



Economic Affairs Committee

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

Tuesday 16 May 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 Kramer; Baroness Liddell of Coatdyke; Lord Londesborough; Baroness Noakes; Lord Verjee.

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Heard in Public

Questions 97 - 119

Witnesses

I: Professor Christina Skinner, Professor of Legal Studies and Business Ethics, University of Pennsylvania, Former Legal Counsel, Bank of England; Professor Tim Congdon, Chair, Institute of International Monetary Research, University of Buckingham.

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Examination of Witnesses

Professor Christina Skinner and Professor Tim Congdon.

Q97 **The Chair:** Good afternoon and welcome to our weekly meeting of the Economic Affairs Committee. I am delighted to welcome Professor Christina Skinner and Professor Tim Congdon to our hearing today on the operational independence of the Bank of England. Before I ask the first question, maybe you could both briefly introduce yourselves.

Professor Christina Skinner: Thank you for having me here. I am an assistant professor of legal studies and business ethics at the Wharton School of the University of Pennsylvania, and formerly of the legal directorate in the Bank of England.

Professor Tim Congdon: I am chair of the Institute of International Monetary Research at the University of Buckingham.

Q98 **The Chair:** Thank you. I will start with a big overview question for both of you to set the scene. We are looking at the operational independence and the performance of the Bank over the last 25 years. If you had a layman sitting beside you, what would you say to him or her regarding the great benefits and/or weaknesses of operational independence over that period?

Professor Christina Skinner: Thank you again. It is a pleasure to be here. To start, as you say, at the highest possible level of your inquiry, central bank independence is of critical importance to the smooth functioning of the economy. As you have no doubt heard, central bank independence was originally established in the UK and elsewhere as a view toward policy optimality. Today, however, central bank independence is increasingly important to the maintenance of a democratic order within the rule of law, essentially ensuring that unelected, although certainly expert enough, central bankers and their instruments do not become tools for the executive branch to bypass legislatures in accomplishing various social or economic policy goals. This applies to the US as much as the UK.

With respect to the Bank of England in particular, it is certainly viewed as an independent central bank and one of the most revered. There is no doubt that, within its walls, central bank independence is taken very seriously. In terms of the concrete benefits of central bank independence, for the most part between 1998 and 2020 we have seen that the Bank's independence seems to have delivered on that promise of policy optimality. The MPC has used its monetary policy tools quite adroitly to keep the UK economy at or close to its 2% inflation target.

There are some weaknesses, however, as I am sure we will unpack throughout this afternoon, which have revealed themselves in the past three years. Specifically, when you look under the hood, the Bank's independence is rather qualified. The Treasury can shape how the Bank carries out its functions or exercises its powers in four different ways: first, in defining the secondary objective through the annual remit letters,

for both monetary policy and financial stability policy; secondly, in setting the terms of indemnity, which have been issued at least twice since 2008; thirdly, in exercising a large degree of oversight and control over the Bank's management of crises, either while providing emergency liquidity assistance or in exercising stabilisation powers; fourthly, doing all of the above with the spectre of the powers of direction operating in the background.

Although the US Treasury has to sign off on the use of emergency liquidity facilities under Section 13(3) of the Federal Reserve Act, none of these other qualifications to the Fed's independence exists within the US legal framework. Furthermore, these mechanisms of Treasury power have tested the Bank's independence in the past three years, specifically by the expansion of Covid-era quantitative easing, political interest in mitigating climate change, and now the exploration of a central bank digital currency.

To sum up, the main benefit of statutory independence is that it gives the Bank a very public buffer to resist what would otherwise be quite considerable control over its functions and objectives by the Treasury, which are exercisable through these various channels. The flipside of this is that the Bank is invariably operating in the shadow of the Treasury's statutory levers of control.

The Chair: Excellent. We will pick up on a number of the topics you raise, so that is very helpful.

Professor Tim Congdon: Britain had a history of macroeconomic instability for much of the post-war period, with the stop-go cycles of the 1950s and 1960s, and then the boom-bust cycles of the 1970s and 1980s. The great achievement of the Bank of England since independence in 1997 is that, for most of that period, inflation was much lower than before. I would need to check the numbers, but in the 20 years up to 2020 inflation averaged exactly 2%, and the economy was also more stable, with a couple of problems that we will come on to in a second.

There are two main blots on the escutcheon in this 25-year period. There was, first, the great recession of 2007 to 2009, and, secondly, the post-Covid inflation, which is more immediately relevant this afternoon. Those two central episodes need to be considered critically.

In my view, the necessary and sufficient condition for low and stable inflation and a stable economy is in fact low and stable growth of the quantity of money. Central bank independence is not necessary or sufficient for that. You can have a central bank that has bad economists following false theories. Then, of course, you get into a much larger discussion.

Finally, the Bank of England, on average in the last 25 years, has done a good job, with those two exceptions, but has it done any better than the "Ken and Eddie show" between 1992 and 1997? I would say not really. On that basis, did we really need all this fuss and bother about

independence? At the end of the day, many of these things come back to politics. In that sense, the announcement of inflation targets at the end of 1992 was at least as fundamental a change as giving the Bank of England independence in 1997.

The Chair: Can I pick you up on one point, Professor Congdon? It has been put to us that you can credit the performance of the Bank, at least in part, in keeping inflation under control to globalisation. How do you view that debate? How important is the role of globalisation in the late 1990s and noughties?

Professor Tim Congdon: I can be very outspoken at times. The globalisation idea is completely wrong. The ratio of trade to world output was rising very sharply through the 1950s, 1960s, 1970s and 1980s, particularly in the 1970s when we had the bad inflation.

Then there is the China effect. Imports from China are about 3.5% of GDP. How on earth can that explain inflation of 100%? No, the explanation for lower inflation is that the growth of money came down to a much lower rate. At least in the early period of the first decade or so of independence, you also had a stronger-growing economy. That is the way you explain low inflation; it is not globalisation.

Q99 **Lord Griffiths of Fforestfach:** One thing we have heard from previous witnesses is the use of the expression "groupthink" or "group thinking". So that we are all speaking from the same page, how would you define "groupthink" or "group thinking" as a subject?

Professor Tim Congdon: I will try to summarise this. The key issue here, in a way, is: how was it that all the people on the MPC—with the exception of Andy Haldane, by the way—were so wrong in late 2020 and 2021? That seems to be the guts of it. Lord Griffiths and I are both economists. If you will forgive me, Chair—Brian and I are both economists—it comes back to economics. Our subject is beset by Samuelson and this idea that national income is a multiple of autonomous spending and that inflation depends on aggregate demand against supply, with this kicking out of the quantity theory of money and so on. You and I agree about this on the whole, Brian.

In fact, there is a divergence in macroeconomics between those who want to interpret inflation entirely by looking at the labour market and to explain what happens to national income and national output by the income expenditure model, which goes back to Keynes, and those like me who would defend the quantity theory of money. In terms of understanding the latest episode, the quantity theory of money has been very fully vindicated.

Finally, these things are very complex, I am afraid. The central banking world in the last 20 to 25 years has been very much beguiled by this three-equation new Keynesianism. We are lucky to have you and Lord King on the panel. In my view, that is a catastrophic set of ideas in which, again, what happens to the quantity of money and the banking

system is not relevant to the business cycle. The basic problem of groupthink on the MPC—the Fed has the same problem—is that it is full of Samuelsonians. The dominant textbook is to blame for what is going on.

Lord Griffiths of Fforestfach: So the groupthink is really that they all ignore the quantity of money in any explanation of monetary behaviour, the behaviour of the economy or inflation.

Professor Tim Congdon: Yes, exactly.

The Chair: Professor Skinner, just out of interest, do you agree with that?

Professor Christina Skinner: I would just add that groupthink is often defined and discussed in terms of the economic perspective and the consequences of relying on a single dominant model for forming views on inflation forecasts and so forth. I agree with that, but it is also important to think about groupthink in the slightly broader sense of how it can contribute to inertia and, in the political economy sense of the word, how it can form a consensus view about how the central bank is used in society and its relationship with political actors. I would agree with the framing of the term, and I would suggest that it has this inertial and political dimension as well.

Q100 **Lord Griffiths of Fforestfach:** That is very helpful. Professor Congdon, you submitted very interesting evidence to us and you put forward four basic recommendations as to what should be done. One is that the reference to money should always be in the open letter between the governor and the Chancellor. There are three others. First, the governor should automatically resign when things go belly up. Secondly, individual members of the Monetary Policy Committee should make individual submissions.

Professor Tim Congdon: That is if they disagree with the report as a whole.

Lord Griffiths of Fforestfach: Thirdly, appointments should be taken away from the Treasury.

In connection with those, if the governor automatically had to resign when things were clearly going in the wrong direction, do you think that would lead to politicisation?

Secondly, if people are going to make individual submissions, what resources do they need to be able to do that? After all, you have a real infrastructure in doing it.

Thirdly, you suggest that the making of appointments should be taken away from the Treasury and transferred to a newly appointed committee. Who sets that committee up? To what extent should Parliament have a key role in that committee rather than government officials or, indeed, the Chancellor?

Professor Tim Congdon: On the question of submissions, I was on the Treasury panel in the 1990s and we received a payment for our time at the Treasury, but it was miniscule. It was really an honorary job. We were all supposed to produce submissions justifying the forecasts we made and the points of view we expressed, and the members of the Treasury panel did so. One would hope that people on the Monetary Policy Committee, who are quite well paid, would have the resources and ability to put together submissions by themselves. In fact, at the moment, I think they have an economist allocated to them if they are external members. That should be sufficient.

On the question of the governor being obliged to resign because things went badly wrong, of course it would be open to the Government to refuse a resignation. My view is that there has to be some mechanism in there whereby individuals are accountable. Maybe I have gone too far; maybe it is too aggressive a prescription. I concede that. Something is needed.

