

POLITICAL ECONOMY RESEARCH INSTITUTE

**PERI**

University of Massachusetts Amherst

The Contested Terrain Approach  
to the Political Economy of Central Banking

Gerald Epstein

August 2014

**WORKINGPAPER SERIES**

Number 354

**POLITICAL ECONOMY  
RESEARCH INSTITUTE**

# **The Contested Terrain Approach to the Political Economy of Central Banking**

*Gerald Epstein*<sup>1</sup>

August 2014

## **Abstract**

The contested-terrain approach to the analysis of central banking – which borrows the term from Richard Edwards’ book on the fight over corporate labour processes – suggests that central bank behaviour, like that of other important institutions of capitalist governance, can usefully be analyzed as a struggle among key classes (and class-fractions) over economic policy. Building on the work of Marx, Kalecki, and Boddy and Crotty, Gerald Epstein and Juliet Schor developed a three class model in the spirit of Keynes, arguing that in advanced capitalist countries, central bank policy is determined by a struggle between industrial capital, financial capital, and labor. This contest over policy, in turn, is shaped and constrained by key structural factors, including the relations between finance and industrial capital, the structure of labour markets, the position of the domestic economy in the world economy, and the dynamics and contradictions of capital accumulation itself. Appropriately modified to reflect the institutional arrangements of the day, this approach can be used to analyse the determinants of central bank policy, as well as the interests that policy is designed to promote.

## **Keywords**

Central Banks; Class Conflict; Monetary Policy

## **JEL classifications**

E52; E58; N20

---

<sup>1</sup> Forthcoming in *The Encyclopedia of Central Banking*, Louis-Philippe Rochon and Sergio Rossi (editors), Cheltenham: Edward Elgar, 2015.

The question “Why do central banks do what they do?” seems like an obviously important question, especially considering that political straight-jackets limit counter-cyclical fiscal policy, leaving central banks as the dominant macroeconomic policy-making institution in most countries. Yet, mainstream macroeconomics has given very little thought to analyzing the economic and political sources of central bank goals and conduct.

Rather, the implicit assumption of most mainstream analysis is that central banks try to make policy in the general interests of society as a whole. From this perspective, “poor” monetary policy stems from failures of theory, judgment or forecasting rather than from a lack of concern for the public interest.

By contrast, the contested-terrain approach to the analysis of central banking – which borrows the term from Richard Edwards’ (1979) book on the fight over corporate labour processes – suggests that central bank behaviour, like that of other important institutions of capitalist governance, can usefully be analyzed as a struggle among key classes (and class-fractions) over economic policy (Epstein and Schor, 1990). Building on Kalecki (1944) and Boddy and Crotty (1975), Epstein and Schor developed a three class model in the spirit of Keynes (1936), arguing that in advanced capitalist countries, central bank policy is determined by a struggle between industrial capital, financial capital, and labour. This contest over policy, in turn, is shaped and constrained by key structural factors, including the relations between finance and industrial capital, the structure of labour markets, the position of the domestic economy in the world economy, and the dynamics and contradictions of capital accumulation itself. From this perspective, policy that fails to

operate in the public interest can often be explained by looking at the narrower interests that dominate the central bank – often financial interests – that those policies are designed to serve. Since the configuration of these four factors may vary across countries and over time, central bank policy is likely to vary as well. For example, building on the work of Hall (1984), Epstein and Schor (1990) show that variations in the relationships between finance and industry in European (close) versus Anglo-Saxon (arms-length) countries, together with different labour bargaining systems, can help explain differences in monetary policy among these countries. The institutional structure of the central bank itself is also crucial. Where central banks are “independent” of the executive branch of government, they tend to be dependent on the financial sector for political support, and therefore tend to make policy with “finance coloured” glasses (Epstein, 1981). This framework helped to explain, for example, the US Federal Reserve policy in the 1930s (Epstein and Ferguson, 1984), and in the Paul Volcker period (1982).

