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Diessner, S.

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The power of folk ideas in economic policy and the central bank–commercial bank analogy

Sebastian Diessner ^a

^aFaculty of Governance and Global Affairs, Leiden University, The Hague, Netherlands

ABSTRACT

This article argues that policy-makers' non-expert or 'folk' ideas can affect policy outcomes in a way that challenges the assumption of economic policy-making being guided by expert ideas emanating from the realm of economics and other sciences. To substantiate this argument, the article invokes literatures on audience costs as well as on economic folk theories to highlight the power of analogies and fallacies in the formulation of policy. While political economists have focused exclusively on the power of the 'household analogy' in the area of fiscal policy, much less is known about its monetary policy equivalent, which the article introduces as the 'bank analogy'. Empirically, the analogy is assessed in the context of what is arguably a least likely case for the power of folk ideas to hold: the European Central Bank's governance of its balance sheet, the most powerful balance sheet in Europe.

KEYWORDS

Political economy;
macroeconomic policy; folk
ideas; central banking; ECB

Introduction

The 'power of ideas' has become one of the most powerful ideas in new political economy research, on the heels of John Maynard Keynes's notorious suggestion that 'the world is ruled by little else' (Parsons 1983: 369, Hall 1989, Blyth 2002, Hay 2006, Gofas and Hay 2010). The burgeoning ideational literature has focused on how policy-makers rely on certain sets of *expert* beliefs, theories, and models in order to inform, perform, and legitimate their decision-making (Baker 2015, Matthijs 2016, Clift 2019, Helgadottir 2022). This chimes in with a prominent strand of public policy scholarship which posits that the legitimacy of policy-makers is grounded in their reputation for scientific expertise (Bawn 1995, Carpenter 2001, Huber and Shipan 2002).¹ Departing from both literatures, this article draws our attention to the power of *non-expert* beliefs, or what I call folk ideas, instead. Specifically, I argue that policy-makers' beliefs about the general public's 'common sense' – irrespective of whether accurate or not – can affect policy outcomes in a hitherto underappreciated manner, and even up to an extent that directly contradicts the expert ideas on which the legitimacy of policy-making purportedly rests. To substantiate this claim, I draw on political economy literatures on audience costs (Lohmann 2003) as well as economic folk theories (Braun 2016, Swedberg 2018) in order to highlight the role of analogies and fallacies in the formulation of policy.

The power of expert ideas and policy paradigms has been scrutinised most extensively in the supposedly scientised realm of macroeconomic policy (Hall 1993, Carstensen and Matthijs 2018, Helgadottir and Ban 2022, van 't Klooster 2021). However, a number of recent studies have grappled with

CONTACT Sebastian Diessner  s.diessner@fgga.leidenuniv.nl  Institute of Public Administration, Leiden University, Turfmarkt 99, 2511 DP The Hague, Netherlands

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the perplexing power of non-expert ideas in the area of fiscal policy in particular. Most prominent among these is the erroneous ‘household analogy’, according to which the state budget functions along similar lines as that of an ordinary household (Stanley 2014, Hopkin and Rosamond 2018, Wren-Lewis 2018, Downey 2022). Yet, the power of non-expert ideas in the other major sphere of macroeconomic policy, namely monetary policy, has received scant attention to date (cf. Braun 2016). This omission is startling, given that monetary policy under the auspices of independent central banks has, for better or worse, emerged as the central lever of macroeconomic governance over the past three decades.² This paper seeks to fill this void by introducing the ‘bank analogy’, that is, the erroneous notion that the *central* bank functions along similar lines as an ordinary *commercial* bank.

A closer look at the governance of central banks’ balance sheets presents us with an unresolved political economy puzzle. While the main purpose of central banking – as opposed to commercial banking – is not the generation of profits, central banks seem extraordinarily keen to avoid posting losses. What’s more, while central banks can hardly become ‘insolvent’ in a fiat currency regime with legally guaranteed currency-creation powers, they tend to fiercely protect their capital bases to pre-empt any suspicion of insolvency. One such case can be witnessed in Europe, where the European Central Bank (ECB) has insisted on positive balance sheet capital both for itself and for the national central banks. This insistence has been deemed ‘surprising’ and ‘puzzling’ by market participants (FT 2010) – the very experts who are typically seen as the main audience of a central bank – and bewildering by economists (Whelan 2012, De Grauwe 2013). Why, then, would central bankers insist on something that appears to go against the very nature of modern central banking?

