KENT UNI MMF CONF, 2022

OUTLINES OF A REFORM PROGRAMME FOR THE UK'S MONETARY REGIME

PAUL TUCKER, RESEARCH FELLOW/HKS[1]

The title of this session is "Lessons from 25 Years of the Monetary Policy Committee". Trying to get to the nub of things, I'm going to ask what one would now change in the MPC set up. That question gets some urgency, or at least salience, from the malaise that monetary authorities seem currently to be in across the western world.[2]

Before turning to the substance, I want, for purposes of disclosure, to begin by recording my own involvement in the path to Bank of England independence. I was private secretary to Governor Leigh-Pemberton when, in the early 1990s, inflation-targeting was introduced. This happened partly because Mervyn, who just spoke, was quickly ready with an alternative regime after the UK fell out of Europe's Exchange Rate Mechanism (ERM); and partly because Chancellor of the Exchequer Norman Lamont backed a regime that would give a much bigger and more overt role to the Bank --- absolutely and, crucially, relative to Treasury mandarins --- since its analysis and forecasts would be published. In at least one private speech, Leigh-Pemberton had expressly described ERM membership as a substitute for independence (and the credibility it could bring to Britain's monetary regime). So the thought of independence was very much alive in the Bank. A few years before, Chancellor of the Exchequer Nigel

[1] Paul Tucker is a research fellow at the Harvard Kennedy School's Mossavar-Rahmani Center for Business and Government. He is the author of *Global Discord: Values and Power in a Fractured World* Order (Princeton University Press, 2022), and *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State*, (Princeton University Press, 2018). He is president of NIESR. He was at the Bank of England for 33 years, including as a policy maker from 2002 to late-2013.

[2] With thanks to David Aikman, Richard Barwell, Charlie Bean and Steve Cecchetti for exchanges on earlier drafts.

Lawson had proposed it to Prime Minister Margaret Thatcher. And George Blunden, who had come out of retirement in the mid-1980s to be Deputy Governor, ended his very last speech by saying the country needed independence but it should not happen until the country was ready for it.

A few years later, after a spell on open-market operations and government debt management (quite useful for designing QE operations), I was the head of Monetary Assessment and Strategy division when the MPC was created. Unlike my bosses, when I saw the size of the Labour majority, I did think the new Labour government would introduce independence quickly because that was the rational thing *for them* to do. Anyway, I supported Mervyn in the face-to-face negotiations on the regime's details with Alan Budd and Stephen Pickford at the Treasury. I then took the minutes of the MPC alongside two other colleagues for five years; and finally, in 2002, became a member of the MPC for over a decade.

Is the malaise rooted in models, or incentives?

Mervyn has talked about the hazards of relying mechanically on models. I completely agree and, for what it is worth, that was his view (and not only his) when he chaired the MPC, as it had been Eddie George's beforehand. During those years --- the Committee's first 16 years --- a not uncommon refrain when presented with model outputs was along the lines of "But we do not believe that. It cannot be so because xyz." Looking back, I think that helpfully shaped the incentives of the staff. They had to come to forecast meetings not only with the outputs of the main forecasting model but also with a story about the economic outlook, and with a series of puzzles that they thought relevant to the committee's formation of its own views and its policy decisions.

The anchor is the committee itself

Part of the challenge with blind adherence to modern macroeconomic models is that they are typically used in ways that assume the nominal target --- in Britain's case, the inflation target --- is fully credible, meaning that long-term inflation expectations are anchored to the target. This introduces the

monetary equivalent of Newton's force of gravity: however great the shock, inflation will tend back to the target.

There are two problems with this. The first, and obviously the greatest, is that articulation of a monetary regime, however well done, cannot possibly do all the work. As with political constitutions, the regime documents are mere parchment. The true anchor is the committee itself.

The second problem underlines that. If a model assumes credibility, the policy question of how to respond to a particular shock becomes how to find the best path for interest rates after weighing the costs of volatility in inflation, volatility in economic activity (including jobs), and whatever else is deemed germane to the welfare analysis. But if the anchor is something to be earned (continuously) rather than a God-given right, that framing of policy's job is profoundly misleading. Instead, the policy challenge is how to achieve all those welfare-efficiency things without endangering the anchor, or even in ways that re-establish the anchor.

The import of all this is that everything --- repeat, everything --- a country's monetary authority says and does must be directed towards reaffirming the credibility of the anchor, which is to say the authority's credibility. Casually shrugging off inflationary (or deflationary) risks in the face of a big shock is costly loose talk. A stark example is the Federal Reserve's dismissal of upside risks to inflation after the 2021 fiscal stimulus. Even if it had been reasonable to regard the most likely outlook as benign, it was hard to maintain that the risks to inflation were symmetric rather than skewed to the upside. That matters to the extent that policy does best to feedback from the mean of the distribution or, alternatively, to head off plausible serious risks. So, the deeper point is not about models but about processes, or people and processes, or something like that.

