RADIX
THINK TANK FOR THE RADICAL CENTRE

FINANCE **OUTLOOK**

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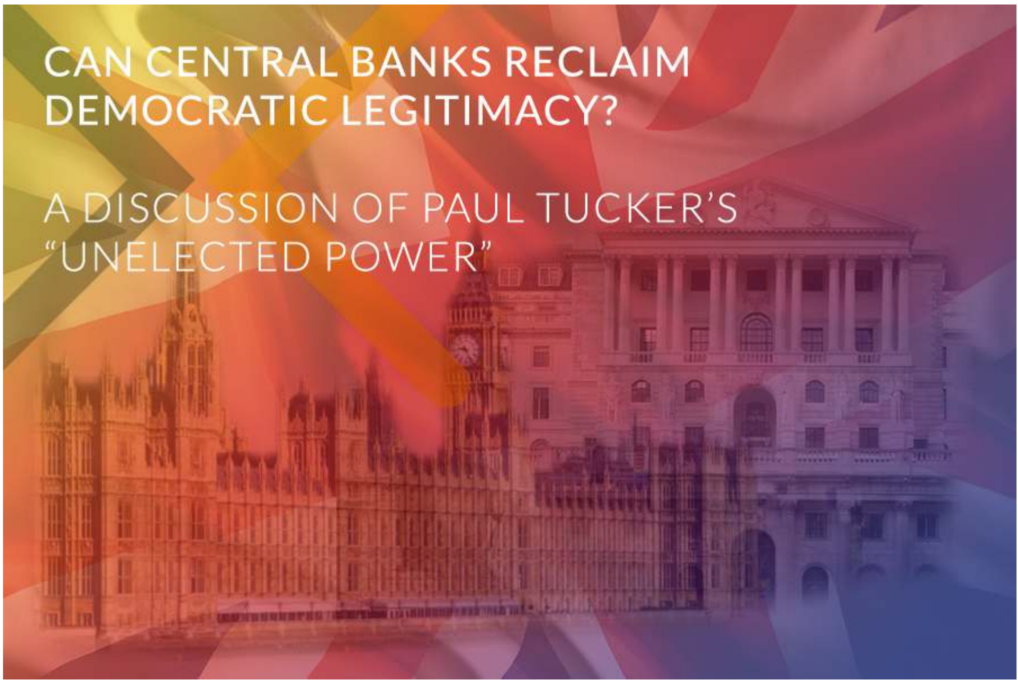


UNELECTED POWER
by Paul Tucker
Princeton University Press
May 2018

OVERVIEW: DEMOCRACY OR TECHNOCRACY? TUCKER'S BOOK IS A BOLD ATTEMPT BUT FALLS SHORT

In a paper published in 2016, RADIX sought to stimulate a debate on how to square the circle of central bank independence with democratic legitimacy.

Paul Tucker, former Deputy Governor at the Bank of England examines this question in detail in his book "Unelected Power" published in May this year.

While recognizing the tension between democratic accountability and 'independent' technocratic bodies, Tucker, perhaps unsurprisingly, remains thoroughly convinced by the model of central bank independence and the broader concept of delegating tasks to "trustee"-type agencies.

Key to Tucker's approach to square this circle is the idea that elected officials should only delegate if there exists a broad consensus on the desired policy and where the respective "trustee" can be constantly monitored in its concrete procedures and outputs to ensure these are in line with democratically legitimized goals and values.

He suggests the parceling up of responsibilities between different bodies with different responsibilities as a way of increasing transparency.

While the book is a bold attempt to tackle a difficult issue, one is left with the impression that structural problems with our economic and political systems are just too entrenched to allow for the kind of incremental technocratic solutions suggested by Tucker himself.

THE FUNDAMENTAL CHALLENGE OF LEGITIMACY

Tucker acknowledges the fundamental challenge to legitimacy confronted by post-crisis central banks

In 2016, in the wake of unprecedented monetary stimulus following the financial crisis, my colleagues at RADIX started a debate about the democratic legitimacy of central banks' actions – particularly quantitative easing (QE) programmes. They argued that, given the distributional consequences of QE, a debate on the limits of central bank independence and how to build political accountability into monetary policy decisions was overdue. In "Unelected Power" Paul Tucker, former Deputy Governor of the Bank of England attempts to tackle these questions.

As somebody deeply involved in policy reforms before and since the financial crisis of 2007-8, Tucker acknowledges the fundamental challenge to legitimacy confronted by post-crisis central banks. Rethinking legitimacy has become necessary, he argues, because monetary authorities do not just continue to hold authority over monetary policy, they have also expanded their responsibilities into the areas of financial regulation.

Their actions during the crisis have raised yet another legitimacy concern, namely how to design a publicly accountable "lender of last resort."

Lastly, and most importantly, central bankers have taken a considerable share of the burden usually carried by fiscal policy makers in the context of recession or low growth – namely to avoid a downward spiral of negative or low economic output and rising unemployment.

IS CENTRAL BANK INDEPENDENCE NOW UNAVOIDABLE?