I shed light on this puzzle by means of an in-depth case study of the ECB’s governance of its balance sheet, drawing on a range of primary sources available from the central bank, including legal acts, official remarks and reports, and staff research. I complement these with an original set of elite interviews with current and former senior decision-makers. My findings suggest that although Europe’s central bankers are cognisant of the irrelevance of balance sheet capital in theory, they nevertheless attach weight to it in practice, in order not to contradict the public’s assumed common sense that persistent losses and negative capital are undesirable. I further submit that the ECB represents a least likely case for the power of such folk ideas to apply, due to its far-reaching political insulation and widely assumed hyper-scientization. Thus, if we find the bank analogy to hold in the case of the ECB, then we may expect the folk-ideational argument to apply in other, less scientized and/or less insulated economic policy-making contexts as well.³

The remainder of the article is organised as follows. The next section discusses two interrelated questions in order to clarify the stakes of my theoretical argument. First, how can we expect policy-makers to relate to a variegated set of audiences? And second, how can we make sense of the ways in which they take the audience of the general public into account? The third section introduces the case study research design, observable implications of the argument, and sources of data. Section four assesses the argument in the context of the ECB’s governance of its balance sheet. The final section teases out implications for future research, with a view to how the study of folk ideas might be applicable not only to central banks other than the ECB, but also beyond the realm of monetary policy-making.

The power of folk ideas in economic policy

A mainstay in the literature on public, and especially economic, policy-making is that much of what policy-makers do boils down to sending carefully crafted signals to shape the expectations of their audiences in one way or another (Hall and Franzese 1998, Carpenter 2001). However, the fact that different audiences may have ‘different stakes, attention cues and information sets’ poses a range of problems for policy-makers, as highlighted in the literature on audience costs (Lohmann 2003: 97). In the canonical version of the audience-cost argument, this means that some audiences will

likely be more attentive towards a given policy than others. Policy-makers will then have an incentive to cater to this attentive audience over and above the rest: the fact that it can impose a reputational cost on the policy-maker – should she ever dare break her promises – is what ultimately renders policy commitments both credible and flexible (Broz 2002: 867, Lohmann 2003). Against this backdrop, the literature on monetary policy-making in particular has long been focused on central banks' signalling efforts towards a narrow, specialised, and hyper-attentive audience of economic experts and financial market participants (Blinder *et al.* 2008, Hayo and Neuenkirch 2015, Birk and Thiemann 2020).

In reality, however, central banks have come to appreciate that their reputations – like those of other bureaucracies (Carpenter 2010, Grube 2019) – are staked on a whole host of attentive audiences (Haldane 2018, Powell 2019, Lagarde 2020). Among this tangled web of addressees, one key audience are central banks' political principals, who determine their legal statutes and thus hold one of the few levers through which to inflict not only a reputational but also an institutional cost on monetary authorities (Posen 1993). Another essential, but traditionally neglected, audience of a central bank is that of the general public. Social scientists have recently begun to branch out of this tradition to study central bankers' interactions with 'the people', that is, non-experts, as well (Holmes 2014, Braun 2016, Lokdam 2020, Moschella *et al.* 2020). Despite these efforts, however, such interactions still 'largely remain a blind spot' (Haldane and McMahon 2018: 758). In particular, research in this mould has focused predominantly on how policy-makers *communicate with* non-experts (Bholat *et al.* 2018, Baerg 2020, Ehrmann and Wabitsch 2021) as well as on the *narratives* they generate and disseminate (Abolafia 2010, Beckert and Bronk 2018). In contrast, the way in which policy-makers *think about* non-experts, and how this affects their policy-making, remains broadly unknown.

This is unfortunate, given that policy-makers' ideas about the general public can reasonably be expected to have a discernible impact on policy outcomes. For example, the ways in which households – among the key actors in the macroeconomy (Sparkes and Wood 2021) – are assumed to react to a given decision is likely to be taken into account before reaching that decision in the first place.⁴ One way this is accounted for in the literature on monetary policy, if at all, is through the lens of New Keynesian macroeconomics, which surveys households' inflation perceptions and expectations (Mankiw *et al.* 2003, Meyler and Reiche 2021). However, as Riles (2018) suggests, inflation expectations are by far not the only area of concern for central bankers when it comes to harnessing their relations with the public, especially if the objective is not merely to achieve effective policy but also to bolster their legitimacy (Braun *et al.* 2022). This means that policy-makers require a broader understanding of the general public than can be obtained through inflation expectation surveys alone.