All that being so, the incentives of monetary policy makers could hardly matter more. I have come to worry that something important happened in the aftermath of the Global Financial Crisis, manifested in politicians trying to reorient the incentives of monetary policy makers. In a nutshell, during 2009-11 the business of maintaining low and stable inflation might have ended up looking easier than it is. That mattered because, during the crisis, the central banks had revealed the extent of their latent fiscal capabilities. In particular,

they had introduced facilities designed to steer the allocation of bank lending towards the real economy; the widely emulated Bank's *Funding for Lending Scheme* did just that (in so far as the real economy was favoured over financial market traders etc). But if central bankers can steer the supply of credit during crises, why not get them to do that during financial peacetime --- except now towards parts of the economy elected politicians (and their backers) want to favour, and away from parts of the economy they disfavour, such as polluters, and so on.

In other words, if maintaining price stability seems easy, then elected politicians have powerful incentives to get central banks to make discretionary use of their latent fiscal instruments to pursue other goals. I think that is a mistake, and potentially a costly one, as it risks diluting or displacing the focus on the core mandate.[3] There is a question here about how to constrain political salami slicing of the regime. But also one about why independent central bankers would acquiesce.

Incentives: prestige and esteem, but for what?

The standard case for independence is that, whatever their better thoughts, elected policy makers have almost overwhelming incentives to give more weight to short-run economic and financial booms than to their longer-term costs. But if delegation to an arm's-length authority, insulated from quotidian politics, is to do its work, it needs somehow to harness the incentives of the regime's stewards, who, after all, are all flesh and blood men and women.

A precondition for this --- one opening up an illuminating perspective on central banks taking on more and more functions --- is that appointed central bank leaders need to care (a lot) about the public prestige and professional esteem accrued from delivering the mandate, or foregone if they do not. Delegation to technocrats does not work without that harness.

So, if a central banker has a public reputation for combatting, say, climate change and inequality, or other social justice causes, maybe s/he will not care

[3] These arguments are at the heart of *Unelected Power*, where they are set out more clearly. After WW2, the Bank of England was actively involved in credit policy, but it was not then independent, being known colloquially as the operational arm of HMT. Independence changed that.

so much about the opprobrium coming their way if (steady state) inflation rises under their watch.[4]

Among other things, this implies an independent central bank's mandate should be as narrow as possible, and its objectives should be both measurable and capable of being monitored by interested members of the public.[5]

Against the background of those general thoughts, we can move from principles and political science to some detailed proposals. There are a dozen.

As emphasized in *Unelected Power*[6], it is important to distinguish the regime itself from the stewardship of the regime. In Britain, Parliament is responsible for the statutory regime; Treasury are responsible for matters delegated to them; and the MPC is responsible for matters delegated to them. So I am going to break my remarks down under those headings. Of course, the MPC regime is not the only regime entrusted to the Bank. But I will touch on the Bank's post-2010 responsibilities for financial stability only where helpful to illuminate a point about the MPC.

Finally, it is important to stress that for each proposal, the argument will be sketched rather than fully laid out.

The legislated part of the regime: something to keep, something to change

The most important part of Britain's monetary regime is found in statutory law. The legislation creates the MPC, and requires it reach decisions by voting, to publish minutes, and to publish a quarterly report on (relevant aspects of) the economic outlook.

Proposition 1: Stay with a lexicographic objective in primary legislation

[4] Having central banks take a leading role in combatting the incidence or costs of climate change, or inequality and other social issues, also risks diluting the incentives of elected governments to use their much broader set of instruments. But that is a different argument from the one explored in the main text.
[5] That sentiment, and those of *Unelected Power*, were captured in an early-2023 speech by the Fed chair. Powell, Sveriges Riksbank Panel on "Central Bank Independence and the Mandate --- Evolving Views." Federal Reserve Board, 10 January 2023.
[6] Tucker, *Unelected Power*.

It also makes price stability --- low and stable inflation – the MPC's overriding objective. In the jargon, the objective is lexicographic: the MPC can pursue its secondary objective only if the primary objective is fulfilled. Since the anchor needs constant reaffirmation given the political incentives to take risks with inflation, that is a good thing.

