Distributive Justice, Political Legitimacy, and Independent Financial Institutions

Josep Ferret Mas

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Directors de la tesi

Prof. José Juan Moreso

Prof. Andrew Williams

Doctorat en Dret

"If the American people ever allow private banks to control the issue of their currency, the banks and corporations that will grow up around them will deprive the people of all property until their children wake up homeless on the continent their Fathers conquered...I believe that banking institutions are more dangerous to our liberties than standing armies... The issuing power should be taken from the banks and restored to the people, to whom it properly belongs."

Thomas Jefferson (attributed)[1]

[1] The first part of the quotation ("If the American people ever allow private banks to control the issue of their currency, the banks and corporations that will grow up around them will deprive the people of all property until their children wake up homeless on the continent their Fathers conquered") has not been found anywhere in Thomas Jefferson's writings. It is identified as spurious. The second part of the quotation ("I believe that banking institutions are more dangerous to our liberties than standing armies...") may well be a paraphrase of a statement Jefferson made in a letter to John Taylor in 1816. He wrote: "And I sincerely believe, with you, that banking establishments are more dangerous than standing armies; and that the principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale." The third part of this quotation ("The issuing power should be taken from the banks and restored to the people, to whom it properly belongs") may be a misquotation of Jefferson's comment to John Wayles Eppes in 1813: "Bank-paper must be suppressed, and the circulating medium must be restored to the nation to whom it belongs." The first known occurrence in print of the spurious first part with the two other quotations is in 1948.

https://www.monticello.org/site/jefferson/private-banks-quotation. See also: "The Avalon Project. The Papers of Thomas Jefferson: Jefferson's Opinion on the Constitutionality of a National Bank, 1791", Yale University.

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Abstract

In the present dissertation I present a broad instrumental account of the legitimacy of independent central banks. I claim that if the right institutional design is chosen, and it protects democratic participation in several ways and promotes some basic distributional goals of the government, the institution of central bank independence might be legitimate, and thus the government might not weaken its own right to rule, or moral authority to create enforceable political obligations, when it delegates control over monetary policy to an independent agency. I also offer a sufficientarian account of the central bank's duties of distributive justice, which claims that the concern to insulate monetary policy from electoral manipulation does not require pursuing only the goal of eliminating inefficiency. The bank should, in addition, protect and promote the basic distributional values of the government. I argue that independent central banks should also protect individuals from unemployment, since monetary policy has such deep effects on employment, and they should to manage the risks generated by financial regulations in ways that avoid jeopardizing the provision of a social minimum, a precondition for any legitimate set of basic structural institutions. Finally, the international aspect of my dissertation explores four arguments to claim that the asymmetries between the least competitive countries and their competitors have been exacerbated by the Eurozone and cannot adequately be dealt with by relying only in *intra-state* solidarity.

Resum

En aquesta tesi defenso que la legitimitat de la independència dels bancs centrals independents pot ser reconeguda per una concepció àmplia de l'instrumentalisme. Si el disseny institucional és l'adequat, i protegiex la participació democràtica de diverses formes i promou els valors distributius bàsics del govern, la institució dels bancs centrals independents pot ser legítima, i per tant el govern no debilita el seu dret a governar, ni la seva autoritat moral per crear obligacions polítiques subjectes de ser executables, quan delega les seves funcions en una agent independent. Així mateix presento una visió suficientarista dels deures de justícia distributiva del banc central, que sosté que la preocupació per aïllar la política monetària de la manipulació electoralista no requereix perseguir com a únic objectiu la eliminació de la ineficiència. Els bancs centrals independents han de protegir els individus de l'atur, atesa la influència de la política monetària en les polítiques d'ocupació, i han de gestionar els riscos generats per la regulació financera de manera que no impedeixin la provisió d'un mínim social, que és una pre-condició per a la legitimitat de qualsevol conjunt d'institucions bàsiques estructurals. Finalment, l'aspecte internacional de la tesi explora quatre arguments per justificar que les assimetries entre els països menys competitius i els seus competidors s'han exacerbat per la creació de l'Eurozona i no poden ser gestionades adequadament si es confia solament amb la solidaritat intra-estatal.

Contents

Introduction

In May 5, 2010, a few days after the bail-out to Greece was approved by the European Commission, the European Central Bank and the International Monetary Fund, on the one hand, and the Greek government on the other, a demonstration in Athens resulted in riots, police brutality and a violent escalation. The police responded with pepper spray and tear gas and at the end a petrol bomb was thrown into the Marfin Bank branch in Athens. Three persons were killed. The Greek Parliament was to vote on spending cuts and tax rises by the end of the week. They included wage freezes, pension cuts and tax rises with the aim to achieve budget cuts of 30 billion Euros over three years, with the goal of cutting Greece's public deficit to less than 3% of GDP by 2014.[2]

During the last few years several demonstrations and riots have followed the deep financial crisis in Southern Europe. Demonstrators often claimed that the European Central Bank was responsible of austerity policies and the vicious spiral of recession and sovereign debt crises suffered by countries like Spain, Greece, and Portugal. In light of this some might argue that the government delegating authority over monetary policy to some independent agent, like a central bank, is objectionably undemocratic, and that the European Central Bank's imposition of austerity policies on the citizens of Eurozone member states is in some sense illegitimate

When I was an undergraduate student, about twenty years ago, my degree was focused in history of philosophy and I thought that philosophers were good at posing interesting questions but that there were no definitive answers to the puzzles they presented. During my doctoral studies I've been engaged in another kind of research, concerned with real-world political problems. To me it makes more sense to address real political problems and contribute to finding answers

[2] http://news.bbc.co.uk/2/hi/8661385.stm. These events had a precedent on December 6, 2008, when an anarchist activist was killed by the police in Athens. The country was immersed in a crisis as a consequence of the global financial crisis that started with the bankruptcy of Lehman Brothers. Two weeks of violent riots followed this incident, which in turn were followed by demonstrations and riots in several countries, including Spain.

to questions, including ones about the legitimacy and justice of independent financial institutions.

During my doctoral research I have focused on these two distinct political problems regarding independent financial institutions like central banks, legitimacy and justice. My dissertation is divided into two parts. The first abstracts from questions about international political theory, and examines whether democratic theory can explain the legitimacy of independent central banks and how theorists of social justice should assess their impact. The second part turns to international questions and the demands of justice arising in the Eurozone and the European Union.

The recent financial crisis produced a global economic recession with deep distributional effects. A growing number of political philosophers have started to ask for the moral and political justification of financial markets, financial practices, and independent financial institutions. My research focusses on the last issues, and asks what could constitute a moral and political justification of independent financial institutions. To answer this kind of question we need to draw on empirical assumptions but we cannot rely only on economics and the other social sciences; we must, in addition, appeal to ethical judgments that employ concepts such as justice, social responsibility, or political legitimacy if we are to clarify the direction financial reform should take.[3]

"Philosophy of Finance", as we might call it, corresponds to a new branch of applied ethics, advanced by ongoing research projects in several universities in Europe, which addresses topics like the moral responsibilities of bankers, sovereign debt crises and justice, the legitimacy of central banks, or the normative evaluation of financial and systemic risk.

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[3] See Joakim Sandberg, "Moral Economy and Normative Ethics", *Journal of Global Ethics* (2015): 176-187. See also Aaron James, *Fairness in Practice: A Social Contract for the Global Economy*, (Oxford: Oxford University Press, 2012), Alexander Douglas, *The Philosophy of Debt*, (New York: Routledge, 2016), and Boudewijn de Bruin, *Ethics and the Global Financial Crisis: Why Incompetence is Worse Than Greed*, (Cambridge: Cambridge University Press, 2015).

Normative political theory addresses conceptual, normative, and evaluative questions concerning politics and society, broadly construed. In this dissertation, I draw on contemporary analytic political philosophy to address some normative issues of independent central banks: legitimacy and justice. The label "analytic" is meant to refer to an argument-based and issue-oriented approach that aspires to terminological precision and clarity in exposition.[4] Analytical political philosophy appeals to principles and theories to address the latter questions. Such principles or theories, I shall assume, are capable of being true or false, or more or less supported by sound reasons.[5] One methodology to address these normative questions is that of *reflective equilibrium*.[6] It requires us to reach a "mutual fit" between the theory and our considered judgments. A reflective equilibrium is reached when the implications of our possibly revised theory are in line with our possibly revised judgments.[7]

In "Rawls on Justification",[8] T.M. Scanlon remarks that "an adequate method for deciding what to believe about a subject must provide some standards by reference to which the current beliefs we happen to have can be

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[4] See Christian List and Laura Valentini, "The Methodology of Political Theory", in *Oxford Handbook of Philosophical Methodology*, Herman Cappelen, Tamar Szabó Gendler, and John Hawthorne eds.¸(Oxford: Oxford University Press, 2016): chapter 27. Also available at: http://personal.lse.ac.uk/list/PDF-files/MethodologyPoliticalTheory.pdf

[5] Christian List and Laura Valentini (2016) claim (page 10 in the website version) that "simply put, concepts can serve as building blocks of principles, which can serve as building blocks of theories."

[6] See John Rawls, *A Theory of Justice*, (Cambridge: The Belknap Press of Harvard University, 1999 (1971)): 15-18, 40-46.

[7] See Christian List and Laura Valentini (2016): 17 (website version). "This works as follows. We begin with some initial theory, then consider the implications of the theory and ask whether they are also in line with our judgments. If those implications fit our judgments, the process stops. It is more likely, however, that only some of the theory's implications fit our judgments, while others do not. We then reassess both the theory and our judgments. In some cases, we may decide, on reflection, to revise the theory by changing some of the constituent principles, so as to bring the theory in line with the judgments we are unwilling to give up. In other cases, we may decide to overrule our judgments and embrace the theory's implications as our new considered judgments."

[8] Thomas Scanlon, "Rawls on Justification", in *The Cambridge Companion to Rawls*, ed. Samuel Freeman, (Cambridge: Cambridge University Press, 2002): 139-167.

judged."[9] To supply such standards, Scanlon examines the justificatory force of Rawls's idea of *wide reflective equilibrium*, or a relationship of mutual support between an agent's specific convictions, general principles and basic ideals. He argues that justification can't plausibly be regarded as *only* a matter of internal coherence because doing so would "beg the question against skepticism."[10] In addition, the reasons to affirm her moral beliefs depend on whether she satisfies substantive standards in securing coherence; for example, whether the revisions she makes to ensure her convictions, principles, and ideals fit with one another are more rather than less plausible. Scanlon illustrates his view by describing Rawls's justification of *justice as fairness,* and showing how as a political conception it gains support from other important ideals like that of liberal public reason and overlapping consensus.

My aim in this dissertation is far more modest than that pursued by Rawls, who aims to defend very general normative political theory that addresses host of questions. I explore the fit between convictions about the operation of independent financial institutions and a more limited range of other convictions about political legitimacy and distributive justice, which I take as provisionally fixed. In the past, political philosophers, with some welcome exceptions like Jon Elster,[11] have not discussed in depth the philosophical problems arising from independent financial institutions. In line with the aim of philosophy of finance, my ambition in this piece of work is to make some progress in evaluating such institutions from the perspective of contemporary political philosophy. I aim to present better justified beliefs about the normative aspects of independent central banks that can resist at least some forms of skepticism from those who

[9] T. M. Scanlon (2006): 150.

[10] David Copp, "Considered Judgments and Justification: Conservatism in Moral Theory," in D. Copp and M. Zimmerman, eds., *Morality, Reason and Truth* (Totowa, NJ: Rowman and Allenheld, 1985), pp. 141 –69.

[11] Jon Elster, "Constitutional Courts and Central Banks: Suicide Prevention or Suicide Pact?", *Eastern European Constitutional Review* No. 66, (1994).

claim that only sound economic arguments can justify the institution, and that we do not need to appeal to ethical or political concerns.

Before drawing on philosophy, it is worth noting some empirical facts relevant to what follows. In modern economies, the central bank changes the money supply by buying or selling bonds in so-called *open market operations*. If the bank wants to expand the amount of money in the economy, it buys bonds and pays for them by creating money. In contrast, if it wants to contract the money supply it sell bonds and removes from circulation the money it receives from the exchange of bonds. As the central bank buys bonds, the demand for bonds goes up, increasing their price while the interest rate on bonds goes down. In contrast, when the central bank makes a contractionary open market operation it decreases the price of the bonds and it increases interest rates on them. In other words, we can also describe the central bank as the media typically do. It choses an interest rate as its target and then manages its own balance sheet through open market operations and adjusts the money supply to achieve the target rate.[12]

In the twentieth century central banks were created to provide financial stability by acting as lender of last resort to provide liquidity to illiquid but solvent banks, and so avoid bank runs and reduce the chance of bank panics and systemic risk.[13] It is useful to distinguish between two periods in recent central bank history. The Bretton Woods era (1944-1971) was characterized by strong regulation, government control, and financial autarky. The main feature of the second period (1971-2007) is de-regulation of financial markets and the triumph of markets. Finally, the emergence of international financial crises and the financial collapse in 2007 calls for international coordination, re-regulation and a new role for independent financial institutions that it is not completely defined

[12] Olivier Blanchard, Alessia Amighini, and Francesco Giavazzi, *Macroeconomics: A European Perspective*, (Harlow: Pearson Education, 2013): 61-79.

[13] The Federal Reserve Bank was incorporated in 1913 after the bank panic of 1907.

yet.[14] Throughout this time central banks have been officially committed to maintaining price and financial stability. To meet this commitment a central bank can employ various strategies; for example, it issues money, controls the interest rate and inflation through open market operations, provides financial services to the government and to other banks, acts as lender of last resort, and supervises the financial system.[15]

Having mentioned some background facts let me now roughly outline how we will proceed in the following chapters.

Beginning with the domestic case involving a single state, our first topic is the *political legitimacy* of independent central banks.[16] Having monetary policy determined by an agent sufficiently independent of the government has valuable effects but it may also create various problems. Some current political debates involve parties who claim or imply that independent financial institutions undermine government's power to create enforceable duties of obedience for the subjects of its authority.[17]

To assess the objection, we need to examine how two prominent defenses of *democratic authority* can explain the political legitimacy of delegating very important decisions to an independent body not subject to re-election and that

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[14] See Charles Goodhart, "The Changing Role of Central Banks", *Bank of International Settlement Working Papers*,no. 326, November 2010.. See also Jef Van Gerwen "Ethical Responsibilities in Central Banking", in *Explorations in Financial Ethics* eds. Luc Van Liedekerke, Jef Van Gerwen (Leuven: Peeters, 2000): 60.

[15] Ibid.

[16] *Political legitimacy* is understood here to involve a political authority possessing a justified right to rule. The right to rule concerns two main ideas: the permission to exercise coercion through law and the normative power to issue commands that create valid duties for the subjects of the authority. See Joseph Raz, "Authority and Justification", *Philosophy & Public Affairs*, Vol. 14, No. 1 (Winter, 1985): 3-29.

[17] During the last few years several demonstrations and riots have followed the deep financial crisis in Southern Europe. Demonstrators often claimed that the European Central Bank was responsible of austerity policies and the vicious spiral of recession and sovereign debt crises suffered by countries like Spain, Greece or Portugal. Some might argue that the government delegating authority over monetary policy to some independent agent is undemocratic.
http://news.bbc.co.uk/2/hi/8661385.stm.

cannot easily be removed by the legislature.[18] To do so I examine how the *orthodox economic case* in favor of central bank's independence fits with philosophical debates about political legitimacy.[19]

I present in chapter 1 two economic arguments to justify independence for either price or financial stability. The *macroeconomic argument* and the *market failure argument* for a central bank's independence claim that independence is a remedial response to the political failure of an unconstrained government, subject to short-term electoral pressures, controlling the central bank. However, debates about the role of monetary policy are often intense and subject to several controversies, and the argument remains conditional to the acceptance of such orthodox views, which can be empirically contestable.

In chapter 2 I turn to the normative debates about justice and independent financial institutions. In September 2008 Lehman Brothers failed although only the day before the main credit rating agencies gave it the most solvent rating for financial institutions. As noted earlier, this was one of the triggering events of a global financial crisis with deep distributional consequences both domestically and globally.

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[18] Independent financial institutions have general goals, such as to control the money supply, fix the interest rate through open market operations and, generally, secure price and financial stability. Thus the decisions of a central bank have a deep impact on the course of the economy, and ultimately on the life-prospects of citizens. For example, whether the central bank undertakes an expansionary or contractionary monetary policy can exert influence on investment and employment and, as a consequence of it, in the absolute and the relative position of citizens.

[19] I argue that *instrumental* and *non-instrumental* accounts of political legitimacy can both accommodate the orthodox economic case for central bank's independence. Instrumentalism claims that democracy is legitimate because it produces the best consequences over time when compared to any other workable form of government. In contrast, pure proceduralism claims that democracy matters because of the fairness of its procedures. Examples of Instrumental views of democracy are Joseph Raz, *The Morality of Freedom*, (Oxford: Oxford University Press, 1986): 38-69, Joseph Raz, "Liberalism, Scepticism, and Democracy", *Ethics and the Public Domain: Essays in the Morality of Law and Politics*, (Oxford: Clarendon Press, 1994): 94-124, and Richard Arneson, "Democratic Rights at National and Workplace Levels", *The Idea of Democracy*, eds. David Copp, Jean Hampton and John E. Roemer (Cambridge: Cambridge University Press, 1993). Examples of Procedural views of political legitimacy include Jeremy Waldron, *Law and Disagreement*, (Oxford: Oxford University Press, 1999) and Kenneth O. May, "A Set of Independent Necessary and Sufficient Conditions for Simple Majority Decision", *Econometrica*, 20 (1952).

The thirty years period before the financial crash of 2008 and the current global recession was characterized by de-regulation of financial markets and economic growth. Despite this, the distribution of income and wealth during these years was stacked heavily in favour of top income households.[20] Moreover, the instability of financial markets after the bankruptcy of Lehman Brothers forced several governments in the world to bail-out financial institutions at the expense of future taxpayers while the "not haves" still face the consequences of recession and unemployment. During these years of economic recession millions of citizens over the world lost their employment and millions too fell below the levels of severe poverty.[21]

Thus, the second chapter of the dissertation examines the relations between central banks and distributive justice. It asks what distributional goals, if any, should central banks pursue? From the 1980's until 2008 it was often claimed that the sole responsibility of central banks was to manage the short-term interest rate and that this magic single policy was enough to secure price and financial stability. Central bankers and mainstream economists defended the view that de-regulation of financial markets was necessary to promote

[20] See John Roemer, "Ideology, Social Ethos and the Financial Crisis", *The Journal of Ethics* (2012): 273-303. Roemer claims that "It is well-known that the distributions of income and wealth have become more unequal in the US during the past 30 years … Households in the top 5% of the wealth distribution increased their share of total wealth from 56.1% in 1983 to 61.9% in 2007. The poorest 40% of households went from a 1983 share of 0.9% of total wealth to 0.2% in 2007. Indeed, all deciles except the top one lost wealth share; there was a massive redistribution from the bottom 90% to the top decile during this period. Even in 1983, the top 5% owned more than the bottom 95%, but this only became more skewed in the last 30 years. Perhaps the most telling statistic is that, of the total economic growth that occurred in the years 1977–2007, 57% (before taxes) accrued to households in the top 1% of the income distribution": 282. See also Thomas Pogge, "The Achilles' Heel of Competitive/Adversarial Systems", *Global Financial Crisis: The Ethical Issues*, Christian Barry Ned Dobos and Thomas Pogge, eds. (Basingstoke: Palgrave Macmillan, 2011): 127-128.

[21] Christian Barry and Matt Peterson claim that collectively "implies a loss of $750 billion in income for developing countries, including a $50 billion loss to Sub-Saharan Africa." They cite the studies made by Dirk Willem te Velde, "The Global Financial Crisis and Developing Countries: Synthesis of the Findings of 10 Country Case Studies", *Overseas Development Institute Working Paper* 306, London, (2009): 1. See Christian Barry and Matt Peterson, "Who Must Pay for the Damage of the Global Financial Crisis", *Global Financial Crisis: The Ethical Issues*, Christian Barry, Ned Dobos and Thomas Pogge, eds. (Basingstoke: Palgrave Macmillan, 2011): 161.

economic growth in a sort of 'trickle-down' economy in which increasing the earnings of asset holders would also maximize benefits for the least advantaged members of society.[22] It seemed then that central banks do not have any responsibility to secure social justice. At one point in the middle of the Euro-crisis, Mario Draghi still made the following statement in front of the European Parliament:

> "Are we doing all we can for growth? Our task is not that. Our task is to ensure price stability and through this contribute to growth. That's what I think we are delivering."[23]

One might think that according to this view (or what I call the *corrective view*) central banks do not have any responsibility for the course of real economy or unemployment. That view claims that the independent central bank should be committed only to eliminating some sort of *Pareto inefficiency*[24] arising from an unconstrained government controlling the central bank. The central bank, it claims, has no responsibility for distributive justice, and need not consider this type of reason in its policy making,[25] but only to avoid the political failures of a government subject to electoral pressures.

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[22] See for an introduction for laypersons to the causes of the current financial crisis, John Quiggin, *Zombie Economics*, (Princeton: Princeton University Press, 2009). See also Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, (New York: Vintage Books, 2011): 111-112. One of the causes of the crisis was the underestimation of the risks associated to financial innovation. The financial crisis has opened lines of research to assess, for example, the political justification of financial risk.

[23] Mario Draghi, April, 25, 2012, http://uk.reuters.com/article/uk-ecb-idUKBRE83O0CJ20120425

[24] According to G. A. Cohen, *Rescuing Justice and Equality*, (Cambridge: Harvard University Press, 2008): 87 a "state A is strongly Pareto-superior to state B if everyone is better off in A than in B, and weakly Pareto-superior if at least one person is better off and no one is worse off". State A is Pareto efficient if none can be better off without making someone else worse off.

[25] This corrective view relies in two distinct arguments: the *macroeconomic argument* and the *market failure argument* and draws on John Rawls's A Theory of Justice, which distinguishes different branches of the government. In one reading of Rawls's branch distinction central banks are committed only to maintaining stability and efficiency in the market economy. The government, which handles fiscal policy, is responsible to apply sound principles of justice in the distribution of benefits and burdens and limit the scope of Pareto efficiency to the cases in which inequalities are arranged for the maximal benefit of the least advantaged members of society. See

Despite the lack of reference to economic growth, real economy, and employment in the Statute of the European Central Bank,[26] we can contrast Mario Draghi's view of independent central banks with Section 2A of the Federal Reserve Act which stipulates the monetary policy objectives of the Federal Reserve Bank of the United States:

> "The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."[27]

It seems that according to the Federal Reserve Act the independent central bank does have some responsibilities regarding distributive justice. Consider then the difference between the corrective view, exemplified in the quoted words by Mario Draghi, and the view maintained by Mark Carney, the current governor of the Bank of England, who mentions in several of his speeches that economic growth and employment are also secondary goals of the bank.[28] The views of Mark Carney, and the objectives set up in section 2A of the Federal Reserve Act, suggest that the central bank's concerns shouldn't be only to avoid decisions a

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John Rawls, *A Theory of Justice*, (Cambridge: The Belknap Press of Harvard University, 1999 (1971)): 276-277.

[26] Article 2 of the Statute of the European System of Central Bank and of the European Central Bank establishes that "the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in article 3 of the Treaty of the European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources." Nonetheless the reference to article 3 of the Treaty of the European Union might allow the bank to pursue wide political goals in a global economy, which of course might include growth and employment.

[27] http://www.federalreserve.gov/aboutthefed/section2a.htm.

[28] See for example his speeches at Cass Business School, City University, London in March 18 , 2014, and that at the University of Sheffield in March, 12 2015.

http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech715.pdf
http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech808.pdf.

government makes purely due to electoral pressures; in addition the bank should be sensitive to some of the government's basic distributional values.

In chapter 2 I first distinguish different values that the government might direct the bank to pursue and present three alternatives. Besides the corrective view, I offer two other alternatives views that claim the division of labor between independent financial institutions seeking only for efficiency and the government seeking justice should not be as radical as the corrective view claims. The diametrically opposing position, the *coextensive view*, says independent financial institutions should promote and pursue the very same distributional values the government should pursue. Finally, the intermediate *sufficientarian view*, which I favour, claims the central bank should pursue a set of values broader than but encompassing inefficiency elimination but narrower than those involved in the second option.

Finally, the international aspect of my research project will explore the demands of justice amongst the member states of the Eurozone. In the past, debates in political philosophy have focused on the democratic deficit of European institutions, while more recently debates are also concerned with solidarity in the European Union (EU).[29] Nevertheless, in a letter to Philippe Van Parijs in June 23, 1998, John Rawls, expressed his concerns about the justice of the European project:

> "One question the Europeans should ask themselves, if I may hazard a suggestion, is how far-reaching they want their union to be. It seems to me that much would be lost if the European Union became a federal union like the United States. Here there is a common language of political discourse and a ready willingness to move from

[29] See Philippe Van Parijs, "No Eurozone without Eurodividend" (provisional version, 2012): 1-21; and Andrea Sangiovianni, "Solidarity in the EU", *Oxford Journal of Legal Studies*, Vol. 33, No. 2 (2013): 213–241. See also Juri Viehoff, "Maximum Convergence on a Just Minimum: A Pluralist Justification for European Social Policy," *European Journal of Political Theory,* (forthcoming).

> one state to another. Isn't there a conflict between a large free and open market comprising all of Europe and the individual nation-states, each with its separate political and social institutions, historical memories, and forms and traditions of social policy. Surely these are of [sic] great value to the citizens of these countries and give meaning to their life. The large open market including all of Europe is aim of the large banks and the capitalist business class whose main goal is simply larger profit. The idea of economic growth, onwards and upwards, with no specific end in sight, fits this class perfectly. If they speak about distribution, it is [al]most always in terms of trickle down. The long-term result of this -which we already have in the United States- is a civil society awash in a meaningless consumerism of some kind. I can't believe that that is what you want."[30]

Thus, we might think that the concerns about social justice in the EU are older than the current financial crisis in the Eurozone, and that member states should have protected each other from threats to social justice and so insured against adverse events, like financial crises, when joining the Eurozone. The institutional design of the Eurozone, however, currently includes very limited forms of solidarity amongst the different member states. It makes sense then to ask whether reform is necessary, and if so which principles of fairness should apply across such member states.

In doing so, it is worth bearing in mind that the creation of an international institution like the Eurozone has exacerbated the asymmetries between member states with different levels of competitiveness. Roughly speaking, due to the different levels of economic competitiveness it is not possible that the same interest rate serves the interests and demands of all

[30] John Rawls and Philippe Van Parijs, "Three Letters on *The Law of Peoples* and the European Union", in *Autour de Rawls*, special issue of *Revue de philosophie économique* (2003): 7-20.

member states to the same degree.[31] Less competitive states have surrendered autonomy over monetary policy, and sovereign debt crises in several countries have proved that states lacking their own currency and their own central bank are less likely to overcome financial crises.[32] European integration, then, creates costs and benefits for the participants and the third chapter explores four different arguments, and their several problems, to claim that a distinctive international distributional branch at the EU level should exist as a result of the creation of the Eurozone.

[31] Philippe Van Parijs (2012): 2. See also M. Feldstein, "The Failure of the Euro", *The Foreign Affairs January*/February (2012).

[32] Katharina Pistor, "A Legal Theory of Finance", *Journal of Comparative Economics* 41 (2) (2013): 14.

Part I: The Domestic Case

Chapter 1: Political Legitimacy and Independent Financial Institutions

1. Introduction

Some current political debates involve parties who claim, or imply, that independent financial institutions undermine government's power to issue commands that create valid duties for the subject of its authority. The concern about the *political legitimacy* of central banks claims that when the government delegates its decision-making powers in an independent central bank it weakens its powers to create enforceable duties for its subjects.[33] To assess the objection, we need to examine the political legitimacy of delegating very important decisions to an independent body and the compatibility of such delegation with democratic values.

Independent financial institutions have general goals, such as controlling the money supply, fixing the interest rate through *open market operations* and securing price and financial stability.[34] Thus, the decisions of a central bank have a deep impact on the course of the economy, and ultimately on the life-prospects of citizens. For example, whether the central bank undertakes an expansionary or contractionary monetary policy can exert influence on investment and employment and, as a consequence of it, on the absolute and the relative living standards of citizens.

The central question of this chapter, then, is whether independent financial institutions undermine the moral power of the government to issue valid commands which in turn create a duty of obedience for the subjects of its authority when it delegates influential functions to an independent body, like the board of directors of the central bank, not subject to re-election and who cannot

[33] *Political legitimacy* is understood here to involve a political authority possessing a justified right to rule. The right to rule concerns two main ideas: the normative power to issue commands that create valid duties for the subjects of the authority and the permission to exercise coercion to sanction disobedience with those commands. See Joseph Raz, "Authority and Justification", *Philosophy & Public Affairs*, Vol. 14, No. 1 (Winter, 1985): 3-29.

[34] The main role of central banks is to be in charge of the money supply through open market operations to adjust their balance sheet and fix the interest rate and monitor the risks of strategic financial institutions. See Charles Goodhart, "The Changing Role of Central Banks", *Bank of International Settlement Working Papers*, no. 326, November 2010: 1-15.

easily be removed by the legislature. For that reason, it makes sense to examine how various prominent defenses of the authority of democracy can explain the political legitimacy of such delegation. We need to justify delegation to those who might deny that the government should waive its rights to issue valid commands on monetary policy. Thus, our topic in this chapter is whether independent agents should be granted the relevant decision-making status and what implications such status for the legitimacy of political institutions. In later chapters we examine what factors should guide the relevant decisions.

Section 2 presents an *orthodox economic case* in favor of central bank independence. Even the case might be challenged on empirical grounds, since the role of independent banks is subject to passionate and controversial debates, the aim of the chapter is to examine how this case fits with philosophical debates about political legitimacy. It argues that instrumental and non-instrumental accounts of political legitimacy can both accommodate the orthodox economic case for independence.[35]

Simple instrumentalism claims that democracy is legitimate because it tends to produce the best consequences over time when compared to any other workable forms of government. In contrast, *pure proceduralism* claims that democracy matters because of the fairness of its procedures. After taxonomising various different conceptions of democratic authority in Section 3, Section 4 presents a justification of central bank's independence by *narrow instrumentalism* which looks at the effects of independent financial institutions on laws and policies. Under this view the good effects of independence on law

35 Examples of instrumental views of democracy are Joseph Raz, *The Morality of Freedom*, (Oxford: Oxford University Press, 1986): 38-69, Joseph Raz, "Liberalism, Scepticism, and Democracy", *Ethics and the Public Domain: Essays in the Morality of Law and Politics*, (Oxford: Clarendon Press, 1994): 94-124, and Richard Arneson, "Democratic Rights at National and Workplace Levels", *The Idea of Democracy*, eds. David Copp, Jean Hampton and John E. Roemer (Cambridge: Cambridge University Press, 1993): 118-148. Examples of procedural views of political legitimacy include Jeremy Waldron, *Law and Disagreement*, (Oxford: Oxford University Press, 1999) and Kenneth O. May, "A Set of Independent Necessary and Sufficient Conditions for Simple Majority Decision", *Econometrica*, 20 (1952): 680-684.

and policy are sufficient for their legitimacy, but this is not the only influential approach to the legitimacy of democracy. Proponents of central bank independence should consider the appeal to procedural arguments and in Section 5 I turn into *broad instrumentalism*, which focusses on the effects of decision-making procedures not only on laws and policies but also on its broader effects on citizens. Finally, Section 6 claims that procedural views do not challenge the legitimacy of independent financial institutions. When presenting such accounts, I sketch several reforms to conclude that the various prominent defences of the legitimacy of democratic authority might converge in recognizing the legitimacy of central bank independence when the appropriate institutional design is chosen.

2. An Orthodox Economic Case for Central Bank Independence

This section examines the orthodox economic case justifying a central bank's independence. It explains two main arguments, the *macroeconomic argument* and the *market failure argument* (or the *inefficient bank runs argument*).

To issue money and influence interest rates are some of the primary functions of a central bank, and performing them has important effects. For example, suppose that we are in an economic bubble and the central bank increases the interest rate. This decision, in turn, will have a negative impact on investment and employment. An expansionary monetary policy designed to avoid an economic recession also has significant distributional consequences: it reduces the negative consequences of recession since an increase in money supply decreases the interest rate and is likely to boost investment and employment. Given that the central bank's decisions have important distributional consequences, how might their independence from an elected government be justified?

In the twentieth century central banks were created to provide financial stability by acting as lender of last resort to provide liquidity to illiquid but solvent banks, and so avoid bank runs and reduce the chance of bank panics and systemic risk.[36] The financial collapse after Lehman Brothers' failure has turned central bank's attention into lending of last resort, financial stability, and unconventional monetary policy. The central bank, as an unconditional source of liquidity to risky, uncertain and hierarchical financial markets where liquidity is scarce, has proved to be necessary to avoid financial collapse and systemic risk.[37]

Without entering into the detail of each of the functions of the central bank, in the following two sub-sections I present two economic arguments to justify independence for either price or financial stability. Even the orthodox economic case does not pursue to reach full agreement in the role of the independent central bank, the rest of the chapter looks how this case fits in various conceptions of legitimate democratic authority. I need to say that the role of independence central banks is focus of intense controversies for more than two centuries and the whole argument about the legitimacy of independent central banks remains conditional to the acceptance of such argument. Even if empirically contestable, the argument could work with alternative accounts of the justification of the value of independence of the institution from electoral pressures.

