy of monetary sovereignty, I seek to provide both empirical and philosophical support for the hunch that Post Keynesian economics and critical Global Political Economy (GPE) can fruitfully enrich and even correct each other. This is the central theoretical ambition of this thesis. First, I will argue that the core theses of chartalism are valid and illuminating; but to account fully for the political economy of monetary sovereignty, chartalism needs to be supplemented with various insights developed in GPE. Conversely, no GPE theory that deals with monetary sovereignty, policy space or macroeconomic dynamics can afford to be ignorant of the chartalist or, more broadly, the Post Keynesian line of thinking. In developing these arguments, I will pay special attention to the merits and weaknesses of the neo-Gramscian approach. Finally, I will argue that despite an apparent conflict, the chartalist emphasis on monetary sovereignty and the normative commitment to cosmopolitan democracy are in principle indeed compatible and, potentially, even point in the same direction. Thus, I examine herein the political economy of contemporary monetary sovereignty from both an explanatory and a normative point of view.

5 For evidence of a recent global shift toward “neoliberal” economic policies, see for instance Soudis (2015), Patomäki (2001, 1–38) and Harvey (2007).
6 Consciously stressing a differing conception of the subject matter, neo-Gramscians, along with many other critical scholars, usually prefer to refer to the discipline as Global Political Economy (GPE) instead of International Political Economy (IPE). In this thesis, I use both names both try to do so as consistently as possible.
1.1 Does Monetary Sovereignty Matter in Theory?

It is certainly possible that the chartalist view of the modern money era and its granting of novel policy space to sovereign currency issuers is mistaken or, at least, grossly exaggerated. If monetary sovereignty did not matter, the apparent paradox posed above would immediately dissolve. Therefore, the important preliminary task is to examine whether monetary sovereignty indeed matters. This chapter begins to discuss the merits of the following chartalist hypothesis:

*The chartalist hypothesis*: Monetary sovereignty matters greatly for the macroeconomic policy space of modern states. Monetary sovereignty of states and, therefore, their policy space have generally increased after the removal of the fixed exchange rate arrangement of the Bretton Woods system.

Many theories in both mainstream IPE and critical GPE, even if usually only implicitly, question – or are in odds with – the chartalist hypothesis. As noted in the introduction here, according to the standard view in the field, the Bretton Woods arrangement provided states with more macroeconomic policy space than the current arrangement does. It is very common to worry that the current era of monetary governance does not allow nation states sufficient policy space to pursue democratic economic policies (see, e.g. Rodrik 2011). Moreover, the conventional wisdom in economics also does not acknowledge the importance (or even the existence!) of monetary sovereignty in the chartalist sense. In the section that follows, I examine some of the key existing theories that reject or neglect chartalism, stemming from both Political Economy and mainstream economics. For reasons of space, this review is far from exhaustive and rather designed to be merely indicative of the sorts of arguments often put forward in the debate. Against the various counterarguments, I maintain that the *core* of the chartalist position is well grounded. It is instead the theories at odds with chartalism that need to be modified or at least partially rejected. Section 1.2. provides examples of states that support the view that monetary sovereignty in fact does matter. Section 1.3., however, places the weaknesses of chartalism under scrutiny. (The chartalist hypothesis stated here is finally revised in the conclusion section of this thesis.)
1.1.1 Monetary sovereigns and the monetary hegemon

Many IPE scholars have gone far in questioning the ability of contemporary states to conduct independent macroeconomic policies. Of those accounts, I will first discuss a view emphasizing the importance of the existence of a monetary *hegemon*. It is a standard position in the literature that a monetary version of American exceptionalism holds true: the U.S. might be the only country that enjoys significant benefits of monetary sovereignty by virtue of the fact that dollar is by far the most popular international reserve and trade currency. Strange (1987) and Kirshner (2008, 2014), among others, seem to accept versions of this view. In the words of the latter, the US has the ability to "sustain deficits on its international accounts that others cannot, and the related and crucial ability to –– take risks and adopt economic policies that would, anywhere else, elicit a withering ‘disciplinary’ response from international financial markets” (Kirshner 2008, 424).

The chartalists usually allow that the U.S. is, to an extent, special. They would certainly agree that no other country has the power to connect the fate of the entire global economy to the demand and twin deficits that it generates, as Varoufakis (2013) suggests the U.S. does. Moreover, Fields and Vernengo (2013, 741) argue from chartalist grounds that the dollar will remain the hegemonic global currency “for a very long period”. However, the chartalists maintain that there are significant potential gains from monetary sovereignty even for states issuing less prominent currencies. While the most peripheral states with very weak monetary systems may sometimes find it hard to benefit from monetary sovereignty, an average state, in principle at least, *could* do so. As Wray (2012, 138) puts it, “in principle the issuer of the reserve currency is not unique, although the external demand for the reserve currency is greater”.

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7 In this section (and occasionally also later), I use the terms “hegemon” and “hegemonic” as they are standardly used in the contemporary “neo-neo synthesis” of IR. In this literature, the terms usually simply refer to the exceptional (even virtuous!) *material* power and ability of the dominant *state*. The neo-Gramscians, whose concept of hegemony I employ in later chapters, give the terms a qualitatively different meaning, as they, following Antonio Gramsci, emphasize *cultural* and *ideological* underpinnings of the hegemony of dominant class interests. Gramsci uses the concept in a rather antagonistic sense.

8 It is important to remember that the U.S. Dollar, while it is easily the most widely circulating currency, is not the only currency with substantial external demand: “To a lesser extent, the financial assets denominated in UK Pounds, Japanese Yen, European Euros, and Canadian and Australian Dollars are also highly desired” (Wray 2012, 134).

9 For the weakest of states, it is often hard to establish monetary sovereignty. It has been common for them to “dollarize” (to use the more stable currency of another state) or peg their exchange rate.
It seems to me that the chartalists are right about the counterfactual that monetary sovereign countries in general – and not only the U.S. – could often pursue more autonomous economic policies than they currently pursue (or have pursued in the past), given the existing global monetary arrangement. The observation that many countries do already take considerable advantage of their monetary sovereignty provides primary empirical support for this judgment. A case in point is Japan who, as things stand, “tolerates” a public debt ratio much higher than the current debt ratio of the U.S. (approximately 230 versus 105 percentage in proportion to the countries’ gross domestic products). Moreover, in comparison to the Eurozone states deprived of their monetary sovereignty, countries like Iceland and Sweden, to name a few of Finland’s neighboring states, have recently exercised their monetary sovereignty with rather encouraging results. When Argentina abandoned its currency board and started to float its currency, it was able to finance a remarkable employment program that within four months created 2 million jobs (Sardoni & Wray 2007). In Section 1.3., I will examine in greater length the case examples of Canada and Argentina that illuminate the importance of monetary sovereignty.

Does the monetary hegemony of one state thus not deprive other states of their monetary sovereignty? Does the monetary dominance of one state not imply subordination of the others? It does but only to a modest extent. In today’s world, monetary sovereigns (that are not monetary hegemons) often have to convert their currency to US dollars in order to operate in the international markets. The extent to which they have to do this varies from country to country – monetary sovereigns are not created equal –, but it is quite impossible for any state today to avoid using dollars (or, for that matter, any other key foreign currencies) altogether. The fact that international trade is largely dollar-based is a clear sign of continuing US hegemony. This does not mean, however, that an average monetary sovereign would not greatly benefit from the fact that it is the monopoly issuer of its own currency. The control over its own currency enables a state to advance many projects, such as employment programs, even if it is short on foreign currency reserves (Wray 2012, 216–217).

In sum, Kirshner (2008), among others, thus goes much too far in declaring the exceptionalism of the dollar. Monetary sovereigns in general – and not only the US – are not necessarily constrained by a “withering ‘disciplinary’ response from international financial markets” (ibid., 424). While the monetary hegemon indeed is in
many ways special, other monetary sovereigns benefit from important, albeit somewhat more modest, privileges as well\(^\text{10}\). The monetary non-sovereigns make up the lowest caste. That there indeed is an important intermediate category of monetary sovereigns between the monetary hegemon(s) and the monetary underdogs has been widely neglected in the IPE literature. For this reason alone, it seems to me that the chartalist account of monetary sovereignty would potentially be an extremely valuable contribution to this literature.

1.1.2 Monetary sovereigns, cross-border capital mobility and credit rating institutions

According to another much discussed – and widely embraced – view in IPE, international capital flows significantly constrain macroeconomic policy strategies available to contemporary states. In its various guises, this position has been intensively debated in both American and British disciplinary journals.\(^\text{11}\) David Andrews’s “capital mobility hypothesis” might be the most discussed mainstream articulation of the idea (Andrews 1994). In his words, proponents of the hypothesis claim that “financial integration has increased the costs of pursuing divergent monetary objectives, resulting in structural incentives for monetary adjustment” (ibid., 203). Andrews even suggests that capital mobility is a Waltzian “structural feature of international politics” (ibid., 203)\(^\text{12}\). Cohen (2008, 155) links the capital mobility hypothesis to the “unholy trinity”, his name for “the fundamental incompatibility between the three desiderata of autonomy of national monetary policy, exchange rate stability, and the free movement of capital”. Cohen’s trilemma, in turn, draws explicitly on the influential Mundell-Fleming model of open macroeconomics.\(^\text{13}\)

\(^\text{10}\) It is undoubtedly correct that the overall geopolitical hegemony of the US, of which its monetary hegemony is but one manifestation, has throughout the last century in various ways conditioned the sovereignty of numerous states in almost all continents (and especially in the Latin America). Moreover, as Strange stressed early on in the debate about the US decline, the US is not about to lose its hegemony in the near future (see Cohen 2008b). However, absent military interventions, there often is nothing much in the US monetary hegemony in itself that would prevent other states from benefiting from their monetary sovereignty domestically. The popularity of dollarization, which I will briefly touch below, comes probably closest to posing such a threat because it threatens to erode monetary sovereignty itself.

\(^\text{11}\) Cohen (2008, 6) summarizes the variance in opinion as follows: “At a minimum, states have been thrown on the defensive, no longer able to enforce their will without constraint. At a maximum, states appear on the verge of total emasculation, with monetary sovereignty soon to be transformed in its entirety from national governments to ‘stateless’ markets”. He suggests that it “seems most likely that reality lies somewhere in between”.

\(^\text{12}\) Here Andrews is following Webb (1991).

\(^\text{13}\) The mainstream Mundell-Fleming model is a conventional point of reference in IPE. The uncritical employment of this model should be questioned.
A more radical variation on the same theme is for instance the idea that “disciplinary neoliberalism” is constraining the economic policy space available to contemporary nation states. Gill & Law (1989) suggested that the “structural power of capital” constraints state policies through several financial and macroeconomic mechanisms (including the threat posed by investment strikes and rapid outflows of financial capital). Later Gill (2003, 116–142) has enriched his analysis of disciplinary neoliberalism with various other elements, the most discussed of which is probably “new constitutionalism” – the process through which disciplinary neoliberalism has been “cemented” by judiciary means. Foucauldian disciplinary surveillance, “panopticism”, is yet another element of disciplinary neoliberalism.

I have argued earlier (Kotilainen 2013) that while the suggested mechanisms of “structural power of capital” on state policies rely, to an extent, on standard misunderstandings concerning the nature of the current monetary system, new constitutional practices are very real and, indeed, have powerfully disciplinary effects on the states’ ability to conduct independent economic policies. To generalize this line of thinking, it seems to me that all theories that counter the chartalist view about the importance of monetary sovereignty by arguing that an average state is, for purely financial or “economic” reasons, obliged passively to react to the pressures induced by market reactions, are almost destined to fail. The effective, or the most fundamental, constraints on state policies are usually of a different sort – a point to which I will return in depth later in the thesis.

If the chartalists have it right that in the case of monetary sovereigns “it is incorrect to argue that the size of a sovereign government deficit affects the interest rate paid on securities” (Sardoni & Wray 2007, 14), much of the alleged power of the financial

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14 Gill (2003, 116–142) discusses the expansion of “market civilization” as a third “dominant historical structure” alongside disciplinary neoliberalism and new constitutionalism. Market civilization refers to cultural aspects and the two other to political economy and legal aspects of the contemporary form of global capitalism.

15 It is surprising how, despite all their discussion about the inadequacy of purely “material” explanations and their emphasis on the importance of ideas, Gill & Law (1989) nevertheless make straightforward claims about the structural power of capital – often based on neoclassical macroeconomic premises. While they rightly point out that “there is nothing inevitable or automatic about a particular policy response to changes in market conditions” (ibid., 486), they fail to see that not even the oppressive economic mechanisms themselves that they discuss work nearly as automatically as their discussion supposes.
markets to restrain government spending in a direct way, disappears\textsuperscript{16}. Soudis (2015), who has conducted probably the most wide-ranging statistical study about the impact of credit rating agencies on economic policies of states, finds that the unquestionable global turn towards neoliberal policies, cannot, in any straightforward way, be attributed to the independent influence of credit rating agencies. Compatibly with the Post Keynesian considerations, Soudis argues that the market actors do not always agree that the decisions of the rating agencies provide novel or relevant information. In the case of monetary sovereigns, credit rating agencies standardly fail to take into account the sovereigns’ unlimited ability to settle their debts in their own IOUs. The actual behavior of market actors often reflects the fact that credit ratings do not matter very much for the finances of the monetary sovereigns (Wray 2012).

The same line of thinking that downplays the direct disciplinary power of credit rating institutions over monetary sovereigns applies to the disciplinary power of the International Monetary Fund (IMF). While the IMF has exercised (and continues to exercise) enormous power over a long list of poor and developing countries, its power in the “advanced” economies has historically been much less significant (Cohen 2008a, 162). Because the IMF exercises authority “through the organization’s control of access to credit as well as through the policy conditions attached to its loans” (ibid., 162), IMF has rarely been in a position to condition monetary sovereigns directly. Unsurprisingly, the elimination of monetary sovereignty in the Eurozone member states has then recently made the IMF an important player in the advanced capitalist economies, too.

In light of the fact that macroeconomic breathing space of monetary sovereigns is in principle rather large, most versions of the capital mobility hypothesis seem to be exaggerations. However, monetary sovereigns can certainly be disciplined by capital in indirect fashions. The absence of hard financial constraints does not imply that constraints, more broadly understood, would be absent. Moreover, as Ahokas and Holappa (2011, 69) point out, speculative transactions may, in rare cases, cause considerable harm even for monetary sovereigns. A sharp devaluation of the domestic currency resulting from a rapid escape of speculative capital may not bring any compensating export benefits if the country has failed to direct capital to productive

\textsuperscript{16}Putting it more mildly, but echoing the chartalist view, Rommerskirchen (2015, 758) argues that “states are by no means passive recipients of market punishment”, but instead “take on the role of active managers of market discipline".
investments (by favoring, for instance, Ponzi behavior in the real estate markets instead). In such a case, a capital outflow would really harm even a sovereign. Generally, however, the monetary sovereigns retain much policy space even if credit rating institutions or capital flows turn against them – a fact that large parts of the literature fail to notice. Should such unfortunate reaction by capital occur, to borrow the terminology of the American school of IPE, the “control gap” between state goals and state abilities (see Cohen 2008b, 95–117), would grow much larger for the monetary non-sovereigns than it would ever grow for the sovereigns.

1.1.3 Monetary sovereignty and the “new geography of money”

Benjamin J. Cohen (2008, 205–310) suggests that the emergence of a “new geography of money” is rapidly eroding monetary sovereignty of contemporary states. The essence of his argument is that there are two kinds of processes leading toward “deterritorialization of money”, currency internationalization and currency substitution. The former has brought about the fact that some contemporary currencies are much more widely used in international transactions between countries than others are. The latter has enabled that some currencies nowadays circulate and are generally accepted within foreign countries.\(^{17}\) Cohen suggests that such deterritorialisation of money is intensifying and is likely to alter the world’s monetary map in dramatic ways.

Furthermore, while Cohen specifies that the processes of currency internationalization and substitution only affect the demand of money, he adds that virtual private monies may in the future threaten even the “remaining privilege” of governmental currency monopolies in the supply side (Cohen 2008a, 213). Very similar sort of worries are expressed by those economists who are afraid that central banks will in the near future lose their ability to conduct monetary policy because their reserve balances will soon no longer be demanded by private banks. Because various e-money innovations may enable banks to find a way to settle their mutual payments without reserve balances, the supply of money may be privatized, and interest rate policy become impossible to implement (B.Friedman 1999; Woodford 2001a). King (1999, 26) worries that “in just the same way as the Internet is unaware of national boundaries”, these private

\(^{17}\) The widespread phenomenon called “dollarization” that has affected many Latin American and African countries is the standard example of currency substitution.
settlement facilities might not be governable by regulatory measures of individual governments.

Cohen argues that, taken together, the demand and supply aspects of the new geography of money will have far-going implications for monetary sovereignty of contemporary states: “Individually, national moneys confront market forces that are increasingly indifferent to the barriers posed by political frontiers. Collectively, therefore, governments face a challenge to their monetary sovereignty that is unprecedented in modern times”.18 (Cohen 2008a, 210) Cohen goes on to suggest that the “Westphalian model of monetary geography” is dead (ibid., 210). Obviously, there is thus a direct contradiction between Cohen’s and the chartalists’ views concerning monetary sovereignty. Whereas Cohen suggests that monetary sovereignty is eroding, the chartalists maintain that the era of monetary sovereignty has only just emerged. Who gets it correct?

It seems that the chartalists have the stronger arguments. If one has digested the chartalist literature, it is actually not hard to figure out where Cohen goes wrong. While he rightly notes that there are tendencies towards currency internationalization and substitution, he does not see that monetary sovereigns have many means to resist the consequences of these processes. I already explained above why currency internationalization – the existence of monetary hegemons and hegemonies currencies – does not erode monetary sovereigns of their privileges. When it comes to currency substitution, Cohen is led astray because he does not appreciate the fact that it is taxes that “drive money”. If a state imposes a tax liabilities that can be settled only in state’s own IOUs, the private sector actors will have an interest to use the state’s currency in their mutual transactions. (Wray 1998.) As a result, the currency of the state will always face substantial demand. Take for instance the issue of dollarization emphasized by Cohen. It is true that many countries in especially Latin America have historically chosen this path. Before the financial crisis there was even renewed interest in dollarization in the continent, a development which can largely be explained by “the ascendancy of neoliberal monetary ideas in these countries” (Helleiner 2003, 424). The erosion of monetary sovereignty through currency substitution has been a real issue in several (often rather peripheral) countries but there is certainly no such “structural”

18 Cohen (2008, 212) argues that the “new geography of money” is a greater threat to monetary sovereignty than capital mobility, because “much more is involved here than just financial markets alone”. The new monetary geography is argued to affect the demand of money for all standard purposes.
inevitability involved in this process as Cohen seems to suppose. The monetary doctrines that support such a tendency are highly contestable. The “taxes drive money” - approach, for instance, can help to reverse the tendency towards currency substitution. Chartalist considerations undermine the alleged supply-side threat of private virtual currencies even more sharply than the demand-side threats posed currency internationalization and substitution. It is true that all sorts of private monies are circulating (and generating heated discussions) nowadays, but they do not in fact have a potential to become serious competitors to the central bank IOUs. Arguing against the worries of the economists to whom I referred above, Fullwiler (2006) asserts that there is not the slightest chance that private banks would not demand reserve balances in the future. This is because the “settlement of payments with the federal government” has to be done in reserve balances (ibid., 515). Fullwiler concludes by pointing out that even though this non-trivial demand for central bank balances is sufficient to guarantee that a central bank can set its short-term policy interest rate exogenously regardless of e-money innovations, “it can likewise relinquish this power if it so chooses – – the ability to set interest rates is most assuredly a matter of political economy” (ibid., 522). Cohen’s worries about the threat of the rise of private monies for the state monies are misplaced for the simple reason that states and their central banks have shown no signs of willingness to donate their central position in the monetary system to the e-money firms.

In sum, the chartalists do not deny that there have been tendencies toward currency internationalization and currency substitution, but they do deny the inevitability that Cohen claims for them. Monetary sovereigns have important powers to resist such tendencies. It is conceivable, of course, that left unchecked they plausibly could alter the Westphalian model of monetary sovereignty. In contrast, the apparent threat of competition for the state money on the supply side posed by e-monies and other private monies seems almost completely illusionary in light of a realistic monetary theory.

1.1.4 Monetary sovereignty and the “fundamental political trilemma”

In his book The Globalization Paradox (2011), Dani Rodrik argues that the world faces a fundamental political trilemma: democracy, nation states and “hyperglobalization” – an extensive form of globalization – are incompatible. If democratic nation states are to be conserved, hyperglobalization has to be disallowed. If hyperglobalization is allowed
and serious attempts to govern it democratically are made, nation states will necessarily become powerless relics. But if powerful nation states protect themselves from hyperglobalization, democracy has to give. Rodrik (2011, 184–206) poses his trilemma in quite general terms and there are considerations that support its existence in several issue areas of governance. Nation states often are not able to face the multiple challenges the globalization has intensified, and democracy is regularly sacrificed. However, it seems to me that Rodrik’s trilemma fails to capture anything fundamental about the political economy of monetary sovereignty.

In terms of monetary relations, the argument for a Rodrik-type trilemma might go like this: The hyperglobalization of the post-Bretton Woods era (manifested by unrestricted financial flows and unforeseen exchange rate volatility), poses a choice between nation states and democracy. This choice cannot be avoided because either we have nation states that will have to submit to the rule of the lenders and credit-rating institutions (in case of which there will be no democracy), or monetary affairs are to be governed in a democratic global institution (in case of which power will not be exercised at the state-level).\(^\text{19}\)

However, as one can infer from the considerations of the previous sections, the choice is not nearly this stark. It is easy to show that the chartalist position – according to which most states of the post-Bretton Woods era are in a meaningful sense monetary sovereigns – contradicts Rodrik’s trilemma. In principle, monetary sovereigns can make effective and democratic decisions even though monetary globalization has been extensive. Indeed, flexible exchange rates even contribute to democratic decision-making at the state level. Because monetary sovereigns do not necessarily have to submit to the rule of lenders and credit-rating institutions even in this era of hyperglobalization, it seems that states, democracy, and monetary hyperglobalization, within certain limits at least, can coexist. Hence, the trilemma dissolves. However, we should be cautious here. While the basic chartalist argument calls the existence of a unconditional Rodrikian trilemma into question, more advanced considerations that stem from the chartalist monetary theory and broader Post Keynesian macrodynamics

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\(^{19}\) It could even be argued that the very logic of Rodrik’s trilemma is strange. Hyperglobalization would appear to erode state power no matter whether decision-making shifts to a global democratic institution or to the “market forces”. In the former case, there would be democracy. In the latter case, there would be no democracy. But in neither case would there be effective decision-making at the state level. Hence, it would seem that the only way to save powerful nation states would be to disallow hyperglobalization – getting rid of democracy is ultimately not likely to help nation states to preserve their power.
do suggest that the co-existence of *small and weak states* and democracy is not an easy one, given the current global financial flows and exchange rate volatility. I will elaborate on this issue in Chapter 5. Nevertheless, it is important to notice that an effective exercise of state-level monetary sovereignty does not *straightforwardly* require that either far-going globalization or democracy should be sacrificed, contrary to what Rodrik claims.

### 1.1.5 Monetary sovereigns versus monetary non-sovereigns of the past

Having considered implicit objections to chartalist view of monetary sovereignty stemming from the Political Economy literature in the above sections, I will now show that hints of *support* for the chartalist claim that the previous global monetary arrangements have constrained states on purely financial grounds at least no less than the post-Bretton Woods system of floating exchange rates does can also be found in the literature. It is, for instance, acknowledged that contrary to contemporary states, historically states used to be extremely prone to defaults: “From the beginnings of sovereign borrowing in Europe and in the Middle Ages until the early nineteenth century, virtually all states that borrowed money at one time or another defaulted” (Thompson & Runciman 2006, 543). While these states sometimes were able to retain their sovereignty in the case of a default – the private creditors of the time usually had very few means to sanction the states –, political and military interventions by other states in the affairs of a defaulted sovereign were extremely common. According to one estimate, between 1870 and 1913 more than 40 per cent of the states that defaulted experienced such a foreign intrusion (Mitchener & Weidenmier 2010). Hence, the lack of monetary sovereignty has standardly used led to a shortage of political and territorial sovereignty.

Moreover, Fields and Vernengo (2013, 747) argue that even the hegemons of the gold standard and Bretton Woods eras, Great Britain and the U.S., suffered from an important financial constraint because their “debt was ultimately redeemable in an asset that was not directly controlled by the monetary authority”. The respective reserve currencies, the Pound Sterling and the Dollar, were namely pegged to gold, which is not true of the dollar in the present monetary architecture.\(^{20}\) While Ruggie (1982, 393) famously

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\(^{20}\) Fields and Vernengo (2013, 747) go so far as to hold that because of the fact that the US is not financially constrained, “the principles of functional finance apply on a global basis”. 

argued that the essence of the embedded liberalism compromise was that the arrangement’s “multilateralism would be predicated upon domestic interventionism”, later in the paper he considered the burden of domestic adjustment measures that, under the Bretton Woods system, fell on certain less privileged countries. This made it difficult for them “to conduct domestic macroeconomic policy and to support exchange rates under pressure” (ibid., 408–409). Hirst & Thompson (2000, 53–54) note that “the degree of national autonomy for medium-sized nation states in the supposed ‘Keynesian’ era is often talked up as much as the powerlessness of national policy is now talked down”.

Further, Panitch & Gindin (2012) have shown that the perceived domestic policy autonomy of the Bretton Woods era came with many economic and geopolitical conditions. Importantly, they also make it clear that the post-war capital controls – which granted crucial breathing space for the states under the fixed exchange rate system – were, from the very start, designed to be of only temporary character. The birth of the Eurodollar markets in the 1950s began to constrain state policy space even long before the Bretton Woods system finally collapsed. Despite the space that the Bretton Woods arrangement gave to the states to pursue their domestic concerns, it, too, had its important limitations that stemmed from both its partially unfortunate architecture and the influence of geopolitical – and eventually also financial – interests on its development. (Panitch & Gindin 2012, 67–159.) In sum, several historical considerations of the literature support the conclusion that in terms of its basic monetary structure, the post-Bretton Woods era is at least no more disciplinary than the previous structures of global monetary economy were.

1.1.6 Monetary sovereignty and the intertemporal government budget constraint

While the IPE literature(s) seem to provide no compelling reasons to reject the chartalist idea that contemporary monetary sovereigns generally do benefit from privileges that were not available to the monetary non-sovereigns of the past, it might be that the mainstream paradigm in economics provides them. Indeed, it has to be remembered that the chartalist theory of state money is the traditional alternative to the mainstream

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21 The operation of the Eurodollar market indeed forced the relaxation of the capital controls and was a main cause behind the breakdown of the post-war arrangement (Panitch & Gindin 2012, 117–13).
22 The Eurozone member states are important examples of contemporary monetary non-sovereigns.
theory of money. Despite all the empirical and historical evidence for state money that has mounted throughout the years (see, e.g. Graeber 2011 or Wray 1998), the chartalist theory of money and public finance have thus far never been widely endorsed in mainstream economics.

From the chartalist point of view, the prevailing economic orthodoxy fails to make an appropriate distinction between states that are currency issuers and states that are merely currency users (Kelton 2011). Instead, the mainstream continues to maintain that even currency issuers finance their spending by either taxing or borrowing from the private sector. Based on this premise, the hypothesized “intertemporal government budget constraint” of standard macroeconomics implies that while governments can run deficits in the short term, in the future they will have to run corresponding surpluses in order to balance their budgets intertemporally. That there is a government budget constraint has been taken to be a nearly self-evident fact by the neoclassical economists and the view has been implicitly accepted by even the best of classic critics of the mainstream, such as Keynes and Kalecki). Against this background of tradition, it is not surprising that the budget constraint postulate has become a target of sustained criticism only during the last couple of decades. (Kelton 2011; Parguez 2002.)

The existence of a budget constraint for monetary sovereigns is questioned by both various historical counterexamples and straightforward operational considerations hard to repudiate (Kelton 2011; Parguez 2002; Bell 2000; Wray 1998; Lerner 1943). Perhaps the most illuminating way to see the falsity of the budget constraint postulate is to examine public finance from a Post Keynesian monetary circuit point of view. The circuit theory maintains that because initial public and private spending cannot be financed out of savings (they do not yet exist!), the primary “flux” phase of the monetary circuit always begins by the decisions of a state and firms to spend – which injects money into the economy. For the state, taxing and “borrowing” in its own currency become possible only in the “reflux” phase of the circuit – only when it has first spent. Moreover, the logic of the monetary circuit implies that taxing and “borrowing” in the reflux phase simply destroy the money created in the flux phase. This implies that taxes and bond sales do not really finance the expenditures of the monetary sovereign state. The fact that deficit spending of the monetary sovereign is

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23 If there indeed is any mainstream theory of money, it is arguably based on the “metallist story” of money (see Wray 1998).
financed by money creation shows that the government budget constraint is based on false operational premises. Thus, the budget constraint postulate is false. (Parguez 2002.)

That there seems to be no convincing way to dispute the most basic lesson of chartalism – monetary sovereigns operating under a flexible exchange rate system do not face a budget constraint in the currency they are entitled to issue – is reflected by the fact that even some mainstream New Keynesians have recently started to change their view on the issue. Several of them now acknowledge that monetary sovereigns cannot be forced to default on the debt obligations denominated in their own IOUs (De Grauwe 2012; Krugman 2013a). Even earlier, there have been individual mainstream economists sympathetic to the chartalist view (see, e.g. Goodhardt 1998). In sum, there is no agreement among economists about how much monetary sovereignty matters. It seems to me that most contemporary economists have not thought deeply on the issue and its implications. One can only hope that this omission will be addressed in the future. In the meantime, researchers in GPE should gain more awareness of the fact that the economic theories on which they standardly choose to base their analysis are themselves contested on fundamental matters. GPE scholars who are critical of the mainstream theories of their own field, almost certainly cannot afford to accept the mainstream views in economics either.

1.1.7 The chartalist economics of monetary sovereigns’ actual constraints

While the chartalists emphasize the importance of monetary sovereignty, they themselves are the first to agree that monetary sovereignty has its limits. Indeed, the chartalist theory is explicit about the narrow “economic” or “structural” limits on the macroeconomic policy decisions of monetary sovereign states. State spending is constrained, for instance, by the availability of real resources and (related to that) by inflation (Wray 2012, 187–190).

Two interesting further constraints on state spending apply in an open world economy even for the monetary sovereigns. Both of these constraints relate to the possibility of a

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24 I will say a little more about this in Chapter 5.
25 It is worth mentioning that the much-discussed Mundell-Fleming model of open economies (Fleming 1962; Mundell 1960) makes use of the concept of “monetary policy independence”, but the model is not based on a theory of monetary sovereignty.
shortage of *foreign* currency reserves. First, a shortage of foreign reserves obviously impedes the capacity of a state to import goods and raw materials from other countries as well as to settle its foreign currency-denominated debts – challenges that pose difficulties even for the state’s domestic production. Second, a lack of foreign reserves may amplify the inflationary effect of fiscal spending. Since an increase in spending results in a higher level of aggregate demand relative to other countries, the country’s external balance easily deteriorates. Because the worsening shortage of foreign reserves devalues the domestic currency, the prices of import goods rise. This process brings about cost-push inflation.\(^{26}\) (Ahokas & Holappa 2011, 66–69.)

Because of these constraints, a peripheral state that issues a currency that lacks value and purchasing power in the international money and goods markets does not enjoy as many benefits of monetary sovereignty as issuers of the most prominent currencies do. If a state has to make many of its import purchases in a foreign currency, it has to collect foreign currency reserves by running current account surpluses. In this case, monetary sovereignty provides the state only with a limited amount of fiscal policy space because enhancing the domestic demand conditions could easily lead to a current account deficit and, as a result, the state’s foreign currency reserves would evaporate – with damaging results. Similarly, issuing foreign currency-denominated debt very easily leads to difficulties because the budget constraint does apply in foreign-currency spending. (Ahokas & Holappa 2011; Wray 2012, 135–137.) While the chartalists are deeply aware of the sort of economic constraints briefly outlined here, the shortcomings of the chartalist “theory of constraints” are examined later in this thesis.

