The Politics of Reversing Central Bank Independence*

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Abstract

The recent confluence of populism, nationalism, and mounting debt has put central banks under political pressure. When and how do governments succeed in politically subordinating central banks? To answer these questions, we derive a novel macro-historical theoretical perspective on the making and unmaking of the political independence of central banks. Complementing new domestic political-conflict perspectives on central banking, we argue that central bank independence (CBI) — splitting central banks from governments — is designed foremost to protect international sovereign lenders. However, under certain conditions, politicians can weaponize central banks against creditors. Tracing the rise and fall of CBI in interwar Germany, we demonstrate how the Reichsbank was used by international lenders to control the Weimar Republic and later by the Nazi regime to expropriate those same creditors.

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1 Introduction

On 28 March 2021, President Erdogan shocked investors by firing a third central bank governor in less than two years. The lira plunged as the International Monetary Fund (IMF) and international markets gave an uncompromising verdict on Turkey's move. The rift between Turkey and the international financial community is unusually public. Nonetheless, it is part of a broader and striking shift in the monetary policymaking environment. The stakes in this contemporary struggle over the control of central banks are momentous.

This is not the first time international lenders and actors have struggled to prevent central bank independence (CBI) backsliding. CBI has been a matter of international economic relations at least since the Algeciras Conference in 1906 when foreign creditors came together to establish the Banque d'État du Maroc (Magali, 1975). In the subsequent years, international agents from the League of Nations to the IMF and Bank for International Settlements (BIS) have invariably pushed for domestic monetary powers to be delegated to independent central banks. In turn, CBI has been attacked in national politics: central banks have frequently been nationalized and undermined (Masciandaro and Romelli, 2015; Binder, 2021; Bodea and Garriga, 2023). While measures of CBI variation acknowledged that independence can wax and wane (Cukierman, Webb and Neyapti, 1992; Bodea and Hicks, 2015*b*; Masciandaro and Romelli, 2015; Garriga, 2016; Romelli, 2024), research analyzing the precise mechanisms of political reversals from CBI is scant.

This gap has been partly addressed in work on the conflicted dynamics of CBI (Masciandaro and Romelli, 2015; Ugolini et al., 2017; Bodea and Garriga, 2023). Broadly, this work emphasizes the role played by power and distributional issues in shaping institutional choices and policy outcomes. For instance, the path-breaking work of Adolph (2013) notes that independent institutional form and actual central banker practices are often decoupled. In so doing, he challenges the faith placed in the formal structures of CBI to keep central bankers' discretionary personal preferences and sometimes opportunistic impulses in check. Similarly, Ainsley (2017) shows that when theories of CBI are adapted to properly account for the place of politically motivated central bank appointments, many of the conventionally understood benefits of monetary delegation go away. Similarly, Baerg, Gray and Willisch (2021), Martin (2022), Redwood (2023), and Moschella (2024) emphasize the role of central bank leadership and its ability to withstand political pressures. Expanding on these lines of argument, Bodea and Garriga (2023) argue that institutional safeguards are important in containing political pressures to reverse CBI.

The essential insight of this work is that formal CBI cannot be taken for granted. CBI failure or backsliding is always possible and, somewhat paradoxically, something central bankers can actively participate in. However, approaches focused on explaining variation through individual-level processes and comparative outcomes fall short of specifying the broader structural conditions under which CBI backsliding is likely to succeed or be frustrated. Tackling this gap, Bodea and Garriga (2023) provide systemic empirical evidence for Latin American economies about the importance of domestic institutional constraints in hindering governments seeking to reign in CBI. Building on this cutting-edge research, in this paper, we shift the focus onto the relatively neglected but no less important place of international structural power in CBI backsliding.

To do this, we first take the study of CBI back to the future. Building on the seminal scholarship of North and Weingast (1989), Maxfield (1997), and Broz (1998), we argue that CBI emerges at the impetus of sovereign lenders rather than governments looking to tie their own hands. Drawing on Polillo and Guillén (2005), Johnson (2016), and Reinsberg, Kern and Rau-Göhring (2020), we further note that lenders are often aided and abetted in the pursuit of CBI by international governmental agencies. The reason for this is simple: CBI is used to split the unity of economic sovereignty. The nation-state is transformed into a divided structure comprised of a fiscal agent and a monetary agent. This structure introduces a coordination problem for governments tempted to turn on their creditors. The independent central bank can thwart a government's will to lower interest rates or fund deficits by printing money. The central bank can also monitor public finances and reduce information acquisition costs for creditors. Moreover, to influence policy outcomes and buttress independence, creditors can embed themselves within the institutional architectures of central banks.

But this, we argue, is only half the CBI story. If the power of international lenders weakens and the separation between the government and its central bank begins to break down, backsliding in CBI is predictable. Furthermore, under such conditions, the infrastructural arrangements of CBI, designed to constrain profligate governments, can be turned against creditors. This explains why—even in extreme cases such as Nazi Germany, a totalitarian regime hellbent on waging a war of conquest—governments almost never disband central banks. Instead, as we shall demonstrate in the Nazi Reichsbank case, they capture and manipulate the economic and institutional underpinnings of CBI to harness central banks and turn them into powerful vehicles of state power.

The paper makes three main contributions. First, using what George, Bennett et al. (2005) call a hypothesis-generating case study, we introduce the political power dimensions of creditor-imposed constraint and governmental control to explain the rise and fall of CBI for the Reichsbank in interwar Germany.[1]

Second, our empirical focus on resource control leads us to reconsider where the emphasis is placed on what central banks do and how they operate. Here, we contribute to a substantial literature on the dynamic interactions between politics and economic policymaking in the context of central banks (Keefer and Stasavage, 2003; Bodea, 2010; Bodea and Hicks, 2015*b*; Baerg, Gray and Willisch, 2021; Pond, 2021; Martin, 2022; Moschella, 2024). Furthermore, we are also contributing to a nascent literature on central banking in authoritarian regimes (Johnson, 2016; Bodea, Garriga and Higashijima, 2019; Redwood, 2023). They are not mere commitment devices or fiscal veto players but also political-distributional instruments of debt relations and repayment. Most importantly, we demonstrate that central banks can be (ab-)used to transfer resources from creditors to governments by means other than through inflationary policies.

Last, we employ this essential analytical insight in a revealing edge case, tracing the Reichsbank's striking interwar development from a hidebound institution under the Weimar Republic's indebted postwar inheritance to a powerful weapon of Nazi economic expropriation.[2] Here, focusing on the historical evolution of the Reichsbank resembles several current debates around mounting fiscal

[1] Here, our work is most related to earlier work by Posen (1993), who argues that sovereign creditors provide an important impetus for delegating monetary policy. Building on this line of argument, Polillo and Guillén (2005) and Maxfield (1997) argue that for many countries, these sovereign creditors are international investors pushing for CBI and penalizing governments for failing to do so. Bodea and Hicks (2015*a*) verify the existence of such mechanisms. Insofar our work is also related to a substantial literature on the political economy of sovereign debt (Panizza, Sturzenegger and Zettelmeyer, 2009; Stasavage, 2011; Mosley and Rosendorff, 2023*b*).

[2] Insofar our contribution is also related to the role of central banks as exploitative institutions (Strong, 2021; Balachandran, 2023; Sen, 2023). For instance, Balachandran (2023) analyzing the role of central banks during the colonial era finds that monetary authorities were an important bureaucratic entity to facilitate the exploitation of territories under colonial rule.

distress in light of increasing protectionist tendencies (Ballard-Rosa, Mosley and Rosendorff, 2024), the rise of right-wing populist parties in Europe and elsewhere (Baccini and Sattler, 2024), and increasing political pressures on central banks indicating greater demand for monetary financing (Georgieva, 2024). At the same time, these domestic dynamics are unfolding in an international financial context in which, due to the rise of China and other alternative creditors, international sovereign debt resolution becomes increasingly difficult and contested (Setser, 2023; Ballard-Rosa, Mosley and Rosendorff, 2024; Kern, Reinsberg and Shea, 2024). Thus, a key advantage of analyzing the Reichsbank in great detail is that recent global political and economic dynamics resemble eerily similar patterns and provide a viable reference to inform policy-making.

2 Existing Theories of Central Bank Independence

The term "central bank" is used to delineate the authority that is responsible for the policies that affect a country's supply of money and credit. "Independence" denotes the idea of a structural separation between central bankers and politicians.[3] When new central banks are formed, and existing central banks are made more independent, governments give up fundamental levers of economic policy (Bodea and Hicks, 2015*b*; Ugolini et al., 2017; Aklin and Kern, 2019*b*; Bodea, Garriga and Higashijima, 2019).

This poses a fundamental question: Why do governments cede power to independent central banks? The need for an independent authority to direct monetary policy is classically thought to arise from the fact that politicians cannot be trusted with the power to control money and credit because they will be tempted to use the printing presses to win re-election or fund projects at the cost of long-run economic stability (Kydland and Prescott, 1977; Barro and Gordon, 1983; Rogoff and Sibert, 1988; Alesina and Summers, 1993; Bernhard, 1998; Conti-Brown, 2017). In this view, the fundamental role of central banks is stabilizing the business cycle. The conventional historical

[3]The concept of independence is multi-dimensional. It includes: institutional independence, defined in terms of freedom from political interference; goal independence, understood as the right to set policy goals such as inflation targeting or maintaining a certain exchange rate; instrumental or operational independence, meaning the capacity to determine how to achieve goals; operational independence, that in practice means the security of tenure for personnel; financial independence, in essence, having an autonomous budget; and legal independence, defined in terms of possessing a legal personality separate from the government's (Balls, Howat and Stansbury, 2016).

account of deepening CBI over the last three decades rests primarily on the posited economic benefit of delegating monetary policy to nonpartisan technocratic experts (Fernández-Albertos, 2015; Balls, Howat and Stansbury, 2016; Borio, 2019). The dominant account of CBI adoption, in turn, rests on a logic of rational learning: CBI is seen to have followed from the ascent and diffusion of a powerful idea rather than from the victory of a particular set of economic or class interests (McNamara, 2002).