2.1 The Macroeconomic Argument

Let's present first the *macroeconomic argument* for central bank's independence historically. After the Second World War and the Great Depression the main role of the central bank focused on employment and the promotion of stable economic growth. The acceptance of the Phillips Curve led to the widespread assumption that central banks could choose between different

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[36] The Federal Reserve Bank was incorporated in 1913 after the bank panic of 1907. The nineteenth century, in the absence of a lender of last resort, was characterized by financial instability and bank panics.

[37] See Katharina Pistor, "A Legal Theory of Finance", *Journal of Comparative Economics* 41 (2) (2013): 315-330.

combinations of unemployment and inflation.[38] A country could achieve low unemployment if it was willing to tolerate higher inflation. Alternatively, it could achieve price stability if it were to tolerate higher unemployment.[39] According to Goodhart, this era of central banking was characterized by strong control of the government over the central bank.[40]

In the 1970s, after the appearance of *stagflation*, the idea of a stable trade-off between employment and inflation was abandoned. Central banks became committed to macroeconomic stability, low inflation, and moderate interest rates. Milton Friedman and Edmund Phelps[41] argued that in the medium run a government's attempts to obtain low unemployment by accepting higher inflation are prejudicial.

The initial beneficial effects of inflation on employment disappear once economic actors adjust their expectations regarding inflation.[42] A government has an interest in re-election, however, and to gain votes is prone to choose to expand the money supply to promote economic growth and reduce unemployment. In the short run, the increase in money supply leads to a lower interest rate which leads to an increase in investment and, in turn, employment. Nevertheless, in the medium run, an adjustment in price level expectations takes place. The lower unemployment rate also leads to an increase in prices. As a result, prices are higher than wage setters expected. They then revise upward their expectations on the increase of prices rate in their wage claims.

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[38] William Phillips, "The Relationship between Unemployment and the Rate of Change of Money Wages in the United Kingdom 1861-1957", *Economica* 25 (100) (1958): 283–299.

[39] Nowadays the trade-off between employment and inflation existing according to the Phillips Curve is thought to take place between the unemployment rate and the increase or decrease in the rate of expectations in inflation. See Olivier Blanchard, Alessia Amighini and Francesco Giavazzi (2013): 220-221.

[40] See Charles Goodhart (2010).

[41] Milton Friedman, "The Role of Monetary Policy", *American Economic Review* 58 (1) (1968): 1-17, and Edmund Phelps, "Money-wage dynamics and labor-market equilibrium", *Journal of Political Economy* 76 (1968): 678-711.

[42]Ibid.

Finally, businesses increase their prices at the same rate. The real interest rate, or the nominal interest rate plus inflation, reflects the increase in inflation. The real interest rate is the basis to calculate the return on investment, and thus investment decreases. The higher output after the initial intervention of the government in favor of employment comes back in the medium run to where it was before the increase in money supply. In the medium run, Friedman claimed, the money supply effects on output and employment disappear, while the increase is reflected entirely in the price level, which distort future investment.[43]

Suppose the central bank is in hands of the government and the government officially commits itself to price stability. However, when the next election looms the government is unlikely to avoid using the money supply to promote its electoral interests. Because the ruling party aims to maintain power, and the electorate can be influenced by manipulating interest rates, the government is less likely to maintain its previous commitment. This is known as the *time inconsistency problem of optimal inflation policy*.[44]

In game theory, *time inconsistency* refers to the incentive for one player to deviate from her previously announced course of action once the other player has moved. Governments are likely to want to reduce unemployment because they are subject to electoral pressures, even if doing so leads to inflation in the future. One political strategy to reduce the bad effects of time inconsistency problems is to make the central bank independent of pressure from the

[43] See Olivier Blanchard, Alessia Amighini and Francesco Giavazzi (2013): 248-250.

[44] See Finn Kydland and Edward Prescott, "Rules Rather than Discretion: The Inconsistency of Optimal Plans", *Journal of Political Economy* 85 (3) (1977): 473-491; Kenneth Rogoff, "The Optimal Degree of Commitment to and Intermediate Monetary Target", *Quarterly Journal of Economics* 100(4) (1985): 1169-1188; Alberto Alesina and Lawrence Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking* 25(2) (1993):151-162; and Per Krusell and Anthony A. Smith, Jr., "On the Welfare Effects of Eliminating Business Cycles", *Review of Economic Dynamics* (1999): 245-272. See also Olivier Blanchard, Alessia Amighini and Francesco Giavazzi (2013): 495-505.

government.[45] On according to this argument, independence is a remedial response to the political failure of an unconstrained government controlling the central bank.

2.2 The Market Failure Argument

Now, let's turn to the second argument, the market failure argument. Financial markets are characterized by risk and uncertainty and liquidity is scarce. If we want to avoid systemic risk, we need an unconditional source of liquidity. Only the state, issuing public debt at the cost of future taxpayers and having a monopoly on money supply through the central bank, can provide this unconditional source of liquidity to financial markets.[46]

The market failure argument appeals to the presence of market failure in financial markets. The assets of private banks are bonds and loans. Bonds are very liquid, easy to sell or buy in markets, but loans are often not liquid at all. The borrower might already have used the loan and be unable to pay back the loan. On the other side of the balance sheet of a private bank there are deposits on demand. As soon as a fraction of these deposits is used for financing illiquid risky loans the possibility of a liquidity crisis arises since banks collect deposits and invest a fraction of them in long-term investments while offering depositors the possibility of withdrawal on demand.

Suppose then that rumors start about the risk of loans not being repaid by a perfectly solvent bank, causing depositors to believe the bank might fail and to choose to withdraw their deposits. The bank might face running out of reserves, and the fear that it will close might actually cause it to close. This is problematic even when a bank fails for the right reason, namely having bad loans. A run on insolvent banks causes depositors in other solvent banks to panic, and withdraw

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45 See also Jon Elster, *Ulysses Unbound* (New York: Cambridge University Press, 2000): 150-153. Jon Elster claims that even a government willing to keep low inflation is subject to the time inconsistency problem of optimal policy because the government is subject to electoral pressures.

46 See Katharina Pistor (2013).

their deposits too. Bank crises, if not stopped, can lead to a financial collapse. Thus, an independent central bank needs to play the role of the lender of last resort, as an unconditional source of liquidity necessary to provide financial stability.

The government can employ various policies to avoid this market failure. It might enforce deposit insurance or restrict bank activities from engaging in some financial operations. Yet when a bank defaults, other banks face a risk of contagion, and if not contained such local risk can produce financial instability and systemic risk. The central bank avoids this risk of contagion by acting as lender of last resort. It can provide liquidity to illiquid but solvent banks to avoid inefficient bank runs, by allowing banks to turn to it for short-term loans.[47] Even so, the central bank might choose not to bail out a private bank when it is not only illiquid but also insolvent, as occurs in the so-called *efficient bank run*. It is less probable, however, that the government can do the same.

Provided private channels exist between the government and the private banks, the announcements by a government to a bank that it will not bail out inefficient banks may not be credible. The insolvent bank can take advantage of the high political cost associated with financial crises.[48]

The market failure argument claims that the lender of last resort should provide with liquidity to illiquid but solvent banks. In so doing, it avoids the problem of inefficient bank runs, bank panics and systemic risk. Yet the independent central bank should not provide capital to banks, and if they are insolvent only the government can bail them out at the expense of taxpayers.

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[47] See Xavier Freixas and Jean Rochet, *Microeconomics of Banking*, (Cambridge: The MIT Press, 2008): 217-265.

[48] Shanker Satynath, "Accommodating Imprudence: The Political Economy of Information in the Asian Banking Crisis", unpublished manuscript, Department of Political Science, Columbia University, 1999, quoted by Jon Elster (2000): 36.

2.3 The Moral Hazard Problem

Even with independent central banks the existence of some risk of contagion might favor a systematic rescue of any bank.[49] This possibility creates a problem of moral hazard.

Credit contracts entail obligations to repay the principal plus interest at a future date. In addition to simple bonds there is a wide range of tradable contractual obligations like asset-backed securities, future options and swaps. They can be issued by the government or private corporations. They link parties in a web of intertwined cross-references comprising financial markets.[50] If we want to avoid financial collapse we need an unconditional source of liquidity to make financial markets more reliable. However, if banks "too big to fail" know in advance that they are going to be rescued by the central bank or the government in case they face problems of liquidity and even insolvency, the burden of risky investments made by financial institutions shifts into the government, and ultimately taxpayers and the citizenry.[51] In light of this, some argue that independent financial institutions are captured by private banks and that they exist only in those banks' interests. Nonetheless, at least in theory, the lender of last resort, independent or not, might increase social welfare by avoiding inefficient closures of solvent banks.[52] It has tools to respond to this market

[49] Charles Goodhart, "Why Do We Need a Central Bank?", *Banca d'Italia, Temi di Discussion*, No. 57 (1986): 1-28.

[50] See Dan Awrey, "Toward a Supply-Side Theory of Financial Innovation", *Journal of Comparative Economics* 41 (2) (2013) and Katharina Pistor (2013).

[51] Charles Goodhart (2010) proposes to create a bank tax that would be used in case of insolvency of a strategic bank "too big to fail". The Federal Reserve Bank proposes to create a special fund in these strategic institutions that would be capitalized in case of insolvency. See:

http://www.federalreserve.gov/newsevents/press/bcreg/20151030a.htm

[52] For example, see the current massive asset purchases and ultra-low interest rates policies to overcome the recession after the financial collapse in 2008. Even it is a counterfactual, estimates from macroeconomic models by the US Federal Reserve, the Bank of England, and others show that, compared with a scenario in which no such action was taken, unconventional monetary policies have improved GDP by between 1 and 3 per cent, reduced the unemployment rate by about 1 percentage point, and prevented deflation. If the emergency measures employed at the start of the financial crisis did indeed head off an uncontrolled downward spiral of the global financial system, then the macroeconomic value of the damage prevention could be far larger

failure in financial markets, but it also has to reject rescue requests by insolvent banks. It can't provide them with capital as well liquidity. Independence makes it more likely that the central bank is not subject to political pressures, and so does not rescue insolvent banks just because of the political cost associated with financial crises.[53]

The orthodox economic case in favor of central bank's independence, even if empirically contestable, claims that independent financial institutions prevent voters being manipulated by an unconstrained government because the independent central bank eliminates two kinds of political failures. The macroeconomic argument claims that government interest in re-election prevents them from achieving a long term low inflation goal.[54]

The market failure argument claims that last resort lending addresses a market failure in financial markets whilst independence corrects the tendency of government to rescue any bank, even if it is not only illiquid but also insolvent. Even if the difference between liquidity and solvency it is not so clear[55] in

than these estimates indicate. See McKinsey Global Institute, "QE and Ultra-low Interest Rates: Distributional Effects and Risks", McKinsey & Company (2014): 1-4.

[53] One might argue that quantitative easing dilutes the difference between problems of illiquidity and insolvency, though it seems that there was not better alternative to stop fire sales and the collapse of financial markets. Some argued that QE policies are emergency policies to avoid systemic risk and financial collapse and they should not be assessed by distributional principles whilst others claim that current unconventional monetary policy is creating deep inequalities and that they should instead be guided by egalitarian goals.

[54] Alesina and Summers (1993) claim that a central bank composed by conservative independent members can better secure this goal. The need for low inflation is empirically contestable since, for example, in case of recession and high unemployment the central bank might need to accommodate the government's interest in reducing unemployment. During the crisis the central bank could have pursued clear inflationist policies to face recession and unemployment, as proposed by some of the most influential defenders of independence. Kenneth Rogoff, "The Bullets Yet to Be Fired to Stop the Crisis", *Financial Times*, August 8, 2011, quoted by Christopher Adolph, *Bankers, Bureaucrats and Central Bank Politics: The Myth of Neutrality*, (Cambridge: Cambridge University Press, 2013): 308. See also Jonathan Kirschner, "The Political Economy of Inflation" *Journal of Economic Surveys* (2001): 1-30; Alan M. Jacobs, *Governing the Long Term: Democracy and the Politics of Investment* (Cambridge: Cambridge University Press, 2011); Alberto Alesina and Lawrence H. Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking*, Vol. 25, No. 2 (1993): 151-162.

[55] Thus, the market failure argument can be empirically contested. However, lending of last resort it is deeply connected with monetary policy, and sometimes it is difficult to know whether the

practice, the main conclusion of the orthodox economic case remains true: independence preempts the government from manipulating the electorate due to short term purely electoral pressures, and in ways against the electorate's long term interests.

Nevertheless, some positions in current political debates claim that it is undemocratic to remove from the hands of the people the central bank's highly influential decision-making powers. To assess this charge, we shall consider various ways to defend democracy as a form of legitimate political authority. In the next sections I address these questions by examining the compatibility with democratic values of delegating these important powers to an independent body not subject to direct electoral accountability.

3. Democratic Authority

Before examining the legitimacy of independent financial institutions we can distinguish between two distinct responses to the problem of legitimacy of democratic authority. In the 1970s when stagflation appeared and Milton Friedman and Edmund Phelps presented their arguments in favor of independent central banks some left-wing politicians opposed their argument by claiming that independence was less likely to produce just outcomes than direct government control of monetary policy since more conservative bankers, with anti-inflationist goals, would increase unemployment. According to the macroeconomic argument, however, the good effects of an inflationary policy on employment disappear in the medium and long run while prices remain high. Critics might question that argument on economic grounds but we shall set those aside and focus on political objections to independence.

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central bank is lending money to banks or rescuing them. What remains true is that an unconstrained government might use lending of last resort to manipulate the electorate's will. See Charles Goodhart (1984) and see also Charles Goodhart and Dirk Schoemaker, "Institutional Separation between Supervisory and Monetary Agencies" Financial Markets Group, London School of Economics, Special paper 52 (1993).

The legitimacy-based objection to independent financial institutions therefore claims that it is undemocratic to remove from the hands of the people some key economic policies. I assume here that democracy is the best form of government; it is the fairer distribution of political power because it is better than dictatorship or an oligarchy composed by an elite. Still we need to respond the question of how democracy as well as being the best form of government also can possess authority over its subjects.

To begin, it is useful to distinguish between what it is to have a *right to rule*, or a claim of authority to create enforceable duties of obedience for the subjects of the authority, and what is to *rule rightly*, or make justified political decisions. Political legitimacy is understood here to involve a political authority possessing a justified right to rule. The right involves a permission to exercise coercion through law and to issue commands and thereby create valid duties for the subjects of the authority.[56] Democratic authority stands for a right to rule that involves a permission to enforce decisions by sanctioning disobedience and a claim to obey by those subject to political authority.[57]

[56] See Joseph Raz, "Authority and Justification", *Philosophy & Public Affairs*, Vol. 14, No. 1 (1985): 3-29. Nevertheless, the independent central bank does not only take decisions that can be understood as directives that others should follow, but mainly has an important role to maintain price and financial stability, which involves managing its own balance sheet, buying and selling financial assets through open market operations to adjust the intended interest rate in the markets and provide stability to financial markets. One might argue then that I'm using a *strong* conception of legitimacy while central bank's legitimacy could be reduced to a *weaker* conception like a permission to exercise power coercively. However, since the government is highly influenced by the central bank's, the latter plays a role in the process of giving reasons for action. Suppose that the central bank is ruled by a foreign country and it constrains the government's role in providing reasons for action. It seems that in the absence of a democratic justification the government's right to create moral duties of obedience and provide reasons for action would be affected by the bank's influence, and that's why a stronger sense of legitimacy is appropriate to assess independent central banks.

[57] Scott Shapiro, "Authority", *Oxford Handbook of Jurisprudence and Philosophy of Law*, eds. Jules Coleman and Scott Shapiro (Oxford: Oxford University Press, 2002): 384. Other views distinguish between the question of *authority*, what justifies that subjects to authority need to obey laws and take them as reasons for actions by virtue of its source rather than by its content, and the question of *legitimacy*, which amounts to providing a normative justification of the permission to enforce laws by the political authority over those subject to it. See Niko Kolodny, "Rule Over None II: Social Equality and the Justification of Democracy", *Philosophy & Public*

Political legitimacy is therefore understood here normatively and not merely descriptively. Citizens may accept *de facto authorities* because they are misguided or threatened by the coercive powers of a dictatorship. We, however, are concerned with *legitimate authority*, or the type of authority that is correctly regarded as legitimate and not merely accepted by those subject to it. As just explained, legitimate political authority stands for a right to rule by creating enforceable duties through directives that subjects are obliged to obey and may permissibly be sanctioned for disobeying. In addition, political legitimacy involves other kinds of rights, including the right to *external sovereignty*, which means that outsiders should not interfere in various ways with the political community's decision-making process.

Political philosophers have justified claims to legitimate political authority in different ways, and we shall focus on the authority of democratically elected governments. What, then, makes democracy a defensible way to create enforceable duties of obedience for the subjects of its authority?

The *consent theory* of political authority claims that a legitimate authority requires the consent by those subject to its commands. For the state to have authority over any person, the state must have the consent of the person subject to that authority. John Locke famously formulated this theory[58] and argued that to follow the commands of political authority involves the subordination by those subject to it. Locke argued that legitimate political authority requires consent by those subject to it because in its absence the state it violates the citizens' rights to freedom.[59] Consent theorists argue that only if I voluntarily obligate myself to comply with the state's commands do I have a duty to comply with the state.[60]

Affairs, (2014): 291. Others make a further distinction between respect for legitimate authority and the duty to obey laws. See Jeremy Waldron (1999): 111-2.

[58] John Locke, *Second Treatise on Civil Government,* (Indianapolis: Hackett, 1990 (1690)).

[59] Ibid.

[60] John Simmons, *Justification and Legitimacy: Essays on Rights and Obligations,* (Cambridge: Cambridge University Press, 2001).

The low probability that any state will secure express consent given the familiarity of permanent political disagreement creates an obvious difficulty for consent theories. In response, Locke appealed to the possibility of *tacit consent* and argued that citizens can acquire a duty to obey political authority merely by residing in a territory and benefiting from the actions of a just state.[61] Because it is often so costly to avoid acting in ways that constitute tacit consent many critics are unconvinced by this response.[62]

I will do not enter to discuss all the variations that consent theorists have proposed to overcome the problems of expressing consent to state's commands. In the rest of the chapter I will just focus on non-voluntarist approaches to legitimate democratic authority. Ronald Dworkin distinguishes between arguments claiming that political legitimacy derives from the fairness of the democratic procedure and arguments that defend democracy as the most likely system to distribute material resources and other opportunities in an egalitarian way.[63] To proceed, we can recall the distinct ways to defend the political legitimacy of democracy. *Pure proceduralism* suggests that democracy matters because of the fairness of its procedures while *instrumentalism* claims that democracy matters because obeying its directives produces the best consequences for law, policy and citizens over time when compared with any other feasible form of government.[64]

Pure proceduralism makes no appeal to any substantive standard independent of the procedure by which the outcome must be assessed. It claims that laws should be obeyed because they emerged in a way that was procedurally

[61] John Locke (1990 (1690)).

[62] Joseph Raz, "Authority and Consent", *Virginia Law Review* 67 (1981): 103-131.

[63] Ronald Dworkin, *Sovereign Virtue: The Theory and Practice of Equality*, (Cambridge: Harvard University Press, 2000): 185-190.

[64] See Thomas Christiano, "Authority", in *The Stanford Encyclopedia of Philosophy* (Spring 2013 Edition), Edward N. Zalta (ed.), URL =

<http://plato.stanford.edu/archives/spr2013/entries/authority/>.

just. In contrast, *non-pure procedural* accounts make reference to the justice of the outcomes of a fair procedure. John Rawls[65] distinguishes between three ways in which we can argue that an outcome is just because it arises from a procedure. Rawls claims that *pure procedural justice* describes situations in which there is no criterion for what constitutes a just outcome other than the procedure itself. Then Rawls makes a further distinction between *perfect* and *imperfect* procedural arguments.[66] Cases of what he terms perfect procedural justice involve a procedure that always produces outcomes that meet procedure-independent substantive standards. In contrast, there is no such guarantee in cases involving imperfect procedural justice since the procedure is only a reliable but not guaranteed method for producing outcomes that are independently justifiable.[67] Perfect or imperfect procedural arguments for a duty to obey the law both claim the resulting laws should be obeyed, and may be enforced, because the fact they emerged from a specific procedure is good evidence that they are independently justifiable.

Pure procedural arguments in democratic theories have argued that simple majority rule binds and they appeal to the assumption that majority voting sums individuals' preferences into a collective preference in a way that is fair because it attaches equal positive weight to each person's preferences.[68] The pure procedural approach is appealing to those who wish to justify a duty to obey the law in a way that might be acceptable to individuals despite their disagreements about what makes outcomes independently justifiable.

In contrast, *simple instrumentalists*, such as Richard Arneson, claim that what renders democratic authority morally legitimate is that it produces the best

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[65] John Rawls, *A Theory of Justice*, (Cambridge: The Belknap Press of Harvard University, 1999 (1971)): 74-75. See also David Estlund, "Democratic Theory," *Oxford Handbook for Contemporary Philosophy*, eds. Frank Jackson and Michael Smith (Oxford: Oxford University Press, 2006): 208-230.

[66] John Rawls (1999 (1971)): 74-5

[67] Ibid.

[68] Kenneth O. May (1952).

consequences over time when compared with any other workable form of government.[69] Proponents of mixed views, like Ronald Dworkin, argue that satisfying the majority principle is no guarantee that a political decision expresses equal concern for everyone even if it does respect the right to an equal say.[70] This is because the decisions taken by majority rule affect other people, including those who have voted against the decision. Democratic decisions always benefit some and burden others, and therefore we should care about the justice of the distribution of these benefits and burdens across society. Relying on the assumption that there exist independent standards to assess democratic decisions, the instrumentalist objection to pure procedural views questions whether we should respect a decision merely because it accords with the equally weighted preferences of the majority. Those preferences concern other individuals, and on pure procedural accounts of democratic authority there is no restriction on the outcomes these preferences might favor.

Those who appeal to independent standards to assess laws and policies may appeal solely to the effects of the democratic process on laws and policies. A *narrow instrumental* position argues that democratic procedures have *epistemic* and *coordinating* value. Those who endorse this narrow imperfect procedural view or narrow instrumentalists, as I call them, suggest that the democratic process tends to produce outcomes that are justified by independent standards because the democratic process, characterized by deliberation and the appeal to public reason, tends to enhance the quality of democratic decisions.[71] Even when

[69] Richard Arneson, "The Supposed Right to a Democratic Say", *Contemporary Debates in Political Philosophy*, eds. Thomas Christiano and John Christman (Oxford: Wiley-Blackwell, 2009): 197-212.

[70] Ronald Dworkin, *Justice for Hedgehogs*, (Cambridge: Belknap Press of Harvard University Press, 2011): 388-392.

[71] John Rawls (1999 (1971)): 199 claims that "in a well-ordered society they [the representatives of the electorate] must, nevertheless, represent their constituents in the substantive sense: they must seek first to pass just and effective legislation, since this is a citizen's first interest."

imperfect, the democratic process is legitimate because it is procedurally fair and it is epistemically the best amongst those that are better than random.[72]

Condorcet's jury theorem tries to show that collectivities can make better decisions than individuals. Suppose we have two options and that each individual is more than 50% likely to choose the correct option. Then, assuming some further conditions, as long as we increase the number of voters the probability of majority rule selecting the correct option increases.[73] On this view, democracy is the best decision-making method on the grounds that it is generally more reliable in making independently justified decisions. Democracy tends to encourage people to think carefully and rationally more than other forms of rule. Participants in democratic deliberation need to justify their arguments to others and this enhances the quality of legislation.[74] Thus, the narrow instrumental view suggests that democracy is likely to produce better effects for law and policy. It is a discovery device to obtain laws which correct individual bias and are justifiable according to independent standards.

We can oppose, at least for the purposes of clarity, narrow instrumentalism to broad instrumental views. This latter position claims that democratic procedures tend to produce better effects on laws and policies but also have broader effects on citizens because legitimate democratic authority also depends on how citizens look at the laws they live under.[75] Such broad

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[72] David Estlund, "Beyond Fairness and Deliberation", *Philosophy and Democracy: An Antology*, ed. Thomas Christiano (Oxford: Oxford University Press, 2003): 69-94.

[73] Marquis de Condorcet, *Essai sur l'application de l'analyse à la probabilité des decisions rendues à la prulalité de voix* (Paris 1785). The scope of Condorcet's jury theorem is controversial, and some argue that it is not enough to justify the value of democratic authority. See for a discussion of its limitations David Estlund, *Democratic Authority: A Philosophical Framework* (Princeton: Princeton University Press, 2008): 223-236.

[74] Thomas Christiano, "Democracy", in Edward N. Zalta (ed.) *The Stanford Encyclopedia of Philosophy* (Fall 2008 Edition) URL = <http://plato.stanford.edu/archives/fall2008/entries/democracy/>.

[75] In John Rawls, "The Basic Liberties and their Priority", *Tanner Lectures on Human Values* (1982): 13-46. Rawls claims that the basic liberties, including the fair value of political liberties, encourage the development of citizen's sense of justice and self-respect and that this is a difference with respect of *A Theory of Justice*, see footnote no. 28 in page 32. See also Martin

instrumentalism claims that democracy produces good effects on citizens because when citizens are entitled to participate in democratic decision-making they are more likely to develop an effective sense of justice. In addition, democratic rights publicly affirm the value of each individual and that supports citizens' sense of self-respect.[76]

The fair value of political liberties in Rawls has two dimensions. First, it requires that citizens have fair equality of opportunity to compete for political offices, and secondly it requires that citizens' votes weight equally, making it less likely that he concentration of economic power controls economic and political life.[77] In *A Theory of Justice* Rawls does not include the fair value of political liberties as a basis of self-respect. In contrast in his 1982 Tanner Lecture he includes them as justification of the importance of a fair democratic process and the priority of basic liberties.[78] Thus, we can argue that in *A Theory of Justice* Rawls conception of democratic authority remains a version of narrow instrumentalism which focuses on the virtue of the democratic process to produce better substantive decisions, while in the 1982 Tanner Lecture he shifts to broad instrumentalism and appeals also to the broader effects of the democratic procedure on citizens, encouraging the development of their sense of justice and self-respect.

In this section I have presented the taxonomy of the different views about legitimate democratic authority. We are concerned only with legitimate democratic authority, which genuinely creates enforceable duties of obedience

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O'Neill, "Liberty, Equality and Property-Owning Democracy", *Journal of Social Philosophy* Vol. 40 No. 3 (2009):, 379–396.

[76] Jon Elster, *The Sour Grapes: Studies in the Subversion of Rationality*, (Cambridge: Cambridge University Press, 1983): 91 goes even further and the author argues that "participation is good for those who participate, at least if the proper institutional design is chosen". However, Elster claims that participation does not enhance the quality of legislation, which enables him to justify in other parts of his work constitutional entrenchment and central bank's independence.

[77] John Rawls, *Justice as Fairness: A Restatement*, (Cambridge: The Belknap Press of Harvard University, 2001): 136-7. See also Martin O'Neill (2009).

[78] John Rawls (1982): 32.

for the subjects of its authority. In the next sections I address the question on how a normative theory of the legitimacy of democratic authority can justify the delegation of powers to the central bank by allowing the independent body to limit governmental decision-making to diminish the risk of inflation and financial instability. I look to possible justifications of the legitimacy of independent financial institutions according to the various views presented in this section. This is necessary to assess the plausibility of the claim that independent central banks undermine the legitimacy of democratic governments.

I start with a narrow instrumental defence of independent financial institutions, and then I move to broad instrumentalism. When presenting the account of independent financial institutions by these diverse defenses of the legitimacy of democratic authority I first start with Estlund's view as a distinctive version of instrumentalism that lies on the narrow conception, and then present a narrow instrumental account of independence. I also make recourse of the *service conception of authority*[79] as another example of the narrow instrumental view that can accommodate independence for instrumental reasons. I then move to broad instrumentalism, which claims that it is not enough that democratic authority tends to produce the best outcomes since we also have reasons to care about how people regard the laws and policies they live under. This opens the way to present Thomas Christiano's position as a prominent example of this type of view which takes into account procedural concerns. Finally, I claim that procedural views do not challenge the legitimacy of independent financial institutions, and I try to respond to a couple of concerns that some proceduralists might rise.

Having said all that, I have to admit that it is difficult to find authors as paradigmatic cases of the different views just presented in this section, since nowadays the majority of conceptions of legitimate democratic authority include

[79] See Joseph Raz (1985, 1986).

both instrumental and procedural elements to justify the creation of enforceable duties of obedience for the subjects of the democratic authority.

4. The Narrow Instrumental Account of Independent Central Bank's Legitimacy

The orthodox economic case in favor of central bank independence claims that independence produces better decisions and therefore it can be accommodated by narrow instrumental views of the legitimacy of democratic authority. As normally understood, the central bank should promote stable prices and financial stability. In contrast, placing monetary policy in the hands of an elected government is often claimed to be undesirable. The possibility of re-election influences government decision-making in undesirable ways. The possibility of re-election influences government decision-making in undesirable ways.

It should be noticed that in pursuing such good effects the central bank might constrain the powers of the government. If the independent central bank promotes a contractionary monetary policy and as a consequence of it, unemployment increases, the government's aim to promote employment may be compromised. Of course, since contemporary democratic systems are complex institutional schemes with a separation of powers and checks and balances, there are other institutions that might constrain the government's goals. For instance, if local governments engage in unsustainable budget deficits, they constrain the government's aim to reduce the state's deficit. Supreme courts also constrain a government's policies by declaring that the legislature has passed laws or regulations that are unconstitutional, and this may be the case most often studied by legal and political philosophers.[80] In this case, the question that I address here

[80] Jeremy Waldron, "The Core of the Case Against Judicial Review", *The Yale Law Journal* 115 (2006): 1346-1406. See also Jeremy Waldron (1999).

is whether independent central banks compromise the legitimacy of a democratic government.

Nevertheless, if we assume a narrow instrumental account of democracy, it is relevant that central banks are able to coordinate individual behaviour in the market to maintain price and financial stability, and produce better long term substantive outcomes, avoiding manipulation of the electorate by the government. Narrow instrumentalism focuses on the good effects of the decision-making process on laws and policies and therefore it can accommodate the case in favour of central bank's independence. Ideally, independent financial institutions are more likely to reach an advantageous outcome when compared to the one arising if monetary policy remains under the direct control of the government subject to short-term electoral pressures, because independence makes the bank largely immune to such pressures.[81]

David Estlund defends a version of the narrow instrumental view he terms *epistemic proceduralism*, which claims that democracy produces substantively better results than any other procedure that is acceptable to all qualified points of view.[82] And in this view it could be adequate to set up independent financial institutions to obtain better substantive decisions. Estlund claims that democracy produces substantively better results than other political arrangements like a dictatorship or an oligarchy, thus we need to accept that procedure-independent standards exist for evaluating political decisions (i.e., that decisions can be substantively better or worse than alternative decisions).[83]

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[81] The governor of the Federal Reserve Bank is appointed by the US President, and confirmed by the Senate, for a 14 years term, which makes the governor immune to the electoral cycle. See Section 10 of the Federal Reserve Act.

[82] According to Estlund, democracy continues to have authority even when it leads to the wrong result, but it would lack authority if it were not at least somewhat likely to lead to the right result. It seems though that if democracy leads to the wrong result it would lack authority and legitimacy. Estlund suggests that democratic decisions should have the moral power to create obligations by commands. Even if the commands are not independently correct it must be moral permissible to enforce such commands, coercing compliance. David Estlund (2008): 1-64.

[83] David Estlund (2008): 65-97.

