



## Economic Affairs Committee

### Corrected oral evidence: Bank of England: how is independence working?

Tuesday 28 March 2023

3 pm

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Members present: Lord Bridges of Headley (The Chair); Lord Blackwell; Lord Davies of Brixton; Lord Griffiths of Fforestfach; Lord King of Lothbury; Baroness Kremer; Lord Layard; Baroness Liddell of Coatdyke; Lord Londesborough; Baroness Noakes; Lord Rooker; Lord Turnbull; Lord Verjee.

Evidence Session No. 3

Heard in Public

Questions 32 - 43

### Witnesses

I: Sir Paul Tucker, former Deputy Governor of the Bank of England; Sir John Vickers, former Chief Economist at the Bank of England.

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## Examination of witnesses

Sir Paul Tucker and Sir John Vickers.

**Q32 The Chair:** Good afternoon. Welcome to this session of the Economic Affairs Committee's inquiry into the operational independence of the Bank of England.

I am delighted to be joined here by Sir John Vickers, and by Sir Paul Tucker from the United States. Thank you for sparing the time. I do not think you need further introduction, given your pre-eminence in the field.

We may have to pause proceedings for a vote; we shall try to make the break as short as possible.

I shall start with a scene-setting question—a starter for 10. Given your expertise and experience, how do you think operational independence is working? Give us a sense of what is working well and where there might be need for improvement.

**Sir John Vickers:** I certainly think that it has worked remarkably well. We have 25 years of independence in monetary policy. The record speaks for itself. Inflation outturns in that quarter century are incomparably better than what went in the previous quarter century, and much of that—not all of it—had to do with independence.

There are, however, stresses and strains in the current environment. They stem partly from QE and its counterpart, which is the much higher government debt to GDP ratio than 25 years ago.

On the financial policy side and prudential regulation, we have only 10 years, not 25, to look at. It is a much more complex area. I believe that there is a lot of scope for improvement in how independence operates. There are some concerns about the politicisation of aspects of financial regulation, but I dare say that we shall come to those issues later.

**The Chair:** Thank you. That is exactly what we needed.

**Sir Paul Tucker:** I very much agree with John's tone on the past. It would be a great mistake even to contemplate diluting operational independence—or, I want to say, independence—in any way. It is hard to imagine navigating the country out of grave financial crisis if a Minister had been deciding interest rates and monetary policy. It would not have been possible to provide such large support to the economy. Bond yields would have gone up and people would have expected inflationary finance.

It is the nature of these events that one wants to improve things, so I shall touch on some headlines.

The Bank is involved in too many things beyond its core remit—somewhat by choice; somewhat under encouragement or direction. It has been perceived at times to be involved in politics—charged politics.

More importantly, and closer to the core, it is fair to say that on monetary policy and financial stability—I would address this to the Federal Reserve

and ECB as well as the Bank—central bankers have not been pre-emptive enough on inflation and various vulnerabilities accumulating in the financial system.

There are some questions about organisation and the new funding model. I say that partly because mainly, not entirely, on paper the regimes are still pretty good—certainly the core of the regimes—but the organisation's stewardship of the regimes could probably do with what the Europeans would call a meditation.

**Lord Blackwell:** The idea of government fiscal policy dealing with the real economy and the Bank of England independently controlling inflation works fine if the two are completely orthogonal, but in reality they both work by their impact on aggregate demand. The Bank of England either supports government fiscal policy or opposes it. Does that not mean, in practice in a democracy, that they have to work out a consensus, as they did before Bank of England independence? Is it that much different?

**Sir Paul Tucker:** In terms of the drift of your question, I want to say no. These are sequential moves. The Treasury moves first with its fiscal policy and the monetary policymaker moves second. It is important that the regime goals and tools for the monetary policymaker—the second mover—are completely clear so that the fiscal policymaker knows what might happen afterwards.<sup>1</sup>

If the drift of your question is that it is inevitable that there has to be joint decision-making, absolutely not. Joint decision-making would take us back to all the problems in the 1980s that Mrs Thatcher's Government and Nigel Lawson could not cure, notwithstanding their sincere personal commitment to price stability.

**Sir John Vickers:** I completely agree. Monetary policy decision-makers move with higher frequency. Fiscal policy is an annual event, perhaps subject to a framework, whereas monetary policy used to move monthly but now does so every six weeks.

Q33 **Baroness Liddell of Coatdyke:** Sir Paul might have answered my question: is the Bank of England being asked to do too much? The monetary policy remit is getting bigger and bigger. The most recent one, in November, had the Government's economic policy objective on supply side reforms, et cetera.

Is there a danger of the Bank losing sight of its main responsibility

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<sup>1</sup> At the moment, the *acquis* requires government debt management not to interfere with monetary policy. To this could usefully be added an injunction on the Bank to the effect that, where it is indifferent between different methods for implementing monetary policy, it should opt for methods that interfere least with government choices about the structure of the public debt. The case for such a principle has become apparent given the costs and risks to the public purse from combining QE with the payment of Bank Rate on the entirety of banks' reserves balances (deposits) at the Bank. See Tucker, "Quantitative Easing, Monetary Policy Implementation and the Public Finances" in *IFS Green Budget*, October 2022, pages 273 (paragraph 3) and 321.

because too much is being asked of it?

**Sir Paul Tucker:** If one has to give binary answers, which is not completely unhelpful, the answer is yes and yes: it is being asked or encouraged to do too much, and that risks distracting it from the core mission.

We have seen over the past few weeks stumbles in the United States and in Switzerland—in part, especially in the United States, due to the distraction of other interests.

**Sir John Vickers:** I agree. I see the question breaking down into two parts: first, whether it is too much to have monetary policy, financial stability policy and prudential regulation, in a sense, under the same roof. I do not think that is too much. It can be organised in different ways.

I would be more concerned about the proliferation of tasks, goals, objectives and trade-offs within each bit under the roof. I agree that things have become unnecessarily complicated.

On the length of remits, I like the Crick and Watson test. Next month is the 70th anniversary of the publication of their paper explaining the structure of DNA. It is fewer than 900 words. It ought to be possible to explain the remit of the Bank of England committee no less succinctly.

**Baroness Liddell of Coatdyke:** That is a very good answer.

**Baroness Kramer:** I am curious about whether the events of the past few weeks have changed the answers or suggested a different emphasis to your response. The ONS has just informed us that LDI led to a fall of about £550 billion in the asset value of defined benefit schemes.

As Sir Paul said—he said it rather nicely—two mid-sized banks failed in the United States and there has been the takeover, or rescue, of Credit Suisse, with interest rates having some play in that as well as regulatory issues.

I wonder whether, putting that package together, we should be picking up lessons from the past few weeks.

**Sir John Vickers:** For monetary policy, my short answer would be: steady as we go. There should not be any deflection from the task of getting inflation back under control.

There could be ripple effects if the crisis were to spread, which is not my expectation, influencing the setting of monetary policy, but I would not think that there were first-order lessons from that.

For financial stability policy, there certainly are lessons about the adequacy or otherwise of equity capital buffers in these institutions.

I was very struck by what senior Swiss policymakers said over the weekend about how effective resolution regimes are. In the US and in Switzerland, and with the UK aspect of SVB, resolution did not happen in

its textbook way in any of those jurisdictions. The senior Swiss authorities cast great doubt on how effective resolution could be in some crisis circumstances. As so much of the global regulatory architecture is premised on that working well, there could be very important lessons.

**Baroness Kramer:** Can you give your thoughts on what those lessons might be, or is it go back and examine?

**Sir John Vickers:** Anyone who thinks that equity capital buffers are excessively high and that resolution is always going to work beautifully had better think again.

**Sir Paul Tucker:** I think that this is a pretty massive issue. Andrew Bailey probably went as far as he could, in an important way, when testifying to the House of Commons Treasury Committee this morning.

I want to say that there are three lessons. First, monetary policy cannot help financial stability problems when you are facing an inflationary problem. For that reason, one lesson is that the central banks, not only in the UK but elsewhere, should have been stress testing a credit crunch and sharp rises in interest rates for their banking systems over the past year. It would have been much more useful to do that than to have a climate change stress test, which I certainly agree other parts of government ought to do. The central banks' priority should have been, "We do not know how far we will have to raise interest rates—perhaps much further than our central expectation. What will that do to credit conditions and stability of the banking system?" That is the first thing.

Picking up on the important comment that John made, it is important to understand that in 2019 the Federal Reserve and the Federal Deposit Insurance Corporation formally decided not to plan for the resolution of large regional banking groups—even though they were told that that was unwise. They came unstuck.

In Switzerland, as Andrew Bailey said this morning, there was a plan. I suspect, but cannot be absolutely sure—I would be staggered if it were not the case—that that plan had been discussed extensively between the Swiss and the Americans and British, because that is where Credit Suisse has its two main subsidiaries. Nevertheless—I cannot remember Andrew's exact words—the Swiss chose not to use the plan.

The Swiss made two further comments. The governor of the Swiss National Bank is reported by the *FT* as saying that resolution can only work in normal circumstances. I am choosing my words carefully. This is a quite extraordinary thing to say because the failure of one of the biggest banks in the world is never exactly going to be "normal circumstances".

