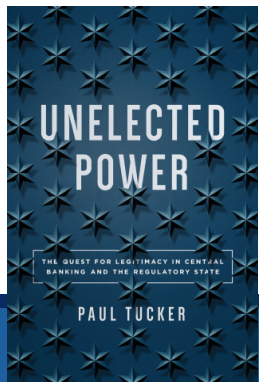


IS THE AGE OF INDEPENDENT CENTRAL BANKS OVER, AND SHOULD WE CARE?

PAUL TUCKER, HKS

PRESENTATION AT TOKYO UNIVERSITY, CARF

1 OCTOBER, 2019

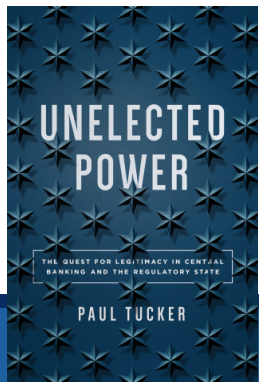


STRUCTURE OF TALK

1. Over mighty citizens? Ways of undermining CBI
2. Does it matter? A constitutionalist view of CBI
3. Constraints: Reconciling commitment technology with democracy
4. Some consequences: Balance sheet, LOLR/Prudential, Self-Restraint

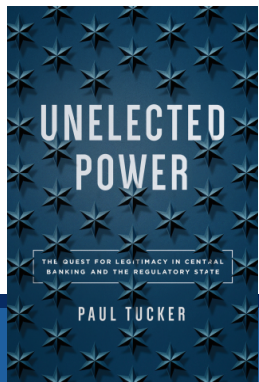


I: OVER MIGHTY CITIZENS?



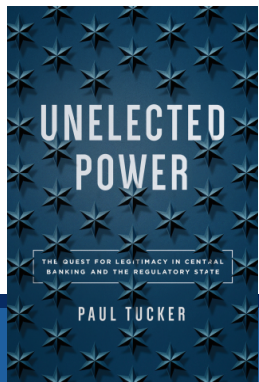
THE NEW FACE OF CRISIS MANAGEMENT

- During and after Great Depression: US President F. D. Roosevelt
- Today: Bernanke, Paulson, Geithner, Trichet, Draghi
 - None of whom were elected
 - Politicians better at finding the words that will make sense to people
- Symptomatic of broader changes in system of government



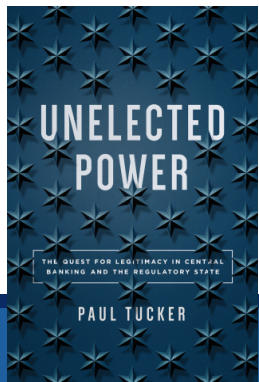
BASIC PROBLEM AND THESIS

- Too much government power for comfort lies in the hands of unelected regulators and activist judges
- Government no longer designed in a principled way
 - In the West, a gap in constitutionalism bequeathed by Locke, Montesquieu, Madison
- Solution: a political norm comprising *Principles for Delegation* to independent agencies



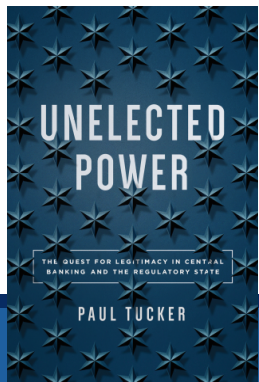
POWER OF THE POST-CRISIS CENTRAL BANKS

- Poster boys and girls of today's Unelected Power
 - New third pillar alongside Judiciary and Military
- Balance-sheet powers used like never before: *latent fiscal powers*
- Plus, new regulatory powers (Fed, ECB, BofE)
 - part of *law-making* state as well as fiscal state
- What constraints needed for legitimacy in a constitutional democracy?