Expert ideas versus non-expert ideas

The political economy literature that *does* study policy-makers' thinking, that is, their cognitive and causal beliefs, has for the most part been limited to ideas emanating from the realm of academic macroeconomics or more generally from the realm of economic expertise (Baker 2015, Dellepiane-Avellanada 2015, Helgadóttir 2022).⁵ This literature has suggested that dominant ideas have long been neoliberal (Mandalkern 2015, Ban 2016) and ordoliberal (Matthijs 2016, Schäfer 2016, Schulz 2017) in nature and content, with a common assertion of policy-makers 'all sharing a conservative macroeconomic outlook' (Iversen and Soskice 2019: 121). In contrast to this, we seem to be witnessing the resurgence of a 'contingent' or 'technocratic' Keynesianism as of late (Clift 2019, van 't Klooster 2021). While productive, these debates have needlessly narrowed the lens of inquiry to pre-established sets of ideas originating from economic theory.

Notable departures can be found in Vivien Schmidt's (2008) discursive institutionalism, which stresses not only the role of ideas more narrowly, but also of 'public philosophies' more broadly, or in John Campbell's notion of 'public sentiments' which reflect 'assumptions that constrain the

normative range of legitimate solutions available to policy makers' (Campbell 1998: 385, as quoted in Stanley 2014: 897).⁶ More recently, two studies in political economy and economic sociology, by Braun (2016) and Swedberg (2018), have broken new ground in this regard, zooming into the role of economic 'folk theories'. While I am indebted to the contributions of both, I seek to depart from them in two ways.

First, my vantage point in this article is the reverse one. I shall be less interested in ascertaining how the public or folk may *actually* think about economic phenomena and be more interested in how policy-makers *assume* the public to view and understand the economy, and how this matters for economic policy. In other words, my aim shall not be to analyse the properties of an economic folk theory in and as of itself, but rather to shed light on policy-makers' 'theories of folk reasoning', so to speak. There are good empirical reasons for this, as discussed further below. Second, I do not deem it plausible for policy-makers to assume that non-experts draw on coherent *theories* through which to make sense of economic policy. Instead, it would seem a safer bet for them to expect the general public to rely on more loosely connected sets of beliefs about the economy. I shall thus speak of folk *ideas*, rather than theories.

Having said this, I do follow Braun's (2016: 1072) effective distinction between a narrow élite of economic insiders versus a broader collective of economic outsiders in order to define the public or 'folk' as non-experts in economic policy. I thus define 'folk ideas' as policy-makers' assumptions about non-experts' economic beliefs – or, put differently, policy-makers' ideas about folk reasoning. Moreover, I heed Swedberg's (2018: 11) advice that a useful starting point to conceptualise the general public's assumed economic sense – and how to make sense of it – can be found in Max Weber's political economy.

In his seminal *Economy and Society*, Weber (1978) sought to 'make a social science concept of householding', which describes how households engage in economic activity, by contrasting it with 'profit-making', which describes how enterprises operate in a market economy (Swedberg 2011: 22–24). Among other key characteristics, householding is supposed to reflect 'a more cautious approach to the management of resources' (or, in the jargon of economics, a stronger appreciation of budget constraints) (ibid.: 23). The value of this distinction, I argue, lies not so much in providing a template for 'types of economic action' (ibid.: 22), but rather for types of economic *reasoning*. In particular, it would seem plausible to assume that policy-makers expect households to reason in accordance with a householding logic.

The household analogy and the bank analogy

The best illustration of a folk idea through the lens of Weber's concept of householding is the notorious 'household analogy' in the area of fiscal policy. In essence, the analogy implies that people's understanding of and personal experience with their own household budget may lead them to assume that the state budget broadly functions along much the same lines. Keynes's *General Theory* prominently exposed this type of reasoning as a fallacy of composition: what might be true of the individual parts of a whole (and even of all individual parts), is not necessarily true of the whole itself. After all, the state budget does operate along markedly different lines from those of the ordinary household, not least due to the government's capacity to levy taxes (which, in turn, affect all households) as well as the fact that it can rely on its own (central) bank endowed with the legal monopoly to issue currency.