The Finance Minister has said that she is not convinced that resolution would work. The *FT* this morning has a story that it concluded a few years ago that it could not do an orderly wind down because of the

liquidity requirements. That is not the issue. The issue would have been: why did not the SNB lend to enable an orderly wind down?

The big thing for Britain and therefore for the Bank of England is that it needs to redouble efforts with international counterparts to decide whether their counterparts are capable and willing to stick to the plans that have been agreed. If it judges that its international counterparts are not capable or not willing, there will have to be some restructuring in the British operations and, I think, in American operations of international banking groups whose home authority seems less than committed to the resolution plans.

The way in which Andrew put it this morning was encouraging in one respect. He did not say that we have discovered that resolution did not work. They discovered that the Swiss did not stick to the plan.

In terms of the themes for your committee, the big thing is that the governor and governors need to talk much more publicly about resolution, as I have urged over the years—typically aimed at Washington DC. The United States and Switzerland are experiencing the costs of not explaining widely what they would do in these situations.

The other lesson is that the microprudential part of the Bank of England—the PRA—needs to move even more towards an approach that works back from failure. The prophylactic supervision that aims to reduce the probability of failure can always be improved, but it is never guaranteed to work. The approach must work back from the possibility of failure, but I do not hear micro-supervisors in the UK, the US or elsewhere talking in that way nearly enough.

I think they have had a jolt—in Britain, it is a lucky jolt because it has not engulfed us—and need to embrace a somewhat different approach to their mission. It will not be novel to them that I think this, but they now have a demonstration of why it is a good idea.

**Lord King of Lothbury:** I have two questions on these fascinating issues—one for Sir John and one for Sir Paul.

You talked, Sir John, about the three areas—monetary, financial stability and micro-regulation—being under the same roof, perhaps with a different way of organising it. Will you elaborate on that and say how you think it would work well, given some of the problems that we have seen?

Sir Paul, the authorities dealing with the failures of Silicon Valley Bank and Credit Suisse appeared in part to be making things up as they went along. In the US, they got very exercised about depositors, whereas in the financial crisis we were more concerned about other forms of short-term finance provided by wholesale funders rather than by depositors.

There does not seem to be a holistic framework to deal with those problems: people looking at the actual incident confronting them and trying to create a policy to deal with it, rather than having a completely well thought-through ex ante framework.

Will you comment on what is needed to improve the ex ante framework, over and above deciding whether the resolution framework will be adhered to?

**Sir John Vickers:** Further to my response to Baroness Liddell's question, what I had in mind, in short, was a streamlining rather than overcomplicating things.

The example that many people point to is the greening of the corporate bond portfolio that the Bank of England had. My view is that it should not have been buying corporate bonds in the first place. I do not think that a central bank, short of very extreme circumstances, has any business doing that. But it did do it, and the portfolio was not as impeccably green as it might have been. A great exercise had to be gone through.

That is muddying things—in particular, public perceptions of what the Bank of England's monetary policy is all about. It should be all about getting inflation back to target and maintaining it there as best as one can in a world where there are bound to be shocks.

It was more about the proliferation of sub-objectives than about making the three parts work together better.

I do think, however, that there is a wider question about whether macroprudential and prudential regulation could become one part of the Bank rather than two parts of the Bank. I am agnostic on that. There are people on the screen and in the committee room who are far better placed to judge that question than I am.

I might be tempted to comment on the other question after Sir Paul.

**Sir Paul Tucker:** Thank you, Mervyn—or Lord King, as I should probably call you.

It is important to bear it in mind that the US was making it up as it went along because it had chosen not to have a plan. The Swiss were making it up as they went along because they abandoned their plan.

There is a whole issue about commitment technology for these plans. To use the jargon of our world, if banking faces a moral hazard problem, we have discovered that there is a pretty big moral hazard problem in the official sector, which is where the great debates will end up.

A bank can fail for a combination of two reasons: a liquidity crisis and a solvency crisis. On the liquidity crisis, if the bank is solvent and viable the central bank should be prepared to fund its short-term claims as they roll off or run.

It is no good deciding whether to do that in the midst of a crisis. It is better to commit to doing it up front, making it clear that you will do so, making clear what instruments you will take as collateral and what excess collateral you will want or require—in the jargon, “haircuts” --- which you and I have been proposing for a few years.

The second thing, which I aired five or six years ago, goes to the question of uninsured depositors. The authorities ought to be more prescriptive about capital stack.<sup>2</sup> I would loosely and broadly have a world in which common equity is first, the bonds that can be bailed in are second, and then regular senior bonds—and then uninsured deposits, and insured deposits.

The point of saying that is that in those circumstances the package I have described is one where, in liquidity, everybody is fine as long as the bank is solvent, because the central bank will lend—the great question that should be posed to the SNB—and, secondly, if it is not solvent and one cannot therefore sensibly lend and has to go into some insolvency or resolution procedure, the uninsured depositors have in front of them absorbing losses, equity, bailinable debt and senior bonds.

There are details that I have left out: how do you treat derivatives, counterparties and the taxman or woman and the people who provide catering services—cleaners, and so on; trade creditors?

I am airing a way of cutting through the issue that is gripping the United States. Should the state insure the entirety of uninsured deposits? It would have the effect that there are no bond issues. Everything will be structured as an uninsured deposit and insured by the state.

Britain could take a lead in this. Although no doubt we have not got it completely right, you and I together have made contributions that the Bank of England could usefully draw on, and the Bank has an opportunity to be an intellectual policy leader in this area.

**Sir John Vickers:** On that last point, I think that we in the UK now have depositor preference for insured deposits, which we did not have 15 years ago; there is some element.

The Fed made a massive intervention for what was supposedly not one of its major banks; this was not a mega crisis. It is not just the guarantee for the uninsured depositors of those institutions. The lending facility that the Fed has introduced is incredibly generous and is nowhere near Bagehot principles, which were supposed to reign in this area.

I have a lot of sympathy with those who have to deal with these crises in a matter of days or over a weekend. Sitting here, in the comfort of not having to take such decisions, it is hard to know what options they had before them. Perhaps, in the Swiss case, the writing down of the AT1 bonds, while letting equity holders get some value, perhaps was by far their least-bad option, but that underlines what a challenge these events are to the resolution regimes that have been constructed in the last decade—so much depends on them working.

**Lord Griffiths of Fforestfach:** Intellectually, the distinction between liquidity and solvency is very clear, but in your experience how difficult is

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<sup>2</sup> Meaning the hierarchy of creditor claims in a formal bankruptcy or liquidation process.



it in practice—in the heat of the moment, when you have a potential crisis—to decide?

**Sir John Vickers:** Paul is better than I am on this because he has experienced it.

**Sir Paul Tucker:** The drift of your question—Charles Goodhart tends to adopt this tone—is that it is always difficult and you can never do it, and that is not true. Sometimes, it is easy; sometimes, it is hard; and, sometimes, it is in between.

The key is that when you have decent notice that a bank is falling into difficulty—which, for goodness' sake, is the case with Credit Suisse and should have been the case with SVB—you have a long time to get to grips with it.

My opening remarks were about pre-emption. It would be understandable if you thought of that in terms of pre-emptive monetary policy, or pre-emptive financial stability policy on credit policy. Actually, you need to be pre-emptive in your resolution preparation.

John is striking a sceptical note on resolution, and I understand that, but the more neutral position is that if the Swiss did not believe in their plan, they had an absolute obligation to go to the authorities elsewhere in the world and tell them that. The Swiss still have a very large bank—I want to skirt around that as far as I can—but should people now be sceptical about them?

I think, for what it is worth, that if only SVB had been prepared properly for resolution it would have been a rather straightforward case. I am basically striking the same note as Andrew Bailey struck in front of the Select Committee this morning, but I am being a bit more pointed about it.

**Baroness Noakes:** You, Sir John, said that perhaps letting the AT1 tier of capital go was the least-bad option. Do you think it is ever appropriate for a central bank charged with financial stability to have the option of inverting the normal hierarchy in capital and creditors?

**Sir John Vickers:** Never say never. A great deal depends on the legal question of whether it was entitled to do that, and it says it was but one reads reports that that is in dispute.

That again is a question mark over resolution. If each of these incidents is going to lead to years of litigation, that is hardly satisfactory.

Where it is impossible to impose losses on bond holders until equity holders are absolutely wiped out, a rescue, if that is what it is, of the Swiss kind, which involves equity holders getting something, is off the table. That might remove an option from policymakers that, in some scenarios, could be valuable. Who knows?

I would not say never, and I would rather the AT1 holders took the loss than taxpayers. Fifteen years ago, it was taxpayers who bore all the losses, and bond holders came out whole, pretty much.

**Sir Paul Tucker:** The statutory regime in the UK would not allow the Bank of England resolution authority to do that. Debates in the Lords, as the legislation went through, were absolutely emphatic about what is called “no creditor worse off”—you cannot be worse off than you would be in a bankruptcy.