The recent literature on CBI places conflicts between governments and central banks and issues around political accountability and legitimacy at the core of their analyses (Adolph, 2013; Johnson, 2016; Goodhart and Lastra, 2018; Best, 2019). Policy and legal research—focusing on central bank governance frameworks, bureaucratic aspects, and appointment patterns on central bank boards—likewise provides unique insights into the conflict-ridden micro-political dynamics underlying central banking (Ainsley, 2017; Shambaugh, 2019; Baerg, Gray and Willisch, 2020). Here, CBI is always contingent and contested. As Lastra (2015, 10) put it, "*central banks inhabit a 'world of policy'*". In this messy world, inevitably, as political scientist Goodman (1991, 330) long ago noted, "*independence is a continuous, not dichotomous, variable. In other words, there are degrees of central bank independence.*" The challenge is to explain the variation in CBI, including processes of reversal and political subordination.

In a subject so complex as CBI, there are inevitably many factors at play, with scholars emphasizing different aspects. The comparative political economy (CPE) literature looks to domestic political structures to explain CBI variation. Drawing on Tsebelis (2002) veto players theory, the dominant hypothesis is that independence is greater in fragmented polities (Farvaque, 2002; Keefer and Stasavage, 2003; Gilardi, 2007). The more divided the context—a federal system, a state with a strong separation of powers, or a coalition government—the higher the predicted degree of CBI. The literature points to various mechanisms driving this association. Bernhard (1998) finds a role for CBI in conflict resolution among competing ministerial interests. Alesina, Roubini and Cohen (1997), Lohmann (1998), and scholars following their tradition attribute CBI to cooperation between parties mitigating the electoral business cycle. Hallerberg (2002) identifies the limited possibilities for targeting monetary policy to particular groups (as compared to fiscal redistribution) as a reason why multi-stakeholder governments are willing to delegate monetary policy.

The varieties of capitalism tradition introduces the broader macroeconomic and institutional context. CBI variation is conditioned by the factors that affect the determination of wages and prices in domestic economies. One branch of this work focuses on societal preferences. The strength of social preferences for reduced inflation is closely associated with greater CBI, which is why CBI cannot be assumed to cause lower inflation despite being correlated with it (Scheve, 2004; Braun, 2016). The other branch of this literature considers the institutional drivers of CBI (Franzese and Hall, 2000). The recent rise of CBI follows from the breakdown of trade unions, price controls, and other socio-economic coordination mechanisms (Iversen, 2000).

Building on the Mundell-Flemming trilemma, international political economy (IPE) scholars have developed an alternative insight into the puzzle of CBI variation: they note that the macroeconomic commitment problem of governments can also be solved through fixing the exchange rate (Broz and Hawes, 2006; Bearce, 2008; Bodea, 2014). What explains the choice between CBI and fixed exchange rates? Broz (2002) argues that the most important factor is the credibility of a government's commitment to respect the autonomy of the independent central bank to which it has delegated the power to set monetary policy. This credibility will, in turn, depend on the type of political regime. In open democratic states, commitments to CBI will be more credible to markets. In contrast, autocratic states have followed fixed exchange rates to anchor monetary policy and compensate for a lack of monetary credibility. The *locus classicus* in this tradition is Maxfield (1997), who argues that CBI constitutes a signaling device designed to convince international investors that a country is committed to sound macroeconomic management.

Taking stock, decades of research in CPE and IPE have done much to unravel the puzzle of CBI variation. In the first generation of scholarship, CBI is seen to develop to the extent that functional substitutes (political consensus, fixed exchange rates, institutions of wage and price coordination) do not exist. Bringing the dynamic politics back in, more recent studies remind us that, in the real world, governments trade off power for CBI; they often need to be pushed into doing so, and the struggle continues downstream. Ainsley (2017) demonstrates that central bankers have tools of their own to fight against imposed constraints, while the predatory propensities of governments never go away. The most recent IPE literature, meanwhile, draws attention to the special role of international financial institutions (IFIs) in shaping this kinetic push and pull between governments and central bankers (Johnson, 2016; Reinsberg, Kern and Rau-Göhring, 2020). It is worth remembering in this context that the introduction of many new independent central banks in the interwar period occurred under the auspices of the League of Nations (Flandreau, 2003; Seddon, 2020). Likewise, Reinsberg, Kern and Rau-Göhring (2020) show how, in more recent times, the IMF targets central bank governance structures in its lending operations.

These new dynamic understandings have yet to be brought together in a unified way that integrates the macro-foundations with a clear set of micro-foundations so that we can directly link events driving the rise and fall of CBI across time and space. Building on the seminal scholarship of North and Weingast (1989), Broz (1998), and Maxfield (1997), in the next section, we build a stylized theoretical framework to guide our analysis of CBI reversals.

3 Argument in Brief: Power Politics and CBI Reversals

Our proposed theoretical considerations focus on identifying conditions under which governments successfully reverse central bank independence. Here, we follow a simple trade-off logic: any government has to balance the benefits against the costs of greater CBI. Whereas existing research focuses on the benefits of CBI and domestic institutional factors in explaining how governments resolve critical trade-offs with respect to varying degrees of institutional and policy constraints (Keefer and Stasavage, 2003; Binder, 2021; Bodea and Garriga, 2023), we are interested in the role of sovereign creditors and their ability to put a stop-gap on a government's financial meddling (Maxfield, 1997; Posen, 1998; Bodea and Hicks, 2015*a*). Our main argument relies on two key insights.

First, the political and economic benefits arising from CBI are not static. There exist situations in which it becomes vital for a government to subordinate monetary authorities to secure its survival. For instance, during the recent COVID-19 pandemic, during which cash-strapped governments were trying to stem mounting public spending but could not find anyone to bankroll these expenses, they were undermining CBI in record numbers (Masciandaro, 2020; Tucker, 2020; Qanas and Sawyer, 2023). We label this dimension as the demand for monetary control dimension. Second, next to political and institutional barriers (Bodea and Garriga, 2023), a key observation in the literature has been that investors often punish sovereign governments for any attempt to undermine CBI (Maxfield, 1997; Bodea and Hicks, 2015*a*; Aklin and Kern, 2019*a*). Thus, even if governments erase the legal and institutional foundations underlying CBI (for a survey, see Bodea and Garriga (2023)), international investors form the last bulwark by placing speculative attacks on a currency, thereby introducing a punitive financial penalty for governments' attempts to undo CBI. In the case of the recent COVID-19 pandemic, ultra-low interest rates alongside the IMF's laissez-faire position—reflected in Managing Director Georgieva's statement urging governments to "*spend, but to keep the receipts*"[4]—were perceived as an open invitation to chip away at the independence of central banks.[5] Here, we argue that governments with a greater demand for monetary control will only succeed in reversing central bank independence when investors' power can be diminished, and thus, the penalty (or economic costs) for undoing CBI can be minimized.

Below we outline in detail the two key factors that condition the level of CBI: (1) the strength of government demand for monetary policy control and (2) the degree of sovereign creditor power. Thereafter, we bring these factors together in a unified analytical framework. To support our proposed key theoretical mechanisms, we provide evidence from several selected case studies that prefigure our main study of interwar Germany. This is important for several reasons. One is to illustrate broad historical and institutional scope of our argument. The global sample offers prima facie evidence that our proposed theoretical mechanisms of CBI reversal translate across different historical eras, governance frameworks (e.g., autocracy vs. democracy), income levels (e.g., emerging markets vs. high-income economies), and geographic locations (e.g., Latin America vs. Asia). The cases also show that governments are motivated by different political rationales when choosing to subordinate their central banks and use a wide range of policies to compensate for CBI. Furthermore, the cases showcase the degree of sovereign creditor power as an important explanatory variable. Lastly, evidence from selected case studies provides support for our interpretation of

[4] "Spend what you can to fight Covid-19, IMF tells member states," The Guardian, April 15, 2020.

[5] The IMF has traditionally played an important role in promoting central bank independence (McNamara, 2002; Polillo and Guillén, 2005; Kern, Reinsberg and Rau-Göhring, 2019). At the same time, it is an important coordinating body during debt crisis resolution and rescheduling, making it a powerful international institution that reflects creditor sentiments (for a survey, see Blyth and Matthijs (2017)).

the links between a government's demand for monetary control and sovereign creditor power in constraining these efforts. Table 1 provides an overview of all the cases mentioned to illustrate our framework.