Epstein (1994) formalized these ideas, building and empirically estimating a highly stylized three class model based on a Marglin-Bhaduri framework. This model shows how differences in industry-finance relations (“enterprise finance” versus “speculative finance”), labour market relations (“Kaleckian” versus “neo-Marxian”) and the degree of central bank independence (“independent” versus “integrated”) could help explain monetary policy. He showed, for example, that independent central banks, which tend to be most influenced by inflation-averse financial sectors, in countries with weak ties between finance and industry (like the United Kingdom and the United States), and with more flexible labour markets tend to pursue tighter monetary policy.

Because of its emphasis on the role of class relations and structural factors in determining the political economy of central banking, the framework must be updated with changes in institutional and economic relationships. For example, in more recent work, Epstein (2002) argues that, in the 2000s, changes in the structures of industry-finance relations and labour markets led to a change in the orientation of monetary policy in many countries. Increased financial orientation of non-financial firms (that is, “financialization”), and increased importance of capital gains for both financial actors and financialized “industrial” firms prompted central banks in the United States, United Kingdom and elsewhere to lower interest rates to support asset prices appreciation. Meanwhile, the reduced bargaining power of labour resulting from key changes in the global competition and domestic political institutions kept wage inflation in check. This change in political economy structures help to explain the shift by the US Federal Reserve and other central banks to a low interest rate environment in the first decade of the twenty-first century.

The contested-terrain approach has been criticized for paying insufficient attention to the question of the central bank control over monetary policy in a world of endogenous credit and financial innovation. Indeed, this framework could be enriched by more research work along these lines.

## REFERENCES

Boddy, Raford and James Crotty (1975), “Class conflict and macro policy: the political business cycle”, *Review of Radical Political Economics*, 7 (1), pp. 1–19.

Edwards, Richard (1979), *Contested Terrain*, New York: Basic Books.

Epstein, Gerald (1981), “Domestic stagflation and monetary policy: the Federal Reserve and the hidden election”, in Thomas Ferguson and Joel Rogers (eds), *The Hidden Election*, New York: Pantheon Press.

Epstein, Gerald (1982), “Federal Reserve politics and monetary instability”, in Alan Stone and Edward J. Harpham (eds), *The Political Economy of Public Policy*, Beverly Hills: Sage Publications.

Epstein, Gerald (1994), “A political economy model of comparative central banking”, in Gary Dymnski and Robert Pollin (eds), *New Perspectives in Monetary Macroeconomics: Explorations in the Tradition of Hyman Minsky*, Ann Arbor: University of Michigan Press.

Epstein, Gerald (2002), “Financialization, rentier interests, and central bank policy”, Political Economy Research Institute,  
[http://www.peri.umass.edu/fileadmin/pdf/financial/fin\\_Epstein.pdf](http://www.peri.umass.edu/fileadmin/pdf/financial/fin_Epstein.pdf).

Epstein, Gerald and Thomas Ferguson (1984), “Monetary policy, loan liquidation and industrial conflict: the Federal Reserve and the open market operations of 1932”, *Journal of Economic History*, **44** (4), pp. 957–83.

Epstein, Gerald and Juliet Schor (1990), “Corporate profitability as a determinant of restrictive monetary policy: estimates for the post-war U.S.”, in Thomas Mayer (ed.), *The Political Economy of American Monetary Policy*, New York: Cambridge University Press.

Epstein, Gerald and Juliet Schor (1995), “The Federal Reserve–Treasury accord and the construction of the postwar monetary regime”, *Social Concept*, **7** (1), pp. 7–48.

Hall, Peter A. (1984), “Patterns of economic policy: an organizational approach”, in S. Bornstein, D. Held and J. Kreiger (eds), *The State in Capitalist Europe*, London: Allen and Unwin.

Kalecki, Michał (1943), “Political aspects of full employment”, *Political Quarterly*.  
Reprinted in *Selected Essays on the Dynamics of the Capitalist Economy, 1933–1970*, Cambridge: Cambridge University Press, 1971.

Keynes, John Maynard (1936), *The General Theory of Employment, Interest and Money*, London: Harcourt and Brace.