Lord Griffiths of Fforestfach: The third point was about this newly appointed committee and who would set it up.

Professor Tim Congdon: There is a problem of infinite regress if you have committees appointing committees appointing committees. The real problem here is that the Treasury is too powerful. The Treasury, in effect, dominates and controls the appointments process. I think the deputy governors at present have all worked in the Treasury. I have to tell you that I do not personally regard them as very good economists. I will be open about it. Some of them are fine as people, but they are not very good economists. They do not have long lists of publications.

In my view, there is a bit of a racket going on. Essentially, friends are appointing each other. That is not right. The average quality of the members—again, I can say these things—is lower than it was in the first decade of the MPC, and the quality of the decisions has gone down too. Something is the matter. Whether or not there should be another committee, it is a proposal, anyway.

Q101 **The Chair:** Can I come back on one point about modelling and groupthink? We have been hearing a lot about how one aspect of groupthink is the use of models in the central bank community and fraternity. One of our number, Lord King, has spoken very eloquently and with great erudition on this. I was just wondering if you could give us some insight as to how much of a problem you see the growth of these models as being. What are they doing and are they distorting decision-making in some shape or form?

Professor Christina Skinner: In some ways, this question is related to the prior discussion about individual submissions. Overreliance on one form of modelling is or could be a problem, but the issue is that we would need more information about what individual members are doing in the formulation of their monetary policy projections, which you really cannot have unless you have individual submissions.

If I was looking to make concrete recommendations to you, I would do so based on looking at what the Federal Reserve does. The members of the FOMC engage in their summary of economic projections, which are individual submissions based on what they view to be the course of inflation and employment and, therefore, what they think the stance and trajectory of monetary policy could be. You could go even further and require individual submissions that explain which models and which staff members were relied upon, as well as doing some kind of modelling stress testing or scenario-based analysis, in which members had to say which risks they took in view and how they weighted those risks.

The short answer to your question is that, yes, it is a problem, but it can be mitigated only if we have more information about what individual members are taking into account when they formulate their views.

Professor Tim Congdon: Again, this question is quite technical because you are asking about models, and models are technical. The standard forecasting model used everywhere nowadays is based upon the Keynesian income expenditure model, and the aim is to determine, usually in a one-year period—possibly a two-year period, but it is the first year that is the focus of a discussion—what is happening to output and employment. This all goes back to books 2 to 4 of Keynes's general theory when it was about determining output and employment. This then comes through Samuelson to university instruction and so on.

What that does not do is determine the price level and inflation over a three, four or five-year period. If you get a big fluctuation in money growth, it will affect the economy over the next three, four or five years, and inflation may take three or four years to come through. In this episode, it did not take as long as that. In the 1980s, it did take four years to come through.

Essentially, it does not matter if you add hundreds of equations and you have a very powerful computer. The models used are of the kind I have described. They are not intended to give you a very clear link between money and inflation. They specifically do not do that. I am sure Lord King will confirm what I have just said. Again, what is going on in economics is ultimately to blame here. The debate between the monetarists and the Keynesians just rolls on and on.

In the first big boom-bust cycle, with the boom from 1971 to 1973 and the bust in 1974 and 1975, the Treasury model was hopeless. I remember going as a journalist to the Treasury and asking questions about why there was no money in the model, and this was back when I was in my 20s. I got no answer at all from the people there. We had a big increase in money growth in 1985 and 1986. I said there would be double-digit inflation. It took four years, but there was. None of these things were forecast at the time by the so-called forecasting consensus. They were just useless.

Q102 Lord King of Lothbury: Can I go back to this question of appointments? In the US, the nomination of a candidate comes out of the White House,

but then there is a congressional process that can be used to challenge that nomination, which sometimes leads to the withdrawal of a candidate and someone else being nominated. Here, we do not really know what the recommendations of an interviewing panel of candidates are to the Chancellor. A name is then appointed.

I am struck by the fact that, for judicial appointments, although, as Professor Congdon says, there is always this infinite regress, if you have people whose personal reputations depend on appointing people whom the community—the legal community, in this case—respect, they do not want to be seen to be making bad appointments. Could you not, therefore, try to mimic that by having a committee of people whose reputations would be tarnished by appointing people who perhaps were not so suitable, certainly relative to others who had applied, and try to get around this infinite regress that way? At present, it just emerges from the Treasury.

I would be interested in comments from both of you. Professor Congdon, perhaps you could comment first about your proposal, and then Professor Skinner about how you would compare the process here with that in the US and what you see as the relative strengths and weaknesses. This is an area where we might have the opportunity to make some useful recommendations.

Professor Tim Congdon: One of the problems here is the constituency from which members are chosen and to what extent the banking industry should be involved. In the States, about half of the governors on the board come from the regional feds, and the regional feds effectively appoint them.

Lord King of Lothbury: The governors are all the central ones. It is the members of the FOMC who are appointed in that way.

Professor Tim Congdon: It is a much more diverse process than happens in the UK. I do not know, but I imagine that, for the regional governors, in practice it is very much the bankers in the particular fed region. Again, I do not know.

There is then this question of whether the banking industry is going to be overrepresented, because in most countries it is really the bankers who come through, not the economists. I am not against the bankers, but what happens here is that it is basically economists appointed by the Treasury.

As for how the constituency decides, how that is organised, and this problem of infinite regress, I do not have a snap answer, I am afraid.

Professor Christina Skinner: Maybe I will start by first giving you a little bit of comparison with the US, as you asked, explaining how the regional reserve bank presidents are appointed as compared to the members of the board of governors, and how those two things combined compare to how appointments are done here.

In the US, the presidents of the regional reserve banks are appointed by their board of directors. Each regional reserve bank has its own board of directors. Of the members of that board, three are chosen by the Fed's board of governors, and six are chosen by the relevant member banks. Thus, the majority of the board members are selected by the private banks, and the board in turn chooses the president.

Sometimes, presidents of the regional feds go on to be appointed to the board of governors, but in other cases a chief economist or some other highly ranked executive at a regional reserve bank goes on to be on the board of governors. The point is well taken that we have this regional and structural diversity in the Federal Reserve system. Some of that finds its way through the appointments process. The board of governors, as the original legislation in the 1913 Act put it, is a political board. As Lord King pointed out, the President makes the initial nomination of a member of the board of governors, and that nomination has to be confirmed by the Senate.

On paper, the two appointment processes in the U.S. and U.K. may seem a bit similar in that the first mover is the Executive, but the system in the US works much better for having more consensus, with a broader range of views across the legislature and the Executive communicating about these appointments. That is because, at working level, the way these appointments go in practice, based on my own experience, is that the Senate Banking Committee—in some cases it is the House Financial Services Committee, but it is mostly the Senate Banking Committee—will have a lot of back channel conversations with the White House.

The group of economic advisers in the White House de facto has the responsibility for choosing the appointment. That is to say that, if there is a group of people under consideration for a potential appointment to the board of governors, it is unlikely that the President will actually make that nomination unless various members of the Senate Banking Committee, who have an interest in the Fed, have already said, "We think that this person works. We're going to publicly show our support for this candidate in the Senate". Therefore, the process is much more likely to result in a confirmation.

Here, my sense is very much that the appointments just sort of emerge—a phrase that was used—from the Treasury. The process seems much more opaque, so I would agree with the sentiment that has been expressed that it would be a productive area of focus to think about reshaping the appointments process.

Q103 Lord Blackwell: I have a follow-up question for Tim. We are not here to judge the economic policies of the Bank, but you have made a strong case that the absence of thinking about money supply in the Bank and the groupthink has ignored the causal impact of money supply on inflation. If you created a counterfactual for the last few years where the Bank had not expanded the money supply but we had had external supply shocks of the sort we have had in food and oil prices, is your argument that that would have prevented inflation occurring in the UK, or

simply that it would have been shorter and more transitory? I just want to understand.

Professor Tim Congdon: In a sense, we always have data and evidence of the effects of money growth, because there are always bank deposits, they always have a rate of growth and there are always effects from that. In the decade to the end of 2019, the growth rate of broad money in the UK was 3.8% on average. There were some ups and downs, but it was a period when, on average, inflation was 2.0% exactly, and there was fairly steady economic growth. I do not have to defend, as it were, stable money growth.

Suppose I had been on the MPC in March, April or May of 2020—fortunately, I was not—and I saw my colleagues wanting to do these things. What would I have done? I am pretty sure that I would not have stopped the loans of the Government, because lives were at stake, so the Bank had to help the Government in these circumstances; there would have been a blip upwards in money growth.

None of these asset purchases was appropriate in those circumstances. The effect of Covid was going to damage the supply side of the economy and reduce the amount of output. Less output means more inflation of any rate of money growth. What they did then was completely wrong. Certainly, the second episode of QE announced in November 2020 was just crazy. It was stupid.

What would the counterfactual have been? The counterfactual would have been like Japan and Switzerland. Yes, they have been affected by these shocks too, but it is more like 4% or 5%. That is very high for Switzerland but it is nothing like our going not up into double digits and all the rest of it. I do not deny that, obviously, in the short run, there are impacts and effects from, for example, what happened in Ukraine and the effect on energy and food prices. What is striking about energy prices is that they have come down now in the world markets. They are lower than they were in February 2022 but still inflation is very high because, if you get rapid money growth, it is going to affect the whole price level and a lot of these discussions about the changes in relative prices.

In summary, the counterfactual is that there would have been less inflation and less macroinstability. There would have been some but it would not have been anything like as bad.