On Estlund's view this does not mean that we need to be ruled by those with greatest expertise in making substantively better decisions. We might argue that some people know those standards, and how to meet them, better than others. Still their superior knowledge does not justify their political authority over others because, according to Estlund, any justification of political authority needs to be acceptable to all qualified points of view and no claim that some have superior knowledge will be acceptable to all qualified points of view.[84]

Some, then, might disagree that the members of the independent central bank are best equipped to know the truth about monetary policy. When comparing the reliability of different devices to take decisions on monetary policy, that is comparing independent central banks with an unconstrained government, we might appeal to those who disagree about the truth on monetary policy. However, they should, as qualified judges who are sufficiently well-informed, reasonably accept the orthodox economic case in favour of central bank's independence presented in Section 2 to remove from the hands of the government various monetary, regulatory and supervisory policies. By accepting such removal, we are not relying only on the superior knowledge of financial experts, but on the claim that all qualified points of view should reasonably accept that making the central bank independent from the government is more reliable because it avoids some serious political failures derived from a

[84] Estlund claims that majority rule may be morally better than a coin flip, but not because it is more fair. Thus, we shouldn't seek fairness at all costs, and so opt for a lottery to take decisions because even lottery is fairer in this case is absurd. What our opposition to a lottery reveals, according to Estlund, is that we need to appeal to some procedure-independent element. Epistemic proceduralism requires more than procedural fairness, and appeals in addition to democracy's epistemic value. Estlund's arguments correspond to what I termed narrow instrumentalism because the author highlights the good effects of democratic participation on laws and policies. However, the author also claims that legitimacy and authority must be acceptable to all reasonable qualified points of view and therefore, it might be said, that also appeals to the effects of legitimate democratic authority on citizens. Estlund claims that no doctrine is admissible as a premise in any stage of political justification unless it is acceptable to a certain range of (real or hypothetical) citizens. Presumably, when it is not the case, we wrong the person over whom we exercise that coercive power. This depends on exactly why it's so important that reasonable people must agree that democracy has epistemic value. This might be so important because democracy will then have certain effects on citizens rather than providing just better decisions. See David Estlund (2008): 206-222.

government handling with monetary policy and falling prey to time inconsistency problems. Assuming that reasonable views are sufficiently well informed to recognize this claim, our argument is not undermined by Estlund's concern to publicly justify the distribution of political authority.[85]

4.1 Independent Central Banks as Self-Binding Devices

Let's now present the *Prisoner's Dilemma* and I'll then try to show next why the famous problem is important when we discuss the political legitimacy of the central bank. The Prisoner's Dilemma is a paradigmatic example from game theory illustrating how it is possible that two rational individuals may fail to cooperate even if it is in their best interests to do so.[86]

Two members of a criminal gang are arrested and imprisoned. Each prisoner is in solitary confinement. The police admit they don't have enough evidence to convict the pair on the principal charge. They plan to sentence both to a year in prison on a lesser charge. Simultaneously, the police offer each prisoner the opportunity either to betray the other, by testifying that the other committed the crime, or to cooperate with the other by remaining silent. Here's how it goes: (i) If A and B both betray the other, each of them serves 2 years in prison; (ii) if A betrays B but B remains silent, A will be set free and B will serve 3 years in prison (and vice versa); and (iii) if A and B both remain silent, both of them will only serve 1 year in prison. To betray a partner offers a greater reward than cooperating with them and all purely rational self-interested prisoners would betray the other. So the only possible outcome for two purely rational self-interested prisoners is for them to betray each other. The interesting part of this

[85] One response to this argument will ask why draw the line between reasonable and non-reasonable views at a point that makes recognizing the time inconsistency problem as necessary in order to qualify as reasonable. It seems though that nothing Estlund say demands locating the distinction at a lower point, if we accept the orthodox economic case as a reasonable view sufficiently plausible, independence does not compromise the government's right to rule.

[86] Shaun Hargreaves-Heap, Bruce Lyons et al, *The Theory of Choice: A Critical Guide*, (Malden: Blackwell, 1992).

result is that pursuing individual reward logically leads both of the prisoners to betray even if they would get a better reward if they both cooperated.[87]

Some present the time inconsistency problem for optimal inflation policy presented above as a dynamic version of the Prisoner's Dilemma.[88] Nevertheless the government, like a group of individuals, is capable of strategic analysis. In situations involving two or more persons people have choices to make and must weigh their consequences and the expected behavior of others.[89] According to one influential defense, making a central bank independent is a *self-binding* device used by governments to avoid time inconsistency in strategic behavior. It is better for the government to tie its hands if it wants to achieve the target of price stability.[90] The independence of central bank ensures this goal by the appointment of financial experts not subject to re-election, and who can't easily be removed by the legislature. Insofar as independence involves the delegation of powers by the government it is similar to the establishment of constitutional constraints.

The government acts in a manner illustrated by the case of *Ulysses and the Sirens*. It exercises its ability to bind itself to achieve a target in the long-term.[91] Delegation in favor of an independent central bank has similar features.

[87] Steven Kuhn, "Prisoner's Dilemma", *The Stanford Encyclopedia of Philosophy* (Fall 2014 Edition), Edward N. Zalta (ed.),

URL = <http://plato.stanford.edu/archives/fall2014/entries/prisoner-dilemma/>.

[88] Jon Elster (2000): 152. One might argue, contra Elster, that the time inconsistency problem for optimal inflation policy is not a dynamic version of the Prisoner's Dilemma. Suppose the best possible government is in office but misinformed citizens would, if not manipulated by the use of money supply, choose instead a bad government in the next elections. We might argue that the government is manipulating the voters in the interest of misinformed citizens. Therefore, at least in that case, the time inconsistency problem does not imply a dynamic version of the Prisoner's Dilemma.

[89] Thomas Schelling, *Choice and Consequence*, (London: Harvard University Press, 1984): 195-212.

[90] Jon Elster famously defended this view. See Jon Elster, *Ulysses and the Sirens. Studies in Rationality and Irrationality*, (New York: Cambridge University Press, 1979); Jon Elster, "Constitutional Courts and Central Banks: Suicide Prevention or Suicide Pact?", *Eastern European Constitutional Review* No. 66; and Jon Elster (2000): 150.

[91] Jon Elster (1979): 61.

The government defers its right to rule over monetary policy to the board of directors of the independent central bank. They act on behalf of the government for determinate purposes, adding financial expertise and avoiding the dilemmas and conflicts of interest that the government face when handling with monetary policy. Thus, as I presented narrow instrumentalism as the view that claims that democratic decision-making process produce better substantive decisions, I claim that it can readily incorporate the argument that in democratic regimes with separation of powers *pre-commitment devices* are adequate to overcome time-inconsistency and they produce better effects on laws and policies.[92]

4.2 The Authority of Independent Financial Institutions as a Service to Its Subjects

The instrumental arguments in favor of an independent central bank lead to the conclusion that citizens better conform to various economic reasons, including avoiding some sorts of political failures, when the government delegates its decision-making powers into an independent central bank and they comply with central bank decisions. Instead of undermining the government's right to rule, deferring to the bank enhances the citizens' conformity with reason. In this case, for the government more choices are not always preferable to fewer choices.[93] If we look at the time inconsistency problem arising from interaction between wage setters, employers and the same government, it is defensible for the citizens to avoid the welfare cost of the government having these additional choices at its own disposal.

In cases where increased choice may bring a decline in welfare there are strategic reasons for the voters to prefer certain choices for the government to be

[92] Jon Elster (2000): 88-174. See also Joseph Raz (1986): 73. Raz argues that "sometimes by relying in indirect strategic reasons one may achieve greater conformity with the underlying basic reasons than is possible through a direct attempt to pursue them".

[93] This view was famously defended by Gerald Dworkin, "Is More Choice Better Than Less?", *Midwest Studies in Philosophy* 7 (1982): 47–61.

unavailable, as occurs in Prisoner's Dilemma situations.[94] The interaction of economic actors "give(s) raise to a dynamic version of the Prisoner's Dilemma, when the parties are all subject to dynamic or strategic inconsistency".[95] Nevertheless the government that takes into account the long term effects of its political failures has the ability to restrict its own freedom of choice and protect itself from time inconsistency by removing monetary policy from its direct control. Here benefits arise from having fewer rather than more options.

Thus, another narrow instrumental view like Joseph Raz's *service conception of authority*[96] can readily accommodate independent central banks

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[94] Gerald Dworkin (1982): 74.

[95] Jon Elster (2000): 152. See also footnote no. 64.

[96] The service conception of authority is a narrow instrumental account of the legitimacy of democratic authority which only appeals to instrumental arguments to justify political authority. Raz grounds the justification of political authority in three theses. The *dependence thesis* is a moral thesis about the way that authorities should use their powers. It claims that directives should be grounded on reasons which already independently apply to the subjects of the directives and are relevant to their action in the circumstances covered by the directive. See Joseph Raz (1985): 3-29 and Joseph Raz, "The Problem of Authority: Revisiting the Service Conception", *Minnesota Law Review* 90 (2006): 1003-1044.

The second thesis Raz terms *the normal justification thesi*.It states that the normal way to establish that a person has authority over another person involves showing that the alleged subject is likely better to comply with reasons which apply to him (other than the alleged authoritative directives) if he accepts the directives of the alleged authority as authoritatively binding and tries to follow them, rather than by trying to follow the reasons which apply to him directly.

The two first theses direct us to take authoritative requirements as exclusionary reasons. It is not the case that political authority adds nothing to our already existing duty to act correctly. If authority is already based on reasons which apply independently, and if following authority will indeed improve conformity with those reasons, then we should not take those reasons into account again upon receiving a directive. Instead we should follow the directive and leave our judgements aside. That is, law should base its requirements on those things we should do anyway, such as respect the rights of others or promote the common good. Joseph Raz claims that we are not always good in selecting the right reasons for action and that justifies the existence of laws (see Joseph Raz (1985): 15). As applied to obligations imposed by authority, Raz calls this *the pre-emptive thesis*, it claims that to take directives as exclusionary reasons means that obedience is not conditional on our assessment of the merits of the action but to act for the reason that it is required by law. The author claims that "the fact that an authority requires performance of an action is a reason for its performance which is not to be added to all other relevant reasons when assessing what to do, but should exclude and take the place of some of them." See Joseph Raz (1986): 46. Leslie Green claims that according to Raz "the directive itself is grounded in them [all other relevant reasons] and, if followed, will serve them better than would fresh judgment." Law is legitimate only if it imposes genuine moral obligations or duties on its subjects. An adequate theory of legitimacy must therefore show how law can have this kind of force. The most influential for instrumental reasons. The government best performs the service of facilitating its subjects in conforming to reason by delegating its powers. It does so to promote sound economic targets, like price and financial stability. When the powers to control the money supply, fix the monetary short term interest rate, and provide lending of last resort are delegated in favour of the independent central bank, the government facilitates the citizens to conform with these goals by obeying the law rather than follow their own judgments. Therefore, independent central banks enhance citizen's conformity with reason.

The service conception can apply to independent financial institutions when the subjects of authority would likely better comply with duties overall by treating their commands as authoritative, establishing *content independent* reasons and *preemptive* duties to obey, than by acting on the basis of their own judgements about what reason demands. In cases where it's more important that agents conform with sound dependent reasons than act on their own judgement Raz's narrow instrumental conception of authority argues that as long as the subject conforms better with reason overall by obeying certain classes of commands and if independent central banks have proved to be reasonably reliable, the subjects have a duty to obey the commands issued by the institution.[97]

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legal theories of legitimacy have been either sanction-based or rule-based. Leslie Green claims that "Austin and Kelsen, for instance, held that one has a duty if and only if one may be subject to sanctions for nonperformance. In contrast, H.L.A. Hart maintained that one has a duty if and only if the behavior in question is required by a social rule which is enforced by serious pressure to conform, thought important to social life, and which may conflict with immediate self-interest". See also Leslie Green, "Law, Legitimacy and Consent", *California Law Review*, (1989): 798-803. See also H.L.A. Hart, *The Concept of Law* (Oxford: Oxford University Press, 1961). See also the criticisms to the service conception of authority in Stephen Darwall, "Authority and Reasons for Acting: Exclusionary and Second Personal", *Ethics* 120 (2010): 257-278 and Stephen Perry, "Two Problems of Political Authority", *American Philosophy Association Newsletter* 31 (2007).

[97] The service conception does not appeal to non-instrumental arguments which correspond to the view that I termed broad instrumentalism. However, it could do so. According to the dependence thesis we might argue that amongst the reasons applying to the subjects of authority there are non-instrumental reasons like the appeal to the development of a sense of justice and self-respect. See Thomas Christiano, *Constitution of Equality: Democratic Authority and its Limits*, (Oxford: Oxford University Press, 2008): 252, footnote no. 22.

We conclude then that independent central banks help secure an advantageous long term outcome when compared to an unconstrained government under short-term electoral pressures and this seems to be sufficient for the conception of democratic authority I called narrow instrumentalism. Independence produces substantively better laws and policies, and under this view this is sufficient for their legitimacy. Indeed, independence provides reasons for action to citizens in one of the cases where it is more important that citizens conform with their dependent reasons than they follow their own judgments.

Suppose, however, that colonial invaders produce better outcomes than some fairly incompetent democratically elected local government. Surely the bare fact of superior outcome isn't enough to legitimize colonial rule? Perhaps, then, better effects are just one element in a more complex sufficient condition that legitimizes independent central bank control over monetary policy.

To address this natural objection and response, it is useful to return to the distinction between the valuable effects of democratic decision-making processes on law and policy and the broader effects on citizens themselves. The arguments for central banks considered by narrow instrumental arguments say central banks will produce better policy. But what about the broader effects on citizens? Perhaps some of these effects of independence are bad. Thus, we need to consider broad instrumentalism.

5. The Broad Instrumental Account of Central Bank Independence

The argument for independent central banks which is based only on its good long-term effects on laws and policies corresponds to a narrow instrumental view that says banks will produce better policy. From a narrow instrumentalist point of view, the right to rule of the central bank does not undermine the government's power to issue commands. It is precisely when it delegates these functions in an independent agent for strategic reasons that it enhances citizen's conformity with economic reasons. Narrow instrumentalism can explain how independent financial institutions enhance the right to rule. Yet narrow instrumentalist accounts of democracy are not the only ones existing in contemporary debates about political legitimacy, and in the view I defend here they do not provide sufficient reasons to regard institutions as legitimate.

One objection to central bank independence is that it takes citizens as ignorant short-termist citizens who are not able to control the government when it is trying to manipulate the result of the next election. One of the main political arguments against independent financial institutions claims that independence insults voters: it treats them as insufficiently competent to control politicians. Even if the government decides to inflate to manipulate the electorate, voters are competent judges and can still decline to vote for that government in the next election. However, we need first to take into account the epistemic situation of voters, since the effects of an expansionary monetary policy in inflation appear in the medium run, when economic actors adjust their expectations on inflation, well beyond the election that the government controlled of monetary policy tried to manipulate. Yet, narrow instrumentalism only claims that this epistemic situation requires us to look for an institutional design that produces better substantive decisions, regardless of citizen's attitudes towards the laws they live under, and this looks unsatisfactory.

Thus, if we want to accommodate the insult objection we need to turn into broad instrumentalism which looks also on the broader effects of democratic procedures on citizens; e.g. when citizens have a say they are more likely to develop an effective sense of justice, and when they are publicly recognized via an equal say their self-respect is likely to be more secure.

Even if independence produce better policies we might question the economists of the 1970s, like Hayek, who appeared to recommend isolating all economic decisions from democratic participation.[98] According to this view, the

[98] Friederich Hayek, *Law, Legislation and Liberty,* 3 volumes, (London: Routledge, 1979).

government tends to fiscal irresponsibility due to politicians having incentives to buy votes through excessive public expenditure. Since politicians are subject to re-election, political representatives are motivated to respond to the wishes of interest groups in the short term rather than enacting legislation for the public interest in the long term.[99] This view favours constitutionalizing independent financial institutions.

Even if this is defensible from a narrow instrumental position on the broad instrumentalist hybrid view of democracy that I find more plausible, it is important that the decision to isolate monetary policy from electoral pressure is taken by a democratic government, with popular support, which prefers the outcomes provided by independent financial institutions than the outcome provided by an unconstrained government, assuming that voters also prefer the advantageous long term outcome and protection from pre-electoral manipulation by the government. Under these conditions, it is unlikely that independence produces bad effects on citizens, feeling insulted and undermining the development of their sense of justice and their self-respect. They might think that they are wise citizens who can protect from manipulation and so the grounds to think it jeopardizes legitimacy seem weak.[100]

The same is true for analogous cases. Suppose a society committed to save for future generations realizes that there is a welfare cost if a government subject to electoral pressures is in charge of natural resources. The society judges that this welfare cost is more important than the intrinsic value of a democratically elected government making the choice of spending/saving the natural resources of the country according to a fair democratic process. As in the case of the

[99] See for a critique of this view Richard Bellamy and Albert Weale, "Political Legitimacy and European Monetary Union: Contracts, Constitutionalism and the Normative Logic of Two-Level Games", *Journal of European Public Policy*, (2015): 257-274.

[100] Further research should distinguish between short and long term effects of monetary policy, since the impact of inflation in citizen's welfare has an intertemporal dimension. See Alan M. Jacobs, *Governing for the Long Term: Democracy and the Politics of Investment*, (Cambridge: Cambridge University Press, 2011).

Norwegian Government Pension Fund, citizens might then choose to delegate these matters to an independent institution, which looks after the natural resources of the country.[101] Pre-commitment might then have clear democratic credentials. What is needed is that the delegation of powers in favor of independent financial institutions comes from a law passed by the legislature, which can indeed impose limits on the institution. If we come back to the case of natural resources, the law can forbid some kind of investments to the independent body handling with natural resources, and it can also create an ethics committee to oversee such investments.

On this broad instrumental view, we can claim that delegating some powers in an independent body, such the independent central bank, is more substantively reliable than leave monetary policy in hands of the government. If the government tries to follow the decisions made by the independent central bank in the long run it will serve better the substantive good than if it were to try to control monetary policy. Not only that, in the broader understanding of instrumentalism, it is also important how citizens regard the laws and policies they need to obey and independence might make feel them ignorant citizens easily bought-off by the government. This requires further justification if we want to claim that independent central banks are legitimate and do not constrain the government's power to create enforceable duties for its subjects. Thus, we look for a hybrid conception of the legitimacy of democratic authority which pays attention not only to the instrumental value of independent financial institutions but also to the value of democratic participation. Constitutionalizing independent financial institutions might be more reliable, from Hayek's point of view, but broad instrumentalism suggests than even democratic franchise is not a guaranteed method to obtain just outcomes according to independent standards, we have adequate reasons to promote democratic participation because when citizens have a say they are more likely to develop an effective

[101] Norwegian Government Pension Fund Act No. 123 of 21st December 2005. http://www.nbim.no/en/the-fund/governance-model/government-pension-fund-act/.

sense of justice, and when they are publicly recognized via an equal say their self-respect is likely to be more secure.

5.1 The Expressive Role of Democracy

None the less we should look more in depth at broad instrumentalism, and its requirement that the democratic collective decision-making process gives each citizen a vote in a majoritarian process with equal opportunity to influence because democratic participation enhances the development of citizen's sense of justice and protects their self-respect. A good example of this broader understanding of instrumentalism, which appeals not only to the reliability of democratic procedures but also their good effects on citizens, is Thomas Christiano's egalitarian defence of democracy.

According to Christiano, in order to publicly advance everyone's interests equally it is not possible simply to implement a substantive conception of what the equal advancement of interests involves, and then structure the common world so as to realize it.[102] There are limitations in our ability to arrive at a shared interpretation and application of a principle requiring the equal advancement of interests[103] and when democratic processes are not implemented substantive

[102] Christiano claims that a common world is a set of circumstances in which the fulfillment of all the fundamental interests of each person affects the fulfillment of all the fundamental interests of every other person. In democracy, Christiano claims, the members of a common world have not just some stake, but also an equal stake, in how their common world is structured. See Christiano (2008): 46-130.

[103] First, there are the facts of judgment: limitations in our ability to interpret and apply the principle of the equal advancement of interests, even when we are conscientiously trying. The second limitation in our ability to arrive at a shared interpretation and application of a principle requiring the equal advancement of interests claims that even when the facts of judgment obtain, people have certain interests in judgment. Christiano claims that people's interests must be advanced equally in such a way that everyone can see that his or her interests are being advanced equally, and democracy is best placed to play this important social role. One of the interests in judgment is to be at home in the world we live in: it matters to us that the world in which we live somehow matches our judgments about how it should be. Otherwise it becomes incomprehensible to us, and we feel alienated from it. In this respect, the author's views correspond to what I've termed broad instrumentalism: the good effects of democratic participation on citizens provide adequate reasons to justify democratic authority, even if it is only a reliable but not guaranteed procedure to meet independent standards of justice. See Thomas Christiano (2008): 75-95.

interests are unlikely to be equally advanced.[104] As Christiano suggests, democratic decision-making is best able to publicly treat others as equals and express the moral value of each citizen.

For this reason, democracy creates an enforceable duty of obedience for those subject to its authority because it is a fair procedure which can publicly advance the substantive good and has good effects on citizens.[105] It treats the interests of everyone as equally worthy, it expresses citizen's conformity with the world they share with others, and enhances their moral personality. For these reasons, Christiano argues that democratic processes uniquely equally advance the interests in judgment because as long as I have some influence on the process I can see the social world as somehow partly my creation, and I feel at home in my social world.[106]

In this respect, Christiano's conception of democratic authority corresponds to what I termed broad instrumentalism. Democratic participation treats people equally with respect to their interests in influence and conformity, so we feel at home in the social world we live in. Thus, it is also the form of

[104] Thomas Christiano (2008):62- 67.

[105] Nevertheless, there are limits to the authority of majority voting. We should not respect majority decisions if they violate rights that are also grounded in public equality. For Christiano those include liberal rights and an economic minimum. Liberal rights are so fundamental to protecting well-being that no society that violates them could be thought to advance the common good. Thus, any law undermining these fundamental basic liberal rights would be a clear public violation of equality, and a democratic assembly passing such law would lack authority. An economic minimum is another limit to the decisions of the democratic assembly because it is necessary for exercising liberal and democratic rights. Public equality itself sets limits to democracy. Only reasonably just governments (i.e., those that realize public equality) have legitimate authority when, indeed, they give each citizen a say in decision-making. See Thomas Christiano (2008): 158-162.

[106] Christiano rejects a pure instrumental view. The author claims that the common world should be structured so as to advance everyone's interests equally. Even the author claims that there is no reliable way in which we can treat people equally with respect to their substantive interests, we also ought to care about treating people equally with respect to certain interests in influence and conformity. Respecting democracy treats people equally in this second sense, although not necessarily equally in terms of the substantive good. On Christiano's view this is the main reason we owe a duty of obedience to the democratic authority. See Thomas Christiano (2008): 75- 95.

government we ought to have because it respects the moral personality of citizens.

Christiano could object to the legitimacy of independent financial institutions by arguing that delegation of powers to independent central bankers leaves some important political decisions with deep distributional effects in the hands of a few financial experts. The objection claims that the capacity of democratic procedures to produce good effects on citizens that justify it will be compromised by delegating such decisions to a few financial experts not subject to electoral accountability because the common world should instead be structured so as to advance everyone's interests equally. We can't select a substantive conception of what the equal advancement of interests involves, and then select a few experts so as to realize it because there are limitations in their ability to interpret and apply the principle of the equal advancement of interests, and to be publicly recognized as successfully doing so.

5.2 Central Bank's Distributional Values

Contrary to that suggestion, we grant that the government should delegate some functions in the central bank for strategic reasons. Independence is justified to avoid time inconsistency problems due to a government's pure electoral interests. It avoids a welfare cost to the long term interests of citizens. Yet to make it possible that Christiano's view can accommodate the orthodox case in favour of central bank independence, it is also necessary that the decision to isolate the government from monetary policy is taken by an elected democratic government, with popular support, which decides to protect citizens from manipulation, because this strategy corrects a collective bias created by the epistemic situation of voters.

One solution that would enhance democratic participation in monetary policy is the government or the legislature fixing its preferences on inflation. After that the independent central bank commits to this inflation target and does not allow the government to re-adjust its preferences once the other agents, wage setters and employers, have adjusted their own preferences according to the government's announcement. This division of tasks between the government, the legislature and independent financial institutions would allow the government to do not fall prey to *time-inconsistency problems* and meet the standards of broad instrumentalism.

However, even this might not be enough for broad instrumentalism. We need to respond to the objection that these experts are unlikely to satisfy the principle of equal advancement of interests. Instead of promoting the public interests, some claim that they are biased in ways favourable to the interests of the financial industry. Thus, independence should respect the values of voters, expressed when they choose a democratic government. To have a legitimate independent financial institution it is necessary that the institution is sufficiently sensitive to the values of the government. Independent financial institutions should promote and/or protect the basic distributional values of a government; they are required to avoid decisions a government makes purely due to electoral pressures but they should not be indifferent to the government's more basic values. Moreover, just because the government has delegated decision-making to the bank in order to avoid certain temptations to which the government is prone it doesn't follow that the bank has a mandate to be completely indifferent to the government's values. The bank's brief is to avoid to the time-inconsistency problem, and doing so could be achieved without complete indifference to government values, and the electorate's preferences.[107]

[107] One solution to avoid the political failures associated with an unconstrained central bank is for the government, or the legislature, to fix its preferences on inflation. After that the independent central bank commits to this inflation target and does not allow the government to re-adjust its preferences once the other agents, including wage setters and employers, have adjusted their own preferences according to the government's announcement. This division of tasks between the government or the legislature and independent financial institutions would allow the government to avoid falling prey to time-inconsistency problems. Indeed, this design is more respectful of citizen's preferences, and sensitive to their interest in political agency. Thus, it diminishes any insult associated with the case for independence. If citizens see that they ultimately are selecting monetary policy, and the independent central bank serves to secure their democratic choice against the risk of time inconsistency problems, they can also see that their democratic rights, which we take for granted are necessary for legitimate political authority, are not undermined by the delegation of powers to an independent central bank. This view is slightly

It is important to notice that even if we argue that independence can advance the interest of citizens by producing an outcome that is advantageous for all of them in the long, the effects of monetary policy are not necessarily the same for the well-off and the worse-off.[108] Even if the independent central bank avoids a welfare cost associated to an unconstrained government controlling the central bank the latter should not accept any decision of the central bank regardless of the consequences in unemployment, or more generally of its distributional consequences. So, when delegating its powers, the government should be able to ask the independent central bank to commit to the government's values abstracting from those deriving from the electoral pressures that generate time inconsistency problems.

different that the one defended by Charles Goodhart and William Buiter when they claim that independence it is only defensible to set an interest rate but with respect to financial stability the government should also participate in the central bank. Their argument might be empirically contestable, for example because it is difficult to separate monetary policy from financial stability, but in my view, there are still good instrumental reasons to maintain independence to avoid voter's manipulation, although I defend that the central bank should undertake this responsibility in accordance to government's basic distributional values. See Charles Goodhart (2010) and Willem Buiter, "The Role of Central Bank in Financial Stability. How Has it Changed?", Discussion Paper no. 8780, *Center for Economic Policy Research* (2012): 1-34. See also his lecture in:

http://www.britac.ac.uk/events/2014/Central_Banks_Powerful_Political_Unaccountable.cfm

[108] See Yan Algan and Xavier Ragot, "Monetary Policy with Heterogeneous Agents and Borrowing constraints", *Journal of Economic Dynamics* (2010): 295-316; Césaire Meh, José Víctor Rios-Rull and Yaz Terajima, "Aggregate and Welfare Effects of Redistribution of Wealth under Inflation and Price-level Targeting", *Journal of Monetary Economics* (2010): 637-652; Jonathan Kirschner, "The Political Economy of Inflation" *Journal of Economic Surveys* (2001): 1-30; Alan M. Jacobs, *Governing the Long Term: Democracy and the Politics of Investment* (Cambridge: Cambridge University Press, 2011); Alberto Alesina and Lawrence H. Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking*, Vol. 25, No. 2 (1993): 151-162; Matthias Doepke and Martin Schneider, "Inflation and the Redistribution of Nominal Wealth", *Journal of Political Economy* (2006): 1069-1097; and Mark Huggett, "Wealth Distribution in Life-Cycles Economies", *Journal of Monetary Economics* (1996): 469-494. See "Global Impact and Challenges of Unconventional Monetary Policy", *International Monetary Fund (IMF) Policy Paper*, (October 7, 2013): 1-39; Eric Santor and Lena Suchanek, "Unconventional Monetary Policies: Evolving Practices, their Effects and Potential Costs", *Bank of Canada Review* (2013): 1-15. Markus K. Brunnermeier and Yuliy Sannikov, "Redistributive Monetary Policy" Princeton University (August 2012): 1-38. See also Martin O'Neill, "Justice, Justification and Monetary Policy: The Case of Quantitative Easing", (manuscript, 2015).

In Chapter 2 I offer a *sufficientarian* account of central bank's distributional goals, according to which banks should protect and/or promote the government's most basic distributional values. I claim that there are reasons to exempt independent financial institutions from a responsibility to distribute expectations of primary goods according to the difference principle, assuming the government should endorse such principle of justice. They should, however, be part both of the stabilization branch[109] of government, and promote investment and employment, and of the transfer branch, not to provide a social minimum directly but to ensure that financial activity does not jeopardize its provision, thereby helping to satisfy one of the conditions that justifies, according to Rawls, the authority of political institutions. Even though independent financial institutions should not be regarded as duty-bound to distribute expectations of primary goods according to the difference principle they should not lie only within what Rawls terms the allocation branch of government.[110] Instead, they must also promote employment,[111] and they must protect the provision of a social minimum that gives individuals security against the systemic risks generated by financial regulation. In this way, granted that political legitimacy depends in part on securing a social minimum, a well-designed central bank might support rather than threaten legitimacy.

[109] John Rawls (1999 (1971)): 243-4. In *A Theory of Justice* Rawls distinguishes between four branches of the government: the allocation branch is to keep the price system workably competitive; the stabilization branch is to keep full employment and that free choice of occupation and the deployment of finance are supported by effective demand; the transfer branch guarantees a certain level of well-being and a social minimum; and finally the distribution branch is to preserve an approximate justice in distributive shares.

[110] John Rawls (1999 (1971)): 243-4.

[111] See Christopher Adolph, *Bankers, Bureaucrats and Central Bank Politics: The Myth of Neutrality*, (Cambridge: Cambridge University Press, 2013). The author terms "accommodation" the capacity of the central bank to be sensitive to government's unemployment policies. In Adolph's analysis it is important to see the interrelation of anti-inflationist policies, the union organisation, and government's employment policies.

5.3 Behind Closed Doors

One of the complaints regarding independent financial institutions is that the decisions by central banks are taken behind closed doors. The secrecy of the meetings[112] of the board of directors of independent central banks seems to contradict the values of public deliberation.[113] Democratic deliberation as a condition for the legitimacy of independent central banks is one of the ways by which citizens have a say and they are more likely to develop an effective sense of justice, and their self-respect is likely to be more secure. I suggest that they can be answers to such concerns by designing central banks appropriately according to broad instrumentalism.

Those who favor a deliberative conception of democracy might argue that central banks' decisions should be contestable, too, and to be so they need to be taken publicly. Some have argued that it is necessary to limit public disclosure to make a central bank effective.[114] However, legitimate independent central banks should eventually publish the minutes of their meetings, although sometimes a delay may be required to maintain efficacy. The actions of independent financial

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[112] See for example Article 6 of the Spanish Act 13/1994 of 1st of June, for the Autonomy of the Bank of Spain (*Ley 13/1994, de 1 de junio, de autonomía del Banco de España*).

[113] Joshua Cohen defines *deliberative democracy* as the view that defends that the democratic procedure is the more just process in virtue of the value of the deliberative process to elaborate laws. A deliberative democracy for Cohen is a framework of social and institutional conditions that facilitates free discussions amongst equal citizens and provides favorable conditions for participation, association and expression. It ensures the accountability of political power with regular competitive elections and publicity. Under this view, the idea of public reasoning provides justification to political authority. It is at the core of the ideal procedure of political deliberation in which participants regard each other as equals and discuss in terms that others have reasons to accept given the fact of reasonable pluralism and that others are ready to cooperate in accordance with the result of deliberation. See Joshua Cohen, "Procedure and Substance in Deliberative Democracy", in *Philosophy and Democracy: An Anthology*, ed. Thomas Christiano (Oxford: Oxford University Press, 2003). The idea of a deliberative democracy is connected to proceduralism because it highlights the virtues of a fair democratic process, and also to hybrid views like the one I termed broad instrumentalism, because the public discussion of laws and policies in which we can all participate have good effects, not only on laws but also on citizens who develop a sense of justice and their self-respect. See also Samantha Besson and José Luis Martí eds., *Deliberative Democracy and Its Discontents*, (Aldershot: Ashgate, 2006).

[114] See Xavier Freixas and Jean-Charles Rochet (2008): 245. See also Bruce Smith, "Private Information, Deposit Interest Rates, and the 'Stability' of the Banking System", *Journal of Monetary Economics* 14 (3) (1984): 294-317.

institutions should be submitted to audit controls, even more exhaustive than those applicable to private banks, and perhaps also subject to the scrutiny of an ethics committee. Democratic deliberation also requires public forums to discuss the decisions of the independent central bank. This idea may be realized by a special committee of the parliament,[115] maybe assisted by experts. To safeguard independence and satisfy the caveat regarding public disclosure of sensitive information, this public forum should deliberate *ex post* about the decisions already taken by the institution. The special committee of the parliament should also provide guidelines for future decisions of the central bank and it can be seen also as a weak form of accountability.

6. The Procedural Account of Central Bank's Independence

We also need to explain the legitimate authority of independent financial institutions against a background of permanent disagreements amongst persons about how to make decisions on monetary policy. We might do so by appealing to the fairness of the delegation of powers in the independent central bank when is taken by a democratically elected government with popular support. Taking Rawls's definition of pure proceduralism, it seems that this view does not challenge the legitimacy of independent financial institutions since to make the central bank independent is a decision taken in a fair democratic procedure with equal opportunity of influence. Even it is sometimes controversial to decide which public offices should be directly elected and which ones are suitable to be ruled by appointees nominated by elected officers, in our case delegation of powers does not seem to look problematic for proceduralism when the government taking the decision to waive its right to rule to an independent body has popular support.

[115] This is the case for the Federal Reserve Bank, the Bank of England and the Bank of Spain.