As I am aware of no ultimately convincing critiques of the *basic* chartalist position in either IPE or economics, I will proceed assuming it is, in key respects, correct. Monetary sovereignty matters – at least “in theory”. Next, I will examine a couple of empirical cases that nicely illustrate how useful monetary sovereignty in fact is when states are able to exercise it without serious constraints undermining it.

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\(^{26}\) Whether a crucial shortage of foreign currency reserve results or not depends, of course, on the reserve position of the state. The constraints apply only for the states low on foreign reserves.
1.2 Does Monetary Sovereignty Ever Matter in Actual Practice?

On chartalist grounds, it can be argued that there has recently been a historical tendency for monetary sovereignty to increase. The Bretton Woods arrangement allowed more policy space than the gold standard era did, and the post-Bretton Woods era allows still more. While the chartalists may be correct in their assessment that monetary sovereignty should matter given the economics of it, does it in actual fact ever matter in practice? After all, the record of economic theories has not generally been very promising when it comes to explaining real-world affairs. To tame possible suspicions about chartalism’s practical irrelevance, I will study the cases of Canada and Argentina to illustrate how monetary sovereignty can in actual fact make a huge difference. I scrutinize the case of Canada because the technical Post Keynesian literature on central bank/treasury operations suggests that it has perhaps the highest level of monetary sovereignty of all contemporary states (Lavoie 2013). After Canada, I examine Argentina’s case since the recent experiences of the country allow me to study actual policies inspired by chartalism (a form of practical functional finance and an employer of last resort program).

Through these case studies, one can begin to assess the practical importance of monetary sovereignty. While it is obvious that the experiences of two countries do not conclusively settle the issue, case studies are easily the best method to approach it. Although the chartalist concept of “monetary sovereign” can be defined quite precisely, an attempt to study the impact of monetary sovereignty on state policies by means of large-N statistical analyses would be futile because absolutely nothing guarantees that states will take advantage of their monetary sovereignty. The soundness of the chartalist argument can hardly appraised statistically, because the chartalists only suggest that monetary sovereignty is a necessary condition for “gaining policy independence” (Sardoni & Wray 2007, 20). Therefore, even if a statistical study found no correlation between monetary sovereignty and (certain type of) state policies, nothing definitive about the importance of monetary sovereignty could be justifiably concluded from

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27 I decided not to study the US who, for reasons discussed earlier, is believed to enjoy special privileges exclusively available to the monetary hegemon. To highlight the point that monetary sovereignty matters even for those sovereigns that are not hegemons, I have chosen to examine other cases. I will also not discuss Japan whose ability to run huge public deficits has for a long time puzzled economists and laypeople ignorant of chartalism. This case has already been extensively discussed in the literature (see, e.g. Forstater & Mosler 2005).
that. No statistical study can satisfactorily answer the crucial counterfactual question of whether a state could act differently given its monetary arrangements and institutions. While quantitative analyses then are bound to lose grip of the myriad of relevant qualitative considerations, case studies can shed light on them.

1.2.1 Monetary sovereignty in Canada

Because of the characteristics of its central bank/treasury operations, it has been argued that Canada, in a certain sense, enjoys greater monetary sovereignty than any other country, including even the US. (Lavoie 2013, 17; Juniper et al. 2014). Lately, the Bank of Canada has “acquired international prestige in its supervisory role and has been portrayed as a leader in the way it conducts policy”, as Lavoie and Seccareccia (2013, 64) point out. While historically the Bank of Canada used to imitate the US Fed, their roles have subsequently reversed. The Bank of Canada was among the first central banks to abandon monetarism for an alternative “new consensus” approach to monetary policy. By the 1998, “the Bank of Canada can be said to have fully adopted a coherent, Wicksellian view” of central banking (ibid., 72). The key elements reflecting the new paradigm were the establishment of interest rate and inflation targeting, as well as the abandonment of the use of bank reserves. In the mid-1990s, the researchers of the Bank of Canada had developed the so-called corridor system of interest rate setting. (Lavoie & Seccareccia 2013).

Many of the institutional features and innovations of the Bank of Canada increase Canada’s monetary sovereignty. Exogenous interest rate setting using the modern corridor system meant that the Bank of Canada took full and precise control over the policy interest rate, the pivotal tool of monetary policy. The Bank of Canada hits the target interest rate more consistently and with more ease than for instance the US Federal Reserve, which still retains several monetarist elements and does not have a fully developed corridor system (Lavoie & Seccareccia 2013). The permission of direct and unlimited central bank purchases of government bonds – a very rare privilege among contemporary central banks – in turn strengthens Canada’s fiscal sovereignty.

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28 It is completely possible that the absence of other necessary conditions for adaptation of progressive economic policies in the case of the majority of monetary sovereigns accounts for the lack of correlation. This is not merely a logical or theoretical possibility. On the contrary, it is evidently the case that monetary sovereignty is not a sufficient condition for the implementation of certain type of policies.

29 The lack of bank reserve requirements makes explicit the fact that reserves do not constrain bank lending.
The Bank of Canada standardly purchases a remarkable quantity of the government bonds (ranging from 10 to 15 per cent). (Lavoie 2013, 16.) The allowance suggests that sufficient institutional conditions for Lernerian functional finance\(^{30}\) are in place. As Lavoie (2013, 16) argues, “Canada has the highest degree of currency sovereignty, since its central bank is unhindered by regulations, its public debt is issued in Canadian dollars, and its exchange rate regime is of the pure float variety”.

In terms of the institutional capacity, monetary sovereignty of Canada has hence recently increased. However, the new consensus view of macroeconomic policy (emphasizing as it is the primacy of monetary policy and the inflation-targeting framework) has, in its distinctive ways, often been detrimental to the exercise of this sovereignty and in some cases even contributed to the erosion of the policy space of modern monetary sovereigns. The relation of new consensus and monetary sovereignty is thus full of tensions. I will study these interesting issues in Chapter 4.

Although Canada has by no means taken the full advantage of monetary sovereignty in terms of fiscal policy, Canada’s economic performance after the global financial crisis has been comparatively strong. Growth rates have been relatively high and unemployment low in contemporary standards. Despite the central bank direct purchases of government bonds, inflation has been extremely modest (just like the Post Keynesian theory allows). In March 2016, Canada’s new liberal Prime Minister Justin Trudeau introduced an ambitious government investment plan that would make Canada the only major economy to conduct fiscal policies of a clearly Keynesian sort. Given the current predicament of the global economy, such a plan promising to take the full advantage of Canada’s monetary sovereignty can only be welcomed\(^{31}\). (Phillips 2016.)

Canada then has a very advanced institutional structure providing it with enormous fiscal capacity and even a clear shift to Keynesian policies is now in the cards. However, until now Canada has exercised monetary sovereignty mostly within the constraints set by the new consensus view that I will examine and criticize in Chapter

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\(^{30}\) Abba Lerner (1951) made an important distinction between “functional finance” and “sound finance”. While the latter conventional approach to public finance seeks balanced budgets by all means necessary, the functional finance approach instead recommends to pay attention to the real macroeconomic effects of government decisions concerning spending, taxation, borrowing and lending. In Lerner’s view, a commitment to “sound finance” is often utterly dysfunctional.

\(^{31}\) Furthermore, as Phillips (2016) notes, the credit rating agencies are probably not going to disturb Canada’s decisions.
I will now turn to a case in which the “Wicksellian” elements are not prominent and the conduct of macroeconomic policy has been much more “Lernerian” in spirit. Given the fact that the economic policies in the Global North are so consensual, I will simultaneously turn to the Global South, more specifically to Argentina.

1.2.2 Monetary sovereignty in Argentina

Argentina learned the lesson of the importance of monetary sovereignty the hard way. As is now widely accepted, its financial collapse of 2001 resulted for no small part because of the misplaced currency board arrangement depriving Argentina of its monetary sovereignty. Under one decade of the currency board, a decline of 48% of the real income of the Argentinian people and a significant rise in the Gini coefficient occurred. The currency board arrangement guaranteed that key social concerns could not be addressed. Given this predicament, exacerbated by the financial crisis, the Argentinian people took to the streets to protest against the government. (Kostzer 2008; Rodrik 2011, 184–190.) Perhaps this grave experience also explains why Argentina learned the lesson of the importance of monetary sovereignty not only the hard way, but also exceptionally well.

While the demands of the people for a different kind of economic order were initially violently repressed, they finally had great effects. Since the crisis, the macroeconomic and financial system of Argentina has been reformed. Argentina decided to default on most of its dollar-denominated debts and the currency board was abandoned in 2002.

32 Sweden might be another example of a country that has recently been able to exercise its monetary sovereignty comparatively constructively despite its adherence to several tenets of the new consensus. While Canada is a relatively large economy whose currency (the Canadian Dollar) has considerable international reserve currency demand, Sweden is a small and open economy with a currency (the Swedish Krona) of little reserve currency demand. This has not prevented Sweden from exercising its monetary sovereignty relatively effectively during the aftermath of the global financial crisis. Since the global financial crisis, Sweden’s fiscal and monetary policies have both been expansionary. Since 2010, Sweden’s structural deficits have risen continuously (World Economic Outlook 2015). It seems that despite its self-imposed limitations of the 1990s, the institutional architecture of Sweden is flexible enough to allow expansionary fiscal policy when it is most urgently needed (Erixon 2015). Furthermore, Sweden’s interest rate policy has been experimental, as the fact that the Riksbank’s repo rate is currently in the negative territory testifies. In contrast to the proximate countries in the Eurozone, the Swedish economy has been performing very well. There are good reasons to believe that the differences in policy space and in the exercise of monetary sovereignty at least partially explain why Sweden does not face the kind of problems the Eurozone has been struggling with for years. Sweden has not been obliged to pursue austerity because of there are no rigid institutional constraints and the fiscal framework is somewhat more flexible in comparison to the EMU member states, such as Finland (see Calmfors 2012). Hence, the Eurozone should learn from Sweden about the importance to leave room for the exercise of monetary sovereignty.

33 In Chapter 4, the sense in which current macroeconomic policies tend to be “Wicksellian” is explained.
Argentina now has a system allowing for Lernerian functional finance. (Kaboub 2007; Tcherneva & Wray 2005.)

Moreover, Argentina has recently experienced with an employment program drawing from the policy prescriptions of the chartalists. As Kostzer (2008, 6) explains, “inspired by the [employer of last resort] programs from certain post-Keynesian institutions, [the key research unit of the Argentina’s ministry of Labor] stressed the idea of a universal program for a group of individuals and targeted the unemployed head of the household”.

34 Between 2003 and 2006, the established employment program (called El Plan Jefes y Jefas de Hogar Desocupados) created two million jobs (for around 13% of the labor force), contributed to rapid economic growth (the officials used to estimate the multiplier effect of the program to be around 2.5) and effectively reduced poverty. Without monetary sovereignty, the implementation of this program would have been impossible. (Kostzer 2008; Tcherneva & Wray 2005.)

Argentina’s experience thus shows that even an individual relatively “peripheral” state can exercise its monetary sovereignty to conduct economic policies that go against the conventional wisdom concerning appropriate economic policies. Moreover, the decision to turn away from the conventional wisdom proved effective in taming the economic and social crisis, even though it by no means has solved all the problems of the country (among other problems Argentina arguably has an inflation problem). Not only did Argentina successfully turn against the prevailing economic doctrines. In addition, since its 2001 default, Argentina has been largely without access to the global credit markets. Despite the worries of some, Argentina nevertheless has the conditions to prosper also in the future. (Scott & Mitchell 2014.) Argentina’s case thereby illustrates that the performance of a monetary sovereign is not fatally dependent on these markets.

In sum, the examples of Canada and Argentina provide strong evidence for the argument that monetary sovereignty does indeed matter in practice given the right institutions and policy decisions. It would be easy to come up with more examples to support the chartalist conclusion that we live in the era of modern money. However, it would also be easy to pick cases were monetary sovereignty, as things stand, does not

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34 Tcherneva (2005, 2) comments the relationship between Argentina’s employment scheme and the chartalist proposals as follows: “Although Jefes is only limited to unemployed heads of poor households and is thus not a true (employer of last resort) program, it nonetheless possesses key institutional features, which have been proposed in the literature on ELR”.
seem to matter that much. I will therefore now return to the peculiar observation I pointed out at the outset of this thesis. Why is it that states that currently enjoy unprecedented levels of monetary sovereignty often converge to economic policies that seem less autonomous than those that they pursued during the previous monetary architectures? In other words, how can we reconcile the contradictory-looking general tendencies toward greater monetary sovereignty, on the one hand, and less autonomous policies, on the other?

1.3 Political Economy Constraints on Monetary Sovereignty – On the Need to Revise the Chartalist Hypothesis

The argument made in this chapter – monetary sovereignty should matter (given the theory) and, to an extent, really does matter – does not imply that sovereignty would always matter. Indeed, as I noted at the outset, it appears nothing short of paradoxical that the post-Bretton Woods era often sees so many monetary sovereigns to adapt a very uniform set of economic policies. More particularly, if monetary sovereignty widens fiscal policy space, as a growing number of people now accept it does, why do states so often pursue restrictive, counter-cyclical fiscal policies?

Against the standard view in IPE and mainstream economics, I maintain that the chartalists are right in emphasizing that monetary sovereignty matters. They also have it correct that in principle – that is, when only the economics of the issue is considered – sovereignty increased when the post-war fixed exchange rate system collapsed. It seems to me, however, that the chartalists fail to provide a comprehensive picture of the political economy of the current monetary regime. Because of its narrow focus, the chartalist account needs to be supplemented. The chartalist hypothesis (stated in Section 1.1.), while correct about the basic importance of monetary sovereignty, needs to be augmented and revised with insights that fall within the disciplinary boundaries of GPE.

The modern monetary theorists, of course, are perfectly aware of the fact that monetary sovereignty in itself does not guarantee that states would in fact take advantage of their macroeconomic policy space. They rarely, however, elaborate on – or much less – have a theory about the reasons why states so often bypass the gains of monetary sovereignty. As Wray and Sardoni (2007, 20) put it, “in the current world situation, floating exchange rates are a necessary, but not sufficient, condition for the implementation of
policies able to promote growth, employment and welfare”. Whether such policies actually become implemented is, in turn, “contingent on the ability and willingness of social, political, and economic actors to do so” (ibid., 20).

While this evaluation is certainly correct – and indeed almost self-evident –, it does not really explain why, in the present conditions of increased fiscal policy space, states often engage in ruthless fiscal austerity. The chartalists are right that sometimes countries tie their hands “voluntarily” and “unnecessarily”. However, this story is too simple and voluntarist as it does not account for key processes of political economy that do the constraining. The task is to explain which factors of the global political economy condition “the ability and willingness” of the decision makers to pursue independent policies. My key goal in this thesis to contribute to such an explanatory theory.35 The chartalist economics of monetary sovereignty have to be incorporated into a comprehensive political economy of monetary sovereignty that is able account satisfactorily for complicated questions such as the ones posed in this thesis.

Now, it is essential to understand that the wider political economy constraints on the exercise of monetary sovereignty are no mere “supplements” to the economic constraints (of which the chartalists are aware; see Section 1.1.7). Indeed, the entire distinction between them – while it may have heuristic value – is spurious if taken literally. First, political economy constraints (such as legal-institutional ones) may be just as binding as most of economic constraints. Second, and more importantly, the institutions and rules of political economy in fact constitute the bulk (if not all) of the “economic” constraints. If for instance, the exchange rate system were arranged in a different way, the policy space of monetary sovereigns would be affected. The same goes for the structure of domestic economic institutions. If central banks did not have the capacity to issue currency and finance state spending – or indeed, if central bank-like entities did not exist – states would face a hard budget constraint (they would have to finance their spending by taxing and borrowing). The strength or even the very existence of economic constraints thus depends on the institutional set-up. The same goes for instance for inflationary pressures – their existence and strength are not robust

35 It is clear, of course, that a theoretical account of the set of conditions that would suffice for the adoption of pluralist and progressive policies cannot really be formulated, even if we restrict ourselves to the “current world situation”, as Sardoni & Wray (2007) do in their account of the necessary condition. An effort to formulate such an account would be uninteresting, because there simply is no unique (set of) condition(s) that in itself would be sufficient.
under institutional changes (hence, for instance, talk of a *natural* rate of unemployment consistent with low inflation is seriously misleading). Indeed, as especially critical realists have repeatedly noted, there are no institutionally invariant economic laws (see for instance Lawson 1999). Even most economic *properties* do have a distinctive socio-political component. As I suggested, monetary sovereignty of contemporary states, for instance, emerges through a complex institutional structure (the necessary components of which are for instance state currencies, domestic monetary and fiscal institutions, practices of a particular kind, and a flexible exchange rate arrangement).

Even when we are not speaking of “concrete” institutional or legal constraints, but concentrate on hegemonic ideologies or discursive formations that influence the decisions taken *within* an institutional framework, we are not speaking about any “softer” (less important) things. The strongest of ideologies and discourses are very pervasive and almost impenetrable – they are hegemonic common sense (of the Gramscian type) that sometimes appears almost to determine what we think and how we act. Since ideologies clearly also influence which kind of institutions are designed, they influence which kind of “economic” constraints on policy we get. To borrow from the philosophy of mind terminology, ideologies and discourses are no mere epiphenomena, but powerful mental causes.

While it is useful to make distinctions between various types of constraints, it is then important not to inadvertently commit oneself to the completely unsustainable (and indeed powerful ideological) view that there is a world of “economic necessity” altogether separate from our thoughts, intentions and politics. On the other hand, one should not erroneously conclude from the fact that economic constraints are not impenetrable or natural that these constraints would be powerless. To simplify somewhat, one can plausibly think that there is an “institutional level” that mediates between the brute natural facts and social thought and action. Moreover, the constraints of the natural world (such as the physical, geological, biological, and ecological ones) also transmit their constraining power into the social world. Social structures are *both* dependent of *and* irreducible to intersubjective thought.

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36 While there are few brute facts in economics, it is important to note that there is a basic “economic” (albeit fundamentally it is rather a geological or ecological) constraint on economic policies: the achievability of real resources constrains production and spending possibilities.
Regarding the apparent paradox of the modern money era I described earlier, it is my contention that the answer to the question of why the increased monetary sovereignty rarely translates to experimental economic policies has to lie in the larger constellation of power relations that shape the current system of global monetary governance. These relations manifest themselves in various ways, including governance approaches that are biased in favor of certain economic and geopolitical interests and against others. My argument is that several distinct but interrelated ideological and institutional elements inform the contemporary framework of governance that prevents, or at least discourages, states from taking advantage of the increased policy space that the enhanced monetary sovereignty brings them. In other words, I will attempt to situate the monetary sovereign states in the wider political economy of the post-Bretton Woods regime of monetary governance. Governance practices, institutions and ideologies thereby become the key issue. Exchange rate arrangements, while they are of great importance for understanding the economics of monetary sovereignty, take a backseat when the exercise of monetary sovereignty is the object of study.

There is indeed a huge and mounting literature on neoliberalism that goes some way towards explaining constraints on the exercise of monetary sovereignty, albeit in an unsystematic and occasionally contradictory manner. While they often highlight important single points, many analyses of “neoliberalism” are often somewhat disoriented. Many of them tend to concentrate almost exclusively on the impact of individual figures like Reagan and Thatcher. Of course, there are the theoretically more advanced accounts of structural, “disciplinary” neoliberalism, too. As explained above, however, these accounts often fail to explain economic policy constraints in the era of monetary sovereigns in a satisfactory way since they postulate economic and financial constraints that are at odds with realistic (Post Keynesian) monetary theory. In

37 In Cohen’s (2008, 3) conception of monetary governance, “the challenge of governance is understood to involve all the main features of monetary relations among states – the processes and institutions of financial intermediation…as well as the creation and management of money itself. Who makes the rules and exercises authority in monetary matters?”.

38 I thus agree with Ruggie (1982, 382): “To say anything sensible about the content of international economic orders and about the regimes that serve them, it is necessary to look at how power and legitimate social purpose become fused to project political authority into the international system” (emphasis in the original). The post-Bretton Woods era of floating exchange rates and monetary sovereigns does give many states fresh policy space that, for a complex of reasons, easily goes unutilized. In a marked contrast to the Bretton Woods compromise, in the present governance regime power and social purpose are, largely, against macroeconomic policies alleviating such social concerns as unemployment, poverty, and household over-indebtedness.
discussing and revising the neo-Gramscian accounts of neoliberal transition and
disciplinary neoliberalism in Chapter 4, I hope to contribute to a more precise and
realistic theory of the limits on the exercise of monetary sovereignty in the
contemporary era.

In what follows, I will first provide a causal-historical account of the development of
the parts of current monetary governance regime that matter most for the political
economy of monetary sovereignty. After that, I will evaluate the regime from a
normative standpoint and make a case for an alternative vision for the exercise of
monetary sovereignty in the contemporary global era. For these purposes, I need a
theoretical framework that allows me to pursue both of these – somewhat separate but
also tightly interlinked – tasks as fruitfully as possible. In the next chapter, I will reflect
on the pertinent theoretical and methodological issues.

2 Theoretical Reflections

There exists no single self-sufficient theory – nor a method – that could
straightforwardly be applied to accomplish the tasks I set to myself above. It is therefore
necessary to select and cultivate promising elements of those existing approaches that
currently are capable of illuminating some key features of the contemporary political
economy of monetary sovereignty. While the overall philosophy that informs the
approach of this thesis recommends to draw eclectically from all compatible theoretical
traditions that are able to produce convincing evidence-based truth claims, a few
frameworks take precedence over the others. These are neo-Gramscian GPE and Post
Keynesian economics. In Chapter 5, I will additionally draw on the cosmopolitan
theories of democracy. Throughout, I am guided by a (critical) realist philosophy of
science. Below, I will consider the merits (and weaknesses) of these approaches. From
this discussion, a justification for my decision to employ these frameworks emerges.
Before that, however, I will briefly comment on the poverty of the standard political
economy problematics in the next section in order to explain why I will not draw much
from the “mainstream” paradigms in neither IPE nor economics in this thesis.
2.1 Common Deficiencies and Omissions of the Standard Approaches to the Study of Political Economy – How to Address them?

While orthodox economists tend to pay only passing attention to the real-world institutions and arrangements of the contemporary global political economy, the overall focus of the existing IPE literature has been content to describe the most general characteristics (such as exchange rate regimes and “hegemonic” currencies) of various eras of governance. There have also been frequent attempts to isolate alleged key relationships between “economic” and “political” factors, while assuming that the larger setting behind those relationships remains constant (Cohen 2008b). The liberal institutionalist and neorealist scholars typically concentrate on debating the issue of cooperation versus noncooperation in the governance of the global economy. A lot of this discussion concerns rather formal properties of the global monetary system, including various types of exchange rate arrangements, political stability conditions and issues of hegemonic power. (Ravenhill 2011; O’Brien & Williams 2010.) These topics of concern evidently reflect the hegemonic power status of the United States in the global political economy. Understandably, status quo theorists in the US are worried about, for example, the future of the dollar, which they – quite correctly – view as inherently linked to the enduring position of the United States as the global hegemon. Generally, the predominance of the so-called American school of IPE ensures that the disciplinary journals are mostly filled with US-centric topics of interest. (Cohen 2008b.)

Since the 1990s, the emerging monetary unions have started to gain attention in IPE. The founding of the European Monetary Union, in particular, raised a lot of interest among scholars. Here too, however, the IPE discussion seems to remain quite exclusively on the general characteristics of monetary unions. While I certainly agree that, for instance, exchange rate regimes do matter a great deal, too exclusive a focus on general formal properties (or relationships) of the global monetary system within the mainstream has been harmful to the relevance and versatility of the research area. These exclusions contribute to the feeling that mainstream IPE journals are “becoming boring” (Cohen 2010).

39 This type of “mid-level theory” can be understood as being an instance of what Cox (1981) calls “problem-solving theory”.
A key deficiency in the existing IPE literature is that frustratingly little can be learned about substantive theories, ideologies and actual practices of monetary governance from reading it. Scholars seem to routinely neglect the importance of covert power relations and ideology. Related to this, many avoid substantive issues of economic theory – not without a great cost for the explanatory power of their theories (Patomäki 2003). Some evidence for this is the inability of the field to account for systemic crises in the global political economy – as Cohen (2009) poignantly notes, IPE scholars generally failed, for instance, to anticipate the outbreak of the global financial crisis.

It seems to me that political economists in general have paid too little attention to monetary doctrines. Of course, some of those doctrines, especially central bank independence has been widely discussed by democratic theorists and theorists of neoliberalism (see McNamara 2002). Even central bank independence, however, is rarely understood to be really only one component of a relatively newly emerged consensus view in macroeconomics. If, on the other hand, political economists explicitly refer to economic theory as such, they usually deem practices like central bank independence and inflation targeting as being instances of “monetarism”. However, this ascription, too, is tenuous. As I will explain in some detail below, it is true that the current consensus has integrated certain monetarist elements, but it has nevertheless also incorporated important features that actually are quite at odds with traditional monetarism. Despite this, recent political economy literature still discusses the view that was indeed hegemonic in the 1980s. It is worrying that most political economists have not taken such shifts in the economic theory and praxis seriously enough. It seems that even some very insightful critical students of neoliberal governance have not yet recognized that the mainstream monetary theory and practice has made certain quite important advances over monetarism (for instance Gill 2003, despite all its merits, falls short in this respect). As the existing literature seems to pay

40 Most of Cohen’s critique is directed at what he calls the American School of IPE, but he is certainly not satisfied with the British School either. Both schools, to add insult to injury – failed almost as severely as neoclassical economists did.

41 By the end of the decade monetary economists and central bankers, however, figured out that its defining assumption – the supposition that a central bank could control monetary aggregates – was fatally flawed. As a result, a new monetary “consensus” began to shape. This development, among others, has not gained sufficient attention.

42 The new consensus has, for instance, adopted some of important tenets of the heterodox Post Keynesian literature (although the new consensus theorists typically have failed to give credit where credit is due). Arguably, the most crucial of these lessons learned is the (at least partial) acknowledgement of the endogeneity of credit money.
too little attention to the development of new hegemonic views within economics, outdated views are often discussed.\textsuperscript{43}

How to overcome the deficiencies and fill the omissions? It may very well be the case that political scientists, even those who focus on the study of the global political economy and its governance, have volitionally restricted their focus in a way that leads them to avoid questions commonly seen to fall within the boundaries of “pure” economic theory. However, it is not really a viable option for political economists to either embrace or ignore contemporary mainstream economics. It cannot be embraced because its methodological underpinnings and ontological commitments reject the very possibility of a field of global political economy with an explicit goal of tearing down the narrowly economistic categories on which neoclassical thinking relies. It is also not advisable for political economists merely to ignore the mainstream. Hegemonic economic ideas have enormous real-world economic, political and social consequences that should be among the GPE’s key objects of study. This thesis, hence, starts from a conviction that the best way forward is critically to evaluate the value and applicability of the various doctrines of mainstream economics from a broader social science perspective.

For this kind of approach to have an impact, economic theory has to be taken seriously enough. In order to avoid vague talk about – and reliance on – half-forgotten economic doctrines, political economists should engage in serious efforts to integrate insights from heterodox economics to their own research. For instance, the neo-Gramscian narratives on the development of economic governance would gain significantly if they were backed by evidence from heterodox economics, as suggested by Patomäki (2003, 197-220). In this thesis, I will attempt to add more flesh to this very plausible argument.

This point generalizes to other schools and many issue areas of the study of political economy: heterodox economics should be taken much more seriously. Potentially, the “dismal record” of mainstream IPE scholars in foreseeing financial crises (Cohen 2009; Helleiner 2011), for instance, could be significantly improved upon. As I will also suggest in this thesis, theorists of cosmopolitan monetary governance, too, would gain

\textsuperscript{43} I certainly do not want to suggest that mainstream macroeconomic thinking has progressed in a fundamental way during the last two decades. The theoretical corpus still basically relies – without any convincing justification – on Say’s law and the neutrality of money axiom (Ahokas & Holappa 2014, 238–278). It seems to me, however, that the current form of mainstream thinking – with its own peculiar doctrines and idiosyncratic institutional manifestations – definitely requires attention of its own.
enormously by studying the works of the Post Keynesians. These remarks apply also the other way around. Economists would do well to incorporate serious political theory and analysis into their theoretical frameworks.

If we, in contrast to the currently dominant IPE paradigm, move beyond the focus on most general characteristics of the global monetary economy and look for the neglected substantive theories and ideologies of global monetary governance, we will soon find a much richer world to investigate. Adopting this vantage point, governance of the global monetary economy does not reduce to exchange rates systems and formal contracts, and agreements between states do not exhaust forms of cooperation. Heterodox perspectives suggest that the future of the dollar may not be the question that matters the most and that monetary unions may be more interesting in their specific institutional structures and substantive policies than in their mere existence. This change in research focus invites the curious political economist to adopt a more pluralistic and eccentric research approach than the ones favored by the mainstream. Let me now have a look at some of the approaches that seem to have something to contribute to the study of the political economy of monetary sovereignty.

2.2 The Promises and the Shortcomings of the Neo-Gramscian Alternative

Whereas, as discussed above, the focus of the mainstream IPE remains on a rather restricted set of variables and topics, the so-called neo-Gramscian school provides an example of a critical school in GPE that highlights the significance of ideology and “cultural” hegemony in global governance. Since they adopt a historical (or “historicist”) methodology, the neo-Gramscians are able to tackle and problematize issues standardly neglected by the mainstream approaches. The works of Robert Cox, Stephen Gill and Kees Van Der Pijl, among many others, have become important points of reference for many critical scholars dissatisfied, or simply bored, with the conventional theories and methodologies in IR and IPE. The Neo-Gramscian school promises an alternative for standard Marxism, too. The school’s critique of Marxist structuralism represented, for instance, by Immanuel Wallerstein’s world-systems theory has appealed to many on the contemporary left. (Ayers 2008, 1–16.)

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44 Whether it is appropriate to speak of a neo-Gramscian school is contested (Ayers 2008, 3).
While the widening of the research focus, advocated by the neo-Gramscians, should be wholeheartedly embraced, the school’s approach also fails in many important respects (see, e.g. Ayers 2008). Two critiques, drawing from Patomäki (2003, 198–200), are especially relevant for the orientation of the present study. Firstly, the inability of the neo-Gramscians to integrate insights from heterodox economics into their analyses has impeded the school’s capacity to illuminate the precise theoretical underpinnings of the hegemonic forms of contemporary monetary governance. The neo-Gramscian stories about “neoliberal transformation” in this area of governance are unsystematic and wanting in concreteness. Secondly, while the neo-Gramscians boldly and characteristically engage in normative analysis, their account of normative critique remains underdeveloped and, ultimately, unsatisfactory.

The great achievement of Antonio Gramsci himself lay in overcoming the economism prevalent in the Second and Third International Marxist thinking. Gramsci, probably more powerfully than any other Marxist theorist before (or even after) him, highlighted the relative autonomy of the political and cultural “superstructure” in respect to the economic “base” (Laclau & Mouffe 2001, 65–71). If I am correct, Gramsci’s emphasis of the cultural hegemony largely accounts for the neglect of economic theory in today’s neo-Gramscian scholarship. This, I will argue, is a very peculiar mistake that partially explains why “the neo-Gramscian school simultaneously overinflates its explanatory powers and is substantially inadequate in its concrete analysis” (Saurin 2008, 25).

The “cultural turn” in Marxism, for which Gramsci underlabored, undermined crude forms of Marxist economistic determinism, which is an invaluable achievement. (Laclau & Mouffe 2001.) However, even though *economism* should be rejected, interest in *economic theory* should not be. I argue that the importance of this distinction is lost when economic theory is uncritically equated with either the mainstream neoclassical theory or its orthodox Marxist critique. These two theoretical traditions – however opposed they are in much of the substance – famously share the view of the primacy of

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45 The topic of “neoliberal transformation” has been at the center of attention in neo-Gramscian scholarship (Patomäki 2003, 199; Ayers 2008).
46 Gramsci understood “economism” to be “the general fallacy of separating the economic from the political” (Short 2012, 45). From the point of view of social theory, economism refers to the idea that economic structures are *primary* in the sense that they *uniquely determine* the form of wider social and political (and, in a strong version, even mental) structures. For the orthodox Marxists of the Second International, such as Karl Kautsky, class struggle was the determinant of all social life (Laclau & Mouffe 2001, 14–19). Similarly, for the ultra-orthodox neoclassical economists of today, such as Gary Becker, all social relations reduce to the calculation of economic utility.
the “economic” with respect to other modes of socio-political existence. They thereby are both deeply economistic traditions of thought. However, it would be quite wrong to equate economic theory as such with economism – the general possibility of economic theory does not hinge on the assumption that the economic sphere would be primary. Indeed, instead of ignoring economic theory altogether, the neo-Gramscians should look for non-economistic forms of economic thought to develop their theoretical approach further. It seems clear to me that nothing of Gramsci’s important lesson about the importance of hegemony and ideology gets lost in doing that. To the contrary, as I hope to illustrate in this thesis.