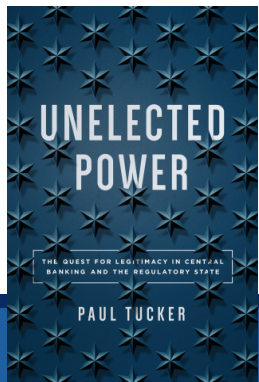
PROPOSALS FROM POLITICAL RIGHT AND LEFT

- From the Right:
 - Ban QE
 - No purchases of private-sector assets
 - No LOLR to individual firms; ie no Discount Window, only OMOs
 - Interest rates to track a legislated rule (eg Taylor Rule)
- From the Left:
 - People's QE: finance government programs
 - Steer credit to reduce inequality or improve productivity
 - Set cyclical fiscal policy
 - Place under political control, because CBI part of “neoliberalism”



WAYS TO UNDERMINE CBI

- Two broad strategies: appointments, and mandate
- Each with a crude and subtle variant



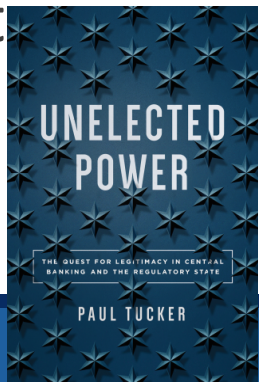
STRATEGIES FOR UNDERMINING CBI

Appointments:

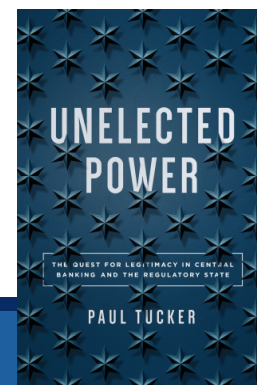
- Crude: Overt political allies unqualified for the role
- Subtle: Experts who are in fact political allies; eg. Burns and Nixon

Mandates:

- Crude: repeal or reduce independence
- Subtle (1): reduce instruments/powers so cannot deliver objectives
- Subtle (2): extend mandate so far that any decent official will want political steer



*II: DOES IT MATTER?
CONSTITUTIONAL
CENTRAL BANKING*



STANDARD ARGUMENT FOR CBI INCOMPLETE

Time-inconsistency problem: standard solutions incomplete

Rules (Kydland/Prescott):

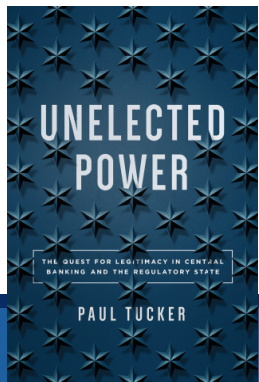
- But why would 'they' stick to the declared rule?

Conservative central bankers who hate inflation (Rogoff):

- But why would govt (re)appoint such a person, and what if they are only pretending to be conservative?

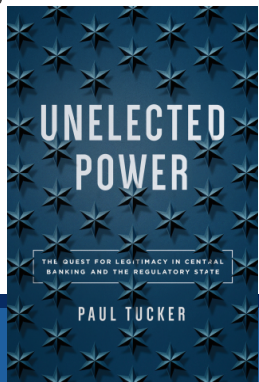
Contract allowing govt to punish CB for missing target (Walsh):

- But what if missing the target suits the govt?
- An infinite regress problem?



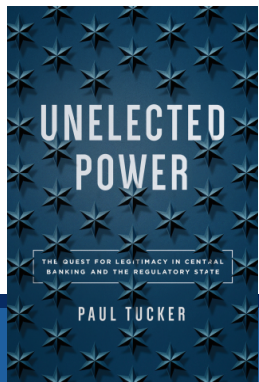
CONSTITUTIONAL CENTRAL BANKING

- Under fiat money, independence for the monetary authority is a corollary of the higher-level separation of powers between the fiscal authority of the legislature and the elected executive government
 - Doubt whether the volatility in output and jobs entailed by gold standard would be tolerated under *full-franchise* democracy
- Central banks a solution to the problem of not giving the monetary levers to the elected exec

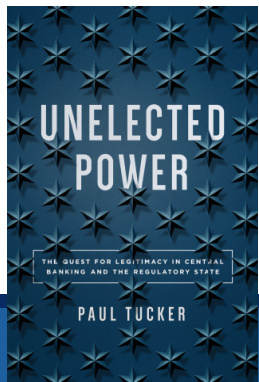


SAVING THE INFLATION RISK PREMIUM

- Not a partisan proposition
- High inflation associated with high uncertainty about inflation, which implies a risk premium
 - Not the compensation for expected inflation, but for risk
 - That is a real cost that does not wash out over time
- So price stability reduces real burden of government debt-servicing costs
 - Political Right could use for tax cuts etc
 - Political Left for public projects etc
 - (Political science literature on why CBI granted in a bit of a muddle)