Do elected politicians now have no option but to comply with the demands of globalised financial markets?

Or are governments that load up on public debt depriving themselves of democratically legitimate decision-making power?

In contrast to my RADIX colleagues, Tucker, perhaps unsurprisingly, remains thoroughly convinced by the model of central bank independence and the broader concept of delegating tasks to "trustee"-type agencies. His aim is not to abolish this model and move towards decision making that is more clearly embedded in parliamentary democracy. This is partly because he believes in the virtues of "credible commitment" and partly because he thinks that globalising financial markets simply demand central bank independence from states with high amounts of marketed public debt. Elected politicians therefore have little choice but to comply.

This argument, of course, could increase rather than decrease concerns about whether there is any kind democratic legitimacy left in a globalised world where free movement of capital has created financial markets that have the 'unelected power' to bend elected governments to their will.

Or, to look at it through a different lens, to what extent are governments that pile up public debt depriving themselves of the ability to make democratically accountable decisions?

A CONSENSUS ON DESIRED POLICY AND CONSTANT MONITORING

Therefore, taking 'independence' as a necessary feature of contemporary financial governance, throughout the book Tucker seeks to suggest principles and precepts for designing independent central banks and regulatory agencies in accordance with the constitutional principles of liberal democracy.

Elected officials should only delegate if there is broad consensus on desired policy and procedures, and outputs can be constantly monitored

Key to his approach is the idea that elected officials should only delegate if there exists a broad consensus on the desired policy (which excludes distributive decisions), and where the respective "trustee" can be constantly monitored in its concrete procedures and outputs.

Moreover, elected officials have the responsibility to observe whether the delegation in general continues to accord with democratically legitimised values and goals.

Most institutional regimes, including central banks, currently fail these criteria

Tucker sees clearly that most institutional regimes, including those for central banks, currently fail at his own criteria. For instance, Tucker notes that the European Central Bank lacks an important element of his suggested regime because its independence is enshrined in multilateral contracts and thus cannot be revised or reformed with democratic means.

He also acknowledges that certain types of QE have distributive consequences and thus breach the boundaries of what a central bank can legitimately do. Somewhat unconvincingly, though, he circumvents the challenge this poses by introducing a distinction between distributive decisions and decisions with distributive consequences directed at other goals (*eg.* price stability).

Some will see this as sophistry that avoids tackling one of the more difficult issues of legitimacy.

Overall, Tucker's proposals are clear and principled; and he is particularly convincing, when he emphasizes subtleties that can make his "design precepts" work. For instance, Tucker believes that a vigorous public debate with critical independent experts is essential for a regime of "trustee"-type independence to be viable at all. Only through this debate does the kind of public scrutiny emerge that is essential for maintaining legitimacy for non-democratic authority with democratic means.

Relatedly, Tucker emphasizes that civil servants like central bankers are neither virtuous representatives of public interest, nor does he believe that they just try to maximise their personal gains (Tucker himself became an academic after his BoE tenure, not an adviser to Blackrock or Pimco as his colleagues from the Treasury did). Instead, in a context where liberal democratic values are upheld, and where professional experts critically scrutinise policy performance, Tucker believes that independent monetary policy makers will primarily care about doing a good job.

DISTRIBUTIONAL EFFECTS OF BANK OF ENGLAND QE PROGRAMME				
	Property Gains	Value of Other Assets	Total increase in net asset value	Income effects
Penelope and Tim Fisher *(High earners, multiple properties, financial investments)*	+ £262,500	+ £175,000	+ £437,500	+£77,250
Martin and Amanda Barrett *(Home owners free of mortgage, savings and investments)*	+ £52,500	+ £17,500	+ £70,000	- £5,250
Jenny and Cameron Dalgliesh *(Teachers, own a small flat with a mortgage, some savings)*	+ £35,000	0	+ £35,000	+ £20,415
Jean and Jackie Morrison *(Renters, no savings, small overdraft)*	0	0	0	0

Source: Quantitative Easing: The debate that never happened, Radix, June 2016
Note: Calculations of the impact of QE on four theoretical households with different combinations of assets and liabilities

Social and institutional factors can make all the difference between a legitimate or illegitimate regime

Despite his use of "design"-language, Tucker thus acknowledges a broader set of social and institutional factors that can make all the difference between a legitimate or illegitimate regime.

ARE THINGS SEPARATE OR ARE THEY INTERTWINED?

But Tucker's most important insight is that, due to the nature of a credit-based monetary system, you cannot separate monetary policy from financial stability concerns.

Since a central bank assumes control over price stability by exchanging privately issued money (bank deposits) for public currency, it thus also needs to make sure that this exchange remains stable, particularly in times of crisis, when the value of financial assets and the stability of banks are in doubt. He writes:

"The missions of preserving banking stability and price stability are intimately intertwined."

Tucker tries to square the circle between intertwinement and separation

It is at this point that Tucker opts for a controversial solution. For even though he acknowledges intertwinement, he ultimately wants to maintain a separation between monetary and financial stability policy in order to allow for clear, output-focused accountabilities to be maintained.