It says, for example, that when the risks to inflation are judged to be on the upside, the committee should act rather than sit on its hands, hoping that there will be benefits to real activity of jobs or labour participation or something else. Just that kind of gamble --- running the economy "hot" in pursuit of "inclusive growth" --- was, I suspect, at the heart of some of the mistakes committed during 2021 by the Federal Reserve, which has a so-called Dual Mandate. As Paul Volcker used to say, that makes no difference so long as one believes there is no long-term trade off between price stability and economic activity (or, I would add, if one thinks stability is a necessary condition for long-run prosperity). But maybe the Fed had incentives to explore whether there was a trade-off, in order to court public popularity, get reappointed, or whatever.[7]

I would, therefore, stick with Britain's lexicographic objective.

Proposition 2: clarify the governance around non-monetary policy balance-sheet operations

The legislated regime does, however, suffer from a problem that, with hindsight, was neglected in the 1998 Act. It does not address inalienable central bank functions that do not fall to the MPC; most notably, acting as the monetary economy's lender of last resort (LOLR). In fact, although no other organ of British government is capable of acting at the LOLR because no other agency can print money, the Bank itself is not under any kind of duty to act as the LOLR. This came to head during the 2007 phase of the Global Financial Crisis.

[7] Arguing the Fed chair should have a single 8 year term, see Tucker, "The Fed Appointments Process Should Be Overhauled", *Financial Times*, 23 November 2021.

The solution is to enact a legislative provision to the effect that the Bank should act as the LOLR wherever it judges stability to be threatened, subject to not lending to fundamentally bust firms.[8] Once the Bank was subject to that duty, Parliament could (and should) repeal the statutory power of the Treasury to direct the Bank to act as LOLR. That remedy, introduced in the 2012 reforming legislation, is the wrong way round: rather than clarifying what independence is for, it intrudes on monetary independence by creating space for tactical political considerations to shape LOLR decisions.

In addition --- most certainly if that change were made, but even if it is not --- the Bank's lender of last resort and other non-monetary policy balance-sheet operations should be placed under the formal control of an executive board (probably comprising the governor and deputy governors). At present, such powers are vested solely in the person of the Governor alone. That puts an awful lot of responsibility on one person, and means that LOLR policy is not guaranteed to benefit from the kind of deliberation, among multiple points of view, that parliament requires for monetary policy and, since 2012, for certain elements of stability policy.[9]

<u>The non-legally binding Remit from the Treasury: one thing to keep but some important changes</u>

The legislated part of the UK's monetary regime includes an instruction to the Treasury to expand upon the MPC's mandate in a remit. The Remit itself is *not* legally binding, and is not drafted like a legal norm (with terms defined, and so on). But it is treated by the Bank as part of the regime, because plainly, under

[8] On the grounds for the constraint, see Tucker, "Solvency as a Fundamental Constraint on LOLR Policy for Independent Central Banks: Principles, History, Law." *Journal of Financial Crises*, Vol.2(2), 2020, pp.1-33.

[9] I recommended the proposed reform during 2012, and might usefully have made it public. The predicament arises because, except where legislation has bestowed specific powers on specific legal persons (e.g., monetary policy powers delegated to MPC), the powers of the Bank are vested in the Governor & Co., meaning the Court of Directors. The Court has, for decades, chosen to delegate to the incumbent Governor all the Bank's powers and responsibilities except those it expressly reserves for itself in a document called *Matters Reserved to Court*. Technically, Court could remedy the problem by delegating to an executive board that it created under internal by-laws.

the UK's parliamentary system, the Executive could equip itself with statutory powers to issue a remit in a legally binding form.

Proposition 3: stick with inflation targeting

The first thing to say about the MPC Remit is that I would stick with inflation targeting, by which I mean the kind of flexible inflation targeting that has been in the Remit from the beginning in 1997.

One great merit of this is that anyone here in the hall can go home and explain to your friends or family why it is sensible to try to achieve low inflation. And you can also explain why the main instrument for achieving that is the interest rate, since interest-rate changes turn up in people's savings rates (if they are lucky enough to have savings) and in borrowing rates. It is hard to overstate how much harder it was to explain money-aggregate targeting and its relatives. When, during the twenty odd years up to 2002, I was a staffer at the Bank, I was occasionally involved in writing papers on updating and applying monetary targets. So, you set a target for the growth of some monetary aggregate of, let's say, 5% and it turns out that it grows instead at 7%. But not infrequently, and sometimes accurately, the Treasury then wanted to say something like "Don't worry, the old 5% is now 7% really because there has been a velocity shock, a shift in the demand for money." Those words are, needless to say, gobbledegook to outsiders --- meaning nearly everyone --- and so amount to a kind of "trust us" claim to indispensable but unmonitorable expertise. If, however, a series of (similarly signed) shocks to money-velocity come along, soon you are running out of compelling explanations for monetary targeting.