Table 1: Country Cases Illustrating Key Mechanisms

Country	Key Mechanism(s) Illustrated	Description of Events
Austrian Empire (1816)	Weak government demand for monetary policy control enabling CBI even though international creditor power was weak	Facing rampant inflation and a severe deterioration in citizens' purchasing power, which threatened the rule of Emperor Francis I, the Empire established an independent National Bank of Austria (OENB). To enhance credibility and symbolize the independence of its monetary policy, the OENB's headquarters were initially located in Milan.
Japan (Post-WWII)	Strong government demand for monetary policy control to fund development and shape political environment undermining CBI	The subordinated Bank of Japan (BoJ) played a key role in rebuilding the economy and implementing industrial policy, transferring easy credit to pre-war elites and building powerful Keiretsus.
CEE (Post-WWII)	Strong government demand for monetary policy control to manifest communist rule and weak international creditor power undermining CBI	After international creditor ties were broken, monobanks were established as the monetary backbone to support communist regimes, allowing communist elites to loot nations and erode financial opposition.
Cuba (Post-Revolution)	Strong government demand for monetary policy control to establish socialist rule and weak international creditor power undermining CBI	Under Governor Che Guevara, Cuba's central bank was turned into a monobank, facilitating economic development through forced credit allocation and manifesting socialist rule, with barter trade with the Soviet Union nullifying creditors' power.
Latin America (1980s)	Strong government demand for monetary policy control to fund development and shape political environment undermining CBI	Subordinated central banks supported ambitious economic agendas and addressed fiscal loopholes due to dysfunctional industrial policies, crucial for the region's economic policies and goals.
China*[a]	Strong government demand for monetary policy control to preserve authoritarian control undermining CBI	The People's Bank of China (PBOC) maintains close control over credit allocation, reinforced by the introduction of the Digital RMB, enhancing Xi Jinping's authoritarian rule and monitoring of personal finances.
Argentina*	Strong government demand for monetary policy control under electioneering undermining CBI	President Fernandez de Kirchner fired Central Bank Governor Redrado for refusing to transfer $6.6bn to a government fund to pay foreign debts, illustrating short-term electoral motives overriding institutional barriers.
Russia*	Strong government demand for monetary policy control to reestablish authoritarian rule undermining CBI. This was done secretly at first due to strong creditor power	Putin's gradual and secretive seizure of the Bank of Russia allowed the government to steer credit allocation to clients and allies, consolidating financial and political control, with the central bank being used to navigate sanctions and devise offshore financial vehicles.
Angola*	Strong government demand for monetary policy control and subordinated central bank complicity in laundering illicit wealth	The central bank's alliance with the government enabled President dos Santos' cronies to siphon money into offshore financial sinks, with guarantees on defaulting loans by financial institutions owned by the President's family.
Turkey*	Weak international creditor power enabling CBI to be undermined by a government with a strong demand for monetary policy control	President Erdogan's administration subordinated the central bank, serving cheap credit to cronies and maintaining access to international financial markets through financial ties with China, Qatar, Saudi Arabia, and Russia, avoiding a full-fledged financial crisis.
Hungary*	Weak international creditor power enabling CBI to be undermined by a government with a strong demand for monetary policy control	Prime Minister Orban quietly appointed loyalists to the central bank board to regain political control without triggering a crisis, deepening financial ties with China, Cyprus, and Russia while maintaining EU funds and showing the IMF the door.

[a]* Indicates contemporary period, circa post-1990

4 Theoretical Framework

4.1 Government demand for monetary policy control

Our foundational premise is that governments are motivated by the pursuit of office. In democratic systems, political benefits are derived from electoral success, while in authoritarian regimes, officials cater to the interests of specific groups and cronies (for a review of this aspect in the context of central banking, see, among others Aklin and Kern (2019*a*), Bodea, Garriga and Higashijima (2019), and Bodea and Garriga (2023)). The political economy literature extensively highlights the role of economic policies in appealing to vested interests and securing the political support of key constituents, specifically through the distribution of cheap credit (for a survey, see Kern and Amri (2021)). Being the central thread linking governments to financial markets, central banks have naturally featured in this capacity. The traditional view postulates that subordinated central banks can artificially lower interest rates in the run-up to elections to allow for the engineering of political credit cycles.[6] In these cases, a government's appetite for electoral victory is so pronounced that it overrides institutional barriers and 'literally' robs its central banks. Argentina in 2010 is a case in point.[7] To free up fiscal policy for her re-election campaign in 2011, President Fernandez de Kirchner fired Governor Redrado for refusing to transfer "*$6.6bn to a government fund to pay foreign debts.*"[8]

While these motives certainly hold for short-term minded governments' motivation to secure their tenure in office, this view under-appreciates the broader power of central banks as what Smith (1776) called "great engine[s] of state." Central banks can forge and shape the political and economic fabric of a nation through orientating policy towards particular growth or development

[6] Built on the Phillips-curve trade-off between inflation and employment, the institutional logic is that governments cannot withstand inflating the economy, infusing an inflationary bias into the economy. To overcome these challenges, a key insight of political economy literature has advocated that governments should not be trusted with monetary policy (Garriga, 2016; Bodea and Hicks, 2015*b*; Bodea and Garriga, 2023). Thus, delegating monetary policy to an independent central bank has been best-practice policy advice (Polillo and Guillén, 2005; Fernández-Albertos, 2015; de Haan and Eijffinger, 2016; Reinsberg, Kern and Rau-Göhring, 2020). Although evidence on the existence of political business cycles is mixed, Kern and Amri (2021) find evidence for the existence of so-called political credit cycles, indicating that governments stimulate credit growth around elections.

[7] Bodea and Garriga (2023) argue that this political maneuvering foreshadowed the reversal of central bank independence that became effective in 2012.

[8] "Argentine central bank boss Martin Redrado steps down," BBC, January 8, 2010.

targets, maintaining patron-client relationships, and laundering the wealth of key elites (Johnson, 2016). For instance, in Latin America, subordinated central banks were instrumental in fostering ambitious economic development agendas and filling fiscal loopholes arising from dysfunctional industrial policies until the late 1980s (Maxfield, 1997; Carrière-Swallow et al., 2016; Bodea and Garriga, 2023). Similarly, in Japan after World War II, a subordinated Bank of Japan (BoJ) and its credit policies (i.e., window guidance) formed the cornerstone of rebuilding a war-torn economy and implementing successful industrial policy (Johnson, 1982; Cargill, Hutchison and Ito, 2003). In many developing countries, the lack of access to international institutional capital markets, institutional frictions at the heart of underdeveloped domestic financial markets alongside governments' diminished bureaucratic capacity to mobilize revenues create a situation where inflation, alongside direct central bank funding of government outlays, forms the bedrock of government finances (Menaldo, 2015; Brooks, Cunha and Mosley, 2015; Pond, 2018; Betz and Pond, 2023). In these instances, subordinating central banks is essential to mobilizing government finances to steer economic policies and achieve specific policy goals. Acting as the central link between governments and financial markets, central banks represent an important pillar in enabling governments to exercise control over credit allocation and thus shape the political fabric of a nation. For instance, in the case of Japan, control over the BoJ allowed the government to transfer 'easy' credit to pre-war elites, allowing them to build powerful Keiretsus (for a survey, see Cargill, Hutchison and Ito (2003)), exercising substantial control over political life while benefiting from Japan's industrial ascent. In the case of countries in Central and Eastern Europe after World War II, turning central banks into monobanks formed the monetary backbone of manifesting communist rule, thereby allowing communist elites to loot these nations while eroding the financial basis to form any opposition (for a survey, see Johnson (2016)). In the contemporary period, in countries such as China, Russia, and elsewhere, central banks still represent an important political lever (Johnson, 2016; Xu, 2018; Pond, 2018; Bodea and Garriga, 2023).[9] In these cases, governments can rely on subordinated cen-

[9] A key aim of political subordinating a central bank is also to limit the interests of sovereign lenders and bankers given their status as a powerful special interest group constraining a government's sovereign decision-making (Clark, Golder and Poast, 2013; Braun, 2020; Best, 2019). Thus, by freeing itself from these constraints and opting for a politically subordinated monetary policy framework, a government can attain a greater degree of sovereignty in its economic policymaking and limit the extent of outside interference (Redwood, 2023).

tral banks to grant preferential access to loans to well-connected firms and industries — artificially strengthening their competitive edge over competitors, crowding out competing firms and businesses while allowing for the close monitoring of financial transactions (Menaldo, 2015; Johnson, 2016; Aklin and Kern, 2019*a*). For instance, Putin's seizure of the Bank of Russia in 2001 illustrates that governments can steer credit allocation to clients and allies and thus exercise substantial financial and political control over a country through its central bank (Johnson, 2006, 2016).[10] In China, the PBOC's close grip on credit allocation has been reinforced with the introduction of the Digital RMB, which represents an additional powerful monitoring device for personal finances, augmenting Xi's authoritarian rule (Petry, 2020; Wuthinitikornkit[1], 2023; Weinhardt and Petry, 2024).

In extreme cases, a subordinated central bank can extract rent within and even beyond a nation's borders. In developing countries, subordinated central banks have historically been transformed into powerful vehicles to launder illicit wealth and provide financial instruments to siphon money into offshore financial sinks (Kern and Reinsberg, 2022). For instance, in the case of Angola, the close alliance of the central bank's leadership with the government was instrumental in enabling President dos Santos' cronies to siphon money into offshore financial sinks and manifest their political and economic position within the country (Kern and Reinsberg, 2022). Among numerous scandals, investigators into the central bank's balance sheet detected guarantees on defaulting loans operated by financial institutions owned by members of the President's family, allowing these family members to "seamlessly" siphon money outside the country into their own pockets.[11] Similarly, subordinated central banks played a pivotal role in facilitating the transfer of wealth and were crucial in the plundering of colonies (for a survey, see Balachandran (2023)). For instance, the Bank of England was key in managing the movement of gold and storing it in the vaults of the Exchequer of the British Empire (Sen, 2023). Synthesizing these insights, we argue that the desire for governmental control over monetary policy fluctuates according to a government's political goals and its ability to bankroll policy measures to attain these. For instance, during periods

[10]More recently, control over the central bank has even allowed the regime to navigate the monetary challenges of the sanctioning regime by devising a web of offshore financial vehicles.

[11]"Sums Don't Add Up for Angola's National Bank", Maka Angola, June 28, 2018.

of crisis or when political power consolidation is a priority, the demand for control intensifies, leading governments to potentially reverse central bank independence (CBI) to exercise more direct influence over monetary policy.

4.2 International creditor power and imposed constraints

Anticipating a government's desire to (ab-)use a central bank to bankroll its political ambitions; sovereign lenders can introduce frictions into the state by pushing governments into divorcing monetary policy from fiscal policy (Reinsberg, Kern and Rau-Göhring, 2020). Expanding on earlier work by Maxfield (1997), Bodea and Hicks (2018), Masciandaro and Romelli (2017), and Reinsberg, Kern and Rau-Göhring (2020), we argue that variations in creditors' ability to penalize governments for their financial meddling will be critical in determining whether a government succeeds in (re-)gaining political control over its central bank.