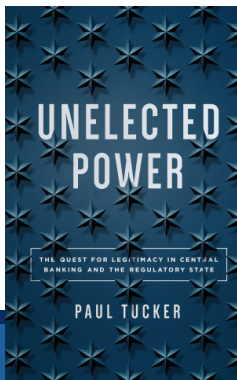


III: *CONSTRAINTS ON CENTRAL BANKING*



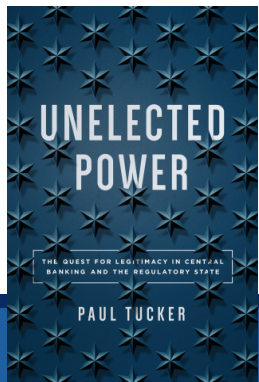
FIVE THEMES OF *UNELECTED POWER*

- Legitimacy up there with Justice
- Technocracy v. Populism:
 - Technocracy should retreat a bit
- Legal liberalism is insufficient:
 - Judges guarding against the arbitrary exercise of power cannot cure a democratic deficit: our republican values matter too
- Gap in constitutionalism concerning points on a **spectrum of commitment devices**
- Our deep (shared) political values should constrain Rational-Choice Institutional Design



WHY LEGITIMACY MATTERS

- Legitimacy makes a system of government resilient in the face of inevitable policy failures and disasters. *OUTPUTS CANNOT SUFFICE*
- Representative democracy special partly because
 - It separates how we feel about the government of the day from how we feel about the *system of government*
 - Because we can sack (vote out) our governors
- Except we cannot vote out our unelected governors
- IA-regimes liable, in slow motion, to erode trust in govt unless they are principled and widely understood

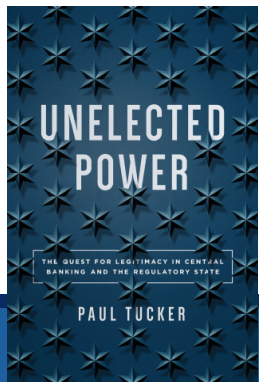


INDEPENDENT AGENCIES: DEFINITION

Definition: *Insulated from the day-to-day politics of both elected branches of government*

Attributes of independence:

- Control over delegated policy instruments
- Job security of policymakers
- Budgetary autonomy (or at least not an *annual* budget process)



ADMIN STATE AND CONSTITUTIONALISM

Germany a rare exception among advanced-econ democracies:

- Under German Basic Law, formally can be no IAs (other than BUBA post Maastricht). Not obviously true *de facto*

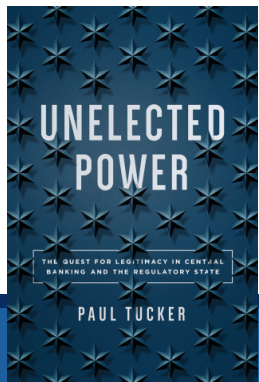
France: Written constitution puts admin under PM, but IAs carved out by Const Court

- IAs now structured under a generic statute, following critical Senate report

USA: Empty non-delegation doctrine, sprawling variety of structures

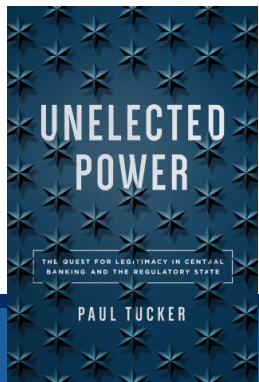
UK: flexibility (of course)

- Long resisted o/a doctrine-cum-tradition of parliamentary accountability
- Partly solved through Select Committee system; now lots of IAs



CONFUSION IN USA

- SEC, CFTC, FTC, FCC not IAs on this definition: annual budget appropriation process gives Congress ongoing leverage
- CFPB is an IA on this definition (does not satisfy *Principles*)
- Fed and FDIC are IAs
- UK: FCA, OfCom, utility regulators are IAs
- Sweden: Riksbank an IA; FSA semi-independent



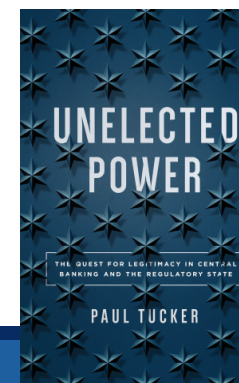
JUSTIFICATIONS FOR DELEGATION-WITH-INSULATION