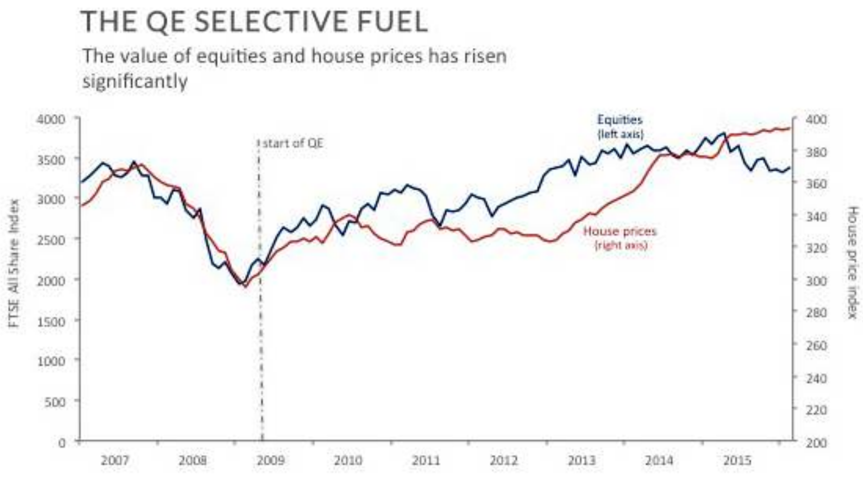
Central banks should thus conduct monetary policy to control inflation; and separate committees within them should use distinct instruments and be exposed to distinct frameworks of accountability to maintain banking stability. "The approach of this book", he writes, "is…to place the burden of containing the social costs of misplaced exuberance on regulatory policies that set a robust standard of resilience for the financial system."

The idea that independent central banks assume more regulatory responsibilities, but that they keep these tasks separate from monetary policy, has been supported by most experts and central bankers since the financial crisis of 2007-8.

THE MAINSTREAM CONSENSUS SOLUTION MAY NOT WORK

But one may question this mainstream solution on two grounds.

First, if anything, monetary policies since the crisis have become ever more intertwined with financial market developments. To avoid deflation and support growth, financial asset inflation and credit expansion have been deliberately fueled; just take a look at RADIX's own [quantitative easing report.]



Source: Quantitaive Easing, The debate that never happened. Radix, June 2016

The suggestion that regulators in central banks can safeguard stability in the light of these massive interventions seems highly implausible, as people like Bill White and Claudio Borio have convincingly argued.

Moreover, if the more fundamental problems of our economy are excessive credit expansion, ever larger stocks of existing financial assets, and deepening imbalances between deficit and surplus economies, it is hard to see how you can separate the conduct of monetary policy and financial regulation from these deeper structural issues.

THE FALLACY OF COMPOSITION

Much like pre-crisis regulators committed the "fallacy of composition" by thinking that individually solvent banks make a solvent banking system, so do Tucker and others commit a "fallacy of composition" in their thinking about financial policy – as if you could divide problems into small portions that can be handled by separate technocrats with separate mandates.

A second and related issue concerns how one communicates and frames policies and thus constructs legitimacy within a democratic public debate.

Here Tucker seems to turn the issue upside down. He starts with delineating technical areas of policy, then wants public debate to follow these technocratic requisites. For instance, since he wants to define financial regulation as a separate policy area, he turns to stress tests as his preferred accountability tool. These tests should allow simulation of what could go wrong without prudential interventions and would thus give legitimacy to what regulators decide to do (just like inflation forecasts arguably do for monetary policy).

Does the rhetorical power of 'stress testing' come from transparency or from their very obscurity of how these tests work?

Tucker thus writes, rather optimistically, that:

> *"[p]ursuing transparent stress testing should, therefore, be a priority if the forces of 'normative expectation' and the legitimacy-conferring benefits of public debate are to be realized. Supervision need no longer be a mystery – of interest and accessible only to the public and their elected representatives only when something goes badly wrong."*

I rather think that the virtues of a "new regulatory state", *ie.* of creating legitimacy through performance-based monitoring, are here stretched to their limits. It is true that the Federal Reserve managed to use stress tests as a tool for imposing higher capital adequacy ratios on US banks; but this worked, not because stress tests give transparency to Fed decisions; rather the contrary. The rhetorical power of stress tests resulted from the very obscurity of how these tests worked.

WE NEED A BROADER, MORE RADICAL DISCUSSION RATHER THAN INCREMENTAL TECHNOCRATIC SOLUTIONS

Tucker thus is right to stress that the current ways of delegating policies to “trustee” organizations like central banks are inconsistent and lack clear rules. His idea of reforming these rules on the basis of constitutional principles is sound.

But his book also makes evident that we need a broader, more foundational discussion of underlying conceptions of statehood that are inscribed in current financial policies and the “new regulatory state”.

Perhaps structural problems in the global economy and in Western political systems are just too entrenched to allow for the kind of incremental technocratic solutions suggested by Tucker himself.