Yet, numerous cases have been identified in the extant literature in which the analogy has been leveraged effectively to garner support for pro-cyclical fiscal policies, such as balanced budget rules and austerity programmes (Blyth 2013, Schmidt and Thatcher 2013, Montgomerie 2016, Seabrooke and Thomsen 2016). Paradoxically, however, the household analogy is not necessarily reflected in actual beliefs held by *households*, as recent empirical work by Lucy Barnes and Timothy Hicks (2022) suggests (see also Bansak *et al.* 2021, cf. Stanley 2014, Ferragina and Zola 2022). This

points to a second key feature of folk ideas: apart from not being firmly rooted in economic theory, they are more likely to operate at *élite* level than at the level of the public or folk itself.

Beside fiscal policy, I argue that a closely related folk idea can be construed in the other substantive area of macroeconomic policy, namely monetary policy. That is, the fallacy that the *central* bank functions along similar lines as an ordinary *commercial* bank. While such a central bank–commercial bank analogy, or bank analogy in short, has been suspected and alluded to in the literature (Kumhof *et al.* 2020), its existence and practical significance have rarely if ever been subject to empirical scrutiny. According to the Weberian logic of householding, a key accompanying attribute of the bank analogy should be a ‘cautious approach to the management of resources’. For monetary policy-makers, this implies avoiding losses that result in negative capital – which, in the case of a commercial bank, would be tantamount to insolvency. Moreover, policy-makers would assume non-experts to object in case monetary policy departed too far from this householding logic, irrespective of whether accurate or not.

The bank analogy displays both of the hallmarks of a folk idea. First, it is not grounded in economic theory, given that negative balance sheet capital does not, in itself, lead to central bank insolvency. Second, the analogy can shape policy outcomes at *élite*-level, without necessarily being borne out at the level of the public or folk itself.

On the whole, the stakes of my theoretical argument can be summarised as follows. If economic policy-makers expect more than one audience to be attentive towards their policies, they will need to make assumptions about their different audiences in order to take these into account in the formulation and communication of policy. When it comes to the audience of the general public, economic ideas and theories can guide policy-making only to a limited extent. Instead, policy-makers will need to make assertions about non-experts’ economic reasoning and beliefs – that is, they will need to resort to folk ideas. In the realm of monetary policy, this manifests itself in the form of the bank analogy, according to which policy-makers assume non-experts to conflate the governance of the central bank with that of an ordinary commercial bank. I now turn to how the argument can be operationalised and assessed in the context of a single-case study by zooming into the European Central Bank’s governance of its balance sheet, the most powerful balance sheet in Europe.

Single-case study research design

I argue that the case at hand – the European Central Bank – represents a least likely case for my theoretical argument to hold: that is, prior knowledge would suggest there are strong reasons to expect it not to apply (Levy 2008: 12). I submit that this is the case in the context of the ECB, for two main reasons: first, because the ECB is a *central bank*, and second, because it is the *European* Central Bank. As regards the first, there seems to be a near-universal consensus in the political economy literature that the connection between (macro-)economics and monetary policy-making could not be more tightly knit. For starters, central banks today are overwhelmingly staffed with economists, be they from an academic, administrative, or private sector background (Adolph 2013, Mishra and Reshef 2019). If anything, the literature tends to debate the *degree* to which central banking and economics affect each other – that is, whether monetary policy is a case of the scientization (Marcussen 2009) or the hyper-scientization (Mudge and Vauchez 2016) of policy – and whether the *direction* of influence runs from economics to central banking (with central bankers having similar backgrounds and career trajectories due to having been trained at the same economics departments) (Adolph 2013, Bennani 2015) or the other way round (with central banks having invested in research units and thereby having come to dominate the field of monetary economics themselves) (Conti-Brown 2018, Dietsch *et al.* 2018, Helgadottir and Ban 2021).⁷

The interplay between macroeconomics and central banking is supposed to be particularly pronounced in the case of the world’s major central banks and, among these, not least the ECB (Freedman *et al.* 2011, Thiemann *et al.* 2021). It thus seems safe to suggest that few scholars would dispute that economic ideas and theories affect central bankers in some way or another. At most, we debate

which schools of economic thought influence their deliberation and decision-making (Bailey and Schonhardt-Bailey 2008), with a common view that the ECB was influenced by ordoliberal economic ideas throughout much of its existence and especially during the early years of the Eurozone crisis (Matthijs 2016: 383, Ban 2016, Schulz 2017). From this vantage point, the suggestion that central bankers may go against their own economic beliefs and act in line with the alleged common sense of the general public instead, is an unexpected and unlikely one.