The lack of an adequate account of normative critique is the second important shortcoming of the neo-Gramscian approach. While neo-Gramscians put much weight on the first order task of critique of the hegemonic world order\textsuperscript{47}, the second-order task of founding the critique on an adequate basis remains uncompleted. This deficiency reflects itself in the lack of interest towards concrete reform proposals, as well as in uncritical celebration of resistance (Buckley 2013). Partially this state of affairs may result from the rather close “family resemblances” between neo-Gramscian and constructivist or poststructuralist thought (Saurin 2008, 39).

Because of these crucial deficiencies of the school, my approach to the study of the political economy of monetary sovereignty is not neo-Gramscian in any straightforward or emblematic sense. I will, however, draw heavily from the valid insights of the neo-Gramscian scholarship. In Chapter 4, I will develop neo-Gramscian hypotheses\textsuperscript{48} concerning neoliberal transformation and new constitutionalism in monetary and macroeconomic governance\textsuperscript{49}. I will take advantage of key Gramscian ideas (among them the notions of hegemony, historical blocs, and organic intellectuals). My goal is to show that it is illuminating to scrutinize the political economy of monetary sovereignty from the point of view of neo-Gramscian analysis. While the neo-Gramscian approach has its own distinct strengths, I approach the school as an example of a critical GPE

\textsuperscript{47} Gill (1993, 24) argues that the Gramscian approach “insists upon an ethical dimension to analysis” as opposed to the mainstream approaches which prioritize “the pragmatic need for systems management”.

\textsuperscript{48} I am aware that neo-Gramscians rarely speak of “hypotheses”. I agree with Patomäki (2003, 200) that they probably should do so and aim at the systematic empirical evaluation of the hypotheses. My goal is to advance this turn in neo-Gramscian thinking.

\textsuperscript{49} New constitutionalism is a Gramscian theme for instance in the sense that it contributes to the “theory of stasis” that late Gramsci developed in his Prison Notebooks (Saurin 2008, 39).
school that could gain from insights drawn from Post Keynesian economics (and realist philosophy of science).

2.3 The Post Keynesian Heterodoxy Concerning Money and Monetary Systems

As I suggested in the previous section, heterodox schools of economics provide insights into the operation of the economy that are not (or at least are not inherently) economistic. Because for instance unorthodox Marxist, Post Keynesian and various “institutionalist schools” of thought are usually deeply aware of the fact that there does not exist any isolated or self-sustaining set of (social) relations that would constitute a closed system, “the economy”, these schools tend to be much more tolerable towards insights from other (social) sciences than the neoclassical mainstream of economics is. Often these schools even encourage articulation of such insights.

The Post Keynesian theory strikes me as the most plausible and advanced theory of certain key processes and institutions of the capitalist monetary economy of the 21st century. Largely, this is because the most fruitful strands of Post Keynesian thought focus explicitly on monetary macroeconomics. Most of mainstream neoclassical thinking remains severely impeded by the images of commodity money. In that tradition, it has namely been standard to think that, fundamentally, money is merely another scarce good among other scarce goods, even though it is convenient to use it as a medium of exchange (Graziani 2003; Wray 1998). Furthermore, within the mainstream, capitalist production still is not seen to aim at the accumulation of monetary wealth. Instead, market capitalism is often theorized to be a pure exchange economy in which everyone gains (in wages, profits or rents) as much as he or she contributes. Post Keynesians, by contrast, unambiguously reject the commodity money

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50 Various “institutionalist” approaches to economics differ from each other to the point that “institutionalist economics” lacks a sufficiently clear object of reference. Post Keynesian economics is an institutionalist school in the simple sense that it pays much attention to the concrete (and relevant) institutions of capitalism. However, as I will argue in this thesis, even Post Keynesian theory, in its present form, is not institutionalist enough!

51 Please note that my endorsement of Post Keynesianism here is aimed to be modest: alternative theories may well be - and often in fact are - more successful in explaining certain other aspects of contemporary actually existing capitalism. For instance, Marxists have arguably the fullest theory about power relations in capitalist societies, whereas Schumpeterians (and perhaps Austrians generally) may claim to have the most developed insights in other areas, such as the theory of innovation. An overall theory of capitalism, of course, would combine the best compatible aspects of the existing theories.

52 Post Keynesian microeconomics exists as well (see Lavoie 2014). However, it seems to me that it does not always have that much to add to behavioralist economics (see for instance the research conducted by Kahneman (2013)), with which it would appear to be be broadly consistent.
approach and instead see capitalism as a demand- and profit-driven economic system in which the right to contribute may even be effectively denied from some people, as there exists continuous involuntary unemployment (Graziani 2003, Wray 2012).\textsuperscript{53} Because of its explicit interest in the theory of money, Post Keynesian theory is thus the most interesting economic theory from the point of view of the study of monetary governance. In this thesis, I argue that when combined with insights from critical political theory, Post Keynesian analysis can be very helpful for understanding and evaluating real-world governance institutions and decisions\textsuperscript{54}.

There are various strands of Post Keynesian thinking (see for instance King (2002) and Lavoie (2014)). The so-called circuit theorists, for example, have been interested in studying the relation between private credit institutions and the cyclical patterns of capitalist economies (Graziani 2003; Keen 2011; Parguez 2002), whereas the chartalists (Knapp 2012; Wray 2012) have concentrated on examining the macroeconomics of sovereign monetary systems, highlighting the importance of state money creation in capitalist economies. These strands – and there are others, such as the traditional Kaleckian, Kaldorian and Davidsonian approaches – can teach a great deal about the operations and processes of the real-world monetary systems. While there evidently are many branches of Post Keynesian thought, they mostly differ in matters of emphasis. There are good prospects of (and there have been attempts at) a Post Keynesian synthesis (Kerr 2005).

In what follows, I draw extensively from the insights of the Post Keynesians. While the chartalist theory of monetary sovereignty underlines my very research setting, other Post Keynesian tenets, too, will prove useful in the course of the study. Even though I approach monetary governance ultimately from the point of view of the study of political economy, the subject matter (political economy of monetary sovereignty) requires me to pay much attention to economic theory as such. Indeed, one of the arguments of this study is that cross-disciplinarity is needed to gain understanding of real-world governance phenomena. Whenever useful, I will also draw from insights of other neighboring fields, such as economic geography, history and jurisprudence.

\textsuperscript{53} For reasons of space, it is not possible to examine these fundamental debates of economic theory here.

\textsuperscript{54} Several articles in a recent book edited by Jäger and Springler (2015) seem to be motivated by this same conviction.
2.4 The Underlying Realism of the Framework

Because of the pluralism of my theoretical orientation, I find it important to emphasize that the approach is coherent metatheoretically. The coherence of the framework might be cast into doubt by those who are accustomed to accept a very peculiar philosophical divide in the social sciences (and within the disciplines of IR and IPE in particular). This is the divide between the “positivists” and the “postpositivists”. Whereas positivist studies are usually seen to aim at tracking statistical regularities between events as if it were possible to separate distinct atomistic events and view the regularities between them as “laws” (Lawson 1997), postpositivist approaches are seen to favor methodologies that promote “understanding” (such as discourse and ideology analysis). In the debate between the schools, the positivists generally maintain that the postpositivists methodologies are not sufficiently “scientific”, while the post-positivists complain that the positivist approaches do no justice to the meanings of phenomena that they consider the defining features of all interesting social entities and processes to be. (Hollis & Smith 1991).

Given this divide, it is standardly assumed that economic theory (of any stripe) almost by way of necessity adheres to a positivist worldview and methodology. On the other hand, the approach of the neo-Gramscians, as much as it puts emphasis on ideological and discursive phenomena, would clearly fall within the second, postpositivist camp. The pluralism of the theoretical underpinnings of my study might thus suggest to the average contemporary social scientist – all too often trained to take the above (pseudo)philosophical dichotomy at face value – that I am illegitimately trying to combine positivist “results” of economic theory with postpositivist insights of hegemony and ideology analysis. He or she might advise me to choose sides, as positivism and post-positivism, so the standard story has it, are mutually contradictory.

However, the above philosophical dichotomy is a false one. Positivism and postpositivism do not exhaust the options available. Accordingly, the corresponding methodological choice should not be made between statistics and discourse analysis, to put the standard choice crudely. Indeed, it seems to me that positivists and postpositivists have both reached erroneous conclusions about the ultimate nature of social reality. The recipe, however, is not simply to “combine” the methodological rivals – that indeed would be illegitimate given the contradictory background philosophies – but to
transcend the methodological divide on the basis of a justifiable philosophy of social science. The way out of methodological dogmatism is to embrace a generally realist ontology and philosophy of science. Scientific realism emphatically “is not a middleground position between positivism and interpretivism” as “the latter two positions actually share much more in common with each other than either does with [scientific realism]” (Rivas 2010, 203–204).

Despite its many merits, I feel reluctant to claim the superiority of critical realism over other accounts of scientific realism. The works of Bhaskar (1975, 1986) provide excellent examples of impressive realist philosophy of science, but so do for instance Putnam (1990) and Searle (1995). While critical realism certainly deserves special credit for its advanced application of realism to the social sciences, it is important to remember that “Bhaskar’s account of scientific realism/critical realism is not the only one and it is possible to develop an account of scientific realism that draws on a wide, and differing, range of intellectual resources that go well beyond Bhaskar” (Wight & Joseph 2010, 3). Critical realism may not even be the clearest heir of scientific realism, as the latter position is most often understood in the philosophy of science (Mäki & Oinas 2004). Furthermore, in some critical realist circles, Bhaskar’s work appears to have become “a canonical meaning-structure” that is taken to be beyond criticism and many critical realists have neglected, for instance, the importance of the recent developments in the empirical sciences (Patomäki 2010, 61). It seems to me that several other contemporary versions of realism in the philosophy of science are more up-to-date in this respect. Critical realism thus has both distinct strengths and distinct weaknesses compared to other accounts of scientific realism.

Why does the endorsement of realism help to overcome methodological dogmatism? In the most plausible realist conceptions, there is a sense in which there is a “world without meaning” (the brute facts of the natural world) and a “world full of meaning” (the social world that emerges from the more basic elements through the interaction of conscious minds). Such a basic ontology does not imply that a strict separation could be drawn between the study of natural and social worlds. Because the social world

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55 I agree with Kuorikoski & Ylikoski (2006) that, for instance, critical realist accounts of causation and explanatory relevance could be developed further based on insights from other recent realist philosophies of science. For reasons of space, I will not enter the interesting points of disagreements between different realisms in this thesis. While certain reservations can be made with regard to all of the established accounts of realism at the level of details, I regard realism as superior to its antirealist alternatives.
indisputably emerges from the natural world\textsuperscript{56} (Searle 1995), it should be clear that causal “mechanisms”\textsuperscript{57} of the natural world continue to have effects in the social world.\textsuperscript{58} It seems equally clear that the reasons, beliefs and meanings of the social world interact with the underlying mechanisms because they are causally efficacious themselves (Raatikainen 2010). The operation of causal mechanisms is a matter to be explained even if many causes peculiar to the social world cannot be accounted for without advanced skills in understanding. As argued by Kurki (2008), causes are not the kind of phenomena that almost all paradigms in IR have imagined them to be.\textsuperscript{59} Consequently, any sharp distinction between causes and reasons – as well as explanation and understanding – ultimately collapses. This fact obviously has liberating methodological implications.

On several occasions, Post Keynesianism has been argued to be underpinned by a (critical) realist philosophy of social science (Dow 1999; Lavoie 2014, 12–15; Lawson 1999). Similarly, those neo-Gramscian elements of which I take advantage of are, I believe, compatible with a realist philosophy of science. However, while Post Keynesian literature contains only relatively minor schisms with realism\textsuperscript{60}, neo-Gramscian insights require more processing to fit a realist approach. Joseph’s (2002) realist interpretation of Gramscian hegemony provides one example of the kind of work that has to be carried on. As he correctly notes, “there is a tension between the

\textsuperscript{56} What should be discussed, really, is only the question of in which way it emerges.
\textsuperscript{57} While I speak of here of causal “mechanisms”, I agree with Kuorikoski & Ylikoski (2006) and Patomäki (2010) that the meaning of the concept should be sharpened and clarified.
\textsuperscript{58} As Tony Lawson (1997) remarks, theoretically, a complete explanation of every social phenomenon would include the occurrence of the Big Bang (if it indeed is the correct theory about the origin of the universe). Obviously, in practice the need for social scientists to take the Big Bang into account in their theories never arises because explanations of the social sciences should be contrastive: it suffices to examine the relevant alternative causes that could explain the event or phenomenon under investigation. There is, however, no a priori reason why mechanisms of the more “fundamental” kind could not figure in the explanations of social events in a fruitful way. Certainly, most would agree that, for instance psychological, biological, or geological explanations have, in some cases, been illuminating or, at least, provided useful raw material, for the social sciences even if they never fully account for any social phenomena in themselves.

\textsuperscript{59} The IR schools have almost invariably understood causes to be “Humean regularities”, by now a view universally rejected in the philosophy of causation (Kurki 2008).
\textsuperscript{60} The scientific value of econometrics might be one such schism. While there are Post Keynesian studies utilizing econometric methodologies, critical realists (see, e.g. Lawson 1997) have often argued that because of its closed-system assumptions econometrics is fundamentally flawed. However, most Post Keynesians avoid heavy use of econometrics. In the final analysis, it may also turn out that not all uses of econometrics are vulnerable to such criticism.
philosophical realist implications of Gramsci’s political analysis and his explicit philosophical claims” (Joseph 2008, 70).

Because of its various concrete methodological ramifications, realist philosophy does not “merely” underlie my approach – it directly informs it in two key respects. Most importantly, realism provides important hints about (i) how best to explain complicated causal-historical processes and (ii) how to engage in constructive normative criticism.

2.4.1 Modelling open systems

The practice of “iconic modelling” (Harré 1970; Patomäki 2002, 123–142) – a realist approach to the modelling of open systems – illustrates concretely how arbitrary the gap between causes and reasons really is: an iconic model about any interesting social phenomenon features causes and reasons side by side. Iconic modelling is based on the conviction that a “reductive” in contrast to an “ampliative” approach to explanatory modelling is the preferable way to pursue research in the social sciences. In practice, this means that the researcher should not attempt to deduce an explanation out of certain allegedly “unshakable” premises, but should instead first come up with a handful of plausible-looking (perhaps contradictory) explanatory stories and then evaluate their explanatory power against the existing evidence. Ideally, only “the most defensible position” would outlive the multiple rounds of testing consisting of empirical challenging and conceptual critique. The explanatory story would be completed in the course of this dialectics. (Rescher 1987, 28–43.) The inspiring motivation behind this research approach is to combine pluralism, imagination and creativity with systematic modelling, explicit hypotheses and an empirical orientation (Patomäki 2003, 206–207).

In this thesis, I will develop neo-Gramscian and chartalist stories by revising them in light of the most relevant and reliable truth claims. Within the constraints of this thesis it is, of course, not possible to test theories in anything like sufficient depth. Competing revisions based on different raw materials could be provided. The key point then is not to say the final word about the issue under study (even though ultimately that, of course,

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61 There is a debate about Gramsci’s philosophical position. It is not hard to find philosophically realist elements in his thinking.

62 In other words, social scientists should not attempt to mimic the style of mathematicians and logicians. There is no secure set of context-independent premises of human behavior (or axioms of action) from which reliable theorems could be deduced. Many economists, for instance, favor this sort of deductivism, but the research agendas based on it generally fail to illuminate.
should be the goal), but to test and develop explanations against each other and the existing empirical evidence.

2.4.2 Realist normative critique

Another methodological lesson of realism concerns the practice of normative analysis. In Chapter 5, I engage in explicit normative evaluation of contemporary monetary governance. First, I will develop a critique of the dominant new consensus practice of governance. Secondly, I will argue that cosmopolitan and Post Keynesian governance thought (including the chartalist branch of the latter) are compatible and even point in the same normative direction.

However, normative research is a contested area of study. The contemporary lay opinion remains confident that moral values are (in some usually unspecified sense) “only relative” or even completely illusionary. In other words, a value statement cannot possibly be a statement of fact, but is merely sort of an opinion. These lay intuitions reflect our cultural and intellectual heritage. The tradition of Western science, in particular, has often assumed the truth of the so-called fact-value dichotomy. An extremely influential philosophical movement in the first half of the 20th century, logical positivism, attempted even to provide explicit foundations for this dichotomy. As an implication of their line of thinking, many of the prominent members of the school came to embrace the view that value statements are not cognitive at all – they are not matters of beliefs but concern only attitudes and/or emotions. If accepted, the logical positivist account of the metaethical status of values would deal a deathblow for all serious argumentative normative considerations since it unavoidably implies that values cannot be rationally discussed. However, there is an overwhelming consensus among contemporary philosophers that the key doctrines of logical positivism have been thoroughly discredited. Because of its dependence on more fundamental discredited dichotomies, the famous clear-cut dichotomy between facts and values developed by the logical positivists is, arguably, in ruins as well. (Putnam 2002.) Critical realists, it seems to me, support Putnam’s conclusion on the collapse of a strict fact-value dichotomy, because they hold the quest for truth and the pursuit of emancipation to be inherently linked (Bhaskar 1986; Patomäki 2002, 143–163). It seems that “the critical realist

63 This line of thinking suggests that whereas beliefs can be true or false and justified or unjustified, attitudes and emotions cannot.
understanding of science allows us to reclaim the normative and critical purposes of social science” (Kurki 2010, 143).

Of course, contested issues do not end here. Even among those social scientists and philosophers who agree that normative research is appropriate and important, there is a disagreement about how best to pursue it. While critical realists sometimes place most weight on immanent critique (following Bhaskar 1986), if realist intuitions are adhered to, also “constructive” forms of normative critique become possible. By way of contrast to realist critique, antirealist philosophies only enable “destructive” forms of critique. This is because they suspect that values cannot be grounded on anything – if values are not real enough, there is no basis for critique from any precise point of view.64 The work of Foucault is a paradigm example of normative critique of the latter kind. While destructive critique is very powerful and much needed, it seems to me that it can never replace the need of a positive commitment to certain moral principles and values.65 In Chapter 5, cosmopolitan theories of democracy are employed as a basis of realist critique of the new consensus framework of macroeconomic governance (in addition to an implicit critique of the latter). Cosmopolitanism is interpreted as a transformative project, the goal of which is to extend and deepen democracy. It is argued that in a marked contrast to the mainstream consensus, Post Keynesian theories can contribute to such deeply democratic project.66

This section concludes the discussion concerning the theoretical framework. In sum, my approach will draw from both critical GPE and Post Keynesian economics and, when relevant, supplement them with insights from other approaches. The framework is underpinned and informed by a realist philosophy of science that equips me with broad guidelines for both causal-historical and normative research.67

64 Hostettler and Norrie (2003) have suggested that critical realist ethics cannot be “foundationalist” in the Habermasian sense for which Bhaskar seems to argue. I find their argument wanting.

65 In other words, “internal” criticism should never replace “external” criticism entirely. This is not the right place to delve any deeper into these interesting issues. I merely note that external critique fortunately does not necessarily require that there would be any Platonist or transcendental basis of critique. As I see it, the work of Habermas is largely an (successful) argument for this conclusion.

66 It is worth noting that the argument for the possibility of realist normative critique does not imply that there would be two entirely separate tasks of social science, one descriptive and the other normative. While it is often, for practical purposes, useful to distinguish explanation from critique, it follows from a realist philosophy that there is no basis for a strict separation between the two. Both tasks are legitimate and part of the attempt to understand the world in which we act.

67 Realism also provides quite a comprehensive and a general theoretical justification for cross-disciplinarity and pluralism in the sciences. If the world consists of multiple emergent layers, different
3 Features and Forces of Sovereignty-Undermining Governance in the Modern Money Era

As the cases of Canada and Argentina (as well as for instance the U.S., Japan and Sweden) well illustrate, the exercise of monetary sovereignty of states may not always be fatally hampered by the existing processes and institutions regulating and constraining it. On the other end of the continuum, sometimes the constraints are so powerful that they completely eliminate the freedoms contemporary currency-issuing states would enjoy in the absence of the constraints. In these cases, as well as in many intermediate ones, governance is *sovereignty undermining*.

The current regime of monetary and macroeconomic governance is, in a couple of different senses, “minimalist”. First, the governance regime relies heavily on monetary policy, which, I will argue later, is a very *thin form of economic policy*. More substantive policies, such as fiscal and income policies, tend to be excluded from the toolbox as too interventionist or “rough”. Second, the preference for thin economic policies finds a corollary in the *dominant position of central banks* and the preference for *impotent institutions of fiscal governance*. Third, the *support basis* of the minimal policies and institutions is often likely to be weak. In the current “confidence regime” the merits of governance practices and institutions are often evaluated on the basis of mere “investor confidence” alone. Effectively, this implies that the investor community has the greatest normative force in voicing its opinion about which policies work and which do not in the debates on public policy. Fourth, contemporary governance, as far as the pivotal macroeconomic policy decisions are concerned, takes place on a rather *low spatial level*. The key institutions of macroeconomic governance operate at the level

disciplines should study the open system properties and dynamics of these various interconnected layers using various overlapping approaches. In other words, high separation walls between different disciplines and approaches are detrimental and without justification.

I employ here the concept of “regime” but I attempt to do so without committing myself to the distinct “regime theory” developed the American school of IPE. I am aware that many researches in the British tradition have been very skeptical about that theory and I find their critique partially adequate. However, for my purposes here the American school style *definitions of “regimes”* are quite acceptable: “regimes embody implicit or explicit understandings about the rules of the game that help to sustain mutually beneficial patterns of cooperation” (Cohen 2008b, 100–101). (Even though I do not agree that the sustained patterns of cooperation necessarily have to be “mutually beneficial”). What is important is that the study of regimes helps to shift the attention from formal organizations to characteristics, structures, and processes of governance that are more informal.
of a nation state, even though the policies of these institutions obviously have wider – and in many cases even global – repercussions.⁶⁹

In this chapter, the goal is to introduce the reader to these key features and forces affecting the political economy of monetary sovereignty. In Chapter 4, I will then outline a causal-historical account of key theoretical linkages and provide examples concrete institutional manifestations of the dominant governance ideas. There the focus will be on the development of the new monetary consensus and its institutionalization through new constitutional measures from the 1990s onwards (this process is shown to reflect and fortify the alleged “virtue” of market discipline and to produce increasingly impotent national fiscal institutions). In Chapter 5, I will evaluate the regime on normative grounds. I will argue that the new consensus fails to provide any potent – transformative and cosmopolitan – alternatives for future governance. Moreover, I will make a chartalist/ Post Keynesian case for supranational institutions of democratic monetary governance that purports to put strict limits to the applicability of market discipline.

It seems to me that the present monetary governance regime derives a putative theoretical justification for its sovereignty-undermining elements from several sources. A prominent theoretical basis for the current form of monetary policy-centered governance is the so-called new monetary consensus embraced by the mainstream of the economics profession. Fiscal institutions, which the consensus argues to be of at most secondary importance, are conditioned by means of new constitutionalism, a set of normative ideas and disciplinary legal practices that contributes to the concern that the

⁶⁹ While these elements of governance “minimalism” are very real, it is evidently the case that the contemporary global political economy, as was the post-war version of it, is light years away from the free market model presented in standard economics textbooks. Multiple actors and norms actively govern global economy in various fashions. Varoufakis (2013), for one, suggests that the global economic arrangement that followed the Bretton Woods era can be envisaged to be sort of a “global minotaur” organized around the twin deficits of the US. In this metaphor, which indeed captures some relevant aspects of reality, geopolitical might and corporate interests trump free markets routinely. By suggesting that contemporary global monetary governance is in certain key respects minimal, I thus do not mean that the global economy is anything close to being a free market system left ungoverned. Quite to the contrary, governance attempts are very real and their fruits usually are in the (short-term) interests of those doing the governing. Contemporary monetary governance takes very dispersed and cacophonous forms, however. The governance framework is by no means coherent. As Cohen (2008, 5) puts it, “As compared with the elaborate rule-based design laboriously negotiated at Bretton Woods, what has evolved since the early 1970s seems both less restrictive and more rudderless. In the eyes of some, it is little more than a “non-system” bordering on anarchy if not chaos”. Or, as Held (2010, 34) states more mildly, “global governance today has some of the characteristics of a multilayered, multidimensional and multi-actor system”.

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prospects for democratic governance are becoming ever dimmer. The influence of “market liberal” theories of globalization and finance strengthen the view that only investor confidence should matter for the legitimacy of economic policies. The prevailing nation- and state-centered views of democracy maintain that democracy – the confidence of the demos as an alternative basis of legitimacy to narrow business confidence – indeed is hopelessly dependent on the Westphalian notion of state sovereignty (and therefore an impotent relic of the past). These theoretical currents are discussed in this chapter.

3.1 The New Monetary Consensus Regarding Thin Economic Policies

The so-called new monetary consensus emerged from the increasingly tight collaboration between academic monetary economists and central bank authorities over the course of the last 25 years. After a brief hegemony of pure monetarism in the 1980s, New Keynesian ideas gained currency during the 1990s, forming an amalgam with the new classical methodology and those monetarist doctrines that survived to see the new decade. In contemporary macroeconomic theory, this synthesis is often referred to as the new neoclassical synthesis (Woodford 2009). The new consensus view on macroeconomic policy is derived from this broader theoretical synthesis (Woodford 2003). Along with the integral connections to the development of the high theory, it bears emphasizing that the new consensus has been heavily shaped by the practical developments of the recent decades. Its doctrines have been adjusted to account for, for instance, the failures of monetary aggregate targeting fashionable in the 1980s. The new consensus, to a significant extent, provides the theoretical content of the contemporary regime of monetary and macroeconomic governance.

The new consensus is rich in explicit, as well as implicit, policy prescriptions. Arguably the most central of its explicit prescriptions is (what I call) the doctrine of the primacy

70 Despite its name, “New Keynesianism” is a branch of neoclassical economics, the mainstream school of thought from whose influence Keynes (1936) famously sought to escape. To the new neoclassical synthesis, new Keynesians add the idea that nominal variables, such as prices and wages, tend to be “sticky” in the short run. This leads to market imperfections that can be corrected by monetary policy.

71 The basic economics of the new consensus can be expressed in three straightforward equations describing the dynamics of the output gap, the inflation rate and the monetary policy rule (see for instance Woodward 2003). Sometimes other equations are added, but these three equations have standardly been taken to describe the essentials of the new consensus model.

72 I argue, however, these lessons of practice have not often affected the broader theory as deeply as they arguably should. The theoretical hardcore of neoclassical economics is left intact by means of further expanding its Lakatosian “protective belt”.

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of monetary policy. It suggests that monetary policy is the most “effective” policy instrument for managing capitalist monetary economies, at least in the usual circumstances. Hence, monetary policy should take a primary role in the economic policy package. An obvious corollary to this doctrine is the inclination of the consensus to dismiss other forms of economic policy (most notably budget and income policies). They are seen as secondary, at best. At worst, the use of these policies is considered outright harmful for the functioning of a “healthy” market economy, except for certain special cases. (Bernanke & Mishkin 1997; Blinder 1996; McCallum 2002; Taylor 1999; Woodford 2003.)

A more implicit, but nevertheless a core doctrine of the consensus is central bank independence, which – to cut to the underlying political ideology – asserts that money is not a proper concern for democratic politics, but that the conduct of monetary policy should instead be left to trained experts. These two doctrines should not be understood as separate tenets of faith, but as internally related and mutually constitutive, since their justification is, to a large extent, derived from the same theoretical framework. In addition to these core doctrines, other key policy tenets of the current monetary consensus include the idea that the focus of the conduct of monetary policy should be on inflation targeting. Moreover, central banks should conduct monetary policy in an “active” fashion and acknowledge the importance of “gradualism” (avoid sudden shifts in monetary policy) and “transparency” (communicate with the market actors routinely).

In addition, there is now an important technical agreement among monetary economists that the primary instrument of monetary policy is the overnight interest rate or its equivalent. (Bernanke & Mishkin 1997; Blinder 1996; McCallum 2002; Taylor 1999; Woodford 2003.)

It bears emphasizing that the new monetary consensus is a very peculiar type of “consensus”. Even though it represents (or at any rate, used to represent) a high level of shared understanding concerning basic issues of macroeconomic policy-making among neoclassical monetary economists and the elites in charge of monetary governance (especially among the central bankers who, as a rule, are monetary economists themselves), the “consensus” view has been contested vigorously by numerous heterodox economists (Arestis & Sawyer 2010; Keen 2013; Levy 1996; Sardoni &

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73 The special cases usually relate to the predicament of a “liquidity trap” in which monetary policy, according to many, becomes ineffective.
Moreover, the theoretical basis of the new consensus is arguably poorly understood even among the broader policy-making elites – let alone the general public. Thus, the new consensus (at least in its literal, technical version) does not amount to a wider societal consensus. Last but not least, because the new consensus can be argued to be partially responsible for the global financial crisis (hereafter GFC) that started from the US banking system in 2007 and subsequently spread to other countries in various forms of demand and debt crises, it comes as no surprise that the “consensus” is today much more open to contestation than it used to be in the beginning of the new millennium. Nevertheless, the new consensus used to manifest some aspects of hegemony and it arguably remains a dominant set of ideas.

Whereas within the discipline of economics the new consensus was recently seen as a reason for great self-celebration (Goodfriend 2007; Woodford 2009; Walsh 2003), its social consequences and political implications remain largely unstudied. As I will explain in Chapter 4, new consensus is a very interesting doctrine from the point of view of monetary sovereignty because it simultaneously takes advantage of monetary sovereignty and undermines it – the possibility of contemporary interest policy is premised on monetary sovereignty but the new consensus view of fiscal policy has contributed to the erosion of monetary sovereignty. I will suggest that the relationship between the new consensus and monetary sovereignty of states is thus extremely ambiguous. To understand this issue, attention to the institutionalization of the new consensus is needed.

3.2 New Constitutionalism and the Institutions of Macroeconomic Governance

The policy preferences of the new consensus have quite directly translated to corresponding institutional demands, as I will show in Chapter 4. According to these demands, institutions of monetary policy should be strong and institutions of fiscal policy weak. Monetary policy institutions “strong” in the desired sense are independent central banks equipped with the courage and mandate to concentrate exclusively on the stability of the overall price level. Fiscal institutions are “weak” in the desired sense if they are so constrained that they are unable to spend “recklessly” as they, absent such constraints, might be tempted to do. “Excessive” public spending and borrowing are

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74 Of these crises, the Eurozone debt crisis has been particularly enduring due to the misdesigned structure of the Eurozone (Hein 2014; Varoufakis et al. 2011).
suggested to lead to accelerating and uncontrollable inflationary pressures and rapidly result in a lack of confidence in the investor community.

Moreover, institutionalization of a certain specific kind is preferred. Means that Stephen Gill (1998; see also Gill & Cutler 2014) and Ran Hirschl (2004) call “new constitutional” are standardly employed to bring about and sustain policy institutions of the desired type. Mandates of central banks, as well as various rules and compacts constraining the conduct of fiscal policy, are designed to take a legal or a semi-legal form.\(^{75}\) According to the hypothesis of new constitutionalism, there is a political purpose of these legal constraints on economic policy – to cement certain neoliberal policies (serving the interests of transnational elites) to the extent that they become legally binding, and preferably virtually irreversible.\(^ {76}\) In other words, the goal is to constrain the policy space of contemporary states. Freedom to experiment with macroeconomic policies is under attack.