There is a particular issue in Switzerland that is nothing to do with resolution regimes or anything like that: whether there is a contractual clause in the AT1 prospectuses that triggered automatic write-down. That is obscured because the Swiss passed emergency legislation to write down those bonds; they did not use their resolution regime at all.

**The Chair:** Thank you very much for those answers.

You have been talking about the events of the past few weeks. May we revert to the remit and objectives of operational independence?

Q34 **Lord Londesborough:** Following on from Baroness Liddell’s question on the Bank of England having too much to do, are the trade-offs between the Bank’s primary and secondary objectives usefully defined and managed well, or do they represent mission creep or potential conflicts of interest? Put another way, are the secondary objectives a distraction from the prime focus of monetary and price stability, or do you feel that they reflect the new challenges facing our economy and, indeed, the global economy such as energy security and net zero?

**Sir John Vickers:** Let me forecast that Sir Paul will be much better on this question than I am, given his wider experience. I was at the Bank of England almost 25 years ago, in a much simpler world when it was very monetary-policy-focused.

I do not believe that we saw it as primary and secondary in the sense that we would give 80% weight to price stability and 20% weight to other things. It was all about inflation, but there was a question when you were knocked off course of how quickly you tried to get back on target.

We discussed that dynamic—that timing question—quite a bit. We saw it very much in a hierarchy of objectives, but with some room for labour market outcomes—growth, and so on. We felt we were all about inflation, just with that question of lags.

With financial stability regulation, it is a much more complex business. The metrics of success are much more elusive. My observation, very much as an outsider, is that there has been too much proliferation, and streamlining, again, is what I would favour.

**Sir Paul Tucker:** I basically agree with John. Both remits, including the MPC’s, have grown considerably since even my time; I left about nine or 10 years ago.

It is a bit more than that. The secondary objective is to help to support the Government's economic policies, and in the teens those policies started to include, from memory, something called monetary activism, which was a signal to have a somewhat broader view of the stewardship of the monetary regime.

A few years later, the Bank changed the name of its key quarterly report from the *Inflation Report*, which reflected the law as John described, to the *Monetary Policy Report*. It slightly invites the thought, and I trivialise it a bit: what can we do with our monetary policy instruments today to make the world a better place?

On the financial policy committee remit, there is a paragraph that says: "The committee should therefore routinely assess whether it can take actions to support the government's objectives in a way that will not conflict with the committee's primary objective. When the committee judges these conditions to be met it should seek to act to support the government's economic objectives in a way that is consistent with the recommendations set out in this remit, including through the use of its policy tools".

What that says is that provided you are more or less satisfied that financial stability will be sustained into the future you ought to use the extraordinary instruments you have, which are essentially for steering the supply and terms of credit, in ways that will support the Government's broader economic policies.

It is absolutely clear that the remit still says "Subject to being satisfied that financial stability is being maintained". One option for the Bank would have been to say, "As with price stability, where we are constantly having to work to maintain the nominal anchor—the credibility of low and stable inflation --- so with financial stability, and therefore we are not released to be an activist policy institution in pursuit of the Government's economic objectives".

That course was open to them. They have not completely taken that course and I suggest it would not have been very comfortable for them to do so. We might come back to this, but I think that there were people in the Bank of England at the time who were very concerned about these words, but they received almost no public discussion.

Even if my interpretation is wrong, at the very least what you should draw from what I am saying is that the precise words matter and that, up to a point, the intent behind them matters. I think it is quite enough to ask these people to maintain stability in the monetary system.

**Lord Turnbull:** I, too, want to go back to Baroness Liddell's question about whether the Bank is being asked to do too much. I think that the answer is probably yes. Another question is: has it done too much? Is there evidence that it has taken actions that have, in a sense, sucked it away from its optimum path of looking after inflation because it has been dabbling in these other affairs?

Is the rather cynical view that these other objectives are a kind of Christmas tree on which the Government stick all sorts of things—diversity, levelling up or climate change—but, when it comes to it, it is water off a duck's back? The Bank is not seriously going to be deflected.

The other question is: perhaps it is not being deflected, but is it asked to do work such as the credit riskiness of climate change? Is there a sense that that is a waste of its intellectual effort, even if it is not actually doing anything?

**The Chair:** Paul, do you want to say something?

**Sir Paul Tucker:** These are tough questions indeed.

I want to answer the first part of Andrew's question in terms of the Federal Reserve rather than the Bank, because it is a bit more comfortable for me.

The Federal Reserve talked for a long time about the importance of inclusive growth. Do I think that that deflected it from acting promptly in response to growing inflationary threats? Yes, absolutely I do, including when the Biden stimulus came, which I do not think one can be neutral about as a central banker. There was a need to tighten monetary policy, but the sense around the Federal Reserve at the time was, "No, this is a great opportunity for inclusive growth".

I do not know whether anything equivalent to that applies to the Bank of England.

The Bank of England and, especially, the European Central Bank have talked about climate change for some years. They have done less than one would have guessed from their proclamations, but the opportunity cost—Lord Turnbull's second point—is really significant.

If one thinks back to Mervyn's predecessor, Eddie George, to Mervyn himself or to me, one recalls the time one spent on speeches on the economy and on the financial system. These were not staff speeches read out by someone with a fancy title. These were personal statements of one's understanding of what is going on. When senior staffers and senior policymakers are making speeches about other things there is a significant opportunity cost, and I suspect that in some way we are paying the price.

No one should doubt that, by saying that the Bank of England should not be terribly involved in these things, I think that climate change or inequality do not matter. I would be perfectly content for the Treasury to pass a law constraining the Bank of England from buying bonds issued by "brown" companies or taking collateral from brown companies, but I do not think that unelected policymakers should make those discretionary judgments themselves. There is not a consensus in our society about what should be done and, where there is no consensus, public policy matters belong with elected officials, not with unelected officials.

**Sir John Vickers:** I see some reputational risk as well as the opportunity cost. It does burnish the central bank's green credentials, which individuals there might welcome, but it dilutes the sense that they are focused on inflation control. There could be some cost to that.

Given my view that they should be focused on the primary objectives and that that work is never done—you cannot tick that box and move on to the secondary objectives—I hope it is baubles on the tree and not more. It is hard to read pronouncements in publications, but I think there has been more than that. I found the climate-related stress tests to be very strange documents. I agree absolutely about the public policy importance of climate change, but it is quite hard to construct a world where the banks are rock solid and safe today from the everyday risk that they face—yet they might face risks from this incredibly alarming but much slower-moving set of events.

There were contortions there that I found pretty hard to credit.

**Sir Paul Tucker:** I agree with that.

**Lord Turnbull:** May I give an example about stranded assets—the idea that we should not invest in oil and gas because they may be stranded assets? The answer is that they can be stranded assets, but the high street is full of stranded assets. The deserts of South America and the southern states are covered with aeroplanes that are stranded assets. Stranded assets are a feature of economic growth and are not distinctive solely of fossil fuel investments.

**Sir John Vickers:** I totally agree.

**The Chair:** May I press you both? Should the FPC letter be stripped of references to climate change and energy security? Are they so confusing and so much of a distraction that they should be taken out? What should be done? What is the practical recommendation?

**Sir John Vickers:** I have not thought about drafting beyond my 900-word limit, I am afraid.

The legislation speaks about the policies of His Majesty's Government, so it is entirely reasonable that there is some summary of that policy; I just think it has become over-elaborate and sucked in too much attention and effort.

**Sir Paul Tucker:** What I think they ought to do in next year's remits for both committees is go back to the 2013 remits—even the 2012 remits—and decide what, if anything, they want to add, with any additions being actively debated in the Treasury Committee and elsewhere. The mood has changed incrementally over a number of years, and that cumulatively has added up to quite something.

That is reflected in the Bank's own sense of mission, which I think is something like "serve the public". For goodness' sake, that is why one becomes a public servant, so I can hardly object to that. However, the

mission of the Bank is not that; the mission is laid down in law. The mission of the Bank of England is to be steward of the regimes bestowed upon it by Parliament and to be accountable to Parliament for that.

In a way, it is slightly less exciting and grand and the relationship with the public is not entirely direct; it is mediated by the elected Parliament, which bestows the great powers that the three of us, Mervyn, John and I, have held. I do not think one can say one is just serving the British public in a way that almost invites people to think that Parliament is disintermediated. My emphasis is on Parliament, not the executive branch.

**The Chair:** We will come back to Parliament in a moment. I am very interested in that indeed.

Q35 **Lord King of Lothbury:** May I take you back to questions of financial regulation? The Bank now has not just monetary policy, but the FPC is doing macroprudential regulation, with the PRA doing microprudential regulation. Would you like to see a change in the structure of that such that the Bank loses either or both? Do you think that it makes sense to have in the same body both macro and microprudential regulation, or should they be part of the same unit that you have mentioned, Sir John, and some have advocated? What do you think is the optimal structure?

**Sir John Vickers:** I feel pretty agnostic. Macro and microprudential should probably cohabit. As to whether they should be in the same institution that does monetary policy, one could perfectly well do that either way. We used to do it in a separated way and then things changed with the advent of macroprudential policy.