In fact, early versions of central banks were privately owned entities and primarily installed to serve as public debt managers and guardians for investors' claims (Ugolini et al., 2017). To protect themselves from appropriation and exploitation, lenders demand a split in the economic sovereign—through the establishment of an independent central bank or the granting of independence to an existing one. This separation turns the state into a two-agent institution (or sometimes called joint-liability) institution. The political construction of this policymaking friction may seem inefficient. Still, it establishes an extremely elegant means of protecting creditors (Posen, 1993; Helleiner, 1995; Keefer and Stasavage, 2003; Bodea and Hicks, 2015*a*).

Lending to sovereigns is fraught with informational and contractual frictions (Brooks, Cunha and Mosley, 2015; Copelovitch, Gandrud and Hallerberg, 2018; Bunte, 2019). There exists an inherent danger of *adverse selection* (or hidden knowledge). It is almost impossible (or at least extremely costly) for a sovereign's creditors to discern what a state will be willing and able to repay (Brooks, Cunha and Mosley, 2015; Ballard-Rosa, Mosley and Wellhausen, 2019; Mosley and Rosendorff, 2023*a*; Betz and Pond, 2023). Problems of *moral hazard* (or hidden action) and *time inconsistency* (inconsistent preferences at different points in time) also abound. Lenders cannot ensure that states will use loans as promised and refrain from subverting them (Sturzenegger and

Zettelmeyer, 2006; Mosley and Rosendorff, 2023*a*). Finally, a lender cannot guarantee contract *enforcement.* There is no higher authority or international bankruptcy court that can compel loan repayment. The consequence of such problems is that sovereign debt markets experience high levels of market failure (Gelpern, 2011; Tomz and Wright, 2013; Mosley and Rosendorff, 2023*a*). Borrowers are forced to pay higher rates for a smaller credit supply than optimal (Henisz and Mansfield, 2016; DiGiuseppe and Shea, 2019; Bunte, 2019). Sovereign creditors can manage the problems of asymmetric information and enforcement by credit rationing, shortening contractual maturities, screening through self-selection, and repeat contracting (Simmons, 2000; Pond, 2018; Mosley and Rosendorff, 2023*a*). Divorcing a government from its central bank has several appealing features. First, by complementing the familiar solutions to the transactional problems of sovereign lending, the two agents- government and central bank- will know more about each other than the lending principals, helping to solve the informational problems of adverse selection and moral hazard. Indeed, substantial literature documents the vital importance of CBI in signaling the viability of a country's macro-financial policy framework (Bodea and Hicks, 2015*b*; Reinsberg, Kern and Rau-Göhring, 2020; Ballard-Rosa, Mosley and Wellhausen, 2019; Gavin and Manger, 2023).

Second, the government and central bank can sanction one another at a much lower cost than an outside lender because they can constrain each other through fiscal and monetary policies (for a survey, see Bodea and Higashijima (2017)). As Seymour Harris has observed, independence means "*the central bank can run in one direction and the government in another*" (Conti-Brown, 2017, 136). Thus, granting greater independence to monetary authorities introduces a coordination problem in the state (Reinsberg, Kern and Rau-Göhring, 2020). This coordination problem functions as a check on the government. The need to cooperate with an independent central bank makes financial meddling more difficult (Baerg, Gray and Willisch, 2021). For instance, the legendary meeting between President Johnson and Fed Governor Martin in 1964 in Johnson's home in Texas is still regarded as one of the hallmark anecdotes concerning a central bank's ability to constrain a government (Blinder, 2022, 2023). An incensed President Johnson, confronting Fed Chair Martin, exclaimed, "*My boys are dying in Vietnam, and you won't print the money I need,*"[12] expressing his fury over the Fed's prior decision to hike interest rates to contain rising inflationary pressure resulting from the administration's deficit spending required to finance the Vietnam War and Johnson's War on Poverty.

Third, sovereign lenders can insist they be made a formal part of the independent central bank's administrative and policymaking architecture. Once embedded, lenders can obtain inside information on the operations of the state and even influence policymaking (Braun, 2020). For instance, in the case of the Reichsbank in 1923, the Allies (who represented Germany's main creditors) gained control over seven of the fourteen seats on the Reichsbank's General Council, the primary supervisory authority for monetary policy to ensure the sustainability of CBI and protect reparation payments. Additionally, they appointed Dr. Bruins, a Dutch economics professor, as the "Note Commissioner," who had the authority to effectively veto any monetary policy decision, thereby exerting significant influence over the bank's actions (Northrop, 1937; Mee, 2019). This logic of political control through incorporation helps explain why, for creditors, the structural choice of CBI is arguably preferable to a fixed monetary rule. Synthesizing these insights confirms earlier notions in the literature about the vital importance of creditors in explaining variations in the degree of political independence of central banks (for a survey, see Maxfield (1997)).

What factors shape the willingness and capacity of sovereign lenders to push for CBI? First, intuitively, sovereign lenders are best placed to secure CBI when governments rely on unsecured lending. Most countries will rely — to a non-trivial degree — on such credit. However, the degree of dependence will vary. In particular, countries with abundant foreign reserves or resources that can be pledged as collateral can avoid instituting CBI (Maxfield, 1997; Bianchi, Hatchondo and Martinez, 2018; Redwood, 2023). This, in turn, implies that countries experiencing windfall revenues will be able to undo CBI. Take, for instance, the case of Russia. After regaining control over natural resource rents, the Putin administration drastically cut back on CBI and weaponized the CBR towards its political agenda (Johnson, 2016). Similarly, the government of Ghana was swift in chipping away the institutional pillars of central bank independence after the country could

[12] "A President at War With His Fed Chief, 5 Decades Before Trump" The New York Times, June 13, 2017.

tap into new-found resource wealth in 2016 (Bawumia and Halland, 2017; Strong, 2021). In these instances, windfall revenues not only reassure investors about a country's ability to service its debt payments but also allow governments to reduce their reliance on external borrowing, diminishing creditors' leverage over a country's macro-financial framework.

Second, the power of sovereign creditors to uphold CBI will be strongest when they remain united. If a lack of coordination among lenders to sovereign or multilateral international organizations is circumvented, the power of creditors to secure CBI will weaken. What may sow the seeds of division among creditors? There are, of course, many possible factors, with geopolitical, global economic, and legal-technological conditions all playing a role. But the breakdown of coordination is far more likely when financial distress causes lenders to become hostile competitors looking to recover whatever they can for themselves (Buchheit and Gulati, 2017; Ferry, 2023). The case of the Reichsbank in the early 1930s is illustrative. Deep conflicts over reparations payments allowed the Reichsbank leadership — under President Hjalmar Schacht — to undermine collective action among Germany's main creditors, undoing the elaborate system of international controls and surveillance holding CBI in place (Feinstein, Temin and Toniolo, 2005). The capacity to coordinate will also erode with the emergence of new powers or financial players that allow borrowers to exit from existing arrangements. The emerging presence of China, Russia, Saudi Arabia, and other nations as alternative sources of capital has enabled countries such as Ecuador (IMF, 2023), Egypt (Herrera and Youssef, 2013), and Hungary (Buzogány, 2017) to cast off CBI. For example, in 2007, Ecuador's Chinese loans-for-oil program laid the groundwork for dismissing international creditors, allowing the country to remove important institutional layers protecting CBI and make way for significant increases in government spending, bankrolled by the nation's central bank (Bodea and Garriga, 2023; Kern and Reinsberg, 2022; IMF, 2023).

4.3 Synthesis of framework

Building on the above-outlined logic, we build a simple theoretical framework focusing on two key factors that condition the level of CBI: (1) the strength of government demand for monetary policy control and (2) the degree of sovereign creditor power. To situate different constellations in a stylized setting, we focus on instances when a government's desire to control a central bank is weak or strong. The combination of the two central variables of our framework generates four CBI conjectures presented in Figure 2. Arguably, governments will move between this continuum most of the time.

Figure 1: Central conjectures of CBI

Government Demand for Monetary Policy Control	Sovereign Creditor Imposed Constraint: Weak	Sovereign Creditor Imposed Constraint: Strong
Weak	B *Fragile CBI*	A *Robust CBI*
Strong	D *Reversals of CBI*	C *Sham CBI*

At one extreme, **Robust CBI** captures situations in which deepening or stable CBI in the context of strong creditor constraints and weak governmental demand for monetary policy control is present (Conjecture A). What might suppress a government's demand for monetary policy control? In short, anticipation of the conventional benefits of monetary policy delegation. First, greater CBI is associated with lower inflation rates, which is important to maintain macroeconomic stability, bolster long-term economic growth prospects, and contain popular unrest (Posen, 1998; Treisman, 2000; Scheve, 2004; Epstein and Rhodes, 2016; Bodea and Garriga, 2023). Second, specific political benefits can arise from greater CBI. For instance, it is well documented that independent central banks can be (ab-)used as scapegoats to implement austere policy measures, insulating governments from popular backlash (Broz, 1998; Bodea and Hicks, 2015*a*; Kern, Reinsberg and Rau-Göhring, 2019). Finally, central bank independence sends an important signal to investors about the viability of a country's macroeconomic policies. In return, governments can expect to be rewarded with better credit ratings, translating into lower interest rates, freeing up additional fiscal space, and providing governments with additional resources (Posen, 1993, 1998; Bodea and Hicks, 2015*a*). When muted government demand for control intersects with creditors motivated and able to play an important role in governments' financial decision-making **Robust CBI** emerges.[13] For instance, Kern, Reinsberg and Rau-Göhring (2019) emphasize the role of IMF conditions aiming at increasing the political independence of central banks to restore investor confidence in stabilizing a country's balance of payments during financial crises.