By contrast, it is easier to explain the effect on headline inflation of big cost shocks, such as from war-induced energy-price surges. Such explanations need, of course, to be accompanied by analyses of domestically generated inflation, in case it is also rising, but that is the core of the monetary policy maker's job. The very fact that people have been annoyed about how inflation running well above target --- in this country, in the United States and parts of continental Europe --- is evidence that that part of the inflation-targeting regime is working. It is if the people are thinking something like "They're meant to deliver inflation around 2%. They're not. What's going on? What's the

explanation?" That is useful, and part of what the target-system was meant to achieve: by incentivising the policy makers to analyse and explain what's going on, and do something about any drift in domestically generated inflation.

Proposition 4: prune the Remits back to where they were in spring 2013

The 1997 MPC Remit basically contained two propositions: an inflation target of 2% as the articulation of the legislation's mandate to maintain "price stability", and an injunction not unnecessarily to amplify volatility in economic activity (and jobs) in the face of cost shocks. The constraint fitted with the statutory lexicographic scheme in the sense that the injunction had force only if medium-term inflation expectations were anchored to the 2% target.

All well and good. Well, except that there has been a tendency over relatively recent years, the last decade or so, to add things to the Remit. This is by no means confined to the MPC. The remit of the Financial Policy Committee (FPC) grew from roughly 4.5 pages in 2013, when the regime was formally established, to over 7.5 pages in 2021.[10] It then shrank back to around 5.5 pages in 2022, but retained the new emphasis on routinely getting on with supporting government policy so long as doing so does not damage stability. The MPC remit has increased less, but still in important ways.

For example, the 2013 version more or less instructed the MPC to introduce Forward Guidance. While it is certainly the case that the incoming governor wanted to introduce forward guidance (FG), this came pretty close to HMT telling the MPC *how* to do monetary policy (which greatly bothered some of my then colleagues).[11] Another addition was a longer specification of government economic policy, seeming to imply the MPC should be more active in providing support when it can. Others include some confusing comments about the governance of "unconventional" operations, and about monetary

---

[10] In word-count terms, this was a three-quarters increase: David Aikman, "How has the Financial Policy Committee's objective changed since its inception?" *Macroprudential Matters*, 9 December 2021. (The FPC was modelled, broadly, but not completely, on the MPC: external members, an obligation to publish minutes, a requirement for HMT to issue a remit, and so on.)

[11] Oddly, the (then) new Remit passage merely said that FG was within the Committee's discretion (properly, a question of law), and so was otiose except as a heavy hint. If the Remit had said anything, it should have been that a certain kind of FG (see below main text) worked by inflation eventually, for a while, overshooting the target, and that that was ok with HMT.

policy allowing inflation to deviate from target in order to accommodate FPC actions.[12]

This tendency to add to the Remits risks signalling a shift in the Treasury's conception of independence: no longer a mechanism for self-binding, but more a means of pursuing government policy with insulation from blame. Whether or not that is intended, and it might not be, I propose that next year the Remit writer should, in their first internal draught, delete everything that has been added since 2012 and ask what they really need to add back. The Bank could usefully go through the same exercise, in order to work out how it feels about the expansion of the executive government's de facto expectations for the MPC and FPC.

Proposition 5: an injunction to explain, qualitatively and quantitatively, the transmission of QE

Turning to economic substance, there are two things I would put into the MPC remit that are not there at present. One of them concerns quantitative easing (QE). I would not have guessed it, but it turns out to be useful to say that the MPC needs to explain - which means the individual members need to explain if they depart from a collective view - how QE works if and when they use it. One of the first things that the MPC did back in 1997/1998 was publish a document on their collective understanding of the monetary transmission mechanism. Individual members were not obliged to endorse it but they each did. By contrast, it has sometimes been quite hard to tell how MPC members think QE works, including crucially how potent (or not) they believe it is.[13]

At times, some members have subscribed to the portfolio-balance account, where QE affects term premia (and perhaps other risk premia). But that explains merely why gilt purchases will affect the yield on gilts and close

---

[12] The former are confusing because a reader could infer that the MPC decides which assets the Bank can buy or lend against, but that is not so. The latter is at best incomplete because it does not cater for circumstances where the FPC needs to act partly because the MPC's policy is creating or fuelling imbalances or financial system vulnerabilities: the text says too much or too little.