I remember a former Bundesbank president arguing against combining monetary policy with financial regulatory policy in more or less these terms: that the reputation of the central bank for price stability is all important; that when financial crises happen it is very bad for the reputation of the financial regulator; that financial crises will inevitably happen and, therefore, they should be kept apart. Personally, I am not persuaded by that bleak view, but there is a point there.

**Sir Paul Tucker:** John's remembering of the Bundesbank position is incredibly instructive given the Bank's history. In 2007 and 2008, the Bank of England was not the micro-supervisor or macro-supervisor and had no prudential powers over the financial system. Even so, when Northern Rock failed, the reputational hit to the Bank of England was enormous. There was an immensely critical moment that was painful for you especially but painful for me as a Bank servant. The cover of the *Economist* had a picture of you. It did not have a picture of you, the then chair of the FSA, and the then Chancellor of the Exchequer; it had a picture of the central banker. The point was not about you ad hominem; it was about the central banker.

If you are the lender of last resort, you are almost inevitably at the scene of a financial disaster. All the discussion over the past week about what

happened in Switzerland is about Thomas Jordan, chairman of the Swiss National Bank; it is not about the chief executive and chair of FINMA. Most people do not even know their names, worthy people though I am sure they are.

I think it is reckless for a country, particularly a country with a large financial system, to separate micro-supervision from the central bank. I have views about how that should be designed within the central bank, which I hope we will be able to come back to later.

What has been learned is that, as practised in the past, prudential supervision has two very distinct aspects calling for very distinct skill sets. The micro role is essentially forensic and has to be executed...one is dealing with the property rights of investors and creditors of specific firms, so it has to be executed in a very rule-of-law way.

Macroprudential policy, in common with monetary policy, is about the aggregate. It is not especially forensic; it is much more analytical and rather more research-based.

It is not that I see no merit in the thought that John airs. It is quite hard to have a single committee with members who are both very much micro and macro people. There are individuals who can operate at the micro level and macro level --- John is one of them --- but they are not plentiful.

That is the origin of the three-committee structure, of which I was, I suppose, both an advocate and significant architect. I think that the lessons are more about the operation and, in some respects, governance of the PRA. I do not like it being a committee as opposed to being a subsidiary.

**Lord King of Lothbury:** Since you were in part an architect of this, can you come back and do a bit of snagging work? Tell us what you would do now in improving how it functions. You said you had some thoughts and ideas. Rather than jump around between subjects this afternoon, let us go straight to your thoughts.

**Sir Paul Tucker:** For the FPC, the big thing is to introduce voting in some respects. The thing for which I and to a degree you can take some responsibility, not full responsibility, is that the legislation encourages the FPC to reach decisions by consensus, for reasons that I can explain if the committee wishes.

The problem is that there has never been a vote in the first 10 years or so of the committee. The cost of it is that we can never really see where the debate is, and that hampers accountability.

The marvellous thing on the monetary side, except when forward guidance was in operation—this was a great cost of forward guidance—is that you see plenty of minority votes, and when you testify to the Select Committee in the Commons it can say, "Mr King, what do you think about this?" Then it comes to me and says, "We know you disagree with that

because you voted differently. What are you disagreeing about? Why are you disagreeing?"

That reveals to the world where the real debate is in the community. It is a fantastic aspect of the MPC. As I say, it was switched off during all those years of forward guidance, to great cost, I think. It has not happened at all on the Financial Policy Committee.

It affects incentives. The marvellous thing on the MPC is that you always have to form your own view because you will be accountable for your vote. You cannot in any way say, "The Governor, deputy governor, or whatever, said that, and I was content with it". You cannot be content with it; you have to have your own view.

There have been substantive issues where it beggars belief that there were not differences of view in the FPC, and it would have been much better if the whole thing had been exposed to daylight through a voting system.

On the PRA, I would do two things. This would be hard to do. There was a reason it was made a subsidiary, which essentially was to try to get the best of both worlds in what John was getting at with the reputational risk to the Bank. The CEO of the PRA would be the CEO of its own subsidiary board, which, subject to an override power at the level of Court, would decide resources for the organisation and everything else within the PRA.

I did not want the CEO of the PRA to be a deputy governor. I can remember the day you came back and told me that the Treasury had decided that the CEO would be a deputy governor. I said to you something like, "Damn it. I haven't got round to briefing on why that is a very bad idea".

The Liberal Democrats in the 2010 coalition forced this issue a bit. One wants the micro supervisors to be under the central bank tent, for reasons I will come back to, but a bit semi-detached—in particular not bending the knee to the core bank's monetary policy concerns. The reason for having it under the same umbrella is that otherwise information will not flow. I discount anybody who says they have a solution to that problem.

As Lord King will know, it was not until the legislation had come into force that we got full disclosure about the big UK banks, even though it had been obvious for months that it was coming our way.

This is repeated across the world. The "solution" to the risk of turf battles is underlap, not overlap.<sup>3</sup> I said to the Treasury Committee in almost my last testimony as a public official or public servant that overlap is uncomfortable for people; underlap is very comfortable for bureaucrats until it goes wrong. Having the micro supervisors under the umbrella gets

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<sup>3</sup> Meaning the organic outcome of strategic interaction between separate bodies: for the public, it is a problem not a solution in a good sense.



rid of the risk of micro supervisors not telling the macro people what is going on.

I would make those two adjustments at least. I have some others later about the organisation of the Bank.

**Baroness Noakes:** I want to clarify what has been said about support for the FPC being consensus-driven. Will you explain that a little further, because that is not what the Act says?

**Sir Paul Tucker:** It is what the Act says. I do not have the words in front of me. I am sorry to bore you with the technicalities, but with monetary policy you turn up and in normal circumstances at least the question is how you are going to deliver inflation at 2% and how you are going to move one instrument, the interest rate, whereas with financial policy the issue is: which of all these various threats do you think you ought to prioritise? Let us prioritise threat C. How many instruments do we have that could help mitigate or reduce that risk? We have four. On which of those instruments do you focus? Let us use instrument 2. Then, how shall we calibrate that instrument?

In the hands of almost any chair this is much more prone to what economists call agenda manipulation rather than the realm of monetary policy. We gave advice and the Treasury wanted to include in legislation going before Parliament an encouragement to reach decisions by consensus, but you are absolutely right to imply that there is nothing whatever in the legislation that prevents voting. There are some things, most narrowly on setting something called the countercyclical capital buffer, which absolutely lend themselves to voting, because it is clear what the instrument is and you are just going to set it.

I do not follow this terribly closely, but I do not have any sense of what the debates about financial stability have been within the FPC, yet it has become obvious over recent months that there are plenty of threats to financial stability and that they are quite likely to continue breaking around us.

**The Chair:** To ask a lay man's question, why was the emphasis on consensus? I understand the decision points you are making, but this debate must have been happening when the legislation went through, so why the emphasis?

**Sir Paul Tucker:** I think essentially it was in order to make the meetings easier to manage and so reduce the capacity for the chair to say, "I think we ought to vote on things in the following order". I do not want to get too technical. It is the capacity of the chair to choose the order in which issues are voted upon that creates a potential problem. Frankly, in hindsight I think that I at least gave too much weight to that.

**Lord King of Lothbury:** The central reason at the time was that in monetary policy there might be two or three plausible decisions that anybody would recommend and you could vote among them. With

financial stability, you might get as many different options as there are members of the committee, so everyone would end up voting for something different and the voting would not resolve it.

There had to be a process of consensus to limit what you could vote on. That was the encouragement. Where you have one instrument, such as the countercyclical buffer, you could vote on it, but the real issue on the committee was, "What is it that we should be discussing and debating?", rather than having eight or nine different views on what the issue was.

**Q36 Lord Blackwell:** I would like to invite you to comment on the scale and practice of quantitative easing and how that fits the Bank of England's remit and independence.

There are two particular scenarios. First, as we know, going into recession the Government end up with a deficit and need to sell large quantities of debt. The Bank of England has used quantitative easing to buy large quantities of debt. Does this in reality or perception compromise the independence of the Bank of England?

Secondly, having gone through quantitative easing, at some stage it has to be reversed to move the overhang of money supply and prevent inflation. The Chancellor last week agreed with the suggestion that part of the financial stability issues that we have seen recently, or see potentially, are due to the speed with which interest rates have risen. Has the use of quantitative easing and the scale of it led to the need to raise interest rates faster than would otherwise have been the case? Again, how does that impact on the way the Bank of England interprets its remit?

**Sir John Vickers:** I know that we are not to comment on the wisdom of policy decisions, but it is hard not to say something in response to that.

My view is that in the early years QE1 was amply justified for inflation control and price stability reasons to get inflation up to around target. I have been puzzled by wave after wave of that since the mid-teens, and I think it amplifies your question.

Where it relates to independence, it does so in many ways. There is the reputational point. I believe this was brought out in this committee's 2021 report on QE. Even though I do not myself for a moment believe that the Bank did QE to help the Government out of a debt hole, I can understand why a sceptical observer might think that that did have something to do with it, particularly when it is followed by a large and prolonged inflation overshoot, whereas in the earlier phases, including the 2016 dollop, the outturns were all consistent with inflation control.