At the opposite extreme are cases where governments succeed in fully subordinating central banks (Conjecture D). We label these situations as **Reversals of CBI**. These situations emerge when the government's demand for monetary control is pronounced and creditor power is diminished. Historically, undoing CBI has been a lender of last resort solution during existential crises. For instance, Poast (2015) argues that historically, central banks were subordinated to fill governments' war chests. However, when governments manage to diminish creditor power, they frequently succeed in subverting politically independent central banks and bend them to their will. For instance, Fidel Castro's power grab in Cuba was accompanied by a full subordination of the Cuban central bank (Gordy, 2022; Arabadzhyan, 2023). Under Governor Che Guevara, the central bank was designed to operate as a Monobank, facilitating economic development through a forced allocation of credit and manifesting socialist rule on the island (Arabadzhyan, 2023). The key to the successful subordination of the central bank was that Castro's administration could overcome the country's isolation from international trade and financial markets by entering into a barter trading system with the Soviet Union, pulverizing creditors' bargaining power, thereby nullifying the pecuniary penalty for subordinating the central bank (Sanchez-Sibony, 2022). In more recent history, President Erdogan's political agenda worked as a powerful catalyst to undermine CBI. Serving cheap credit to his cronies in the construction industry while trying to garner popularity among the Turkish electorate built around credit policies, President Erdogan's financial meddling led to soaring inflation and sent the Turkish Lira onto a wild roller coaster ride. However, leveraging

[13] This conjecture is closely related to the findings in Posen (1993) and Posen (1998), who emphasize the importance of financial interest groups in pushing governments towards CBI.

Turkey's geopolitical position, President Erdogan succeeded in subordinating the country's central bank and consolidating political power while still maintaining access to international financial markets. Importantly, President Erdogan's ability to widen the country's creditor basis to include China,[14] Qatar,[15] Saudi Arabia,[16] and Russia[17] helped to avoid a full-fledged financial crisis due to reversing CBI. A similar pattern has been observed in Hungary. While Orban's political maneuver to subordinate the MNB led to short-term volatility in financial markets (Ainsley, 2017; Bodea and Hicks, 2018), his administration was able to deepening financial ties with China (Völgyi and Lukács, 2021), Cyprus,[18] and Russia[19] while convincing the EU to keep funds flowing. As a signal of Hungary's ability to deal with international investors' speculative attacks in response the attempts of undermining CBI, the Orban administration even showed the IMF the door (Scheiring, 2022). Importantly, by diversifying the international creditor base, the administration could gain control over the MNB without derailing the Hungarian economy.

The framework also generates two intermediate predictions. First, **fragile CBI**, where there is space for central bank autonomy but it lacks an anchor, in the context of modest government demand for monetary policy control and minimal creditor constraints (Conjecture B). In what will generally be an unstable institutional equilibrium, **fragile CBI** describes the situation in which, despite weak creditor power, government incentives to regain political control over a central bank remain muted. This situation emerges when the political and economic benefits are so pronounced, entrenched, or unquestioned that governments have no incentive to undo CBI. Frequently, for instance, CBI is also ideologically deeply anchored in society, and additional constitutional safeguards exist, which work as a deterrent to the undoing of CBI (McNamara, 2002; Polillo and Guillén, 2005; Blyth and Matthijs, 2017). To illustrate Conjecture B, consider the case of the Austrian Empire in 1816. Rampant inflation and a dramatic deterioration in citizens' purchasing power, threatening the rule of Austrian Emperor Francis I, gave the impetus to establishing an independent National

[14] "Erdogan says Turkey has raised FX swap deal with China to $6 bln," June 13, 2021.

[15] "Turkish central bank triples Qatar currency swap line to $15 billion as economy flounders,"CNBC, May 20, 2020.

[16] "Erdogan seeks investment for Turkey's strained economy with Gulf visit," Reuters, July 17, 2023.

[17] "Some Russian Banks May Have Swapped Gold for Dollars, Report Says", February 7, 2024.

[18] "Minister Csaba Lantos' former secret business revealed from the Cyprus Confidential project,"Direkt 36, November 14, 2023.

[19] "EU Greenlights Hungary's Russia-Backed 'Deal of the Century," Bloomberg, March 6, 2017.

Bank of Austria (OENB). To infuse credibility into the Empire's monetary dealings and symbolize the independence of monetary policymaking, the OENB's first headquarters were even moved to Milan. From this remote location, the OENB remained at arms-length from government interference, an outcome also enabled by the emergence of multiple sources of sovereign lending in Paris and London in the late nineteenth century that weakened creditor cohesion and power (for a review, see Pressburger (1966) and more recently, Jobst and Kernbauer (2016)).

The second intermediate outcome (Conjecture C), we label **Sham CBI**. Here, governments have a strong political urge to regain full political control over a central bank, but international investors stand in the way and threaten to place a punitively high penalty on government attempts to undermine CBI. Reversal attempts send an alarming signal to investors. Fearing rising inflation and the evaporation of their credit claims, investors often shun governments bent on reversals. This leads to a sudden pick-up of capital flight and thus exchange rate volatility (Bodea and Hicks, 2018). Historically, efforts to diminish central bank independence (CBI) frequently result in deteriorating conditions for sovereign borrowing and increased volatility in exchange rates, thereby jeopardizing macro-financial stability (Fernández-Albertos, 2015; de Haan and Eijffinger, 2016; Bodea and Garriga, 2023). To avoid triggering a downward financial spiral, even governments totally bent on control will seek to limit the amount of information available to outsiders about the extent of CBI backsliding, and monetary policy officials often collude in such processes. Undermining CBI almost always begins away from public view, making it difficult for creditors and opposition groups to collect information about the degree of central bank dependence or to organize to impose stricter discipline. Put another way, CBI backsliding usually begins with secret collusion between a government and its central bank and progresses gradually (Adolph, 2013; Johnson, 2016; Martin, 2022; Bodea and Garriga, 2023; Baerg, Gray and Willisch, 2021). Johnson (2016) illustrates this point beautifully in the case of Russia, where the Putin administration started to gradually pack the central bank board with loyalists shortly after assuming power. Similarly, in the case of Hungary, Prime Minister Orban began by quietly appointing several loyalists to the board of Magyar Nemzeti Bank in an attempt to gain more political control over the central bank and fend off further interest rate hikes without triggering a crisis (Ainsley, 2017). In both cases, Putin and Orban were able to coopt central bank officials in the subtle processes of power centralization.

5 The Case Study of the Reichsbank

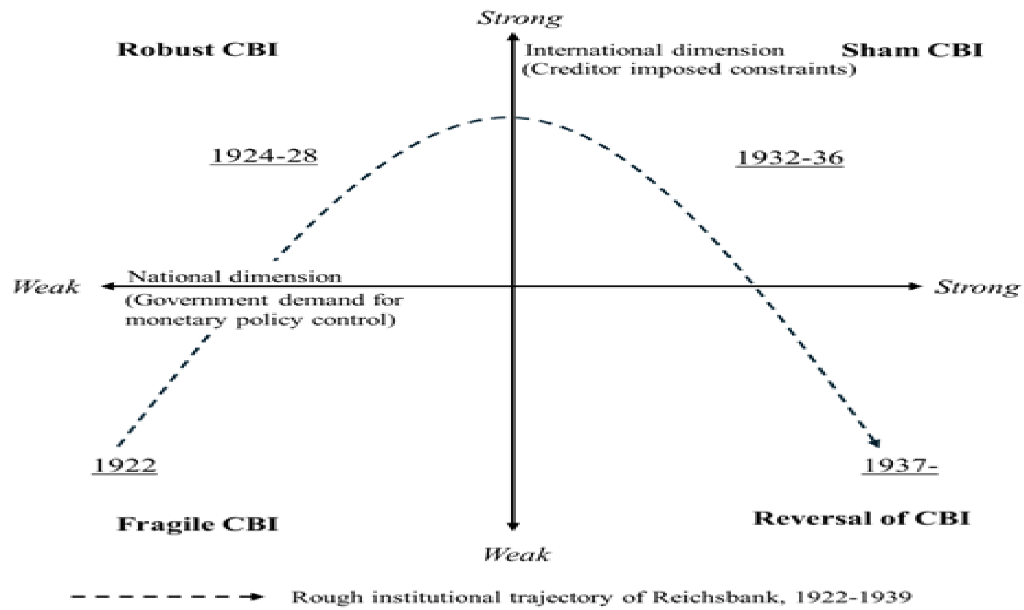
To illustrate the mechanisms underlying our theoretical model, we present the case of the Reichsbank. The institutional timeline we trace and the case's integration with our framework is summarized in stylized from in Figure 2. First, the Reichsbank's historical evolution illustrates how pressure from international creditors led to the adoption of CBI. Built on a unified position to force Germany into economic and political concessions, the Treaty of Versailles manifested a unique bargaining position for the Allies (who became Germany's main creditors). In fact, the end of World War I can be regarded as an exogenous power shift tipping the balance of power towards Germany's main creditors. As a result, to secure reparation payments after World War I, the Allies were the main driving force behind the implementation of CBI. Second, the Reichsbank's transformation after the "Great Depression" showcases how mounting internal fiscal and political pressures, in combination with a faltering multilateral creditor alliance, paved the way to CBI reversal. We show that the increasing political subordination of the Reichsbank was instrumental in massive wealth expropriation, fueling Nazi Germany's war chest. Importantly, a subordinated central bank can expropriate investors and stimulate an economy without (immediate) inflationary consequences. Finally, today, the Bundesbank's governance structure serves as the "*world's role model for a strong and independent central bank*"(Hefeker, 2019, 1). Nevertheless, countries that follow this blueprint often fail to recall the historical path to present-day CBI in Germany.[20]

5.1 Inserting an independent Reichsbank into the Weimar Republic

The Reichsbank emerged as the central bank of a unified German Reich after the Franco-Prussian War of 1871. Starting its operations on January 1st, 1876, the Reichsbank was a "*juridical person under public law.*" The Reich's Chancellor became head of the Reichsbank, ensuring substantive government control (Holtfrerich, 2012). Although the majority of the Reichsbank's shareholders

[20]While seen as a blueprint for monetary policymaking, safeguarded by an independent central bank, the case of the Reichsbank/Bundesbank illustrates that central bank independence is a fragile institutional arrangement susceptible to political disruptions.