As Hirschl (2004, 100–148) discusses in length, new constitutional practices of constitutionalizing negative rights of property and non-interference have their roots in liberal legal thought. Hirschl presents Ronald Dworkin as an influential contemporary liberal constitutionalist who asserts that “positive” rights ought not to enjoy the same legal status as “negative” rights do. Even though the process of new constitutionalism can justly be seen as an attack against democratic values, it is important to understand that law in itself is not inherently neoliberal or in the service of the rich and powerful. Positive rights, such as the right to political participation and democratic will-formation (and even the right to certain social services), can in principle be protected by law to the same extent as negative investor and property rights (and much better than balanced budgets!). The contested new constitutional practices can probably spread only because the international legal system remains rudimentary. The absence of supranational democratic arenas of lawmaking enables powerful transnational actors to dictate the rules of the game (Hirschl 2004). Crucially, also the monetary sovereignty of states is undermined because of this international legal oligarchy. In Chapter 4, I will discuss the

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\(^{75}\) Many IPE scholars employ the concept of “legalization” when they discuss “the imposition of legal constraints to governments” (Cohen 2008b, 112). In comparison, however, the new constitutionalism hypothesis says much more about the ideological goal of legalization about which the American scholars remain reticent.

\(^{76}\) In this context, the word “constitutionalism” is not to be taken too literally: all judicial means that serve the purposes described, can count as examples of new constitutionalism.
new constitutionalization of the current monetary consensus. In Chapter 5, I will suggest some ways to challenge it.

3.3 The Normative Appeal of Market Discipline

Thomas Friedman (1999) famously argued that in our current age of globalization, the “electronic herd” of investors is in a position to control the economic policies of nation states. Continuous deviation from the will of the investor community means effective self-destruction for a state stubborn enough to keep on its own course. Conversely, choosing the course preferred by the investors means that “your economy grows, and your politics shrink” – a state of affairs Friedman wholeheartedly applauded (ibid., 87). While the picture Friedman paints is factually fallacious in its pronouncement that states are passive receivers of market punishment or approval (as I argued in Chapter 1), it perfectly illustrates the strong normative preference for rule by investors and lenders inherent in many conservative and market liberal theories of globalization and finance. The belief that market discipline can help governments to pursue “sound finances” and increase economic efficiency – and thereby legitimize their actions – remains very widespread and influential among economists and policy-makers alike (Rommerskirchen 2015, 755–756; Chwieroth 2009, 94).

Indeed, arguably the most influential contemporary argument against furthering democratic economic governance is that democracy inevitably leads to the detriment of the “confidence” of investors – the type of confidence that is indispensable for any prosperous economy. To avoid this, it is thus necessary to advocate institutions and rules that are designed to restrict the scope of democracy in order to improve the security of the investors. Most widely discussed examples of such “confidence enhancing” means are the new constitutional investment protection clauses included in all major multilateral trade deals and IMF’s “structural adjustment” programs. In terms of monetary policy, “independent” central banks, the conventional argument goes, are the most reliable way to boost investor confidence. Monetary policy is most confidence enhancing when the central bankers are significantly more conservative and inflation-wary than average citizens (Rogoff 1985; Herrendorf & Lockwood 1997). Moreover, an important piece of the current monetary consensus is the view that monetary policy should be conducted in the spirit of gradualism: abrupt and unexpected shifts in interest rates should be avoided in order not to scary the investors.
In the area of fiscal policy, it is austerity that supposedly enhances confidence. Various “fiscal compacts” and rules instituted in the recent years are so designed that large scale counter-cyclical government spending becomes almost outright impossible if the rules are abided by. The point of austerity and fiscal compacts, so the story goes, is to restrict and channel the conduct of fiscal policy in order to prevent “confidence harming” public debts from accumulating. Public debts are thought to harm confidence because as they accumulate, lenders start to expect (perhaps judging from the falling credit ratings) that at some point the government will find it hard to make its payments and may even default on its debts, and a financial loss for them, the lenders, will result. Because of the additional risk, the lenders then require higher interest on their loans, which makes it even harder for the government to finance its deficits. Consequently, the government may find it tempting to raise tax rates or “inflate” the economy in order to cope with the debts. These actions, according to the standard wisdom, affect the willingness to investment in a detrimental way.77 (Blyth 2013, 104–177.) Active fiscal policy is often resisted even if it did not amount to mounting debts – again, to a great extent because of “confidence” reasons. High levels of taxes are resisted, because given them firms would move to regions with more “credible” tax regimes. Credibility, of course, translates to lower taxes (and more subsidies) for them – possibly creating the classic “race to the bottom” dynamic. In the same way, government spending programs tend to be resisted, even if governments were in a good enough financial position to finance them “soundly” (from existing surpluses, for instance).78 (Alesina & Ardagna 2009; Blyth 2013.)

The various economic and financial theories underpinning the current regime of global monetary governance seem to agree that the confidence of investors is the necessary and by itself even a sufficient basis of legitimacy for economic policy. As we saw in Chapter 1, monetary sovereigns are not passive victims of market punishment.

77 This theory about the harmfulness of expansive fiscal policy sometimes takes extreme forms. According to the controversial Ricardian equivalence hypothesis the link between government debt and the degradation of expectations is a necessary and quite a direct one. Given its strong behavioral assumptions, the hypothesis suggests that a government deficit will lead the economic actors to form “rational expectations” about the tax burden becoming heavier in the future. These expectations will then lead to the decision of the public to save now (and reduce the willingness to consume and investment). If the government, instead, starts to run surpluses, the Ricardian equivalence suggests that the actors will adapt their expectations and anticipate the tax burden to lighten in the future. These expectations will then lead to more consumption and investment at present. (Barro 1974; Buchanan 1976.)

78 Credibility arguments against public programs abound. One of the most influential is made by Alesina and Ardagna (2009) who suggest that reductions in government spending are an effective way to promote positive expectations in the economy even and especially during a recession.
However, they often are ideologically committed to doing everything that supposedly pleases markets. Indeed hegemonic governance ideas – and the new monetary consensus is a case in point – place considerable emphasis on the need to satisfy the will of the market actors. In sum, although market discipline itself is a rather manageable force if the monetary sovereigns decide to tame it, the apparent virtues of market discipline have enormous normative power. The widespread enthusiastic attitude towards market discipline makes it a very strong force capable of discouraging state-level exercise of monetary sovereignty.

3.4 The Enduring Support for Nation State-Based Institutions of Monetary Governance

The pivotal monetary and macroeconomic governance institutions of the contemporary era are nation-state based (Rodrik 2011, 208). Indeed, the global monetary system is “a universe of diverse national monetary spaces, not one homogenous entity” (Cohen 2008a, 3). While the Bretton Woods system was an impressive, even if only partially successful, effort to govern some areas of economic policy cooperatively, today’s efforts towards systematic global economic governance are comparatively weak, despite the fact that the remaining Bretton Woods institutions, the IMF and the World Bank, continue to exercise considerable – and highly contested – power especially in the developing world. The so-called G-7 and G-20 groups, too, have provided controversial governance proposals. (Ibid., 56–81.) The development that led to the present, disintegrated state of affairs was partially intended. More importantly, however, integration crumbled because of processes that almost none of the actors could envisage before it was too late to react.

Based on his trilemma hypothesis that I discussed in Chapter 1, Rodrik (2011, 207–232) provides an argument for why global governance indeed should remain weak (or at least not go much further than it did under the Bretton Woods arrangement). This view provides an apt example of the enduring support for national institutions of monetary governance. Rodrik claims that national self-determination is both more realistic and more desirable than far-going democratic global governance would be. For him, it is

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79 Which policies in fact please “markets” is a hard question that I will briefly tackle in Chapter 5.
80 For instance, Paul Volcker believed (1979, 4) that “a controlled disintegration in the world economy is a legitimate objective for the 1980s”.
81 Keynes was among the rare actors who clearly saw how the established version of Bretton Woods system would prove unstable without an automatic mechanism for surplus recycling (Varoufakis 2013).
more realistic for obvious implementation difficulties that supranational democracy faces. In order to justify its greater desirability, Rodrik asserts that the shared global identity of the world population is not sufficiently strong as compared to national and communal identities. He refers, for instance, to the World Values Surveys that provide evidence that a clear majority of the world people do not identify as “global citizens”. Rodrik therefore goes on to argue that the desirable way to preserve democracy is to stick to nation states and to restrict globalization from turning into “hyperglobalization” detrimental to the capacity of the nations to decide on their own course of action. (ibid., 207–232.)

In the core of Rodrik’s argument against global governance is in fact a standard conclusion of much of the traditional democratic theory in general: democracy is seen to be possible only on the condition that a strong (prior) group identification has taken place. While some theories go so far as to suggest that authentic democracy really is only possible in entities of very small size (such as a square or conference hall where people can be in touch with each other directly), it is more commonplace today to argue that a national identity provides a sufficient basis for functioning democratic institutions. This kind of conception of the legitimacy basis of democracy is seen to be compatible with the actual democratic practice in which democratic politics appears to take place mostly in nation states sufficiently homogenous in terms of their population. (Held 2006, 290–311.) Indeed, Rodrik notes that attempts at democratic global governance seem to crumble already at the regional level, of which the experiences of the European Union are evidence (Rodrik 2011, 214–220).

Although fresher theories of deliberative and cosmopolitan democracy (Benhabib 1994; Held 2010, 2006; Patomäki & Teivainen 2004) have on numerous grounds challenged the conventional ways to think about democracy, the influence of the idea that democracy, for the time being at least, really is feasible only inside nation states, contributes significantly to the belief that governance should not take place above the state level. Obviously, if democratic governance beyond the state is not possible, supranational governance would be autocratic and, therefore, illegitimate and undesirable.82

82 Whereas the worries about the possibility of democracy in the absence nation states are widely shared, the mainstream economic theory remains mostly silent about the desirability and feasibility of global governance in general. Certainly, however, there is nothing in the current “monetary consensus” that
In terms of the exercise of monetary sovereignty, it could – at first glance – appear that the prominence of national institutions in monetary governance would help the states to exercise their monetary sovereignty. However, in the presence of sufficiently many of the sovereignty-undermining elements of governance (in a sufficiently strong form) that are discussed throughout this thesis, the economic policy spaces of the separate nation states diminish considerably. When this happens, the national focus of governance actually then turns against the possibility to exercise monetary sovereignty! In these circumstances, as I will argue in Chapter 5, supranational exercise of monetary sovereignty is required in order for the people fully to benefit from chartalist monetary sovereignty.

Generally, those in support of market discipline have two kinds of attitudes towards national monetary governance. The first attitude is to continue to maintain that governance decisions should be made at the national level, which implies that disciplining states – mostly through ideological influence, but in cases of small and vulnerable states also by “structural” measures – is possible, but time-consuming and very vulnerable to future backlashes. The second attitude is to opt for new constitutional disciplinary measures, which often also are institutionalized at the national level, but which work much more effectively if their legal validity and enforcement mechanisms are supranational. Both ways to impose market discipline – when they are effective – bring about powerless nation-state-based institutions of governance. Because supranational new constitutionalism eliminates or, at least, greatly diminishes the risk of short-term backlashes, there are signs that the supporters of market discipline increasingly favor the second way of dealing with national monetary governance. However, although the benefits of the supranational disciplinary strategy lie in its “effectiveness” and lesser vulnerability to changes in the political mood of nations, these benefits come with a great risk. The buildup of supranational institutions of governance namely brings in its wake the possibility of their subsequent

would favor democratic forms of global monetary governance. As the short history of the Eurozone suggests, monetary governance along the new consensus lines is even more autocratic at the regional level than at the state level.

83 For instance, the reason why the Eurozone’s macroeconomic legislation (and the institutional framework that it underlies) so effectively eliminates the fiscal policy space of the member states lies partially in its supranational character. Similarly, the disciplinary power of the multilateral “free trade” agreements derives from their legal validity and enforcement that is not dependent on decisions of national courts and parliamentary institutions.
democratization – that is, the possibility of supranational democratic monetary governance that would repeal, or at least set limits to, market discipline.

4 The Emergence of the Sovereignty-Undermining Governance Regime

Having introduced some of the key ideas behind sovereignty-undermining monetary governance in the last chapter, in what follows I will examine the current regime of governance first from a causal-historical and then from a normative point of view. In this chapter, I aim to show how Post Keynesian theory can contribute to several aspects of the neo-Gramscian story of the “neoliberal transition”. I will do this by formulating neo-Gramscian claims into hypotheses and testing them against Post Keynesian views. In Section 4.1., I will carefully examine the formation of the theoretical paradigm of the new consensus. Here Post Keynesian take on the new consensus provides the substantial core of the approach (that is enriched with neo-Gramscian hegemony analysis). In Section 4.2., I will turn to the question of how a concrete institutional regime undermining the ability of the contemporary states fully to exercise monetary sovereignty has been constructed. In this section, it is Post Keynesian analysis of monetary institutions along with the new constitutionalism hypothesis that inform the explanatory approach. The explanatory stories of these two sections are designed to complement each other. My key theoretical objective in this chapter is to show that a broad synthesis of Post Keynesian economics and neo-Gramscian variant of critical GPE proves useful if one wishes to understand the sovereignty-undermining essence of contemporary macroeconomic governance and explain the peculiarities of “neoliberal transformation” in this policy context. Chartalist economics of monetary sovereignty can plausibly be complemented with a neo-Gramscian political economy if certain Post Keynesian modifications to the latter are made. I summarize the theoretical conclusions in Section 4.3., as well as in the conclusion section of this thesis.

In chapter 5, I will then evaluate the record of the hegemonic minimalist practices of monetary governance. First, I will examine why it appeared to be marvelous before the outbreak of the GFC in 2008 and explain, why in the final analysis, it was not. Second, I will examine the performance and prospects of the regime during the enduring post-crisis era of weak growth, high unemployment and continuing macroeconomic instability. Finally, I will provide an argument for a transformative monetary governance
approach that would take advantage of the novel possibilities of the modern money era and go beyond the hegemonic governance-for-maintenance approach promoted by the new consensus. Drawing from both chartalist monetary theory and theories of supranational democracy, I will argue for a substantial form of macroeconomic governance. Theoretically, the key conclusion that I draw in this chapter is that the endorsement of chartalism does not necessarily contradict ambitions for supranational or global democracy, but concretizes them and may even amplify them (as the rest of the Post Keynesian theory, in different ways, does).  

Within the broader topic of monetary governance, my emphasis in what follows will be on the political economy of monetary sovereignty and (integrally related to it) business cycle governance. I will examine the political economy of the ideologies, policies and methods employed by monetary sovereigns in their attempts to govern the macro-level instability produced by the global monetary economy. It is impossible, of course, not to pay attention to the issues of monetary governance more broadly understood.

4.1 The Development of the New Consensus

My interest in the question concerning the development as well as the endurance of the contemporary form of macroeconomic governance motivates me to study it from a broadly neo-Gramscian perspective. The defining “consensual” element in the new consensus literature reinforces this motivation, because as Joseph (2008, 101) argues, “the introduction of Gramsci into IR is designed to highlight the importance of an ideological, consensual, value- and understanding-based account of world order”. Given the orientation of the research project, a Gramscian perspective to the hegemonic theory and practice of monetary governance is certainly in order. On the other hand, Post

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84 As is thus evident from the paragraph division, the remainder of the study has both a causal and a normative component to it: Chapter 4 evaluates an explanatory story concerning the emergence of the regime and Chapter 5 evaluates normative merits of contemporary governance. However, I do not see the causal and normative accounts as separate in any strong sense (for reasons discussed in Chapter 2). Because the political economy of monetary sovereignty covers issues pertinent to both explanatory and evaluative theories, I see a need to address them both at some length. Both neo-Gramscian theories and cosmopolitan theories of democracy, in fact, tackle both explanatory and normative concerns. Notwithstanding the historicist focus of much of their analysis, neo-Gramscians are explicit about their normative commitment to a counterhegemonic struggle. Despite the centrality of their normative arguments, cosmopolitans also aim to explain (both the growing motivation for, as well as the functioning of, their models of supranational democracy). Because critical GPE encompasses causal-historical and normative concerns, a treatment of both is motivated by reasons of completeness (and indeed by the very impossibility to distinguish the concerns sharply).

85 For a decent survey to the study of monetary governance, see for instance Cohen (2008a).
Keynesian monetary theory, as it provides us with relatively coherent critique of the new consensus, helps to spot consensus’s soft spots and thereby ground counter hegemonic ways of thinking. The guiding idea is to employ Post Keynesian theory in an attempt to develop and revise neo-Gramcian thinking. In this section, I will concentrate on examining the merits and weaknesses of the following hypothesis.

**Neo-Gramscian hypothesis 1**: a ‘neoliberal transition’ in monetary governance has been carried out from the 1970s to the present day. This process has coincided with a formation of (a) a ‘hegemony’, or (b) a ‘dominance’ of monetarist / market fundamentalist ideas in this governance area.

Why is this hypothesis neo-Gramscian? Ever since Cox (1987), the topic of “neoliberal transition” has been probably *the* central topic in the neo-Gramscian literature (Patomäki 2003, 199; Saad-Filho & Ayers 2008, 147). Moreover, forms of market fundamentalism and monetarism are standardly discussed themes in neo-Gramscian scholarship. Similarly, the “conditions” of hegemony and resilience of hegemonic ideas and historical blocs are classic Gramscian research areas. (Ayers 2008.) Hence, most neo-Gramscian would probably be ready to accept the above hypothesis as a correct summarization of their *basic* views concerning the development of monetary governance in the recent decades. Disagreements about the “degree” of hegemony are common, which is why some would claim that monetarist or market fundamentalist ideas are hegemonic, whereas other would claim that they are merely “dominant” (not sufficient to fulfil the various conditions of hegemony). For this reason, I explicated above alternative (a) and (b) versions of the hypothesis.

In the course of scrutinizing this hypothesis, I will dedicate much attention to the role that experts play in producing influential governance ideas.86 I conclude that monetary economists and central bankers form an epistemic community in which they act as Gramscian “organic intellectuals”87 advancing the interests of the dominant sectors of the population – the dominant “historical bloc”88. My critical intention is thus both to explain why contemporary macroeconomic governance takes the form it takes today, as

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86 As Gill (2012, 29) puts it, “one of the more interesting questions concerning the nature of leadership in global capitalism relates to the role of experts or epistemic communities that define forms of regulation and governance in key sectors of the global political economy”.

87 For Gramsci, organic intellectuals “are the thinking and organizing elements of the ruling class—the ‘deputies’ who are entrusted with the organizing components of the social system. They grow ‘organically’ with the dominant class, and it is this group of people that is most responsible for maintaining hegemonic relations” (Merton 2005, 41–42).

88 Gramsci famously used the concept of “historical bloc” to refer to social complexes underlying and sustaining hegemonic thought and practice (Laclau & Moufffè 2001).
well as simultaneously to account for some of the false elements of the theory on which its dominance is based.89

I emphatically will not merely tell just another story about the recent history of global capitalism. Instead, the specific purpose of the story I tell is to help to revise and develop the existing neo-Gramscian narrative. By utilizing empirically rich studies of central banking and drawing from the theoretical insights of Post Keynesian economics, I thereby attempt to answer affirmatively the question raised by Patomäki (2003, 200): “Can components of the post-Gramscian stories be tested and falsified, whether qualitatively or quantitatively, and can the stories thereby be revised?” 90

I will start scrutinizing the history of the new monetary consensus from the breakdown of the post-war Bretton Woods system. While some elements of the current monetary consensus can be traced back to the Bretton Woods era itself or even further back to the preceding eras, the most popular formulations of the consensus ideas are clearly later product. Even when the views themselves are old (such as Knut Wicksell’s ideas that I will discuss indirectly), the centrality they now enjoy has taken many years to build up.

4.1.1 The ideological elements that contributed to the disintegration of the Bretton Woods arrangement and shifted the locus of governance back to the national level

While it is true, as is often argued, that the Bretton Woods era ended partially because of the “material” economic contradictions inherent in the system – of which the co-called Triffin dilemma (Triffin 1960) captures probably the most severe one –, one should not exclude ideological factors from an explanation of the disintegration of the system. Or, to put it more accurately, ideological factors were intertwined with material factors to the point that a distinction between them becomes close to meaningless. (Panitch & Gindin 2012, 122–132.) To see the importance of ideology and the power interests buttressing them one only has to remind oneself that it was the geopolitical ideology of the US, represented by its chief negotiator Harry Dexter White at the 1944 Bretton

89 The form of critique is explicated for instance by Bhaskar (1986). The best-known example of such critique is certainly Marx’s classic account of bourgeois Political Economy the nature of which Marx sought to explain as much as he sought to explain capitalist mode of production itself. It is certainly true that most gaps and errors in theories can be explained simply by the complexity of the subject matter. As is well known, however, it is commonplace that all kinds of sociological factors influence scientific theory building.

90 Patomäki’s question is inspired by Alker (1996, 269–270) who asks if there is “a way of making world historical accounts empirically revisable while at the same time allowing them to have the reflective character and dramatic force of a tragic morality play or the ironic happiness of a Russian fairy tale”.

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Woods conference, which shaped the design of the arrangement in a fatal way. Because of geopolitics, the plan for an alternative arrangement advocated by Keynes (the main British negotiator), which was explicitly so designed that it would probably not have been vulnerable to the kinds of shocks that ultimately undermined the post-war system, was rejected (Varoufakis 2013). Instead, a less advanced and more unilateralist monetary system came into being. Furthermore, while these perceived geopolitical interests fundamentally shaped the system, they were behind the US decision to exit the arrangement as well. The US cooperated as long as (and to the extent that) it served its goals (Panitch & Gindin 2012, 122–132). When the horns of the Triffin dilemma threatened US might, its government decided to do away with the system.

Alongside geopolitical unilateralism, perhaps the most crucial ideological factor that at the final years of the Bretton Woods arrangement eroded its legitimacy was the powerful idea that the world economy could function more effectively without virtually any governance at all. While the post-war years consolidated an “ideology of the ‘mixed economy’” (Gill & Law 1989, 478), during the attempt to restore conditions of steady accumulation, the advocacy of “free markets” became an increasingly popular ideological sentiment in the US. From its point of view, the Bretton Woods restrictions on international capital movements (that in fact were in many ways evaded during the latter years of the arrangement) and trade rules were seen as elements of undesirable protectionism (Davidon 2009). “Material interests” and ideological currents again reinforced each other. Probably because of the “free market” sentiments that influenced also its domestic economic policies, the hegemon of the post-war system never quite bought into the embedded liberalism compromise to the extent that European countries did (Ruggie 1982).

The enormously influential market ideology that even today continues to bolster the anti-governance point of view, of course, has never been realized in actual practice: the real-world global economy has never functioned (nor could function) according to pure market principles alone. Even the gold standard system of the 19th century was anything but an arrangement allowing market forces to operate freely (Knafo 2013). In light of history, political governance seems indispensable. The question, which form governance institutions and efforts should take, is thereby among the key questions to be asked about any complicated social system. However, the erratic effects that free market “common sense” has had on the governance practices from 1970s onwards should not
be underestimated. In monetary governance, one of its initial (and somewhat surprising) effects was to ensure that the locus of monetary governance moved back to the state level. In the conditions of global economic disintegration, the institutions that gained most prominence and power were national central banks. I will argue later that their prominence has been taken as a premise in the main monetary governance ideologies of the post-Bretton Woods era. I now turn to the history of the specific monetary governance doctrines of the modern money era. Chronologically, I begin with monetarism – the doctrine that certainly most contributed to the demise of post-war Keynesianism.

4.1.2 Taking control over fiat money

After the disintegration of the Bretton Woods system, several of the most prominent of the ever more prominent central banks (foremost among them the US Federal Reserve and the Bank of England) started to conduct monetary policy according to a monetarist recipe that had formed in the academia from the 1950s onwards (see, e.g. Friedman & Schwartz 1963; Brunner & Meltzer 1972). In essence, the recipe was to control the growth of the money supply by rather simple money growth rules without any consideration to macroeconomic cyclicity. According to Friedman (1959, 90), “the stock of money [should be] increased at a fixed rate year-in and year-out without any variation in the rate of increase to meet cyclical needs”. This idea found considerable support at the time, because it was seen to be consistent with broader economic policies supposedly favorable to the “free” operation of market forces.

From the point of view of monetary sovereignty, the most interesting fact about monetarism was its advocacy of strictly controlled fiat money. The monetarists simultaneously argued (1) that a global monetary system based on national fiat currencies with floating exchange rates is the most preferable arrangement, (2) that fiscal interventionism is harmful, and that (3) monetary policy were to be conducted according to strict rules rather than by political discretion. For fiat currencies the monetarists argued for reasons of efficiency: it would be a waste of resources to mine precious metals to serve as media of exchange. A floating exchange rate arrangement they favored because they believed it would function similarly to the “specie-flow”

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mechanism of the gold standard era that supposedly corrected trade imbalances automatically and in a free market fashion. They disliked fiscal policy and preferred rules to discretion simply because in their view the intentions of politicians could never be trusted. In sum, the monetarists argued that the governance of fiat monies should be sharply separated from politics. (Friedman 1962; Sardoni & Wray 2007.)

Effectively, the monetarists thus argued for a monetary arrangement that maximized monetary sovereignty in the chartalist sense – and went on to suggest that that the sovereigns will do wisely to “tie their hands”. The idea that monetary sovereignty could be utilized for progressive social purposes was thus outright rejected. A new method of restricting sovereignty was devised: “With the gold standard long gone and Bretton Woods moribund, money stock targets – their legitimacy and necessity scientifically attested – became the vehicles of discipline” (Tobin 1981, 30–31). The monetarists proposed a program of monetary disinflation that was carried out in multiple countries. The monetarists thus harnessed the increased policy independence, brought about by the floating exchange rate arrangement, to an attempt to keep inflation in check by means of monetary aggregate targeting. Paradoxically then, the monetarists took advantage of the novel monetary sovereignty, but for disciplinary purposes.

The monetarist policies were based on the neoclassical general equilibrium framework, which implies that the only things that matter are real variables and relative prices. What the monetarists added to this framework was a rule for the determination of the money supply. In contrast to other equations determining the general equilibrium, adherence to such a monetarist rule was, of course, a policy decision. While the supplies of real factors are set by the markets themselves, “the supply of money is not the result of preferences, endowments, or technology; rather it is fixed by government (central bank) policy” (Fazzari & Minsky 1984, 114). The monetarists insisted that a political decision not to adhere to such a rule would come with the cost of disturbing the general equilibrium, and thus lead to economic inefficiency. According to the logic of the monetarists, then, the neutrality of money was not really an inevitable fact, but rather something to be ensured by policy. In this conception, money is neutral only when it

92 The neutrality of money is a core neoclassical axiom. Simply put, it holds that nominal variables have no influence on real variables. Historically, the idea has come in various versions: the current New Synthesis maintains that money is neutral in the so-called long run, while it is accepted to be non-neutral in the short run. (Ahokas & Holappa 2014.)
does not get “out of order” – what it, according to the monetarists, all too frequently did (Fazzari & Minsky 1984).

Monetarism, as I see it, became the first official governance ideology of the modern money era. Its defining thesis suggested that the quantity of money had to be governed in a fashion that did not disturb the operation of the self-correcting free markets. In other words, money had to be kept in check in order to make sure that its non-market determined movements did not interfere with the efficient market allocation of real resources. The heydays of monetarism proved short-lived. I examine the causes of the failure of monetarism in the next section.

4.1.3 The failure of the monetarist experiments

It is clear that an explanation of the emergence of the current monetary consensus must account for the fall of monetarism. Without the failure of monetarism, there would have been no intellectual vacuum for the new consensus ideas to fill. Moreover, it is crucial to understand the intellectual heritage of monetarism in order to understand the recent governance ideas. This is because the newer ideas owe important intellectual debts to monetarism even if they depart from its core theses in noteworthy respects.

The key monetarist practices were abandoned by the late 1980s. The defining monetarist policy suggestion of controlling the growth of the money supply was ultimately recognized to have been a failure by central bankers and scholars alike. By 1988, it was widely observed that a central bank has no control over any monetary aggregate and, furthermore, that none of them was correlated with inflation anyway. (Minsky & Fazzari 1984; Tobin 1981; Wray & Papandriou 1994.)

Before the eventual consensus that precise monetary aggregate targeting simple was neither achievable nor worthwhile, there had been countless real-world manifestations of the failure of monetarism. During their heydays, monetarist policies produced instability and financial crises routinely. Among others, Minsky & Fazzari (1984, 113) argued that the “fiscal/monetary policy mix of 1979-1981” caused the early 1980s recession that also greatly contributed to the Latin American debt crisis. In Canada, the monetarist experiment of 1975–1982 triggered the most severe recession of the country since the depression of the 1930s (Lavoie & Seccareccia 2013). Monetarism, instead of bringing the monetary stability it preached, contributed to grave instability. Under
monetarism, growth rates were sluggish and unemployment tended to increase in most countries (Saad-Filho & Ayers 2008, 121).

Ultimately, the failure of monetarism cannot be accounted for without a discussion of the shortcomings and contradictions of the entire “methodology of positive economics” (see for instance Mäki 2009). The monetarist economic policies were based on grave misconceptions concerning key dynamics and institutions of modern monetary economy. Their instrumentalist methodology encouraged monetarists to ignore real-world economies. It is one thing to err about the operations of complex systems, and it is quite another to accept that as a virtue. Hence, an erroneous philosophy of science underlying its methodological conception was actually a key cause of the failure of monetarism. In contrast to the more obvious factors, this underlying reason for the failure often remains unacknowledged. Indeed, the mainstream of economics continues to be haunted by the old problems of its “positive methodology”.

In one crucial respect, however, monetarism was not a failure. Its intellectual hegemony effectively undermined the popularity of Keynesian counter-cyclical policies and the negotiation position of the working class in many countries (Saad-Filho & Ayers 2008, 120–121). This is one aspect of the lasting legacy of monetarism. However, as Saad-Filho & Ayers (2008, 121) put it in Marxist terms, “although monetarism was part of a successful project of social domination, it did not provide the basis for a viable system of accumulation”. Because of their multiple defects discussed in this section, monetarist policies were discredited by the end of the 1980s. From there on, a new post-monetarist “consensus” began to take shape. The failure of the monetarist experiment was a necessary enabling condition for the emergence of the subsequent governance ideas, but certain aspects of monetarism proved resilient. I will now discuss how monetarism – in a remarkable but incomplete way – was transformed by the new consensus.

4.1.4 The theoretical response to the failure

As a response to the failure of monetarism, many key elements of the current version of neoclassical monetary theory molded in the course of the 1990s. After the theoretical limbo that followed the disorientation caused by the failure of the monetarist experiments, the first developments of what later came to be called the “new consensus” gradually relinquished the core monetarist claim that monetary aggregates would be the
proper instrument of monetary policy. Instead, many theorists and practitioners of monetary policy now came – sometimes reluctantly – to embrace the view that the money supply is basically “endogenous” as had been argued by Post Keynesian economists, such as Hyman Minsky and Basil Moore (1988), for years. (Lavoie & Seccareccia 2013.). According to the endogenous money view, bank loans are not financed out of existing bank deposits, and bank deposits – in turn – are not financed out of central bank reserves. In contrast to the so-called money multiplier model, the market demand for loans is seen to determine the amount of bank deposits and the amount of – thereby created – deposits to determine the amount of central bank reserves (which the central bank has to supply to the banks on demand). (Moore 1988; Setterfield 2006.) The believers in the old monetarist exogenous money way of thinking resisted these reversions of causality since they implied that central banks do not have anything near of full control over monetary aggregates (the presupposition on which the entire theory and practice of monetarism was premised).

Because the emerging mainstream consensus adopted important elements of the endogenous money approach, it has seemed to many – even to some critics – to be on a firmer footing empirically than the monetarist monetary theory ever was. Despite the important advances over monetarism, however, the new consensus set out to preserve as many elements of the neoclassical monetary theory as possible given the fact that the simple quantity theory of money had to be abandoned (Fontana 2006). The consensus indeed appeared, in the opinion of many mainstream economists, successfully to reconcile the reality of endogenous money creation with the defining neoclassical tenets of long-run neutrality of money, (a somewhat complicated) version of Say’s law and much the rest of the accepted legacy. Given that the empirical facts would have allowed competing – and arguably more institutionally realistic – interpretations, such reconciliation can be interpreted as not purely scientific, but also deriving from extra-scientific sociology of science factors, or from straightforward ideological motivations.

Why was the choice of the new consensus theorist to conform to the standard neoclassical conclusions a factually underdetermined – or even a fallacious – decision?

93 It is possible to distinguish various meanings of “endogenous” money (see for instance Wray (1992) who distinguishes theoretical, statistical and control notions of endogeneity).