6.1 A Duty to Rule

Nevertheless, some proceduralists might assume the people have an inalienable right to make decisions over various issues that include monetary policy. In this view, the value of democratic participation is not merely instrumental, as when we claim that a democratic process with equal opportunity of influence produces better laws and policies, but it is intrinsically valuable. Some of those who argue that the value of democracy is not entirely due to its effects, might object that the bank is not politically legitimate to issue commands in the scope of the intrinsically valuable democratic decision-making process.

We should note that the idea of collective pre-commitment has been criticized with regards to judicial review and independent constitutional courts. Jeremy Waldron is well-known for arguing that the legislature is comparatively more legitimate than the constitutional court in resolving conflicts of values and issues about rights.[116] Such view claims that against a background of permanent disagreements only the rule "one person, one vote" is fair to solve the dispute between different factions while securing equal respect for everyone.[117] Since

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[116] See Jeremy Waldron (2006). See also his well-known book (1999). I need to say here that Waldron does not discuss the time inconsistency problem of optimal inflation policy. See Jon Elster (2000): 92 footnote no. 8.

[117] Jeremy Waldron argues that taking into account the "circumstances of politics" only majority voting expresses equal respect for people's opinions and preferences. Waldron claims that there are reasonable disagreements not only in the different conceptions of the good that citizens hold, but also in their conceptions of justice and issues about rights, see Jeremy Waldron (1999): 99-103 and 149-164. However, the author also defends that democratic franchise is a fair procedure because it realizes equal respect, and thus it is substantively good. We might argue that Waldron is not a pure proceduralist, since he claims that democracy it is "at best a case of imperfect procedural justice" (Waldron (1999): 155) but I think that it is useful to distinguish between the substantive qualities of the procedure, it realizes equal respect, and the desired outcome provided by democratic procedures, it realizes justice. In my view Waldron does not claim that we need to address substantive concerns regarding political outcomes, and therefore remains, at least in some of his claims, a proceduralist. Nevertheless, non-pure proceduralism and broad instrumentalism also claim that the fairness of the procedure is grounded in instrumental values like political equality. See Thomas Christiano, *Constitution of Equality: Democratic Authority and its Limits* (Oxford: Oxford University Press, 2008). See also Peter Singer, *Democracy and Disobedience*, (Oxford: Oxford University Press, 1974) and Jeremy Waldron (1999). Finally, see Thomas Christiano, *The Rule of the Many: Fundamental Issues in Democratic Theory*, (Boulder: Westview Press, 1996).

debates about monetary policy are intense and full of controversies, one might argue that it has intrinsic value that the government makes decisions on monetary policy even if it falls prey to time-inconsistency problems.

Let's suppose that a doctor offers a smoker the possibility to take some medication to help her quitting the addiction. The patient well might argue that she prefers to quit smoking without any external help, because this adds some value to his decision and moral personality. Thus, we might suppose that some could claim that the fact the voters want monetary policy off the legislative agenda it is not an adequate reason to take it off the agenda. This kind of proceduralist might also argue that even if voters, when supporting the constitution, prefer abortion removed from the ordinary legislative agenda this is not an adequate reason to enact that preference through a constitutional right. Pure proceduralists may object to the constitutional court's decision on abortion that this kind of issue engages with some of citizens' deepest convictions. Even if this rejection of delegation is plausible a similar appeal to the intrinsic value of citizens' deciding monetary policy through their representatives seems less credible. It is not one of the deepest human convictions that the government should be able to manipulate the electorate's will by using monetary policy to reduce unemployment when this strategy, in turn, deliver a less efficient outcome in the long run.

Proceduralists however might accept the delegation of powers by revising their view of the intrinsic value of deciding all decisions by majority voting. To do so, they might require only that citizens retain ultimate control over those decisions delegated to some independent agency.[118] On the revised view the decision to delegate monetary policy to an independent body is acceptable if revocable by a simple majority voting in the parliament for a government that pledges to control monetary policy directly. This is a key difference when

[118] Jeremy Waldron (1999): 55 claims that what it is important is that the people are governing themselves.

compared to the majority required for a constitutional amendment to bring back to legislative control a constitutional right. I've already claimed that for broad instrumentalists it is not plausible to claim that economic policy-making should be constitutionalized. Instead, contrary to what Hayek and some monetarists suggested, it is necessary that a majority of the legislature has the power to decide to recover direct control over the central bank and monetary policy if the democratic representatives become unconvinced of the case for pre-commitment, because that accommodates broader instrumentalist concerns for democratic participation.

In the case of independent central banks, we can argue that citizens have chosen a government that binds itself by delegating control of certain aspects of monetary policy in order to avoid voter's manipulation and the welfare costs likely to arise if government directly controlled monetary policy. Citizens have an equal say when they vote for political parties or presidential candidates according to their preferences for more or less independent central banks. During the elections citizens may also choose their representatives according to their preferences to appoint a president of the central bank committed to higher or lower rate of inflation. Independent financial institutions do have democratic credentials since their powers are delegated by a democratically elected government and their key decision-makers can be appointed by the same government.[119] One might still claim that this democratic form of pre-commitment respects a fair procedure in collective decision-making because ultimately the citizenry retains the power to rule over themselves by a majoritarian decision-making process.

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[119] Article 24 of the Spanish Act 13/1994 of 1st of June, for the Autonomy of the Bank of Spain (*Ley 13/1994, de 1 de junio, de autonomía del Banco de España*). See also Section 10 of the US Federal Reserve Act and the Bank of England Act 1998 (amended in 2009 and 2012).

6.2 Accountability

A non-pure procedural view that assumes substantive concerns regarding political outcomes play some role in making political institutions legitimate could claim that even if the delegation of powers into the independent financial institution is taken by a government with popular support, it is necessary that these agents remain accountable before their principal, the government, because only the latter is elected through a fair democratic procedure. Yet, the members of the board of an independent central bank are often not easily removable, and this helps ensure their independence from the government and the banking system. If the government was able to dismiss the delegates when they were acting against the will of the government, simply there will not be independent central banks.

Some might object to the account of independence presented here that the orthodox economic case presents the members of the independent central bank as angels who just act according to the public interest while I present the members of the government as self-interested individuals just interested in re-election.[120] However, the government might care about various things other than re-election, and it can be moved by moral motives as well as self-interest. However, even that's also controversial, some claim that there empirical evidences that independent central banks are better at controlling inflation and they avoid some political failures of an unconstrained government.[121]

[120] Christopher Adolph, *Bankers, Bureaucrats and Central Bank Politics: The Myth of Neutrality*, (Cambridge: Cambridge University Press, 2013): 31

[121] See Finn Kydland and Edward Prescott, "Rules Rather than Discretion: The Inconsistency of Optimal Plans", *Journal of Political Economy* 85 (3) (1977): 473-491; Kenneth Rogoff, "The Optimal Degree of Commitment to and Intermediate Monetary Target", *Quarterly Journal of Economics* 100(4) (1985): 1169-1188; Alberto Alesina and Lawrence Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking* 25(2) (1993):1510162; and Per Krusell and Anthony A. Smith, Jr., "On the Welfare Effects of Eliminating Business Cycles", *Review of Economic Dynamics* (1999): 245-272.

Nevertheless, there is a wide believe that independent central banks are captured by the financial industry, they take undesirable policies like austerity, and their rulings are illegitimate. So far I have argued that independent central banks might be legitimate if the right institutional design is chosen. On the broad instrumental account of the legitimacy of independent central banks, when the basic distributional values of the government are protected and the institution respects democratic participation, we might argue that independence does not undermine the legitimacy of a democratically elected government.

However, in the current negative attitudes against banks, some try to show that central banks are just a puppet of the financial industry. One of the main objections to independent financial institutions is the so-called revolving-doors argument. It claims that it is important where the members of the board of directors of the bank sat before occupying such position and where they will sit, since although they are normally appointed by the same government, many of them just come back to the financial sector once their term of office expires.[122] However, there are easier ways to avoid the revolving-doors problem and maintain the claim that full accountability will just end with the good effects of independence. The government or the legislature might easily regulate future careers of the members of independent financial institutions and limit the possibility of them working in private financial institutions once their term in office expires.[123]

Nevertheless, for some proceduralists independence remains problematic because of the lack of accountability of the members of the board of directors of the central bank. Even if desirable, a sectarian president of the independent

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[122] Christopher Adolph (2013): 70-181 claims that the different approaches of members of independent central banks to inflation or accommodation of unemployment depend on their careers, if they were members of the financial sector or bureaucrats, and he claims that their aim to secure a future position in each of the cases influence more or less inflationist policies of the institution and their disposition to accommodate governmental concerns.

[123] Of course, the argument of the capture of regulators can be more complex and further research would require a more detailed analysis.

central bank can't be easily removed,[124] and so independence might be even worse than a government in hands of monetary policy.[125] On this matter, Elster suggests that the legislature, by a majority of two thirds, should be able to remove the president of the central bank.[126] This formula is a way to make the members of the board of directors weakly accountable without undermining the virtues of independence that we deemed necessary to avoid some political failures associated to an unconstrained government in hands of monetary policy.

7. Conclusion

The present chapter offers a modest response to the challenge that independent financial institutions may pose to the legitimacy of democratically elected governments. It claims that there are good effect-based or instrumental reasons to delegate monetary policy in an independent institution like the board of directors of the central bank. Narrow instrumentalism might therefore claim that the independent central bank does not undermine the government's right to create enforceable duties of obedience for those subject to its authority. Even this is enough for that narrow view, I claim that independent financial institutions should also meet procedural concerns and look at the broader effects of the democratic procedures on citizens.

The good effects on monetary policy of independence, avoiding political failures of an unconstrained government are not enough to claim legitimate authority. The institution shouldn't be alien to citizen's preferences and values, because when voters are able to express their views in a fair democratic process and take part in the shaping of monetary policy, democracy has good effects on

[124] For example, the Governor of the Bank of England can be removed only on certain circumstances by the other members of the bank and with the consent of the Chancellor.

[125] Jon Elster (1994): 66 claims that "[Supreme] courts and [Independent Central] banks (as I shall call them for brevity) may, if unchecked, become dominated by sectarian ideologies that take no account of the public interest".

[126] Jon Elster (1994): 66-71.

them. The design of the institution just sketched in these sections emphasizes that it is not sufficient that independence has good effects in producing a better monetary policy with advantageous long-term effects. Indeed, the legitimacy of the institution needs to allow the democratic participation of citizens and their democratic representatives in the institution because this allows citizens to develop a sense of justice and secure their self-respect.

Broad instrumentalism claims this to be necessary for the legitimacy of the democratic authority, and provides adequate reasons for the legitimacy of democratic authority, even if there are more reliable processes and there is no guarantee that democratic outcomes will be independently justifiable. If we want to meet procedural standards of legitimacy such independent financial institutions, which have powers delegated by a government with popular support, need also not be indifferent to governmental values. They should be able to reject the government's instructions when they deem that they are due to pure electoral pressures but what I defend here is that they should not be indifferent to governmental values and citizens' attitudes.

The main conclusion is that independent financial institutions are not necessarily illegitimate but rather they might be legitimate if the correct institutional design is chosen. As argued by Derek Parfit, different theories can sometimes converge in supporting the same conclusions, and the case of independent financial institutions may provide a further illustration of this phenomenon.[127]

[127] Derek Parfit, *On What Matters, Volume 2*, (Oxford: Oxford University Press, 2011): 269-275.

Chapter 2: Distributive Justice and Independent Financial Institutions

1. Introduction

From the 1980's until 2008 it was often claimed that the sole responsibility of central banks was to manage the short-term interest rate and that this magic single policy was enough for securing price and financial stability. Central bankers and mainstream economists defended the view that de-regulation of financial markets was necessary to promote economic growth in a sort of 'trickle-down' economy in which increasing the earnings of asset holders would maximize benefits for the least advantaged members of society.[128] It seemed then that central banks do not have any responsibility to secure social justice.

The present chapter examines the relations between central banks and distributive justice. What distributional goals should central banks pursue? The aim is to examine how theories of social justice should assess the impact of independent central banks on distributive justice. I will work in a Rawlsian theoretical framework, and ask how Rawls's conception of democratic equality should respond to the problem of central banks and distributive justice. I distinguish different values that the government might have reason to direct the bank to pursue, and I present three alternative views. The *corrective view* claims that the independent central bank should be committed only to eliminating some sort of Pareto inefficiency arising from a government handling monetary policy. The central bank, it claims, has no responsibility for social justice, and need not consider this type of reason in its policy making.

The two alternative views claim that the division of labor between independent financial institutions seeking only efficiency and the government seeking justice should not be as radical as the corrective view claims. The first opposing view, the *coextensive view*, says independent financial institutions

[128] See for an introduction for laypersons to the causes of the current financial crisis, John Quiggin, *Zombie Economics*, (Princeton: Princeton University Press, 2009). See also Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, (New York: Vintage Books, 2011): 111-112. One of the causes of the crisis was the underestimation of the risks associated to financial innovation.

should pursue the very same distributional values that the government should pursue. And finally, the intermediate *sufficientarian view* says the central bank should pursue a set of values broader encompassing inefficiency elimination but not necessarily equivalent to those the government should pursue.

In Section 2 I begin by presenting the Rawlsian theory of justice, *Justice as Fairness*, and its component distributive ideal *democratic equality*. Section 3 presents a more general taxonomy of different candidate values for central bankers: *instrumental* and *non-instrumental*, *promotional* and *distributional*, and finally amongst the latter, *egalitarian*, *prioritarian* and *sufficientarian* values.

Section 4 presents what I call the corrective view, drawing on John Rawls's distinction between various different branches of the government.[129] On one reading of Rawls's branch distinction central banks are committed only to maintaining efficiency in the market economy. The government, which handles fiscal policy, is responsible for applying sound principles of justice in the distribution of benefits and burdens and for limiting the scope of *Pareto efficiency* to the cases in which inequalities are arranged for the maximal benefit of the least advantaged members of society. I claim that this is an unreasonable interpretation of Rawls's branch distinction, given the fact that the decisions of central banks benefit some at the expense of others and such conflicts of interest should be resolved fairly. If a central bank pursues a particular just option without consulting the government, it can't say that its choice is uniquely favoured by the elimination of inefficiency and it also can't say that it was elected. This lack of a justification for the specific choice made sounds troubling.

Counter-arguments to the corrective view claim that independent financial institutions should be guided not only by efficiency but additionally by

[129] John Rawls, *A Theory of Justice*, (Cambridge: The Belknap Press of Harvard University, 1999 (1971)): 243-244.

distributional principles. The natural question, then, is which distributional values should guide central bank's policy-making?

Section 5 presents the coextensive view, which claims that central banks should be guided by the same distributional values as the government. The view appeals to the fact that central bank is one of the main institutions of the basic structure and makes decisions that have deep distributional effects. Thus, the view claims, it should be guided by Rawls's two principles of justice. Assessing this proposal, I examine the government's distributional values, and present three different interpretations offered by philosophers of Rawls's *difference principle*, as a *principle of reciprocity*, as a *Pareto egalitarian principle* and as a *lexical prioritarian principle*. Ultimately I argue that the coextensive view is problematic because it overlooks Rawls's branch distinction, which suggests that there is a division of labour between different institutions of the basic structure, and since the central bank is not well equipped to administer the difference principle it should be guided by a narrow range of distributives objectives.

Finally, in Section 6 I present a third, arguably superior, intermediate view that argues central banks should pursue distinctive distributional values. I offer a *sufficientarian* account of central bank's distributional goals, according to which banks should protect and/or promote the government's most basic distributional values. I claim that there are reasons to exempt independent financial institutions from a responsibility to distribute expectations of primary goods according to the difference principle. They should, however, be part both of the stabilization branch of government, and promote investment and employment, and of the transfer branch, not to provide a social minimum directly but to ensure that financial activity does not jeopardize its provision, thereby helping to satisfy one of the conditions that justifies, according to Rawls, the authority of political institutions.

Finally, the sufficientarian view of the role of central banks makes sense of Rawls's conception of democratic equality. Given the deep impact of central bank's decision-making on the range of values affirmed by Rawls, the independent central bank should not pursue only efficiency. Furthermore, it acknowledges the importance of Rawls's branch distinction since the central bank it is not well equipped to distribute fairly expectations of primary goods, but needs to pursue distinctive distributional values not necessarily equivalent to those the government should pursue.

2. Rawls's Conception of Distributive Justice as Democratic Equality

The design of each society, with its laws, policies and institutions, results in different distributions of economic benefits and burdens across members of the society. The resulting economic distributions fundamentally affect people's lives and to some extent are predictable, and lie within various agents' control. Arguments about the principles that govern the design of such laws, policies, and institutions constitute the debate over 'social justice' in the sense that concerns this dissertation.[130] These principles provide moral guidance for the political processes and structures that affect the distribution of economic benefits and burdens in our society.

One of the simplest principles of distributive justice is that of strict equality, and some of its most recent advocates include Larry Temkin[131] and G. A. Cohen.[132] The principle is most commonly justified on the grounds that people are morally equal and that equality in material goods and services is the best way to recognize this moral ideal. The main objection to this solution is that there are likely to be alternative feasible allocations of material goods that make some people better off than they would be in a strictly equal distribution without

[130] Rawls treats 'social justice' as one aspect of distributive justice and as focussed on the design of the basic structure. John Rawls (1971 (1999)): 6-10.

[131] See Larry Temkin, *Inequality*, (Oxford: Oxford University Press, 1997).

[132] See Gerard Allen Cohen, *Rescuing Justice and Equality*, (Cambridge: Harvard University Press, 2008).

making anybody else worse off. Such allocations are called *Pareto superior* allocations.[133] According to G. A. Cohen, a "state A is strongly Pareto-superior to state B if everyone is better off in A than in B, and weakly Pareto-superior if at least one person is better off and no one is worse off".[134] State A is *Pareto efficient* if none can become better off without making someone else worse off.

The most influential theory of justice in contemporary political philosophy is that of John Rawls, and was first formulated at length in *A Theory of Justice* in 1971. The aim of Justice as Fairness, Rawls's theory of justice, is to combine the principles of efficiency and equality, and provide a systematic liberal egalitarian alternative to *utilitarianism*.[135] The latter claims that justice requires maximizing the sum of utility, and so affirms a purely aggregative principle. Utilitarianism is a distribution-insensitive form of *welfarism* although distribution-sensitive forms of welfarism are also possible.

Welfarists claim that whether institutions are just, is dependent on the way they distribute welfare amongst individuals. They take welfare as the standard of interpersonal comparison, the 'metric' or 'currency' of distributive justice used to determine an individual's level of advantage, and decide who is better off or worse off than others. What's crucial for utilitarian welfarists is the individual's level of utility, or level of preference-satisfaction, or some other set of facts that make a person's life worth living for her.

Instead of welfare, Rawls's view focuses on individual's lifetime expectations of social primary goods, including amongst other things wealth and income. Such a metric is not assumed to provide a plausible account of well-being. Instead Rawls supports his favored metric on the grounds that it provides

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133 Julian Lamont and Christi Favor "Distributive Justice", *The Stanford Encyclopedia of Philosophy,* (Fall 2014 Edition), Edward N. Zalta (ed.), URL =

<http://plato.stanford.edu/archives/fall2014/entries/justice-distributive/>.

134 Gerard Allen Cohen, *Rescuing Justice and Equality*, (Cambridge: Harvard University Press, 2008): 87.

135 John Rawls (1999 (1971)): xi-xii.

a plausible account on how to design political and economic institutions.[136] Another distinct view is that advanced most influentially by Amartya Sen, who focuses on *capabilities*, and claims that what is important is how individuals function and what they are capable of doing.[137]

For Rawls the primary subject of justice is the basic structure of society, or more exactly, the way in which major social institutions distribute fundamental rights and duties and determine the division of advantages from social cooperation.[138] The principles of justice for the basic structure are justified by showing they are the object of a hypothetical agreement in an original position. In this original position the representatives of society, as free, equal, and rational persons, choose the principles of justice behind *a veil of ignorance*. They do not know their place in society, class position or social status, fortune in the distribution of natural assets and abilities, or their conceptions of the good.[139] Thus, the agreements reached in the original position are fair because they are taken in an initial position of equality defining the fundamental terms of association.

Rawls argues that the parties in the original position have decisive reason to choose the following two principles of justice from a menu of alternatives, including utilitarianism:

1. Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with similar liberty for all.
2. Social and economic inequalities are to be arranged so that they are both:

[136] See John Rawls, "Social Unity and Primary Goods" in *Utilitarianism and Beyond,* Bernard Williams and Amartya Sen eds., (Cambridge: Cambridge University Press, 1982): 159-186; and also John Rawls, *Political Liberalism*, (New York: Columbia University Press, 1993): 173 - 212. Lecture V: Priority of Right and Ideas of the Good.

[137] See John Rawls, *Justice as Fairness: a Restatement*, (Cambridge: The Belknap Press of Harvard University, 2001): 168-175. Section 51 The Flexibility of an Index of Primary Goods.

[138] John Rawls (2001): 6.

[139] John Rawls (1999 (1971)): 11.

a. Attached to offices and positions open to all under conditions of fair equality of opportunity (principle of fair equality of opportunity)
b. To the greatest benefit of the least advantaged, consistent with the just savings principle (the *difference principle*).[140]

The first principle of justice and the principle of fair equality of opportunity (2a) also have economic implications. For example, the former principle protects freedom of occupational choice and so requires a labor market but, according to Rawls, can in principle be satisfied by certain forms of capitalist and liberal market socialist societies. The latter principle protects individuals from misfortune in the social lottery that shapes individuals' access to positions of authority and influence, and is standardly read as requiring that individuals with the same ambitions and level of fortune in the natural lottery have the same prospects of success in competitions for those positions. The difference principle (2b) is a distributive principle that rejects any utilitarian-like requirement to maximize the sum of benefits and instead combines concerns with efficiency and equality. Departing from strict equality, the difference principle allows inequalities as long as they maximize the expectations of the least advantaged.[141] Rawls aims to justify the institutions of the basic structure that profoundly influence the life prospects of citizens. The difference principle together with the principle of fair equality of opportunity and the basic liberty principle jointly govern the basic structure of society, the assignment of rights and duties and the division of advantages from social cooperation.

Although I work in a Rawlsian distributive framework within this chapter, it is useful to notice that philosophers have proposed several more general categories of distributive principle, which can be stated as follows:

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[140] John Rawls (1999 (1971)): 243.

[141] Many philosophers have discussed complexities in understanding the difference principle. For example, see Philippe Van Parijs, "Difference Principles", *The Cambridge Companion to John Rawls*, Samuel Freeman ed., (Cambridge: Cambridge University Press, 2003): 200-240; and Andrew Williams, "The Revisionist Difference Principle", *Canadian Journal of Philosophy*, Volume 25, Number 2, (June 1995): 257-282.

Pareto efficiency: never waste opportunities to make someone better off without making some other worse off.

Pure aggregation: maximize the sum of benefits.

Sufficiency: minimize the number of persons who fall below some threshold.

Equality: minimize the extent to which some are worse off than others through no choice of their own.

Priority: benefit individuals in a way that attaches greater urgency to benefiting the least advantaged.

As said earlier, to measure the advantage between the better-off and the worse-off philosophers have also proposed different standards of interpersonal comparison. Rawls focuses on an index of primary goods such as basic liberties, opportunities to occupy positions of authority and influence, income and wealth, and the social bases of self-respect.[142]

In Justice as Fairness the principles of basic liberty and fair equality of opportunity are lexically prior to the difference principle, so it is not permissible to compromise basic liberties to seek greater welfare.[143] The difference principle is necessary for a just distribution of benefits and burdens across the members of society in a cooperative system amongst free and equal individuals for the mutual advantage of everyone. Without the difference principle, moral arbitrary factors like the social lottery, variations in genetic endowment or historical factors would unfairly influence the distribution of primary goods. Thus, the difference principle requires that institutions arrange inequalities to ensure that individuals share the effects of luck in a manner that it is maximally beneficial to those with less luck.

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[142] John Rawls, "The Basic Liberties and their Priority", *Tanner Lectures on Human Values* (1982): 23.

[143] John Rawls (1971 (1999)): 214- 220.

Rawls departs from the benchmark of an equal distribution and takes into account economic efficiency by claiming that it is not required to stop at equal division when economic inequalities improve everyone's expectations, including those of the least advantaged.[144] If we have an initial distribution (D1) 100,100,100 it is not unreasonable to move to a Pareto superior distribution (D2) 120,150,200 even if we depart from strict equality. However, expansions in inequality are not permitted by the difference principle when they do not benefit the least advantaged, as in (D3) 90, 110, 300. As a result, Rawls regards democratic equality as an ideal of *reciprocity* that fits the ideal of citizens as not only free but equal.[145]

As noted, in distributive ethics we can distinguish between principles of equality, priority and sufficiency. The *principle of equality* claims that it is bad, or unjust, if some are worse off than others.[146] The *priority principle* establishes that the moral value of benefiting individuals diminishes as they become better off.[147] Finally, the *principle of sufficiency* states that it is bad, or unjust, if any individual have less than enough; in its anti-egalitarian variant it also states if everyone has enough it is not bad that some are worse off than others.[148]

Derek Parfit draws a distinction between principles of equality and priority.[149] To contrast them Parfit employs the well-known *levelling down objection* to equality. We compare the following distributions: (D1) 100,100,100; (D2) 120,150, 200. *Egalitarians* claim that it is in at least one respect fairer for everyone to have the same than for some to have more than others due to luck

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144 John Rawls (1993): 281-282.

145 John Rawls (2001): 124.

146 See Larry Temkin "Egalitarianism Defended", *Ethics* 113 (4) (2003):764-782. See also Larry Temkin, "Equality, Priority, and the Leveling Down Objection", in *The Ideal of Equality*, Mathew Clayton and Andrew Williams, eds. (Basingstoke: Macmillan, 2000): 126-161.

147 See Derek Parfit, "Equality or Priority?", in *The Ideal of Equality*, Mathew Clayton and Andrew Williams, eds. (Basingstoke: Macmillan, 2000): 81-125.

148 See Paula Casal "Why Sufficiency is Not Enough", *Ethics* (2007): 296-326.

149 Derek Parfit (2000): 84.

rather than choice. *Prioritarians* instead claim that it is not good to make everyone worse off in order to achieve equality. They favor discounting the moral value of a benefit as the absolute level of advantage of the recipient is raised. To defuse the levelling down objection, egalitarians may take a pluralist view. Thus, pluralist egalitarians, like Temkin, concede that D2 is better than D1 at least in the sense that the outcome is beneficial to the individuals involved but still claim that the value of an outcome depends not only on the absolute level of advantage of the individuals involved but how they do compare with each other.[150] D1 is not all things considered better than D2 but insist that D1 is in one way better than D2 because it is more equal. A pluralist view, like *Paretian egalitarianism*,[151] tries to accommodate the levelling down objection and use the efficiency principle to restrict the scope of egalitarian principles. Thus, its advocates favor the most egalitarian member of the set of non-wasteful distributions. So, imagine we can choose between D1, D2 and (D4) 100, 150,220. Pareto egalitarians will discard D1 and D4 and take D2. D1 is Pareto inferior than D2 and D4, while D4, even it is Pareto superior than D1 is less equal than distribution D2.

After this short introduction the rest of this chapter proceeds in this Rawlsian framework, although I do also make some references to several other principles of distribution. Thus, I take expectations of primary goods during lifetimes, including wealth and income, as the currency of distributive justice to measure the level of advantage of individuals and make interpersonal comparisons. The difference principle is also taken as the principle of distribution and it is analyzed in more detail in section 5. To begin with, in order to respond to the question of which distributional values should guide central

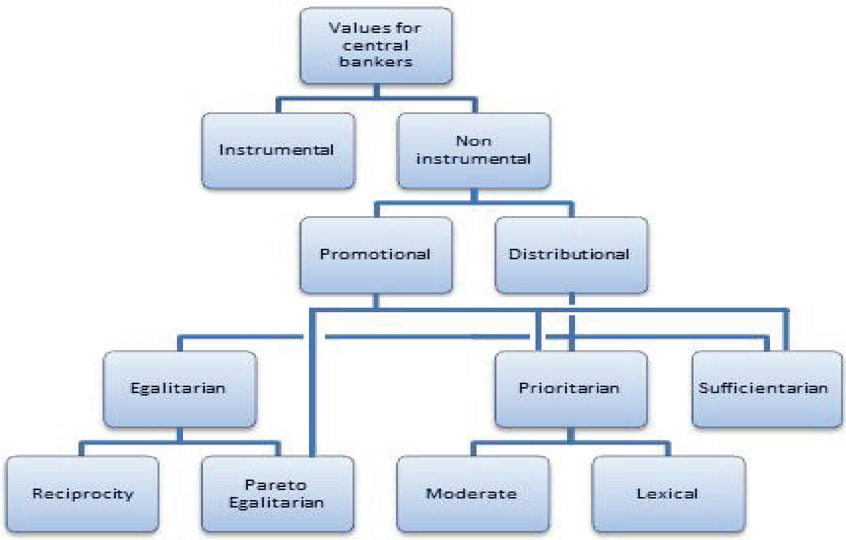
[150] See Larry Temkin (2003).

[151] See Rex Martin, *Rawls and Rights*, (Lawrence: University Press of Kansas, 1985): chapter 6. See also Andrew Mason, "Egalitarianism and the Levelling Down Objection", *Analysis*, (2001): 246-254. See finally, Nils Holtug, "A Note on Conditional Egalitarianism", *Economics and Philosophy* (2007): 45-63.

bank's decision-making, the next section presents some taxonomy of various candidate values for central bankers.

3. Candidate Values for Central Bankers

Before discussing the distributional goals that should guide central bank's policy-making it is useful to make some distinctions between different candidate values for central bankers: *instrumental* and *non-instrumental*, *promotional* and *distributional*, and finally amongst the latter, *egalitarian*, *prioritarian* and *sufficientarian*.



Independent central banks normally are, and should be, committed to instrumental values like price and financial stability, which are good due to their effects in investment and employment. Independent central banks promote certain means, or instrumental values, because the government aims to promote investment and employment. The central bank leaves end selection to the government, which normally aims to promote these goods and delegates these functions to the independent financial institution as a self-binding device to do not fall prey to time inconsistency problems arising from the political cycle. However, should central banks be committed to any other of the government's values?

As noted, instrumental values are good because of their effects. In contrast, non-instrumental values are good but not entirely due to their effects. They can be good in themselves, like a morally good will, or be good derivatively, like the value of constituent parts of wholes that are good in themselves. Within the group of non-instrumental values, it is useful to distinguish between *promotional* and *distributive* values. Distributive values are ones that guide the allocation of benefits across different individuals but, unlike promotional values, don't necessarily focus on anyone's absolute level of advantage, or require the creation of benefits. Promotional values, by definition, require producing more of something. It might also be worth distinguishing aggregative promotional values that increase the sum of benefits and non-aggregative promotional values that favor preserving or increasing benefits for *each* person.

Amongst promotional values we can also distinguish those which are *satiable* and *not satiable*. A principle is satiable if it is in principle possible to completely satisfy it, and insatiable if it is always possible in principle to satisfy it to a higher degree.[152] The promotion of average wealth, which we normally measure in terms of the GDP growth rate, lies in the category of insatiable promotional values. Like classical utilitarianism, aggregative promotional values are insensitive to the distribution of benefits and burdens amongst individuals. In contrast, distributional values are of a different kind. They guide the distribution of benefits and burdens amongst the members of society resulting from the economic, legal and political structure understood as a cooperative venture for the mutual advantage of free and equal persons. Rawls's difference principle might be understood as an exclusively distributional value that

[152] Joseph Raz, *The Morality of Freedom*, (Oxford: Oxford University Press, 1989): 235 - 236. See also Andrew Williams, "The Revisionist Difference Principle", *Canadian Journal of Philosophy*, Volume 25, Number 2, (June 1995): 257-282.

prohibits expanding inequality in ways detrimental to the least advantaged, or as a mixed value that it is both distributive since it prohibits sacrificing the less advantaged for the more advantages and promotional since requires maximizing the expectations of primary goods for the least advantaged.

For illustration imagine we can choose between the following distributions: D1 (100, 100, 100) and D2 (120, 150, 200). The distinction is important because if we take the difference principle as an exclusively distributional principle we are not required to choose D2 but permitted to choose either D1 or D2. In contrast, if we take the difference principle also as a promotional value, we can't choose any other distribution than D2, which is the distribution that maximizes the expectations of primary goods for the least advantaged.

We can now distinguish amongst various different distributional values. *Egalitarians* aim to minimize the extent to which some are worse off than others through no choice of their own. Egalitarian values might be grounded on *reciprocity*, or an aversion to benefitting at the expense of others, and might be reconciled with the Pareto principle. *Paretian egalitarians*, for instance, use the efficiency principle to restrict the scope of egalitarian principles. Thus, they favor the most egalitarian member of the set of non-wasteful distributions. *Prioritarians* instead aim to benefit individuals, and where conflicts exist about who to benefit they attach greater urgency to benefiting the least advantaged. Prioritarians care about the absolute level of welfare of the worse-off but they do not take any egalitarian principle to restrict the range of inequality when comparing advantage between the wealthy members of society and the least advantaged. *Lexical prioritarians* attach absolute priority to the interests of the least advantaged when there is a conflict while *moderate prioritarians* also attach priority to them, but not absolute priority. Finally, *sufficientarians* aim to minimize the number of persons who fall below some threshold. The doctrine of sufficiency comprises "a positive thesis stressing the importance of sufficiency and a negative thesis rejecting equality and priority."[153]

In this Section I have presented different candidate values for central bankers. If we claim that independent financial institutions should be guided by distributional values, we need to decide which of these distributional values should be pursued by the institution. However, before doing this, the next section will present the corrective view, which claims that central banks need to promote only price and financial stability eliminating some Pareto inefficiencies caused by the political failures of the government, and need not to consider distributional values in their policy-making.