Expertise

- Landis during 1940s: separation of powers is redundant
- Does not work: could have an independent body that gives public advice to a political decision maker
- Necessary but not sufficient

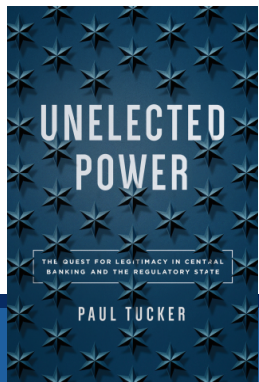
Credible commitment

- *Politician*: re-election/current popularity: pursues welfare *today*
- *Technocrat*: professional and public reputation for delivering mandate
 - Requires mandate that constrains, and
 - To generate audience costs, ***a society capable of bestowing esteem (republican honour)***



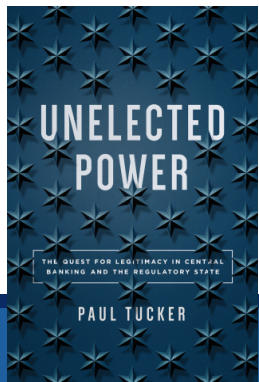
COMMITMENT v. DEMOCRACY

- But do institutionalised commitment devices violate our democratic values?
 - *Our freedom to change our minds about ends and means*
- On the one hand, delegation is designed to help the democratic state deliver better results by sticking to the people's purposes: in that sense credible commitment is enabling of democratically generated purposes.
- On the other hand, the people have to remain free to change their purposes.
- The resolution has to be either that there are some commitment problems where democracy, as ordinarily understood, should be suspended or, alternatively, that *institutional technology designed to enable credible commitment can come in degrees*.



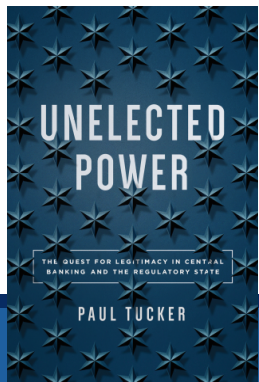
ABUSES v. MISUSES OF POWER

- Escape from thinking that hazards to our system of government are only:
 - A. extra-legal acts that can be remedied via the courts, and
 - B. within-law policy failures that can be remedied via the ballot box.
- Neither suffices where all political parties have incentives to renege on a substantive promise (for example, low inflation) and, further, the social costs of their doing so are long-lasting (because they become embedded in people's expectations and behaviour).
 - Those are serious *misuses of power*.



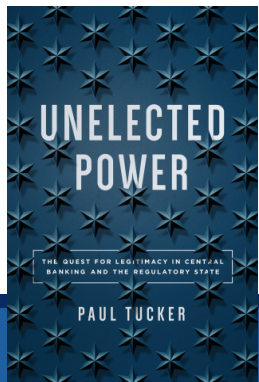
IA REGIMES AS NON-ENTRENCHED COMMITMENT TECHNOLOGY

- Think of an IA as a commitment device *pro tem*, but only *pro tem*:
 - Suspension of “trial and error” policy-making *for the time being*
 - *Not formally entrenched, but grit that politicians put in their own way*
- Trustees for a clear public purpose
 - statutory mandate is the ‘trust deed’
 - as such, it could be vague or constraining
- More codified, less room for welfarist learning
- **More entrenched the independence, tighter constraints needed**

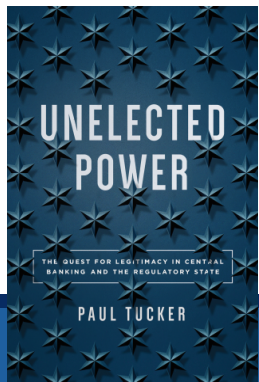


A HIERARCHY OF AGENCIES

- Delivery agencies under Ministerial control
- Regular policy agencies under political control
- Independent agencies that are *Trustees* for some carefully mandated public purpose
 - *normal monetary authorities fit here*
- *Guardians* of a constitutional value
 - 4th/nth branches: if the *only* way of securing that value



PRINCIPLES FOR DELEGATION



INSTITUTIONAL DESIGN: OUR POLITICAL VALUES

Freedom:

- *republican* freedom from domination
- *liberal* freedom from interference exceeding what's needed to deliver public purposes