Figure 2: Dynamics of Reichsbank CBI, 1922-1939



were private banks, the government had the final say. As monetary policy was anchored in the gold standard, the Reichsbank was fairly constrained (James, 2016). This situation changed in August 1914, when the Reichsbank was forced to fund Germany's war expenses. The subordination of the bank to the government and its monetization of government debt led to soaring inflation, which was not contained after the end of the war.

Finding itself in economic and political turmoil, Germany agreed to grant the Reichsbank legal independence in late May 1922 in exchange "*for a moratorium on reparations payments*" (Holtfrerich, 2012, 115). CBI was integral to not just the Brussels (1920) and Genoa (1922) international monetary conferences and but also the Dawes Plan (1924). As Northrop (1937, 28) comments, the strengthening of CBI "*was an outgrowth of foreign distrust of Germany.*" The power of Germany's creditors was augmented by their ability to coordinate a common position through the Dawes Plan. We can think about this unstable period as supporting Conjecture B of our framework. CBI was fragile and subject to the vicissitudes of the shifting balance between the government, poorly coordinated creditors, and the Reichsbank's own initiatives. There was scope, in this hyper-inflationary context, for central bankers to exercise a non-trivial degree of autonomy. This freedom to maneuver proved crucial for the issuance of the Rentenmark in October 1923 and the installment of the Gold Bank in 1924, which established a medium of exchange independent of Germany's chaotic public finances. Given the multiple and competing demands on the Reichsbank, it is obviously misleading to suggest that its independence had a stable political or institutional foundation. Indeed, even though the Reichsbank's new legal basis limited direct government influence, it was not until the ratification of the Bank Act in late August 1924 and the conclusion of the Dawes Plan negotiations that it gained full legal and operational independence. Importantly, the financing of government deficits by the Reichsbank "*that had motivated the Allies to press the German government for the autonomy of the Reichsbank*" (Holtfrerich, 2012, 116) ended.

To further ensure the viability of CBI and shield reparation payments, the Allies secured seven of the fourteen seats on the Reichsbank's General Council, the central oversight body over monetary policy, and placed Dr. Bruins, a Dutch economics professor, into the position of "note Commissioner". (Northrop, 1937; Mee, 2019).[21] Thus, the Board of the Reichsbank would be half foreign and under the effective control of a 'technical adviser'. Norman admitted: " *"The technical adviser" idea was shoved in as being more effective than the mere strengthening of the Reichsbank and less obnoxious than the Caisse de la Dette.*"[22] Furthermore, archival documents indicate that the Allies were actively interfering to get Hjalmar Schacht selected as the President of the Reichsbank (Holtfrerich, 2012). As Holtfrerich (2012, 120) documents "*even the British Ambassador in Berlin, D'Abernon [...] intervened in favor of Schacht.*"

In addition to implementing these institutional controls, installing Schacht was instrumental in maintaining the viability of reparation payments (Mee, 2019). Besides being intimately connected with central and private bankers alike, Schacht worked as an interlocutor on behalf of the Allies. For instance, alongside Parker Gilbert, the Reparation Agent in Berlin, Schacht repeatedly "*wanted to discipline the states' fiscal policy by drawing funds away from their banks*"(Holtfrerich, 2012, 125). Similarly, he repeatedly refused to lower interest rates or give in to the popular demands of

[21]German and foreign representatives had to be independent of their national governments. Besides England, France, Italy, Belgium, the United States, the Netherlands, and Switzerland were represented. Importantly, the 'Note Commissioner,' also called a 'technical adviser' could effectively veto any monetary policy decision and thus exercise substantial power of the decision-making of the Reichsbank (Mee, 2019).

[22]Norman to Strong, 14 November 1921, BOE OV31/5

the government to monetize public debt. As an aggressive advocate for fiscal prudence, Schacht "*violently opposed the German social policy and especially the social assistance system*" (Muehlen, 1939, 24), and even went so far to intervene with the Mendelsohn Bank and the Deutsche Bank to effectively block a \$75 million loan in December 1929 (Bohle, 2014). Divorcing the Reichsbank from the government, Germany's creditors installed a watchdog aligned with their interests and had the teeth to force the government into fiscal austerity. Underscoring its strong independent stand in relation to the German government, the Reichsbank earned itself the title "Extra-Government" (Mee, 2019).[23]

Viewing the evolution of the Reichsbank through this historical lens, CBI was instituted in a period where the memories of inflation muted governmental demand for monetary policy control. However, the strongest support for Conjecture A of our framework comes from the fact that Germany's main creditors imposed CBI to enhance their political leverage and secure reparation payments by turning the Weimar Republic into a joint liability structure. The elaborate structure of foreign control imposed under the Dawes Plan, together with the internal organization of the Reichsbank, was designed to enmesh Germany in a set of commitments that would defend the international monetary construct of the gold exchange standard and secure creditor's interests at the expense of all other considerations. However, there were latent risks in this joint liability structure. The Reichsbank's independence was, in effect, detached from most domestic sources of legitimacy. The bank was caught in a straitjacket of foreign creditor influence that made it hard to respond to evolving domestic needs. This latent design weakness would surface as governmental demand for monetary control returned with a vengeance with the onset of depression economics.

5.2 Depression conditions and retrenching Reichsbank independence

Several historical developments surrounding the "Great Depression" that undermined creditor constraints and increased government demand for monetary policy control are central to the understanding of the Reichsbank's transition from independence to subordination. Even before the pressures of the Great Depression struck, increased political pressure encouraged the Reichsbank

[23]The importance of individual central bank governors and their ability to withstand political pressures is well documented in the literature on CBI (for a recent survey, see Redwood (2023)).

to secretly collaborate with the government in a pattern of over-borrowing and overspending that corresponds to Conjecture C of our framework. This hidden backsliding in CBI was vastly accelerated by the rapidly deteriorating global economic conditions between 1928 and 1932, ultimately leading to a significant weakening of political unity among Germany's main creditors. Their own scramble for recovery and increasingly open collusion between the German government and Reichsbank engineered a break-up of their unified position. This lifted the international political pressure that had been essential for maintaining CBI. A faltering German economy and resultant social unrest (Tooze, 2006) made it necessary to deploy the monetary arsenal of the Reichsbank. This combination of a weakening international anchor and increasing domestic pressure paved the way for a reduction of CBI during the 1930s, as posited by Conjectures C and D of our framework. We describe both of these developments in greater detail below.

First, the onset of the Great Depression meant a turn to protectionism, which resulted in a reshuffling of global financial relations (Feinstein, Temin and Toniolo, 2005). Whereas the members of the League of Nations were initially in agreement about Germany's reparation payments, rising political tensions meant a serious setback. Constant disagreement on loan modifications, in combination with a deteriorating political climate between the Allies, meant that the unified position of those nations crumbled. For instance, the United States declined to participate in creating the Bank of International Settlements (BIS), underscoring its political stance in favor of full repayment of outstanding private debts (Simmons, 1993). Schacht worked secretly to undermine collective action between Germany's creditors while maintaining an outward appearance of independence. In particular, he weakened the bargaining position of creditor nations by opting for a strategy of bilateral negotiations with each individual creditor (Weitz, 1997). The complete breakdown of international cooperation arrived with the Lausanne Conference of 1932 which symbolically was never ratified (Toniolo, 2010).

To put these developments into theoretical context: the onset of the Great Depression amplified existing frictions among Germany's main sovereign lenders (Ritschl, 2012). These tensions were also reflected in the Young Plan's agreed modifications to the Reichbank's governance structure (Bergmann, 1930). Besides a reorganization of reparation payments, the Young Plan eliminated "*not only the Reparations Agent and the Transfer Committee but also the foreign members of the Boards of the Reichsbank*" (Bergmann, 1930, 595).[24] Thus, the Young Plan returned substantial political leverage over the Reichsbank to the German government.

The second development was the collapse of the German economy which hugely increased government demand for monetary policy control. The economy was thriving on monetary stability since 1924, as international investors poured money into Germany (Schnabel, 2004; Ritschl, 2012).[25] For instance, US financiers' direct and indirect investment in Germany "*exceeded 10% of U.S. GDP in 1931*" (Ritschl and Sarferaz, 2014, 350). But at the outset of the global economic crisis, Germany found itself on a devastating downward path (Doerr et al., 2018). For instance, Doerr et al. (2018) (citing several sources) report that German industrial production declined more than 40%. In late May 1931, rumors emerged about Germany's inability or reluctance to maintain reparation payments with devastating financial consequences (Bohle, 2014). Domestic and international investors fled the country, effectively putting the German financial system on the verge of collapse (Schnabel, 2004). Trapped between a rock (i.e., a fixed exchange rate) and a hard place (i.e., the need to bail out German banks), the Reichsbank's reserves dwindled in its attempt to counter capital flight out of its failing banking system, resulting "*in the abandonment of the gold standard*"(Schnabel, 2004, 866). Under pressure from international financial markets, the Reichsbank held to its restrictive monetary policy path (even in absence of the gold standard) and introduced capital controls, while the Brühning government pursued extreme fiscal austerity in the hope of restoring international investor confidence (Ritschl and Sarferaz, 2014).

This policy was enacted in the death-throes of creditor imposed constraints however. Walking the path of austerity, the German administration effectively put the national economy into free fall. Since the outset of the Great Depression, Germany was almost completely cut-off from international financial markets, so a combination of crumbling exports and extraordinary debt left the government with few options for economic maneuvering. The Reichsbank's tight monetary policies, in combination with Brühning's austerity measures, lent substantial impetus for rising social tensions.