[13] In 2021, the Bank reported that not much research had been conducted on QE since 2013. I understand that that has since changed. https://www.bankofengland.co.uk/independent-evaluation-office/ieo-report-january-2021/ieo-evaluation-of-the-bank-of-englands-approach-to-quantitative-easing

substitutes. One still needs to explain why compressing term premia is expected to affect the path for aggregate demand.[14]

Some MPC members, rejecting that account of QE, have seemed to subscribe to the alternative signalling account, whereby QE reinforces the force of forward guidance that the policy rate will remain low for a long time. But if one holds to the signalling theory, then it is not obvious why one needs to do much QE at all. One could argue that “throwing the kitchen sink at it” underlines the commitment, but that argument has force only if the “sinks” in question have effects that reinforce credibility.

In other words, a signalling-theory advocate needs to explain the mechanism via which QE delivers the supposed signal. One possibility is the consequent exposure to financial losses, but that cuts both ways. And where that sub-account is rejected, as I believe some MPC members have, a substitute mechanism of some kind needs to be invoked. QE cannot be a signal just because someone, however authoritative, says it is. If that alone were enough, the Governor waving from the steps of the Bank would suffice if s/he proclaimed it a credibility-affirming signal. In the transmission of monetary policy, hydraulics come before expectations.

As well as qualitative explanation, the policymakers’ account of the transmission of QE needs to be *quantified*. As things stand, it is quite hard to discern when central banks--- not only in Britain but also, I should stress, the US FOMC and so on--- judge that they need more QE, how much they believe of a bit more QE will affect the outlook for demand in a year or so, and, given lags, for inflation some while after that. That is an uncomfortable gap, because surely the policy committees need to form just that kind of quantitative view --- an expectation subject to uncertainty --- when, favouring more QE, they decide *how much* more to do.

[14] As former US FOMC member Jeremy Stein pointed out years ago, if term premia are artificially compressed for a period, there is a risk-free arbitrage in borrowing long and investing in a default-free overnight instrument. That is not conducive to lower term premia stimulating extra real investment. The point is not that the no-effect story is true but that policy makers (not subscribing to the signalling account) need to explain why they *each* think it is not true.

So, I think the Remit could usefully be revised to say, in effect, that we do not want to live with this gap and that, therefore, the MPC should fill it if (or whenever) it is going to use QE as an instrument of monetary policy. The importance of this is underlined when one remembers that QE, when massive and continued over a long period, effectively switches off the bond market's vital signals on credibility.

Proposition 6: distinguish QE from MMLR and other asset-purchase operations

The other thing I want to say about QE is that it is important to distinguish QE purchases of government bonds (and other instruments) from purchases that serve other purposes. QE is about stimulating aggregate demand in order to achieve the inflation target.

The gilt purchases in October 2022 were not badged as QE, and rightly so because they were intended to stabilize the gilt market and to break the spiral of forced selling by highly levered pension funds (although see below). For not dissimilar reasons, while recognizing the terrible pressures created by the particular circumstances, I think it was a mistake to treat the spring 2020 purchases as QE, which meant not reversing them once market conditions had stabilized. That is because it was odd to think of stimulating aggregate demand when aggregate supply was closing down (voluntarily and by government order). Instead, the problem faced by governments (elected fiscal authorities) was how to get cash to households and small businesses. There was no need for central banks to finance that fiscal support once government bond markets were functioning; and, in terms of the public finances, every reason not to do so given the precious opportunity to lock in extraordinarily low long-term yields (below the average of any plausible path of monetary policy rates).[15]

There was, by contrast, good reason for the Bank of England and, in the US, the Federal Reserve, and other central banks, to intervene to stabilize government bond markets during the exceptional volatility triggered by the realisation that Covid was serious. But that would have been a Market Maker of Last Resort (MMLR) operation, which might not have needed to be anything like as big as

[15] Tucker, "Quantitative Easing, Monetary Policy Implementation, and the Public Finances." *Institute for Fiscal Studies Green Budget* 2002, chapter 7.

the ”QE” purchases actually made, and which in any case would have been unwound, with bonds being sold back, avoiding the monetary overhand, once markets stabilized.

The key thing here is not that my judgement on those particular episodes is right, it is, rather, that I think the Remit should require the Bank to distinguish between different types of gilt (and other) purchase operations according to their purpose. Recently Steve Cecchetti and I published a piece in VoxEU identifying five purposes that a central bank could have in buying government bonds in the market.[16] They are, briefly, to stimulate aggregate demand (monetary policy); to provide emergency financing to government; to stabilize bond markets; to provide liquidity to those selling the bonds; to steer the allocation of credit to (or away from) particular destinations. Whether the last is legitimate for an independent central bank is moot (but not elaborated upon here).

