Beth A. Simmons: Rulers of the game: central bank independence during the interwar years, in: IO 50, 3, summer 1996, pp.407-43, outlined by Nadine

Question: What are the implications of central banks' independence with regard to stability and cooperation within a fixed rate regime?

Hypothesis: "Systemic [international monetary system] instability can come from an unlikely quarter: the most independent central banks in the system" (p.408).

Substantiation: "Highly independent central banks are more likely to be domestic inflation hawks, increasing the likelihood of systemic deflation and destabilization under these conditions" (p. 408). Or else, domestic price stability has a higher rank for central bankers, then international exchange-rate cooperation in times, when these two are in conflict.

Causal logic: **Tradeoff between the goals of domestic price stability and an external equilibrium re BOP**:
The rules of the game for BOP in a fixed exchange rate mechanism:
1 Deficit countries, which experience gold outflows have to contract their money supply or decrease interest rates, while surplus countries have to increase their money supply or interest rates.

2 Dilemmas: noncooperative incentives and asymmetric adjustment responsibilities
A) In surplus countries: when a decrease in interest rates conflicts with inflationary pressures
B) In deficit countries: when an increase in interest rates conflicts with a policy aimed at stimulating the economy in times of recession.
C) While to deficit countries have to deflate to remain liquid, the surplus countries do not face punishment in terms of insolvency.

3 Institutional solutions to provide for cooperation
A) Hegemonic Stability Theory: One dominant economic power enforces the compliance and provides the necessary temporary liquidity (foreign exchange loans) for the deficit countries.
B) Monetary Regime (Bretton Woods/IMF, European exchange rate mechanism): international regime with compulsory regulation for debtor countries to deflate and surplus countries to inflate and funds provided to deficit countries to balance their sheets. Such regimes can also codify (financial) punishment mechanisms when the surplus countries do not comply by the rules.

4) Conceptual framework for the analysis of central bank policies
A) Governments have difficulties in making a credible commitment to price stability because they have time-inconsistent preferences and act according to political business cycles.
B) In granting the central bank independence and monetary competency, governments can make credible commitments to price stability since banks, typically net creditors, loose from inflation and have obvious incentives to prevent it.
These basic assumptions allow for the inference of three testable hypotheses/ predictions p.425):
I More independent central banks will be more deflationary and will place a higher priority on domestic price stability than will other central banks.
II Central bank policy in general will be more deflationary under left-wing governments, whose ex ante credibility is thought to be lower
III If the more independent central banks act strategically, they will moderate their behavior under left-wing governments in order to preserve their longer-term independence.

5) Results of empiric research (pp. 427-434):

I Central banks conducted their monetary policies in a way to counter business (inflation/recession) cycles. All findings provide evidence that central banks' willingness to play by the rules was strongly influenced by the direction of the business cycle.

II The more independent central banks conducted policies that were systematically more deflationary than those taken by the more politically controlled banks and more than those required for external adjustment (BOP). Also, the more politically controlled central banks (with parliamentary oversight) were much more likely to choose bank rate policies that fell in the cooperative region re external balance than the politically independent one.

III Central bank policies where far more contractionary under left governments then under right governments to provide "extra" credibility for left governments (note here it's in relative terms).

IV A tentative conclusion from the fact that monetary accommodation tends to be slightly greater under left wing governments is that the monetary authorities were not completely free from political pressure and even banks with high degrees of independence moderated their behavior to preserve long-term independence.

(The empiric evaluation of alternative explanations (IVs to determinate monetary supply and interest rates) like BOP, political instability, fiscal policy (as an alternative source for government credibility), maximization of trade competitiveness, Hegemonic Stability Theory scored comparatively weaker)

6) Summary of the causal logic

Major surplus countries with a highly independent central bank are very likely to increase their interest rates when they perceive as what they reckon to be domestic inflationary pressures, instead of inflating their money markets to counterweight BOP imbalances. In times of slow economic growth, deficit countries are then either forced to follow suit and deflate as well attempting to keep their currency at a fixed rate, or they shall experience an even greater BOP-deficit and reduction of their foreign exchange reserves. Instead of being able to simulate growth and export competitiveness, they will have to contract their economy or else will arrive at a point where they run out of foreign exchange to pay up for their deficits. At this point, they will then either have to default or to devaluate their respective currencies.