It gives rise to a situation where the fiscal effects of monetary policy, which will always be there, are magnified to a considerable extent, especially when the government debt to GDP ratio is approximately 100%, whereas it used to be approximately 40%, because the interest rate sensitivity of the fiscal position, which your question refers to, is that much greater.

As for threats to independence, which I hope will not materialise, when monetary policy has potentially very large fiscal effects there are concerns of a kind that used not to exist in the old days.

**Sir Paul Tucker:** Starting with the second part of Lord Blackwell's question, I believe that if interest rates had been raised sooner and less gradually the effects on the fiscal position would have been less significant. I have not seen the Chancellor's exact words, but as you presented them I would not accept that characterisation because it would imply that raising interest rates at all would be a problem, whereas the problem is not interest rates; it is that domestically generated underlying inflation has been drifting away from target and the Monetary Policy Committee has found itself playing catch-up.

On the broader point, I say two things. It has muddled things a bit. There is a story circulating in Washington that a few years ago a Chancellor of the Exchequer, speaking at an event, said that the Bank of England did not have a balance sheet, the implication being that that was because the Chancellor of the day could say no to extra tranches of quantitative easing.

That itself raises another question. This is another angle on John's point about 2016 and 2020, with which I completely agree. In a way, it is surprising that the Government did not lean against the extra quantitative easing in 2020 after the bond markets had been stabilised in the spring. (I absolutely agree that was necessary—it is not quantitative easing as such.) But it was in the Government's interest to oppose or discourage extra quantitative easing because they could have funded themselves much more cheaply in the bond markets than they could in effect by borrowing from a central bank at a floating rate of interest, which is what QE does.

The enormous thing is that it is important to distinguish purchases of government bonds that are undertaken for the purpose of stimulating aggregate demand from purchases of government bonds that are made to stabilise the bond markets, because when you have done that you move on. John is exactly right. Both after the Brexit referendum when the Bank intervened to stabilise markets and in the spring of 2020 when it intervened to stabilise bond markets, one could applaud the stabilisation operations but be baffled by why the bonds were not sold back into the market once conditions had tolerably restabilised. A kind of buy-and-hold policy turns everything into quantitative easing.<sup>4</sup>

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<sup>4</sup> In fact, a central bank can have about half-a-dozen reasons for buying government bonds, only one of which is directly to stimulate aggregate demand in pursuit of achieving the inflation target (QE). Each distinct purpose needs its own governance process, and in the UK only one (again, QE) belongs wholly with the MPC. See Cecchetti and Tucker, "Understanding How Central Banks Use Their Balance Sheets: A Critical Categorisation", Voxeu, 1 June 2021. <https://cepr.org/voxeu/columns/understanding-how-central-banks-use-their-balance-sheets-critical-categorisation>. Related to this, the MPC must formally approve any change in the supply of base money (bankers' reserves balances with the Bank). In fact, however, the Bank of England did not sterilize (withdraw) the base

The UK is now starting to do okay on this. In the United States there is a sense that so-called quantitative tightening, selling off the QE portfolio, will cause bond market volatility and that will be an inherently terrible thing. Of course, one must be careful, but one does not work for the City of London or Wall Street; one is trying to stabilise the economy and meet the inflation target, not help traders, even though they are very noisy.

**Lord Blackwell:** I do not think that the Chancellor was criticising the Bank of England for the level of rates; it was the speed. I probably agree with your comment that perhaps it should have raised it earlier.

**Sir Paul Tucker:** Gradualism has, at least with hindsight, proved costly in the United States, the UK and elsewhere. I and a number of others would say that without hindsight, but that is of no interest.

**Lord Blackwell:** Based on what you are saying, how much contact and discussion has there been, or should there be, between the Bank of England and the Treasury on the Bank's bond purchases?

**Sir Paul Tucker:** Certainly, at an operational level, one would want complete understanding of what is going to happen, and how. I was still in the Bank when QE began and there was close professional co-ordination with the Debt Management Office about the design of the auctions, the timing of them and how they fitted with DMO auctions because, after all, they were selling bonds at that point and we were buying bonds.

That is separate from the policy decision about whether there should be QE. That was itself decided in a properly co-ordinated way between the then Governor, Lord King, and the crucial conversations with the then Prime Minister. I remember the weekend very well: Mervyn was good enough to call me a number of times. That was set out in an exchange of letters between the then Chancellor, Alistair Darling, and Mervyn, which laid out the rules of engagement, including the indemnity.

The indemnity is often misunderstood. My own view of the indemnity is that profits and losses will go to the Treasury anyway, so I saw it as a political economy device for ensuring that everybody knew that up front rather than having to understand the mysteries of the Bank of England and Treasury. The indemnity was not doing something desperately novel. The Bank of England is part of the British state.

**The Chair:** Sir John, do you have anything to add before we move on?

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money injected by its market-maker of last resort purchases of gilts to contain the LDI forced-selling problem last autumn. The Bank has defended that on the grounds that the amounts were small. But that is a fairly basic mistake as signals matter too, and those purchases were indeed mistaken for QE by some of the world's most prominent economists and economic commentators, as well as (unprompted) by Harvard undergraduates. This is a point about both regime design and career development at the Bank.

**Sir John Vickers:** On that point, no, but, so the thought is not lost, I have one footnote to the earlier discussion about committee dynamics on the monetary policy side.

I found the communication reforms that the MPC introduced a few years ago a little puzzling, because I do not think that the vibrancy of the debates circa 2000 would survive if we had to publish everything on the day of the policy decision, as now happens.

**The Chair:** There may be a vote in the not-too-distant future, so forgive us if we suddenly have to break off. I know that Baroness Noakes wants to come in on a subject in which a number of us are interested.

Q37 **Baroness Noakes:** Mention was made of the accountability of the Bank to Parliament. Of course, the strength of accountability is an important counterweight to the operational independence of the Bank of England.

The Bank of England has changed hugely over the past 25 years in terms of what it does and how big its balance sheet is after a decade or so of QE. I would be interested in the observations of each of you on how effective you think the accountability of the Bank is and whether there are any areas in which you think we could make some changes or improvements.

**Sir John Vickers:** The question is about accountability to Parliament, which is part of wider accountability.

My impression, based on a relatively brief experience on this side of the table, as it were, and observing it subsequently, is that accountability for monetary policy decisions is pretty good. There are regular appearances. It is clear what the task is and what the outturns are. We are not in a perfect world, but it is reasonably good.

Financial policy accountability for what can be incredibly important and yet very technical—setting the countercyclical buffer, the systemic risk buffer or whatever—is considerably less good, as is, on that front, wider accountability and transparency.

**Baroness Noakes:** Is that associated with what we were talking about a moment or two ago—the way in which the FPC works not making transparent some of the processes in reaching decisions?

**Sir John Vickers:** It is partly that, but there is also a much smaller community other than those with very clear commercial interests who follow these decisions on the financial policy front, whereas the community that follows inflation would be the public at large and you have a large commentariat—press, economists, academics and others—who are all over that issue in a way that does not happen on the financial stability side.

**Sir Paul Tucker:** John's last point is a profound issue, but it merely underlines the importance of parliamentary scrutiny of what goes on at

the FPC and the PRA and, therefore, of introducing some degree of voting and, where they disagree, disagreement.

What has not worked well are the cumulative changes to the remit, with hardly any public discussion of them. Public discussion might have ended in applause. That is fine, but, instead, really important changes to the regime for the Bank were made without a great deal of debate. I think that has been somewhat costly.

John said—I broadly agree and I said so myself earlier—that testimony on monetary policy has generally worked well. I do not think it worked terribly well during the period of forward guidance. I do not think that is anyone's fault in particular, but forward guidance is pointless unless you have a stable majority in the committee that is voting for your forward guidance. If forward guidance spanning three or four years can be undone in the following month because some people have changed their minds, or a new member of the committee has arrived, it is absolutely pointless. The effect of forward guidance, therefore, is to make it more of a chair-led committee.

This is also true in the United States, and to an extent it sucks the oxygen out of public hearings. I mention this because I think that forward guidance probably carried on too long and parliamentarians and others perhaps were not sufficiently seized of this cost. When people talk about groupthink, in a way, forward guidance is a commitment to groupthink. I do not believe there was a great deal of groupthink in the past. For goodness' sake, even when he was governor, Mervyn found himself in a minority some of the time.

There are lessons on the monetary policy side and they bear some relation to this overly gradual approach to the inflationary problem that the UK and others face. I think the greater problem is on the financial stability side. John's point about there being an active lobby on the financial stability side is incredibly significant.

We have seen this in the debate about including a competitiveness objective, which I think would, perversely, be quite damaging for the City of London in the medium to long run. I think it will be quite damaging to stability. Somehow, overcoming the weight of the lobby, which, for goodness' sake, has every right to pursue its interests, just underlines the importance of that testimony.