Second, and in terms of the audience-cost part of the argument, there are good reasons to suspect that the *European Central Bank* should be particularly shielded from some of the costs that its audiences can inflict upon it. After all, the ECB is commonly seen as the most independent central bank in the world, owing to an ‘unprecedented divorce between the main monetary and fiscal authorities’ (Goodhart 1998: 410). The ECB’s statutes are codified in the European treaties, providing the central bank with quasi-constitutional *de iure* protection from interference with its policy-making. The notorious difficulty of overhauling the treaties creates a high hurdle for imposing an institutional cost on the supranational central bank, thus diminishing the ‘risk of change’ to its independence (Posen 1993: 255). This essentially leaves the reputational channel through which the ECB may incur a cost *de facto*.

Taken together, the ECB’s strong interlinkages with economic research, in combination with its extraordinary degree of independence, suggest that it should be unlikely for the central bank to see a need to cater to the general public’s alleged economic sense, given that it would face little to no institutional cost if it chose not to. Thus, if we found the folk ideas argument to hold in the case of the ECB, there should be some reason to expect it to apply not only to ‘less’ independent central banks, but also beyond the realm of monetary policy and in other spheres of public policy – which are frequently assumed to be under the near-exclusive influence of economic experts (Fourcade *et al.* 2015, Christensen and Mandelkern 2022, Golka and van der Zwan 2022) or under the spell of powerful ideas emanating from economics and related academic disciplines (Béland and Cox 2013, Hirschman and Berman 2014).

Observable implications and data

What would we expect to observe for my folk ideas argument to hold and how would we be able to observe it? The argument entails three observable implications. First, policy-makers exhibit that, in principle, balance sheet losses and negative capital should not pose problems for their policy-making in and as of themselves – that is, they are aware of the nature of central banking in a fiat currency regime, at least in theory. Second, their statements and decisions imply that they do care about losses and capital in practice nevertheless, in apparent contradiction to the above. There would thus have to be another motivation behind their behaviour. Finally, when probing into these motivations, the evidence indicates that they are not explained by reputational threats from central banks’ commonly presumed main audience of economic experts and financial market participants. Instead, it is the general public – that is, non-experts – who are deemed to be the main audience of concern in this case.

To be sure, ascertaining policy-makers’ beliefs is a challenging task at best, especially when these policy-makers are endowed with institutional independence and when their deliberation and decision-making are non-public. The relatively recent turn towards central bank transparency eases these concerns (Dincer and Eichengreen 2009), without removing them altogether. Consequently, scholars are well-advised to draw on as wide a range of primary sources as possible, including legal provisions and decisions, central banks’ in-house research, and official communication outputs (speeches and press releases), in addition to relevant secondary sources (literature and media reports). Where necessary and feasible, these should be complemented with supplementary data gathered through interviews with policy-makers and other stakeholders. This article invokes all of these, starting from EU legal provisions and the ECB’s in-house research, which are contrasted with the central bank’s decisions and communications, and triangulated with original data gathered from

a set of semi-structured elite interviews. The latter were conducted with current and former officials at executive and senior management levels – ranging from advisors to heads of division and directors-general, to board members, deputy-/governors and vice-/presidents – covering both the ECB and a number of national central banks (NCBs) across euro area and non-euro area member states.⁸

The power of folk ideas in practice: the ECB's governance of its balance sheet

At the inception of Europe's monetary union, the soon-to-be-established European Central Bank was endowed with a capital base of five billion euros, subscribed by all EU national central banks acting as its 'shareholders' (Statute of the ESCB and ECB, Art. 28 & 29). According to Ingram (2010), an early insider as the ECB's first director for accounting, the precise sum of five billion was not arrived at by means of any discernible calculation. Instead, it was informed by practical considerations – namely, to provide the central bank with an additional source of revenue to cover its own expenses – as well as by strong perceptual and presentational concerns – namely, to create a 'buffer' against potential losses to foster the ECB's perceived financial independence and strength (Ingram 2010: 162, see also Scheller 2006: 115). However, the notions of financial 'independence' and 'strength' were contested at the time and had still not been 'defined concretely' years after (de Lhoneux 2005: 169-170).