4. The Corrective View

In this Section I present the corrective view, drawing on John Rawls's account in *A Theory of Justice* of what distinguishes the various different branches of the government.[154] On one reading of Rawls's branch taxonomy central banks should be committed only to maintaining efficiency in the market economy. The government, which handles fiscal policy, is responsible for applying sound principles of justice in the distribution of benefits and burdens and ensuring that inequalities are arranged for the maximal benefit of the least advantaged members of society.

153 See Paula Casal (2007): 296-326, for a critical analysis of the principle of sufficiency. Casal claims that the doctrine of sufficiency comprises "a positive thesis stressing the importance of sufficiency and a negative thesis rejecting equality and priority". She suggests to substituting the absolute requirement to maximize sufficiency for a claim that sufficiency matters greatly, and also that sufficiency supplements equality or priority rather than replace them. See the defense of the principle of sufficiency in Harry Frankfurt, "Equality as a Moral Ideal", *Ethics* 98 (1987): 21–43; "Equality and Respect", *Social Research* 64 (1997): 3–15, and "The Moral Irrelevance of Equality," *Public Affairs Quarterly* 14 (2000): 87–103. See also Roger Crisp, "Equality, Priority, and Compassion", *Ethics* 113 (2003): 745–63; and "Egalitarianism and Compassion", *Ethics* 114 (2004): 119–26.

154 John Rawls (1999 (1971)): 243-244.

The corrective view claims that the central bank should promote values other than distributional ones, including stable prices, moderate long-term interest rates and financial stability.[155] These are instrumental values that are worthy of pursuit because of their effects. The government delegates its powers to the independent central bank to ensure these instrumental values because it wants to promote investment and employment. On this view the bank is committed to price and financial stability to eliminate some form of Pareto inefficiency derived from a government handling monetary policy and does not need to take in consideration distributional reasons in its policy-making.[156]

[155] See Jon Elster, "Constitutional Courts and Central Banks: Suicide Prevention or Suicide Pact?", *Eastern European Constitutional Review* No. 66 (1994): 66-71; and also Jon Elster, *Ulysses Unbound* (New York: Cambridge University Press, 2000): 150-153. See also Milton Friedman, "The Role of Monetary Policy", *American Economic Review* 58 (1) (1968): 1-17: and Edmund Phelps "Money-Wage Dynamics and Labor-Market Equilibrium", *Journal of Political Economy* 76 (1968): 678-711.

[156] One might attribute this view to Mario Draghi when to explain his resistance to implement Quantitative Easing policies and provide liquidity to national debt bonds, argued in April, 25, 2012, that the European Central Bank was not committed to promote growth [and employment] but only to pursuit price stability, which indirectly would serve to promote growth: "Are we doing all we can for growth? Our task is not that. Our task is to ensure price stability and through this contribute to growth." See:

http://uk.reuters.com/article/uk-ecb-idUKBRE83O0CJ20120425

Article 2 of the Statute of the European Central Bank set forth that the primary objective of the European System of Central Banks shall be to maintain price stability and does not mention employment, economic growth or the real economy as targets of the central bank. One might argue though that Mario Draghi's view has changed since 2012, as the use of unconventional monetary policy and Quantitative Easing by the ECB seems to show. Still, a defender of the corrective view might claim that these unconventional policies are put in place just to avoid a risk of deflation. The case of the European Monetary Union is analyzed in part II of this thesis, as a different case than the domestic one studied in this first part of the dissertation.

In contrast to Mario Draghi's view of independent central banks, we might oppose Section 2A of the Federal Reserve Act which stipulates the monetary policy objectives of the Federal Reserve Bank of the United States: "The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."

http://www.federalreserve.gov/aboutthefed/section2a.htm.

4.1 The Orthodox Economic Case for Central Bank Independence

We can come back to the orthodox economic case in favor of central bank independence presented in Chapter I to see how the need to avoid Pareto inefficiencies favors central bank independence. The orthodox economic case involves two main arguments. The *macroeconomic argument* claims that government has an interest in re-election and to gain votes is prone to choose to expand the money supply to promote investment and reduce unemployment. In the short run, the increase in the money supply leads to a lower interest rate which leads to an increase in investment and, in turn, employment. Over time, in the medium run, price level expectations adjust and the lower unemployment rate also leads to an increase in prices. Prices are higher and distort future investment, reducing output and employment in the long run.[157] This is known as the *time inconsistency problem of optimal inflation policy*.[158]

The second argument to justify central bank independence is the *market failure argument* and refers to market failures in financial markets. An independent central bank needs to play the role of the lender of last resort, as an unconditional source of liquidity that provides financial stability. The central bank avoids this risk of contagion by acting as lender of last resort. Even so, the central bank might choose not to bail out a private bank when it's not only illiquid

[157] Olvier Blanchard, Alessia Amighini and Francesco Giavazzi, *Macroeconomics: A European Perspective*, (Harlow: Pearson Education, 2013): 248-250.

[158] In game theory *time inconsistency* refers to the incentive for one player to deviate from her previously announced course of action once the other player has moved. Governments are likely to want lower unemployment because they are subject to electoral pressures, even if it leads to inflation in the future. One political strategy to avoid the bad effects of time inconsistency problems is to make the central bank independent of political pressures. See Olivier Blanchard, Alessia Amighini and Francesco Gaviazzi (2013): 495-505. Jon Elster claims that even a government willing to keep low inflation is subject to the *time inconsistency problem for optimal policy* because the government is always subject to electoral pressures; see Jon Elster (2000): 150-153.

but insolvent too,[159] the so-called *efficient bank run*.[160] It's less probable, however, that the government can do the same. The insolvent bank takes advantage of the high political cost associated with financial crises.[161]

What I call the corrective view of the relation between central banks and distributive justice highlights this commitment to help eliminating this Pareto inefficiency, or welfare cost due to some political failures of an unconstrained government controlling the central bank.[162] Once this objective is secured, the corrective view claims that the fiscal or distribution branch in hands of the government should distribute the Pareto superior allocation of resources according to sound principles of egalitarian justice.

4.2 Rawls's Branch Distinction

To build a theory of justice committed to the corrective view, we can turn to John Rawls's conception of Justice as Fairness. In *A Theory of Justice*, Rawls argues that his two principles of justice apply primarily to the basic structure of society: the major political and economic institutions which exert deep and unavoidable effects on citizens' motives and expectations of primary goods.[163]

The difference principle regulates the differences in lifetime expectations of primary goods, and requires that such inequalities be arranged to maximize the lifetime expectations of primary goods enjoyed by the least advantaged

[159] Charles Goodhart "Why Do We Need a Central Bank?", *Banca d'Italia, Temi di discussioni* nr. 57 (1986).

[160] Xavier Freixas and Jean Rochet, *Microeconomics of Banking*, (Cambridge: The MIT Press, 2008): 217-265.

[161] Shanker Satynath "Accommodating imprudence: The political economy of information in the Asian banking crisis", unpublished manuscript, Department of Political Science, Columbia University (1999), quoted by Jon Elster (2000): 36.

[162] See Jonathan Kirschner, "The Political Economy of Inflation", *Journal of Economic Surveys* (2001): 1-30; Alan M. Jacobs, *Governing the Long Term: Democracy and the Politics of Investment* (Cambridge: Cambridge University Press, 2011); Alberto Alesina and Lawrence H. Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking*, Vol. 25, No. 2 (1993): 151-162.

[163] John Rawls (1999 (1971)): 6-10. See also his article "The Basic Structure as Subject", *American Philosophy Quarterly* (1977): 159-165.

members of society.[164] In *A Theory of Justice*, however, Rawls also distinguishes between four branches of the government: the allocation branch is to keep the price system workably competitive; the stabilization branch is to keep full employment and that free choice of occupation and the deployment of finance are supported by effective demand; the transfer branch guarantees a certain level of well-being and a social minimum; and finally the distribution branch is to preserve an approximate justice in distributive shares.[165]

The allocation and the stabilization branches of government, according to Rawls, aim to "maintain the efficiency of the market economy".[166] On this view, Rawls's theory of social justice seems to be committed to what I've called the corrective view. The central bank is committed to keep the price system competitive. In contrast, the transfer and the distribution branches are the part of the basic structure responsible to secure a sufficient level of advantage for everyone, and other demands of social justice. Following the branch distinction proposed by Rawls, the corrective view claims that there is a neat division of labor between the government and the independent central bank. The former is guided by principles of justice while independent financial institutions should promote efficiency alone.

The corrective view of how theories of justice apply to independent central banks claims that independent financial institutions should aim to promote values like stable prices, moderate long-term interest rates, and financial stability and do not need to consider distributional values in its policy making. Independence, according to the orthodox economic case, avoids the risk that due to pure electoral pressures the government manipulates the electorate against the electorate's long term interests, and has no other responsibility.

[164] John Rawls (1999 (1971)): 243.

[165] John Rawls (1999 (1971)): 243-244.

[166] Ibid.

Still, monetary policy clearly has deep distributional effects. Let's take the simplest example. To issue money is one of the primary functions of a central bank, at the core of the justification of the independence of the institution. To see the distributional consequences of central banking imagine that we are in an economic bubble and the central bank decides to increase the interest rate. This in turn will have a negative impact in investment and employment. And the impact is also substantial if we look at the consequences of an expansionary monetary policy to avoid an economic recession. It helps to stop the negatives consequences of recession on unemployment. Because the decisions of central banks benefit some at the expense of others, such conflicts of interest should be resolved fairly. If the government is faced with these choices, and selects a particular just option, it can at least say it has been elected. Now imagine a central bank that pursues a particular just option without consulting the government. It can't say that its choice is uniquely favored by the elimination of inefficiency and it also can't say that it was elected. This lack of a justification for the specific choice made sounds troubling.

The corrective view looks implausible as an interpretation of Rawls's egalitarianism because of the impact of monetary policy on employment and the deep distributional effects of financial crises, which might leave significant parts of population living under a decent social minimum.[167] If we think of Rawls as

[167]See the difference of the corrective view with that maintained by Mark Carney, the current governor of the Bank of England, who mentions in several of his speeches that economic growth and employment are also goals of the bank. See for example his speech at Cass Business School, City University, London in March 18, 2014, and that at the University of Sheffield in March, 12 2015.

http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech715.pdf
http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech808.pdf.

See also James Tobin (1972) "Inflation and Unemployment" *American Economic Review:* 1-18. See also William Phillips, "The Relationship between Unemployment and the Rate of Change of Money Wages in the United Kingdom 1861-1957", *Economica* 25 (100) (1958): 283–299. Nowadays the trade-off between employment and inflation existing according to the Phillips Curve is thought to take place between the unemployment rate and the increase or decrease in the rate of expectations in inflation. See Olivier Blanchard, Alessia Amighini and Francesco Giavazzi (2013): 220-221.

defending the value of egalitarian societies, it seems implausible to assume that his view would accept that central banks should commit *only* to eliminating certain forms of Pareto inefficiency caused by a government subject to electoral pressures. Given the deep distributional impact of central bank decision-making on the range of values affirmed by Rawls's view, it seems more likely that banks should play some role in promoting a wider set of goals. This seems even more likely if we take into account the existence of non-ideal conditions, such as international tax competition, that can limit the government's own ability to increase progressive taxation or tax capital.[168] One might argue, then, that the corrective view adopts a too strict an interpretation of Rawls's branch distinction, which does not correspond to his ideal of democratic equality. The same Rawls claims that the branch distinction does not correspond to four groups of different institutions, or the usual organization of the government, but to four main functions of the government,[169] and we might well argue that each institution plays a role in the achievement of these four branches-functions.

We need to consider then the other two alternative views. The coextensive view, which comes in the next section, is the opposing view to the corrective one just presented. It claims that the independent central bank should endorse the very same distributional values as the government. Finally, in Section 6, I present the sufficientarian view, as an intermediate position between the first two.

5. The Coextensive View

The corrective view seems to overlook that according to Rawls, the two principles of justice apply to the basic structure of society. It seems undisputable that the central bank is one of the main institutions of the basic structure of the domestic

[168] See Peter Dietsch, *Catching Capital: The Ethics of International Tax Competition*, (Oxford: Oxford University Press, 2015).

[169] John Rawls (1999 (1971): 243 claims that "these divisions do not overlap with the usual organization of the government but are to be understood as different functions."

state. Indeed, the bank's decisions have deep distributional effects on the life course of citizens. Thus, it seems more reasonable to claim, as the coextensive view does, that the independent central bank should be guided by the difference principle than claim that it needs to seek for efficiency only. In order to assess the alternatives to the corrective view I examine different distributional values that the government might endorse. Since I work in a Rawlsian framework, I assume here that the government is guided by democratic equality, and so tries to design the basic structure to satisfy fair equality of opportunity and the difference principle. Rawls claims that in the original position the hypothetical representatives choose the two principles of justice to regulate precisely the institutions of the basic structure of society as a fair system of cooperation amongst free and equal individuals in a well-ordered society for the mutual advantage of everyone. Rawls describes the major institutions of society as the political constitution and the principal economic and social arrangements. He justifies its importance for justice by appealing to their deep impact in the life prospects of citizens.[170]

So, if we're looking at the different values that the government might have reason to direct the bank to pursue, it seems that if the independent central bank is one of the major institutions of the basic structure, proponents of the coextensive view have good reasons to claim that the central bank should pursue the very same distributional values as the government. For Rawls, the difference principle requires that inequalities in income and wealth should be arranged to benefit maximally the expectations of some representative individual from the least advantaged members of society. His goal, as I've repeatedly suggested, is to provide a principle of justice which is consistent with the demands of Pareto

[170] John Rawls (1999 (1971): 6. Many authors have defended this focus in the basic structure of society. See Miriam Ronzoni, "What Makes a Basic Structure Just?", *Res Publica* 14 (2008):203–218, A. J. Julius, "The Basic Structure and the Value of Equality", *Philosophy and Public Affairs* 31 (2003): 321–355, Thomas Pogge, "On the Site of Distributive Justice: Reflections on Cohen and Murphy" *Philosophy and Public Affairs* 29 (2000): 137–169, and Andrew Williams, "Incentives, Inequality, and Publicity", *Philosophy and Public Affairs* 27 (1998): 225–247.

efficiency in the allocation of resources. Thus, the difference principle moves along the line of efficient distributions, or Pareto frontier, and favors distributions in which inequalities are arranged to the maximal benefit of the least advantaged.

It is important to note, however, that there is some debate about how to interpret the difference principle since Rawls's statements are not always clear and consistent. Some interpretations present the difference principle as requiring the promotion of benefits whilst others see merely it as disfavoring inequalities that come at the expense of the least advantaged. The next section elaborates on various possible readings of the difference principle.

5.1 Different principles

Philosophers have distinguished at least three different interpretations of the difference principle. Under the *reciprocity view* of the difference principle, any point in the set of feasible distributions is acceptable if its implementation does not expand inequalities in ways detrimental to the least advantaged (the *non-maximinimizing view*). In this view, drawn from the first of the three interpretations of the difference principle that we can find present in *A Theory of Justice*,[171] the difference principle does not require institution designers to maximize benefits available to the least advantaged; instead it simply prohibits inequalities in the distribution of primary goods detrimental to the least advantaged members of society, a requirement that, as Rawls notes, could be satisfied by a strictly equal distribution.[172] In contrast Paretian egalitarian values

[171] See John Rawls (1999(1971)): 68.

[172] See John Rawls (1999(1971)): 68. Rawls claims that "a society should try to avoid situations where the marginal contribution of those better off are negative, since, other things equal, this seems a greater fault than falling short of the best scheme when those contributions are positive. The even larger difference between classes violates… democratic equality". See also Andrew Williams, "Linguistic protectionism and wealth maximization", in *Arguing about Justice: Essays for Philippe Van Parijs,* Axel Gosseries, and Yannik Vanderborght eds. (Louvain-la-Neuve: Presses Universitaires de Louvain): 395 – 403. Williams explains these different interpretations of the difference principle and claims that the reciprocity view "does not favor any specific level of wealth maximization but merely prohibits increasing inequality in ways detrimental to the least advantaged": 399.

require eliminating Pareto inefficient allocation of resources and selecting the most egalitarian member of the set of non-wasteful distributions (*the Paretian egalitarian view*).[173] Granted certain assumptions about expectations being *close-knitted* and *chain-connected*, we can then not choose any point in the set of feasible distributions but the Pareto efficient point of this set of distributions that maximizes the advantage of the least advantaged members of society. The Paretian egalitarian interpretation of the difference principle, drawn from Rawls's *Justice as Fairness: A Restatement*,[174] allows inequalities that are not detrimental for the least advantaged and maximize their benefits. Thus, it allows a wider range of inequality in the distribution of benefits because it requires maximizing the promotion of benefits for the worse-off.[175] Finally, the requirement to maximize the benefits of the least advantaged members of society can be interpreted according to lexical prioritariansim, which makes no reference to equality but requires promoting benefits, and in cases of conflict attaching priority to benefiting the worse-off members of society (the *leximinimizing view*).[176]

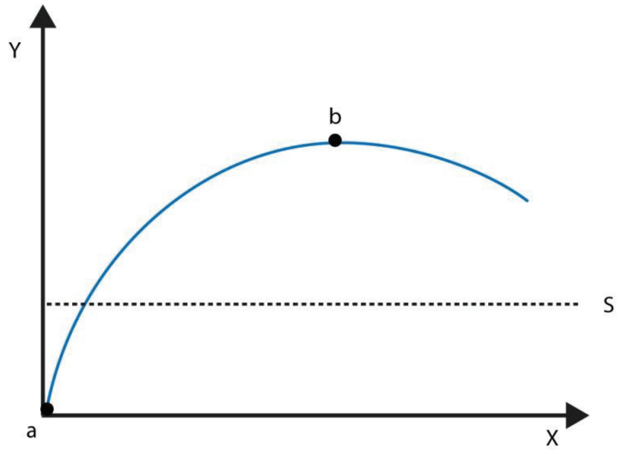
[173] John Rawls (2001): 59-60. See also Rex Martin, *Rawls and Rights*, (Lawrence: University Press of Kansas, 1985): chapter 6.

[174] John Rawls (2001): 59-60. See also his earlier article "A Kantian Conception of Equality" reprinted in *John Rawls: Collected Papers*, Samuel Freeman ed. (Cambridge: Harvard University Press, 1999): 254-266, and originally published in *Cambridge Review,* 96 (1975): 94-99.

[175] John Rawls (2001): 59-60 claims that we need to compare schemes of cooperation and then choose the scheme in which the worse-off are better-off than any other scheme. Andrew Williams (2011): 396-397 calls this interpretation of the difference principle the *maximinizing difference principle* and it is opposed to the *non-maximinizing egalitarian principle*, what he suggested me to call the reciprocity view. This view does not require maximize wealth, but merely prohibit increasing inequality in ways detrimental to the least advantaged. Some claim that this view does not allow too much inequality since, in Rawls, amongst the primary goods to distribute there is the social basis of self-respect. According to this argument, inequality undermines the self-respect of the worst-off and so limits inequalities. However, some others claim that this interpretation of the maximinimizing view is implausible since individual's self-respect does not depend on comparisons with the richest members of society.

[176] Derek Parfit (2000): 116-121 distinguishes between different interpretations of the difference principle in Rawls's texts and defends that the difference principle should be understood as a lexical prioritarian principle by virtue of which "inequality is unjust only if it worsens the position of those who are worse-off". See the Appendix "Rawls's View".

Figure 1



In the figure the horizontal axis measures the advantage of the wealthier members of society while the vertical axis measures the advantage of the least advantaged members of society. The curve is the set of feasible distributions. Then the difference principle is the principle of distribution of shares that constrains the feasible distributions. Point A is the benchmark of equality between these simplified two groups of citizens, while B marks the Pareto efficient distribution in which no one can be made better off without making anyone else worse-off. Any point to the right of B is Pareto incomparable, and prohibited according to the difference principle because it fails to maximally benefit the least advantaged members of society.

- Under the reciprocity view of the difference principle, any point in the set of feasible distributions is acceptable if it does not expand inequalities in ways detrimental to the least advantaged (the non-maximinizing view).
- In contrast, Pareto egalitarian values require eliminating Pareto inefficient allocation of resources and selecting the most egalitarian member of the set of non-wasteful distributions (the Paretian egalitarian view).

- Lexical prioritariansim makes no reference to equality but requires promoting benefits, and in case of conflict attaching priority to benefiting the worse-off members of society (the leximinimizing view).

Thus, we can distinguish three interpretations of the difference principle. Under the reciprocity view any point in the set of feasible distributions is acceptable if it does not expand inequalities against the interests of the least advantaged (any point between A and B in the figure above). In this view, drawn from the first of the three interpretations of the difference principle present in *A Theory of Justice,*[177] promoting the expectations of the least advantaged does not require maximizing their level of benefits. Instead it merely requires avoiding inequalities in expectations detrimental to the least advantaged members of society. Thus the reciprocity view might choose any point between A and B in figure 1 but it is not required to choose point B.

In contrast, Paretian egalitarian principles require eliminating Pareto inefficient allocations of resources, and choosing from amongst the set of efficient distributions in a way that minimizes inequality. The Paretian egalitarian interpretation of the difference principle, drawn by Rawls's *Justice as Fairness: A Restatement*[178] allows inequalities that are not detrimental for the least advantaged and maximize their benefits (Point B). Thus, it allows, and even favors, a wider range of inequality in the distribution of benefits because it requires securing an efficient distribution of primary goods.

Finally, the requirement to maximize the benefits of the least advantaged members of society can be interpreted according to lexical prioritarianism, which makes no reference to equality but requires only that in case of conflict of interest

[177] See John Rawls (1999 (1971)): 68.

[178] John Rawls (2001): 59-60.

we attach priority to benefiting the worse-off members of society. Thus, it also selects in figure 1 the Pareto efficient point B of the set of feasible distributions.[179]

According to the coextensive view, assuming the government is permitted by its distributive values to influence the independent central bank, subject to the constraint that it does not do so in order to enhance its chances of re-election, the independent central bank should promote the same distributional values as the government. After distinguishing the three interpretations of the difference principle, we can conclude that only the latter two views require promoting wealth rather than just ensuring that some given level of wealth is fairly distributed. So, one crucial issue, then, is whether a requirement to advance the interests of the least advantaged is a satiable or an insatiable promotional principle. We can distinguish between (i) a "consumerist" interpretation of Rawls, which requires promoting economic growth indefinitely, and expanding inequalities as long as they maximize the expectations of the worst-off and (ii) a "green" interpretation of Rawls, which once we have reached a social minimum for everyone requires us only to avoid expansions in inequality detrimental to the least advantaged. On the latter view, we have more discretion to take into account goals other than the promotion of income and wealth, such as the preservation of nature.

The corrective view claims that there is a neat division of labor between the government and the independent central bank. The former should pursue justice while the appropriate goal of independent financial institutions is only to secure price and financial stability by eliminating various inefficiencies arising from an unrestrained government controlling the central bank.

On the coextensive view, the opposing view worth exploring, contrary to the division of labor between independent financial institutions and the

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[179] In this simplified two groups figure, the lexical prioritarian and the Paretian egalitarian views of the difference principle select the same point B. In examples with three or more groups of individuals the two views just select the same point when chain connection and close-knitness condition obtains. See Andrew Williams (1995): 260.

government favoured by the corrective view, the independent central bank has to take into account the distributional values (but not the electoral interests) of the government. Independent financial institutions should also promote and/or protect the distributional values of a government guided by the difference principle.

The government may delegate its powers to the independent central bank not only to avoid some sort of Pareto inefficiency but also to reduce certain types of injustice. The government may, for example, adopt the reciprocity view. Then, departing from the benchmark of equality it can choose any point between equality and the Pareto efficient point that maximally improves the situation of the least advantaged but once everyone enjoys a social minimum it is not required to promote their wealth and income any further. Instead, assuming it has secured the social minimum, the government is required only to distribute fairly expectations of primary goods, including wealth and income, and so to avoid expanding in inequality between the well-off and the worse-off in ways detrimental to the latter group.

So, we might take the argument that economic growth promotes the maximization of the expectations of primary goods for the least advantage (the *trickle-down argument*). An advocate of the reciprocity view, however, need not accept that argument, even if it was sound, because it offers a wider range of options to the government; for example, once it has secured the social minimum it might stop at an equal distribution or choose any point between A and B in Figure 1. In contrast, the Paretian egalitarian and the lexical interpretations of the difference principle favours maximizing expectations of primary goods for the least advantaged members of society (point B in Figure 1). They need to favour economic growth *if* the trickle-down argument was true. Because of the way in which the latter view is then *fact-sensitive*,[180] it can disfavour the

[180] G. A. Cohen distinguishes between principles that are fact sensitive and those that are not. See G. A. Cohen, "Facts and Principles", *Philosophy & Public Affairs*, (2003): 211-245. See also his book, *Rescuing Justice and Equality*, (Cambridge: Harvard University Press, 2008).

promotion economic growth only if it is not the case that it maximizes the benefits of the least advantaged.

The reciprocity view offers a wider range of options to the government since it provides adequate reasons to choose between equality and Pareto efficiency, assuming it has secured the social minimum. It does not require but does at least permit promoting a *stationary state*.[181]

The reciprocity view is consistent with Rawls's *non-intrinsic egalitarianism*[182] that claims that inequality produces outcomes that are bad for various reasons. Rawls argues that inequality can be undesirable because (i) it prevents the satisfaction of people's basic needs, and (ii) can lead to inequalities in social status that encourage those of lower status to be viewed both themselves and by others as inferior. Rawls further holds that inequality can be bad insofar as (iii) it leads to the domination of one part of society by the rest. Martin O'Neill[183] claims that the badness of these outcomes, (ii) and (iii), plus others

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[181] John Rawls (2001): 63-64.

[182] See John Rawls (2001): 130-131. See also Martin O'Neill, "What Should Egalitarians Believe?", *Philosophy & Public Affairs* (2008): 119-156. O'Neill calls non-intrinsic egalitarianism the view that holds that inequality is not intrinsically bad but it is bad for the sort of reasons expressed by Rawls or Scanlon. The author distinguishes reason (i) from (ii) and (iii), adding the badness of these inegalitarian outcomes to others offered by Scanlon and Nagel: (iv) it weakens self-respect, especially the self-respect of the worst-off; (v) inequality creates servility: and (vi) it undermines fraternal social relations. The concerns (ii) - (vi) about inequality express therefore a concern about how people should live together as free and equals. As Martin O'Neill puts it "The badness of these outcomes [exploitation, domination and differences of status] can best be understood by virtue of the contrasting value of certain kinds of fraternal, egalitarian social relations." See also T. M. Scanlon, "The Diversity of Objections to Inequality," delivered as the Lindley Lecture at the University of Kansas (Lawrence, Kansas: 1996), reprinted in *The Difficulty of Tolerance* (Cambridge: Cambridge University Press, 2003): 202-18. See Thomas Nagel, "Equality", in *Mortal Questions* (Cambridge: Cambridge University Press, 1979): 106-27.

[183] See Martin O'Neill, "What Should Egalitarians Believe?", *Philosophy & Public Affairs* (2008): 119-156.

offered by Scanlon[184] and Nagel,[185] can best be understood by virtue of the contrasting value of certain kinds of fraternal, egalitarian social relations.

Non-intrinsic egalitarianism, as O'Neill calls it, offers more reasons for egalitarians who hope to withstand Parfit's Levelling-Down Objection. Explaining some of those reasons, O'Neill argues that non-intrinsic egalitarianism can still claim that there are some grounds to prefer distribution (D1) 100,100,100 than (D2) 120,150, 200. Non-intrinsic egalitarians can claim that (D1) is in various ways better for many individuals since it is more likely to preserve their self-respect or protect them from relations of domination. The sort of fraternal social relations resulting from distributive equality enable non-intrinsic egalitarians to claim, without making any reference to the intrinsic value of equality, that we have adequate reasons to secure equal distribution and limit economic growth, even when doing so fails to maximize the income and wealth of the least advantaged members of society.

The coextensive view offers the government to make this choice and then direct the bank to pursue the very same distributional goal. We have reasons to think that if the independent central bank needs to seek justice it is more reasonable that promotes the distributional choice made by a government with popular support rather than choose a just option without popular support. However, as I offered three interpretations of the difference principle and also the distinct response that they can offer to economic growth, it seems that the coextensive view can't offer a fully satisfying answer to my problem. If we want to claim that Rawls's ideal of democratic equality favours the independent central bank promoting the same distributional values as the government we

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[184] See T. M. Scanlon, "The Diversity of Objections to Inequality," delivered as the Lindley Lecture at the University of Kansas (Lawrence, Kansas: 1996), reprinted in *The Difficulty of Tolerance* (Cambridge: Cambridge University Press, 2003): 202-18.

[185] See Thomas Nagel, "Equality", in *Mortal Questions* (Cambridge: Cambridge University Press, 1979): 106-27.

would need to establish first which of the different interpretations of the difference principle is the most plausible one, and this is a matter of some debate.

The coextensive view claims that the concern to insulate monetary policy from electoral manipulation does not require the central bank to pursue only the goal of eliminating inefficiency. Independent financial institutions shouldn't be concerned only with efficiency because monetary policy has a huge distributive impact, and this favors those institutions pursuing additional goals, including the distributional ones favored by the government because whenever a policy has a distributive impact it should be guided by distributional principles.

However, do central banks need to be duty-bound to distribute lifetime expectations of primary goods according to the difference principle, assuming the difference principle applies to government decision-making? Those who endorse the corrective view can claim that the coextensive view relies on the ambitious assumption that all policies that have a deep distributive impact should be guided by the same distributional principles. This assumption is questionable since we can identify examples where policy choice has a deep distributional impact that certain decision-makers may disregard. Suppose, for example, that a government agency decides to impose on milk producers certain conditions on rearing cows (e.g. more space for each cow in their farms), and these regulations in turn will increase the price of milk for consumers. It does not look reasonable to claim the agency must attend to these distributive consequences, and has reasons against regulation because of negative distributional impact on milk consumers; it seems more likely that if this distributional effect is relevant then it should guide the decisions of some other government agency.

So, in a similar way, one might argue that if monetary policy has deep distributional effects the government must use taxation, or some other policy, to attend to the inequalities provoked by the central bank. It seems that the coextensive view does not make sense of Rawls's branch distinction and the division of labour between different institutions of the government. Even if the independent central bank is one of the institutions of the basic structure, the branch distinction suggests that Justice as Fairness does not require applying the difference principle to every institution of the basic structure. The two principles of justice instead apply to the basic structure *as a whole*. We need to look at the interplay of the different institutions of the basic structure and then assess whether the entire basic structure satisfies the two principles of justice.[186]

The coextensive view appears incapable of providing a sound justification for Rawls's branch distinction, since it claims that every institution of the basic structure should apply the difference principle and this sounds troubling. Perhaps some agencies are better equipped to pursue some of the goals of each branch of the government than others, and simply the independent central bank is not equipped to administer the difference principle.[187] We might then have no other option than to come back to the corrective view. It claims that there is a sharp division of tasks between the independent central bank and the government, and concludes that the bank does not need to consider distributive principles in its policy-making. However, in section 4 I tried to show that this was also an unreasonable interpretation of Rawls's branch distinction and Justice as Fairness. We need, then, to look to an intermediate view between the two opposing ones presented so far.

6. The Sufficientarian View

The sufficientarian intermediate view, like the coextensive view, claims that the concern to insulate monetary policy from electoral manipulation does not require that independent financial institutions pursue only the goal of eliminating inefficiency. Those institutions shouldn't be concerned only with

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[186] See Miriam Ronzoni, "What Makes a Basic Structure Just?", *Res Publica* 14 (2008):203–218.
[187] John Rawls, *Political Liberalism,* (New York: Columbia University Press, 1993): 231-240.

efficiency because there is a huge distributive impact produced by monetary policy, and this favors those institutions pursuing at least some additional goals.

Both the coextensive and sufficientarian view oppose the corrective view. However, the sufficientarian view, contrary to the coextensive view, denies that central banks should be duty-bound to distribute expectations of primary goods according to the difference principle. That does not mean that the independent central bank should be indifferent to the government's distributional values. Instead it should protect and promote the most basic distributional values of a government guided by the difference principle, and avoid decisions a government makes purely to electoral pressures.

Turning back to Rawls's branch distinction, we should recognize that the appropriate functions of independent financial institutions do not lie only within the allocation branch. Those institutions should do more than merely secure the elimination of some Pareto inefficiencies in the long run because their decisions benefit some at the expense of others, and such conflicts of interest should be resolved in ways that take, maybe not all, but some demands of fairness into account.

With this in mind, we can argue that independent central banks should also be viewed as part of the stabilization branch, which protects individuals from unemployment, since monetary policy has such deep effects on employment.[188] Although central banks do not directly secure a social minimum, they can also be compared to parts of the transfer branch because they should attempt to manage the risks generated by financial regulations in ways that avoid jeopardizing the provision of a social minimum, a precondition for any legitimate set of basic structural institutions.