In any case, each purpose needs its own mini-regime, as the second to fifth purposes are obviously not monetary policy as such (even when they help the transmission of monetary policy, and can belong with the central bank). The label “QE”, and the governance it entails, should be used only when the purchases are designed directly to stimulate aggregate demand. Purchases for other purposes are not for the MPC to decide. That means, by the way, that any net injection of base money via non-MPC operations must either be formally approved at the time by MPC (making it a joint operation) or, alternatively, sterilized (or as the Bank used to say, drained). As it happens, that did not happen when, during October 2022, the Bank created money when conducting MMLR operations to calm the spiralling effects on the gilt market of forced sales by highly levered and illiquid pension fund vehicles.[17]

[16] Cecchetti, S. and Tucker, P. “Understanding how central banks use their balance sheets: A critical categorisation.” 1 June 2021. VoxEU.

[17] Whenever the Bank is operating a regime of reserves averaging, the draining operation can occur any time before the end of the maintenance period (but has to be larger, the more the operation is delayed). When there is no maintenance period, as in recent years, sterilization needs to effected quickly so that the nature of the money injection is not mistaken for QE and so that the MPC’s prerogatives are respected.

Proposition 7: review the Remit for coping at the zero lower bound

The final thing I would say about the substance of the MPC Remit, and here I do not have an answer, is that once central banks have got through the current inflationary and stagflationary problems, as eventually they will, they might well find themselves again facing the problem of a low long-run equilibrium real rate of interest, and therefore the problem of monetary policy hitting the zero lower bound (for nominal rates) more frequently than my generation of policymakers would have guessed. So, what is to be done about that? Does it mean that there should be stronger automatic fiscal stabilisers, or that there should be a higher inflation target, or both?

Half a decade or so ago, not a few people thought advanced economies, including the UK, should be reviewing that big challenge. It will still have to be addressed unless the forces reducing risk-free real interest rates go into reverse. [18]

It is anything but easy to judge how the monetary regime should be tweaked, however. For example, it would be awkward to raise the inflation target now because it would be done from a position of weakness. Had central bankers been onto the domestically generated inflationary pressures much more quickly, it might have been possible to use the separate cost-shock effects on headline inflation to raise the target opportunistically. But that wasn't to be. Instead, given the blows to credibility over the past couple of years, there is a tangible risk that raising the target now could simply fuel concerns the target might be raised still further if and when expedient in the future.[19]

The Appointments Process

[18] The Fed did conduct a review but ended up with a new regime designed to cope only with the problem they then had (below target inflation while stuck at the ZLB). In particular, the new regime effectively precluded pre-emptive action in the face of inflationary shocks (to domestically generated inflation or expectations). I would say that a necessary criterion for any adequate regime is that it should be capable of addressing a wide range of plausible problems, including those prominent in the history of monetary policy.

[19] A point also made by former Fed chair Ben Bernanke in David Wessel, "Alternatives to the Fed's 2 percent inflation target." Brookings, 7 June 2018, p.7 (of16).

As a bridge between remarks on the design of the regime (law and Remit) and the MPC's delegated stewardship of the regime, there is something to be said about the composition of the MPC, since obviously the stewards are flesh-and-blood men and women who have been appointed by the executive government to exercise the powers conferred by Parliament.

Proposition 8: put the Bank of England back into the MPC

On this, it is, I suggest, instructive to make a contrast between, on the one hand, the composition of the MPC that I served as secretary and then joined as a member twenty-odd years ago with, on the other hand, that of the MPC over more recent years. The early MPC had, at the beginning, at least four or five members who were deeply versed in the territory where monetary theory meets monetary practice: in other words, in the questions that arise if you actually want to do quantitative easing, forward guidance, and so on. They were Eddie George, Mervyn King, Charles Goodhart, Ian Plenderleith, and later myself. By the time Mervyn was Governor, I think that there were three, maybe three and a half people on the committee who fulfilled that criterion. But since Paul Fisher retired from the committee in the mid-teens, the number would be either zero or one. And that is the point of mentioning this. On the face of it, it looks like an environment where Eddie George, a great central banker, might not have got onto the Monetary Policy Committee at all, let alone become Deputy Governor or Governor. That is because it is not easy to see how his particular skill set, from his years on the Bank staff, would have been valued sufficiently to get onto the committee.

So, there is a serious point about the composition of the committee: about the skill sets (plural) that society wants, or needs, on the MPC. Of course, the country should want the committee to include academic macroeconomists coming out of the top university economics departments; and it should also want business economists, and sometimes different kinds of academic economists who can challenge the macroeconomic and microeconomic thinking of the MPC and the staff. But maybe central bankers steeped in the markets and the implementation of policy, and in reading the conjuncture,

might be useful too; certainly, private sector market experience is not a substitute.