As a result, the ECB has been confronted with questions about its balance sheet capital at various points throughout its existence. In 2004, after two years of losses on its foreign reserve portfolio due to the strength of the euro vis-à-vis the US dollar, the central bank published a working paper aiming to revisit the role of central bank capital. While views expressed in working papers are not necessarily those of the ECB, the authors stressed that, in theory, balance sheet capital 'does not seem to matter for monetary policy implementation, in essence because negative levels of capital do not represent any threat to the central bank being able to pay for whatever costs it has' and that 'a central bank is not directly constrained in the amount of credit it can sustain, unlike any other economic agent' (Bindseil *et al.* 2004: 23, emphasis in original).⁹

Yet, would monetary policy-makers sign up to this understanding of central banking as well? Evidence from elite interviews strongly suggests so (see Table A.1 in online appendix for an overview, supplementary material). Among interviewees, a broad consensus prevailed that central bank capital 'does not matter' (Interview 1) 'in economic or monetary policy terms' (Interview 9), 'is irrelevant in a paper standard' (Interview 3), 'is not really a problem' (Interview 8) and that 'in theory, you can have negative capital' (Interview 6), which 'does not influence the performance of monetary policy (...) at all' (Interview 10).

Paradoxically, however, the ECB has sought to insist on positive capital both for itself and for a number of national central banks in practice. Among others, in 2003 and 2004, it provided two legal opinions on a proposal by the Finnish government which had planned to reduce the capital of its national central bank, Suomen Pankki. The ECB (2004) opined that it was 'seriously concerned' by the proposal, which led to its eventual withdrawal by the government. The striking discrepancy between suggesting that balance sheet capital should not matter in theory, while insisting that it not be reduced in practice, resurfaced during the Eurozone crisis, and with a vengeance. The dissonance came to a head when the ECB addressed the case of the Czech Republic in its Convergence Report of May 2010 (ECB 2010: 239), finding that.

Česká národní banka [the Czech National Bank] is faced with accumulated losses beyond the level of its capital (...) A negative capital situation may adversely affect an NCB's ability to perform its ESCB-related tasks as well as its national tasks. (...) Česká národní banka should be provided with an appropriate amount of capital within a reasonable period of time so as to comply with the principle of financial independence.

A reply from the Czech authorities came promptly and was nothing short of extraordinary. In a press release titled 'The Czech National Bank disagrees with the ECB Convergence Report', the Bank's governor dismissed the ECB's position as 'unjustified' and 'not based on any legal regulation' (CNB 2010). The statement went on to stress that 'the CNB regards as completely unacceptable' the

view that negative capital may have an adverse impact on the performance of its tasks, suggesting that its capital position has ‘never undermined its independence or limited its decision-making and operational capacity in any way’ (ibid.).

By the end of the same year, however, the ECB doubled down on its insistence on positive capital – *literally* doubling its capital base from five billion to ten billion euros – in a move which dumbfounded market participants (FT 2010, ECB 2011). Remarkably, the only condition on which the decision had to be based was ‘the Governing Council’s perception of the need to maintain the ECB’s capital adequacy’ (Ingram 2010: 165, EU Regulation EC 1009/2000). What, then, informs this perception? What motivations underlie the central bank’s preoccupation with ‘adequate’ capital in practice, despite being seen as irrelevant in theory? Put differently, if the ECB does not see the issue as a technical problem in itself, whom does it fear could *make* it a problem? Which audiences does it expect to incur a reputational cost from, if any?

Evidence from elite interviews can help shed light on these questions (see Table A.2 in online appendix for an overview, supplementary material). Contrary to the common assumption of central banks’ words and actions being geared, above all, towards financial markets, most interviewees did not consider market participants to be the main source of concern with regard to balance sheet capital. Rather, markets were deemed to ‘understand these things’ and thus to ‘not care much about’ nor be ‘so preoccupied with’ a possible erosion of the ECB’s capital base (Interviews 8, 9, 10). As one respondent even ventured to suggest: ‘banks are more rational than the central bank here’ (Interview 1).