[188] The central bank should protect or promote the basic values of the government, protecting people from unemployment, as suggested by the Federal Reserve Act or the speeches of Mark Carney, the current governor of the Bank of England.

In figure 1, the sufficientarian view selects line S. The independent central bank should minimize the number of persons who fall below some threshold, the social minimum. The government should then be responsible, once everyone enjoys a decent social minimum, for distributing expectations of primary goods according to additional sound principles of justice.

This interpretation makes more sense of the branch distinction offered by Rawls in *A Theory of Justice*. It denies a complete division of labour between the central bank and the government, assigns different distributional goals to each institution, but understands that both institutions should take some role in the achievement of the four different functions of the government. If this view is sound, independent central banks need to consider not only price and financial stability, and pursue economic efficiency, but satisfy the positive principle of sufficiency which states that it is bad if any individual have less than enough.[189]

Maybe the central bank shouldn't be guided by the very same principle of sufficiency as the government. Perhaps it should attend to only some rather than all threats to sufficiency; e.g. unemployment but not health insurance. Perhaps the central bank needs lots of information to be guided by some types of insufficiency, which central bankers can't be expected to possess. The argument of the sufficientarian view is that the central bank is not equipped to distribute lifetime expectations of primary goods according to the difference principle, and thus it might claim too that it shouldn't be responsible for all demands of fairness arising from its decision-making. However, it seems that the central bank is well equipped to protect citizens from unemployment and manage the risks generated by financial regulations in ways that avoid jeopardizing the provision of a social minimum, but not to attend other threats to sufficiency like health risks.

The sufficientarian view can then tackle the first objection to the corrective view. So taking into account the distributional consequences of central banking it is not reasonable for independent central banks to be committed only

[189] See Paula Casal "Why Sufficiency is Not Enough", *Ethics* (2007): 296-326.

to efficiency principles and to entirely disregard distributional values. However, it also recognizes that independent central banks should not be duty-bound to distribute expectations of primary goods according to the difference principle, since different institutions or agencies of the government might be better equipped to pursue some goals or functions rather than others.

Rawls's branch distinction suggests that there is a division of labour between the government and the independent central bank, and the latter should have a narrow range of distributive objectives. Thus, the central bank commits to a principle of sufficiency and assuming it secures the social minimum, if its policies expand inequalities in ways detrimental to the least advantaged, other branches of the government, like the distribution branch (taxation), should come to place and distribute wealth and income according to the difference principle.

The sufficientarian view of the role of independent central banks makes sense as an interpretation of Rawls's conception of democratic equality because the principle of sufficiency in Rawls supplements the difference principle.[190] The latter requires the government to maximize the distribution of lifetime expectations of primary goods for the least advantaged. So, it is possible that in the absence of the requirement of a social minimum, the worst-off need to live temporarily below a decent minimum.[191] Moreover, the principle of basic liberties takes lexical priority to the difference principle, and constrains the means available to maximize lifetime expectations for the least advantaged. In Rawls however, the social minimum is not subordinated to the principle of basic liberties, and so it is arguable that more resources should be dispensed in avoiding depravation.[192]

[190] Paula Casal (2007): 326 claims that "the difference principle is conjoined to at least three further satiable requirements, concerned with civil liberties, a social minimum, and the sustainability of liberal institutions."

[191] Paula Casal (2007): 324.

[192] Ibid.

If we assign a principle of sufficiency the role of guiding the decisions of central banks, we can finally attempt to give a response to the problem of how Rawls's theory should assess the distributional impact of central banks, since according to Rawls the provision of a social minimum is a precondition for any legitimate set of basic structural institutions.

Part II: The International Case

Chapter 3: Distributive Justice and the Eurozone

1. Introduction

Are there *duties of distributive justice* that apply amongst Eurozone member states? In the past, debates in political philosophy about the European Union have focused on the democratic deficit of European institutions, while more recently debates are also concerned with solidarity in the European Union (EU).[193]

The creation of an international institution like the Eurozone has exacerbated severe asymmetries between member states with different levels of competitiveness. Roughly speaking, due to the different levels of economic competitiveness it is not possible that the same interest rate serves the demands of all member states, including the most and the least competitive.[194] The latter have surrendered autonomy over monetary policy, and sovereign debt crises in several countries have proved that states with neither their own currency nor their own central bank are less likely to overcome financial crises.[195] European integration creates costs and benefits for the participants and this chapter explores four different arguments to claim that a distinctive international distributional branch at the EU level should exist as a result of the creation of the Eurozone.

The financial crisis in the Eurozone caused serious distributional consequences. Because of asymmetries exacerbated by the common market, the common currency, and the common monetary policy, over time less competitive

[193] See Philippe Van Parijs, "No Eurozone without Eurodividend", (provisional version, 2012): 1-21; and Andrea Sangiovianni, "Solidarity in the EU", *Oxford Journal of Legal Studies*, Vol. 33, No. 2 (2013): 213–241. See also Juri Viehoff, "Maximum Convergence on a Just Minimum: A Pluralist Justification for European Social Policy," *European Journal of Political Theory,* (forthcoming).

[194] Philippe Van Parijs (2012): 2. See also M. Feldstein, "The Failure of the Euro", *The Foreign Affairs January*/February (2012).

[195] See Katharina Pistor, "A Legal Theory of Finance", *Journal of Comparative Economics* 41 (2) (2013): 14.

countries become worse-off than others.[196] In particular, the recent economic recession and the financial crisis have worsened the situation of the least advantaged members of these countries.

Member states voluntarily created an international institution like the Eurozone to promote their mutual advantage and decided that the costs borne in generating this surplus are to be offset via intra-state solidarity. The currency union has several advantages as those arising from the common currency being adopted by other countries as a reserve currency. In addition, economic efficiency can benefit from the reduction of the transaction costs associated with international operations and from the removal of the uncertainty associated with exchange rate fluctuations.[197] However, European integration creates costs as well as benefits for the participants. With the fixed exchange rates entailed by a

[196] Martin Feldstein "The Failure of the Euro", *The Foreign Affairs*, January/February 2012: 1-8, claims that "(i)f Greece were not part of the Eurozone, its exchange rate would adjust over time to prevent this large and growing trade deficit. More specifically, the need to finance that trade deficit would cause the value of the Greek currency to decline, making Greek exports more attractive to foreign buyers and encouraging Greek consumers to substitute Greek goods and services for imports. … Greece faces the persistent problem of a rising current account deficit, which has now reached ten percent of GDP, because Greece's productivity (output per employee) increases more slowly than Germany's, causing the prices of Greek goods to rise relative to the prices of German and other European goods. …. If the ECB keeps inflation in the Eurozone at about two percent, German wages can rise by five percent a year. If Greek wages also rise by five percent a year while productivity in Greece grows by only one percent a year, the prices of Greek goods and services will increase two percent faster than the prices of German products. That increase in the relative prices of goods and services would cause Greek imports to rise and exports to stagnate, creating an increasingly large trade deficit…. Eliminating the existing current account deficit would require making Greek prices much more competitive than they are today, by reducing the cost of producing Greek goods and services by about 40 percent relative to the cost of producing goods and services in the rest of the Eurozone. Since that is not likely to be achieved by increased productivity, it must be achieved by lowering real wages relative to the real wages of Germany and other countries in the Eurozone. This would be a very painful process, achieved at the cost of years of high unemployment and declining incomes."

[197] See Philippe Van Parijs (2012): 2. The author claims though that "these advantages, however, come at the cost of greater rigidity. If one country with its own distinct currency becomes less competitive relative to its trading partners, it can adjust smoothly by letting its currency devalue relative to that of its trading partners, thereby making it easier for its products to compete with foreign products both at home and abroad, while spreading the cost of the adjustment throughout the population in the form of higher prices for foreign goods (including trips abroad, for example) and any other goods whose production includes foreign goods. By contrast, with the fixed exchange rates entailed by a common currency, no such option is available, and the trade imbalance induced by the divergence in competitiveness is reflected in increased unemployment and its various unwelcome consequences."

common currency, devaluation is not an available option, and the trade imbalance induced by the divergence in competitiveness amongst member states may be reflected in increased unemployment and its various unwelcome consequences for the less competitive members.[198] Provided that they cannot make adjustments with their own currency or central bank, the least advantaged members of these countries are less well protected from unemployment and recession, and no other mechanism to protect them of these evils has been put in place in the European Monetary Union.[199]

In light of these assumptions, the present chapter would like to explore four different arguments to claim that a distinctive international distributional branch at the EU level should exist as a result of the creation of the Eurozone. The conclusion is that the four arguments provide *pro tanto reasons* to claim that the asymmetries exacerbated by EU integration cannot adequately be dealt with by relying only on *intra-state solidarity*.

Section 2 is a brief summary of Rawls's conception of international distributive justice. Negatively speaking, the view rejects extending the difference principle across the world because doing so would be insufficiently sensitive to the value of collective self-determination and collective liability. Positively speaking, Rawls claims that nation states nevertheless do have a *duty of assistance* towards other states and that they need to comply with demands of justice towards *burdened societies*,[200] which implies that principles of fairness apply to states that have more than enough, like the members of the Eurozone. The present chapter draws on these Rawlsian ideas of international fairness and others, like the duty to build and maintain just institutions, and collective self-determination, to present two arguments which are meant to justify that principles of fairness apply amongst wealthy member states of the Eurozone. In

[198] See Philippe Van Parijs (2012):2; and Martin Feldstein (2012): 1-8.

[199] See Martin Feldstein (2012).

[200] John Rawls, *The Law of Peoples*, (Cambridge: Harvard University Press, 1999 (1993)).

addition, I provide two more arguments that look at the European Monetary Union in light of cooperative justice and insurance.

The *fair adjusted procedural argument* claims that cooperation amongst the member states is legitimately subject to negotiation and voluntary agreement, and that member states should be liable for the treaties they entered into with other member states. It grants that there is no general requirement to regulate distribution of costs and burdens amongst member states, but it claims that some morally mandatory aims, some outcomes, must be satisfied by freely negotiated agreements.[201] Treatises bind only if they are fairly negotiated and sensitive to some distributive conditions regarding outcomes; e.g. one requiring that all member states can guarantee a social minimum.

I then move to a more general argument: the *collective self-determination argument*, which extends an egalitarian concern with the value of *non-domination*[202] amongst individuals to the relations between collective agents. The argument claims that the interdependence amongst member states in the

[201] Thomas Christiano, "Climate Change and State Consent", in *Climate Change and Justice*, Jeremy Moss ed. (Cambridge: Cambridge University Press, 2015): 17-38.

[202] See John Rawls, *Justice as Fairness: a Restatement*, (Cambridge: The Belknap Press of Harvard University, 2001): 130-131. See also Martin O'Neill, "What Should Egalitarians Believe?", *Philosophy & Public Affairs* (2008): 119-156. O'Neill calls non-intrinsic egalitarianism the view that holds that inequality is not intrinsically bad but it is bad for the sort of reasons expressed by Rawls or Scanlon. Rawls argues that inequality can be undesirable because (i) it prevents the satisfaction of people's basic needs, and (ii) can lead to inequalities in social status that encourage those of lower status to be viewed both themselves and by others as inferior. Rawls further holds that inequality can be bad insofar as (iii) it leads to the domination of one part of society by the rest. Martin O'Neill claims that the badness of these outcomes, (ii) and (iii), plus others offered by Scanlon and Nagel can best be understood by virtue of the contrasting value of certain kinds of fraternal, egalitarian social relations. The author distinguishes reason (i) from (ii) and (iii), adding the badness of these inegalitarian to others offered by Scanlon and Nagel: (iv) it weakens self-respect, especially the self-respect of the worst-off; (v) inequality creates servility: and (vi) it undermines fraternal social relations. The concerns (ii) - (vi) about inequality express therefore a concern about how people should live together as free and equals. As Martin O'Neill puts it "The badness of these outcomes [exploitation, domination and differences of status] can best be understood by virtue of the contrasting value of certain kinds of fraternal, egalitarian social relations." See also T. M. Scanlon, "The Diversity of Objections to Inequality," delivered as the Lindley Lecture at the University of Kansas (Lawrence, Kansas: 1996), reprinted in *The Difficulty of Tolerance* (Cambridge: Cambridge University Press, 2003): 202-18. See Thomas Nagel, "Equality", in *Mortal Questions* (Cambridge: Cambridge University Press, 1979): 106-27.

EU erodes the international background conditions of justice and the capacity of states to exercise the appropriate level of control over their political choices, and assumes this is a sufficient reason to call for principles of fairness to ensure that member states are reasonably free from domination by the strongest states.[203]

The third argument, the *fair entitlement argument*, claims that the EU and Eurozone can be seen as a cooperative venture to generate a surplus and then asks how we should distribute the gains from it.[204] *Cooperative justice* requires that when distributing the surplus generated by EU integration each member state receives an equal return calculated according to the cost of its contribution to generating that surplus.

Finally, many authors assume that international institutions' failure of protect states against suffering some luck-based inequality is objectionable. Exploring this position, I move then to the fourth argument, the *luck sharing argument*, which claims that the most advantaged and the least competitive member states of the Eurozone should protect their citizens from insufficiency and material deprivation. To do so they should mimic a *hypothetical insurance market* by supplying compulsory insurance at a fixed premium for everyone on the basis of speculations about what the average member state would have purchased insurance had the antecedent risk of various economic shocks been equal.[205]

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[203] Miriam Ronzoni, "The Global Order: A Case of Background Injustice? A Practice-Dependent Account", *Philosophy & Public Affairs* 37, no. 3, (2009): 248.

[204] Here I follow the justification of cooperative justice to distribute the costs and benefits of a lingua franca in Philippe Van Parijs, *Linguistic Justice for Europe and for the World*, (Oxford: Oxford University Press, 2009): chapter 2.

[205] Ronald Dworkin, *Sovereign Virtue: The Theory and Practice of Equality*, (Cambridge: Harvard University Press, 2000): 80.

1.1 Some Remarks about the Eurozone

I should start with a brief description of the design of the Eurozone. Monetary policy of the zone is the responsibility of the European Central Bank (ECB) and the European System of Central Banks (ESCB), which comprises the ECB and the central banks of the EU member states who have joined the euro. The principal task of the ECB is to keep inflation under control.[206] Though there is no common representation, governance or fiscal policy for the currency union, some cooperation does take place through the Eurogroup. The Eurogroup is composed of the finance ministers of the Eurozone member states who meet a day before a meeting of the Economic and Financial Affairs Council of the European Union (Ecofin). The Eurogroup is not an official council formation but when the full EcoFin council votes on matters only affecting the Eurozone only Eurogroup members can vote on it.[207]

Member states have been negotiating since the beginning of the Eurocrisis on the policies to deal with the crisis, including the Stability and Growth Pact, the Treaty on Stability, Coordination and Governance, the European Financial Stabilisation Mechanism (EFSM) and its successors in the European Financial Stability Facility and the European Stability Mechanism. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)

[206] Article 2 of the Statute of the European Central Bank set forth that the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Union and the ESCB shall act in accordance with the principle of an open market economy with free competition. See the difference with the Federal Reserve act that mentions employment as one of the goals of the US central bank.

[207] If it is difficult to identify the EU parliament with the legislature of a domestic state, it is even more difficult to claim that it is the parliament of the Eurozone. This is one of the main differences between the domestic case presented in Part I and the Eurozone. Not all countries represented in the EU parliament are members of the Eurozone. The ECB powers are not limited by a law passed by the European Parliament. Rather it is an institution derived from the Lisbon Treatise and the statute of the ESCB and the ECB, signed by the member states of the Eurozone. Indeed, the EU parliament does not have the power to recover control over monetary policy. The powers of the ECB then are limited by international conventions. Furthermore, the European Central Bank can't commit to the basic distributional values of a democratically elected government, since there is no such democratic government in the Eurozone. See Article 129 of the Treatise of the European Union and Protocol no. 4 of the Statute of the European System of Central Banks and of the European Central Bank.

includes the Fiscal Compact, by virtue of which member states have committed to ensure that national budgets are in balance or in surplus.[208]

It seems clear that the political design of the Eurozone raises questions about the political legitimacy of the European Central Bank and the Eurozone.[209] We might ask, for example, whether democratic states should have designed the system of authority within the EMU differently and whether they can bind themselves via treaty to uphold the existing system. I'm not going to address these important questions here but focus on questions about the degree to which solidarity is desirable amongst the Eurozone member states. The financial crisis in the Eurozone did and still does have serious distributional consequences, and countries like Greece when facing the economic recession had sunk into a "vicious spiral" which led to a sovereign debt crisis and the market's fear of Greece insolvency.[210]

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[208] Richard Bellamy and Albert Weale, "Political Legitimacy and European Monetary Union: Contracts, Constitutionalism and the Normative Logic of Two-Level Games" *Journal of European Public Policy*, (2015): 257-274.

[209] See Richard Bellamy and Albert Weale (2015); Francis Chevenal and Frank Schimmelfennig, "The Case for Demoicracy in the European Union", *Journal of Common Market Studies* 51(2) (2013): 334-50; Kalypso Nicolaïdis, "European Demoicracy and its Crisis", *Journal of Common Market Studies* 51(2) (2013): 351-69; Fritz Scharpf, *Governing in Europe: Effective and Democratic?*, (Oxford: Oxford University Press, 1999); Fritz Scharpf "Monetary Union, Fiscal Crisis and the Preemption of Democracy", MPIfG Discussion Paper 11/11, Munich: Max Planck Instituten für Gesellschaft; and Philippe Van Parijs, "Demos-cracy for the European Union: Why and How" (manuscript, 2013).

[210] Philippe Van Parijs (2012): 6, explains that troubled countries of the Eurozone had to increase social benefits for the increasing number of unemployed workers and transfer funds to the troubled financial private institutions. These factors, in turn, made the country engage in unsustainable public deficits and the government had to reduce public budgets and increase taxes. This in turn had the predictable but undesired effect of decreasing local demand and deepening the economic recession.

See also Christian Barry and Matt Peterson, "Who Must Pay for the Damage of the Global Financial Crisis", in *Global Financial Crisis: The Ethical Issues*, Christian Barry Ned Dobos and Thomas Pogge, eds. (Basingstoke: Palgrave Macmillan, 2011): 161-162, for the explanation of the same "vicious spiral" in international financial crises which lead to the impossibility to comply with internal demands of justice in order to face "contractual debt obligations."

The debates about the powers of the European Central Bank regard the existence of the anti-bailout clause (article 125 of the EU Treatise) and the prohibition for the European Central Bank to expand the money supply by purchasing national debt bonds to finance budget deficits. These powers for the ECB can provide the central bank a channel to provide liquidity to national bond markets smoothly and avoid the market's fear of insolvency of any member state. These powers at the end can diminish the effects of the "vicious spiral" of financial and sovereign debt crises. Greece, Spain and other member states claim that it is necessary that the ECB provides liquidity to their public debt and sustain budget deficits, to protect the least advantaged members of these societies. Nevertheless, these debates take place along with debates about the inequalities generated by EU integration. As said before, over time asymmetries exacerbated by the common market, the common currency and the common monetary policy tend to make less competitive countries worse off than their competitors.[211] In particular, the economic recession and the financial crisis have worsened the situation of the least advantaged citizens of these countries relative to that of the least advantaged citizens of other member states.

2. Rawls's Conception of International Distributive Justice

The Rawlsian view of international distributive justice roughly says that national states owe a *duty of assistance* to certain other states, and in particular to *burdened societies*,[212] like those in great need derived from war, famine or natural disasters. In general, since states need to guarantee human rights and an economic minimum for their members, peoples have a duty of assistance towards countries that cannot achieve a liberal or a decent regime capable of providing a humanitarian minimum for its subjects.

[211] Martin Feldstein (2012): 6-7.

[212] John Rawls, *The Law of Peoples*, (Cambridge: Harvard University Press, 1999 (1993): 35-44.

Rawls's view claims that according to the principles agreed for a society of liberal and decent peoples,[213] egalitarian principles of distributive justice apply at most to the *domestic* basic structure. In a just international order satisfying the *Law of Peoples* national societies are seen as reasonable moral agents responsible for the inequality-involving consequences of their choices, for example, about saving, consumption, and demographic change.[214] According to the Rawls's account of the international original position, democratic and non-democratic but decent states would agree to arrange cooperation amongst them to preserve their freedom, independence and sovereign equality and affirm a duty to observe treatises.[215]

Within contemporary political philosophy it is common to distinguish two major schools of thought regarding global distributive justice. *Cosmopolitans*, as I shall use the term, are those who affirm egalitarian duties of distributive justice amongst individuals, and claim they apply beyond across the borders of states.[216] On the other hand, *liberal statists* claim that the requirement to display equal concern in political decision-making arises *only* within institutions that claim legitimate political authority over individual subjects, who are assumed to be morally obliged to obey the institutions' commands, and may permissibly be punished if they fail to do so. This sort of legitimate political authority exists only at the domestic level, and therefore special egalitarian duties of distributive

[213] Rawls provides a list of eight principles of justice that would be agreed by liberal and decent peoples: 1. Peoples are free and independent, and their freedom and independence are to be respected by other peoples. 2. Peoples are to observe treaties and undertakings. 3. Peoples are equal and parties to the agreements that bind them. 4. Peoples are to observe a duty of non-intervention. 5. Peoples have the right of self-defense but no right to instigate war for reasons other than self-defense. 6. Peoples are to honour human rights. 7. Peoples are to observe certain specified restrictions in the conduct of war. 8. Peoples have a duty to assist other peoples living under unfavourable conditions that prevent them having a just or decent political and social regime, John Rawls, (1999 (1993)): 37.

[214] Philippe Van Parijs, "International Distributive Justice", in *A Companion to Contemporary Political Philosophy*, Robert Goodin and Philip Pettit eds., (Malden: Blackwell, 2007): 642.

[215] John Rawls (1999 (1993)): 37.

[216] Thomas Pogge, "An Egalitarian Law of Peoples" *Philosophy & Public Affairs*, (1994): 195-224.

justice, claim liberal statists, exist only amongst co-citizens of a sovereign domestic state.[217]

Rawls's view appears to be closer to that of the liberal statists. Thus, he does not clearly state any substantive egalitarian principle to govern cooperation amongst sovereign peoples for a well-ordered society of liberal and decent peoples. His international original position is different than the domestic one where the representatives choose the difference principle to govern a fair system of cooperation in a well-ordered domestic society.[218] Rawls is quite clear when he discards a global difference principle. He instead claims that there is a duty of assistance towards burdened societies and that this is a principle with a target. It is therefore a principle that it is *satiable* since it holds until a burdened society has achieved a just regime as a liberal or decent people.[219] The duty of assistance has a target after which aid may cease, namely, the point at which a society has become well ordered. It does not mandate the establishment of international institutions to regulate inequalities. In this respect, the duty of assistance is more like Rawls's *just savings principle*, requiring a society to save only to the point where it can support just institutions and a decent life for its people.[220]

That national states have a *duty of assistance* with other national states and they need to comply with demands of justice towards *burdened societies*[221] implies that principles of fairness apply to states that have more than enough,

[217] Thomas Nagel, "The Problem of Global Justice", *Philosophy & Public Affair* (2005): 113-147.

[218] See Philippe Van Parijs (2007) and Thomas Pogge, (1994).

[219] Rawls compares the duty of assistance with the principle of just savings for the domestic state. He claims that a well-ordered society does not need to be wealthy. "Thus, the savings rate as a constraint on current consumption is to be expressed in terms of aggregate capital accumulated, resource use forgone, and technology developed to conserve and regenerate the capacity of the natural world to sustain its human population. With these and other essential elements tallied in, a society may, of course, continue to save after this point, but it is no longer a duty of justice to do so." John Rawls, (1999 (1993)): 107.

[220] John Rawls (1999 (1993): 107. See also Charles Beitz, "Rawls's Law of Peoples", *Ethics* (2000): 21.

[221] John Rawls, *The Law of Peoples*, (Cambridge: Harvard University Press, 1999 (1993)).

like the members of the Eurozone. However, Rawls argues that peoples are collectively responsible to act justly.

In *The Law of Peoples* Rawls exemplifies his view in a case with two states:[222] state A decides to industrialize while state B opts for a "more pastoral and leisurely society". After a while state A is wealthier than B and Rawls concludes that it is not required to tax state A to provide funds to state B.[223] Why, according to the Rawlsian case of collective responsibility, justice does not require to redistribute between state A and state B, provided that state B is a well ordered society? One possible argument is to say that leisure is a primary good to count in the distribution of costs and benefits between the two states. Therefore, state B is not the least advantaged member of this two-member group. Although it enjoys less wealth this is compensated by the enjoyment of more leisure.[224]

However, this explanation does not play any role in the Rawlsian conception of international distributive justice. As just mentioned, it assumes that no substantive egalitarian principle should govern the distribution of primary goods amongst sovereign peoples like A and B. Rawls's conception of international justice claims that once a people reaches some threshold of wealth, it is responsible of its own conception of justice and takes responsibility of the way it has decided to organize and cooperate according to it.

Maybe a variation of the case presented by Rawls might be more compelling. At the start the rate of population growth is high in state A and B and both provide equal justice for women. In state A, however, gender justice is given priority, and women participate more in politics and economics. Consequently

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[222] We might see the case as a case of moral hazard. If we tax state A to transfer funds to state B the risk to fall short of production and wealth shifts from state B to state A.

[223] John Rawls (1999 (1993)): 117.

[224] John Rawls, *Political Liberalism*, (New York: Columbia University Press, 1993): 181-182, footnote no. 9. Rawls claims that his index of primary goods could be extended to include leisure, and therefore if we look at the distribution of expectations of these primary goods between state A and B we should take into account that state B enjoys more leisure.

“they gradually reach zero population growth”. In state B although endorsing the same conception of gender justice, “because of its prevailing religious and social values, freely held by its women” the rate of population growth does not reduce. As in the earlier case, after a time state A is wealthier than B and Rawls concludes again that international distributive justice does not require taxing state A to transfer funds to state B.[225] The case illustrates that a peoples’ political and civic culture is the crucial element that according to Rawls determines how a people fare, and that’s why a global distributive principle beyond the duty of assistance is not required.

The analogy between the family and the state might be useful to understand the normative value of collective self-determination. Suppose that we seek equality of opportunity for new born babies. We might think that if we bring all children to an orphanage that would provide more equality of opportunity amongst them. However, one might correctly object that if children remain with their families they do better in life. This second scenario involving families, one might argue, produces a Pareto superior unequal distribution of opportunities compared with the first distribution present in the orphanage scenario. Although families produce inequalities in opportunity they are defensible because their existence provides far more opportunities to children compared with their replacement by orphanages.

Some argue that states have an analogous value to individuals as families,[226] defending the existence of states by claiming they produce better effects than a world without states, or a world with a single state. When the Eurozone is composed by a number of member states the citizens of each one are better off in absolute terms that in the case that there were no states or there was a single European state. We then have reasons to accept their existence despite

[225] John Rawls, (1999 (1993)): 118.

[226] See Christian Barry and Pablo Gilabert, “Does Global Egalitarianism Provide an Impractical and Unattractive Ideal of Justice?” *International Affairs* (2008)> 1025-1039.

the fact they increase the level of inequality amongst citizens of different member states.

Rawls's discussion is suggestive but inconclusive. It suggests (1) reasons to not mechanically extend the difference principle due to the importance of collective self-determination and collective liability and (2) reasons to think there are distributive obligation amongst groups above sufficiency when engaged in certain kinds of collective project, e.g. discharging the duty of assistance and the just savings principle. The remaining sections present some further arguments, as developments of these themes, and the idea that the European Monetary Union is in some respects comparable to a cooperative scheme to distribute the costs of alleviating the plight of burdened societies, and so governed by some egalitarian or prioritarian principle to divide the surplus generated by European integration.

3. The Fair Adjusted Procedural Argument

The creation of the European Union has been justified for the purposes of solving problems of coordination between the member states. At the beginning the main coordination problem was to avoid war between the European countries.

The possibility of military aggression between states became less of a threat and economic considerations become more significant. First member states agreed to create a common market to avoid transactional costs derived from custom duties. The voluntary integration process, always pursuing enhanced economic *efficiency*, led eventually to the creation in 1999 of a common currency and monetary policy, to avoid the costs derived from exchange rates and divergent monetary policies.

A single currency might be adopted as a reserve currency by foreign states and international markets. Economic efficiency can benefit also from the reduction of the transaction costs associated with international operations and from the removal of the uncertainty associated with exchange rate fluctuations.[227] However, if a country retains its own distinct currency and central bank and becomes less competitive relative to its trading partners, it can adjust relatively smoothly by letting its currency devalue relative to that of its trading partners. By contrast, with a common currency, no such option is available, and the trade imbalance induced by the divergence in competitiveness is reflected in increased unemployment and its various unwelcome consequences for the less competitive countries.[228]

To begin with, the first argument to justify a principles of fairness applying across member states of the European Union is the fair adjusted procedural argument, which claims that cooperation amongst the member states is legitimately subject to negotiation and mutual agreements.

Thus, the argument assumes that the demands of distributive justice remain at least partly procedural, and accepts that member states are free to enter into agreements that influence the distribution of costs and benefits arising from the production of the Eurozone surplus. Yet the argument also insists that each state's powers to consent to binding agreements is constrained by the *morally mandatory aim* of preserving a social minimum appropriate for all residents in the Eurozone. Thus, the demands of justice amongst the member states of the Eurozone remain procedural insofar as they are negotiated and agreed amongst the parties but the procedure itself is adjusted in ways sensitive to satiable distributive considerations. Even there is no complete independent standard to assess the fairness of the overall agreement, some morally mandatory aims, some outcomes, like ensuring a social minimum for all the residents of the Eurozone need to be meet by the agreement reached amongst the member states.

[227] See Philippe Van Parijs (2012): 2.

[228] See Philippe Van Parijs (2012): 2.

My statement of the procedural argument draws from Christiano's conception of state consent in his paper 'Climate Change and State Consent'.[229] Here Christiano takes the factual claim that the legitimacy of international conventions and cooperation to solve global problems is subject to negotiations amongst sovereign states. In addition, he claims that to be legitimate the agreements to which states consent must be constrained by various mandatory moral aims, such as poverty eradication or global warming prevention. Thus, states are bound to comply with these mandatory moral aims and the latter constrain state's freedom of contract and the content of international agreements.

State's consent is therefore not enough to make international agreements legitimate. The pure procedural view needs to be adjusted. There are some outcomes that must be obtained by these agreements reached upon a fair procedure of negotiation. According to the argument, then, the need to protect all Europeans from poverty and ensure a social minimum, is condition that can cancel, or undercut, for the validity of the agreements that create the Eurozone.

Some might claim that the Rawlsian duty of assistance might support a European social minimum. However, it seems that a global duty of assistance is not only a *satiable* but also a *diminishing* principle.[230] Thus, if countries outside the Eurozone are far less able to secure a social minimum for their members, then we should attach priority to them, and first assist these countries rather than the less burdened countries within the Eurozone. Cosmopolitans criticize Rawls's dualism in providing different principles of justice for the domestic and the international case. In chapter 2, however, we claimed that Rawls endorses a variety of non-intrinsic egalitarianism, and it is also worth exploring the

[229] See Thomas Christiano, "Climate Change and State Consent", in *Climate Change and Justice*, Jeremy Moss ed. (Cambridge: Cambridge University Press, 2015): 17-38.

[230] See Joseph Raz, *The Morality of Freedom*, (Oxford: Oxford University Press, 1989): 235 - 236.

implications of this aspect of Rawls's view for the procedural argument, and fairness within the European Union.[231]

As noted, Rawls assumes that the nature of interaction between different individuals, peoples, or societies can influence the extent to which a distributive inequality between them is objectionable.[232] If we hold that inequality is not intrinsically bad but is bad, for example, because it undermines egalitarian, fraternal social relations, the relative strength of the social relations between peoples or societies will determine the degree of concern we should have for distributive inequalities that obtain between those peoples or societies.

This view then rejects a *strong cosmopolitan* view that completely rejects the value of national states and this is consistent with non-intrinsic egalitarianism. It also provides reasons for looking for an egalitarian or prioritarian principle for the Eurozone. Since EU integration implies a higher degree of interaction between different societies we might argue that the duty of assistance in the Eurozone requires all member states to cooperate to guarantee a higher threshold of wealth and income, and even to attend to the range in expectations between the least and most advantaged.

A Rawlsian non-intrinsic egalitarian is able to explain why there is a moral duty to ensure a social minimum for all the citizens of the Eurozone as a consequence of the ongoing cooperation amongst the members of the Eurozone, without relying in a global principle like the duty of assistance that we might reasonably believe that will require priority for the least advantaged peoples of the world rather than those of wealthy European countries.

The higher degree of interaction caused by a common market, a common currency, and a common legal structure might provide reasons to claim that this international association must be guided by some principle, attaching priority to

[231] See Martin O'Neill, "What Should Egalitarians Believe?", *Philosophy & Public Affairs* (2008): 119-156.

[232] See Martin O'Neill (2008): 138.

the worst-off members amongst them in case of conflict. We might claim that it should be governed by a prioritarian principle, and that this principle can be understood, like the just saving principle, as a satiable principle.