Perhaps I may say one thing about Lords hearings that may have changed in recent years. When I was a policymaker at the Bank—and certainly when John was—at hearings at the Commons there would be the governor and a few other committee members and everybody was encouraged to speak, and indeed did speak. In the Lords, however, one would accompany the governor—I accompanied two governors—and all the questions were addressed to the governor. Quite apart from it being a complete waste of time for those who accompanied the governor, which is neither here nor there in the great scheme of things, this was not tremendously sensible because it absolutely affirms the idea of a chair-

led policy function, whereas the whole design of the Bank of England was to avoid that, and Mervyn himself lived that and it was good.

**Baroness Noakes:** The governor came alone this year and did not waste anybody else's time.

May we return to whether there is any practical way of opening up accountability on the non-monetary policy side—the macro and microprudential aspects—because it does seem to me and indeed to others grappling with the PRA in particular that there is something of an accountability deficit in those areas?

**Sir Paul Tucker:** Take evidence from people with the opposite point of view from that of the banks. Some of their views are interesting, but it will at least air the issues. It would also add some democratic legitimacy to it in a world where the only voices heard are those of officeholders and the industry, not other bodies. I do not think that other bodies, even when they are called consumer bodies, can claim to represent the general public. Elected members of the House of Commons are much more tuned into the concerns of households than various NGOs. Nevertheless, they have a point of view, and up to a point the United States does that better. All sorts of people testify to the Senate Banking Committee.

**Sir John Vickers:** At times I have been critical of aspects of financial stability policy, both the setting of the systemic risk buffer and what I see as the lack of rigour in some of the stress tests. I would have been more than happy to submit a paper or appear before a parliamentary committee on that. On those issues of transparency, it does not matter who is right or wrong. Presumably, the Bank rather than I will be right, but in my view there should still be a light shone.

**The Chair:** I should like to take the next two questions together because we are about to vote. Perhaps Baroness Kramer and Lord Griffiths could pose their questions and then get answers to them.

**Baroness Kramer:** I just want to pursue this a little further.

I think we accept the general tone that at present there is some deficit in accountability to Parliament. Is this something that you remedy through procedure, as it were? Are you saying in a sense that the committee system is perhaps not adequately designed for this task because it meets too sporadically on various different issues in fairly constrained timeframes? Or are you saying that the issues have a natural complexity so we need someone else, as it were, to translate this and do the analysis, so that bog standard politicians such as us can understand exactly what it is we are looking at? Or do you need both?

**Lord Griffiths of Fforestfach:** My question is about accountability to the general public. The governor makes speeches but also appears on radio and television and so on. He is clearly viewed by the public as a spokesman. In addition, there was a time not long ago when individual members of the Monetary Policy Committee were making many

speeches.

**The Chair:** We will suspend the session for a few minutes and then resume your question.

*The Committee suspended for a Division in the House.*

**The Chair:** Welcome back to this hearing of the Economic Affairs Committee. We were in the midst of hearing a question from Lord Griffiths.

Q38 **Lord Griffiths of Fforestfach:** I wonder whether we could have a comment from our two witnesses on the issue of accountability to the general public. The governor appears on radio, television and so on, and is really seen by most people as the face of the Bank. In addition, members of the MPC, and sometimes of the FPC, give lectures that receive a lot of publicity, and sometimes they contradict each other. I wonder whether you have any views on that aspect of accountability, or any comments on how it could be improved, or perhaps on things that should not take place.

**The Chair:** Sir Paul, taking those two questions together, including Baroness Kramer's question, do you want to start?

**Sir Paul Tucker:** Starting with Lord Griffiths' question, it is tremendously important that when the governor of the day goes on radio or television, or whatever, they make it clear that they are speaking on behalf of a particular committee, or the Bank as a whole, and are not representing their own views, except when they are.

If I may say so, Mervyn handled this very well during the period when he was in a minority. He once conducted a press conference representing the majority view without it being disclosed for another week that he had voted against it. I phrase that slightly lightly, but it was a tremendously important moment in the integrity of the Bank's accountability and the distinction between spokesperson for the institution as a whole, or a particular committee, and then the voter with one vote (and a casting vote in the event of a draw on particular committees). It is of tremendous importance that an incumbent governor, or deputy governor for monetary policy, or a deputy governor speaking for financial stability, distinguishes very carefully between their own view and vote and the view of the institution or the committee.

That being so, part of the answer to your question is that when there are disparate views and votes, it is quite important for the governor to convey to the general public that that is a strength, because it is the opposite of groupthink and is the mark of real debate, not relying—I care about this very much—on one man or one woman but on a proper debate among equal professionals.

If I may say something very quickly about Baroness Kramer's question, there is a very big distinction between strengthening the staff of Select Committees, including committees in the Lords, or maybe a central unit



that does that, and setting up something in the Cabinet Office that does it. Literally your Peer, lowercase and uppercase, Jonathan Hill has floated the idea of perhaps setting up a monitor of the regulators. I predict that if you do that you will all be very disappointed. Who will monitor the monitor? This is Juvenal's problem, of course: who will guard the guardians? Are we actually sure that in Britain we have enough experts to people such a body? The United States has one and I do not think it is very good. The US body is in the executive branch. I think it is a bit different if it is an organ of Parliament.

**Sir John Vickers:** Baroness Kramer's question is about wider accountability, not just parliamentary.

**Baroness Kramer:** Particularly parliamentary accountability.

**Sir John Vickers:** The point I was going to make would go wider but could feed into parliamentary scrutiny. When I was at the Bank one thing we did was publish a book on the models we used, because everyone realised they were quite an important aid to decision-making. They were not transparent before and we put a lot of effort into explaining the context and so on. The pressure to publish made the models better; it was a very healthy thing.

One thing I have found quite difficult, looking at what the FPC is doing, is that the calibration exercises are very hard to fathom if you are on the outside. There was a very important paper by Martin Brooke and others in 2015 on which the FPC and the governor at the time seemed to place a lot of reliance. I thought they were very good economists and it was a very sensible model, but some extremely odd assumptions had been fed into it. If that had just been available to the wider economics community, it would have been a much better informed debate, which would have helped parliamentary scrutiny.

Another example is stress testing. I can see that there is confidential information and that this may be inherently difficult, but again it is very hard to see the mechanics of the stress test and what is driving what. There was a Bank of England stress test in, I believe, late 2018. One of its features was higher interest rates, which are very topical, but its effect in their workings was to boost bank profitability, not the opposite, because margins went up. I can see that effect. You think, "Hang on. There must be an offsetting effect. Can we see a bit of the plumbing?" It is totally invisible. I think it would be very helpful to have at least a little bit more out in the open.

On Lord Griffiths' question, a related issue is whether the governor is overstretched. A higher profile for some of the deputies could be part of dealing with that. I suspect that there is an intrinsic difficulty in the accountability of financial regulation. To simplify this, if I were a member of the general public, it might seem that with financial regulation either nothing happens, which is boring, or bad things happen, which is interesting. We hope that will be very infrequent. That is different from the month-by-month, constant flow of information—inflation,

supermarket prices, the mortgage rate—bearing on the monetary policy side.

Q39 **Lord Rooker:** I have a couple of specific questions about parliamentary scrutiny. I will ask them separately.

During our evidence session a few weeks ago we heard from Chris Giles, economics editor of the *Financial Times*, who said—I paraphrase—that because of the four Ps, petty party-political points, the Treasury Committee was not doing its job of holding the Bank of England to account. He criticised the function and quality of the MPs' questioning. Does parliamentary scrutiny of the Bank of England serve the interests of the general public? Is his view typical? I do not know. It is nearly 30 years since I left the other place and I was never on the Treasury Committee.

**Sir Paul Tucker:** I have not followed the Bank or its Treasury Committee hearings sufficiently closely over the past nine years to have a view. When the now Lord McFall chaired that committee, it was pretty effective. That was partly because he and Michael Fallon, who was what the Americans would call the ranking member and a Tory, aimed at unanimous reports.

John McFall was quite careful to limit the number of initiatives. Andrew Tyrie kept that up, and it was pretty effective scrutiny. I do not know what happened afterwards.

When political life in Britain became very charged for a while—perhaps it still is—and the Bank was perceived by some, fairly or unfairly, to be in the flow of that politics, the natural thing for Treasury Committee members to do was not to hunt as a pack, as it were, but to fall into their various partisan positions, whether that be party or referendum partisan. To the extent that that happened, I hope that by the Bank continuing to stay out of politics, particularly constitutional politics, it can get back to or underpin the Treasury Committee working as a group.

This is very different from the US Senate or the European Parliament's ECON committee, where each member has a question and they may not even stay after they have asked it and heard the answer. They will never abandon their question to pursue the questioning of another member.

When I testified alongside Eddie George or Mervyn King, and perhaps with John—I cannot remember—the Treasury Committee had the capacity to work as a group and occasionally to abandon an individual's particular question because they had, if you like, got the governor on the ropes and so would stick with that theme. I thought that that was a source of strength. Our collective view was that, "This isn't terribly comfortable but it's very good".

**Sir John Vickers:** I have a lot of respect for Chris Giles, but I have not seen things in that light myself. Like Paul, I have not followed events closely.

The most formidable parliamentary committee that I appeared before—I hesitate to say this as two of its members are present—was the Parliamentary Commission on Banking Standards, chaired by Andrew Tyrie. Lord Lawson was also among its members. What sticks in my mind is being quizzed about the intricacies of Basel III by the Archbishop of Canterbury.