94 The embracement of underdetermined theories in fact has to be explained by such factors.
Foremost because there was, as I noted, a theoretical tradition that had proceeded much deeper in the study of the implications of the endogenous money – a tradition that had indeed rejected the core neoclassical conclusions for good reasons and could account for the empirical facts (reasonably) well. Because of the failure of monetarism, Post Keynesian monetary theory indeed could justifiably see itself in many respects vindicated, but the new mainstream consensus has declined to draw the same kind of macroeconomic and economic policy conclusions Post Keynesians have drawn. New consensus economists have taken for instance the long-run neutrality of money as an axiom and consistently failed to investigate the matter (Fontana 2007). Since these theoretical decisions were undetermined or even fallacious, it was from the start probable that the dominance of the new consensus line on thinking might eventually erode partially because of its weak “correspondence” to the facts of the social and institutional reality (as clearly had happened to monetarism before). Indeed, I will argue later that this is exactly what has started to happen. Let me first, however, briefly explain how the new consensus handled the evidence for the endogeneity of the money supply.

Knut Wicksell (1898) had engaged himself already prior to Keynes to the task of integrating endogenous money creation with the core of the neoclassical theory. It is unsurprising that the new consensus economists were led to reread Wicksell and use some of his notions as guidance to the theory-preserving reconciliation (Boianovksy & Trautwein 2006; Woodford 2003). The fundamental idea that re-emerged from this rereading of Wicksell was the concept of “natural rate of interest” (the real interest rate that would balance investments with savings). Wicksell’s theories of “pure credit economy” started from the premise that the money supply is endogenous. Secondly, he explained the phenomenon of inflation by the deviation of the bank interest rates from the natural rate of interest. Finally, Wicksell drew a clear policy conclusion: a central bank simply had to move the loan rates closer to the natural rate. These three elements, albeit in extended forms, also constitute the core of the new consensus. (Fontana 2007.) Even though the evolving consensus accepted the reality of endogenous money itself, the postulation of a natural rate of interest effectively allowed the new consensus

95 Tellingly, Woodford even borrowed the name of his influential 2003 book *Interest and Prices* from Wicksell’s *Geldzins und Güterpreise* (1898).
theorists to escape the immediate implications of horizontal money for the wider mainstream theory of macroeconomics. (Pilkington 2014.)

The Wicksellian paradigm has never been universally accepted. From the start, there has been fragile-looking elements in the consensus. Post Keynesians do not accept the last two elements of the simplified neo-Wicksellian framework outlined above. In short, this is because, according to mounting evidence, “the principle of effective demand applies to the short run as well as the long run” (Fontana 2007, 53). In this more dynamic Post Keynesian picture, macroeconomic policy has permanent real effects shaping the supply factors of the economy and thereby affecting “both sides of the output gap” (ibid., 53). Thereby the chosen interest rates may alter the natural rate itself. The possibility of this clearly renders the consensus explanation of the source of inflation unacceptable and simultaneously necessarily undermines its policy prescriptions.

In sum, I would characterize the overall theoretical response to the failure of monetarism as a decision to develop a neo-Wicksellian framework instead of drawing from the arguably more coherent and advanced Post Keynesian endogenous money approach. By turning Wicksellian, Woodford and other new consensus economists rejected – or mostly just ignored – the Post Keynesian explanatory framework and the policy conclusions derivable from it. In addition, given that the Wicksellian ideas, too, were so different from monetary targeting, the new consensus theorists continued to embrace surprisingly many broader policy implications of their monetarist predecessors, albeit for revised reasons. The primacy of monetary policy was central among the preserved implications, for which the consensus formulated a new justification (in addition to the fact that for monetary policy itself it gave a new content).

4.1.5 The primacy of monetary policy (as an active stabilization policy!)

The monetarists had based their argument for the primacy of monetary policy on their conviction that, fundamentally, governance of the money supply was the sole legitimate task of basic macroeconomic policy. In their view, however, the legitimacy of monetary policy did not stem from the idea that any instability of the economy would require effective means to stabilize it. There was simply no room left for such considerations because the economy was assumed self-equilibrating. Instead, the legitimacy of monetary policy (and the justification for the existence of the central banks) stemmed from standard efficiency considerations. Monetarists argued that it was simply more
efficient to let the central bank run a currency monopoly than to allocate real resources to the mining of gold or other precious metals (which, they continued to think, could in principle work as “commodity monies”96) (Friedman 1962). For the monetarists, effective governance of the business cycle was hence never a reason for the strict central bank control of monetary policy that they advocated. Indeed, Friedman (1960) repeatedly argued explicitly against the idea of stabilizing the business cycle by means of either fiscal or monetary policy – the monetarists resisted the entire idea of governing cyclical fluctuations. Their view also implied that monetary and fiscal policies should not be coordinated, but rather ought to be strictly separated (Tobin 1981, 31.). Indeed, the monetarists embraced strictly rule-governed monetary policy in order to ensure that a democratic government would not attempt to stimulate the economy out of a depression. Electorally tempting counter-cyclical measures, the influential public choice models of the time suggested, would eventually only end up producing harmful inflation. These anti-Keynesian – and obviously also anti-democratic – conclusions drawn were a key product of the intellectual collaboration between monetarists and public choice theorists. (Blyth 2013.)

Like their monetarist predecessors, the new consensus theorists argued for the primacy of monetary policy but for quite different reasons. Departing from monetarism, the new consensus claimed that the capitalist market economy would operate at its full potential on the condition that the central bank was able to track the economy’s natural rate of interest and set the policy interest rate at the corresponding level. Active interest rate policy was thus seen as necessary in order to guarantee full employment97. If, however, central bankers failed to track the natural rate of interest, inflation or deflation would ensue. In other words, for the new consensus economist monetary policy was required in order to stabilize the business cycle, close the “output gap” and bring about the optimal macroeconomic outcome. In this vision, neutrality of money, is “not an automatic outcome of market processes, but requires a specific political strategy of interest-rate feedbacks to changes in the price level and/or output” (Tamborini et al. 2014, 85).

96 Post Keynesians (see Wray 2012, 261–281) have cast even the theoretical possibility of a commodity money into doubt.
97 “Full employment” was then redefined to mean the level of employment at the non-accelerating inflation rate of unemployment (NAIRU) in contrast to literal full employment (employment of the entire voluntary labor force).
In terms of the broader macroeconomic picture, imperfect competition and sticky prices – characteristic elements of the New Classical Synthesis – are here the “key devices that provide the welfare-theoretic foundations for an ‘active’ rule-based monetary policy” (Tamborini et al. 2014, 80). The New Keynesian element in the current mainstream “consensus” is, in this respect, considerable because the idea of active demand management (even by means of monetary policy) has been alien to the more conservative branches of the neoclassical tradition. On the other hand, the monetary policy focus itself is clearly partially explainable by the monetarist heritage the resilience of which can certainly be largely attributed to institutional path dependence. The content of monetary policy today, however, is more Wicksellian than it is monetarist.98

The new consensus years saw the continuation and intensification of the “fiscal counterrevolution” against the “golden age” economic policies that had begun already during the final years of the Bretton Woods system. In the mid-1990s, it became increasingly popular idea among governments to pursue public surpluses – mere balanced budgets were no longer enough in the ruling ideology according to which “rising surpluses were the sole source of funds for the cash-strapped state” (Parguez 2002, 81). Given its unforeseen belief in the potency of interest policy, the new consensus regarded counter-cyclical fiscal policy as essentially useless. According to Blinder (1996, 7), fiscal policy could in principle be used for stabilization, but “in practice, however, monetary policy is the only game in town99 nowadays”, because of the “need to reduce large fiscal deficits”. In the picture that emerged, states could well continue accumulating surpluses for future financial needs even if this implied procyclical fiscal policies. Fontana (2009) discusses further reasons for the new consensus disdain of fiscal policy: supporters of the primacy of monetary policy have appealed to at least historical evidence (the failure of the old synthesis Keynesian emphasis on fiscal policy), theoretical constructions (such as “Ricardian equivalence”) and practical arguments (“long inside lags” of fiscal policy compared to monetary

98 That the current mainstream synthesis is both New Keynesian and neo-Wicksellian does not mean that the economics of both Keynes and Wicksell had not differed from it in most fundamental matters! (See, e.g. Boianovsky & Trautwein 2006; Tamborini et al. 2014.)

99 By “town”, Blinder (1996, 7) hastened to point out, he meant the whole of the “industrial world”.

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policy). All of these arguments against fiscal policy have been contested in the literature.\footnote{100}

It bears emphasizing that the currently dominant paradigm of macroeconomic governance is \textit{not} a laissez faire – better to do \textit{nothing} – type of governance paradigm. The critics often overlook this fact (and thereby miss the potential openings for more effective specific criticisms of the consensus). However, the paradigm’s exclusive obsession with monetary policy suggests that the new consensus nevertheless entails a very minimalistic approach to the governance of the monetary economy. In the picture that emerged in the 1990s, instability of capitalist national economies would be overcome merely with pedantic interest rate policy of a very special character. The idea being that macroeconomic instability can be “fixed” by minor tuning.\footnote{101}

Whereas the monetarists were in favor of even automatized versions of rule-following, the new consensus gave significantly more room for the discretion of the central banking elite on whose expertise it was willing to count much more than the monetarists had been. Although most new consensus theorists have been very much in favor of policy rules (of the type developed by for instance John Taylor), these rules are much less rigid – more heuristic – than the strict Friedmanian ones. This fact explains why the calls for central bank independence (voiced exactly to guarantee “independent” discretion and decision-making) have been so loud under the dominance of the new consensus. I will have more to say on central bank independence in Section 4.2. Now I turn to the formation of the new consensus theory and strategy of “confidence building” as both a goal and tool of macroeconomic policy.

\footnote{100} Tcherneva (2008, 41) summarizes the new consensus view on fiscal policy as follows: “To the extent that the [new consensus] restores some role for fiscal policy, it is neither a dominant role, nor is it clear what exactly that role should be. It only reaffirms that fiscal policy is inherently inflationary”.

\footnote{101} There is another sense in which the new consensus approach to macroeconomic governance is a minimalistic approach. According to the consensus, money and \textit{all} forms of macroeconomic policy are completely “neutral” in the long term. The decisions of monetary authorities have no permanent effects on future output that is determined exogenously by the supply factors of the economy. While in the new consensus view monetary policy is hyper-effective in the short run, it affects the future output capacity in no way. In the long run, macroeconomic policy has no effect. This is a remarkable view.

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In the new consensus view, a basic objective of macroeconomic policy is to “build confidence” in the investor community (Blinder 1996; Woodford 2009). Moreover, the new consensus holds that there is a particular style to conduct monetary policy in a maximally confidence-building fashion. Indeed, the current paradigm of monetary governance can helpfully be characterized as a confidence paradigm. The word “consensus” in the new consensus can be taken to refer to both a consensus among neoclassical monetary economists and a confidence-based synchronization between the conduct of monetary policy and the actions of investors. (Woodford 2003.)

The post-war theory and practice of monetary policy was based on the belief that the effectiveness of monetary policy required rapid and unexpected changes in its conduct. For instance, abrupt loosening of monetary policy was believed to “shock” the economy out of a deflationary spiral and, accordingly, extreme tightening was pursued to tame inflationary pressures in the economy. Today leading monetary authorities in Western central banks completely reject this shock doctrine. In contrast to the post-war beliefs, in the consensus view the stability of the monetary system is sustained by skilled fine-tuning of the target interest rate in conjunction with efforts to enhance transparency and communication with the investor community. (Goodfriend 2007).

How did this drastic change in the attitude occur? From the early 1990s onwards, monetary economists and central bankers started to argue that successful, confidence-building monetary policy would require – in addition to a reliable commitment to price stability – that monetary authorities adopted an approach of “fine-tuning”. This approach came down to a couple of closely related prescriptions: Firstly, unexpected changes in the interest rate target were to be avoided. Secondly, in order to reach a target interest rate, the policy interest rate were to be raised or lowered only with extreme gradualism. The purpose of this novel temperance was to assure the investors that the central bank would do anything that is needed to guarantee that financial conditions will not alter radically in the future and that the interest rates on various assets can thus always be reliably calculated beforehand. Especially in the US, central bankers started to highlight the importance of transparency and efficient communication of central banks’ monetary policy targets to the investor community (Blinder 1996; Woodford 2009). In this new consensus view, without confidence between monetary
authorities and investors, the willingness to invest would wane – to the detriment of the economy at large. If, on the other hand, communication with the markets were improved, investors would see fewer risks and thereby invest more, to the benefit of all.

Theoretically, the new consensus practice of confidence building derives from the broader changes in the neoclassical macroeconomic theory from the so-called Lucas critique onward. Drawing their inspiration from Lucas (1976), Kydland and Prescott (1977; 1982), among others, argued that without consideration of underlying parameters, such as the effects of a particular macroeconomic policy on the expectations of the individuals, macroeconomics lacks adequate micro-foundations. Based on these developments, the current “new synthesis” macroeconomic models supposedly endogenize the role of expectations in a successful fashion.102

Other theoretical influences trace further back. Like many features of the current monetary policy paradigm, “central banking as management of expectations” was already pioneered by Wicksell and his followers, such as Lindahl for whom “the formation of expectations in the cumulative process played a crucial role for the determination of the speed and extent of inflation” (Boianovsky & Trautwein 2006, 177). In his view – clearly anticipating the new consensus position – the “main task of monetary policy is to help the public to form consistent expectations” (ibid., 182).

In recent years, political economists have examined the emergence of various “confidence regimes”. They have noted that government officials increasingly find that the future business climate has to be kept stable or at least highly predictable in order to attract private investment flows. (Cohen 2008a.) The emphasis that the new monetary consensus places on confidence-building macroeconomic policy should be seen against the more general tendencies toward the increase of the ideological power of finance. Because of this power, the imperative of a stable investment climate is today evidently a

102 The novel urgency of the need to build confidence in the financial community apparently added force to the argument that fiscal policy ought not to be used in order to stabilize the economy. Public deficits, the new consensus emphasized, harms confidence. Falling credit ratings were taken as a reliably sign that a government had been profligate and could not be trusted. (Parguez 2002.) In a complete reversion of Keynesianism, according to the theory of “expansionary austerity” investor expectations about the future might even become brighter if public expenditures were cut in the middle of a recession (Alesina & Ardagna 2009; see also Blyth 2013, 165-176). The possibility of expansionary austerity is a controversial topic among the mainstream of the economics profession. The influential papers of Alesina and his collaborators have been contested on numerous grounds, while they have gained supporters as well. Moreover, these ideas have also been extremely influential among policy-makers in the Eurozone. (Blyth 2013.)
major consideration in *all* economic governance from multilateral trade agreements to the details of monetary policy. From this point of view, the new monetary consensus is an especially interesting doctrine since it contains an explicit theory of confidence building.

It can be argued that mainstream monetary economists and monetary authorities have served as the organic intellectuals formulating and defending the present policies and institutional settings for the benefit of the current historical bloc that unites key capitalist forces, especially the finance, insurance and real estate (FIRE) sectors (Hudson 2012). The contemporary networks of central banks are examples of “transgovernmental networks” through which public agencies maintain “links with similar agencies in other countries” in order to govern global concerns (Held 2010, 34). The new consensus has served as ideological glue for these networks.

4.1.7 The first neo-Gramscian hypothesis revised

The first neo-Gramscian hypothesis stated that a ‘neoliberal transition’ in monetary governance has been carried out from the 1970s to the present day. It suggested further that this process has coincided with a formation of (a) a ‘hegemony’, or (b) a ‘dominance’ of monetarist / market fundamentalist ideas in this governance area. How should this hypothesis be evaluated in light of the empirical and historical evidence and Post Keynesian considerations provided above?

The hypothesis has turned out to be *partially* correct. The same kind of broad processes and decisions that have shaped various other areas of governance from at least the 1970s onward have shaped monetary and business cycle governance, as well (for example, through the importance attached to investor expectations). A transition of sorts clearly has happened and there are several good reasons to call this transition “neoliberal” (i.e., relate it to neoliberal developments in other governance areas). The danger, however, is that this label – while it well captures various broader patterns – easily loses track of various contradictory developments. In monetary governance, “neoliberal transition” has not been a linear development, as the discussion above makes very evident.

The hypothesis is also correct in that certain governance doctrines have been dominant during the past two decades, and they thus have shaped the governance framework in multiple ways. However, recent monetary governance ideas have never quite been “hegemonic” in the full Gramscian sense of that term. As we saw above, monetarism
was ultimately rejected and its practical dominance (the “monetarist experiments”) lasted only for a very short and unstable period. As I will argue in Chapter 5 in more depth, it seems clear by now that the new consensus, too, has failed to achieve hegemony. Rather than there being a full-fledged and sustainable hegemony, a process of “passive revolution” is underway. I thus concur with Gill (2003, 116–142) who argues that not all elements of full Gramscian hegemony are manifested in contemporary transnational governance attempts. While hegemony has been the goal of the consensus, the current form of macroeconomic governance is fragile given the significant prospects and opportunities for opposition. It is thereby more acute to theorize the new consensus-style governance as “dominant” or “supremacist” form of monetary governance. It is even illuminating to see the new consensus as one that belongs to a “post-hegemonic” world, in which “political appeal and capacity to include and incorporate subordinate elements is being replaced by a politics of dominance and supremacy” (ibid., 180). For these reasons, the (b) version of the hypothesis fares much better than the (a) version does.

Despite its convincing core, the first neo-Gramscian hypothesis clearly fails in certain respects, which is why it is in need of revision. A very troublesome part of it is the typical neo-Gramscian belief that today’s monetary governance ideas would be monetarist. As shown here, the new monetary consensus rejects most of monetarism in theory and also in practice to the extent that it embodies a qualitatively different kind of view of business cycle governance. The neo-Gramscian hypothesis is indeed in urgent need of updating. Without grasping the theory and policy prescriptions of the new consensus, neo-Gramscean GPE fails to fully illuminate the key issues related to the political economy of monetary governance and monetary sovereignty – despite its clearly potential insights on that topic (insights that deserve much further attention).

Similarly, it seems a mistake to claim that the new consensus doctrines are “market fundamentalist” in any simple sense, albeit this point is admittedly more open to interpretation. The new consensus preaches and practices active business cycle stabilization, and it explicitly recognizes the non-neutrality of money and economic policy in the short term. In the New Keynesian framework that underlies the monetary consensus, market outcomes – because of various “frictions” – are often seen as macroeconomically inefficient, a viewpoint that justifies policy intervention. On balance then, the new consensus is less market fundamentalist than the monetarist
doctrine was. However, the primacy allocated to interest rate policy as a stabilization tool – as well as the themes of confidence building and active communication with the market players – clearly reflect a continuing reliance on the market mechanism. The story of market fundamentalism is thus mixed. The main lesson for the neo-Gramscians is to pay more attention to these complications. To repeat, the neoliberal transition in monetary governance has not been a linear development.

4.2 The New Constitutionalization of the Monetary Consensus

Even though the new monetary consensus provides the standardly accepted ideothetical framework informing the governments to abstain from demand management and the central banks to pursue a special type of monetary policy, it is clear that the mere popularity of any governance ideology in itself does not curtail monetary sovereignty of any state. While theories and ideologies guide policies in various crucial ways, as long as they remain “mere” theories and ideologies, they do not dictate policies. The current consensus on monetary affairs, however, has been institutionalized. In contrast to mere ideology, an institutionalized ideology constraints policy options directly and in some cases even forces specific policies.

In this section, I will first argue that the new consensus view of macroeconomic governance has been prone to be institutionalized and legalized in a new constitutional fashion.\footnote{Ran Hirschl (2004), who examines the political economy of new constitutionalism in a book-length form, provides background for this argument. His discussion is focused on constitutional revolutions in four sample countries of Israel, South Africa, New Zealand and Canada. As Hirschl (2004, 50–99) documents, the many economic and political institutions of these countries have been reoriented, in one way or another, to suit the currently dominant governance approach. Even though Hirschl’s attention is not on monetary affairs, his general discussion concerning the spread of constitutional neoliberalism in these countries suggested to me that also the countries’ monetary governance related practices might have been shaped by new constitutionalism. That indeed turned out to be the case: central bank independence was adopted in these four countries during their constitutional revolutions or shortly in their aftermaths. Other related new consensus doctrines, too, have institutionalized in a new constitutional manner. New Zealand became a pioneering country in new consensus style monetary policy already in 1990 when it adopted an inflation target. Canada and Israel did so the next year and South Africa followed them in 2000. Canada, as we saw in Chapter 1, is partial exception because its monetary architecture allows for the full exercise of fiscal sovereignty.} Secondly, I attempt explicate the precise relation of the new monetary consensus, new constitutionalism and monetary sovereignty. I will thereby link the constitutionalization of the new consensus firmly to the political economy of monetary sovereignty in the era of modern money. Analogously to Section 4.1., I will examine the
merits of a neo-Gramscian hypothesis with the tools of Post Keynesian analysis of monetary institutions:

*Neo-Gramscian hypothesis 2*: New constitutional measures have been employed in the (partially successful) attempt to cement the ‘neoliberal transition’ in monetary governance and, as a part of this project, complete the elimination of the macroeconomic policy space of contemporary states.

Stephen Gill (1998) is the most prominent proponent of the new constitutionalism hypothesis that has been subject to much discussion in GPE during the last two decades. Gill and others maintain that, besides other issue areas, new constitutional practices affect monetary governance by making its “neoliberal transition” extremely hard to reverse (Gill & Cutler 2014; Hirchl 2004). Further, Gill (2003) has clearly argued that new constitutionalism has contributed to the processes that have narrowed the policy space of contemporary states – completing the influence of other factors related for instance to the structural power of capital. Gill, as well as many other political economists, could thus probably adhere to the second neo-Gramscian hypothesis as I formulated it above.

New constitutionalism and the current monetary consensus have reinforced each other in many ways. To illustrate their interlinkages, in what follows, I will look at the operation of the contemporary version of independent central bank – the pivotal governance institution of today – in New Zealand, Eurozone and in several post-socialist economies. In addition, I will point out changes in the fiscal institutions and policies these states. In doing so, I aspire to show that it is no coincidence that independent central banks have been empowered and fiscal institutions have been undermined simultaneously. The recent development that has brought about both of these phenomena is seen as a case of constitutionalized monetary consensus in action. Towards the end of this section, some of the ambiguities of this phenomenon are pointed out and the second neo-Gramscian hypothesis is revised in light of the discussion.

4.2.1 *New consensus and the era of the independent central bank*

In its contemporary form, an “independent” central bank is a very recent construction – almost whatever we mean by the adjective “independent”\(^\text{104}\). Initially, central banks

\(^{104}\) “Independence” of a central bank can take various meanings (see, e.g. Wray 2007).
were often designed to finance government deficits (Hudson 2012; Knafo 2013). And even though modern polyarchical democracies have never allowed much of direct or participatory control over monetary matters (Mann 2013), during the postwar Keynesian era the agenda of monetary policy decision-making was firmly under the control of the elected governments. Only 30 years ago, only three central banks in the world (Federal Reserve, German Bundesbank and Swiss National Bank) could have been considered independent in approximately the modern sense. This means that the rise of central bank independence and the intellectual formation of the new consensus clearly coincide. It is a well-established fact that the new consensus era also saw the numerical expansion of independent central banks all around the world (Bibow 2010; Cukierman et al. 2002; Rapaport et al. 2009).

In contrast to the ambivalent position of the monetarists and much of the earlier canon, virtually all new consensus theorists have unanimously embraced independent central banks as by far the best possible solution in central banking. This view is taken for granted to the extent that most new consensus economists nowadays do not even bother to give any explicit argument in its favor. Even though new consensus thinkers were not the first ones to advocate independent central banking, they have certainly given a new meaning to it. For both empirical and theoretical reasons it is then fair and illuminating to treat central bank independence as an essential ingredient of the specific new consensus policy framework. Without either independent central banks or the new consensus, monetary policy as we know it would not exist.

Moreover, the contemporary independent central bank is standardly given as a paradigm example of new constitutionalism (Gill 1998; Hirschl 2004). This raises an interesting

105 Merely nine countries increased central bank independence during the 1970s and 1980s. Between 1990 and 2008, astonishing 84 central countries did so!

106 Historically, the idea of an independent central bank has attracted many friends as well as many foes. Generally, theorists emphasizing the importance of “expertise”, “credibility”, “rules”, and “stability” have been in its favor, while theorists valuing democratic governance and expressing skepticism towards technocratic decision-making elites have despised the idea. The German ordoliberals, whose intellectual influence gave the Deutsche Bundesbank its “independence” very early on, were among the first advocates of an independent central bank (Blyth 2013, 138-143). It might struck many as somewhat curious that foes of independent central banking include the father of monetarism, Milton Friedman. He believed that the power to decide upon the “money supply” was too important to be left to the government officials (Friedman 1962). Of course, Friedman was no democrat; in his mind, the power over money could not be left to the public either. Instead of all forms of “political” governance, Friedman was in favor of simple algorithmic and apparently nonpolitical money growth rules.

107 Some go so far in their suspicion of democratic decision-making on economic policy that they even advocate independent fiscal councils (Calmfors & Wren-Levis 2011) to counteract the danger of “reckless” deficit spending.
question concerning the interlinkages of the present monetary consensus and new constitutionalism. I now turn to the task of tracing marks of the new consensus in several central banks to illustrate the way in which the consensus has been constitutionalized. I will look at the cases of The Reserve Bank of New Zealand, European Central Bank, and various central banks in post-socialist economies. Simultaneously, I will briefly explain how macroeconomic governance looks from the perspective of the fiscal policy institutions in these countries.

4.2.2 New Zealand after its constitutional revolution – the pioneer for the new consensus

New Zealand is a textbook example of both new constitutional practices and new monetary consensus policies. In terms of the former, Hirschl (2004) examines New Zealand’s rapid turn to new constitutional politics from the 1990s onwards. Because of the country’s historical adherence to the British common law tradition, the politics of New Zealand once used to be comparatively unconstrained by its legal institutions. The situation started to change rapidly a couple of decades ago. Especially the New Zealand Bill of Rights Act 1990 contributed to the constitutionalization of the country’s politics in a number of wide-ranging ways. Since the ratification of this act, appeals to constitutional law and judicial review cases have suddenly become common in matters of politics. (Ibid., 24–27).

In addition to the constitutionalization of core sectors of its politics, New Zealand’s economic policies have thoroughly affected by the new consensus. In order to combat inflationary pressures and greatly influenced by the literature on central bank independence, the Reserve Bank of New Zealand adopted a new legislative framework in 1989, which mainstream monetary economists have greeted as a great advance. It is now widely accepted that contemporary inflation targeting originated in New Zealand for reason of which the country is standardly employed as a textbook example of modern day central banking (in the literature, a distinct “New Zealand model” has often been distinguished from “Bundesbank model”). Major new consensus theorists have been hugely impressed by the institutional developments in New Zealand because the

108 Reddell (1999, 71) even notes that “the specific economic literature on inflation targeting – – followed the New Zealand innovation rather than led it”.

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country was among the first ones to give up monetary targeting favored by the monetarist approach. (Reddell 2015, 1999; Archer 1997.)

Simultaneously as New Zealand pioneered modern central banking, it imposed novel rules on fiscal policy, specified for instance in the Fiscal Responsibility Act of 1994. The articulated purpose of the rules was to “stabilize” fiscal deficits and improve a dismal inflation record. In order to understand these developments in New Zealand, interlinkages of various economic and legislative reforms have to be grasped. As Reddell (2015, 204) puts it, “if thoroughgoing reform of the governance of core government agencies had not happened to be under way” at the time of the central bank reform, “it is highly unlikely that the Reserve Bank would have become known as the first adopter of modern inflation targeting”. (Reddell 2015, 1999; Hirchl 2004; Kelsey 1997.) In short, New Zealand is a paradigm example of the constitutionalized monetary consensus. It witnessed the co-emergence of central bank independence and strict fiscal policy legislation reflecting the primacy of monetary policy.

4.2.3 The case of the Eurozone – constitutionalized new consensus on steroids

Let me take another example. The institutional structure of the Eurozone is strikingly illuminating. First, it illustrates well the practice of constitutionalized new consensus. Second, it makes evident many of the logical conclusions that the new consensus doctrines have for monetary sovereignty (which I will explicate in due time).

It is easy to make the case that macroeconomic governance in the Eurozone reflects key aspects of both the current monetary consensus and new constitutionalism. Regarding the former aspect, Sardoni & Wray (2006) argue that ECB generally conducts monetary policy according to the prescriptions of the new consensus even if a couple of its practices are at odds with those of the US Federal Reserve.\(^\text{109}\) In terms of the latter aspect, the mandate of the ECB and the Maastricht convergence criteria exemplify new constitutional attempts to make “neoliberal” economic policies irreversible (Gill 1998; Patomäki 2012, 189–222). Calmfors (2012, 13) points out that the new European Fiscal Compact even stipulates that “the Eurozone countries should introduce into their national laws, preferably constitutions, balanced-budget rule – as well as automatic correction mechanisms including obligations to implement measures to correct

\[^{109}\text{The differences are mostly matters of “implementation, timing, competence” not related to the “underlying theoretical orientation” (Sardoni & Wray 2006, 451).}\]
deviations from a balanced budget over a defined period of time”. Leading theorists of the new consensus (at least used to) believe that strict fiscal restrictions of the Eurozone are to be applauded (see, e.g. Woodford 2001b).

How did the constitutionalized new consensus shape the institutional design of the Eurozone? A strong and independent central bank was created but it was left without a mandate to finance the fiscal policies of the member states. No federal institution with fiscal capacity was established. Further, no mechanism of debt restructuring or surplus recycling was set up. Economists informed by the chartalist theory were able to foresee that an institutional design of a monetary union of this sort would end in the kind of disaster in which it did end when the crisis of the Eurozone set in (Bell & Nell 2003; Goodhart 1998).

In sum, the case of the Eurozone illustrates perfectly how the consensus ideology promoting strong monetary policy institutions and weak fiscal capacity can turn into reality with the help of new constitutional measures. In rare places has the new constitutional institutionalization of the monetary consensus ideas affected state monetary sovereignty and fiscal policy space as adversely as it has done in the Eurozone. To put in bluntly, in the Eurozone the constitutionalized new consensus has been on steroids.

4.2.4 Cementing consensus in post-socialist economies

The new consensus doctrines became the macroeconomic governance related subset of the broader Washington consensus that was forcefully imposed on many developing and transition economies during the 1990s (Harvey 2007). The unofficial partnership between new constitutionalism and the new consensus can be illustrated further by scrutinizing the shared experience of most post-socialist economies.

Central bank reforms in 26 former socialist economies have taken a legal character with a speed unprecedented in the West. Moreover, many post-socialist countries – such as Estonia, Lithuania, Poland, Czech Republic, Armenia and Moldova – have recently adopted a form of central bank independence that exceeds “that of the highly independent Bundesbank during the 1980s”. (Cukierman et al. 2002, 239) The post-socialist central bank reforms provide cases of strong new constitutionalism. I suppose that in contrast to the post-socialist economies, the hegemonic discourses of neoliberal
governance have been so much better internalized in the cultures of countries such as the United States that as far going need to constitutionalize the desired type of monetary governance does not arise there. In the former socialist countries, neoliberalism has been resisted at the level of culture more strongly, which is why the task of policy-making elites to make unpopular governance practices legally binding is especially urgent in these “new democracies”. As far as monetary governance is concerned, in addition to – or even instead of – a transition to democracy, the post-socialist economies have witnessed a far-going transition to new constitutionalism.

How strong is the link between these hardline new constitutional reforms of the post-socialist economies and the current consensus among monetary economists? It appears considerable for two related reasons. First, the new consensus has had a direct influence on the mindset of the authorities in the post-socialist economies. As Cukierman et al. (2002, 256) put it, “the fact that the average level of legal independence of the new CBs of economies in transition is substantially higher than that of developed economies during the 1980s at least partially reflects the shift in professional consensus among economists and policymakers in favor of CBI between those two decades”.110 Second, the prospects of joining the EMU greatly increased the level of legal independence of central banks (Cukierman et al. 2002). Hence, the developments of the post-socialist economies have also imitated the new monetary consensus inspired institutional reforms in the Eurozone discussed above. Unsurprisingly, the policy space of the fiscal institutions in the post-socialist economies has generally shrunk considerably. Recently Romania, Estonia, Bulgaria, Latvia and Lithuania (the “REBLL alliance”) have become much-celebrated poster children of allegedly successful fiscal austerity. (Blyth 2013, 216–226.)