A principle with a target, which mandates member states to contribute to a duty to build and maintain just institutions and assist other member states until all countries secure an adequate social minimum, or a decent life for all their citizens. The just saving principle across generations implies that the first generations will have to make some material sacrifice in order to initiate the process of building more just institutions for later generations. Furthermore, the distribution of burdens within that process will resemble a progressive tax insofar as less wealthy earlier generations will sacrifice a smaller proportion of their wealth than wealthier later generations to secure its continuation. Once society has reached a level of wealth that secures just institutions, including a social minimum for everyone, the remaining generations will not need to save to make future generations become even better off than them; they merely need to sustain the level of wealth that has already been secured. In the same way, a prioritarian principle of justice amongst Eurozone member states can be understood as a duty to build just institutions, and ensure a social minimum for everyone, that due to unequal background conditions requires more from wealthier states than less wealth states to ensure this target is reached. Once reached, however, the principle does not assume there is a duty to promote further material development that demands more of the wealthy than the less wealthy.

Replying to the position just outlined, some critics might argue that it fails to ground redistribution across member states since individual states can themselves always provide a social minimum for their own citizens provided they comply with their internal demands of distributive justice. What they need to do is to end domestic corruption and tax evasion, be more productive, improve the education system, tax capital, etc. If this criticism is sound, even if periods of recession call for austerity measures, member states can always secure a social minimum for their own citizens by imposing the costs of austerity on the section of the population above the social minimum, and ideally on the most advantaged individuals amongst it.

Suppose, however, this section of the population declines to bear those burdens, for example, by voting against the increases in income tax necessary to fund the benefits and investment necessary to secure a social minimum for their less fortunate fellow citizens. Does this make a difference to what justice demands of individuals in *other* states?

According to their critics, the arguments canvassed so far need to distinguish between changes in a member state's capacity to act justly towards its members and changes in its actual likelihood of doing so. The high levels of poverty in any member state might derive either from limited capacity explicable by international injustice or from a lack of local solidarity that constitutes domestic injustice. The fair adjusted procedural argument claims that member states should contribute to ensure that everyone enjoys a social minimum, but if a state fails to secure the minimum for its own citizens when it has the capacity to do so, why should citizens from other states be obliged to pick up the slack?

4. The Collective Self-Determination Argument

Those who resist more egalitarian distributive principles in the Eurozone often appeal to the responsible agency, liberty and collective liability of member states. Anti-egalitarians claim that member states should often be at liberty to make their own decisions about how best to advance their aims, and that it is unfair to make member states liable to bear certain costs arising from other member states' decisions or to relinquish certain advantages gained through their own efforts.[233]

[233] Andrew Williams "Liberty, Equality, and Property" in John S Dryzek, Bonnie Honig, and Anne Phillips (eds.), *The Oxford Handbook of Political Theory* (Oxford: Oxford University Press, 2006): 498-499.

In cases involving individuals, egalitarians have recognized the agency problem, and authors like Ronald Dworkin, G.A. Cohen or Richard Arneson, have argued that from the standpoint of distributive justice, inequalities arising from factors under the agent's control are often unproblematic.[234] At the beginning of this chapter, I employed Rawls's idea that peoples are responsible for their own conception of justice, and the consequences for their liabilities of implementing it. Rawls's cases of the two states presented in section 2 provide some reasons to claim that justice does not require redistribution between them, granted that both are well-ordered societies, because they are responsible collective agents.

It is important to note, however, that after announcing the principles of international justice for a society of free and independent peoples, Rawls recognizes that supplementary principles may be added to his initial list. In particular, Rawls claims that "(t)here will also be principles for forming and regulating federations (associations) of peoples, and standards of fairness for trade and other cooperative institutions".[235] A little later, he concludes that

> "In addition to agreeing to the principles that define the basic equality of all peoples, the parties will formulate guidelines for setting up cooperative organizations and agree to standards of fairness for trade as well as certain provisions for mutual assistance... Consider fair trade: suppose that liberal peoples assume that, when suitably regulated by a *fair background framework*, a free competitive-market trading scheme is to everyone's mutual advantage, at least in the longer run."[236]

[234] See Richard Arneson, "Equality and Equal Opportunity for Welfare". *Philosophical Studies* (1989): 77-93. See also G. A. Cohen, Cohen, "On the Currency of Egalitarian Justice", *Ethics* (1989): 906-44. See also Ronald Dworkin, *Sovereign Virtue: The Theory and Practice of Equality*, (Cambridge: Harvard University Press, 2000).

[235] John Rawls (1999 (1993)): 38.

[236] John Rawls (1999 (1993)): 42-43.

The idea of a "fair background framework" is parallel to that of *background conditions of justice* that Rawls uses in the domestic case. Rawls appeals to the latter idea to argue that we need what he calls 'principles for institutions', and that we can't rely solely on principles for individuals, as libertarians suggest. However, the argument doesn't explain which specific international inequalities jeopardize fair background conditions amongst peoples, and it does not assume that we need specific institutional principles in addition to ones already included in the *Law of Peoples*.

Rawls also doesn't explain why trade and competition are important within international associations but the idea is that unless we create institutions to regulate international trade associations then fair background conditions may not be maintained over time.[237] Cooperative schemes and associations amongst peoples, like in the Eurozone, may well be permissible under Rawls's view of international justice *provided that they include mechanisms for preserving fair background conditions*, and this proviso does not assume such schemes need to be regulated by egalitarian principles like the difference principle. Indeed, Rawls himself appears to cast doubt on the idea when he claims that "(s)hould these cooperative organizations have unjustified distributive effects between peoples, these would have to be corrected, and taken into account by the duty of assistance".[238]

More specifically, Rawls argues that in a cooperative trading organization some principles may be added to maintain fair background conditions. Rawls discussed this possibility at various times but did not explore the idea in detail.[239] In the domestic case the appeal to background fairness assumes that after a while the accumulated of transactions that are fair considered in isolation and of

[237] See footnote no. 52 in John Rawls (1999 (1993)): 42.

[238] Ibid.

[239] John Rawls, *Political Liberalism*, (New York: Columbia University Press, 1993). Lecture VII: The Basic Structure as Subject, 257-288.

historical contingencies and factors beyond the control of the less advantaged are likely to influence agents' abilities to enter freely into binding agreements.[240]

The basic social institutions of the domestic state have a deep impact on citizens' life prospects and they are meant to prevent the erosion of these background conditions of justice and regulate a cooperative system by sound principles of justice. In the Rawlsian domestic case it is clear that these background conditions of justice should preserve (i) *fair equal opportunity* for official positions and jobs, so people with equal talents should have equal access to social positions, (ii) the *fair value of political liberties*, to avoid that concentrations of economic power controls economic and political life, and finally, (iii) a maximinimizing scheme of equal *basic liberties and rights* for all members of society. But what are the international background conditions to preserve in an association of states for trade?

The challenge faced when the appeal to fair background conditions is extended from the domestic to the international case is to specify the conditions that must be preserved in the latter context. Taking into account the interdependence between domestic and global justice, Ronzoni claims that avoiding international background injustice may be required to ensure that states possess *effective sovereignty*.[241] Ronzoni's argument also suggests states need to have enough power to be able to secure internal socio-economic justice. They need to have both effective *control over internal socio-economic dynamics* and r*easonable freedom from external interference*. These are the conditions under which the coexistence of, and interaction between, independent states can be justifiable.

Similarly to the domestic case of agreements and contracts, Ronzoni's account can be framed in terms of pure procedural justice: we start from an existing practice where what matters is not that the relevant actors (individuals

[240] John Rawls (1993): 265.

[241] Miriam Ronzoni (2009): 231.

or states) be, substantively equal in wealth, say, but rather that they interact under certain conditions that, if maintained, will make any outcome of their interaction just.[242] Ronzoni illustrates her view with the problem of international tax competition, which she claims erodes the power of sovereign states to implement the appropriate public policies to realize domestic justice. She concludes that if states are sufficiently exposed to tax competition, then states lose their effective sovereignty, and that only supranational institutions can regulate such competitive practices in order to avoid the erosion of fair background conditions.

In "Two Conceptions of State Sovereignty and their Implications for Global Institutional Design"[243] Ronzoni employs an analogy between individual freedom and collective agency in order to claim that it is necessary to regulate international background conditions to ensure the substantive problem-solving capacity of the states and their ability to make genuine discretionary choices.[244] If sovereign states are to be understood as agents whose freedom ought to be respected, then attention should be paid to the positive aspects of their sovereignty. Negative sovereignty is understood as immunity from external interference that a sovereign state enjoys, while positive sovereignty "instead, indicates a dimension of (institutional) self-mastery; it is, once again like its

[242] Miriam Ronzoni (2009): 248 claims that "In the case of individuals and contracts, we sketched a picture where agreements are free and fair, whatever their outcomes, as long as agents have some reasonable freedom (a) to reject them and/or(b) to renegotiate their terms. We then showed how, from a background justice perspective, in intense scenarios of socioeconomic interaction the outcomes of past agreements can erode conditions a and b of pure procedural justice. Similarly, in the global case, we are not interested in *outcomes*; we do not require states to be equally affluent, possibly not even that they each implement the same conception of domestic social justice. We are instead interested in effective sovereignty as a set of conditions under which independent sovereign states can interact justly. And just as in the domestic case, under circumstances of intense international interaction and interdependence the conditions of effective sovereignty, and hence of *international background justice*, may be eroded."

[243] Miriam Ronzoni, "Two Conceptions of State Sovereignty and their Implications for Global Institutional Design", *Critical Review of International and Social and Political Philosophy*, (2012): 577-580.

[244] Miriam Ronzoni (2012): 575.

individual counterpart, a ‘freedom to’, and, crucially, an internally enabling condition; a state is positively sovereign when it possesses the internal resources to decide which kind of polity it wants to become and acts on it successfully.”[245]

According to Ronzoni’s view, the practice of international tax competition needs to be regulated to avoid the erosion of a state’s ability to implement its own conception of justice. Ronzoni sees the erosion of international background conditions as the loss of this positive solving capacity of states and their ability to make genuine discretionary choices. Analogously we can claim that if the practice of a common monetary union, with fixed exchange rates, “might be politically unjust in that it creates unjustifiable systemic obstacles to positive sovereignty” and makes unjustifiably difficult a people’s access to self-determination.[246]

If the Ronzonian argument is defensible, we need institutions to regulate international practices that would otherwise erode some state’s positive collective self-determination. On this view, the idea of non-domination is specified as involving a capacity to make voluntary collective choices. Following Rawls’s appeal to the idea fair background conditions to ensure that inequalities amongst individuals do not gradually expand and threaten fairness in transactions amongst them, the collective self-determination argument analogously claims that if the EU fails to maintain international background conditions and member states cannot be reasonably free from external interference and domination. Unless background conditions are regulated the agreements and transactions amongst the member states of the Eurozone would result unfair and factors beyond the control of the least competitive countries are likely to influence state’s abilities to provide justice and enter freely into binding agreements.

[245] Miriam Ronzoni (2012): 577.

[246] Miriam Ronzoni (2012): 583.

The interdependence created by the creation of a single market and a common currency generate threats to collective control comparable to those that exist in the domestic case. EU integration created more interdependence amongst European member states. They voluntarily entered into international agreements and transferred sovereignty to EU institutions in order to secure certain gains, and this leads to a natural objection to the forgoing argument. *Libertarians* claim that if member states had fair initial background conditions and extensive powers to decide to enter into agreements voluntarily, whatever emerges from the use of the extensive powers of the member states is just and enforceable.

Ronzoni's argument, however, suggests that international background conditions in the Eurozone should be regulated, and that we have reasons to claim that even if the 'starting gate', or initial background conditions, were fair we should not accept a pure procedural conception of justice in the Eurozone. Instead we must resist the argument that whatever emerges of the extensive powers of the member states is just and enforceable. Under Ronzoni's view we need to regulate the Eurozone to ensure that after a while the initial practice does not undermine the background conditions of justice, and jeopardize collective self-determination of the least competitive member states.

Ronzoni's appeal to self-determination tries to provide a plausible account of the reasons to object to the agreements reached about entry into the Eurozone, and the treaties reached to ensure that member states will avoid budget deficits. What then makes such agreements voluntary and enforceable?

For one answer, consider Robert Nozick's idea of a *historical entitlement theory*, which comprises a *principle of acquisition* that explains how rights in previously unowned objects can be acquired and a *principle of transfer* that explains how such rights can be relinquished along with a *principle of rectification* that explains how to redress infringements of those two prior principles. Nozick argues that provided the principle of acquisition is satisfied a transaction is voluntary in a sense that renders a transfer enforceable as long as the owners of the rights involved assent to it.[247] On this view, if the provision remains satisfied, all rights are alienable, and if so the starting gate objection is less plausible than it would otherwise be. We need to assess, then, whether right to the conditions necessary for collective self-determination are, as an entitlement theory implies, alienable rather than inalienable rights.

Here it is useful to consider Serena Olsaretti's criticism of Nozick's conception of voluntary transactions. Olsaretti agrees that if people have property rights they can transfer them through voluntary exchange. But a choice is relevantly voluntary, she holds, "if and only if it is not made because there is no acceptable alternative" where what counts as an acceptable alternative is specified objectively, and includes, minimally, the stipulation that sacrificing one's basic needs is not acceptable.[248]

Put it this way, the argument claims that member states transferred part of its sovereignty to the institutions of the EMU but less competitive countries accepted the terms and conditions of the EMU because they had no better option and would not freely agreed on maintaining these terms and conditions if they had an acceptable alternative. According to Olsaretti, when people makes contracts because they had no better alternative, or when they sacrifice their basic needs, these contracts are invalid and unenforceable. It is not clear though that if Spain and Greece remained outside the EMU they would have suffered an unacceptably bad outcome, or why they agreed to join the EMU because of this fact. Surely they would have agreed even if the option of remaining outside had been acceptably good because entry seemed so much better. Moreover, suppose that a person is facing a risk of death and makes a contract with a doctor to operate her. It seems that she doesn't have any better option, since death isn't a

[247] Robert Nozick, *Anarchy, State and Utopia*, (New York: Basic books, 1974).

[248] Serena Olsaretti, *Liberty, Desert and the Market: A Philosophical Study*, (Cambridge: Cambridge University Press, 2004).

good alternative, but it is not plausible to conclude that she can't enter into a contract with the doctor which is voluntary in a sense that involves it having a binding character.

It seems, then, that it is at least disputable whether in order to make voluntary agreements member states need to be above some level of sufficiency that guarantees a social minimum for all their citizens, and can't risk sacrificing their basic needs.[249] If so, it is worth pursuing a different argument to question the existing design of the Eurozone which focuses less on the conditions under which member states agreed to join the Eurozone and more on the possible effects of them doing so. One such argument focusses on the fact that the less competitive countries entered into the Eurozone without possessing, in effect, adequate insurance against the risk of a financial crisis that would leave many of their citizens in conditions of serious material deprivation, and severely limit their capacity for collective self-determination. Does this risk call into question the legitimacy of their agreement?

Some might argue that to question whether the less competitive countries' decision to enter the Eurozone is binding is objectionably paternalistic, and overlooks the possibility that rights to a social minimum and to collective self-determination are alienable via exchange at least when there is a sufficiently good available alternative to the exchange, as seems the case. Suppose then that the less competitive states would not have sacrificed their basic needs to avoid

[249] See Mathew Seligman, "Luck, Leverage, and Equality: A Bargaining Problem for Luck Egalitarians", *Philosophy & Public Affairs* (2007): 266-292. In this article Seligman challenge the idea that inequalities coming from people's choices rather than circumstances or chances do not need to be compensated. The author presents a case in a Dworkinian island where some shipwrecks are not starving but uncomfortably hungry while one of the immigrants has decided to fish in deep waters and obtained plenty of fish. If then they decide to cooperate, and since the others are uncomfortably hungry, the successful immigrant can impose exploitative terms to others. Seligman concludes that even these inequalities come from immigrants' choices rather than brute bad luck, the resulting distribution is unjust and luck egalitarianism is flawed. See also Paula Casal, "Why Sufficiency is Not Enough", *Ethics* (2007): 322 claims that "it may be preferable merely to supplement luck egalitarianism with a sufficiency principle that tempers its concern for choice and responsibility. We might, then, favor a form of sufficiency-constrained luck egalitarianism, which allows that some inequalities in outcome may arise justly but denies that individuals' having less than enough is ever justifiable by appeal to voluntary choice."

deprivation and domination had they declined to join the Eurozone. Why not accept that they are empowered to gamble their security in order to obtain even greater gains from further European integration?

To answer the question, note first the agreement could be still criticized, and its binding character questioned on non-paternalistic grounds that avoid restricting the options of agents for their own good. To understand this possibility, consider enforcement from the perspective of third parties to the agreement, like EU citizens in general, rather than the perspective of the less competitive states. If the agreement is binding then those states will be expected to take this account, given the legal structure of the EU can then be called upon to provide security and enforcement to the agreements made by the contracting member states. Those third parties, however, might reasonably object to an expectation that they participate in a legal structure that enforces such agreements irrespective of whether their content leaves parts of the population of the EU in conditions of severe material deprivation.[250]

In addition, the binding character of the agreement and its enforceability might be questioned by arguing that group decisions can sometimes treat individual members sufficiently negligently so as to undermine the group's normative power to bind itself via certain agreements. Pursuing this line, some might argue that even though democratically elected the governments of some Southern countries were insufficiently solidaristic in their internal redistributive policies to possess the normative power to join such a highly risky venture as the EMU, at least under its current terms. On this view, we should question whether states should always be held responsible for their conception of justice when it becomes sufficiently defective. When relatively affluent voters in Southern states are insufficiently concerned about their less fortunate poorer and younger fellow citizens to establish redistributive mechanisms to share with them the risks of

[250] See Seanna Schiffrin, "Paternalism, Unconscionability Doctrine, and Accommodation", *Philosophy & Public Affairs* (2000): 223-233.

monetary union this has implications not only for the relations with their fellow citizens but also with citizens in more competitive countries, and the governments that represent them. Even if it would be mutually advantageous to make agreements they may lack the power to do so if it would come at a sufficiently high cost to the less fortunate members of less competitive societies. Under such conditions, admitting those countries into an unmodified monetary union amounts to collaborating in the creation of serious domestic injustice. This casts doubt on whether states have the normative powers to make binding collaborative agreement, and supplies weighty reasons to avoid exercising any such powers if they do exist.

Recognizing that the distributive problems raised by monetary union cannot be solved purely on procedural grounds and by appealing to treaties opens the door to questions about what member states do owe to each other when entering into the European Monetary Union. Surely we have reasons to recognize that the citizens of the wealthiest states shouldn't collaborate with other member states that are committing serious domestic injustices, and that they owe something to the least advantaged members of those societies. But can we say more?

5. The Fair Entitlement Argument

In the last section I tried to show that once member states decided to cooperate to enter into the Eurozone, they should care about the situation of the least advantaged members of other member states, and that if we want to regulate the background conditions of the Eurozone, a natural way is to distribute the surplus generated by EU integration fairly, avoiding domination.

Amongst the different objections to inequality, Thomas Scanlon claims that a reason for the elimination of inequalities is that they give some people an unacceptable degree of control over the lives of others.[251] The idea of preserving collective self-determination presented in the previous section reflects our egalitarian concerns in preserving member state's capacity for enter into binding agreements and make discretionary political choices. If we want to ensure that less competitive member states are not dominated by the most competitive ones, and that transactions amongst them remain fair, a natural way to proceed is to distribute the surplus generated by a cooperative scheme, like the EMU, in ways that prevent the richest countries exerting objectionable forms of control over poorer members.

The Eurozone can also be seen as a cooperative venture to generate a surplus and as such we should ask how to distribute the aggregate gains it generates.[252] Even we are not facing exactly the same concerns as in domestic justice -- where, for example, we might aim to maximize the expectations of primary goods for the least advantaged members of society -- a cooperative venture like EU integration is one distributive problem that egalitarians should try to address. One influential egalitarian view of cooperative justice claims that each state has a fair entitlement to obtain an equal return of the surplus generated by EU integration, according to the cost of its contribution to generating it, which is the marginal difference to the surplus probably made by its inclusion.[253] Even it is difficult to calculate such costs and benefits, and the argument is mainly speculative, the idea is that we should calculate what are the commonly produced benefits arising from the Eurozone and the costs for each member state to contribute their production, and distribute the surplus in order that each one is entitled to a share of the benefits and burdens generated by EU integration proportional to its contribution.

[251] See Thomas Scanlon, "The Diversity of Objections to Equality" The Lindley Lecture, University of Kansas February 22, 1996: 1-18.

[252] Here I follow the justification of cooperative justice to distribute the costs and benefits of a lingua franca by Philippe Van Parijs, *Linguistic Justice for Europe and for the World*, (Oxford: Oxford University Press, 2011): chapter 2.

[253] Philippe Van Parijs (2011): 50-82.

The view is that each state contributes to the generation of the EU surplus and so each one is entitled to receive her share. Suppose that for the least advantaged member states to join the Eurozone they need to incur an extra cost in making their economies more competitive and productive in order to deal with the trade imbalances generated by a single currency area, while both the least competitive and the most advantaged countries enjoy the benefits of the EMU. Assuming the benefits justify the investment for the least competitive countries, cooperative justice requires that the cost of producing this surplus is distributed according to the overall ratio of costs and benefits.

It makes sense to compute the costs for less competitive states and its competitors of the Eurozone, and the share that structural beneficiaries should pay for the gains they obtain in the common market in order that all of them, winners and losers, obtain a fair return for their contribution in the production of the EU surplus. Let's suppose that the Northern countries of the Eurozone (N) have a cost (NC) to produce the marginal difference to the surplus probably made by their inclusion in the Eurozone, and that they obtain (NB) benefits from the creation of the Eurozone. On the other hand, Southern countries (S) have a cost (SC) to produce the marginal contribution probably made for their inclusion in the EMU to obtain (SB) benefits from the common currency.

The total gross benefit (β) from the creation of the Euro is equal to (NB+SB), and derives, for example, from the elimination of transactional costs derived from eliminating exchange rates and custom duties. To be an overall positive benefit the total gross benefits, β, needs to be higher than the costs for the Northern and Southern States: $\beta > NC+SC$. However, to be mutually advantageous, at least for this simplified two groups of countries N and S, the Euro project should also comply with two more requirements: $NC < NB$ and $SC < SB$.

In this (perhaps overly) simplistic story, it can be reasonable to look for efficiency or mutual advantage in the EU. Suppose the Eurozone is a mutually advantageous project, so that SC<SB and NC<NB. A mutually advantageous distribution of the costs and benefits can justify the participation of all the member states in the Euro club, and provide EU institutions with output legitimacy. Securing mutual advantage, however, does not prevent some participants contributing more than others to generating the Euro surplus while securing fewer benefits. It can happen, for example, that SC is ostensibly higher than NC while NB is also ostensibly higher than SB. Under these circumstances, it seems that egalitarians should require more than a guarantee that each state is a net winner that enjoys some share of the cooperative surplus. But how much more is required?

To address the question, it is worth considering the *fair entitlement argument* presented by Van Parijs when discussing the case of a *lingua franca*. Van Parijs's argument requires not only mutually advantage but cooperative justice, and so applies to cases where cooperation produces only *relative losers*. Roughly stated, the argument claims that in a cooperative venture to produce a non-excludable and non-rival public good like a lingua franca we should equalize the rate of return for the investment made by each co-operator.

The benefits of the lingua franca for each individual to be given by the number of speakers of other languages with which learning the shared language makes communication possible while the cost is associated with the time devoted to learn the lingua franca, the costs of English lessons at home and abroad, or to buy English text books. Van Parijs takes cooperative justice as to be the appropriate cost to distribute the cost of learning a lingua franca as a second language. The citizens of "Franca", who already know the lingua franca as a native language, and have no cost to learn it, also enjoy the benefits of their native language being a lingua franca, and thus we can require them to contribute to the cost of providing a public good.

Cooperative justice requires that the cooperative surplus be distributed in proportion to each party's contribution to the cost of producing it.[254] The overall gross benefit β=NB+SB should be higher than the total cost NC+SC and then we need to apply this overall ratio of β/(NC+SC) to all participants who will receive their return according to their contribution to generate the cooperative surplus: SC x (β/(NC+SC)) for Southern States and NC x (β/(NC+SC) for Northern ones. Therefore, cooperative justice rules out the possibility that any member is a net loser except in the case where the overall costs NC+SC exceed the overall benefits β.

To understand the idea of cooperative justice employed by Van Parijs the way a company divides profits amongst its shareholders may provide a good example. Each shareholder contributes to the initial share capital of the company C with $c_1, c_2, c_3 \ldots c_n$. So, $C = \sum c_1 + c_2 + c_3 \ldots + c_n$. Every year the company obtains β profits from its business, and each shareholder receives c_x x β/C. It is only possible that a shareholder is a net loser if the overall costs, C, exceed the overall benefits, β, and they have to share the losses. Otherwise, every shareholder receives her fair share in the profits according to her contribution in the initial share capital of the company.

One of the problems of the present argument is that it relies on a purely aggregative requirement of mutual advantage. As a result, it might be satisfied even if cooperation makes some badly off individuals much worse off. For this reason, the argument may seem under-inclusive because it leaves some types of injustice unaddressed. Moreover, the requirement might fail to be satisfied merely because cooperation reduces aggregate wealth by making many very well off individuals worse off even though the condition of very badly off individuals is improved to a slightly smaller degree. As a result, the argument may be over-inclusive because it disfavours such a change even though many egalitarians might regard it as an improvement.

[254] Philippe Van Parijs (2011): 65.

The fair entitlement argument has some appeal because it parallels one of the several types of reasons cited by Scanlon to care about equality; i.e. his claim that within certain cooperative schemes there are reasons to ensure each of the co-operators has an equal share in the surplus the scheme produces.[255] Requiring that schemes are mutually advantageous also makes sense if we should avoid situations of domination, and protect member state's capacity to make political choices and implement their conception of justice.

However, the fair entitlement argument does not provide reasons to oppose internal injustice in the distribution of the surplus. To correct this omission I have tried to provide reasons to claim that once member states enter into the EMU they owe some justice to the least advantaged members of other states, and that will require calculating at least some of the likely costs of different forms of increased integration for individual citizen.We should, then, draw a distinction between views that construe a fair share as just an aggregate sum that some collectivity has discretion to distribute amongst its members in ways it decides and (more credible) views that distribute the sums with strings attached, or conditions regarding distribution amongst the individuals who comprise the collective. A minimal version of the second type of more complex view would require no individual to suffer certain forms of absolute deprivation.

6. The Luck Sharing Argument

Another objection to the cooperative justice argument is that seems unfair to make rewards proportional to contribution, and so the worry arises that it might also be unfair for cooperative justice to distribute a surplus similarly when lesser contributions arises from some characteristic that we have reasons prevent disadvantaging those who possess it. In previous sections, I argued that member

[255] See Thomas Scanlon (1996): 1-18. See also Aaron James, *Fairness in Practice: A Social Contract for the Global Economy*, (Oxford: Oxford University Press, 2012). See also Charles Beitz, *Political Theory and International Relations*, (Princeton: Princeton University Press, 1979).

states should be responsible for eliminating poverty in the Eurozone, that member states should be protected against certain forms of inappropriate control by their more powerful partners, and that the surplus produced by the Eurozone should be distributed according to certain principles of cooperative justice. I also noted that many authors find some plausibility in the view a failure to protect states from luck-based inequalities is objectionable. The fourth and last argument we shall consider draws on this concern, and claims that the agreement to establish and maintain just institutions for the Eurozone should include a *luck sharing* component.

Dworkin's theory of *equality of resources*, the main rival liberal luck sharing theory of justice to *justice as fairness*, privileges institutions producing resource distributions that could have emerged from a specific kind of fair market process.[256] Dworkin does not use a metric to provide a plausible account of *well-being* but rather he supports equality of resources on the ground it provides a plausible account of how to design political and economic institutions.

Equality of resources is an account of justice in the distribution of whatever resources are privately owned. Dworkin argues that an equal division of resources, as the best understanding of the value of equality, presupposes an economic market in some form. Dworkin's case of shipwreck survivors who arrive on a previously unowned island and want to distribute the resources according to some version of the *envy test* provides this idea this market, and so serves as an analytical device to assess just distributions. The envy test is meant to test an equal distribution of resources, and states that "no division of resources is an equal division if, once the division is complete, any immigrant would prefer someone else's bundle of resources to his own bundle".[257] Dworkin then proposes an *auction* to address two kinds of complaint of unfairness that a survivor can make depending on whether she prefers either (a) another survivor's lot, or (b)

[256] Ronald Dworkin, *Sovereign Virtue: The Theory and Practice of Equality*, (Cambridge: Harvard University Press, 2000).

[257] Ronald Dworkin (2000): 68.

that lots had been divided in an alternative way, and there is no reason to favor the actual division.[258]

In Dworkin's description of the auction the immigrants have a number of clamshells. Each distinct item on the island is listed as a lot unless someone notifies the auctioneer of her desire to bid for a part of the item, in which case the part itself becomes a new lot. Dworkin then claims that "the auctioneer then proposes a set of prices of each lot, and discovers whether that set of prices clear all markets, that is, whether there is only one purchaser at the price and all lots are sold."[259] At that point the relevant envy test will be met, and nobody will be able to complain about the unfairness of the initial equal distribution of resources.

Dworkin recognizes that luck may still play a role in such an auction; for example, luck in how many people shared your tastes and ambitions, and how this affects the price of your preferred lot. His aim nevertheless is to provide guidance in evaluating and reforming actual distributive institutions by checking the extent to which they approximate ideal market processes. He also recognizes that if immigrants "are let alone, once the auction is completed, to produce and trade as they wish, then the envy test will fail shortly".[260] In, say, five years, someone will prefer other's bundle of resources because for example the other was more successful than him in trading.

We can distinguish between cases in which circumstances vary because of (a) different ambitions, (b) different *option luck*, and (c) different *brute luck*. Dworkin's equality of resources aims to be *ambition-sensitive* and *endowment-insensitive*. It allows inequalities depending on people's choices, so that those individuals who decide to invest rather than consume, or those who choose to work hard in a profitable way, may retain the gains of their ambition. In contrast,

[258] Ronald Dworkin (2000): 68.

[259] Ibid.

[260] Ronald Dworkin (2000): 73.

equality of resources disfavors a distribution being endowment–sensitive, or affected by differences in skills between individuals with the same ambition.[261] Dworkin contrasts cases of option luck, as a "matter of how deliberated and calculated gambles turn out... and brute luck, as a matter of how risks fall out that are not in that sense deliberate gambles".[262] Certain differences in option luck should not be compensated but what then about differences in cases of brute luck?

In very simple cases in which we want to allocate unowned resources, the envy test is satisfied by the auction in which each individual has the same bidding power. However, in real world cases complicated by production, exchange and differential luck the procedure has to accommodate ambition-sensitivity and endowment-insensitivity. Differences in income-earning potential or capabilities and disabilities are differences of brute luck. Differences in outcome derived from different option luck should not be compensated. Then we look at differences of brute luck in light of insurance. Having two individuals with the same risk of suffering brute luck and the same opportunity to insure against that risk, Dworkin strikingly concludes that if unfortunately the risk materializes and one of them has insured and the other not, equality of resources does not compensate from the former to the latter.[263] The difference between them is a difference of option luck against a background of *equal opportunity to insure* which does not call for redistribution.

This antecedent condition of a background of equal opportunity of insurance is not met in the real world because individuals face different risks and opportunities to insure against brute bad luck. Thus, Dworkin proposes a hypothetical insurance market through compulsory insurance at a fixed premium for everyone on the basis of speculations about what the *average*

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[261] Ronald Dworkin (2000): 89.

[262] Ronald Dworkin (2000): 73.

[263] Ronald Dworkin (2000): 76.

individual would have purchased by way of insurance had antecedent risk been equal. His proposal is that we design institutions to ensure that no individual is worse off that she would have been had this insurance scheme taken place. Dworkin then concludes that we could have a fund collected by taxes “to match the fund that would have been provided through premiums if the odds had been equal”.[264]

We might begin with the idea that member states were in a background of equal risk. Some might then claim that member states of the Eurozone would have decide not to insure against the financial crisis because if they had wanted protection then one easy way to buy insurance against the vicious spiral that lead to high levels of unemployment in the less competitive countries of the Eurozone was to decline to enter in the Eurozone, as Sweden, Denmark or the UK did.

Recall that under equal background conditions, Dworkin argued that when insurance is available differences in brute bad luck are matters of optional luck that do not call for redistribution.[265] In the case of two individuals who face the same risk of blindness, and the same insurance options, but who make different purchasing decisions, Dworkin claims that equality of resources would not support redistribution from the person who had insured to the person who had not if they were both blinded in the same accident, or if neither of them had insured against that kind of accident.[266]

Elizabeth Anderson criticized Dworkin’s egalitarianism for these harsh conclusions and claimed that justice does not permit “to abandon anyone, even if imprudent.”[267] Some egalitarians acknowledge that the latter position is

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[264] Ronald Dworkin (2000): 78.

[265] Ronald Dworkin (2000): 77 claims that “if everyone had an equal risk of suffering some catastrophe that would leave him or her handicapped, and everyone knew roughly what the odds were and had ample opportunity to insure…then handicaps would pose no special problem for equality of resources.”