**Lord Rooker:** There is plenty of evidence that Select Committees hunt as a pack only when the witness is not a Minister.

I have an example with which to point up my second question. Does the input to the Bank's remit as set out in the Chancellor's annual letter receive appropriate scrutiny in Parliament? I came across an example by accident. It is the Chancellor's letter of 3 March 2021—the one before the current one—from when the present Prime Minister was Chancellor. Its second paragraph is virtually word for word the same as the one from last November, except for one sentence. In 2021, part of the second paragraph said, "The Government's commitment to price stability and the Bank of England's operational independence remains absolute". The remit letter of 17 November last year includes exactly the same paragraph, but that sentence is missing. It is nowhere in the rest of the letter, even by implication.

I do not know what happened this morning, but would the Treasury Committee pick up on something like that? Why would it change the drafting of what is a regular letter—I have looked at others, which are similar—where there is an absolutely clear commitment to operational independence, and the rest of the paragraph is exactly the same, word for word? That sentence is missing. Would you expect decent parliamentary scrutiny to pick that up?

**Sir Paul Tucker:** Yes, as a question to be put to the Treasury. If the Bank of England was asked that question, the answer it should properly give, because it is true, is, "We are independent under a law passed by Parliament and we shall continue to exercise powers consistent with that law, until or unless you remove our independence". Ultimately, it is the law that matters, not the remit in that respect.

That question could usefully be put to the Treasury but the broader point is one that I tried to underline earlier. I did not know about the change you have identified; I do not spend my time going through these documents. Whereas these documents were essentially stable for the first 15-plus years of the MPC's life, since around 2012-13 they have become quite dynamic. People should be alert to these changes and ask the Treasury to explain them. Although it is not terribly comfortable, they should ask the Bank of England's leaders what they think of them.

This comes back to the separation between the externals and the internals. To the extent that the Bank is asked about this, these are questions for the executive, not the external members of the MPC or FPC. The responsibility of external members is the stewardship of the regime, not its design. The executive are actors, part of the bargaining process

for what that regime is. In a broad sense, you raise a profoundly important point.

**Lord Turnbull:** The difference in questioning that Chris Giles illustrated is that someone offers an opinion and tries to get an answer that can then be used politically—that “gotcha” moment.

The Parliamentary Commission on Banking Standards was schooled to operate in the same way as the Committee of Privileges, as you might have seen the other day. That is completely different in that you have a dossier, you come out with a fact and ask, “What do you think about that?” We had quite a lot of barrister help and that produced a much more penetrating kind of questioning. The various Select Committees probably need to study these two methodologies and start training people to operate the more barrister-led method.

**Sir Paul Tucker:** I am not completely convinced of that. For some things, yes, but when it comes to monetary policy and financial stability, one really wants a Select Committee to get the stewards of the regime—the members of the MPC and FPC—to describe and explain what they do, their uncertainties and choices in language that the public can understand and which the media can report. Debates about the regime itself are slightly different. I accept that.

Q40 **Lord Verjee:** We have covered this a little bit, but in your opinion is there sufficient transparency in the work of the Financial Policy Committee and Prudential Regulation Authority? Are there some circumstances where a lack of full transparency is justified?

**Sir John Vickers:** To underline and elaborate on earlier answers, no. There are clearly issues of commercial confidentiality, which necessarily limit what can be done. I have sometimes found it really difficult to understand the underpinnings of policy decisions taken by the FPC—for example, on the systemic risk buffer.

Apologies for being autobiographical, but I once experienced a very odd lack of transparency. The FPC put out a consultation paper pointing in a direction that I thought unwise to follow. I made my response to that consultation public and had a column in the *FT*. Next morning, I woke to discover that the Bank had rebuffed my view. That was fine, if a little odd when we were still in the consultation phase. I could not get hold of the rebuttal issued by the Bank, despite repeated attempts that day. There was total opacity. That sort of thing is very unsatisfactory. A lot of progress could be made on that front.

**Sir Paul Tucker:** I do not need to add anything to what I said earlier.

Q41 **Lord Griffiths of Fforestfach:** My question is about the size and make-up of the Bank’s committees, and whether that is appropriate—whether there are enough external members. My concern is whether there is enough intellectual diversity at present in the committees.

For example, I cannot remember when we had the first rise in interest

rates but it was some time after a number of commentators had said that the money supply was growing rapidly. As far as I could see, nobody at the MPC held up their hand and said, "It's time we raised interest rates". That went on for some time.

We could look at federal systems such as in the US or the European Central Bank. In Europe, we have people such as Otmar Issing, who is critical of the euro. He took a different line from the standard one of the Bank of England. From the president of the Bundesbank, and similarly from the Federal Reserve Bank of St Louis, we typically have a non-Keynesian perspective. In not challenging that inflation is transitory, do we lack intellectual diversity on these committees?

**Sir John Vickers:** There has been reasonable diversity and cut and thrust in the MPC for most of the time. That all calmed down a lot in the teens. It also appeared in the voting records. Perhaps when you are down on the floor there will not be much disagreement anyway. There was an awful lot of unanimity for a long time, including about the quantum of QE, not just the bank rate. There is clearly now a diversity of views. I agree that it is a shame that there were not more uppish voices earlier.

I would not want to get tied in to the point on monetary aggregates but, as a number of people point out, with the change in the title of the inflation report to the monetary policy report, the content seems to have less and less to do with money. We always thought that that was useful information, although I would certainly not count myself as anything like a monetarist.

**Lord Griffiths of Fforestfach:** There are so many varieties of monetarism.

**Sir John Vickers:** Any kind.

**Lord Griffiths of Fforestfach:** That is extreme.

**Sir Paul Tucker:** Lord Griffiths would be less impressed by the relative intellectual diversity of the Federal Reserve and the ECB a few years ago. In the UK, people such as Danny Blanchflower, Adam Posen, Willem Buiter, DeAnne Julius and those within the executive took very different views a few years ago.<sup>5</sup>

John hit the nail on the head. The culture of unanimity during the teens and lasting a bit longer was a product of forward guidance. Whatever one thinks of the merits or demerits of forward guidance as a monetary policy tool, culturally it seems to have been difficult to shake off. Perhaps policymakers in Britain, as well as in the States and elsewhere, were not quite seized enough by this. They did not realise they needed to make a

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<sup>5</sup> I should have added that I do not favour moving to the MPC or FPC having a majority of externals. That is because the externals could then vote to use the Bank's balance sheet when they are not accountable for the risks of financial loss or other matters beyond price stability or financial system stability.

break back into the old ways of doing things after they were no longer stuck at the zero lower band. Some cost has been paid for that.

In the past, we saw that intellectual diversity is possible. There are some other things to be said about committees that may be current.

**Lord Davies of Brixton:** I wish to pursue the point raised by Lord Griffiths. This has been an extremely interesting session and very educational. There has been a disappointing level of consensus—too much—and very few “gotcha” moments.

Sir John, in answering our first question, said that this had worked well. I am not convinced by that but it seems everyone else has this consensus that, in broad terms, it worked well. Are we suffering from an Overton window, with a received level of wisdom in the middle and the system failing to pick up people outside it? Obviously, there are votes and disagreement but there is still a broad thrust. The debate is as much about the speed rather than the direction adopted. Is that unfair?

**Sir John Vickers:** On my remark about the overall success of monetary policy, exhibit A would simply be the inflation track record. Through the 20th century, this country tried all sorts of ways to achieve price stability: the gold standard, fixed exchange rates, monetary aggregates, et cetera.

Those all failed, one way or the other, with a lot of economic cost. Starting with the inflation-targeting regime in 1992-93, which predates the committee, until two years ago the price stability achievement was remarkable against a background that previously had been dismal by the standards of comparator countries. That was a huge success. That credibility is a massive economic asset for the country, which must be preserved and protected.

The past couple of years have clearly been less glorious on that front, partly due to policy mistakes and a lot down to rotten luck. That might play into the earlier discussion about the hierarchy of objectives. You could imagine that, after 20 years of success, we would think, “We’ve nailed the primary objectives, so now let’s rootle around in the secondaries”. We have all learned, both with the inflation record since 2021 and in recent weeks with financial stability, that those primary objectives certainly cannot be taken for granted. That is my broad response.

On the earlier point, we talked about intellectual diversity on the Monetary Policy Committee. The same question could be asked of the FPC, which has, in my dealing with it at any rate, presented a remarkably united front. That is good in some ways and, I would suggest, not brilliant in others.

**Lord Davies of Brixton:** There is the whole issue of regulatory capture.

**Sir John Vickers:** There is clearly a risk of that. Again, the best antidote is transparency and fresh air.

**Lord Davies of Brixton:** Rather than a wider diversity of views.

**Sir John Vickers:** A wider diversity of views in that setting would be good. Of course, I do not know what is going on in the room. Again, we talked about the lack of voting. The phalanx view appears on the outside. That has not been the case with monetary policy for most periods.