In contrast, interviewees persistently invoked the general public – possibly alerted through the media – as the chief audience of concern when it comes to central bank losses and capital. In particular, it was suggested that ‘a big problem comes from public perception’ (Interview 8) and that negative capital would amount to ‘a permanent invitation to journalists’ (Interview 3) as well as ‘a reputation risk with public opinion – with *misinformed* public opinion’ (Interview 9). Conversely, respondents deemed it ‘very hard to explain’ the true nature of central bank capital to the wider public in order to correct such misperceptions (Interview 10). In the words of one interviewee, this was due to ‘the people which have common sense and would say: “well, losses are not good in any case”’ (Interview 7), irrespective of whether these are incurred by a central bank or by a commercial bank.

One could be tempted to conclude that this kind of folk reasoning, despite being feared by monetary policy-makers, did not have an actual impact on policy outcomes. The opposite is true, however. Fears of balance sheet losses and negative capital have, in fact, been seen as key motives restraining central bankers from taking on additional risks at a time when resolute crisis action was needed ever so badly (De Grauwe 2013). Although the ECB did act eventually and forcefully to banish the spectre of a disorderly disintegration of the Eurozone during the crisis, it did so only belatedly (Schulz 2017), and its balance sheet *shrank* rather than expanded between 2012 and 2015, in sharp contrast to its major peers across the globe. The power of folk ideas, it seems, has held remarkable sway over one of the most powerful balance sheets in the world.

Conclusion

Keynes was right in more than one sense when he noted that ideas were ‘more powerful than is commonly understood’, being a keen observer not merely of the power of expert ideas, but also and especially of the ‘interrelationship between ideas and *practice*’ (Parsons 1983: 370, emphasis added). The case of the ECB’s governance of its balance sheet reveals that although Europe’s monetary policy-makers are well aware of the irrelevance of central bank capital in theory, they nevertheless insist on maintaining positive capital in practice. When probing into the reasons behind this incongruence, the available evidence suggests that policy-makers deem themselves constrained by the general public’s misperceptions of central banking. In particular, non-experts are believed to disapprove of the central bank in case policy outcomes deviated from the ‘common sense’ that

losses and negative capital are ‘not good’, in line with household reasoning. Alternative explanations to the power of folk ideas – namely that the ECB has fully internalised ordoliberal economic beliefs or that most of what central banks say and do is ultimately geared towards financial market participants and other expert audiences – hardly appear plausible in this light. The recent initiatives by major central banks like the Federal Reserve and the ECB to reach out and ‘listen’ to their non-market audiences are a case in point. For scholars of political economy, however, the argument put forward in this article cautions us to not limit ourselves to studying how policy-makers *communicate with* – but also to ascertain how they *think about* – non-experts.

Nevertheless, two caveats are in order. First, as a supranational central bank, the ECB is, of course, not merely faced with ‘one’ public but with 19 national publics. These national non-expert audiences may differ in terms of their views towards monetary policy in general and towards central bank losses and capital in particular. While scrutinising the sentiments of 19 different publics would have been beyond the scope of this paper, many of my interviewees did reflect on their experience in national central banking as well, indicating broadly similar dynamics across countries.¹⁰ Second, and related, the relationship between policy-makers and non-experts might be less direct than is assumed in the nascent literature on how central banks engage with ‘the people’. Instead, it might be mediated by national or European elected representatives, who may or may not translate increased public attention into substantive political contestation (see also Table A.2 in online appendix, supplementary material). However, in the eyes of interviewees, the underlying problem was deemed to be ‘public opinion first and, *depending on public opinion*, utilization by the political sphere (...) of the emotion of the public opinion to attack perhaps the central bank and criticize what has been done’ (Interview 7).