I doubt there is a formal cure for this. For example, while it would in principle be attractive to create a central banking equivalent of the UK's successful Judicial Appointments Commission, I doubt there are enough monetary and central banking experts to serve on such a commission without relying too much at any particular time on a handful of recent senior Bank office holders. Instead, the Court (if it continues), the parliamentary oversight committees and interested commentators need to be prepared to speak out.

Reforms to stewardship of the regime

My proposals on the Remit and the make-up of the MPC concern Treasury stewardship of the matters delegated by Parliament to it. Now I turn to the MPC’s (and, more generally, the Bank’s) stewardship of matters delegated to them.

Proposition 9: return to the Inflation Report

First of all, although this sounds trivial, the Bank should announce, soon, that it is going to return to naming its quarterly report the *Inflation Report*, rather than stick with the still relatively recent innovation of calling it the *Monetary Policy Report*. The point of returning to the *Inflation Report* is that it reminds everybody, including the committee themselves, and the Bank’s staff, that there is a lexicographic objective, whereas the shift to *Monetary Policy Report* conjures, maybe even internally, something uncomfortably close to “We've conquered this inflation stuff. It is anchored. What else can we do with our monetary policy instruments --- to promote our idea of the good, or whatever the government wants?”

I do not want to get into the contents of the quarterly report; it now includes analysis of a special topic, which is a good thing, but otherwise seems to carry

less analysis of the standard data than a decade or so ago. I would suggest, however, that the Bank needs to reemphasize that, even though not a sensible target, money matters (as an indicator, and on some views of risk premia as a causal actor). So, the committee should include analysis of the monetary aggregates, not just credit quantities and prices, in its publications and policy statements. Although not of burning interest to many members of the public, this would tie the Bank to taking the monetary aggregates seriously, and signal that to the commentators who intermediate between Bank publications and the wider public.

Proposition 10: return to staggered announcements of decisions and forecasts

At the risk of sounding like the old TV programme *All Our Yesterdays*, I would also urge the Bank to move away from announcing the MPC's decision, the MPC Minutes and the *Inflation Report* forecasts all at the same time. The current set up, introduced about half a decade ago, introduced extraordinary time constraints. It is important that the discussions of the economic outlook and, separately, of policy are not impaired by having to think at the same time about how to write them up. Among other things, having to make the policy decision, and write all the explanations, a day or so before the MPC formally makes and announces its policy decision might make it harder for the committee to take account of late news and arguments. It also forfeits the opportunity to ensure commentators devote time, separately, to the policy settings and decisions, to the minutes of the committee's deliberations (including minority votes), and to the committee's collective view of the outlook.

Proposition 11: exercise self-restraint with Forward Guidance

Finally, I want to say a couple of things about forward guidance. First, it is vital to distinguish between, on the one hand, Woodfordian[20] forward guidance when policy rates are stuck at the Zero Lower Bound (ZLB) and, on the other

[20] After the economist Mike Woodford.

hand, statements about future policy when no longer stuck at the ZLB. That vital distinction --- sometimes characterised as Odyssean versus Delphic --- has been blurred, elided, or just junked.[21]

In Woodfordian-Odyssean mode, the policy maker is trying to commit to keep policy rates low for *too long*; i.e., beyond the point of economic recovery and a return of underlying inflation to (or above) target.[22] But the same sounds and scribbles --- "forward guidance" --- have come to be habitually employed when, freed from the ZLB constraint, policy makers are merely talking about what they are going to do. The first is a commitment, the second a prediction, and so they obviously do not have anything like the same analytical grounding. The elision, moreover, is costly because policymakers' unqualified predictions about their future choices are unreliable, not for any nefarious reason but because they do not know what is going to happen in the world. They do not know which known risks will crystallize, and which shocks will take them completely by surprise.

Policy makers talking about what they expect to do might help compress volatility on Wall Street or the City of London, but that is not the central mandate, and so risks policymakers taking their eyes off what is actually going on in the economy and the balance of risks to demand and inflation over the years ahead.

The way I would sum up my prescription, then --- for the ECB and Fed as well as BofE --- is: talk less about yourselves, and instead talk more about the economy, about the economic outlook, with its uncertainties and risks.

---

[21] The first use of those labels might have been in Jeffrey R. Campbell, Charlie L. Evans, Jonas D. M. Fisher, Alejandro Justiniano, "Macroeconomic Effects of Federal Reserve Forward Guidance", *Brookings Papers on Economic Activity*, Spring 2012.