With these case studies, I have established the fact that the new monetary consensus – at least in several interesting cases – has often been constitutionalized in a new constitutional fashion. It seems evident that this observation is not limited to the cases examined here even if they provide instances where the phenomenon is especially clear. The fact that the policy institutions and practices of the Reserve Bank of New Zealand provide a standard and widely imitated textbook model of consensus monetary policy...
guarantees that I have not been examining mere exceptions but tracking a more general development. Of course, the cases of the Eurozone and post-socialist economies are no exceptions either – on the contrary, they are cases that illustrate the logic of the process especially clearly. However, it bears emphasizing that the monetary consensus has not everywhere been accompanied by new constitutional politics to the same degree as in the cases that I examined here. Obviously, this recognition does not change the fact that there has been a significant and sustained global tendency towards the constitutionalization of the consensus policies. In the remainder of this chapter, I will explicate the lessons the above discussion contributes to the study of political economy of monetary sovereignty.

4.2.5 The ambivalent relationship between the new monetary consensus and monetary sovereignty (and the role of new constitutionalism in its “resolution”)

The relationship between the new consensus and the monetary sovereignty of contemporary states is peculiar. On the one hand, the new consensus directly draws on – indeed requires – monetary sovereignty. On the other hand, the consensus has importantly legitimatized key new constitutional processes that are undermining monetary sovereignty. Let me elaborate on this seeming contradiction and clarify the way new consensus attempts to “resolve” it.

New consensus interest rate policies and inflation targeting presuppose monetary sovereignty in the full chartalist sense. Evidently, only a monetary sovereign with its own floating currency and a central bank operating under a flexible exchange regime can conduct monetary policy in the style new consensus advocates (Fischer 2001, Taylor 2001). A state using a foreign currency has no authority to decide on the interest rate and a state pegging its currency is not free to set the interest rate as it wishes. The new consensus accepts the view of Obstfeld and Rogoff (1995, 95) in that a “basic reform of domestic monetary policy institutions” is preferable over fixing the exchange rate.\footnote{However, the influential “bipolar view” on exchange rate regimes (see Fischer 2001) maintains that a hard peg similar to the EMU arrangement works considerably better than intermediate solutions (soft or adjustable pegs). There is no mystery why the new consensus has been in favor of the fixed exchange rate arrangement of the EMU – new consensual monetary policy is possible in the conditions of the monetary union because the ECB has no exchange rate constraints (because the euro is a floating currency). In other...}
Simultaneously, as shown above, the consensus views on fiscal policy have served to deepen the neglect of fiscal policy and accelerated the new constitutional narrowing of the fiscal side of monetary sovereignty. The case of the Eurozone, for instance, illustrates this issue extremely vividly. This development is not surprising because the new consensus theory remarkably has no essential economic role to play for the modern state government! (Fontana 2009).

I explained in Section 4.1. how this paradoxical attitude towards monetary sovereignty first emerged in the monetarist thought. The new international monetary architecture for which monetarists argued actually enhanced monetary sovereignty, while many monetarist policies served to restrict its free exercise. Already the monetarists understood that arbitrary controls on policy have to be built and built deliberately. Subsequently, the constitutionalized new monetary consensus has taken the monetarist attitude one crucial step further by imposing strict legal limits on the exercise of fiscal policy. In addition, the relationship of the new consensus to monetary sovereignty developed an important new flavor, because the consensus recommended the active exercise of the domestic monetary policy space granted by monetary sovereignty.

On balance then, the new consensus both requires monetary sovereignty and undermines it. This fact appears to be contradictory, of course, but the new consensus attempts to remove that contradiction in the good old way – by making a distinction. The new consensus wants to fortify monetary policy sovereignty and weaken fiscal policy sovereignty. To make this point clearly, it is worth quoting Woodford’s (2001, 71) important observation:

*Fortunately, commitments to budget balance or to deficit limits have achieved new prominence in macroeconomic policy in the same period that has seen increased emphasis upon central bank independence and actively anti-inflationary monetary policy, both in the U.S. and in the European Union.*

From the perspective of the political economy of monetary sovereignty, Woodford describes a crucial development. Contrary to the impression one gets from reading Woodford, however, the increasing appeal of central bank independence and novel fiscal commitments has been no *coincidence*. New constitutional measures have been words, the fact that *individual* countries have lost their monetary sovereignty is no obstacle to the consensus policies.
employed both to strengthen the monetary policy related aspects of monetary sovereignty (e.g. the development of independent central banks) and undermine its fiscal policy related aspects (e.g. strict fiscal rules and compacts, as well as an institutional separation between fiscal policy and monetary sovereignty). The new constitutional project seems to be mediating the ambivalent relationship between the new consensus and monetary sovereignty in a crucial way.

It might seem for a moment then that the new constitutional way to resolve the contradictory attitude of the monetary consensus towards monetary sovereignty could actually work. However, the halfway endorsement and halfway rejection of monetary sovereignty is likely to have reached its limits. The institutional and functional separation between monetary policy and fiscal policy cannot be sustained – let alone completed – as the global financial crisis clearly indicates (Bibow 2010). Woodford’s (2001) suggestion of coordinating monetary policy and fiscal policy by using fiscal targets fails because it does not provide an adequate role for fiscal policy (Tcherneva 2008). From my chartalist perspective, there cannot be authentic exercise of monetary sovereignty without unrestricted fiscal policy space. The wrap-up then is that the new consensus undermines the most important aspect of monetary sovereignty, even if it does necessitate other (ultimately related) aspects of this sovereignty. It seems that all attempts of the new consensus to resolve its contradictory relationship with the underlying issue of monetary sovereignty are likely to fail. This predicament contributes to a fading of the new consensus hegemony – a theme elaborated further in Chapter 5.

4.2.6 The second neo-Gramscian hypothesis revised

The second neo-Gramscian hypothesis formulated at the outset of this section stated that new constitutional measures have been employed in the (partially successful) attempt to cement the ‘neoliberal transition’ in monetary governance and, as a part of this project, complete the elimination of the macroeconomic policy space of contemporary states. Like the previous hypothesis, this one, too, has to be revised in light of the Post Keynesian scrutiny I placed on it in above.

112 In Woodford’s view, an independent central bank pursues “autonomous monetary policy… a rule for setting its instrument (in practice, a nominal interest rate) that is independent of fiscal variables” (Woodford 2001b, 4, emphasis in the original).
Again, the core idea of the neo-Gramscians is vindicated – new constitutional measures have been used to cement the recent transition in monetary governance. However, it seems that the latter part of the hypothesis is both too weak (in one sense) and too strong (in another sense). It is too weak because not only have new constitutional measures been employed in an attempt to eliminate the policy space of contemporary states, but these measures have been perhaps the primary reason why the state policy space has shrunk. It is not so much the case – as neo-Gramscians often assume – that markets or “capital” in and of themselves would have great disciplinary power over state policy in a “structural” sense. In that picture, the role of the new constitutional measures is only to cement, polish or regularize that power. Rather, in my precise view the new constitutional practices themselves often seriously constrain monetary sovereignty in the first place. They are not mere add-ons, but frequently actually the key discipliners! As I hinted already in Chapter 1, theories of disciplinary neoliberalism (Gill’s version and many other equivalent ones) should place most of their weight on new constitutional type of measures rather than on any alleged straightforward market power over states. Monetary sovereignty and the macroeconomic policy space of advanced states are in much more blatant danger from the new constitutional project than from the market mechanism, which – as much evidence testifies – is often surprisingly blind and powerless vis-à-vis the monetary sovereign states. Hence, the second neo-Gramscian hypothesis should be revised to incorporate the chartalist position that highlights the importance of monetary sovereignty.

It seems the above hypothesis also claims too much, because it ignores much of the complexity of the political economy of monetary sovereignty. While the loss of monetary sovereignty and the vanishing of macroeconomic policy space are considerable in the case of fiscal policy, such tendencies (usually) do not exist in the case of monetary policy. To the contrary, contemporary central banks are sovereign and extremely powerful in many ways. However, it is not the case that new constitutional measures have not been applied to monetary policy – the contemporary independent

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113 Central banks are pivotal governance institutions, as for instance the GFC reminded us. They are generally capable of exercising control over their key policy variable, the short-term interest rate. They are “sovereign” even in the sense of being independent from democratic decision-making and therefore have “free hands”. However, it is true that central banking networks are transnational which can be understood to constrain the sovereignty of individual central banks (while this simultaneously bolsters their power as global actors).
central bank is a product of new constitutionalism at its purest. Rather, as elaborated above, the ambivalent relationship of the new consensus to the different aspects of monetary sovereignty has meant that the role of new constitutionalism is to undermine the fiscal aspects of the exercise of monetary sovereignty and strengthen monetary policy related aspects. The goal has not been the total elimination of the exercise of monetary sovereignty. Again, Post Keynesian attention to the operation of policy institutions sheds light on – and helps to revise – the neo-Gramscian position.

4.3 Tentative Conclusions on the Relationship of Post Keynesian Economics and neo-Gramscian GPE

In section 4.1., I argued that on the course of its development the new monetary consensus has come to encompass aspects of both scientific theory and a dominant (even if never quite hegemonic) political ideology. On the one hand, the consensus has largely rejected monetarism and incorporated elements of institutional realism the importance of which Post Keynesians have long emphasized. Endogenous money stock determination and many essential operational features of the monetary system have been partially incorporated into the mainstream view of macroeconomic policy. On the other hand, new consensus monetary policies target unobservable theoretical abstractions (“natural rates of interests”) and explicitly favor policies that supposedly enhance confidence of financial market actors – the core actors of the hegemonic “historical bloc”. Most importantly, the “organic intellectuals” of the bloc, mainstream economists and monetary authorities, support the evidently erroneous idea that monetary policy fine-tuning is an omnipotent stabilizer of the cyclical demand fluctuations of capitalist monetary economies. In Section 4.2., I examined the partial new constitutionalization of several key aspects of the monetary consensus. I showed that in various states the development of monetary policy institutions (independent central banks), on the one hand, and fiscal institutions, on the other, have been simultaneously both (i) influenced by new consensus doctrines and (ii) shaped by new constitutional practices of varying intensity. Towards the end of the chapter, I explicated the ambiguous relationship the monetary consensus has formed with state monetary sovereignty and explained how the new constitutionalist project has mediated this relation. I concluded the section by expressing my suspicion that ultimately, however, the contradictions of the relationship cannot be mediated successfully.
In this chapter, I showed that in addition to providing important means for the critique of the existing GPE and orthodox economic theories (see Chapter 1), insights gained from the Post Keynesian theory can be employed in conjunction with a particular political economy research agenda and in a constructive way. I established this conclusion by studying neo-Gramscian research questions (concerning neoliberal transition and new constitutionalism) with the aid of Post Keynesian economic analysis. By revising the neo-Gramscian hypotheses, I concretized the neo-Gramscian narratives of the “neoliberal transformation” in monetary governance using the insights drawn from a realistic monetary theory and empirical evidence. These revisions were summarized in Sections 4.1.7. and 4.2.6. above.

The key theoretical lesson of this chapter is clear. In order fully to account for the emergence of the contemporary governance regime that undermines key aspects of monetary sovereignty of multiple states, insights from both Post Keynesian economics and neo-Gramscian GPE can be very illuminating. The immediate focus of this chapter has been on the contributions of Post Keynesian theory to the study of standard neo-Gramscian topics. From the point of view of the main argument of this thesis, however, the ultimate reason to reconcile neo-Gramcian thinking with Post Keynesian economics is to provide chartalism with a satisfactory political economy of monetary sovereignty. In the conclusion section of this thesis, I will draw from the neo-Gramcian lessons of this chapter to revise the chartalist hypothesis formulated in Chapter 1. I hope to contribute to a future “flexible synthesis” of these perspectives to generate further light on the political economy of monetary sovereignty – a point I will also return to in the conclusion section.

In addition, the argument here suggests it is possible to broaden the research agenda of neo-Gramscian GPE to contribute to the study of the “traditional” topics of economic theory (such as explanations of the determination of business cycles, income distribution, inflation and employment)\textsuperscript{114}. The constitutionalization of the new consensus, for instance, has consequences for all of these matters as the experiences of the Eurozone testify. Ultimately, economic issues are too important to be left to economists; they should be tackled from a pluralist social scientific perspective. Comprehensive and realistic answers to the questions posed by economic theory are

\textsuperscript{114} Such a widening of vision is precisely what Patomäki (2003, 206) argues that the GPE theories should attempt if the discipline hopes to be relevant in the future.
bound to be less “neat” than most economists would like. The social scientists who are interested in truth should not be afraid of the defensive reactions from economists.

5 Evaluating and Overcoming the Consensus Regime

In Chapters 3 and 4, I examined the way in which the post-Bretton Woods monetary governance regime – its practices and ideologies – have come to undermine the monetary sovereignty of modern states that the post-Bretton Woods monetary arrangement bolsters (see Chapter 1 on the latter point). It is now time to evaluate the functioning of the regime. How to deal with the fact that the modern money era does not allow for the full exercise of monetary sovereignty? Should monetary sovereignty be exercised in the current global age anyway? And if it should, in which way?

I start by examining the performance of the new consensus before the outbreak of the GFC and during the (still ongoing) recessionary or unstable growth period that followed the crisis against the consensus’s own criteria of success. I conclude that because of its immanent failures, the new consensus has in important respects shattered but nevertheless continues to influence contemporary policies (Section 5.1.). I then turn to the task of developing a Post Keynesian/chartalist case for the transformative and cosmopolitan exercise of monetary sovereignty that has not been possible under the new consensus regime (Section 5.2.). In the conclusion to this chapter (Section 5.3.), I will draw further theoretical lessons for the attempt to synthesize Post Keynesian economics and critical GPE.

5.1 The Failure of the New Consensus

Before turning to the fundamental concerns of democracy that the current practice of monetary governance raises in the next section, I will start by reviewing new consensus-style macroeconomic governance from the consensus’s own immanent point of view. The new consensus emphasizes and promises macroeconomic efficiency and stability. To get a representative overview of the “new normative macroeconomics” (Taylor 2000, 22) championed by the new consensus, see for instance Woodford’s (2003, 381–626) view on optimal policy and its implementation.
according to the consensus’s own criteria of success? If not, what has happened (or what is about to happen) to the consensus itself? This immanent line of critique nicely paves way for – as well as complements – the extrinsic line pursued in the next section.

The following hypothesis – drawing on both neo-Gramscian and Post Keynesian thought – suggests itself:

_The Neo-Gramscian / Post Keynesian “failure hypothesis”: New consensus style macroeconomic governance has failed to achieve a full hegemony. This is partially because of the ultimate inability of the consensus to satisfy its own immanent standards related to macroeconomic stability. The dominance of the consensus is fading and the consensus doctrines will likely be replaced by significantly modified governance doctrines in the near future._

### 5.1.1 The apparent success of the New Consensus

“Great moderation” – a success worth celebrating?

The new consensus thinkers found a reason for self-gratitude in the fact that the era of 1984–2007 was characterized by decreased volatility in, for instance, average output and price level in the U.S. This period of stability was mostly seen to have been caused by improvements in the monetary policy paradigm. In combination with the deregulated financial markets, inflation targeting appeared to have successfully built up confidence in the investor community and monetary policy was supposed to have become extremely effective. In the consensus literature, this era is known is generally known as the era of “Great Moderation”. (Gali & Gambetti 2009.)

It is indeed true that during the 1990s, the U.S. economy expanded in an apparently stable fashion, whereas much of the rest of the world – Europe, Japan, East Asia, Latin America – suffered from volatility, financial crises and high unemployment (Cohen 2008a, 77). However, the GFC made the arguments for the existence of the Great Moderation to seem suspicious, to put mildly. Given the weaknesses in the consensus storyline, an alternative explanation of the Great Moderation is required and indeed several attempts for such an explanation have been made. Following the pioneering research of Hyman P. Minsky (1986), and Steve Keen (2013), I maintain that the “Great Moderation” was a phase of merely apparent stability that actually brought about

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116 Remarkably, the new consensus’ own of criteria of success do not encompass any authentic democratic considerations. Further, insofar as the new consensus is a substantial element of the new constitutional project, the consensus’s own criteria of success actually embody counter-democratic goals.
increasing instability in the financial markets and a near exponential rise in the level of private debt. On this account, the new consensus style economic policies had very little to do with providing stability.

The explanation that Keen (2013) offers finds support elsewhere – also outside the Post Keynesian literature. As Tamborini et al. (2014, 106) note, “it is widely reported in empirical studies that boom-bust cycles driven by investment-savings imbalances are typically associated with low and stable inflation”. In the recent literature, this has become known as the problem of the “missing inflation” (Borio 2008). Krugman (2013b) now concedes that the era of Great Moderation coincided with the fatal expansion in the level of private debt that contributed to the GFF.

The Appeal and Futility of the Confidence Regime

Another celebrated aspect of the new consensus has been the belief that the consensus policies successfully enhances confidence of the investors (see Section 4.1.6 for an outline of this idea). Here I will briefly examine (1) whether the new consensus attempts to boost confidence in fact “work” as they are supposed to, and (2) whether public sector fiscal involvement in the economy in reality harms investor confidence, as is widely believed nowadays. It is also worth asking (3) whether the confidence of the demos (as opposed to the exclusive confidence of investors) should be taken into account by monetary governance doctrines for narrow “economic” reasons, too.

(1) *Do the conventional attempts to enhance investor confidence work?* Is it true that the contemporary monetary consensus has made investors more confident? While the question is elusive and therefore a hard one to answer precisely, some strong considerations would seem to cast a deep shadow over the belief that new consensus policies enhance investor confidence. The age of new consensual monetary policies, independent central banks and austerity has provided weak economic growth, increasing fragility and high unemployment (Davidson 1999, 21–23; Lavoie & Stockhammer 2012; McCombie & Thirlwall 1999, 80–82).

To illustrate, let me take the example of the Eurozone during its – still enduring – economic crisis. Do we have any reason to suppose that the restrictive fiscal measures advocated have enhanced confidence? The historical record does not support the view that markets would necessarily prefer disciplinary spending patterns of states. Chang
and Leblond (2015) show convincingly that the dramatic changes in the bond yields of the Eurozone states since the onset of the monetary union can be attributed to the varying market expectations concerning the states’ ability to cooperate. They argue that “market confidence in the euro area has – – always rested to a large extent on the expectation of its solidarity” (ibid., 628). Because in case of a debt crisis it is solidarity that guarantees that sufficient liquidity is provided to prevent any defaults, “all of the emphasis placed on austerity and fiscal policy coordination may have been a diversion” (ibid., 648). Credit markets might be judging weak Eurozone states because of the monetary union’s obvious lack of solidarity and inadequate institutions, and not because of the “profligacy” of these states. The Baltic countries (see Blyth 2013, 216–226) or New Zealand (Kelsey 1997) are no adorable success stories either). These examples suggest that the constitutionalized new consensus is not a sustainable recipe to enhance investor confidence.

In terms of the high theory, the new classical project of “endogenization of expectations” (described briefly in Section 4.1.6) is arguably defective in its present form. While it is a true insight that the role of expectations should somehow be integrated to economic theory, the current attempt to endogenize expectations by deriving them from new classical “microfoundations” fails in terms of realism. There is little reason to believe that the sort of expectations postulated by the standard neoclassical microeconomic theory would be relevant in any way because the uncertain expectations of people of flesh and blood are formed in the complicated interplay of psychological and social factors. On the most fundamental level, this theoretical failure explains why new consensus attempts to boost positive expectations in investors have often be so unsuccessful.

Tentatively, it can then be concluded that there is little evidence that new consensus policies would be capable of enhancing business confidence in any systematic way. Moreover, it is probable that the entire contemporary framework of economic policy fails in this respect. As Saad-Filho & Ayers (2008, 124) put it, the “the advocates of neoliberalism invariably overestimate investment and growth that can be generated through the adherence to the neoliberal demands”. Now let me examine the other side of the coin
(2) Does public involvement in the economy harm investor confidence? For various reasons such a conclusion would be hasty, to say the least. Blyth (2013, 3) notes how financial investors often are, in Olivier Blanchard’s words, “schizophrenic about fiscal consolidation and growth”. Despite wide-spread beliefs to the contrary, in practice investors seem to love liquidity and dislike austerity. Moreover, Post Keynesians have often pointed out that even if large government occasionally implies a big budget deficit, large-scale public involvement does not usually harm investor confidence. For instance, a downgrade of a government bonds does not necessarily lead to an increase in the interest rate demanded on the government’s loans. The chartalists note that while credit-rating agencies often fail to take into account the fact that a monetary sovereign country does not even face a risk of defaulting in its own currency, investors may not pay much attention to such misinformed downgrading decisions. While, for instance, Japan’s credit rating has been lowered countless times in the recent years, its interest rates have never risen considerably.

Further, Mazzucato (2013) provides recent and widely praised evidence suggesting that heavy state involvement in the innovation process anything but harms business confidence. To the contrary, private investors tend to be the most convinced of the business ideas that the public sector first finances and develops to a sufficient stage. Mazzucato shows that in countless cases the public sector has born a risk the “venture capitalists” were unwilling and/or incapable of bearing. Hence, it seems that the consensus wisdom and the widely held beliefs about the harms of fiscal involvement for investor confidence are in urgent need of revision.

(3) What about confidence of the demos? In the literatures of economics and finance, as well as in economic policymaking, the catchword “confidence” almost invariably refers to confidence of investors and lenders. This usage standardly ignores the fact that in order to be socially sustainable macroeconomic policies should probably convince a much broader set of people – that is, ultimately, the global population as a whole. In Section 5.2., the implications of this idea finally bring me to the fundamental normative concerns of cosmopolitan democracy. Here I will justly briefly explain why the new consensus attention to confidence is of too narrow sort. Economic policies that are deemed unjust by the demos ultimately will not succeed – according to the pure “economic” standards alone – even if they had all the prima facie support of the creditors and investors.
Rodrik (2011, 184–190) explains how the financial markets lost confidence in Argentina even if the leaders did absolutely everything to please the markets just as the consensus advised. In fact, “what sealed Argentina’s fate in the eyes of financial markets was not what Cavallo and de la Rúa were doing, but what the Argentine people were willing to accept” (ibid., 188). Although illuminating, the Argentinian case is no exception. The current socio-economic crisis of Greece, for instance, shows similarities with respect to the importance of the domestic politics for financial market confidence. The Troika-imposed “cure” of austerity policies has routinely failed to convince investors. Contrary to the widespread, but erroneous accusations that Greece has somehow failed to impose the required austerity and bulk of the “structural reforms”, Greece has largely swallowed the “medicine” (even if under the SYRIZA government first somewhat reluctantly). Why do the financial markets remain unconvinced (still in spring 2016)? Simply because they know that the patent might not tolerate the cure. They know very well that the suffering of the Greek people produces an immense “political risk”. As Rodrik (2011, 188) summarizes it, “when globalization collides with domestic politics, the smart money bets on politics”. To put the conclusion more precisely, when the consensus economic policies produce results the people are unwilling to accept, financial markets lose confidence in the consensus policies, despite all the declarations about their confidence-building character. The insufficient of attention to the grievances of the people goes a long way toward explaining why the new consensus has failed to attain hegemony – the consensus often fails to provide even illusionary answers to the needs of citizens, something that every successful hegemony does. Eventually, a politically unsustainable regime will collapse – no matter how great its appeal to lenders and investors. The futility of the confidence regime suggests that viable future monetary governance doctrines should pay much more attention to the confidence of the demos than the current consensus does.

5.1.2 Evaluation of the new consensus macroeconomic stabilization policies during the global financial crisis and its aftermath

The ineffectiveness of both conventional and “unconventional” monetary policy measures and the quiet return of fiscal policy

As I explained in Chapter 4, the primary role of monetary policy in contemporary macroeconomic governance derives from the current mainstream neoclassical
macroeconomic synthesis. The new monetary consensus holds that countercyclical interest rate policy is, in “normal” circumstances, capable of solving the business cycle problem endemic to capitalist market economies. That is a big promise. The belief in the omnipotence of monetary policy came under a serious test during the global recession that followed the GFC (a crisis that itself plausibly was partially caused by the inadequacy of the consensus policies consensus). A much-discussed response of key central banks to the GFC was experimentation with “exceptional monetary policy measures”. These included actions such as Fed’s three rounds of quantitative easing (QE) as well as its relatives adopted subsequently by central banks of the Eurozone, England and Japan, among others (Fawley & Neely 2013). Nevertheless, the standard new consensus recipe of neo-Wicksellian monetary policy is still widely adhered to (even if with various modifications).

Ben Bernanke, the chair of the Fed during the GFC, has been among the key advocates of the idea that the means of monetary policy are not exhausted even at the “zero-lower bound” of the policy interest rate (Bernanke & Reinhart 2004). As Lavoie and Seccareccia (2013) poignantly note, it is rather ironical that Bernanke and other new consensus economists advocate “unconventional” monetary policy measures since, fundamentally, they usually are just old conventional monetarist type of measures in disguise.

Following the Post Keynesian literature, I maintain that monetary policy – including the unconventional measures – is a very weak and unreliable tool for taming cyclical fluctuations in the level of aggregate demand. The standard consensus interest rate policy is undermined, for instance, because its “transmission mechanism” seems to be quite unrobust. First, the propensity to invest is far from determined by the rate of interest because the importance of profit expectations tends strongly to overrule its effect. Secondly, the propensity to consume cannot be governed by the interest rate tool either. In contrast to the consensus wisdom, a higher (lower) interest rate may actually lead to an increase (decrease) in private spending. This could result because when the interest rate rises, incomes of the interest recipients go up. More importantly, since higher interest rates lead to bigger government budget deficits (as the payments for bondholders increase), the net monetary wealth of the private sector grows. This effect should stimulate spending and investment. Indeed, there is little evidence that interest rate policy works in as effective a way that the new consensus expects. (Sardoni &
Because the new consensus preference for the centrality of monetary policy is clearly underdetermined by evidence, the most plausible explanations for this trust seem to be ideological in nature. Monetary policy is probably simply seen as more “market friendly” tool than its alternatives.

In the final analysis, the unconventional monetary policy measures, too, are likely provide cold comfort for those who still believe in the effectiveness of monetary policy. The effectiveness of quantitative easing is questioned by operational and theoretical considerations as well as by empirical evidence. Fullwiler (2013) argues that banks need neither reserves nor deposits to extend credit, which questions the operational logic of the QE policies. The QE seems to be based on the discredited money multiplier model incompatible with the endogenous money view (Lavoie 2010). Because a version of endogenous money is in principle embraced by the new consensus, it is odd for the consensus theorists to believe in the efficacy of QE type of measures. Unsurprisingly, the empirical success of quantitative easing, claimed by the authorities, can be disputed on strong grounds. As Fawley and Neely (2013, 81) put it, “the proliferating research on the effects of QE generally indicates that it had the desired effects on asset prices but the effects on the broader economy are much more difficult to discern because it is not possible to know with any certainty how economic conditions would have evolved without these policies in place”.

There are hence strong reasons to believe that monetary policy does not work very well (there are even further reasons but I do not have the space to discuss them here). It is certainly conceivable that the problems of the current consensus lie not in the monetary policy focus as such but on the specific targets, instruments and policy rules (inflation targeting through short-term interest rate management in accordance with Taylor-type rules). Instead of inflation, for instance actual output or aggregate demand could be

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117 It is also clear that, despite its New Keynesian elements, the new consensus is very far from what Keynes’s views on stabilization policy. Keynes effectively dismissed Wickel’s idea of a natural rate of interest already in the 1930s. He argued that a monetary economy is inherently unstable and that there exists no single interest rate by targeting of which a stable growth path could be achieved. No “natural” interest rate could balance investments with savings – the “classical axioms” (the gross substitution axiom, the neutrality of money axiom and the ergodic axiom) had to give. Because of the deficiencies he saw in monetary policy as a macroeconomic policy instrument, Keynes was led to advocate strong fiscal measures, “socialization of investment” and the “euthanasia of the rentier”. The new branch of economic thought – subsequently dubbed as macroeconomics – Keynes gave birth to, was thus initially premised on the insight that the macro-dynamics of a monetary economy are inherently unstable and not fixable by mere fine-tuning. (Keynes 2009.)
targeted (Tamborini et al. 2014). On Post Keynesian grounds, it is unlikely, however, that these amended interest rate rules would work *much* better in stabilizing the business cycle. Generally, most Post Keynesians see monetary policy to be of at most auxiliary use in stabilization policy. As Fullwiler (2013, 190) summarizes this view, “monetary policy stimulus, because it operates almost entirely through raising the leverage of the non-government sector even in the case of QE, is a stark contrast to fiscal policy that by definition raises the income and net financial wealth of the private sector”.

Fortunately, there have been some signs that fiscal policy might be returning. In countries such as the US and Australia the size of the after-crash fiscal stimulus was sufficient to prevent the domestic deepening of the crisis in these countries. While in the former growth and employment rates improved already in 2010, the latter was probably the only major economy in the world that did not suffer a major recession after the GFC. Successful large-scale fiscal spending in these states clearly contradicts the fine-tuning approach of the new consensus. Monetary policy, after all, was supposed to have become hypereffective and the “only game in town” (Blinder 1996, 7). The US and Australia thus provided sufficient fiscal spending *despite* the fashionable trends in macroeconomic theory. How could that happen? First, as an enabling condition, these large and strong fiscal federations had all the policy space in the world to exercise their monetary sovereignty and feed their economies with deficits big enough to prevent the kind of debt deflationary spiral that swallowed many European countries, among others. Second, the existence of automatic stabilizers led to huge budget deficits without any policy decisions. Third, the governments of the countries were pragmatic enough to recognize that they needed to use their fiscal capacity to provide discretionary spending. The practical necessity thus triumphed over the fashionable monetary theory.

Most governments, particularly in Europe, nevertheless were unwilling or – because of their new constitutional institutional structure – *unable* to engage in large-scale fiscal spending. The northern governments continued to belief in the consensus, while the southern victims of the new constitutionalism could only conform as they had lost their monetary sovereignty altogether. It is clear enough that the new consensus framework was incapable of providing any useful answers to the question of how to govern the post-GFC economies.
Heterodox ideas entering the mainstream debates on macroeconomic policy and shattering the consensus

There are many signs that the consensus on macroeconomic policy is shattering. This is not surprising because the last decade has been particularly harsh towards it. For many, it has been more of a surprise that the change in thinking has not been as rapid as one would have expected it to be in the current crisis-prone environment. One sign of the growing discontent with the mainstream approach is the rising popularity and influence of heterodox schools of thought. Even prominent economists who regard themselves as belonging to the mainstream have recently reformulated and discussed some heterodox ideas – elements of the consensus are thereby contested even in the neoclassical debates.

Here, I will comment on two recent mainstream debates centered on, what historically are, heterodox ideas. These are the debates on “secular stagnation” and the importance of state money. Given these debates, I will ask whether the heterodox ideas of long-run non-neutrality of money and the importance of (chartalist) monetary sovereignty could be incorporated into the mainstream view. The purpose here is to evaluate whether these heterodox ideas are likely to have transformative effect on the current thinking and practice.

During the last couple of years, the so-called secular stagnation hypothesis has started to arouse interest (and provoke debate) in the mainstream. New Keynesians like Summers (2014) and Krugman (2013b) now believe that the decreasing population growth in combination with several other factors has brought about a situation where private sector demand has sunken to a permanently insufficient level to keep economies operating at their full potential. Summers (2014, 71) argues further that “we are seeing very powerfully a kind of inverse Say’s Law” according to which “lack of demand creates its own lack of supply”. In this view, only frequent bubbles, like the recent notorious housing bubble in the US have “concealed” this situation. Keen (2014, 2) believes that the widespread New Keynesian support for this hypothesis “implies it will soon become the conventional explanation for the persistence” of the present recession.

The secular stagnation hypothesis sounds very familiar from the heterodox point of view in that that it effectively suggests that the reason for the weak growth performance

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118 Summers (2014) lists six factors including “reductions in demand for debt-financed investment”, “changes in the distribution of income” and “substantial global moves to accumulate central bank reserves”.
in the advanced economies is related to a chronically insufficient level of private effective demand causing serious long-term real costs. This possibility has been suggested in the Post Keynesian literature from at least the early 1980s onwards (King 2002). Because mainstream now seems to show interest towards these Post Keynesian long-term concerns, there hopefully is an element of truth in Summer’s (2014, 65) claim that “macroeconomics, just six or seven years ago, was a very different subject than it is today”. As Keen (2014) argues, the secular stagnation hypothesis should probably have implications for the mainstream monetary theory. Finally yet importantly, the secular stagnation hypothesis has policy implications undermining the exclusive reliance on monetary policy and thereby contributing to desirable potential return of fiscal policy (Summers 2014; Krugman 2013b).