Q104 **Lord Verjee:** Going back to groupthink, there is one clear argument that you select from the great and the good. You take as little risk as possible and you select people with high reputational achievement. The problem with that is that you are then selecting from a cadre or class of people who are going to be thinking the same. There could be an argument that what we need in these committees is thought diversity. To get thought diversity, you need to start appointing different types of people; that is the only way you are going to get it. I would be interested in your views on that.

Professor Tim Congdon: This may seem rather unkind to people on the committee but some of them hide behind the committee view. If the committee as a whole is taking the view that it took in May 2021, which was completely and totally wrong, how do you then, as a member of the committee, defend it? You say, "It was the committee view". Both in America and here, people then say, "Look at the consensus of macro forecasts".

This is from my own experience. You say that the great and the good, the well-qualified and the well-known get appointed. I have to tell you that that is not the real world at all. I have very sharp exchanges sometimes with one or two people in this room, and they know it. Deep down, you believe in the same thing and the same end so you can quarrel—and you do. You do not hide behind the committee, partly because you believe what you are saying.

Professor Christina Skinner: This question of being able to hide behind the committee speaks to the potential requirement of having to publish individual statements. It speaks to the question of process and whether committees operate by voting or by consensus. That has some bearing on whether you can hide behind a committee view.

I would also emphasise that all the statutory committees have a real opportunity to be unique, in the fact that they have external members. The board of governors and the regional reserve banks do not have this aspect of having external members, which could be a real opportunity to introduce different viewpoints. With no real commentary on the current composition of the external members, I wonder whether that opportunity is being maximised. Of course, this goes back to the ultimate question of how appointments are done and where you are looking for talent.

Q105 **Lord Londesborough:** Can I ask you both about the expanded remits of the Bank of England and, indeed, central banks in general, especially the growing list of secondary objectives? That includes climate change, net zero and, in the FPC's case, increasing competition in the financial sector and supporting economic growth and international competitiveness. Do you believe that the Bank is now being asked to do too much and becoming distracted from its focus on primary objectives? Perhaps worse than distraction, is actual damage being done?

To quote one of our witnesses last week, Martin Wolf of the *FT*, are we on a slippery slope? Or do these expanding remits resemble the rambling roses, if I can borrow our Chair's metaphor from last week, that reflect the changing risks across today's economic landscape?

Professor Tim Congdon: In America, the Fed has a dual mandate, which is keeping inflation down: price stability and full employment. That raises some issues that are related to this. I am going to make a strong statement here: I am very much in favour of a central bank being given a price stability mandate and not a dual mandate. In a sense, you could say that both of those are primary objectives.

On the secondary objectives point, I have no special wisdom except what many people feel, which is that this is not what the central banks can do. At the most straightforward level, the central bank is not like a commercial bank. It cannot get involved in risk assessment. It cannot assess credit risk. That is not what it is supposed to do. If it has assets that are friendly to the climate change agenda, the risk is that it is going to get involved with commercial risk. It then gets mixed up with politics because some of these climate change projects take place in one region or constituency and not another. This is not the kind of thing that central banks should be doing.

Lord Londesborough: Professor Skinner, perhaps you could comment, particularly in relation to the US and the Fed, on how primary and secondary objectives are handled and balanced.

Professor Christina Skinner: Yes. I have quite a number of views here. This is something I have thought about quite a bit so I will give you a comparative perspective and then, at the end, perhaps circle back to this question of the dual mandate. Absolutely, there is a risk. We are giving central banks generally too much to do and there is a risk that giving them a climate change objective, in particular, can or will politicise central banks.

For most of their modern history, central banks have been understood to be stewards of economic and monetary stability, so asking central banks to take on climate change really has an aura of central planning in so far as it implies that central banks can or should be used by Governments to engage in some degree of economic engineering.

Why do I say that? For one, the Bank of England—and the Fed, for that matter—does not have the tools to directly impact climate change or biodiversity, which I understand is also being considered to be potentially within the remit of sustainability, broadly speaking, expansively defined. At best, the Bank can pressure supervised institutions, through its regulatory and supervisory tools, to lend to some sectors or companies and not others, or to make financing cheaper for some and not others.

The judgment of which sectors of the economy are able to attain attractive financing, or which should effectively starve for capital, should be reserved, in the first instance, to markets. Further constraints on private sector credit allocation should be imposed by elected legislatures, not central banks, because such judgments imply massive structural transformations of the economy and require trade-offs that are really difficult to make.

At present, these trade-offs include choices on energy security, which is going to require an embrace of fossil fuels to support the population's transition to net zero until that technology is feasible. Net-zero objectives are also going to involve trade-offs that, in essence, invariably put the central bank right in the middle of questions that are at the forefront of political debate.

I see the introduction of climate change as this one-way path to a much more politicised central bank. I agree with the framing of the problem in terms of a slippery slope. Where do you draw the line? There are many important economic issues that a society has to wrestle with. Once you start asking the central bank to take on one of them, how do you distinguish between others?

I will now give you a comparison with the Fed and why the Bank is in a more complicated position in this regard. The Federal Reserve has been much more reserved than the Bank of England in terms of what it is going to do and how it is going to use its tools regarding climate change. Initially, the Fed got a little bit of international criticism for this, but it has been able to successfully take cover behind the structure of its independence.

A few months ago, the Fed chair gave a well-received speech on climate change and, in particular, the Fed's independence. He underscored that the Fed is going to stick to its mandate. What he meant by that was that the Fed's mandate does not include addressing climate change with monetary policy tools. As he pointed out, climate change is not impacting price stability or unemployment right now, so that can be the end of the story for the Fed. For the Bank of England, it is much more complicated because it has this secondary objective to have regard to the Government's economic policy, which includes financing a transition to net zero.

Also, I would point out that the Bank is in a much more complicated position than the Fed because of its financial stability remit and the accompanying secondary objective. In the United States regulatory arrangement, the Fed is not the macroprudential authority; in fact, it does not even have an explicit financial stability mandate. Congress thought about giving the Fed a financial stability mandate in the 2010 Dodd-Frank Act but it decided not to because it was concerned that it would be too open-ended.

Even though the Fed is moving forward and studying climate change under the auspices of financial stability, broadly implied by its "lender of last resort" power and its role as a regulator and supervisor of large financial institutions, it does not have any obligation or authority to look at all manner of financial stability risks, including the way that climate change is being defined by some central banks right now.

Of course, the Bank has a secondary mandate to attend to the Government's economic goals. The Treasury has clearly used the opportunity of the annual remit letter to ask it to do so, making climate change a priority for the FPC and something that it has to consider. There is no similar mechanism for the US Treasury to compel the Fed to think about climate change as part of its remit. I cannot speak for the Fed, of course, but I am pretty sure that Fed leadership is very happy that it does not have to take in view what the Administration want it to do about climate change because this is a hotly debated and polarising question right now.

Q106 Lord King of Lothbury: Let us suppose that the central banks have taken your advice and not only pruned the rambling roses of the Chair's secondary objectives but sprayed them with weedkiller. We are right back to monetary stability, price stability and financial stability. You can think of three ways of trying to approach this. I want to get your reflections on the institutional arrangements.

First, you could give price stability to the central bank and financial stability to a separate body. Secondly—this is where we are now—you have both responsibilities in the same institution but with separate committees, the MPC and the FPC. Thirdly, you could say, "We can't easily distinguish price and monetary stability on the one hand from financial stability on the other. They are both affected by monetary policy", so you put them in one committee. You do not have to choose between those three but do you have any reflections on the arguments that would be relevant to thinking about the institutional design of achieving these core responsibilities?

Professor Christina Skinner: If anything, the past couple of years have shown us that it is very difficult neatly to separate financial stability policy and price stability or monetary policy. Often, especially in emergency situations, there are going to be policy interventions that implicate both objectives and functions; I am thinking of QE in particular. Of the menu of options that you laid out, the Fed's model—where there are not separate committees for considering financial stability and monetary policy but, rather, the board generally thinks about all these issues as it goes about setting policy—at least gives it the agility to consider the financial stability aspects of a monetary policy intervention and vice versa.

Professor Tim Congdon: In practice, the central bank has the balance sheet and the ability to lend but it has only so much capital. In terms of financial stability and price stability, you have to involve not just the central bank, possibly with two committees or two organisations, but also the finance ministry. Sometimes, there is also a separate deposit insurance agency. The relative roles of these different organisations are very difficult. In the past 25 years, there have been lots of quarrels between them in all the countries where there have been problems at various times.

My view is that it is best to have price stability and financial stability in one organisation; indeed, that is one of the messages of the great recession period. However, you also have to have very good links with the finance ministry. In my view, it is quite a good thing if the central bank has plenty of capital and the ability to go to the commercial banks and say, "We may have a problem. Can you help?" That then gives it some independence from the finance ministry—in our case, the Treasury. Having said that, in a really big crisis, the central bank usually has to go back to the finance ministry or the Treasury and say, "Can you give an indemnity?", and so on, so it is not just a matter of the financial regulator and price stability; it is also a matter of the finance ministry and its relationship with both organisations.

Lord King of Lothbury: If you became Chancellor next month, would you be tempted to change the existing architecture or to leave it as it stands and ensure that there was adequate communication between the current bodies that have been set up?

Professor Tim Congdon: I am very pleased that, as a result of the great recession, the regulatory authority for the banks went back to the Bank of England. That was a good thing to have happened. It should not have been split out in 1997. I would not want to make radical changes as of now.

Q107 **Lord Griffiths of Fforestfach:** Tim, you mentioned one thing that is interesting: the capital of the central bank. I suppose I have always assumed that, effectively, the central bank is part of the Government. It nominally has capital, unlike for example—I think this is true—some central banks. I think that the Swiss national bank has private shareholders so, from the point of view of the governor of the Swiss national bank, Thomas Jordan, what he does has a meaningful constituency. If that capital is being eroded because of certain policies, he is answerable in a way that the governor here is not. I wonder whether you could expand on your view on that.