[24] From an institutional perspective, the Young Plan meant the removal of foreign control, whereby "*the President of the Reich was given the deciding voice and all elections by the General Council were subject to his confirmation*"(Northrop, 1937, 31). For an in-depth analysis of additional operational changes, see, Northrop (1937)."

[25] As Ritschl (2012) argues these capital inflows built the backbone for reparation payments.

We can safely say that the domestic and international policy responses to the Great Depression created a uniquely adverse environment for maintaining CBI.

5.3 Subordinating the Reichsbank in the Third Reich

While the Brúhning administration clung to its fiscal straitjacket, unemployment soared to 6 million in 1933. This crisis required immediate attention. In light of a crumbling international creditor coalition, the newly elected Nazi regime did not wait long to mobilize the financial arsenal of the Reichsbank. In the following section, we outline the gradual transformation of the Reichsbank to powerful weapon expropriation, highlighting the role of central banks in shaping the economic and political fabric of a country (i.e., Conjecture D). In particular, we demonstrate that the increase in control over the Reichsbank between 1933 and 1939 translated into the development and implementation of increasingly bellicose financial schemes to fuel Germany's war chest (for an overview, see Muehlen (1939)).

As often observed in the process of CBI reversals, one of the first moves of the Nazi regime was to quickly switch the leadership team of the Reichsbank, reinstalling Hjalmar Schacht as President of the Reichsbank in March 1933. Advocating for Hitler (in particular among the German business elites) after his resignation from the Reichsbank in 1929 and being intimately connected with central bankers around the world (Mee, 2019), Schacht became an important agent for its transformation "*into a weapon for foreign economic exploitation*"(Wolfe, 1955, 401). In October 1933, to equip Schacht with substantial political leverage, modifications to the banking law (of 1924) were introduced that disbanded the Reichsbank's General Council and thus took away "*control of private owners of the Bank*" (Holtfrerich, 2012, 129).[26] These changes in personnel and in legal statutes marked the onset of CBI reversal that became increasingly aggressive and opaque from a creditor's perspective, leading to a complete revocation of CBI in 1939 (Holtfrerich, 2012; Mee, 2019).

Upon assuming the leadership of the Reichsbank, Schacht immediately started pursuing ag-

[26]Several other institutional changes, transferring substantial powers to the President of the Reich were also included in these modifications. Importantly, the Reichsbank's President could nominate members of the Banks' Directorate which would be approved by the Reichs' President. For a discussion of these institutional changes, see Holtfrerich (2012).

gressive debt diplomacy to drive an even deeper wedge into an already fragile creditor coalition (Tooze, 2007). Whereas the US was concerned about private investor exposure, Britain pursued a strategy of "economic appeasement," and France favored full repayment of all debts. In fact, none of the creditors had either sufficient leverage or interest to turn against Germany on their own (Tooze, 2006). Although Schacht had cautiously deployed similar tactics during the late 1920s (per Conjecture C), the emerging global disintegration, in the absence of the gold standard, significantly reduced the opportunity costs of his brinkmanship. In several conferences, Germany started to negotiate debt settlements with countries individually and offered competing deals. As Schacht had hoped for, creditors started "*to fight among themselves*" (Weitz, 1997, 161), leading to an erosion of their collective bargaining power and allowing the Nazi regime to attain an almost full debt moratorium by June 1934. In particular, the inability to counter Germany's financial meddling meant that Schacht was able to push ahead with critical domestic legislation reducing the sovereign debt burden. For example, the regime put into law the so-called "Gesetz zu den Zahlungsverbindlichkeiten gegenüber dem Ausland" on June 9, 1933. The new law meant that Germany would service its debt payments on long and medium-term loans in Reichsmark (Wolfe, 1955).[27] In addition, the Reichsbank engineered numerous monetary instruments to boost public spending and further squeeze creditors.

On the domestic side, the regime put in place numerous repressive financial regulations, setting a path for the full political subordination of the financial system and subsequent elimination of opposing business elites (Wolfe, 1955; Overy, 1996; Tooze, 2006). For example, starting with the Reich Credit Law of December 1934, firms in the financial industry were required to attain a permit for the issuance of any large loans (Wolfe, 1955). Furthermore, firms were restricted to paying out dividends of no more than 6%, unless additional payouts were directly channeled into the purchase of government bonds (Overy, 1996). Another cornerstone of the plan was the so-called "Mefo-Bills." Comparably to today's public-private partnership programs, the regime

[27] An important aspect of this arrangement was that German debtors could not directly pay their debt but had to deposit funds into the so-called "*Konversionskassen*" (Taylor, 1933, 90). These funds would directly reimburse foreign debtors at 50% of their original claim at a discounted interest rate (Weitz, 1997, 154). Furthermore, this scheme allowed Germany to defer its payments until such a time as German export revenues would be sufficient to cover the shortfall in foreign currency reserves. Put simply: if international creditors "*wanted repayment of their debts, they would have to purchase German goods*" (Tooze, 2006, 73).

set up “Metallurgische Forschungsgesellschaft” (i.e., “Mefo”) as a private company with the sole purpose of issuing bills in exchange for armament deliveries (Ritschl, 2002; Tooze, 2006). Backed by Reichsbank guarantees, the *modus operandi* was straight-forward: the “Mefo-Billis” could be discounted with the Reichsbank up to a five-year term (Muehlen, 1939; Holtfrerich, 2012). As these bills did not imply a direct fiscal transfer from the Reichsbank to the government, this scheme was an effective way of moving large chunks of defense spending off-balance while avoiding immediate inflationary repercussions. Furthermore, it did not directly violate the statutes of the Versailles Treaty’s CBI requirement. However, the launch of “Mefo-Bills” was equivalent to introducing a domestic parallel currency.

On the international front, the Reichsbank acted quickly on the devaluation of major currencies in 1933 and 1934, and picked up government bills at a fraction of their face value (Muehlen, 1939; Tooze, 2006). Moreover, in light of worsening trade relations with Germany’s main trading partners, Schacht started to rapidly set-up bilateral trade arrangements with other countries to boost exports and secure resource imports (Ritschl, 2001). Starting with Hungary and Romania in 1934, Schacht built an entire web of these bilateral trade agreements, including with several countries in Latin America (Neal, 1979). At the heart of this web were financial clearing systems, which were built on an overvalued Reichsmark vis-á-vis those trading partners that could not effectively retaliate (Ritschl, 2001).[28]

In combination with additional repressive measures — such as import restrictions, wage suppression, and price controls — the aforementioned inventions were effective in containing inflationary pressures and supporting the German economic recovery, but they were not sufficient to garner enough foreign currency reserves and release constant pressure from the balance-of-payments. Under this permanent pressure, the Reichsbank skated on the thin ice of its foreign reserves — covering less than a month’s worth of imports — curtailing its room for maneuver (Tooze, 2006). Hitler’s ambitions to ramp up the armament of Germany, combined with the permanent threat of a de-

[28] Setting up these type of barter trading and financial clearing systems has been used in other contexts, too. For instance, in the case of Cuba in 1959, these bilateral trade and investment agreements between Cuba and the Soviet Union were instrumental in retaining macroeconomic stability while subordinating a nation’s central bank and financial system (for a review, see, for instance, Arabadzhyan (2023). A similar pattern can be observed in the recent case of China, where bilateral trade and investment treaties relying on RMB-based clearing mechanisms, provide a monetary shield against potential future sanctions (Weinhardt and Petry, 2024).)

tailed balance of payments, increasingly led to tensions between Schacht and the Nazi establishment (Ritschl, 2002).

5.4 Turning the Reichsbank into a financial weapon

Whereas, initially, the Reichsbank's efforts concentrated on breaking fragile creditor coalitions and manipulating financial accounts, greater political subordination gave rise to the blunt expropriation of trading partners, the extortion of the Jewish population in Germany, and the looting of occupied territories (Tooze, 2007).

As the Reichsbank's financial engineering was not sufficient to fund Hitler's 'Four Year Plan' (Tooze, 2006), the Nazi regime's measures to mobilize resources became even more aggressive and desperate. To sideline the Reichsbank's uncooperative leadership, "*on* 4^{th} *April 1936 Hitler appointed Hermann Göring as special commissioner for foreign exchange and raw materials*" (Tooze, 2006, 277). This marked the beginning of increasingly brutal ways of mobilizing funds.

On October 22^{nd} 1936, Göring issued a circular decree on foreign exchange regulations that implied sweeping confiscations of "*every dollar, franc or pound, every ounce of gold and all Germany's remaining foreign assets*" (Tooze, 2006, 277). The decree's provisions provided the legal basis for expropriating foreign cooperations and creditors. In his Congressional testimony, Heinrich Kronstein (1943, 440) states that — in the case of American companies operating in Germany — the "*decree declares American corporations, domiciled in the United States, residents of Germany and makes their property thereby public property of Germany.*" To enforce the decree, Göhring selected *Reichsführer SS* Reinhard Heydrich. The selection of Heydrich was instrumental for extorting Germany's Jewish population (Bajohr, 2002). For instance, Bajohr (2002, 156) citing the head of the Hamburg Foreign Exchange Office, *Oberregierungsrat* Krebs, states that exchange and customs investigations "*on direct instruction of Heydrich were responsible for the anti-Jewish radicalization of foreign exchange policy.*" Tooze (2006, 277) reports that as a result of this intervention "*over the next twelve months Göhering's teams bagged 473 million Reichsmarks in foreign currency.* Although the Reichsbank administered these 'looted' funds, they were effectively stripped of the important function of controlling the circulation of foreign exchange. As Schacht opposed this radicalization of mobilizing funds for the Nazi's war machinery, constant conflicts with Gôhring and the Nazi elites emerged (Simpson, 1959).

As a consequence, Hitler revoked the independence of the Reichsbank on January 30^{th}, 1937 to gain "*total control of the Reichsbank and unlimited access to her credit*"(Holtfrerich, 2012, 135). Furthermore, Schacht was released from his position as Minister for Economic Affairs in November 1937.