Values of the ***rule of law:***

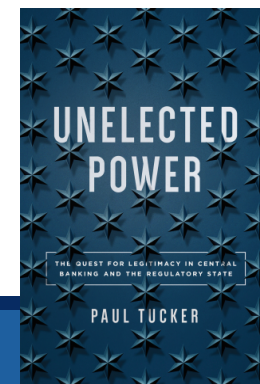
- predictability, generality, clarity, etc
- fair and open adjudication

Democratic values:

- participation, representation, public deliberation, transparency, contestability, etc

Constitutionalism:

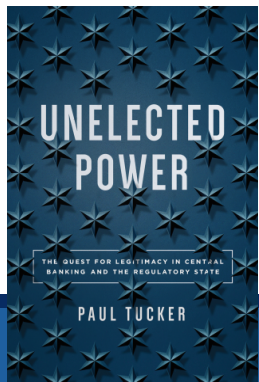
- separation of powers, etc



PRINCIPLES FOR DELEGATION TO IAs

- Delegation Criteria for *Whether* to delegate
- Design Precepts for *How* to delegate
- Multiple-Mission Constraints

Rational-choice institutional design constrained by deep political values

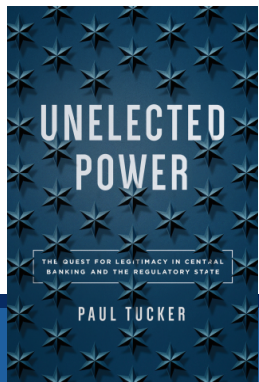


WELFARE v LEGITIMACY

	<i>Satisfy Principles</i>	<i>Could satisfy Principles</i>	<i>Cannot satisfy Principles</i>
Delegated to an IA	Democratically legitimate welfare enhancement	Remediable legitimacy problem	Unremediable legitimacy problem
Under political control	N/A	Welfare opportunity cost	Sensible.

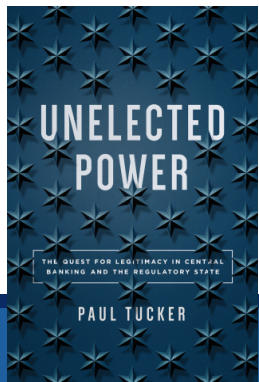
PRINCIPLES FOR DELEGATION TO IAs

- 1) **Broadly settled public preferences re purpose**
- 2) Problem of credible commitment
- 3) **No big *choices* re distributional issues or high-level values**
- 4) **Legislature to set a clear objective that can be monitored**
- 5) Decisions via one person-one vote committees, after deliberation
- 6) **Transparency enabling public debate and accountability**
- 7) Clarity re powers in emergencies
- 8) Multiple-mission agencies: separate committees with 'dedicated' majority



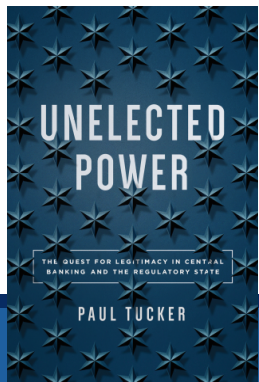
EMERGENCIES

- Clarify ex ante what happens when an IA could help contain a disaster but is at boundary of powers:
 - eg temporary formal extension of powers granted by elected politicians
 - in practice, probably relies on a delegated power to exec branch
- If IA could act within existing powers but in ways not remotely contemplated by public or legislators, consult elected politicians
 - eg ECB should have done so

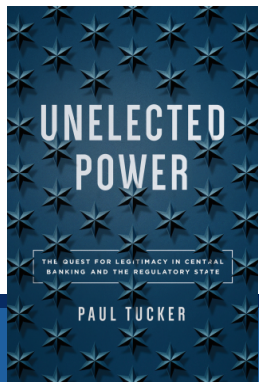


MULTIPLE-MISSION CONSTRAINTS

- 1) Missions are intimately intertwined
- 2) Better results expected from joint production
 - eg, o/a info flows
- 3) Each mission meets tests for IA status
 - do not delegate a non-independent mission to a IA
- 4) Separate statutory policy committees for each mission
 - with a majority of members of each committee on only that committee