Professor Tim Congdon: I would be interested to hear what Professor Skinner says here because, strictly speaking, the Federal Reserve is privately owned. The Federal Reserve is owned by its banks. In practice, of course, it is really a government organisation but it is in fact legally owned by its banks.

In my view, the question of the capital of the central bank is very important in terms of its ability to deal with a crisis. Obviously, in a crisis, the central bank will often have to lend to commercial banks, sometimes even outside the commercial banking system. Its ability to do so and take risks depends on the size of its capital.

There is another aspect to all this, which is that the central bank usually issues notes and makes a profit from the notes issued. Of course, that should go to the Government. It then has these banking-type operations. They could be in the private sector. Historically, in the UK, they were in the private sector. In some countries, they still are; the US is slightly odd and the Swiss may be an unusual case.

In my view, the kinds of operations carried out in 2007, 2008 and 2009 could have been carried out by a public-private partnership. Obviously, that would then lead to much larger issues. In practice, what goes on is not that different from that because, in crises in the US, the Federal Deposit Insurance Corporation is usually involved; the FDIC is financed by insurance premiums paid by the banks, which are in the private sector. The FDIC is in fact owned by the federal Government but the federal Government have never had to inject capital.

In this country, for example, during the secondary banking crisis of the 1970s, organised by the Bank of England, the losses would have fallen on

clearing banks and the Bank of England would have taken only 10%. The reason this is important is that you often hear this line of argument that, as Martin Wolf says, this industry takes the profits and big bonuses when things are good and then, when things are bad, it is government money at stake. That is why it is quite important to open up the possibility that banking operations, such as lender of last resort, could be a public-private partnership. It is less of a radical change than it seems because, in fact, that is sort of what happens in these crises.

Professor Christina Skinner: It would be useful for you to hear more about the ownership differences. Precisely as you say, the ownership structure is quite different because the Federal Reserve is owned by its member banks, which has implications for the nature of its independence fundamentally because the US central bank is not a state-owned bank. It was never nationalised in the way the Bank of England was. The Federal Reserve has its own capital and therefore does not need to go to the Treasury for things such as indemnities. Therefore, you do not see the kinds of statutory powers of direction that the US Treasury has over the Fed.

Operationally, though, the member banks do not really have any influence over the way in which the Fed conducts monetary policy. It really has to do with these questions of purse strings. With that being said, there is not much you can do by way of the ownership structure of the Bank of England. You are not likely to un-nationalise or privatise it. However, it perhaps recommends paying attention to some of the recommendations that Professor Congdon has just made.

- Q108 **Lord Blackwell:** We have talked about the dual mandate but, as Professor Congdon indicated, there is actually a tri-mandate for the Bank of England because it also has microregulation as well as price stability and financial stability. Professor Congdon, you said that you thought it was right that the PRA had come back into the Bank of England but it is possible to see potential conflicts between micro and macro policy. In a recession, the Bank of England might want to expand monetary policy and the PRA might want to tighten bank capital for risk reasons. Is it sensible that these are in the same organisation, with these conflicts handled, or would it be better if they were separate?

Professor Tim Congdon: There is the micro-macro question and there is the question of these conflicts between different types of policy. On the first, it is normally an individual bank that receives the loan from the central bank. The central bank, therefore, will want to know what the asset quality of that individual bank is, what its capital is, what its management is like and so on. That is why the job of regulation, in terms of specifying the rules and checking how they are enforced in an institution, should be in the central bank because the central bank needs to know what is going on in the individual commercial banks when it lends to them. That is why you should not have a separate regulator.

On this question of conflicts between capital requirements and monetary policy decisions, this is where it is absolutely fundamental that there

should be the same management at the end of the day. I want to just make a point here. We have at the moment this tremendous enthusiasm among people involved in this sort of activity and looking at what happens to the banking industry. They are saying, "We need more capital because the banks are going to be safer".

The first effect of putting up the capital requirement on banks is to cause the banks to shrink their risk assets relative to the rest of the business. Of course it is. The effect of that is going to be deflationary. When we come to adding another 1% to the top-up rules that are possible under the Basel rules, the first effect is to deflate the economy. The effect is the exact opposite of what you are supposed to be doing.

These decisions should be taken together in one organisation. They should not be split out. If you get the FPC saying one thing and the MPC saying something else, again, it has to be sorted out in one organisation.

Lord Blackwell: Professor Skinner, are there any lessons from the US on this?

Professor Christina Skinner: Broadly speaking, your questions are about conflicts between microprudential and macroprudential or between financial stability and monetary policy. On the micro-macro question, given the interconnectedness of the financial system, it is difficult to imagine a world in which these functions are separate. However, the tensions that have arisen in the past couple of months, particularly regarding the banking turmoil with Silicon Valley Bank, suggest that there needs to be a clearly established framework for toggling trade-offs between the mandates. There also has to be some thought given to which priority is going to come first.

For example, this has been a very live issue for the Fed in the past couple of months where inflation has demanded rate hikes. Pretty much everyone understood that those hikes were going to be destabilising somewhere, somehow, in the financial system. Regardless of that fact, the Fed increased interest rates twice in the face of financial instability, which suggests that it has a clear hierarchy of objectives even if this has not been crystallised into a framework.

Furthermore, I agree with the sentiment that what we have seen in the recent banking stresses is a failure on the microprudential supervisory front but this does not necessarily warrant the conclusion that more macroprudential constraints are required in the form of higher capital requirements nor that the two problems can be sufficiently distinguished.

Lord Blackwell: If I understand what both of you are saying, there are potential conflicts but it is better that those conflicts are resolved in one organisation than just being left to two separate organisations fighting each other.

Professor Tim Congdon: Yes.

Professor Christina Skinner: I agree with that.

Q109 **The Chair:** Professor Congdon, in terms of having one organisation and two committees, to pick up on Lord King's point, does that get a tick in your mind? Is that the right approach, with similar people sitting on both committees? It has been put to us that this may increase the chance of groupthink across the organisation if you get the same people going from one committee to another. I am just interested in your views on that.

Professor Tim Congdon: That is a very good question. I have to confess that I do not really have a snap answer. It seems to me that, at the end of the day, it is very important that the chap or lady at the top needs to knock heads together and somehow come to a compromise. If there really is a big dispute, that is the job of the governor.

Professor Christina Skinner: Again, the Fed presents a contrasting model because we do not have these separate statutory committees for macroprudential, microprudential and monetary policy. Everyone is just sitting on the board of governors. Of course, you then have the FOMC members, but those are the same people plus some reserve bank presidents also.

If the question is specifically about the recent banking turmoil and whether that is evidence of groupthink, I am not sure that it is evidence of groupthink per se. While it was certainly a failure of imagination not to see how quickly a run could take place with social media and a very large uninsured depositor base, and it was a complete miss on failing to set parameters around interest rate risk in the banking book, I am not sure that is a product of groupthink. Maybe it is a function of distraction or having too much to do, but I am not sure the committee structure is something that could be faulted in that particular case.

Professor Tim Congdon: It is very important to emphasise that it is not the job of the regulators or the central bank to stop a bank going bust. I do not know the details, but if a bank, as appears to be the case with SVB, essentially has a management that decides to put a lot of risk on the bond book ahead of a big interest rate rise, it will lose money and may go bust. It should go bust. The important thing is that the system as a whole soldiers on and is unaffected by that bust. It will not normally be the case that everybody is doing barmy things. Normally, some organisations will be doing sensible things, and that was true in this instance.

This may seem a little bit of a digression, but it is important. In most countries, banks have to buy fixed-interest securities for the treasury book or bond book. They have securities they can sell in a hurry. One of the problems with fixed-rate securities is that, when interest rates rise, there is going to be a capital loss. Normally, with interest rates wobbling around by 1% or 2% a year, it should not matter, but when you have just had a 400 or 500 basis point move in a year or 18 months, the losses, even for one-year or two-year paper, are quite large.

I suggest that all Governments should issue variable-yield bonds, which exist at the moment, where the yield on the bond changes as short-term

rates change and the capital value is then given. These are much more appropriate in the treasury book of banks than these fixed-rated bonds. In my view, the British Government should have some conventional, some indexed and some variable-rate bonds specifically for the banking industry. That would end this problem.

Q110 **Lord Blackwell:** Can I follow up with Professor Skinner on the role of the Financial Stability Oversight Council and whether you think that provides a good model?

Professor Christina Skinner: No, I do not think that it is a very good model at all for identifying or preventing financial stability risk—so you have some advantage over us in that regard. I will give you a couple of reasons why. First, the design of the FSOC’s statutory powers for identifying and then addressing systemic risks has really been flawed from the outset. Congress gave the FSOC, as its principal power, the ability to designate non-bank financial institutions as systemically important, and we call these institutions non-bank SIFIs for short.

That power has two significant, indeed fatal, flaws. The first is that it is a binary on-off switch. One day, an institution is going about its business as an insurance company or an asset manager, and then the next day it is subject to what would have most likely been bank-like regulation and supervisory models, which was completely inapposite to the business models of most of these institutions. Secondly, the power was not broad-based. It was intentionally designed to single out individual entities.

These two design features combined generated a tremendous amount of push-back from financial institutions and basically raised what became insurmountable challenges to the FSOC’s ability to prove in any non-arbitrary way that the material distress of any one of these institutions would be destabilising to the US financial system. For these two basic reasons, FSOC’s primary power, its power to designate these non-bank SIFIs, has basically been dead since 2018 and is not looking very likely to come back at any point.

Aside from that, the only other meaningful power that the FSOC has is to make recommendations to primary regulators about activities that it considers to be systemically risky, and then to urge or recommend that those primary regulators do something about it. This was more or less successful maybe once, in regard to money market fund reform that happened in the SEC. Ultimately, this model has not been tremendously popular, because it stands to politicise financial regulation and financial stability issues.