[266] Ronald Dworkin (2000): 77.

[267] Elizabeth Anderson, “What is the Point of Equality?” *Ethics* (1999): 287-337. See also Mathew Seligman (2007).

problematic in cases of absolute deprivation. and they suggest a sufficientarian version of egalitarianism.[268] As Andrew Williams describes it, on "this view, individuals have weighty claims against suffering certain forms of absolute deprivation that cannot be relinquished through voluntary decisions, no matter how favorable the background conditions."[269]

In light of this, we might think that if less competitive member states decided not to insure against unwelcome unemployment caused by trade imbalances in the currency union, justice still requires that institutions to protect their citizens from absolute deprivation, even if they faced favorable background conditions. Even if we assume that Southern member states do not act justly to protect their citizens from poverty or domination, and the differences between the most advantaged countries and the least advantaged ones are due to different option luck, the sufficientarian element within a plausible account of luck egalitarianism requires institution designers to protect them from insufficiency.

To sum up, egalitarians require that distributions are sensitive to the responsibility of the agents, and that they remain responsible of their choices, but they should not disregard situations of absolute deprivation, even if it is voluntary and due to the agent imprudence. We might claim for example that if the Eurozone guarantees a level of sufficiency, member states will be responsible of the voluntary agreements they make with other members of the Eurozone, and problems of domination will not arise. However, sufficientarian egalitarians still face a dilemma between liberty and liability if they want to safeguard sufficiency. Sufficientarian luck egalitarians might choose to *internalize* the cost of sufficiency imposing the cost of insurance against insufficiency to the less competitive countries, and then limiting liberty, or *externalizing* such cost

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[268] See Paula Casal (2007): 322.

[269] Andrew Williams, "Liberty, Equality, and Property" in John S Dryzek, Bonnie Honig, and Anne Phillips (eds.), *The Oxford Handbook of Political Theory* (Oxford: Oxford University Press, 2006): 501.

through general taxation across the Eurozone, and thereby hold states liable for other states choices as well as their misfortunes.[270]

Member states could have agreed to impose on each other a duty to insurance against insufficiency when creating the Euro. Less competitive countries could have used a portion of the surplus generated by EU integration between 1999 and 2007, to buy insurance against the risk of financial crisis and the unwelcome consequences of mass unemployment and poverty in their countries. One might still argue that to have demanded member states to internalize such a cost is *paternalistic* insofar as it involves states forcing other states to treat their own members justly to at least a minimal degree. However, since to buy insurance it is not in the interest of the states *per se* but in the interest of the least advantaged members of their societies it seems that the objection is less problematic in this case than in cases involving paternalism for individuals.

So, most advantaged member states might be required to refuse to grant enforceability to the agreements made by member states when they judge that they are contrary to some standards of justice or do not meet sufficient conditions for their legitimacy.[271] The least competitive states didn't buy insurance for the risks of a financial crisis leaving some of their members in

[270] Andrew Williams (2006): 501-503.

[271] Seanna Schiffrin, "Paternalism, Unconscionability Doctrine, and Accommodation", p*hilosophy & Public Affairs* (2000): 223-233, argues that "viewing autonomous agreements as worthy of respect does not entail relinquishing one's own capacities to exercise independent moral judgment or to set distinct priorities for action. If one is asked to facilitate the enforcement of such agreements, one may refuse for a variety of reasons... In deciding whether to join the endeavour of others, it is often permissible to consider its content. Without indicating disrespect for another's autonomy, one may refuse to devote one's own energies to further her immoral deal just as if one had been asked to be a party to the agreement, one might have refused on grounds that the content was itself immoral or unfair... This posture of selective involvement or selective non-enforcement need not be motivated by distrust of either parties' ability to judge what is in their good... The refusal to enforce need not represent an effort to supplant the judgment or action of the contracting parties or an intention to stop them from engaging in (solely) mutually regarding immoral action. (Such efforts would be paternalist, on my account). Instead, the motive may reasonably be a self-regarding concern not to facilitate or assist harmful, exploitative, or immoral action."

situations of material deprivation, and when this risk materializes, we can conclude that other member states shouldn't have cooperated to such injustice by entering to the EMU with them.

I've tried to provide reasons to claim that we must acknowledge that even if less competitive countries could have easily decided to do not enter in the Eurozone, and protect against the unwelcome consequences caused by the trade imbalances within the common currency throughout devaluation and finance of budgetary deficits by their own currency and central bank, other member states also owe something to the least advantaged members of these societies that are suffering from material deprivation.

The different arguments presented in this chapter provide grounds to develop a more reasonable mixed view that both internalizes and externalizes the costs of securing sufficiency for the case of the Eurozone. A scheme for distributing those costs should also be governed by progressive taxation across member states. The need to develop such a scheme is pressing not only ensure that integration better satisfies the demands of justice but also to render morally binding the agreements that create and maintain the Eurozone. In the absence of reform, the most advantaged face the charge that they are collaborating in the imposition of injustice on the least advantaged citizens of other member states.

States also might have other grounds for redistribution. Suppose that once the member states of the Eurozone decide to create a common currency union, they also consider extending Dworkin's hypothetical insurance market to share the risks their enterprise generates. First, and most importantly, redistribution is required to prevent absolute deprivation; second, to mimic insurance, once the first principle has been satisfied. Then secondly member states should provide compulsory insurance at a fixed premium for each state on the basis of speculations about what the average member state would have purchased by way of insurance had antecedent risk of brute bad luck been equal.[272]

[272] Ronald Dworkin (2000): 80.

Conclusion

This dissertation has examined the justice and legitimacy of independent financial institutions. Beginning with the domestic case, the first topic was the *political legitimacy* of independent central banks. Having monetary policy determined by an agent sufficiently independent of the government has valuable effects but it may also create various problems. Some current political debates involve parties who claim, or imply, that independent financial institutions undermine a government's power to create enforceable duties of obedience for the subjects of its authority.

To assess the objection, I examined how two prominent defenses of *democratic authority* can explain the political legitimacy of delegating very important decisions to an independent body not subject to re-election and who can't easily be removed by the legislature.[273]

I presented in Chapter 1 two economic arguments to justify independence on grounds of either price or financial stability. The *macroeconomic argument* and the *market failure argument* for central bank's independence claim that independence is a remedial response to the political failure of an unconstrained government controlling the central bank. I assessed how this orthodox economic case fits with various influential theories of the legitimacy of democratic authority although the acceptance of such an orthodox view is controversial.

John Rawls distinguishes between three ways in which we can argue that an outcome is just because it arises from a procedure. Rawls claims that *pure procedural justice* describes situations in which there is no valid criterion for what constitutes a just outcome other than the procedure itself. Then Rawls

[273] Independent financial institutions have general goals, such as to control the money supply, fix the interest rate through open market operations and, generally, secure price and financial stability. Thus the decisions of a central bank have a deep impact on the course of the economy, and ultimately on the life-prospects of citizens. For example, whether the central bank undertakes an expansionary or contractionary monetary policy can exert influence on investment and employment and, as a consequence of it, in the absolute and the relative position of citizens.

makes a further distinction between *perfect* and *imperfect* procedural arguments. Cases of what he terms *perfect procedural justice* involve a procedure that always produces outcomes that meet procedure-independent substantive standards. In contrast, there is no such guarantee in cases involving *imperfect procedural justice* since the procedure is only a reliable but not guaranteed method for producing outcomes that are independently justifiable.

Assuming that the legitimacy of democratic authority corresponds to cases of what Rawls calls imperfect procedural justice, I distinguish between two possible justifications of the delegation of powers over monetary policy. A *narrow instrumental* view claims that democratic procedures have *epistemic and coordinating* value, and so has good effects on law and public policy. On the other hand, a *broad instrumental* view claims that democratic procedures tend to produce better effects not only on law and policy but also on citizens; e.g. when citizens have a say they are more likely to develop an effective sense of justice, and when they are publicly recognized via an equal say their self-respect is likely to be more secure.

I introduced a justification of central bank's independence by *narrow instrumentalism* which looks at the effects of independent financial institutions on laws and policies. Independence is a self-binding device used by a government subject to electoral pressures to avoid time inconsistency problems for optimal policy. Under this view, this effect suffices for their legitimacy but this is not the only influential approach to the legitimacy of democracy. Consequently, proponents of central bank independence should also consider the appeal to procedural arguments and *broad instrumentalism*, which focusses on the broader effects of the decision-making process on citizens and how the latter regard the laws and policies they live under. Finally, I concluded that narrow instrumentalism does not provide sufficient conditions to legitimise the independence of central banks, and I defended a broad instrumental account of the legitimacy of democratic authority. If the right institutional design is chosen, and it protects democratic participation and promotes some basic distributional goals of the government, broad instrumentalism assesses that the institution of central bank independence might be legitimate, and thus the government might not weaken its own right to rule, or moral authority to create enforceable political obligations when delegates control over monetary policy to an independent agency.

The second chapter of the dissertation addressed the question of what distributional goals a central bank should pursue? One answer, the corrective view, claims that central banks do not have any responsibility for the course of the real economy or unemployment. That view claims that the independent central bank should be committed only to eliminating some sort of *Pareto inefficiency*[274] arising from an unconstrained government controlling the central bank. The central bank, it claims, has no responsibility for distributive justice, and need not consider this type of reason in its policy making,[275] but only to avoid the political failures of a government subject to electoral pressures.

I first distinguished different values that the government might direct the bank to pursue and I presented three alternatives. Besides the corrective view, I offered two other alternatives views, which claim that the division of labor between independent financial institutions seeking only efficiency and the government seeking justice should not be as radical as the corrective view claims. The opposing view, the *coextensive view*, says independent financial institutions should promote and pursue the very same distributional values the government

[274] According to G. A. Cohen, *Rescuing Justice and Equality*, (Cambridge: Harvard University Press, 2008): 87 a "state A is strongly Pareto-superior to state B if everyone is better off in A than in B, and weakly Pareto-superior if at least one person is better off and no one is worse off". State A is Pareto efficient if none can be better off without making someone else worse off.

[275] This corrective view relies in two distinct arguments: the *macroeconomic argument* and the *market failure argument* and draws on John Rawls's A Theory of Justice, which distinguishes different branches of the government. In one reading of Rawls's branch distinction central banks are committed only to maintaining stability and efficiency in the market economy. The government, which handles fiscal policy, is responsible to apply sound principles of justice in the distribution of benefits and burdens and limit the scope of Pareto efficiency to the cases in which inequalities are arranged for the maximal benefit of the least advantaged members of society. See John Rawls, *A Theory of Justice*, (Cambridge: The Belknap Press of Harvard University, 1999 (1971)): 276-277.

pursues. However, those who endorse the corrective view can claim that the coextensive view relies on the overly ambitious assumption that all policies that have a deep distributive impact should be guided by the same distributional principles. This assumption is questionable since we can identify examples where policy choice has a deep distributional impact that certain decision-makers may disregard.

One might argue that if monetary policy has deep distributional effects the government must use taxation, or some other policy, to attend to the inequalities provoked by the central bank. The coextensive view appears incapable of providing a sound justification for Rawls's branch distinction, since it claims that every institution of the basic structure should apply the difference principle and this sounds troubling. Perhaps some agencies are better equipped to pursue some of the goals of each branch of the government than others, and simply the independent central bank is not well equipped to administer the difference principle.[276]

Finally, the intermediate *sufficientarian view* I favour claims the central bank should pursue a set of values broader than but encompassing inefficiency elimination but narrower than those involved in the second option. This sufficientarian intermediate view claims, like the coextensive view, that the concern to insulate monetary policy from electoral manipulation does not require pursuing only the goal of eliminating inefficiency for independent financial institutions. They shouldn't be connected only to efficiency because there is a huge distributive impact of monetary policy and this favors those institutions pursuing additional goals. However, it claims, contrary to the coextensive view, that it is reasonable to argue that central banks should be exempted to distribute expectations of primary goods according to the difference principle. Instead they should protect and promote the basic distributional values of a government guided by the difference principle, avoid decisions a

[276] John Rawls, *Political Liberalism,* (New York: Columbia University Press, 1993): 231-240.

government makes purely in response to electoral pressures but the bank should not be indifferent to the government's basic distributional values.

Using Rawls's branch distinction,[277] we should recognize that the function of independent financial institutions do not lie only within the allocation branch. Those institutions should do more than merely secure the elimination of some Pareto inefficiencies in the long run because their decisions benefit some at the expense of others, and such conflicts of interest should be resolved fairly. With this in mind, we can argue that independent central banks should also be viewed as part of the stabilization branch, which protects individuals from unemployment, since monetary policy has such deep effects on employment. Although central banks do not directly secure a social minimum, they can also be compared to parts of the transfer branch because they should to manage the risks generated by financial regulations in ways that avoid jeopardizing the provision of a social minimum, a precondition for any legitimate set of basic structural institutions.

Finally, the international aspect of my research project explored the demands of justice amongst the member states of the Eurozone. Chapter 3 focused on the question about solidarity amongst the Eurozone member states. The financial crisis in the Eurozone caused serious distributional consequences. Over time asymmetries in competitiveness exacerbated by the common market, the common currency and the common monetary policy tend to make some countries become worse off than others,[278] and provided that they cannot make adjustments with their own currency or central bank the trade imbalance induced by the divergence in competitiveness amongst member states is reflected in increased unemployment and its various unwelcome

[277] John Rawls, *A Theory of Justice*, (Cambridge: The Belknap Press of Harvard University, 1999 (1971)): 276-277.

[278] Martin Feldstein "The Failure of the Euro", *The Foreign Affairs*, January/February 2012.

consequences.[279] In particular, the economic recession and the financial crisis have worsened the situation of the least advantaged citizens of these countries relative to that of the least advantaged citizens of other member states.

I've explored four arguments that provide *pro tanto reasons* to claim that the asymmetries exacerbated by the Eurozone cannot adequately be addressed by relying only on *intra-state* solidarity.

To begin with, the first argument to justify a principle of fairness applying across member states of the European Union is *the fair adjusted procedural argument*, which claims that cooperation amongst the member states is legitimately subject to negotiation and mutual agreements. Thus, the argument assumes that the demands of distributive justice remain at least partly procedural, and accepts that member states are free to enter into agreements that influence the distribution of costs and benefits arising from the production of the Eurozone surplus. Yet the argument also insists that each state's normative powers to consent to binding agreements are constrained by the *morally mandatory aim* of preserving a social minimum appropriate for all residents in the Eurozone. Thus, the demands of justice amongst the member states of the Eurozone remain procedural insofar as they are negotiated and agreed amongst the parties but the procedure itself is adjusted in ways sensitive to satiable distributive considerations. Even when there is no complete independent standard to assess the fairness of the overall agreement, some morally mandatory aims, some outcomes, like ensuring a social minimum for all the residents of the Eurozone need to be meet by the agreement reached amongst the member states.

The second argument is the *collective self-determination argument*, which extends the egalitarian concern for relations of *non-domination* amongst individuals can be transferred into collective bodies. The argument claims that

[279] See Philippe Van Parijs, "No Eurozone without Eurodividend", (provisional version, 2012): 1-21:2; and Martin Feldstein (2012): 1-8.

the interdependence amongst member states in the EU erodes the international background conditions of justice, and that is a sufficient reason to call for principles of fairness to ensure that member states are reasonably free from domination by the strongest states. Similarly to the domestic case of agreements and contracts, Ronzoni's account can be framed in terms of pure procedural justice: we start from an existing practice where what matters is not that the relevant actors (individuals or states) be, substantively equal in wealth, say, but rather that they interact under certain conditions that, if maintained, will make any outcome of their interaction just.[280]

If we want to ensure that less competitive member states are not dominated by the most competitive ones, and that transactions amongst them remain fair, a natural way to proceed is to distribute the surplus generated by a cooperative scheme, like the EMU, in ways that prevent the richest countries exerting objectionable forms of control over poorer members. The third argument, the fair entitlement argument, claims that the Eurozone can also be seen as a cooperative venture to generate a surplus and as such we should ask how to distribute the gains it generates.[281]

The view is that each state contributes to the generation of the EU surplus and so each one is entitled to receive its fair share. Suppose that for the least

[280] Miriam Ronzoni, "The Global Order: A Case of Background Injustice? A Practice-Dependent Account", *Philosophy & Public Affairs* 37, no. 3, (2009): 248 claims that "In the case of individuals and contracts, we sketched a picture where agreements are free and fair, whatever their outcomes, as long as agents have some reasonable freedom (a) to reject them and/or(b) to renegotiate their terms. We then showed how, from a background justice perspective, in intense scenarios of socioeconomic interaction the outcomes of past agreements can erode conditions a and b of pure procedural justice. Similarly, in the global case, we are not interested in *outcomes*; we do not require states to be equally affluent, possibly not even that they each implement the same conception of domestic social justice. We are instead interested in effective sovereignty as a set of conditions under which independent sovereign states can interact justly. And just as in the domestic case, under circumstances of intense international interaction and interdependence the conditions of effective sovereignty, and hence of *international background justice*, may be eroded."

[281] Here I follow the justification of cooperative justice to distribute the costs and benefits of a lingua franca by Philippe Van Parijs, *Linguistic Justice for Europe and for the World*, (Oxford: Oxford University Press, 2011): chapter 2.

advantaged member states to join the Eurozone need to incur in an extra cost in making their economies more competitive and productive in order to face to the trade imbalances generated by a single currency area, while both the least competitive and the most advantaged countries enjoy the benefits of the EMU. Cooperative justice requires that the benefits from the EMU are distributed in proportion to the cost of producing this surplus, assuming the cost to join the EMU for the most competitive countries is less than the cost for the less competitive ones.

One influential egalitarian view of cooperative justice claims that each state has a fair entitlement to obtain an equal return of the surplus generated by EU integration, according to the cost of its contribution to generate it, which is the marginal difference to the surplus probably made by its inclusion.[282] The idea is that we should calculate what are the commonly produced benefits arising from the Eurozone and the costs for each member state to contribute it, and distribute the surplus in order that each one is entitled to a share of the benefits and burdens generated by EU integration proportional to the cost of its contribution.

I also noted that many authors find some plausibility in the view that a failure to protect states from certain types of luck-based inequality is objectionable. The fourth and last argument we shall consider draws on this concern, and claims that the agreement to establish and maintain just institutions for the Eurozone should include a *luck sharing* component.

We began with the idea that member states were in a background of equal risk. Some might then claim that member states of the Eurozone would have decide not to insure against the financial crisis because if they had wanted protection then one easy way to buy insurance against the vicious spiral that lead

[282] Philippe Van Parijs (2011): 50-82.

to high levels of unemployment in the less competitive countries of the Eurozone was to decline to enter in the Eurozone, as Sweden, Denmark or the UK did.

The *luck sharing argument* claims that the most advantaged members of the Eurozone and least competitive ones should protect their citizens from insufficiency and material deprivation, and secondly should also attempt to mimic a *hypothetical insurance market* through compulsory insurance at a fixed premium for everyone on the basis of speculations about what the average member state would have purchased insurance had antecedent risk of various economic shocks been equal.

The four arguments explored can provide *pro tanto* reasons to claim that the costs and benefits arising from the Eurozone shouldn't be compensated relying only in via intra-state solidarity, and that member states have duties of justice with other member states and the least advantaged members of these countries.

To conclude, let me express my thanks to the few readers that remain at this point, and reiterate my initial claim that my aim has been to examine some normative aspects of independent financial institutions, legitimacy and justice, and explore arguments to provide better informed judgements about the ethical dimensions of central banks. I have tried to pursue the goals of philosophy of finance understood as a particular branch of applied ethics that explores the moral and political justification of financial practices and institutions, with the aim of informing future financial reform. Since independent central banks are powerful institutions I have tried to provide reasons to claim that their legitimacy depends not only on avoiding electoral manipulation and seeking an inflation target or efficiency, In addition, they must respect rights to democratic participation and achieve some sound distributional goals in order to secure their legitimacy. In doing so, I tried to explore arguments to overcome the thesis of the skeptics who claim that only economic considerations should be taken into account for the design of the institution and its policies.

Glossary

Broad instrumentalism claims that democratic procedures tend to produce better effects on laws and policies but also have broader effects on citizens because legitimate democratic authority also depends on how citizens look at the laws they live under. Such broad instrumentalism claims that democracy produces good effects on citizens because when citizens are entitled to participate in democratic decision-making they are more likely to develop an effective sense of justice, and when they are publicly recognized via an equal say their self-respect is likely to be more secure.

The *coextensive view* says independent financial institutions should pursue the very same distributional values that the government should pursue.

The *collective self-determination argument*. The egalitarian idea of *non-domination* amongst individuals can be transferred into collective bodies. The argument claims that the interdependence amongst member states in the EU erodes the international background conditions of justice, and that is a sufficient reason to call for principles of fairness to ensure that member states are reasonably free from domination by the strongest states.

The *corrective view* claims that the independent central bank should be committed only to eliminating some sort of Pareto inefficiency arising from a government handling monetary policy. The central bank, it claims, has no responsibility for social justice, and need not consider this type of reason in its policy making.

The *difference principle* claims that social and economic inequalities are to be arranged so that they are to the greatest benefit of the least advantaged, consistent with the just savings principle. The difference principle is necessary for a just distribution of benefits and burdens across the members of society in a cooperative system amongst free and equal individuals for the mutual advantage of everyone. Without the difference principle, moral arbitrary factors like the social lottery, variations in genetic endowment or historical factors would unfairly influence the distribution of primary goods. Thus, the difference principle requires that institutions arrange inequalities to ensure that individuals share the effects of luck in a manner that it is maximally beneficial to those with less luck. Rawls's difference principle might be understood as an exclusively distributional value that prohibits expanding inequality in ways detrimental to the least advantaged, or as a mixed value that it is both distributive since it prohibits sacrificing the less advantaged for the more advantages and promotional since requires maximizing the expectations of primary goods for the least advantaged. I present three different interpretations of Rawls's *difference principle* offered by philosophers, as a *principle of reciprocity*, as a *Pareto egalitarian principle* and as a *lexical prioritarian principle*.

Distributive values are ones that guide the allocation of benefits across different individuals but, unlike promotional values, don't necessarily focus on anyone's absolute level of advantage, or require the creation of benefits.

Egalitarians aim to minimize the extent to which some are worse off than others through no choice of their own. The *principle of equality* claims that it is bad, or unjust, if some are worse off than others.

The *fair adjusted procedural argument* claims that cooperation amongst the member states is legitimately subject to negotiation and voluntary agreement, and that member states should be liable for the treaties they entered into with other member states. It grants that there is no general requirement to regulate distribution of costs and burdens amongst member states, but it claims that some morally mandatory aims, some outcomes, must be satisfied by freely negotiated agreements. Treatises bind only if they are fairly negotiated and sensitive to some distributive conditions regarding outcomes; e.g. one requiring that all member states can guarantee a social minimum.

The *fair entitlement argument* claims that the EU and Eurozone can be seen as a cooperative venture to generate a surplus and then asks how we should distribute the gains from it. *Cooperative justice* claims that each state has a fair entitlement to obtain an equal return of the surplus generated by EU integration, according to the cost of its contribution.

Instrumental values are good because of their effects. In contrast, non-instrumental values are good but not entirely due to their effects. They can be good in themselves, like a morally good will, or be good derivatively, like the value of constituent parts of wholes that are good in themselves.

Instrumentalism claims that democracy matters because obeying its directives produces the best consequences for law, policy and citizens over time when compared with any other feasible form of government.

Legitimate political authority stands for a right to rule by creating enforceable duties through directives that subjects are obliged to obey and may permissibly be sanctioned for disobeying

The *lexical prioritarian view* of the difference principle requires to requires only that in case of conflict of interest we attach priority to benefiting the worse-off members of society.

The *luck sharing view* claims that the most advantaged members of the Eurozone and least competitive ones should protect themselves about insufficiency and material deprivation, and secondly should also attempt to mimic a *hypothetical insurance market* through compulsory insurance at a fixed premium for everyone on the basis of speculations about what the average member state would have purchased insurance had antecedent risk of various economic shocks been equal.

The *macroeconomic argument*: A government has an interest in re-election, however, and to gain votes is prone to choose to expand the money supply to promote economic growth and reduce unemployment. In the short run, the increase in money supply leads to a lower interest rate which leads to an increase in investment and, in turn, employment. Nevertheless, in the medium run, an adjustment in price level expectations takes place. The lower unemployment rate also leads to an increase in prices. As a result, prices are higher than wage setters expected. They then revise upward their expectations on the increase of prices rate in their wage claims. Finally, businesses increase their prices at the same rate. The real interest rate, or the nominal interest rate plus inflation, reflects the increase in inflation. The real interest rate is the basis to calculate the return on investment, and thus investment decreases. Independence preempts the government from manipulating the electorate due to short term purely electoral pressures, and in ways against the electorate's long term interests.

The *market failure argument* appeals to the presence of market failure in financial markets. Suppose then that rumors start about the risk of loans not being repaid by a perfectly solvent bank, causing depositors to believe the bank might fail and to choose to withdraw their deposits. The bank might face running out of reserves, and the fear that it will close might actually cause it to close. This is problematic even when a bank fails for the right reason, namely having bad loans. A run on insolvent banks causes depositors in other solvent banks to panic, and withdraw their deposits too. Bank crises, if not stopped, can lead to a financial collapse. Thus, an independent central bank needs to play the role of the lender of last resort, as an unconditional source of liquidity necessary to provide financial stability. It can provide liquidity to illiquid but solvent banks to avoid inefficient bank runs, by allowing banks to turn to it for short-term loans. Even so, the central bank might choose not to bail out a private bank when it is not only illiquid but also insolvent, as occurs in the so-called efficient bank run. The market failure argument claims that the lender of last resort should provide with liquidity to illiquid but solvent banks. In so doing, it avoids the problem of inefficient bank runs, bank panics and systemic risk. Yet the independent central bank should not provide capital to banks, and if they are insolvent only the government can bail them out at the expense of taxpayers.

Narrow instrumentalism: Those who appeal to independent standards to assess laws and policies may appeal solely to the effects of the democratic process on laws and policies. A *narrow instrumental* position argues that democratic procedures have *epistemic* and *coordinating* value. Those who endorse this narrow imperfect procedural view' or narrow instrumentalists, as I call them, suggest that the democratic process tends to produce outcomes that are justified by independent standards because the democratic process characterized by deliberation and the appeal to public reason tends to enhance the quality of democratic decisions.

The *orthodox economic case* for justifying a central bank's independence is grounded by two main arguments, the *macroeconomic argument* and the *market failure argument* (or the *inefficient bank runs argument*) The orthodox economic case in favor of central bank's independence, even if empirically contestable, claims that independent financial institutions prevent voters being manipulated by an unconstrained government because the independent central bank eliminates two kinds of political failures. The macroeconomic argument claims that government interest in re-election prevents them from achieving a long term low inflation goal.

Pareto efficiency: never waste opportunities to make someone better off without making some other worse off.

Paretian egalitarianism tries to accommodate the levelling down objection and use the efficiency principle to restrict the scope of egalitarian principles. Thus, its advocates favor the most egalitarian member of the set of non-wasteful distributions.

The *Paretian egalitarian* interpretation of the difference principle allows inequalities that are not detrimental for the least advantaged and maximize their benefits.

Perfect and Imperfect procedural justice: John Rawls distinguishes between three ways in which we can argue that an outcome is just because it arises from a procedure. Cases of what he terms perfect procedural justice involve a procedure that always produces outcomes that meet procedure-independent substantive standards. In contrast, there is no such guarantee in cases involving imperfect procedural justice since the procedure is only a reliable but not guaranteed method for producing outcomes that are independently justifiable. Perfect or imperfect procedural arguments for a duty to obey the law both claim the resulting laws should be obeyed, and may be enforced, because the fact they emerged from a specific procedure is good evidence that they are independently justifiable.

Political legitimacy is understood here to involve a political authority possessing a justified right to rule. The right to rule concerns two main ideas: the normative power to issue commands that create valid duties for the subjects of the authority and the permission to exercise coercion to sanction disobedience with those commands.

Prioritarians aim to benefit individuals, and where conflicts exist about who to benefit they attach greater urgency to benefiting the least advantaged. The *priority principle* establishes that the moral value of benefiting individuals diminishes as they become better off.

The Prisoner's Dilemma is a paradigmatic example from game theory illustrating how it is possible that two rational individuals may fail to cooperate even if it is in their best interests to do so. Two members of a criminal gang are arrested and imprisoned. Each prisoner is in solitary confinement. The police admit they don't have enough evidence to convict the pair on the principal charge. They plan to sentence both to a year in prison on a lesser charge. Simultaneously, the police offer each prisoner the opportunity either to betray the other, by testifying that the other committed the crime, or to cooperate with the other by remaining silent. Here's how it goes: (i) If A and B both betray the other, each of them serves 2 years in prison; (ii) if A betrays B but B remains silent, A will be set free and B will serve 3 years in prison (and vice versa); and (iii) if A and B both remain silent, both of them will only serve 1 year in prison. To betray a partner offers a greater reward than cooperating with them and all purely rational self-interested prisoners would betray the other. So the only possible outcome for two purely rational self-interested prisoners is for them to betray each other. The interesting part of this result is that pursuing individual reward logically leads both of the prisoners to betray even if they would get a better reward if they both cooperated.

Promotional values: Within the group of non-instrumental values, it is useful to distinguish between promotional and distributive values. Promotional values, by definition, require producing more of something. It might also be worth distinguishing aggregative promotional values that increase the sum of benefits and non-aggregative promotional values that favor preserving or increasing benefits for each person.

Pure proceduralism claims that democracy matters because of the fairness of its procedures. Pure proceduralism makes no appeal to any substantive standard independent of the procedure by which the outcome must be assessed. It claims that laws should be obeyed because they emerged in a way that was procedurally just.

Pure procedural justice: John Rawls distinguishes between three ways in which we can argue that an outcome is just because it arises from a procedure. Rawls claims that *pure procedural justice* describes situations in which there is no criterion for what constitutes a just outcome other than the procedure itself.

Rawls's branch distinction: In *A Theory of Justice*, however, Rawls also distinguishes between four branches of the government: the allocation branch is to keep the price system workably competitive; the stabilization branch is to keep full employment and that free choice of occupation and the deployment of finance are supported by effective demand; the transfer branch guarantees a certain level of well-being and a social minimum; and finally the distribution branch is to preserve an approximate justice in distributive shares.

Rawls's two principles of justice:

1. Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with similar liberty for all.

2. Social and economic inequalities are to be arranged so that they are both:

   a. Attached to offices and positions open to all under conditions of fair equality of opportunity (principle of fair equality of opportunity)
   b. To the greatest benefit of the least advantaged, consistent with the just savings principle (the difference principle).

The *reciprocity view* of the difference principle, any point in the set of feasible distributions is acceptable if its implementation does not expand inequalities in ways detrimental to the least advantaged (the *non-maximinimizing view*).

Simple instrumentalism claims that democracy is legitimate because it tends to produce the best consequences over time when compared to any other workable forms of government.

Social justice: The design of each society, with its laws, policies and institutions, results in different distributions of economic benefits and burdens across members of the society. The resulting economic distributions fundamentally affect people's lives and to some extent are predictable, and lie within various agents' control. Arguments about the principles that govern the design of such laws, policies, and institutions constitute the debate over 'social justice' in the sense that concerns this dissertation.

Sufficientarians aim to minimize the number of persons who fall below some threshold. The *principle of sufficiency* states that it is bad, or unjust, if any individual has less than enough; in its anti-egalitarian variant it also states if everyone has enough it is not bad that some are worse off than others.

The *sufficientarian view* says the central bank should pursue a set of values broader encompassing inefficiency elimination but not necessarily equivalent to those the government should pursue. According to this view central banks should protect and/or promote the government's most basic distributional values. I claim that there are reasons to exempt independent financial institutions from a responsibility to distribute expectations of primary goods according to the difference principle. They should, however, be part both of the stabilization branch of government, and promote investment and employment, and of the transfer branch, not to provide a social minimum directly but to ensure that financial activity does not jeopardize its provision.

Time inconsistency refers to the incentive for one player to deviate from her previously announced course of action once the other player has moved. Governments are likely to want to reduce unemployment because they are subject to electoral pressures, even if doing so leads to inflation in the future.

The *time inconsistency problem of optimal inflation policy*: Suppose the central bank is in hands of the government and the government officially commits itself to price stability. However, when the next election looms the government is unlikely to avoid using the money supply to promote its electoral interests. Because the ruling party aims to maintain power, and the electorate can be influenced by manipulating interest rates, the government is less likely to maintain its previous commitment. One political strategy to reduce the bad effects of time inconsistency problems is to make the central bank independent of pressure from the government. On according to this argument, independence is a remedial response to the political failure of an unconstrained government controlling the central bank.

Utilitarianism claims that justice requires maximizing the sum of utility, and so affirms a purely aggregative principle. Utilitarianism is a distribution-insensitive form of *welfarism* although distribution-sensitive forms of welfarism are also possible. Welfarists claim that whether institutions are just is dependent on the way they distribute welfare amongst individuals. They take welfare as the standard of interpersonal comparison, the 'metric' or 'currency' of distributive justice used to determine an individual's level of advantage, and decide who is better off or worse off than others. What's crucial for utilitarian welfarists is the individual's level of utility, or level of preference-satisfaction, or some other set of facts that make a person's life worth living for her.

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