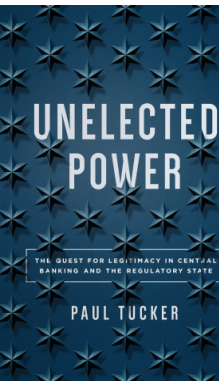


IV: *CONSEQUENCES FOR CENTRAL BANKS*



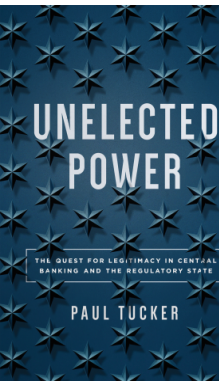
PRINCIPLES FOR BALANCE-SHEET POLICY

- Time consistent: central banks should not deny that they will do things that in fact they would do. So any absolute constraints must be in primary legislation and incentive-compatible for law-makers.
- Balance-sheet operations should at all times be as parsimonious as possible consistent with achieving their objectives, in order to aid comprehensibility and accountability.
- Minimize risk of loss consistent with achieving statutory objectives.
- *If* permitted to operate in private-sector paper, should be in as many sectors as possible; with selection of individual instruments as formulaic as possible; and valuation methodology published.



BALANCE-SHEET SIZE

- Following paying interest on reserves, could in principle have three instruments:
 - policy rate (and talk about reaction function)
 - size of balance sheet
 - composition of asset portfolio.
- **Principle of parsimony** means not all are needed all of the time
- Under normal circumstances, let balance sheet sized be determined by banks choosing the level of reserves they each wish to target over a monetary maintenance period

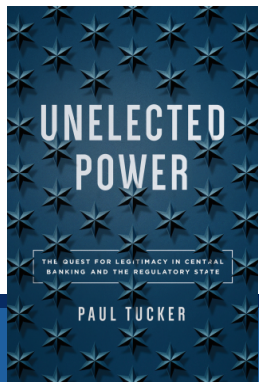


CURRENT ISSUES

- Helicopter Money: is fiscal policy
- Tiered Negative Rates: is fiscal, and so needs political blessing
- Buying equities: takes into industrial policy o/a role in governance
- Raise inflation target: get broad-based public support
- Move to average target: confront whether it is comprehensible to the public and legislators
- Hybrid fiscal/monetary policy: will money creation really be insulated?



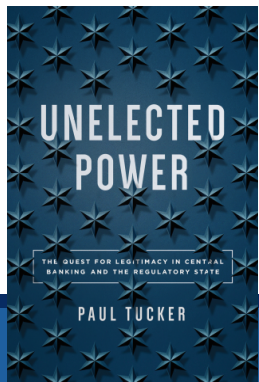
CENTRAL BANKS AND FINANCIAL STABILITY



CENTRAL BANKS AND PRUDENTIAL STABILITY

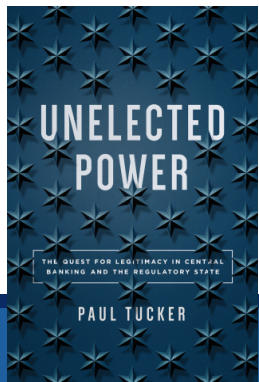
“I insist that neither monetary policy nor the financial system will be well served if a central bank loses interest in, or influence over, the financial system.”

Paul Volcker, “The Triumph of Central Banking?”, 1990



ONE FUNCTION LEADS TO ANOTHER

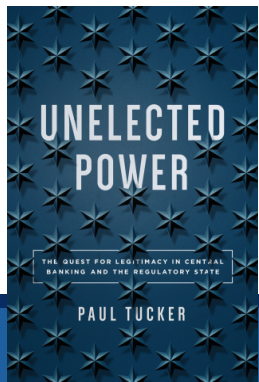
- LOLR needs information to judge soundness of potential borrowers
 - in circumstances where prophylactic sup and reg have “failed”
- Will want to be able to influence policy on minimum resilience requirements, and to be assured supervision is professional
- BofJ and BUBA do this *de facto* but not *de jure*
 - not in accord with today’s application of political values: accountability in the public sphere
 - ***Principles* require function be formalized, with objective, constraints etc.**



MONETARY SYSTEM STABILITY

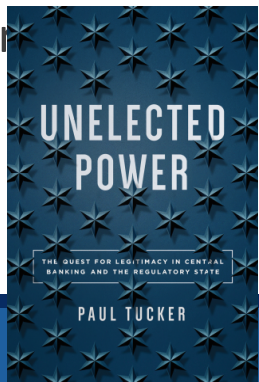
Mission with two parts:

- Stability of the value of central bank money in terms of goods and services
- Stability of the value of private banking-system money in terms of central bank money



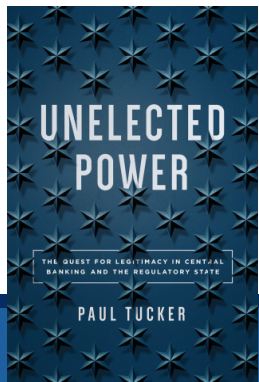
A MONEY-CREDIT CONSTITUTION

- Others have argued for a Money Constitution
 - Because need to know it won't chop and change
- Given FRB, must be a Money-Credit Constitution. Five broad elements:
 - an objective for price stability;
 - a standard of resilience for the private banking system, with consequent constraints on balance sheets;
 - a lender-of-last-resort regime to provide liquidity insurance to sound intermediaries;
 - a statutory framework for resolving fundamentally bust firms in a more or less orderly way, so that the LOLR doesn't bailout such firms but sticks to its job of providing liquidity reinsurance;
 - and, crucially, constraints on the use of central banking's latent fiscal and regulatory power

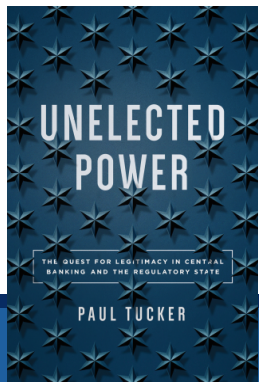


LIBERAL CONSTRAINT BITES ON MACROPRU

- “An IA’s rule-making should not interfere with individual’s liberal rights more than necessary to achieve the legislated purpose and objective (proportionality)”
- Problem for, eg, across-the-board LTV and LTI caps for borrowers: not proportional because other, less invasive options



*CENTRAL BANKING UNDER
AN ETHIC OF
SELF-RESTRAINT*



THREE PILLARS OF UNELECTED POWER

“I don’t hate [him]...I do love him, but the day that I say that I agree with him when I don’t, is the day he must get rid of me because I am no use to him anymore.”

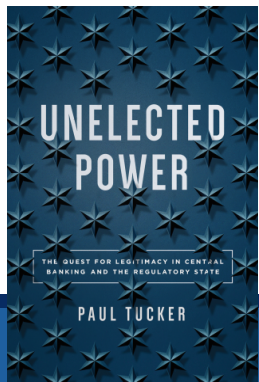
Field Marshal Alan Brooke after a row with Winston Churchill, Spring 1944

“The Justices have their being near the political marketplace, in which the effects of their judgments are felt...A number of controls are built into their craft, which they practice under the scrutiny of a profession whose expectations and approval must matter to them.”

Alexander Bickel, 1962

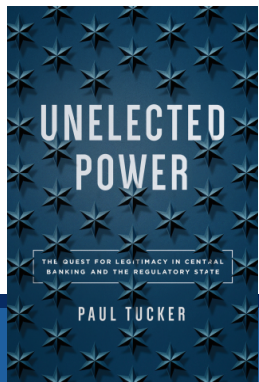
“Central bank governors require three qualities above all. A deep commitment to price stability. An ability to be clear and direct to politicians about the policies that are required to produce economic stability. And the ability to be unpopular when circumstances require.”

Mervyn King at a retirement dinner for Jean-Claude Trichet, 2011



SELF-RESTRAINING CENTRAL BANKERS

- Like military but unlike judiciary, the central bankers must be ready to advise in private on the wider government policies that are *necessary* for monetary-system stability
- Unlike military, precisely because they have job security, they must not press and press, while not equivocating in their advice
- Unlike military, they can repeat this advice in public at their own initiative, but in doing so the intimate connection with their formal mandate must be explicit and able to withstand tough scrutiny;
- They cannot be in the business of offering their opinion, in private or public, on things they happen to know about or are interested in but do not rely upon in fulfilling the trust placed in them by legislators;
- Like judiciary, they must not be drawn into offering specific private advice or public remarks about things they will or might have to decide
- Like judiciary, as legitimacy seekers, they can (and, rationally, ought to) explain their institution to the public
- Like judiciary, they must be ready to take criticism.



UNELECTED DEMOCRATS

THANK YOU FOR LISTENING,

PAUL TUCKER, CARF, TOKYO UNIVERSITY, 1 OCTOBER 2019