[22] The edict to keep the policy rate low for "too long" captures the thought that the strategy is, technically, time inconsistent. That, in theory, is how it works: the expectation of (above-target) future inflation reduces real interest rates, which stimulates demand today etc. Woodford himself stipulated the prescribed path for rates should depend partly on the future incidence of shocks. In practice, those who employed the strategy were gambling that once the "too long" phase was reached, the economy would not be hit by a nasty cost shock that added to the domestically generated inflationary pressures from excess demand. That gamble did not pay off (the energy and supply-chain shocks). It is not clear how many commentators understood this gamble against the Gods before it went awry. FG perhaps worked in theory but not in practice.

Second, but not wholly separate from that first point, forward guidance (of either kind) cannot work unless there is a stable super-majority in the committee. If "guidance" issued today for, say, the next five years is vulnerable to being dropped at the next meeting because just one member has changed her/his mind, and that possibility is understood, the initial "guidance" will be given little weight. In particular, in practice Woodfordian guidance has to tie the hands of future members of the committee if it is to work; they effectively join with their votes pretty much decided for them in advance, unless they want to overturn the apple cart.

In consequence, forward guidance provides another route for pushing a one person, one vote committee towards a leadership-led committee. Here, I think there is a trade-off that needs to be recognised between the efficiency benefits of articulating a state-contingent plan for future policy and the costs of losing one person, one vote (when people in the committee are truly free to say in any meeting, "I really don't agree with that.")

My view is that the (net) benefits of committee deliberation that culminates in a free vote exceed the costs of not conveying a collectively agreed future path for the policy rate. I concede that not doing the latter has some efficiency costs, but I think true one person-one vote decision making helps avoid big mistakes. In other words, I think avoiding big mistakes is more than worth epsilon sacrifices in efficiency. If it has the benefits I claim, that is because each member is accountable for their own vote, and accordingly under a burden to explain it (including *to* themselves!).

I hope it is apparent why my first and second concerns about Forward Guidance are related. Briefly, one starts off needing a chair-led policy during Woodfordian (commitment) forward guidance, but that very different committee culture risks, through habit, becoming embedded by the time the ZLB problem has passed, and so of persisting during a period of predictive "forward guidance". Worse, if the first phase lasts many years, as it did, new members of the committee are not immediately inducted into a culture of individual decision-making and accountability.

If that sounds a bit abstract, ask yourself whether it is plausible that all (every single one) of the individual members of the MPC during its first couple of decades would have seen no risk to inflation during 2020 and 2021. It is the

unanimity that is startling, and I suggest that is a product of the ultimately corrosive culture of Forward Guidance.

I do not quite see how to cater for this in the Remit from the Treasury, so instead I think it is a matter for the committee's stewardship. Recent minority votes, whatever one thinks of their merits or demerits, are encouraging in this respect. So is the MPC's move to discuss unlikely but plausible scenarios, which are a potentially useful tool for conveying its reaction function (so long as the analysis addresses circumstances in which the anchor has slipped, or needs to be secured).

Proposition 12: MPC should be relaxed about FPC offsetting some of the risks to stability from long periods of easy monetary policy

Finally, and briefly, MPC should be relaxed if FPC chooses --- as it should have done, but did not --- to offset some of the effects of persistently easy monetary policy on risks to financial stability. Many people worried that a combination of QE and FG was fuelling a search for yield that, in time honoured ways, drove up leverage and liquidity mismatches outside the re-regulated banking sector. Short of a general policy for shadow banking and its ilk (a separate question), stability policy makers could usefully – I think, should --- have increased minimum collateral requirements in traded markets, and in clearing houses. That would indirectly have capped leverage in those markets.

The point here is that MPC should not worry if FPC does act in that kind of way to preserve stability. This seems to underline the value of introducing voting to FPC, which might help overcome a bias against action, but belongs to a separate debate rather than to thoughts prompted by the MPC's twenty fifth anniversary.

Summing up

Inflation is always and everywhere a political economy problem. A nominal anchor can be achieved only through the design of regimes that are incentive

compatible for elected politicians and unelected technocrats. It is no easy thing, as the key moving parts of any regime can be picked apart. After the unravelling of the Bretton Woods international monetary system half a century ago, it took Britain 25 years to find its way to a decent monetary regime. Now that regime is itself 25 years old, and in recent years has been developed or expanded in various ways.

This chapter has set out a dozen propositions aimed at underpinning and, perhaps, revitalising Britain's Monetary Policy Committee and the regime entrusted to it. It has not addressed the many reform proposals --- such as merging the MPC and FPC, or having regional representatives on the MPC --- with which I disagree. Nor has it addressed the incentives of the regime’s parliamentary and other overseers.