From the point of view of the economics and political economy of monetary sovereignty, the most interesting heterodox idea that has recently been discussed in the mainstream as well is the key chartalist idea that monetary sovereignty matters for macroeconomic policy. De Grauwe (2012) argues that monetary sovereignty does seem to matter. This point is embraced and developed further for instance by Krugman (2013a) in a New Keynesian fashion. However, the ambivalence and unclarity about the importance of monetary sovereignty and the role of the state in mainstream macroeconomics continues even after these partially encouraging interventions. Krugman, for instance, obviously has not read Goodhart (1998) since he maintains that the idea about the importance of monetary sovereignty is derivable from the Mundell-Fleming model.

Despite the fact that reformulated heterodox ideas (such as long-run non-neutrality of money and macroeconomic policy and the importance of monetary sovereignty) are gaining some ground in the mainstream policy debates\textsuperscript{119}, there are countertendencies and reasons for skepticism, too. First, faith in monetary policy and confidence building remains strong. There are even some signs that a “new” new consensus – not crucially

\textsuperscript{119} As a further encouraging development, there are some signs that some Post Keynesian implications of the endogenous/horizontalist money view (the basic idea of which is, in principle, already part of the new consensus) are taken more seriously. The much-discussed Bank of England reports on monetary theory and policy, for instance, question ideas in which even some new consensus economists continue to believe in (McLeay et al. 2014). The papers are interesting because they seem to confirm the belief that the ideas of monetary authorities often tend to be heterodox compared to the academic orthodoxy. However, in many cases the authorities may also be old-fashioned compared to the academic consensus. In Finland, for instance, the Bank of Finland and the ministry of finance tend to be conservative compared to even mainstream New Keynesian economics (see, e.g. Haaparanta 2011).
different from the old one – might be emerging. Moreover, it is very troubling that the mainstream attitude towards pluralism in economics has not significantly improved, even if several heterodox arguments are now being reformulated and discussed. The fact that neoclassical authors tend to fail seriously to engage with the heterodox literature that predates and foreshadows their ideas is an obstacle for theoretical advances. One might also suspect that the mainstream theory of macroeconomics is powerful enough to cope with all counterevidence – mere “empirical curiosities” and “paradoxes” from its point of view – without fundamentally changing its vision. On balance, however, I tend to think that the rise of the heterodox influences, taken together, might be just enough to sake the consensus and provide room for improved macroeconomic governance in the future. At least potentially, both of the heterodox ideas discussed here could undermine the core of the new consensus (and the entire new neoclassical synthesis) and lead to the kind of changes in governance that the “failure hypothesis” expects.

5.1.3 The future of the new consensus?

As the “failure hypothesis” (see introduction to the Section 5.1.) suggested, it really seems that the new consensus – like monetarism before it – has essentially failed to achieve full Gramscian hegemony. The new consensus remains a “consensus” in name only. Moreover, it seems that an important reason for this failure is quite similar to the fundamental reason for monetarism’s failure (see Section 4.1.3). Real-world monetary economy does not work nearly as these doctrines suggested it would work. The ambiguous relation that new consensus has with monetary sovereignty is one manifestation of this (see Section 4.2.5). Its failure to get it “roughly right” (as Paul Davidson would put it), means that the new consensus has failed according to its own standards – instead of sustained macroeconomic stability it contributed to the GFC and to the present recessionary, crisis-prone environment.

No matter how close to hegemony the new consensus ever was, it is now possibly about to lose even the remaining aspects of its dominance. Moreover, as we saw above, the partially promising infiltration of heterodox ideas into the mainstream debates makes it plausible that macroeconomic thinking – and thereby governance – will change in the near future. How radical the change will be, can hardly be predicted. The scenario of the failure hypothesis, however, is likely to be at least partially vindicated. In other
plausible scenarios, the core of the consensus proves to be more resilient in the near future and significant modifications of the doctrine will wait for the next major crises. The developments undermining the consensus are fortunate, since the monetary consensus, even despite its advances over monetarism, is not the kind of governance doctrine that ought to shape institutions and decisions in the modern money era. However, the crucial question is – what should replace it?

5.2 Democracy, Cosmopolitanism and Monetary Sovereignty – Post Keynesian Insights on Democratic and Cosmopolitan Thought

In Section 5.1., I took a critical look at the performance of the new consensus taking its own criteria of success (macroeconomic effectiveness and stability) as given. As outlined in the introduction to this chapter, I will now employ a different criterion of success: democracy. In terms of GPE theory, I will switch attention from neo-Gramscianism to cosmopolitan thinking. This switch in theoretical perspective is motivated by several reasons. First, given its emancipatory spirit, neo-Gramscian approach is surprisingly weak in normative political theory. Its fuzzy metaethical stance, lack of explicit democratic theory, and inconcreteness of its reform proposals mean that in this area of study fruitful seeds have to be searched elsewhere. They can be found – perhaps in their ripest form – in the contemporary theories of cosmopolitan democracy. Second, by turning attention to cosmopolitanism for the remainder of this thesis, I endeavor to make the very important point that many kinds of syntheses between Post Keynesian economics and critical GPE are possible.¹²⁰ I return to the theoretical tradition of cosmopolitanism in due time, but let me first say a few things about democracy as a normative standpoint of evaluation of governance.

By suggesting that democracy is a reasonable candidate for a normative standpoint, I do not mean to imply that the value of democracy would stem from a transcendent reality of some kind. Values do not exist independently of social practices, but emerge through them. Nevertheless, values are not reducible to any particular set of social practices – a fact that explains the remarkable (even if incomplete) ability of human beings to rise above their particular traditions and settings. I should also hasten to point out that

¹²⁰ For reasons of space, here I can only develop a rudimentary account of the role of democracy in the contemporary political economy of monetary sovereignty. Because I felt that this question is too important to be ignored, I chose to include this discussion in this thesis despite the fact that it is in some respects more of an epilogue than a full discussion. While the discussion is brief, I think it illuminates extremely pertinent issues.
democracy is certainly not the only authentic criterion against which to evaluate the practice of monetary governance. Relevant considerations of “efficiency”\textsuperscript{121}, for instance, may thus occasionally override those of democracy. However, whether efficiency considerations should override democratic concerns at some particular instance is always a question that itself – from the point of view of legitimacy – can only be democratically settled. Largely because of its exceptional epistemic qualities, democracy has important second-order value that first-order candidates for value, such as efficiency, cannot claim to have (Habermas 2006).

In my understanding, democracy does not only have invaluable epistemic value but also entails substantial implications. Hence, institutions that call themselves “democratic” only because they utilize, for instance, electoral means do not count as democratic if they fail to fulfill the relevant substantial criteria\textsuperscript{122}. In what follows, I will give much weight to two such criteria (they by no means exhaust other criteria). The first is (i) the transformative criterion which holds that truly democratic governance seeks to extend the breadth and scope of democracy. In other words, a democratic society wants to expand, or at least does not want to narrow, its “democratic horizon” and thus looks for novel democratic possibilities\textsuperscript{123}. This view can be justified, for instance, along the lines of theories of deliberative democracy (Held 2006, 231–255).\textsuperscript{124} Because at the very minimum democratic governance never gives up its democratic potential voluntarily, no permanent, new constitutionalism-style narrowing of the scope of democratic governance would take place in a genuinely democratic society.

The other substantial criterion I employ is (ii) the criterion of all-inclusiveness, which states that the group of decision-makers should coincide with the group of “decision-takers” (Held 2010, 173). This criterion finds much support in the history of democratic theory because underlying it is probably the main justification of democracy – the people should decide about precisely those affairs that affect them. As Held (ibid., 175)

\textsuperscript{121} What are the “relevant considerations of efficiency” is often anything but a straightforward question.

\textsuperscript{122} Democracy is, of course, a fundamentally contested idea and several theories of democracy are content with competitive elections (Held 2006, 125–157).

\textsuperscript{123} This does not imply that in a truly democratic society every single decisions or even institution should be democratically governed. Democracies will probably decide to leave many decisions privately or (even technocratically) settled. Rather, my point is that a true democracy should always have the option to transform the undemocratic institutions by democratic decisions if these institutions are perceived to make decisions pertinent to the public interest.

\textsuperscript{124} Held (2006, 3) himself believes that “democratic ideas and practices can in the long run be protected only if their hold on our political, social and economic life is extended and deepened” (emphasis in the original).
emphasizes the goal of securing all-inclusiveness often “points to the necessity of both the decentralization and the centralization of political power”. I will make use of these two criteria because they are among the ideas that also motivate calls for cosmopolitan democracy. Moreover, I suggest that the implications of these criteria for macroeconomic governance can helpfully be clarified from a Post Keynesian point of view.

Below, I will first contrast the new consensus view of macroeconomic governance with a Post Keynesian alternative. Whereas the former view can only be identified with a maintenance approach to governance, the latter can readily be interpreted as a transformative approach that indeed is compatible with the transformative criterion of democracy. I then go on to show that Post Keynesianism satisfies the all-inclusiveness criterion as well – conventional nationalist and statist conceptions of democracy that contribute to the growing gulf between decision-makers and decision-takers are no obstacles for Post Keynesian thinking on monetary governance. New consensus style “minimalist” governance, in contrast, obviously fails also in terms of the second criterion since it contributes to a growing gulf between decision-makers and decision-takers. Finally, I will attempt to formulate a plausible cosmopolitan interpretation of Post Keynesian economics – and chartalism in particular. After having made a chartalist case for supranational exercise of monetary sovereignty, I conclude by suggesting lessons for future attempts at synthesizing Post Keynesian and cosmopolitan perspectives.

5.2.1 A general case for the transformative exercise of monetary sovereignty

Monetary governance for what?

The very idea of governing a system appears, at first glance, to encompass a strong element of conservativism, since a system well governed is maintained (and does not fall apart). What then is the justification of governing the global monetary system – an integral part of the capitalist world economy, which – in addition to producing wealth – evidently produces also inequalities and other negative “externalities” on a massive scale? I question the apparently radical idea of letting an unjust system fall apart on two major grounds. First, it is probable that an uncontrolled systemic collapse would produce a state of total disruption from which nothing constructive would be likely to
arise. In today’s conjuncture, a sudden meltdown of the monetary system would undoubtedly encourage different varieties of fascism and inward-looking right-wing populism in most corners of the world, even if progressive alternatives could emerge in a few places. Secondly, and more importantly, to dislike systemic governance for apparently progressive reasons probably results from a defective understanding of the possible natures of governance itself. Governing a system does not necessarily mean attempting to preserve a system; a system can be transformed through governance.

A crucial distinction, hence, can be made between governance for maintenance and governance for transformation. Governance for maintenance approach aims to preserve the core of a system as intact as possible. It hopes to purify the system and defend it against adverse influences and forces. Fundamentally, this type of governance is “technical” in nature. In contrast, the governance for transformation approach aims to govern the system in such a fashion that conditions for its transformation will emerge. Here governance is extended and deepened, in a step-wise manner, until the system transforms, in a controlled way, into a qualitatively new kind of system. Towards the end of the process, the emerged system may hardly be recognizable as a successor of the initial system. While there is a technical element in all governance, fundamentally governance for transformation is critical in spirit. Although there may occasionally be need for “fine-tuning” that makes some ultimately undesirable elements of the initial system work better, the clear end goal here is a qualitatively different system.\(^{125}\)

New consensus and the maintenance of undemocratic governance structures

Now, my argument is that the new monetary consensus, and the sovereignty-undermining governance regime that it entails, is a paradigm example of the maintenance approach. The point of the approach is to govern only to the extent that, fundamentally, everything will remain the same. There are several features in the current monetary governance regime that suggest that the consensus-style governance is for preserving the status quo as it exists. First, there are the explicitly antidemocratic features such as the advocacy of central banks conducting monetary policy independently of democratic will-formation. Second, there are the more implicitly

\(^{125}\) Keynesian macroeconomic policies, for instance, ought to be conducted in this critical spirit. All the “fine-tuning” done should be such that it enhances the possibility of the eventual transformation of the system. A case in point of “fine-tuning for transformation” is full employment schemes. While they in the first instance do not change the fundamentals of the system, they definitely carry the critical potential to do so (Kalecki 1943).
antidemocratic features such as the power of the private lenders and credit rating institutions to voice their (much respected) opinions about which policies are “credible” enough to be implemented. Third, and probably the least obviously, the primacy that monetary policy enjoys in the governance of business cycle fluctuations torpedoes democratic imagination, because it suggests that a serious macro-level deficiency can be “corrected” by mere management of the interest rate. Let me briefly look at these three issues in turn.

It is an uncontested – and usually celebrated – fact that contemporary “independent” central banks are governed in a technocratic fashion. However accepted “common sense” the legitimacy of this practice nowadays sometimes appears to be, in the margins an intellectual controversy rages over whether this element of technocracy can be mated with a democratic society (Levy 1996). Ultimately, disagreement about this issue clearly comes down to different conceptions and theories of democracy. Even though for instance Blinder (1996) maintains that independent central banking and democracy are compatible, it is evident that his conception of democracy is very narrow. It is possible that both new consensus policies and new constitutional arrangements are consistent with elitist conceptions of democracy (Held 2006, 125–157). However, what is clear is that these policies and arrangements help to erode the conditions for a deeper democratic transformation and thereby serve the status quo.

The legitimacy of the power of lenders and private credit rating agencies to force “credible policies” on states is even less frequently questioned than the existence of technocratic central banks (on democratic grounds, at least). While the issue remains largely undiscussed in public debates, there exists large and growing literature that shows how incompatible private financial power and genuine democracy in fact are. There is then a debate whether the market allocation of finance is a “beneficial constraint” on public policy or whether it is rather a detriment undermining legitimate forms of decision-making. (Rommerskirchen 2015.) The first position, embraced by the current monetary consensus, obviously represents the maintenance approach.

In contrast to the first two considerations, my third claim – that the monetary policy focus in macroeconomic governance hinders democratic imagination – has rarely been explicated in any literature. As explained in Chapter 4, in contemporary monetary systems monetary policy is about managing a key (e.g. “overnight”) interest rate (the
price at which private banks can borrow base money from the central bank’s discount window). The basic task of a central bank is to manage the interest rate in such a fashion that the propensities to save and invest will balance. The correct management of the interest rate is then supposed to result in full employment at the so-called NAIRU level. The Scylla and Charybdis of macroeconomics, “involuntary” unemployment and inflation, would thereby both be avoided: the basic macroeconomic failure of capitalist market economy is apparently solved.

What is undemocratic about this neat and straightforward technical solution (which probably does not work altogether, but let me suppose it does for the sake of argument)? The interest rate is currently managed based on rules and algorithms that economists and central bankers have designed. Democracy does not enter the picture, because interest rate setting is framed as a mere technical puzzle. Democracy does not make the rule work any better, because in the new consensus story, only one value of the interest rate yields the “correct” result at a given time. However, the ultimate democratic problem here is not the consensus practice of monetary policy, but the monetary policy focus itself. There would, of course, be alternative ways to manage the interest rate, but the point seems to generalize to them: monetary policy – no matter how it is conducted – is not effective in governing monetary economies towards more meaningful democracy. This is because, at least understood in its standard sense, the conduct of monetary policy does not even potentially open up any truly imaginative democratic horizons. Monetary policy is fine-tuning that in itself is of little use in transformative governance. Unsurprisingly then, maintenance approach to governance is obsessed by it.126

To conclude, it seems to me that the antidemocratic aspects to an extent inherent in the conduct of monetary policy do have a clear implication for those struggling for democratic economic policies. The implication is to pay less attention to monetary policy and to struggle for democratic forms of economic policy (such as varieties of fiscal policies). Because if monetary policy is inherently both ineffective and undemocratic, as I argued, why bother with it? I am for instance aware of few ultimately convincing proposals for meaningful democratization of central banks, but this might

126 For sure, interest rate policy does have all kinds of important (for instance distributional) consequences. Hence, it is obviously political. My point is simply that conventional monetary policy does not seem to offer truly interesting possibilities for democratizing macroeconomic governance. They have to be searched elsewhere.
not matter much! The point is to move beyond the primacy of monetary policy. While the new consensus is clearly a maintenance approach to governance, Post Keynesian theory seems to offer a transformative alternative.

**Post Keynesian Governance for Democratic Transformation**

As has become evident from my discussion above, monetary and macroeconomic governance, as currently practiced, are highly undemocratic areas of governance. One might wonder could they ever be politicized so effectively that calls for their democratization would start to resonate with the general population. Even though that day may still seem remote, the recent successes in the politicization of multilateral trade agreements, for instance, suggest to us that even highly “technical” areas of economic policy-making can be contested. As soon as trade agreements were perceived as harming widely valued things such as public health and environmental standards and labor rights, the negotiations on multilateral free trade agreements started to attract waves of protests. Plausibly, the same thing could happen in monetary affairs, because macroeconomic policies (intimately linked, for instance, to the accessibility of finance) often affect the same (kinds of) issues as trade policies do. The ongoing resistance against austerity, now in the Eurozone, already has politicized aspects of monetary governance and economic policy. While these protests still rarely have focused on the institutional level of monetary governance, such protests are likely to become more frequent.

The nearly inherent maintenance character of the monetary policy centrism of the consensus becomes more clearly visible if we consider the ways in which alternative economic policies are more substantial in character and lend themselves easier to meaningful democratic control – thereby opening up interesting and novel democratic possibilities. This fact simultaneously provides a strong reason for the transformative interpretation of the Post Keynesian theory. As well-known, fiscal policy is in certain respects comparable to monetary policy. Indeed, the macroeconomics literature often discusses them as being in some respects substitutes for each other (as active policy instruments). In the history of neoclassical economic thought, many positions on the

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127 The anti-austerity protests do quite explicitly question the decision not to employ countercyclical fiscal measures during a crisis and provide a sufficient level of public investment.

128 “Alternative” in the sense that these policies can be used to pursue at least certain comparable goals (such as alleviating the cyclical instability of capitalist economies); while in substance these policies are quite different.
right balance between the two forms of policy have been uttered. According to the prevailing wisdom of the new consensus, however, monetary policy is clearly preferable to fiscal policy in normal circumstances. According to the Post Keynesians this conventional wisdom concerning the relative effectiveness of monetary and fiscal policy is on shaky grounds. They argue that whereas monetary policy cannot generate new net flows of income, fiscal measures can (Fullwiler 2013, 190). Partially because Post Keynesians take this to be a key point, they advocate fiscal measures of various kinds as opposed to the present focus on monetary policy.

While this debate may, at first glance, appear to be a narrowly economic one (concerning merely the relative effectiveness of these policies), it is of critical importance to note that the Post Keynesian advocacy of fiscal measures points towards a recognition that this standard debate between monetary and fiscal policy might not be the most important one. Let me next clarify how this recognition emerges and why the effectiveness debate is a one-sided perspective to the relative merits of macroeconomic policies.

Whereas in the neoclassical literature “fiscal policy” standardly refers to (often unspecified) a set of temporary “pump-priming” measures, many Post Keynesians – especially the chartalists – explicitly reject this form of fiscal policy. Instead of pump priming, Post Keynesian embrace targeted fiscal policies of various kinds. Moreover, they argue that fiscal management of the economy has to be ongoing and not based on the kinds of temporary shocks that mainstream economists occasionally advocate in those special cases where they see room for active fiscal policy. Post Keynesians thus prefer targeted demand management, rather than just any form of fiscal policy. (Tcherneva 2014.)

The Post Keynesian argument for ongoing stabilization and enhancement of demand conditions stems from the huge body of evidence suggesting that the capitalist market economy is not self-equilibrating neither in the “short run” nor the in the “long run”. This is in direct opposition to the key (neo)classical hypothesis according to which markets, when left to operate without interference, will reach a socially optimal equilibrium (at least in the long run). Post Keynesians argue that (i) in a monetary economy, the level of effective demand in the economy determines the utilization rate of the available capacity, and (ii) the level of effective demand that would bring about the
desirable utilization rate rarely occurs by mere spontaneous interplay of the market forces alone. It follows that some form of demand management is required in order to achieve the desirable rate of capacity utilization. (Ahokas & Holappa 2014; Lavoie 2014.)

While the new consensus, too, recommends a weak form of ongoing demand management (by means of interest rate policy), Post Keynesians argue for more substantial measures, such as public employment schemes. The conduct of such demand management policies, the chartalist correctly emphasize, in many cases requires that monetary sovereignty can be exercised without the kinds of constraints that I have discussed throughout this thesis. This is the main reason why I believe that monetary sovereignty should continue to have an important role to play in the contemporary world.

Moreover, in order to guarantee better fulfilment of social needs – and to employ people on branches that contribute something worthwhile to their communities – the key macroeconomic policy institutions and decisions, the Post Keynesians at least imply, should be democratically governed. Now, the call for public design of institutions and communal allocation of employment stirs up various democratic possibilities – of a breadth and depth of which monetary policy could never inspire. A real but standardly downplayed debate between macroeconomic policies hence concerns their inherent conceptions of, and potentials for, democracy. The exclusive focus on the effectiveness debate ignores the democracy debate. Regardless of which type of policy is more “effective” in a narrow meaning, fiscal policy clearly is potentially much more democratic than monetary policy. In other words, compared to monetary policy fiscal policy is in all crucial ways clearly politics (rather than mere policy).

In this section, I have made a case for a transformative and democratic exercise of monetary sovereignty based on the Post Keynesian theory (as opposed to the maintenance approach to governance based on the new monetary consensus). In a marked contrast to the new consensus style fine-tuning that evidently aims at the preservation of the status quo, Post Keynesian “fine-tuning” can plausibly be interpreted – or at any rate directed – to aim at the transformation of the system. In the next section, I attempt to put some more flesh on these bones by considering the normative question.
whether transformative macroeconomic governance should be pursued supranationally or globally rather than only nationally or locally.

5.2.2 The apparent conflict between monetary sovereignty and supranational democratic governance

There is no straightforward way to assess which institutional arrangements would best contribute to the realization of meaningful, transformative democracy. Among other controversial questions, the proper constitution of the demos remain contested in both democratic theory and practice. In simple terms, it is often not clear who should decide. What is the appropriate “level” of governance in a given issue? In the traditionally technocratic arenas of macroeconomic and monetary governance, answers to this question are even exceptionally unclear. Standardly, the makers and takers of decisions anything but coincide. In advocating for instance independent central banking, the current monetary consensus pictures this state of affairs as a virtue. Even if we concentrate, as I will do below, on democratic views on macroeconomic governance – those that also fulfill the transformative criterion of democracy – the existing answers to the question concerning the right demos often appear ambiguous or even contradictory.

Indeed, there appears to be a conflict between the chartalist endorsement of monetary sovereignty and cosmopolitan theories of supranational or global monetary governance. While both of them start from the conviction that democratic governance is valuable – and are thus in a broad agreement with my line of argumentation in the previous section –, they seem to reach contradictory conclusions about national self-determination in economic affairs. Whereas the chartalists standardly cherish the capabilities of the modern monetary sovereign states to exercise their full monetary sovereignty and pursue independent economic policies, cosmopolitan democratic theorists are convinced that a global economic and monetary system organized around nation states – and their unilateral policy decisions – cannot deliver authentically democratic outcomes. Furthermore, cosmopolitans (like GPE scholars in general, as I discussed in Chapter 1) often doubt whether there even exist authentic monetary sovereigns in today’s globalized economy. This disagreement obviously raises a fundamental question: are nation states the right decision-makers of macroeconomic policy?

In what follows, my goal is to reconcile these prima facie plausible, but at face value contradictory, views of the chartalists and the cosmopolitans. I accomplish this by
arguing that establishment of supranational and global mechanisms of democratic monetary governance is the most promising way forward if one wishes to reap the potential benefits of monetary sovereignty in the future. In other words, I suggest that there are important reasons why monetary sovereignty should be exercised on the regional and global level rather than on the state level. I will start by outlining the respective key arguments of the cosmopolitans and the chartalists.

5.2.3 Cosmopolitan theory, monetary sovereignty and macroeconomic policy

What David Held calls “the paradox of our times” nicely captures the main reason for the ever more frequent calls for a global edition of democratic politics: “the collective issues we must grapple with are increasingly global and, yet, the means for addressing these are national and local, weak and incomplete” (Held 2010, 143). As a basic premise, most of the theories and proposals for “global”, “cosmopolitan”, or “supranational” democracy share a version of the view that diverse processes related to “globalization” have, to large extent, eroded the decision-making abilities of nation states – and hence simultaneously seriously undermined democracy itself in the process.

To restore conditions of meaningful democracy, the cosmopolitans argue, various supranational, or often even truly global, reforms or novel institutions are urgently needed (Holden 2000, 1–13; Patomäki & Teivainen 2004). According to several authors, these institutions should be accompanied with a comprehensive legal framework, i.e. a cosmopolitan law (Held 2010, 93–116). A few cosmopolitans have even argued for a centralized global government (Wendt (2003) even argues for its inevitability), even if most proponents of supranational governance are not prepared to go this far. While cosmopolitan theorists tend to be motivated by the same kind of concerns posed by global challenges that are escaping effective state-level governance (e.g. global climate change, crisis-prone global economy and finance, global inequality, and prevention of

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129 Following Holden (2000, 2) I do not make a strict distinction between these epithets here, but use them more or less interchangeably.

130 In my interpretation, cosmopolitanism can be seen as a branch of critical GPE. Of course, not all advocates of global democracy are critical in precisely the same transformative sense that I understand the term. Moreover, obviously not all cosmopolitans work within the discipline of GPE.

131 Despite cynical criticism, cosmopolitanism is not an empty intellectual exercise guaranteed to remain without practical consequences. Multiple concrete institutional proposals for global democracy have already been made and countless practical actions to establish supranational or global have been taken, many of them even at the “official level” of policy-making. (Held 2010, 50–66.)
warfare and nuclear disarmament), their theoretical and practical solutions to these challenges are very varied and practically all of them are contested by others. (Held 2010, 1–26; Holden 2000, 1–13.)

Despite their differences, even the most modest theories of supranational democracy necessarily question the standard Westphalian model of exclusive state sovereignty. As Held (2010, 96) puts it, “any assumption that sovereignty is an indivisible, illimitable, exclusive and perpetual form of public power – entrenched within an individual state – is now defunct”. What does, or rather should, this mean for monetary sovereignty? The most prominent proponents of global democracy have rarely tackled the implications of global democracy for monetary sovereignty of nation states in any great depth. For some guidance, I next briefly examine David Held’s views on economic cosmopolitanism.

David Held (2010, 107–110) discusses “economic cosmopolitanism” as one aspect of his cosmopolitan vision (alongside legal, political and cultural aspects). Perhaps his key claim with respect to economic cosmopolitanism is that there exists a cosmopolitan “rationale for a politics of intervention in economic life” (ibid., 108). To justify this principle, he specifies that “market economies can only function in a manner commensurate with self-determination and economic freedom if [the indeterminacy of the market system itself] is addressed systematically and if the conditions of the possibility of self-governance are met” (ibid., 190). While Held blames the Washington Consensus for a weakened governance at all levels, as for the erosion of the “capacity to provide urgent public goods” (ibid., 154), his positive account remains somewhat inconcrete about the desirable future of economic sovereignty in general and monetary sovereignty in particular.

Despite its vagueness on the subtleties of supranational economic governance, Held’s work nevertheless provides useful general outlines of cosmopolitan thinking that can be applied also to the issue of monetary sovereignty. As Held emphasizes,

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132 Contemporary cosmopolitan political philosophy has been developed in the works of Barry, Beitz and Pogge, among others (see Held 2010, 44–50 for a brief summary).

133 Compared to Held, Patomäki & Teivainen (2004) are very explicit about what democratic governance of the global political economy could mean at the institutional level. They propose various reforms of the existing institutions of global economic governance (e.g. IMF, World Bank and WTO) as well as advocate novel global institutions and mechanisms (that could enable e.g. effective global taxation and debt arbitration). The theme of monetary sovereignty, however, is not explicitly examined in this work either.
cosmopolitanism does not necessarily imply the end of contemporary states but perhaps only the end of the *primacy* they have traditionally enjoyed: “While states are hugely important vehicles to aid the delivery of effective public recognition, equal liberty and social justice, they should not be thought as ontologically privileged” (Held 2010, 67). In this conception of cosmopolitanism, states may continue to have a role to play. As Held puts, “recognizing the complex structures of an interconnected world, political cosmopolitanism views certain issues as appropriate for delimited (spatially demarcated) political spheres (the city, state or region) while it sees others...as needing new, more extensive institutions to address them” (ibid., 106).

Held’s conception of cosmopolitanism thereby does not imply that exercise of monetary sovereignty by contemporary states should automatically be condemned. If certain cosmopolitan qualifications are fulfilled, the state may be even the appropriate body to exercise control over monetary and fiscal policy. In Held’s view of global economic policy, a cosmopolitan version of social democracy “must be pursued while ensuring, on the one hand, that different countries have the freedom they need to experiment with their own investment strategies and resources and, on the other, that *domestic policy choices uphold basic universal standards*” (ibid., 167; my emphasis).

While Held thereby would probably endorse a form of monetary sovereignty exercised by nation states, it is noteworthy that he seems to insist upon a sort of (what I call) *cosmopolitan condition* on the legitimate conduct of domestic economic policy. The condition requires that national exercise of monetary sovereignty have to be compatible with economic policies promoting global good. To elaborate the idea further, in a weak formulation, this condition would require each country to exercise its monetary sovereignty in a way that does *not harm* the ability of other countries to conduct progressive economic policies. Formulated more strongly, the condition would expect countries’ exercise of monetary sovereignty to *promote* cosmopolitan social democracy. How likely the fulfillment of the cosmopolitan condition (in either formulation) would be in practice, Held leaves open. For reasons discussed below, I suspect that the cosmopolitan condition is frequently violated.

In sum, cosmopolitanism – in Held’s version – is compatible with nation states in charge of *some* parts of macroeconomic policy. However, given the hard-to-fulfil cosmopolitan condition for domestic economic policy, in much of macroeconomic policy the best solution might not be the easiest solution. Deeper supranational
coordination is clearly required, and, as I will argue below, the states may not always be
the most preferable entities to exercise monetary sovereignty. Having discussed what
(Held’s) cosmopolitanism could imply for macroeconomic policy and monetary
sovereignty, I will now turn to the other side of the coin. What do Post Keynesian and
chartalist theory imply for cosmopolitan democracy?

5.2.4 Post Keynesian theory and cosmopolitan democracy

The implications of Post Keynesian theory for cosmopolitan democracy are complicated
and, it seems, even outright contradictory. On the one hand, many Post Keynesians have
proposed reforms to establish satisfactory forms of global governance (see, e.g.
Davidson 2009 and Lavoie & Stockhammer 2012) and a couple of political economists
have even drawn on Post Keynesian ideas in their models of global democracy (see, e.g.
Patomäki 2012, 189–222; Patomäki & Teivainen 2004). On the other hand, most Post
Keynesians have never spelled out the implications of their thought for global economic
governance134. This is unfortunate since contemporary economists ought to pay explicit
attention to the globalized economy. As I suggested above, the chartalist theory appears
particularly suspect from the point of view of a cosmopolitan vision. Let me elaborate
briefly on what is cosmopolitan and what appears uncospoplonal in the Post
Keynesian theory.

The Cosmopolitan in the Post Keynesian Theory

A plausible case can be made that Post Keynesian research generally has the most
cosmopolitan implications of all the work conducted in economics. Although
mainstream neoclassical theories often seem to imply that state borders should give way
for more or less unregulated global markets, there is hardly any room left for
meaningful forms of democracy in this framework. Obviously, advocacy of far-going
undemocratic market globalization does not count as cosmopolitan (indeed
cosmopolitanism largely is a reaction against exactly that). Out of the alternative
heterodox schools then, the Austrians, for instance, completely fail to see the graveness
of current global challenges and seem to be fixated by the idea that small-scale
decentralized solutions are always beautiful. From the opposite viewpoint, very few

134 Here they are actually following Keynes himself who, while a key figure in developing the post-war
governance architecture, never explicitly theorized international economy in any great depth.
Marxist economists are in favor of cosmopolitan governance of global capitalism (they might be in favor of cosmopolitan socialism of some sort, but that is another story).