You see this happening in the US with climate change. The Biden Administration have made climate change a major priority. They have referred to their intent to make climate change subject to a whole-of-government approach. What we have seen is that Congress has not been acting quickly enough or comprehensively enough, so the Administration instead have chosen to use the FSOC, which is helmed by the Treasury

Secretary, to try to apply moral suasion to the various financial regulators to do something about climate change with their various regulatory and supervisory tools. However, this looks to inappropriately insert the Administration into financial regulation because, in our system, Congress has designed the financial regulators to be independent of government by making their agency heads very difficult to remove.

Lastly, it is worth pointing out that the FSOC has had a tremendous amount of criticism for the fact that its membership is incredibly expansive. This is almost the opposite of what we were talking about in terms of groupthink, but it has weakened the efficacy of the FSOC. There are 15 agencies or interests represented on the FSOC, and most of them do not have much experience with systemic risk, which has created an incredible cacophony at that agency. So, no, I do not think it has been a terribly successful model at all.

Lord Blackwell: That was a very clear answer. Thank you.

Q111 **Baroness Kramer:** Let me follow on from those last comments. We are probably going over old ground with my question. Having described a system that really does not work in identifying systemic risk, especially nascent systemic risk, do you have some comments on the structure that we have here in the UK with the Bank of England? We were told, after the last financial crisis, that we now have a regulatory framework that will be very sensitive to systemic risk and spot it early, and that we are not going to get caught short again. A lot of people have raised questions about that, but I would like to have your thoughts on that process.

Professor Christina Skinner: We have learned that, try as we might with improved regulatory frameworks, it is very difficult for all central banks to anticipate the sources of financial instability and what those shocks will be. The most productive use of regulatory resources is in focusing on making banks resilient to all manner of financial stability risk and not trying to carve out these bespoke regimes to anticipate X or Y financial stability risk. You see in some of the public speeches from Fed governors that the Fed is basically coming around to the view that the focus should be on resilience, full stop, and not necessarily resilience to X or Y risk.

There is also this question of whether more macroprudential tools are needed. I point out that the Fed has far fewer macroprudential tools than the FPC does. The Fed has never turned on the countercyclical capital buffer, although we do have it. Its view is that, in tailoring capital requirements to stress tests, it is accomplishing the same result. The Fed does not have the ability to increase requirements for mortgage down payments if it thinks the mortgage market is overheating, and my guess is that it does not want the power over LTV ratios.

It does not seem that our US financial stability has been worse for wear; I repeat my view that SVB was a product of micro and not macroprudential failure. To the extent that the FPC has been focused on thinking about structural vulnerabilities in the system in regard to, for

example, CCPs, stablecoins or liquidity and money market funds, that has been a productive and effective use of its time. Trying to go the climate change route and thinking about where specific risks are coming from is probably going to be less productive.

Baroness Kramer: Can I ask for your thoughts, Professor Congdon?

Professor Tim Congdon: One thing I would like to say on this whole subject is that it is a wonderful world in the sense that the banks never go bust. Then, of course, regulation and supervision have succeeded, have they not? No, not necessarily. If you have a competitive system, the banks are taking risks. When there is a bad downturn, there will be losses and some banks will go under, and that is a sign of health. There is competition. In the great recession, there were complaints that the losses in the British banking system were 3% to 4% of risk-weighted assets. In fact, the capital was more than that. While they were incurring these losses, they had operating profits.

I put it to you that the real problem would be if there were not losses in a bad crisis; there is something wrong there. To keep on topping up capital to stop a risk is not a good idea, because it will cause the banking system to shrink relative to the economy. The banks are going to be judging their capital against the risk and the assets, and the less capital they have, the smaller their risk assets are going to be and the less they can help the economy. Does that answer your question?

Baroness Kramer: To some degree it does. The reason why there is an attempt to get this degree of stability is to avoid the ongoing shocks and, therefore, the impact on ordinary people's lives. What other mechanisms would you look at to achieve that kind of insulation?

Professor Tim Congdon: The critical shock here is loss of money on deposit, and there are a number of structures in place to make sure that does not happen to people beyond a certain level, so it does not affect ordinary people. As long as that is the case, it seems to me that it is quite important that there should be lots of risk in the system. It should not bother people. It would be a very worrying sign if no banks ever went under.

This business over the last 15 or 20 years of adding on capital to what the banks must do has had a very detrimental effect on the valuation of the banking sector on all the main stock markets. In the old days, banks were valued at two times book or more, and now they are often valued at book or less. The ratio of lending to the private sector to output has gone down in many countries, certainly in Britain. I do not think that, at meetings like this, we should always advocate more and more capital to make banks ever safer.

Professor Christina Skinner: In answering your question, it is important to emphasise that the development of resolution frameworks since the global financial crisis has also been very effective in confining losses to an individual institution and preventing these spillovers into the

real economy. The Bank of England is an excellent resolution authority, and part of the reason there was not a scramble for the SVB's UK assets is that the UK entity had been ring-fenced. The fact that these resolution co-ordination policies exist, which are set up ex ante internationally as well, goes a long way toward fulfilling the financial stability remit, in the way that you are thinking of it, by preventing these spillovers into the real economy, which is very important.

Baroness Kramer: Are there any macroprudential tools that we do not have and should have and that would make a difference? You talked about Silicon Valley Bank basically being a failure of microprudential regulation. Do we have the right relationship between micro and macro?

Professor Christina Skinner: We do, yes. The banking turmoil with SVB, Signature Bank and First Republic was about microprudential failures and individual risk management failures at banks that, in turn, had macroprudential effects, which is why the US Government and the Fed used the systemic risk exception to set up facilities, to give them aid and to insure deposits.

I do not see a dearth of tools as the heart of the problem. I cannot think of anything we could add that could have prevented that, because the risk in that situation was really hidden in plain sight. We can look to much more low-hanging fruit in that situation.

Q112 **Lord Verjee:** I would like to get your views on whether there is sufficient international co-operation between central banks and regulatory bodies to pre-empt financial instability. Can you also comment on that in view of what has happened recently in Switzerland with Credit Suisse and the lessons we have learned from that?

Professor Tim Congdon: I am probably not your standard kind of guy. As I said, it is sometimes a good thing if banks go under, and it would be disturbing if they did not. It is a sign of competition and of organisations taking responsibility for their own decisions if, every now and again, something goes under. The key point is that the system is not affected. On the whole, in the crises, even back in the great recession, when there really were some problems, at the end of the day deposits were paid back, the system went on, the economy recovered and so on.

My view is that there is too much international regulation, and that the BIS in particular is too powerful. I know that a lot of American bankers would agree with me. It is quite important that there be responsibility at the national level, which means that you do not comply entirely with the BIS Basel III rules, and there should also be some responsibility in individual organisations, which means, from time to time, mistakes will be made and banks will go under. I am not advocating for it, of course, but it is not a good sign if the system is terribly safe and not taking any risks. As I say, since 2008, when Basel III has been in force, bank capitalisations have typically been at book or less rather than multiples of book, which had been the norm for decades before that, and ratios of bank lending to GDP have gone down everywhere.

Lord Verjee: You think that international co-operation is fine, but what happened in Switzerland showed that you have international co-operation and yet the Swiss National Bank just made its own decisions.

Professor Tim Congdon: The main problem with what the Swiss National Bank did was a very specific decision that the bondholders would be wiped out and the equity holders would be paid something. There have been lots of problems about that, but that is a very specific issue. I do not have anything in particular to say about international co-operation except that the Basel III rules have gone too far. I know that it may be unfashionable to say, but it is very much my view. When you stand back and look at the way that the stock market values the banks, what banks are doing in their societies and the ratios of lending to GDP, something has changed since 2008, when the Basel III rules came in.

Professor Christina Skinner: My impression is that international co-operation on supervisory matters and on resolution is working pretty well, to the extent that it can, and that there are lots of open and frequently used lines of communication between the PRA and the Fed in regard to supervision and resolution. At the end of the day, supervision has to happen on the national level, just like resolution does. I think it was Lord King who coined the phrase that banks are international in life and national in death. International co-ordination works as best it can, and ultimately, when there is a failure of supervision or resolution, that has to be reckoned with through the national authorities doing their own introspection.

Q113 **Lord Griffiths of Fforestfach:** May I just challenge you on that, Professor Skinner? The feeling I get—there is no hard evidence—is that international co-operation has not worked well. The whole idea of having the Basel BIS structure of co-operation was that there was a playbook. The essence of the playbook was that taxpayers should not be required to bail out banks, and that CoCo bonds in Switzerland had priority over equity.

In this time when four banks have gone bust, what was intended was not what has happened, and so you had an immediate response from people in regulation—or for us, giving evidence earlier, Paul Tucker—that this was not the expected outcome of the regulatory structure that had been designed. I was in Switzerland chairing a meeting two weeks ago with the governor of the central bank there. My impression is that what it has done is not what it was intended that it should do, and it is true of the US, in the way that the President bailed out the banks. Am I overly dotting “i”s and crossing “t”s?

Professor Christina Skinner: I will not comment specifically on the Swiss situation, other than to make the remark that applies both to the US and the Swiss, which is that, ultimately, you can set up co-operative arrangements in the central banking and regulatory space, but at the end of the day the political situation of any given economy is likely going to override whatever situation was designed.

That said, in the case of the United States, the fact of the matter is that one can have disagreements about bailing out uninsured depositors, although the way it was presented to the public was not necessarily as a bailout. Rather, on a more technical level, the FDIC would compensate the uninsured depositors. That additional funding was going to come from a special assessment on the banks themselves and not taxpayers. With regard to the bank term funding facility that the Fed created, that did not use or implicate taxpayer funds aside from a small credit loss provision that the treasury would provide.