The "*Anschluss*" of Austria marked another escalation. Although the motives for annexing Austria were political, it provided the Nazi regime with ample opportunities to loot the country (Tooze, 2006). Immediately after German forces moved into Austria on March 15^{th}, 1938, Reichsbank employees took control of the Nationalbank and ordered the transfer of its reserves (Taber, 2014). Similarly, one day after the occupation of Czechoslovakia on March 14^{th}, 1939, a representative of the Reichsbank arrived at the Czech National Bank, ordering the immediate transfer of its gold reserves to the Reichsbank. Furthermore, the Nazis dismissed the bank's leadership, introduced a currency peg favoring the Reichsmark, and put an occupation tax into practice, siphoning out resources (Schweigl, 2016). Throughout the war, the Nazis applied this tactic and variations of it in occupied territories to gain access to ever more financial funds (Wolfe, 1955; Taber, 2014; Jobst and Kernbauer, 2016).

The Nazi regime also ramped up its brutal extortion measures against the Jewish population.[29] The events of *Kristallnacht* meant the "*massive countrywide burning of Jewish synagogues and attacks on Jewish stores and shops, as Jewish men were beaten, arrested, and sent to concentration camps*" (Weitz, 1997, 238). These events set in motion the "*fiscal destruction*" of the Jewish population (Ritschl, 2019): besides a brutal tightening of existing regulations, the "Aryanization" of Jewish property went into full force, which meant the transfer of this property (at a fraction of

[29] In fact, since 1933, the Jewish population was subject to increasing extortion. Although in the early years, emigration in exchange for a conversion of assets into "*Konversionskassen*" at the Reichsbank — whereas only a fraction could be converted into foreign currency (at an arbitrary exchange rate) — in combination with a "flight tax" of 25% were permitted (Ritschl, 2019), an increasing number of new directives represented a turning point for the worse starting in late 1936. Discriminatory measures — such as prohibitions against Jews engaging in certain business activities and professional occupations — were dramatically extended. In April 1938, Jewish wealth exceeding 5000 Reichsmarks had to be registered and became subject to a 25% capital levy after the *Kristallnacht* in November 1939. A perverse clause on these additional taxes were that they had to reach the amount of 1 billion RM (Ritschl, 2019).

its actual value) to Germans.[30] The events of November 1939 marked an escalation of one of the most horrific crimes in human history: the Holocaust.[31]

Hitler's replacement of Schacht with Walther Funk as President of the Reichsbank cleared the way for unlimited monetary financing and full extortion (Mee, 2019). To ensure full compliance, the Reich's government passed a new banking law on 15^{th} June 1939, according to which the "*Bank was subjected to the Reich's unlimited sovereignty and [...] obliged to support the realization of aims set by the Nazi leadership*"(Holtfrerich, 2012, 134). With a fully subordinated Reichsbank, almost all remaining institutional barriers to priming the credit pump and outright looting occupied territories were removed (Tooze, 2006). To summarize the financial *modus operandi* after 1939, the Nazi regime kept its war machinery going by "*stealing the gold out of the central banks of the countries they occupied, and the rings and gold fillings of the victims they killed, [and] smelting it all into gold bars disguised to look like it came from their own central bank*"(Eizenstat, 2004, 340).

This history strongly supports Conjecture D of our framework. It reveals the enormous power that can be gained from subordination once the separation between a government and its central bank is dissolved. Freed from the straitjacket imposed by creditors, the Reichsbank was turned, under the German government's demand to wage war, into a weapon of increasingly overt and coercive appropriation and exploitation.

6 Concluding Remarks

This study offers a simple yet important extension to the CBI literature. CBI has mostly deepened since the 1980s (Romelli, 2024). Yet, as is increasingly apparent, CBI is almost always contested. To complement existing literature (for a recent review, see Bodea and Garriga (2023)), we map CBI within a greater political game and broader international historical context.

Starting from the idea that central banks play a key role in sovereign debt markets, we show how

[30] For an overview of these measure of extortion, see, Bajohr (2002), Kuller (2013), and Ritschl (2019).

[31] The Reichsbank's leadership dismissed these measures but still processed and laundered these looted assets. Harshly criticizing the course of the Nazi leadership, Schacht speaking to Reichsbank employees said: "*The burning of Jewish synagogues, the destruction and looting of Jewish businesses, the ill treatment of Jewish citizens was so disgraceful that every decent German must blush with shame.*" (Weitz, 1997, 241). Furthermore, as Schacht attempted to block government use of central bank funds, he was removed from the Reichsbank on January 20^{th} 1939 with the words that "he would not fit into the entire National Socialist Framework"(Schacht, 1953, 495).

creditors pressure states into adopting CBI. This mitigates the political risks of sovereign lending by creating a structure in which governments and central banks monitor and discipline each other. However, when creditor coalitions weaken, CBI retrenchment is predictable. Importantly, our framework also unpacks the various sources of a government's demand for monetary policy control and considers the factors that will influence the price that governments will need to pay to achieve CBI reversals. Put bluntly, we argue that governments with a greater demand for monetary control will only succeed in reversing central bank independence when investors' power can be diminished, and thus, the penalty (or economic costs) for undoing CBI can be minimized.

Drawing on historical evidence from the Reichsbank in the 1930s, we first show how creditors instituted CBI under an elaborate system of international controls to help protect reparations and debt servicing schedules. We verify that a weakening of international creditors and the diminishing political potency of multilateral organizations substantially reduce the opportunity costs of reigning in CBI. Finally, in the absence of creditor-imposed constraints, we show that an increasing political subordination of monetary authorities to national governments allows for wealth expropriation by means other than through inflation. As such, we see our work as a complementary extension to the current literature wave analyzing CBI's emergence and reversals (Adolph, 2013; Fernández-Albertos, 2015; Martin, 2022; Bodea and Garriga, 2023; Romelli, 2024; Moschella, 2024).

There are limitations, however, to our simplified framework. Additional cases and existing research suggest the need to link our structural perspective with granular insights into the political process of central bank reversals. Three micro-level factors and processes stand out as being worthy of further consideration. First, even if a government attempts to rollback on CBI, veto players and institutional safeguards may frustrate its efforts (Bernhard, 1998; Hallerberg, 2002; Crowe, 2008; Mas et al., 2020). In fact, CBI is usually safeguarded by national and/or international legal provisions. In some cases, such as the Eurozone, CBI is deeply anchored in foundational treaties and dense institutional ties, making it hard to overcome these barriers (e.g., Frieden and Walter, 2017). An important implication is that reversing central bank independence is likely to be more feasible in settings with weak governance frameworks (Bodea and Garriga, 2023).

Second, central banks themselves are often fierce defenders of the status quo and can sometimes fend off attempts to revoke their independence (Lohmann, 1999; Johnson, 2015, 2006; Martin, 2022; Redwood, 2023). Facing resistance from a central bank's leadership, governments frequently have opted for personnel rotations in central bank boards to undermine a 'stubborn' leadership's authority within the central bank (Adolph, 2013; Ainsley, 2017; Blinder, 2023). Intensifying internal pressures in conjunction with amplifying political pressure via various channels (e.g., media campaigns), governments aiming to reclaim authority over monetary policy will often push to a degree where central bankers yield and step down (Dreher, Sturm and De Haan, 2010; Binder, 2021). Once resignations are set in motion, governments can flip out key personnel to gain greater political control. For instance, in the case of Hungary, Governor Simor withstood numerous political attacks and multiple rounds of corruption allegations that were steered up to remove him from the leadership of the MNB because he did not succumb to political pressures threatening MNB's independence.[32]. While being able to hold onto office, several loyalists of the Orban administration were placed on the central bank board, limiting Governor Simor's ability to withstand political pressures. He was eventually replaced in 2013, making way for the political subordination of the MNB.

Finally, even when governments cannot change the legal provisions or personnel anchoring CBI, they may be able to destroy the ideational and institutional basis for independence. In particular, they can impose institutional goals that are incompatible (Lohmann, 1992). For instance, despite advances to grant greater political independence, the People's Bank of China (PBoC) is trapped between several competing goals. The central bank's mandate foresees that PBoC distributes subsidized loans to state-owned enterprises, safeguards financial stability, and maintains a stable exchange rate (Chan, 2019; Weinhardt and Petry, 2024). Navigating many conflicting targets, the PBoC is tied up in meeting these competing goals, rendering even greater political independence ineffective. Thus, assigning additional and conflicting policy goals and mandates can be an effective tool to undermine the independence of monetary authorities without raising the red flags of de jure rollback and central bank governor sackings (Mas et al., 2020).

Staying with this policy process perspective, however, our work closely maps the monetary

[32] "Hungary's Simor breaks silence on government attacks," Central Banking, June 22, 2010.

responses to the current pandemic and rising debt distress in developing and emerging market economies (for an overview, see Mitchener and Trebesch (2023), Mosley and Rosendorff (2023*a*), and Setser (2023). Increased demand for monetary financing maneuvers central banks to the verge of their mandates and boosts their political leverage disproportionately while intensifying geopolitical tensions have led to a greater degree of creditor fragmentation (Setser, 2023; Ferry, 2023; Mosley and Rosendorff, 2023*b*). In many instances, this increased geopolitical and economic fragmentation accompanied by a protectionist policy stance has the potential to weaken built-in safeguards and thus create an enabling environment for governments to reverse the political independence of central banks. For this reason, even the Managing Director of the IMF, Kristalina Georgieva, underscoring the vital role of the IMF as a guardian of creditor interests in fending off political pressures on monetary authorities (Georgieva, 2024), has recently sounded the alarm on the viability of CBI in retaining global political stability. As our findings and the case of the Reichsbank indicate, this statement is not blown out of proportion but points to the potential of increased political subordination of central banks in charting the way for further geoeconomic fragmentation and conflict, with the potential of jeopardizing future global political stability.

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