By contrast, Post Keynesian thought seems to have much to offer in terms of cosmopolitanism. Of course, Post Keynesian economic theory is not of much help in spelling out the fundamental philosophical principles of cosmopolitanism, but at the level more specific principles or institutional design Post Keynesian theory is likely to prove an apt tool for the global democrat. Post Keynesian economics is, of course, similarly helpful as a guide for understanding global monetary and macroeconomic processes – the natures of which undoubtedly should have consequences for any solid cosmopolitan vision in this area of governance.

Even though Keynes did not write much about international economy per se, many cosmopolitan elements in contemporary Post Keynesian theory can be traced back to his thought. At the most fundamental level, Keynes was oriented to conceiving the economic system as a whole. Informed by this spirit, Post Keynesians are especially wary of the so-called fallacy of composition (the general fallacy of inferring the properties of the whole from the properties of its individual parts). For this reason, Post Keynesians are generally reluctant to recommend economic policies that, while plausibly successful if implemented by a single country, would be unsustainable (and harmful for all or most countries) if adapted globally. As a case in point, Post Keynesians standardly criticize export-oriented austerity policies as being tantamount to “exportation of unemployment” or of ignoring the accounting fact that sectoral balances “must sum to zero”.

Export-oriented policies are seen as part of a “begging thy neighbor”-type of growth strategy. Clearly, these Post Keynesian arguments are premised on the fundamental cosmopolitan intuitions that a country should not (1) adapt self-interested competitive strategies harming the good of the whole (that is the global community), or (2) undermine collective deliberation and decision-making by unilateral action.

Further, many Post Keynesian economists have developed explicit and detailed proposals for more effective governance of the global monetary system. Probably in a

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135 Two ways to calculate the gross domestic product \( Y = C + I + G + (X - M) \) and \( Y = C + S + T \) can be rearranged to yield the sectoral balance identity \( (S - I) = (G - T) + (X - M) \) which equals \( (S - I) - (G - T) - (X - M) = 0 \). This result implies that a country net indebted to foreign countries must have a deficit in either in its public sector balance or in its private sector balance (this fact is bound to bring problems at least if the country is not a monetary sovereign). If one country is a creditor, there necessarily must exist corresponding debtor(s).
more sustained fashion than anyone else, Paul Davidson (2009) has paid attention to the pitfalls of the post-Bretton Woods global monetary economy and come up with a number of proposals to reform the system. Davidson’s work – as well as Keynes’s own proposal for an international currency union – has inspired many Post Keynesians to develop their own reform proposals. Post Keynesian thought has also influenced a few political economist studying the future possibilities of a global democratic institutional reform. Patomäki (2012, 189–222) has suggested that the future cosmopolitan reform should take the form of “Democratic Global Keynesianism”. Patomäki thus unites a vision of global democracy with an explanatory framework that has incorporated many Post Keynesian insights (along with many other elements).

On the Chartalist Emphasis on State Sovereignty

Given its heavy emphasis on state authority and the might of the sovereign, the chartalist theory may look old-fashioned and outdated in the cosmopolitan eyes. Whereas Post Keynesian theory generally is often clearly cosmopolitan in both its vision and policy implications, the chartalist theory of state money may appear outright anti-cosmopolitan. There are at least three reasons for this impression. First, the chartalists share a strong belief in the capability of monetary sovereign states to shape their own economic destinies. Second, most chartalists usually concentrate rather exclusively on economic policy options available to the contemporary states. Third, many chartalists regularly emphasize, and to an extent even celebrate, the historical continuity of sovereignty from the ancient temples and empires to the modern-day states (Graeber 2011, 43–71; Hudson 2004, 99–127; Wray 1998) which easily amplifies the anti-cosmopolitan impression. How relevant the experience of these empires is to the contemporary world, one might justifiably ask. Yet, as we have seen, the economics of monetary sovereignty have not really changed. Moreover, as pointed out in this thesis many times, in certain important respects, state sovereignty in the chartalist sense has even recently increased. Therefore, chartalist theory is – or should be – extremely relevant.

Despite the uncosmopolitan appearance of the chartalists, there is no doubt that contemporary chartalists are committed democrats (at least the most prominent of them are!). Furthermore, they passionately maintain that public policy should serve the
“public purpose”.\textsuperscript{136} (Wray 2012, 190–193.) It is my contention that, despite a certain lack of cosmopolitan awareness and interest from the part of the chartalists, a convincing chartalist case for supranational and democratic exercise of monetary sovereignty can be articulated. I will outline its main features in the next section.

5.2.5 A chartalist case for democratic supranational monetary sovereignty (or, on the relative inefficiency of state level exercise of monetary sovereignty)

The core of the modern chartalist theory \textit{per se} is neither cosmopolitan nor nationalist/statist\textsuperscript{137}. Instead, it is a fairly technical theory based on operational analysis and accounting considerations (Wray 2012, 1–186). However, virtually all modern-day chartalists subscribe to a Keynesian view of macroeconomic dynamics. Of course, this is no pure coincidence – there are both historical and substantial reasons for this link. In the wider picture, the key concern of chartalists is to analyze the implications of the state theory of money – a theory that Keynes (1930) accepted as basically correct. The work of Abba Lerner (1943; 1947; 1951) significantly strengthened the connection between chartalist and Keynesian thinking since he drew many of the conclusions that a coherent understanding of fiscal and monetary policy operations of the state has for economic policy\textsuperscript{138}. Moreover, the policy space available \textit{for} Keynesian economic policies is greatly enhanced if something like state theory of money is true, a fact that certainly motivated many Keynesians to study the principles of chartalism. Further, the chartalists typically articulate their Keynesian more or less in the spirit of “social democracy” (of the type that for instance Held could endorse). But what about chartalism’s commitment to the (nation) state? Is it true that, because of its far-going emphasis on state sovereignty, chartalism is a view with potentially anti-cosmopolitan implications?

I will argue the opposite. I believe that despite its clearly statist framing, the Westphalian emphasis of chartalism is not at all essential to the theory, but a historical contingency. Indeed, there are several reasons to believe that chartalist-Keynesian

\textsuperscript{136} Wray (2012, 192) expresses a transformative understanding of democracy. The public purpose is “inherently ‘aspirational’ in the sense that there is no endpoint as the frontiers of the public purpose will continually expand”.

\textsuperscript{137} Or, neither social democratic nor libertarian, for that matter.

\textsuperscript{138} Many policies considered as “Keynesian” today were in fact formulated in an explicit form first by Lerner (Colander 1984, 1573).

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policy measures would work considerably *better* were they conducted at a supranational or global level. Ideally, monetary sovereignty should thus be exercised at the regional or global (rather than at the state) level. I will put forward a chartalist case for cosmopolitan exercise of monetary sovereignty:

*The chartalist case for cosmopolitan exercise of monetary sovereignty*: Supportive arguments for supranational or global exercise of monetary sovereignty can be derived from the core of the chartalist theory. The statist/nationalist framing of chartalism is unnecessary or even unwarranted.

The first chartalist argument for the conclusion that the nation states are not the optimal entities to be the exercises of monetary sovereignty is that especially small and weak nation states are unable to enjoy maximum benefits of sovereignty (the reasons for which I explained already in Section 1.1.7) Since their currencies are weak and not on high demand in the global markets, such states must work hard to acquire sufficient foreign currency reserves in order to settle their payments and debts. The way to acquire these reserves is to run current account surpluses, which requires that other countries must be willing to run corresponding deficits. When sufficiently many countries pursue this strategy at the same time, deflationary tendencies in the world economy strengthen. This is an integral part of the predicament of today’s world economy. While weak states, too, potentially do benefit from their sovereign right to issue currency, without a strong export sector they – that is the majority of countries in the Global South and even many in the Global North – are too dependent on foreign currencies to enjoy anything like the full advantage of their sovereignty. As Ahokas & Holappa (2011, 69) note, just these countries would benefit from less conditioned exercise of monetary sovereignty immensely.

The second argument (related to the first one) for the relative inefficiency of state level exercise of monetary sovereignty is motivated by the recognition that in the current governance architecture it is actually often *rational* for many economies to pursue austerity measures. As the chartalist (and Post Keynesian literature more generally) often admits, Keynesian prescriptions for expansionary fiscal policy are much more risky in a small currency area than in a large one. Small and open economies may very well run into troubles if they decide to expand their domestic demand by running large budget deficits since their budget deficits are often likely to translate to unsustainable
current account deficits. Certainly, this danger does not mean that small open economies categorically could not conduct expansionary fiscal policy – they often can to a modest extent – but it does mean that small open economies do have a certain “austerian interest” in the conduct of their domestic economic policy. Although often wrongly caricatured to advocate perpetual fiscal expansion and ever-higher wages in all circumstances, the Post Keynesian literature actually contains plenty of evidence that it may not be in the interests of small open economies to pursue wage-led growth nor even to engage in much expansionary fiscal spending. For the economies with an austerian interests, profit-led growth strategies might well produce better outcomes than wage-led ones. Small and open economies also cannot easily afford the current account deficits to which large-scale public spending could result. (Lavoie & Stockhammer 2012; McCombie & Thirwall 1999.)

The fact that a large number of individual nation states are motivated to pursue strict fiscal policies is problematic from the Post Keynesian point of view. The growth of the world economy, as a whole, is dependent on the growth of the world effective demand (Lavoie & Stockhammer 2012). In addition to the serious macroeconomic problems it poses, the widespread preference for domestic austerity is detrimental from the point of view of global democracy. The constant neo-mercantilist competition between states about the favorable current account balances (which are not available for all of them) strengthens the anti-cosmopolitan idea that “my own nation’s advantage” – whatever the employment and other costs to the foreigners – must take an exclusive focus. As long as this line of thinking remains popular, it is very hard to imagine realistic cosmopolitan futures. Moreover, the export competition has its adverse effects on democracy and (social cohesion) also within each state pursuing the strategy of competitive deflation. Cutbacks in wages and social spending obviously harm and disempower the most vulnerable, but because of the usefulness of these measures in the neo-mercantilist game – of which few states believe they could afford to abstain –, the credibility of alternative blueprints of economic policy appears low. As a result, those sectors of the population that most benefit from the export-orientation also have the most political weight, confidence and influence on decision-making.

139 Of course, the small open economies also have an expansionary interest in the sense that they should hope their trade partners to provide a sufficient level of demand for their exports, while they themselves pursue austerity. Austerity in all countries leads to deflation in all countries (a predicament that would serve the interests of only very small minorities within the countries).
The third chartalist-inspired argument against leaving the exercise of monetary sovereignty for the nation states alone relates to the wider political economy of the contemporary predicament. Global capitalist elites benefit from the existence of a large number of separate small and weak nation states. Elites can play these states against each other and the states often are not strong enough to coordinate sufficiently effective economic, social and regulatory policies despite their in principle significant capabilities as monetary sovereigns. Individual democracies acting alone are probably not able to fight the institutional and ideological forces that are undermining their monetary sovereignty.

As I have argued throughout this thesis, many political economy – distinct from pure “economic” or “structural” – factors seriously undermine the ability of monetary sovereigns to take advantage of their sovereignty. Because this predicament seriously restricts the possibilities for democratic will-formation, the contracted policy space is very unfortunate an effect from the point of view of transformative and cosmopolitan democratic theory. The diminishing ability of states to take advantage of their monetary sovereignty tends to lead to politics of austerity, privatization waves, and ever more regressive income distribution. These processes are not easily reversed by single states. As a case in point, the new constitutional project cannot be stopped without a significant coalition of forces because an attempt to reverse the process effectively might require, for instance, establishment of a cosmopolitan arena for democratic law making.

It then seems that the Heldian “cosmopolitan condition” on the legitimate national exercise of monetary sovereignty and macroeconomic policies (formulated above) is frequently not likely to be met. The condition required that national exercise of monetary sovereignty would have to be compatible with economic policies promoting the global good. For reasons explicated above, the way in which national monetary sovereignty is currently exercised fails to promote cosmopolitan social democracy and potentially also harms the ability of foreign countries to conduct progressive economic policies. It seems to me that supranational exercise of monetary sovereignty is needed.

Why would not “just” a return to a Bretton Woods type fixed-exchange rate arrangement and progressive national policies be enough? Would that not direct the

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140 Gill & Law (1989, 491) suspect the same in their theoretical context of the structural power of capital: “The structural aspect of [the power of internationally mobile capital] owes much to the division of the world into competing states”.

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nations to exercise their monetary sovereignty in a way that promotes “cosmopolitan social democracy” by eliminating the austerian interests of the states? Why yearn for supranational exercise of monetary sovereignty? A return to Bretton Woods-style arrangements, advocated by for instance Rodrik (2011, 233–250), strikes me as unsatisfactory. It seems to me that all attempts to counter the destabilizing and antisocial forces of contemporary globalization – the very same forces that in fact undermined the Bretton Woods system and are in the process of undermining all the then established progressive domestic programs – with a return to the post-war set of solutions are futile. There is no return. As Cohen (2008, 164) notes, “now there is pressure to go to the root cause itself – to address the effects of macroeconomic divergence directly via changes of monetary and fiscal policy, intruding on sensitive domestic priorities”. Many cosmopolitans provide overt support for new fiscal policy measures at a regional or global level. Especially, there has been frequent calls for supranational taxation in the recent years (see for instance Held 2010, 109; Patomäki 2001; Piketty 2014, 515–539). Slightly reformulated, these proposals are consistent with the chartalist logic.

In sum, I have outlined a chartalist case for cosmopolitan exercise of monetary sovereignty. I have argued that, logically, chartalism is no more committed to the sovereignty of the nation states as it was once committed to the sovereignty of the temples or to the sovereignty of the crowns. On several chartalist grounds, monetary sovereignty should be exercised by supranational entities. I have shown that despite their apparent conflict – on a more fundamental level – chartalism (as Post Keynesian thought more generally) and the cosmopolitan macroeconomic governance are compatible. Moreover, I have argued that they may ultimately even point in the same direction.

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141 Rodrik (2011, 236) says, “What we need, in effect, is an updating of the Bretton Woods compromise for the twenty-first century”.

142 The return to the Bretton Woods would probably not even be any more realistic than the establishment of supranational institutions to exercise monetary sovereignty. To restore the Bretton Woods-style capital controls alone would be a very demanding exercise because of the huge resistance. Such controls might not even be desirable. As Sardoni & Wray (2007, 2) put it, “going back to fixed rates would require – – a thorough reform of the international economic system, which should either reintroduce the old controls or invent new ways to limit capital mobility”.

143 However, it is not clear why monetary sovereign states would ever sacrifice this much of their sovereignty voluntarily. This “compliance puzzle” (Cohen 2008b, 106–108), of course, should be tackled in subsequent studies on the political economy of monetary sovereignty.
5.3 Tentative Conclusions on the Relationship of Post Keynesian Economics and Supranational Democratic Governance

If the exercise of monetary sovereignty at the national level were both economically efficacious and democratic, there would be few reasons to yearn for supranational monetary governance. However, according to the chartalist reasoning, which at first sight might seem to suggest precisely that view, the conclusion regarding the superfluity of supranational governance does not follow. While chartalism initially appears somewhat isolationistic or even nationalistic, many of its core arguments actually suggest that its implications are not necessarily anti-cosmopolitan at all. First, small countries who cannot use their chartal currencies in the international market have less policy space than do those countries in whose currencies goods and raw materials are priced and sold. Secondly, a small and open economy faces many more dangers when pursuing Keynesian fiscal policies than a large economic region does. The “austerian interests” such economies therefore have, pose obvious problems for both economic effectiveness and democracy. Thirdly, individual states acting alone may fail to get rid of the sovereignty-undermining constraints. It is demanding to practice experimental economic policies, in a normatively hostile environment where capitalist elites can play states against each other. New constitutional practices, for instance, may only be effectively combated when supranational arenas of lawmaking are democratized. Given these considerations, the chartalists should actually often be in favor of large economic areas and/or global governance.

Many branches of Post Keynesian economics are already quite explicitly cosmopolitan and propose various kinds of global arrangements or institutions. Because the policy space available to small monetary sovereigns with low demand for their currencies is narrow in comparison to the more influential currency-issuers, the chartalist theory offers additional Post Keynesian reasons to conclude that, other things equal, large economic areas are superior to smaller ones in terms of macroeconomic governance. Because the chartalists believe that strongly integrated economies should be equipped with institutions of sufficient federal fiscal capacity, the chartalists should thus often call for supranational exercise of monetary sovereignty.

Could cosmopolitan democrats and Post Keynesian economists learn from each other in a sustained fashion? Given their overlapping interests, there certainly are numerous
prospects for mutual learning. Were they fully acquainted with the realistic theory about the economics of monetary sovereignty, cosmopolitans could (i) formulate normative arguments that are more substantial than the present ones and (ii) design better-functioning institutional arrangements to realize democratic ideals in monetary governance. In turn, Post Keynesians could improve their thinking by becoming more explicit about the cosmopolitan elements of many of their key ideas. Were they to collaborate more closely with the cosmopolitan political theorists, the Post Keynesians could potentially overcome the remaining ingrained shackles of “methodological nationalism” so characteristic of much of the economic theorizing offered from Smith and List onwards (Wimmer & Schiller 2002).

6 Conclusions, Lessons, and Implications

Substantive conclusions
The Bretton Woods era of international monetary cooperation ended in 1971 as its internal contradictions and counter-hegemonic power consequences provoked the United States to dismantle the system unilaterally. In year 2016, the world has not yet returned to the level of cooperation in monetary affairs that prevailed during the post-World War II decades. The Bretton Woods system has been amply studied and its history and properties have been much discussed. What kind of an era the post-Bretton Woods era of monetary and macroeconomic governance is, however, remains – in certain important respects – unclear. The realities of the modern money era have seldom been adequately grasped. Similarly, the question regarding the future prospects of governance has often been neglected or answered using wrong presuppositions and faulty analysis of the contemporary era. These topics should certainly be of great general interest because, to put it bluntly, the question of whether money will control the world or the world will control the money hinges on the answers to them.

In this thesis, I provided an account the fundamental issues of the political economy of monetary sovereignty in the modern money era. In Chapter 1, I started by examining the chartalist view of monetary sovereignty. According to the chartalist hypothesis monetary sovereignty matters greatly for the macroeconomic policy space of modern states. Moreover, the chartalists maintain that monetary sovereignty has generally increased in the absence of a Bretton Woods-style fixed exchange rate regime – a view
that reverses the standard position taken in the political economy literature. First, I played various influential theories of GPE and mainstream economics against the basic chartalist position to show that despite the counterarguments, the case of the chartalists remains strong, while the theories in discordance with chartalism should be modified or rejected (Section 1.1). Second, I used the specific cases of Canada and Argentina empirically to establish the conclusion that monetary sovereignty can matter in practice as well as in theory. Indeed, the post-Bretton Woods era really is the era of modern money – a fact that potentially opens many doors for new kind of monetary governance (Section 1.2.). Having vindicated the basic chartalist position on monetary sovereignty, I went on to suggest that several processes and ideological developments in the post-Bretton Woods monetary system tend to trump many of the practical potentials and theoretical considerations of chartalism. Indeed, at first sight it seemed nothing short of paradoxical that the modern money era (which gave birth to monetary sovereigns in the full chartalist sense) has witnessed developments that have led to homogenous and regressive slow-growth economic policies. From this evaluation, I drew the conclusion that the political economy of monetary sovereignty must be such that monetary sovereigns cannot adequately take advantage of their policy space (Section 1.3.).

In Chapter 2, I outlined the basic theoretical framework from which I subsequently drew in my attempt to resolve the apparent paradox of the modern money era. In Chapter 3 and 4, I showed that the dominant elements of the current macroeconomic governance regime downplay the ability of the states to govern economic and social instability by appropriate and just means. The new monetary consensus, the project of new constitutionalism, the normative appeal of market discipline, and the enduring support for national institutions of governance form the core of the sovereignty-undermining regime (Sections 3.1.–3.4.). The constitutionalized new monetary consensus – with all its ambiguities – does the major work in constraining the economic policy space of contemporary states (Sections 4.1.–4.3.). It thus turns out that the “paradox” of the modern money era is not really a paradox. The current “historical bloc” (to use the Gramscian concept) – finds a strong interest in the attempts to restrict key aspects of monetary sovereignty precisely because we live in the era of modern money that opens up possibilities for democratic monetary governance actually contributing to the public purpose. Ideology and agency – along with structures – thus counts in the political economy of monetary sovereignty.
Finally, in Chapter 5 I went on to examine the key further question that arose from the preceding chapters – how to deal with the fact that the modern money era does not allow for full exercise of monetary sovereignty? I evaluated the current new consensual practice of monetary governance using two distinct normative points of views, and offered ideas for prospective alternatives to it. First, I argued that the new consensus is about to lose its dominance partially because of its failure to provide the kind of macroeconomic stability that it has promised. This failure is not surprising because, for several reasons, the new monetary consensus does not seem to be the right sort of governance doctrine for informing institutional design and policy-making in the modern money era (Section 5.1.) Secondly, I suggested on the grounds of both cosmopolitan democratic theory and Post Keynesian economics that the new consensus style of macroeconomic governance is sacrificing the exercise of monetary sovereignty for the maintenance of the existing practices and relations of domination. I argued the case for the transformative exercise of monetary sovereignty and suggested that its prospects could potentially be greatly enhanced if institutions for supranational democratic governance were established to replace the present nation-state-centered exercise of monetary sovereignty (Section 5.2.)

Distinct Lessons for Theoretical Paradigms

In addition to the substantive conclusions offered on the political economy of monetary sovereignty outlined herein, this study provides distinctive lessons for various theoretical paradigms. First, there are Post Keynesian lessons for various branches of GPE. In Chapter 1, I argued that political economists in general (as well as neoclassical economists) should study the basics of chartalism in order to understand why monetary sovereignty makes a difference for the possibility of as state to conduct independent fiscal and monetary policies. In Chapter 4, I showed that neo-Gramscian hypotheses concerning neoliberal transition and new constitutionalism in monetary governance need revision in light of Post Keynesian monetary theory (see Sections 4.1.7. and 4.2.6.). In Chapter 5, I suggested that also cosmopolitan democrats can draw from Post Keynesian thought to develop their normative arguments and proposals for institutional reforms in monetary governance and macroeconomic policy.

Post Keynesian economics makes four major contributions to the study of the contemporary political economy of monetary sovereignty. First, the modern chartalist
theory suggests that the idea of monetary sovereignty is not outdated. To the contrary, we live in the modern money era. Monetary sovereigns are in principle much less constrained than monetary non-sovereigns. Second, in light of the broader Post Keynesian theory many of the key mechanisms that GPE theorists have suggested to undermine the financial position of the states “structurally” or “economically” only become potent because of the popularity of particular types of governance ideas, institutions and policies of the post-Bretton Woods era. In other words, free capital movements, credit rating institutions or even “globalization” as such do not eliminate the macroeconomic policy space of monetary sovereigns. Gill and Law’s “structural power of capital” or Cohen’s “new geography of money”, for instance, are much less threatening phenomena if countries adapt appropriate strategies by enforcing their monetary sovereignty. Similarly, Rodrik’s trilemma would partially dissolve. Third, Post Keynesian theory helps to notice that it is the constitutionalized new consensus that is the most effectively eroding the macroeconomic policy space of the monetary sovereigns. Finally, Post Keynesian thought contributes to the proposition that monetary sovereignty ought to be exercised at a supranational level.

Second, critical GPE offers lessons for Post Keynesian economics in general and the chartalist theory of monetary sovereignty in particular – the theory the strengths and weaknesses of which inspired this thesis the most. The chartalist hypothesis (as stated at the outset of Section 1.1.) can be partially revised in light of the evidence and considerations found in this thesis. Its first part (monetary sovereignty matters greatly for the macroeconomic policy space of modern states) is convincing, as I argued in the first chapter. The second part (monetary sovereignty of states and, therefore, their macroeconomic policy space having generally increased after the removal of the fixed exchange rate arrangement of the Bretton Woods system) is the one that seems to be in need of augmentation and revision in light of the later chapters. Given the economics of state finances and flexible exchange rate arrangements, the monetary sovereignty of contemporary states definitely has improved, but their actual policy space often has not increased. Especially the recent new constitutional restrictions on the exercise of monetary sovereignty, the implementation of which has been promoted by the simultaneous emergence of the new monetary consensus, guarantee this state of affairs. The political economy of monetary sovereignty is thus more complex than the chartalists occasionally imply when they fail to pay systematic attention to such
processes. The Post Keynesian literature in general clearly needs to be supplemented with a Political Economy, such as the neo-Gramscian account, from the perspective of which I herein have suggested a way to revise the Chartalist hypothesis. As the argument of Chapter 5 suggests, the chartalists should also learn to draw cosmopolitan conclusions from their theory as certain other parts of the Post Keynesian literature already sometimes do. In sum, Post Keynesians should learn as well as teach.

More General Lessons

In addition to the above-mentioned lessons for specific theoretical paradigms, there are several theoretical implications of a more general sort that can be derived from this study. First, a systematic study of the global political economy clearly presupposes an economic theory; one simply cannot conduct research without making implicit or explicit commitments to certain presuppositions about various economic processes. I maintain that those commitments – to the extent possible – should be of the explicit sort. As noted throughout this thesis, too large a portion of the research in GPE remains drastically unclear about its presuppositions. While the commitments of the mainstream American school are almost invariably neoclassical – and most researchers usually seem perfectly happy with those commitments –, certain critical branches of GPE have fallen into the trap of implicit neoclassical commitments often unwittingly and to the peril of the explanatory and critical potentials of many of their research programs. Even when one makes a strategically or epistemically justified decision to employ assumptions, theories or models of mainstream economics, one should always make sure that the most up-to-date version of the mainstream theory is employed, or at least grasped. Doing GPE certainly should not be reduced to researching the history of economic thought and practice.

Second, the converse of the first implication above applies equally – every economic theory assumes some kind of a broader view of a political economy. The theories of macroeconomics and international economics usually assume a global political economy, while microeconomic theories may do with more local assumptions (“local” in a spatial sense). As noted on various occasions here, no alleged economic laws or invariant regularities would remain robust under considerable “manipulation” of their
underpinning political economy. In other words, sufficient changes in the underlying political economy would necessarily cause crucial changes in the economic “laws” and regularities. The moral for economic theories is that they ought to become more explicit about their range of applicability. As things stand, a typical economic theory is vulnerable to the simple charge that its range of applicability is not the “real world” but perhaps only an imagined formal system. Economics certainly should not be a formal science – it ought to make truth claims about real-world economies, as well as about the real possibilities for their future development. The only way for economics to become explicit about its range of applicability is to broaden its vision. Doing realist economics without attention to power relations, ideologies and political institutions, – the political economy – is hopeless. Just as theories of political economy are as valid as their implicit economic theory, economic theories cannot afford to remain ignorant of the other social sciences.

Third and related to the two first points, the theories of both GPE and economics should arguably become more “institutionalist”. This is a lesson not merely for the mainstreams of these disciplines but for their heterodox approaches as well. While, for instance, neo-Gramscian GPE and Post Keynesian economics already pay explicit, realistic attention to institutions (and indeed emphasize the importance of such focus), both should become institutionalist in an advanced, more “global” sense. By this, I mean that these schools ought to broaden their view of the relevant institutions. Let me illustrate by taking the debates around macroeconomic policy space and monetary sovereignty of contemporary states as an example. As shown in this thesis, GPE theorists have often fail to scrutinize macroeconomic institutions at the operational level in anything near the similar detail that the Post Keynesian monetary economists have done. The Post Keynesians, for their part, have regularly failed to consider political and legal institutions systematically enough, which is why they have not developed a theory about such phenomena as new constitutionalism, or entities like nation states. Inclusive

144 This formulation of the idea draws from Woodward’s (2003) manipulability theory of causal explanation.
145 Many essential power relations and ideological elements of governance will remain hidden from political scientists unless they choose to dig deeper into the “technicalities” that are being formulated by economists in the languages of economics, statistics and mathematics.
146 Methodological nationalism that plagues also Post Keynesian economics (even if not to the degree as it plagues most other schools) could be overcome if the analytical value of nation states was questioned explicitly.
institutionalist approaches could help to build new bridges between economics and GPE, an insight that takes me to the more general point below.

Fourth, a continuing dialogue aimed at a flexible theoretical synthesis between economics and the study of political economy is needed. It is clearly not enough for interdisciplinary intercourse to occur only occasionally when researchers are under the most urgent pressure to widen the perspective. This kind of ad-hoc consultation is bound to be both too selective and unsystematic. While even occasional coupling of perspectives can undoubtedly provide creative insights, it is unlikely to lead to a well-developed theoretical framework able to generate sustained knowledge production and learning. A synthesis of heterodox perspectives in economics and GPE would be an important opening in this respect. If Political Economy could be studied in a fashion that also provided roughly right answers to the standard questions of economy theory, then the instrumentalist approaches of the American school of IPE and neoclassical economics could be challenged. Without such a critical synthesis, however, it is highly unlikely that the mainstreams of these disciplines could ever be confronted effectively enough. It seems similarly clear that the synthesis approach to the study of political economy should embody very high epistemic standards or there can be no real chance of paradigm chances. Empirical orientation, clarity and syntheses ought to replace dogmatism, obscurity and fragmentation. The hard but necessary task is to unite pluralism, emancipatory motivation, and such high standards.\footnote{Cohen’s (2008) discussion concerning the differences of the American and British schools of IPE motivates this call. It is probably true that the obscurity of the British school methodology greatly contributes to the marginalization of the school. This is unfortunate since a lack of ambition and vision marks the American school. How best to combine clarity and other key epistemic standards with a broad perspective is the crucial question. Critical realists deserve merit for their explicit attempt to answer this question.}

Fifth, the prospects of flexible theoretical synthesis that unites high epistemic standards, pluralism and emancipatory spirit would be enhanced if a coherent realist approach to the study of political economy were endorsed (see Patomäki 2003 for a detailed argument). Since Post Keynesian economics and critical branches of GPE often agree on many questions concerning the underlying ontology and methodology, it is possible that they could move closer to each other with the aid of a realist framework. Many scholars have already suggested that Post Keynesian economics departs from the mainstream neoclassical tradition partially or precisely because of its adherence to realism (Dow 1999; Lavoie 2014, 12–15; Lawson 1999). It is indeed very plausible to
suggest that no position on any single substantial issue distinguishes Post Keynesian theory from the mainstream as dramatically as does its philosophy of science. Further, while it is true challenge that some critical schools of GPE currently tend to adhere more to a post-positivist view, it seems that the core insights of schools like neo-Gramscianism can be incorporated into a realist framework without any crucial damage. Indeed, it has been argued that key neo-Gramscian ideas can be “founded” on a realist basis as the existing realist analyses of concepts such as hegemony and ideology illustrate. The arguments of this thesis certainly support the conclusion that fruitful realist revisions are possible. The (critical) realist methodology of “iconic modelling” gives a way to incorporate such revisions into explanatory stories. Despite the challenges, the prospects for far-going cross-disciplinary collaboration do in fact seem quite promising.

While this thesis has concentrated on Post Keynesian economics, Neo-Gramscian GPE and cosmopolitan democratic theory, the argument about the importance of syntheses between GPE and economics generalizes. What I really have done is used these schools as *examples* of schools that could gain in positive ways from cross-disciplinary learning. In my current judgement, however, Post Keynesian, neo-Gramscian and cosmopolitan theories have the most to offer for the study of political economy of monetary sovereignty. Other kinds of syntheses, of course, would work better in other areas of study.

I will end by suggesting a few topics for subsequent studies on the political economy of monetary sovereignty. First, the precise nature of the constraints on the exercise of monetary sovereignty has to be further explicated. Are some constraints “harder” than others are and in which way? Similarly, the interrelations of the constraints need to be studied. For instance, what is the exact connection between the kinds of constraints on monetary sovereignty that the chartalists themselves stress (see Section 1.1.7.) and the kinds of constraints that a neo-Gramscian approach helps to illustrate? Finally, the crucial question about which institutions should exercise monetary sovereignty and conduct macroeconomic policies in the future needs further attention. In which precise form could monetary sovereignty be exercised at a supranational level? For which purpose exactly?

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148 It is possible that neo-Gramscian and cosmopolitan GPE can be more easily synthesized with Post Keynesian line of thinking than, for instance, more orthodox Marxian GPE that comes with an apparently self-sufficient theoretical package.
Bibliography


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