Again, I am not sure that I see international ramifications from the way that the US designed the system, but I will set the Swiss situation to the side.

Q114 Lord King of Lothbury: Can we try to separate out the regulation of banks before they have died with the resolution frameworks that apply afterwards? The BIS has no legal authority to set standards. They have to be legislated domestically. After the BIS made its recommendations in 2011-12, there was a big debate within the EU on the extent to which the BIS recommendations would be adopted or not. The reason for that is that only domestic Governments can actually pass legislation that governs the banks, but since banks span many borders, unless you are prepared to force all banks to set up separately capitalised subsidiaries in different jurisdictions, you need some idea of how the regulations are going to apply to the institution as a whole. That is one area.

The second one, and this is where I want to ask you, Professor Skinner, about the US, but also perhaps Professor Congdon, is the extent to which politicians get involved when they are not supposed to. On paper, one thing that was constructed after the financial crisis was a process to agree a resolution process for international banks, which is most banks that really matter. This was something we had not had before, and it had caused enormous troubles after the failure of BCCI in 1991, because the bankruptcy law that applied and insolvency procedures for banks were different across jurisdictions. In the UK, assets were available to pay off creditors all over the world, while any assets in the US are reserved for creditors in the US. There is a straight conflict here.

The idea was to have a resolution process that could be applied everywhere and that different authorities agreed on. The trouble is that, when even quite small banks go under, you find that the politicians intervene and do not allow the resolution process to operate as it should. It was not intended that the uninsured depositors would be guaranteed. That was not part of the resolution process, but the politicians intervened to do that. You end up with this odd position in which the uninsured deposits of a failed bank are guaranteed, but the uninsured deposits of all other banks apparently are not until they, in turn, fail. There is confusion there.

In the Swiss case, it is going to be a matter of law that is decided. It looks as if the Swiss authorities had a legal loophole to change the order of priority of creditors, even though—and it is very interesting in this

body—the House of Lords insisted on inserting an amendment to the powers setting up a resolution authority in the UK to make it unlawful for the statutory resolution authority, the Bank of England, to change the order of priority of creditors, so the Bank cannot do that. What the UK authorities did in the case of SVB UK was to relax the ring-fencing requirements. That, too, was not part of the concept of a resolution authority.

My experience from before all this was put in place was that when a bank fails, politicians feel it absolutely impossible to stay out of the process of handling who gets the money and who does not. Can you think of a way of resolving this, given how it works in the US? Then maybe, Professor Congdon, you could comment on how, in the situation of a failed bank, which we hope is not too regular but has to happen if it makes big mistakes, it should work.

Professor Christina Skinner: You put it very well. We agree completely on the fact that these frameworks are inextricable from the political economy environment in which they are deployed. Just as you say, the US situation was the product of politics, horse-trading and calculations, which I can guess at but cannot begin to know. That seems unavoidable, and we should anticipate that it will happen when a bank fails.

How to stop it going forward is a really challenging question. We had to wrestle with this question in the monetary policy space, which is why we gave central banks independence in the first place, so that they could tie themselves to the mast and not be susceptible to the changing political winds. I am not sure how you accomplish that same thing in the regulatory or supervisory space, for that matter.

One interesting topic that we have not really touched on, but is beneath the surface of all these conversations, is that central banks have multiple functions, but they are not all captured under this umbrella of independence in the way that we are strictly speaking of. Independence really pertains to monetary policy, but in a world where central banks are also engaged in regulation and supervision, there is no real consensus that those actions fall under the heading of independence, so keeping politicians out of it is really hard. Some people would go so far as to say that regulation and supervision are always political. I would be interested to hear whether my colleague has any better ideas for keeping politicians out of resolution and regulation.

Professor Tim Congdon: I really do not. These are very difficult questions. We have covered quite a lot of ground this afternoon. We want to keep the Government out of these matters as much as possible. We want the bank to first deal with any losses by itself without having to get these politicians involved. This is partly a matter of the capital the central bank has and partly one of what the deposit insurance organisation has, if there is one. In the UK, of course, it is a little unclear what is going on. The commercial banks themselves may want to put some money in the pot, perhaps on the quiet, or tell the central bank that they are prepared to do so, as they have in previous crises.

I have raised the question of whether there could be a public/private partnership here, so that it is not government money at stake, as these loans to banks sometimes get into trouble. I do not have a magic solution, I am afraid. There are various things that can be thought of, but it is very clear that if a central bank has no capital, and if there is no deposit insurance corporation, when things go wrong in the banking system you will have to go to the finance ministry and politicians straightaway.

- Q115 **Baroness Kramer:** My question is on exactly the same territory; I would say that I will not ask it, but I just want to pursue this. The reality in the real world is that a resolution that allows for bank failure is very rarely going to be allowed to follow its due course. There might be limited circumstances in which the thought is that the knock-on impact is going to be de minimis on this particular occasion, which can happen. If, in the generality and in most circumstances, this is a myth and not a real course that is going to be followed, do we need to restructure and change our thinking, and look to redesign the frameworks? Is the consequence, for example, that you simply have to insure all deposits regardless in order to remove some element of political pressure? Are there changes in role or responsibility? Does there need to be different language or conversation? I am just concerned that we behave as though the world will work as we would like it to, and yet what we actually have to deal with is reality, which includes the reality of political pressure.

Professor Tim Congdon: I do not have much to add. If you had 100% deposit insurance, that really would be a moral hazard problem. Even large companies placing deposits with different banks would not take any interest in how careful the bank is in its operations. At least, at the moment, large depositors have to pay attention to bank solvency, and I know, from experience on City committees and things like that, that when there is a large sum of deposits it is split between a number of banks, precisely because of the risks. I am completely against 100% deposit insurance.

Professor Christina Skinner: For the record, I also would not support 100% deposit insurance. I think it exacerbates the problem, rather than making it better, by inserting the state into financial regulation far more than it should be. To go back to our prior conversation, it puts the onus on microprudential supervision. We have been very focused on macroprudential supervision, as we should be, but we need to go back to basic principles and think concretely about what can be done to make sure we do not get to the stage of having to resolve a bank, if we know that is potentially going to be a more politicised process than the microprudential supervision. There were a number of lessons learned from the SVB situation that the Fed will take heed of.

- Q116 **Lord Davies of Brixton:** We are exercised here about the accountability of a central bank. There is a conflict between accountability and independence. We are particularly interested in accountability to Parliament—Commons and Lords, because we are in a Lords committee here. Does the existing structure strike the right balance, and if not how

can it be improved? You touched on this in your evidence, but perhaps you will expand on the situation and how it works in the States by comparison.

Professor Tim Congdon: There are two kinds of accountability. There is accountability in monetary policy for macroeconomic mismanagement, if there is some, and let us hope it all works well. There is also an accountability, occasionally, for losses. These are quite different things. Accountability for losses brings us partly to this question, which we have discussed in the last half hour or so, of what happens when something goes wrong with the commercial banking system and how far the central bank should put itself on the hook for the losses. There is also something else we need to discuss this afternoon, which is the question of what happens if the asset purchase facility that the Bank of England has, because of its QE operations, has losses.

There are different dimensions of accountability. It is a huge question. I do not know whether I have answered it.

Lord Davies of Brixton: It is really about accountability to the public in the form of Parliament.

Professor Tim Congdon: It is fair to say that this committee has done a pretty good job in the last two or three years. The question of whether the Treasury Committee of the House of Commons has done a good job is much more moot, in the sense of what has happened in this crisis. There has to be some mechanism by which the Bank makes itself available to Parliament, politicians and so on. Basically, it is asked questions in committees.

The question of the financial losses is another difficult area, and in general, just to be clear, central banks make payments to Governments, not the other way around, but that is another question.

Professor Christina Skinner: It is helpful to bifurcate the question in terms of accountability toward legislators and then the way that central banks do things to hold themselves accountable to the public. On accountability to the legislature, you are doing a good job, so I will just have nice things to say about this committee, relative to what we see in the US. The work of your committee has been very public and thorough. The relevant committee in the US would be the Senate Banking Committee. It is very rare to see that committee have a multisession inquiry. It certainly has not done that in regard to QE or CBDC, even though people have urged it to. There are rarely lengthy congressional reports put out on these subjects that then enhance the public's ability to scrutinise and learn about the central bank's actions, which could be very productive.

There has also been critique of the depth of congressional oversight. It has been pointed out that often the questions being asked to the Fed chair at semi-annual monetary policy hearings, for example, are quite shallow. Alan Greenspan once made a comment along the lines of: "If

you could understand what I was saying, you did not understand me clearly". That was a joke, but intentionally so. The level of congressional scrutiny of the Fed's actions has really turned on the personalities in office. For a time, we had a ranking member of the Senate Banking Committee who was quite interested in the Fed, and so there was a higher level of scrutiny, but that waxes and wanes with the individual Congress members. That has not been terribly productive, in terms of the rigour of legislative oversight of the Fed.

Coming to this question of how the Fed holds itself accountable to the public, like other central banks around the world, it was a relatively opaque institution maybe 10 years ago. It has made efforts to become more transparent, such as having more FOMC meetings, publishing the minutes of the meetings and lightly edited transcripts, and issuing more reports—a supervision and regulation report and a financial stability report. However, the Bank of England has been doing all these things, in some cases for longer. The Bank of England was issuing a wider range of reports on its actions and decision-making before than the Fed was. In this particular respect, I am not sure that you have a great deal to learn from the US, although transparency is a perennial issue and it is always something to reflect upon, to the extent that you identify weaknesses.

Q117 Baroness Liddell of Coatdyke: The main purpose of what the committee is doing is looking at the structures. After 25 years, it is time to look at the structures around the independence of the Bank of England. This is quite a blunt question. Does separating responsibilities of fiscal and monetary policy really work in practice?