**Sir Paul Tucker:** I have just one point, tonally. John and I sound as though we agree but it is not obvious that the people who run the Bank of England would agree with us.

Each of us tiptoes around the following. We are very supportive of an independent central bank. We admire its achievements over a long period, but we have managed to say critical things about QE, forward guidance and the FPC. I would add the inaction on shadow banking, communication on resolution policy, and I could add a number of other things as well.

Although, somehow, the tone we adopt is constructive—as it is meant to be—we have each offered lists of things that we think need some attention. In itself, that is a form of diversity of view. We count as part of the community of central bankers in our country.

**Lord Verjee:** How easy is it in practice for people of differing views to express them? Even in a committee such as this, it is pretty hard work to express such differing views. I can imagine that sitting in a committee in the Bank of England it would be hard to express them. How do we address that?

**Sir John Vickers:** Some very different views were expressed on the MPC in its early days. Willem Buiter or DeAnne Julius never struck me as terribly inhibited. A lot of credit for that feeling should go to the then governor. Eddie George had a very strong personality in some ways but he was a terrific chair of that committee, and allowed and encouraged within the room all those views to come forth.

**Sir Paul Tucker:** I completely agree. If anything, I would characterise that period of one person, one vote as giving individual members incentives to put themselves in the minority to get some publicity. There was no cultural obstacle to doing that within the Bank. That continued when Mervyn was governor. When he voted in a minority, the rest of us effectively put him in that minority. On some occasions, I was in the minority with him and on others in the majority against him.

**Lord Turnbull:** I have noticed a strong core of Bailey, Broadbent, Cunliffe and Ramsden—or BBCR—who go to all three of these committees. They are then joined by various outsiders. Is there a tendency for that group to become solid in working with each other day after day? If it is Wednesday, it is the MPC; if it is Friday, it is something else. It is the same group. Is that a problem?

**Sir Paul Tucker:** This gets us into interesting territory. I will make what is not in any way an ad hominem comment. The dispositions of former

Treasury officials are in general different from those of Bank of England officials. Although I admire and greatly respect each one of them, I slightly wish that there were fewer former Treasury officials in these positions. I also wish that there had been rather more Bank of England people.

When the MPC began, four people on the committee, perhaps five, were experts in what lies between monetary theory and monetary practice: Eddie George, Charles Goodhart, Ian Plenderleith and Mervyn King. That number went down; for a while it went to zero.<sup>6</sup> Now it is probably one. At times, this has shown in operational policy. This matters to the point you are getting at.

There is a difference between being brought up as an adviser to an ontologically different type of person—a Minister—and as somebody who aspires to be a policymaker. I shall probably live to regret making that comment. It really is not about any of the individuals, whom I greatly admire.

It matters, for example, whether there is a pre-meeting of the executive before the FPC or MPC. There should not be—that is, except when QE started. Then, Mervyn very gingerly reached out—as the Americans would say—to Charlie Bean, myself and a few others to say, “Shall we do this QE thing? If we do, when we start we will probably need unanimity”. He was completely open with the whole committee about that.

Apart from that, there was no pre-cooking at all. You would go into the meeting and think, “Oh my goodness, that’s what they think. I don’t think that”. Or sometimes it would be, “That’s interesting, I think that, too. I didn’t know they thought it”.

That goes back to what John said about Eddie. Mervyn sustained it. It is both precious and a necessary condition for the Bank of England model working at all. One or two of you praised the Fed and ECB models. Both those committees are chair-led, more or less. Everybody tacks to the chair.

The Bank of England model was never intended to be based on that. One of the greatest responsibilities of the governor of the day, whoever she or he may be, is to ensure that what you are worrying about does not happen. I have no strong reason to think that it does happen. It was not insignificant in the life of the institution to take on so many people whose formation was as advisers.

That is much less important than the period of forward guidance, which more or less requires a supermajority, where you slightly suppress your views in the interests of having a coherent, forward-looking message. One of the great responsibilities that Andrew Bailey now has is to restore

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<sup>6</sup> And, perhaps for the first time in its history, for the Bank’s executive team (not only the MPC).



a culture where he is indifferent to what the others think and he finds out the result.

**Sir John Vickers:** I refer back to the communication reforms and the publication of decision, minutes and the *Monetary Policy Report* on the same day. That must have changed the internal dynamics a lot from how they used to be. It must have given the executive more power. I do not see how you could prepare it all for that announcement unless that was the case. In the old days, we would make a decision and the next round of debate would start on what went into the minutes, the inflation report and so on. Then, the lags were too long but now with it all being instantaneous that must have changed things.

**Sir Paul Tucker:** I completely agree with that. This is a very important point.<sup>7</sup>

Q42 **Lord King of Lothbury:** This has been a fascinating session about the design of the policy architecture of the Bank and its responsibilities. On the set-up of the team that we put on the pitch, when you were both in the Bank there were never any more than two deputy governors and four executive directors. There are now four deputy governors and around 30 executive directors. Would you want to change that, and what do we learn from the rest of the world's central banks about the appropriate organisation of the Bank of England?

**Sir John Vickers:** Paul will be much better than I am on the latter question. Four deputy governors seems more than the ideal number. I would have thought two or perhaps three was optimal. That relates to whether the head of the PRA counts as a deputy governor, as discussed earlier. Of course, in the very old days, before supervision was taken away from the Bank, it had one deputy governor. It did everything with one. I suppose this is another manifestation of inflation.

**Sir Paul Tucker:** I would do two things, with half a thing on the end. I would move to a system with a senior deputy governor—it does not matter what they are called—for the following reason. We are talking about an organisation, not the relationships. In such a one-on-four or one-on-three organisation, only one person—the governor of the day—is invested all the time in the whole organisation, including back offices, finance, IT, et cetera. That concentrates power too much. When it was one-on-two, it was tolerable because you could sometimes have an intimate and quite challenging meeting between three people.

A one-on-one was better. I saw that when I was private secretary to the governor. The governor could not do things where he did not carry the deputy. It was actually even better if the No. 2 was at the stage in their career where they did not particularly expect to be governor and were not trying to topple them.

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<sup>7</sup> That is because it shifts power to the chair, against the intentions of the original design of the MPC; and because it impairs scrutiny.

The Bank of England that grew in the 1990s and became so excellent was the product of a set-up with a one-on-one. The deputy governor of the day, whom I would now call the senior deputy governor, was invested in everything. Some of the things that happened over recent years, which perhaps we frown on a bit, would have been less likely had there been a deputy governor saying, "I really don't agree with you about this. I want you to know that".

Secondly, and even more importantly, there should formally be an executive board—there is in the ECB and the Federal Reserve, to answer the second part of your question. Here is why: the formal structure of the Bank of England, which not many people understand, is that, except where powers are conferred by Parliament on particular bodies such as the MPC, FPC and so on, all the Bank's powers are best viewed as vested in the governor and company. In other words, that is the Court of Directors, which reserves a few things for itself such as signing off on budgets but otherwise delegates everything to the person of the governor.

That means things such as lender of last resort, market maker of last resort and a host of other things that do not fall to the MPC or FPC, because they are central banking, can ultimately be decided on by the governor of the day on their own. It would be far better if there were a formal executive board. That could be set up by Parliament but the Court of Directors could do it. For what it is worth, at a particular point in my career, I suggested that this might happen. I rather wish I had been public about that at the time. I think it should happen.

I would not have the PRA chief executive as a member of that executive board that decides on lender of last resort, market maker of last resort, et cetera.<sup>8</sup> The chief executive would have their own board—that of the PRA. In my ideal set-up, the senior deputy governor would chair that much of the time, rather than the governor, insulating the governor a bit from the hazards of microprudential failure.

Summing up, the organisation needs reform.

Finally, it is also important than on any such executive board, all members need to be appointed through the process of Treasury/Prime Minister appointments. There was a period—perhaps it happens now—where the COO was given equal ranking internally to the deputy governors. I can see how an organisation might want to operate like that, but it does not fit with the de jure position of these people's responsibilities. The people appointed under the law are accountable to Parliament; those not appointed under the law are staff.

**Q43 The Chair:** I end with one simple question. We covered the waterfront, remit, transparency, accountability to the department, et cetera. Out of

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<sup>8</sup> That is because when the question of LOLR arises, the micro-prudential supervisors will often be perceived as having been slow to contain a problem, giving them incentives to support liquidity support rather than resolution or liquidation

all the subjects we have touched on, what is the one thing that if you had a magic wand you would want to be top of the list to improve the operational effectiveness and independence of the Bank?

**Sir John Vickers:** My snap answer is transparency of the FPC and PRA, so far as commercial confidentiality allows.

**Sir Paul Tucker:** I will give a different answer. The organisational changes I mentioned at the end would significantly improve the performance of the Bank of England over coming years. It would take a decade or so for them to bear fruit—but they would.

**The Chair:** Excellent. Thank you both very much. The fact that we have gone well over time is probably a sign of my bad chairmanship, but I think it is more a sign that you have given incredibly insightful and rich answers. You can tell from the number of supplementary questions that we had a lot of interest in what you said. I am incredibly grateful to you both for sparing so much time, for giving such great answers and helping us with our inquiry.