These caveats notwithstanding, can the folk ideas argument travel beyond the case of the ECB and even that of monetary policy? First, as far as central banks other than the ECB are concerned, the views of the Bank for International Settlements on the subject of balance sheet capital are particularly incisive. According to its former general manager, the Bank itself had ‘no doubts about’ the actual strength of central banks’ balance sheets but believed that this confidence was ‘based on an understanding of the special character of central banks that may not be shared’ by others – and that this lack of understanding, ‘however erroneous’, ought to be taken seriously and internalised by monetary policy-makers (Archer and Moser-Boehm 2013: 1, 3). Second, the obvious candidate beside monetary policy and the bank analogy is that of fiscal policy and the household analogy, the perverse power of which has been amply documented in the literature. A crucial implication, however, is that folk ideas turn out to be at their most powerful not necessarily in the minds of the public or folk itself, but much rather in the minds of policy-makers. Another plausible candidate beyond monetary and fiscal policy is the jurisprudence of constitutional courts which – in the European context in particular – have found themselves having to adjudicate what counts as valid economic theory and what does not (Gerner-Beuerle *et al.* 2014, Goldmann 2014, Borger 2016), including on the question of central bank losses and negative capital (De Grauwe 2014).

In terms of future research, the most pertinent application probably lies in the realm of monetary-fiscal *coordination* (Van Doorslaer and Vermeiren 2021), with central banks and governments having become ever more closely entangled in the aftermath of the great financial and COVID-19 crises. Recurring debates about the UK government ‘maxing out its credit card’ while relying on debt purchases by the Bank of England or reports of looming central bank losses that would need to be covered by ‘taxpayer funds’ are just two illustrations of how the politics of public sector balance sheets is poised to take centre stage in future battles over economic policy (Gabor 2020, IPPR 2020, Goodman and Aldrick 2022). If we accept that such fallacies can have a bearing on policy – and if we bear in mind that monetary and fiscal policy together account for almost the entirety of macroeconomic governance today – then this suggests that economic policy-makers might be less in thrall of expert ideas, theories, and models than we are often prone to assume. Acknowledging the power of folk ideas is a first step in this regard.

Notes

1. In the words of Susan Webb Yackee (2021: 147), 'to maintain their reputations as experts and preserve the[ir] legitimacy', policy-makers tend to be 'constrained to make decisions in keeping with established science'.
2. The centrality of monetary policy found its most dramatic expression after the financial crisis of 2008 and again in the early stages of the COVID-19 crisis due to central banks' capacity to act as balance sheets of last resort (Cour-Thimann and Winkler 2016), backstopping financial markets and governments alike (Buiter 2020; Diessner and Lisi 2020). The effects of central banks' crisis policies, however—including and especially of quantitative easing (QE)—have been met with growing criticism over the years (Dietsch et al. 2018).
3. Note that this does not imply that folk ideas are the *only* reason for which central banks may attach weight to positive balance sheet capital (see Diessner 2019), but rather that it is an important yet woefully understudied one.
4. For an attempt at 'opening the black-box of the household' and its role in the macroeconomy, see Montgomerie (2021).
5. An important recent contribution by Cornel Ban and Bryan Patenaude (2019: 2) has aimed to 'advance the state of the art by looking beyond academic economics and into other fields of economic expertise ranging from the private sector to think-tanks', but equally does not leave room for non-expert ideas.
6. Similarly, Eriksen (2021) has made the case for a 'public reason model' of agency policy-making.
7. A closely related literature studies performativity and the role of economic models for the economy and for economic policy (Braun 2015, Fligstein et al. 2017, Kranke and Yarrow 2019, cf. Rilinger 2022).
8. Interviews were transcribed and ethics approval as well as informed consent were sought. A list of interviews together with dates, formats, and codes is provided in the online appendix (see supplementary material).
9. Later ECB in-house research supports this view, with Bunea et al. (2016: 17) noting that '[c]entral banks are protected from insolvency due to their ability to create money and can therefore operate with negative equity'. See also Lagarde in European Parliament (2020: 9).
10. One anonymous reviewer and my colleague Fabio Bulfone have pointed out that the notion of the 'folk' may lead one to think of the 'Volk', with all its connotations, and that a German audience may matter more to the ECB than other audiences. On the 'very German argument' of central bank balance sheets requiring protection, see Spielberger (2022: 10). My analysis suggests, however, that both the theoretical irrelevance and the practical relevance of balance sheet capital are views held among central bankers beyond Germany.

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Notes on contributor

Sebastian Diessner is an Assistant Professor at the Institute of Public Administration at Leiden University. His research focusses on the politics of economic policy and on the interaction between technological and institutional change in capitalist democracies.

ORCID

Sebastian Diessner  <http://orcid.org/0000-0002-9458-980X>

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