Professor Tim Congdon: The problem really arises when there are very large budget deficits and these have to be financed. If they are financed from the central bank, they can be very inflationary and extreme, because they sometimes add to what is called the monetary base, and then the banks expand their balance sheets by a multiple of that. This is not, by the way, a model of how the banks need to work that I like very much, but that is one view. The deficit can be financed from the commercial banking system and it creates money directly, or it can be financed by the sales of debt outside the banking system when there are no monetary effects.

These issues are very political, partly because, if there is financing from the central bank or commercial banks, it would be inflationary, and then there are the effects on bond yields, interest rates and financing at the long end rather than the short. The issues are indeed huge, and I am well known as an advocate of low budget deficits.

I would like to make one point, because it is such a huge subject. Today in Britain, as in most European countries, there is not much economic growth. I am afraid that is just the way that things are. Any kind of deficit at all will tend to raise the ratio of debt to GDP. In these circumstances, it is essential to maintain a very low budget deficit, a balanced budget or even a budget surplus.

Supply-side tax cuts, unfunded tax cuts, as we had last September, Keynesian fiscal boosts and so on are all just fantasies. It is very important that the central bank, in our case the Bank of England, and the Treasury understand that this is not a world where large budget deficits can last for any length of time.

Baroness Liddell of Coatdyke: Earlier on, while you were replying, you gave the impression that you thought the Treasury was too powerful. How do you balance that power relationship?

Professor Congdon: These are very large questions. After the Second World War the Bank of England was nationalised. Somewhere in legislation, it was said that the Treasury could overrule the Bank of England. Fiscal policy was supposed to be the way to run the economy. The experience of the last 70 years or so is that monetary policy is desperately important and that discretionary fiscal policy is a mistake, but these things are much debated by economists. Personally, I would like the Treasury to become simply a department to control public spending and be in charge of the public expenditure, and not to get mixed up with macroeconomic policy. That is a very strong view.

The finance ministry and the central bank must always be in touch about how the public debt is being managed, the monetary policy implications of that debt and so on. That is true even if the Government are running a very strong position in terms of the sustainability of the debt over time. It would always be the case that the central bank and the finance ministry must work together on the public debt: the composition, the maturity pattern, the monetary consequences and so on.

Professor Skinner: I am going to answer your question from the perspective of the Bank's independence. Advocates of central bank independence in theory should want the separation between monetary and fiscal policy to hold in practice, because, as we have been discussing, these fiscal policy decisions involve questions of resource allocation that should be left to democratically responsive institutions, the Government and legislature. Central banks really do not have the legitimacy to take them on.

In practice, this is incredibly hard in a world where QE and QT are part of the normal toolkit. In 2020, we have a QE programme that looks a lot like monetary finance. In 2022, we have QE that looks like it is giving an assist to the Government for their somewhat irresponsible fiscal programmes. In both those cases, we see a world in which QE is blurring the line between monetary and fiscal policy. At least in 2020, QE could be justified on grounds of emergency. The question is whether using it outside of an emergency suggests something different: that it is much closer to a political response to a need that has been articulated from the Treasury, again operating in the shadow of these powers of direction.

Concretely, to the questions you are asking about the committee structure and so forth, perhaps the best that can be done is to think about a formalised committee structure for dealing with balance sheet

operations and not just leaving it to an ad hoc decision-making process by the Bank's executive.

Even more specifically, we could think through how the Bank can move toward developing a framework, reviewable or renewable at five-year intervals, that sets the groundwork for QE. This recommendation again holds as much for the US as it does the UK. This would involve setting out, ex ante, the triggers for using quantitative easing for a financial stability intervention versus a monetary policy intervention, when those would be the same and how they would be different.

Of course, we cannot come up with an algorithm to decide when the central bank can use QE because every panic is different, but having some principles or ground rules around QE would go a long way in at least reassuring the public that the use of an asset purchase intervention is not a direct response to some kind of political need for fiscal intervention.

Q118 Baroness Noakes: Building on that very point, you said that QE has blurred the line between fiscal and monetary policy. To what extent has it harmed the independence of the Bank of England? Are there risks going forward if this issue is left unresolved? We have had a huge expansion of the balance sheet. Certainly in the UK that is indemnified by the Treasury, which has added another fogging of the situation. Have we done irreparable harm to the independence of the Bank of England by that?

Professor Skinner: No, we have not done irreparable or maybe even any real harm to the Bank's independence, but we are at a critical juncture where the Bank has an opportunity not only to clarify some ground rules but also to set some boundaries around QE, what it is and what it should be used for. I will point out two or three concrete suggestions in this respect.

First, bear in mind that the Bank's QE programme included a small portion of corporate bonds within the asset purchase facility. The Fed's large-scale asset purchases do not include any corporate bonds. That creates a little bit of space and a toehold for the Treasury to pressure the MPC, through the annual remit letters, to use the corporate bond-buying scheme for fiscal or political purchases. The closest the Bank came to that was in respect of sustainability and potentially trying to green the corporate bond aspect of the QE programme. That is something to be mindful of to explain which sectors of the economy assets are being purchased in, in what amounts and why.

Secondly, you mentioned the deed of indemnity. I do think it should be published. We know from the exchange of letters that Treasury was able to set the terms of risk control and to approve what assets were purchased. This goes back to the corporate bond component of the APF. That seemed to be the hook that extracted a promise from the Bank to co-ordinate the normalisation process with the Debt Management Office. The public really needs to be able to scrutinise those letters.

Thirdly, Professor Congdon has raised the point about what happens to the Bank's net income in regard to a QE programme. The fact that the Bank of England, like the Fed, is losing money does not necessarily dent its independence, but it does factor into this bigger picture about whether QE is worth it. We need to be able to explain to the public the costs and benefits taken in full view. Part of that includes an assessment of what happens to the Bank's net income.

Professor Congdon: This is rather a strong statement. Large central bank balance sheets are going to be more politically controversial than small ones. If you want to minimise the dangers of political involvement and interference, the central bank should have a small balance sheet as far as possible.

In terms of the assets the central bank has, if it has only government assets, that is relatively uncontroversial. If it has claims on the private sector, there is immediately a risk that you will be accused of favouritism to political causes or even corruption and these kinds of things. The assets should always, as far as possible, be claimed on the state and be very straightforward.

On this front, I would just say that QE could have been done in a totally different way. I wrote a pamphlet in late 2008 and early 2009 that advocated QE in those circumstances, but I said, "It should be done like this", instead of the Bank of England increasing money by going to the commercial banks and saying, "We'll add to your cash reserves; you create a deposit, then use it to buy gilts from insurance companies and pension funds, et cetera".

It was the increase in the quantity of money that mattered to the economy, in my view and certainly in the view of Lord King. That could have been done by the Government. The Government could have gone to the commercial banks and said, "Lend us £200 billion". That goes into a deposit in the Treasury, which is not included in the quantity of money in economic terms because government spending does not depend on it, whereas the private sector's behaviour does depend on the money balance it has. The Government then spend that £200 billion buying back its own debt. When they get the debt in, they tear it up. Then you do not have these government securities in the asset purchase scheme making profits and losses that are reported in the newspapers and discussed at parliamentary committees—you just have the positive effect on the quantity of money. The composition of the Government's debt has changed; the size of the central bank's balance sheet has not. I would have preferred that it was done like that.

You then get this question—Mervyn King was Governor of the Bank at the time—"What the hell is going on? Monetary policy is my job. It is not your job at the Treasury". The important thing is to reach a consensus among economists and between the Treasury and the Bank of England about how they want to run the economy. In my view, they should focus on the low and stable growth of the quantity of money. Within that framework, a lot of the answers come out relatively simply.

Baroness Noakes: Has the way QE has been operationalised impaired the independence of the Bank of England?

Professor Congdon: So far, it has not really. This should not be an issue at all, but there have been quite large losses on the bond portfolio. This will no doubt be asked at parliamentary committees—it will be in the newspapers and so on. It should not really be because it is not really a resource lost to the nation. There will be all sorts of awkward questions raised and so on. It will affect the status of the Bank of England. It could have been avoided.

The Chair: To pick up on Baroness Noakes' point, has there been sufficient scrutiny and accountability as regards QE? Was Parliament fully apprised of the decisions being taken when they were taken?

Professor Congdon: Those are very difficult questions. The decisions had to be made relatively quickly by a relatively small group of people because they are extremely market sensitive. The Bank of England has not explained itself very well, no. The explanation provided by the economics department is wretched. I could do a far better job myself. As for the accountability to Parliament, this is not really for me to answer. It is for your committees to decide.

The Chair: Professor Skinner, let us look back at the experience with QE over the last few years from a US perspective. Earlier, you said that Parliament does a better job than Congress. I am putting words into your mouth, but I think that was what you were saying. Is there anywhere else where there has been good parliamentary accountability and scrutiny of QE?

I am just trying to tease out whether we need to be looking at processes here. These are highly complex issues. For a legislature to be able to scrutinise and hold central bankers to account, as Professor Congdon said, often at very short notice on these highly complex things is quite a tall order. None the less, given the scale of the issues we are talking about, that is a question we should be asking ourselves. I am just interested in what your view on that is.

Professor Skinner: In the UK there has been quite a bit of parliamentary scrutiny of QE. The Bank has, at least relative to the Fed, made more of an effort to explain itself. There has also been research and publication by the IEO—Independent Evaluation Office. The Fed does not have anything precisely comparable to that.

My big-picture takeaway with QE is that it is really difficult because the way QE works, whether it works and whether the benefits outweigh the costs, is not really known by anyone yet. Even among professional economists, both within central banks and outside of central banks, these theories keep evolving. One thing that has been certain for quite some time now is that there is a sufficient level of questioning about whether QE is worth it, stated very simply. The direction of scrutiny at least

should be directed to that question. What are the costs and what are the benefits? We at least have to keep defining them.

Lord King of Lothbury: The initial impact of QE is an increase in the amount of money in the economy. If you insist on trying to explain QE without any reference at all to money, you are going to have trouble trying to explain it, are you not?

Professor Congdon: We do not disagree about this. In a way, the problem is that many economists in Britain find it difficult to explain anything without referring to money. To some extent this may be behind the complexity and the confusing nature of the Bank of England's account of QE which, in the general view, is not really very good.

I am sorry, George, but can I have your permission to change the subject? We have talked about America and Britain. There is also Europe, where the question of what has happened with all of the purchases of bonds by the ECB has a very important international dimension, in the sense that some nations' debt has been bought much more than others. By the way, the loans the ECB has given have been much more to the Italian and Spanish than to the German banking system. We are happily not involved with these issues. We have had some problems here with this episode, but we have been relatively okay.

Having said that—Lord King probably does not agree with me—it would have been much better done in 2009 and 2010 by the Government and not the Bank of England. Of course, there would have needed to be a discussion of the monetary policy consequences.

Baroness Noakes: My other question has been largely covered. There was a consensus between you that having one organisation to manage the different aspects of the Bank's remit, monetary policy, financial stability and macroprudential supervision, was a good thing. Do you have any comments on the way in which the committees manage those trade-offs or the way the Bank is structured to manage those trade-offs?

If we accept that it is a good thing to have it in one organisation, you then have to have good and effective ways of managing the trade-offs between the different tasks the Bank has been given. Do you have any comments on how well it is structured? That is one of the things we are focused on.

Professor Skinner: If you have a Bank of England model with separate statutory committees, and not the Fed model where everyone is on the board of governors, there is an opportunity for internal governance reform, for which you probably would not even need legislation, to better co-ordinate among those committees where certain shared policy interventions and objectives arise.

We have been talking about QE—that is the main one. My understanding of the Bank's governance is that these interactions are presently governed through some shared memberships, by the Governor in

particular, and a series of concordats between the various committees. If you read the concordats themselves, they are at quite a high level of abstraction.

Not to keep hammering home this point, but one wonders whether there needs to be some concrete framework that is publicly scrutinisable about what the trade-offs are specifically. We were talking earlier about SVB and the trade-offs between increasing interest rates and causing financial instability. How are central banks going to prioritise among those trade-offs and what will the co-ordinating mechanism be? That seems like something the Bank needs, if it is going to continue to have separate statutory committees in a world of QE and QT.

Professor Congdon: In 1997, the Bank of England got operational independence, and lost financial regulation and debt management. Since then, financial regulation has gone back to the Bank England, but there are these separate committees. I am not sure that I have any very strong view on the question of how they should relate to each other and so on, but I would say something about debt management.

The Debt Management Office is a Treasury agency. In my opinion, it really should be part of monetary policy. I would really like—in a sense it used to be like this, except the Bank did not have independence—the Bank to be in charge of monetary policy, financial regulation and banking regulation and debt management, but then the criticism from Terry Burns is that it would be overmighty.

The key issue is what makes sense in terms of putting all these decisions together in an organised policy. In my view, they should all come together. Of course, sometimes there are financial consequences that need to be checked with the finance ministry, with the Treasury. Okay, you have issues and problems, and it is for the people on the spot at the time to sort them out.

Q119 **The Chair:** There are two final questions from me. One is a specific one on CBDCs. If a CBDC were to be introduced, what impact would that have on the Bank's operational independence and all the topics we have been discussing this afternoon? A lot would depend on the design of the CBDC—we understand that—but we all know the general direction of travel and the general issues that central banks are facing.

Professor Skinner: I will assume for the purposes of this discussion that we are talking primarily about a retail CBDC and not a wholesale CBDC. The introduction of a retail CBDC would certainly diminish or call into question the Bank's independence. I more or less agree with the prior testimony you have heard in this inquiry that it would be best for everyone if the issue of CBDC were dropped.

As you correctly pointed out, many aspects are still hypothetical, but, if we take as a given the things that we more or less know about how a CBDC would be designed, I want to point a few things out about

independence, introducing more conflicts and the way it reforms the Bank's relationship to people, to ordinary households.

On the independence question, to my mind the issue arises from the fact the Bank has been clear, like the Fed, that it has no plans to retire cash any time soon. I suppose this makes sense from a public messaging perspective. They want to assure the public that there is not going to be a cliff-edge effect on their privacy. This means that, as a balance sheet matter, CBDC is likely to increase liabilities, unless you are going to shift around bank reserves and money market repos. I will put that to the side for a moment.

If it does increase liabilities on the balance sheet, the question is what the central bank is going to buy in terms of assets to match those liabilities. We invite the kinds of questions we have already been talking about. If the central bank is going to buy more gilts, does that create more opportunity for pressure to engage in monetary finance? If the central bank is going to buy corporate bonds, that invites the opportunity for pressure to engage in politically motivated credit allocations. That seems like a lose-lose on both fronts.

We also have to ask about the indemnity. Are the purchases going to be indemnified? Is the introduction of the CBDC going to create a new relationship between the Bank and the Treasury that we need to examine? Finally, who is going to set parameters around how much CBDC the bank would create? If we are looking at QE as a model, is the Bank going to have to go to Treasury every time it wants to increase the supply of CBDC? Is that very decision going to become politicised?

The second category of problems related to independence with CBDC is about the issue of conflicts among the mandates. It is unavoidable that CBDC is going to introduce more conflicts between monetary stability and financial stability. We know that the introduction of a CBDC is going to disintermediate the banking sector at least to some extent. The question is what the financial stability ramifications of that will be. Is credit going to become more expensive for households if private deposits diminish? That seems contrary to the remit letter, which requests that the FPC have regard to productive finance. There is also this question of what happens during a crisis. If there is a CBDC option, is that going to increase the flight to pound safety in the case of a digital pound, and so forth?

The most troubling aspect about CBDC in terms of the Bank's independence is that it creates this direct relationship between a central bank and people for the first time. That raises additional questions, which are already really tricky to sort out in regard to banks. Is the central bank obligated to engage in some emergency liquidity assistance to households? Is the central bank going to go further down the path of entertaining ideas around a people's QE that have been put on the table by various academics? That will really strain the independence of the central bank. For these reasons, I am not terribly in favour of a CBDC.

Professor Congdon: I have to confess I am not really sure what a central bank digital currency is. I am sorry if that confession of ignorance staggers you, but that is my situation. I have a strong suspicion that it is true of other people in the room this afternoon. It is clear this is not a new unit—there is not going to be Bitcoin against sterling; the unit remains the pound. It does not seem to me that there is any question of the Bank of England getting involved in having retail liabilities generally because it would need to have a huge increase in staff numbers to deal with issues such as money laundering, and this would become very political.

Yes, in some sense we could all join the settlement system, which is really what is going on here. Instead of the settlement system being a small number of banks that look after our payments and are very good at reducing the cost of carrying out transactions—that is really what the banks do—we all belong to a settlement system. Let us suppose that is what happens. Why is it that our deposits, our money, our wallets, whatever they are, are claims on the Bank of England?

I understand that some of the big tech companies do not like the payments they make to credit card companies. That is really what is going on and what is driving them. They would like to be able to trade in their own liabilities. In other words, you would have a claim on Apple, Amazon or something, which you would use to make a payment. The technology is there. What do they ultimately settle in? They ultimately settle in Bank of England cash, as happens with the banking system.

It does not seem to me that this would affect the independence of the Bank of England at all, but it certainly would affect the way monetary policy is conducted. As I say, I have a lot of difficulty conceptualising all this. There are huge changes going on in financial technology, and something of this sort may happen. We know that in places such as Kenya and Somalia a lot of payments are not made through banks; they are made through wallets on mobile phones and things like that. But I must confess that it is mind-blowing and mind-bending.

The Chair: I am very conscious that we are over time. Forgive me, colleagues. I want to just put one final question to you, Professor Congdon. I have a quote from Larry Summers. It brings us right back to where we began, which is groupthink and the experiences of the last few years. Larry Summers said this. “Most of those who have to deal with inflation”—that is, today—“are too young to remember when it was last a serious issue”.

Here is a hypothesis. Monetarism was a success and it controlled inflation. People in the central banking community said, “Inflation is dead. We can forget about money supply. We can focus on other things. We can put that to one side, along with the models and everything else”. There has become a global groupthink over the last 15 years or so, and people such as you have been excluded. Is that basically your hypothesis here? You have almost become victims of your own success in this.

Professor Congdon: I am biased. Plainly, I would say, and I do believe, that monetarism transformed macroeconomic policy in Britain. Indeed, we dropped fiscal policy and fine-tuning. That was dropped in 1976 for 30 years or so. We ended prices and incomes policy, which was the first reaction to inflation in the 1960s and 1970s. We had a consensus that the control of inflation was a matter of monetary policy, that it was a technical thing and that the job could be given to a committee of experts because there was no long-run trade-off.

We had a period of excellent macroeconomic outcomes. Part of the trouble is that these ideas certainly had political and even ideological content. They are more of the right than the left. Yes, there has been a kind of complacency or amnesia: "Let's forget about all that". That partly explains it.

The spring of 2020 was absolutely extraordinary for me. I look at these figures week by week and month by month. Very few people in the world still do, but some do. You saw what was going on, and you just thought, "What are these people doing?" In fact, the consensus of economists at the time was very much that there were years of disinflation in prospect. To me it was obvious there was going to be an inflationary outcome.

The Chair: With that, thank you very much to both of you. This was a very insightful session. Thank you for all your great answers.