HOUSE OF LORDS

Select Committee on Economic Affairs

Corrected oral evidence: Quantitative Easing

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Members present: Lord Livingston of Parkhead (The Chair); Lord Bridges of Headley; Viscount Chandos; Lord Fox; Lord Haskel; Baroness Kingsmill; Baroness Kramer; Lord Monks; Lord Skidelsky; Lord Stern of Brentford.

Evidence Session No. 2 Virtual Proceeding Questions 12 - 21

Witness

I: Sir Paul Tucker, Research Fellow at Harvard Kennedy School and former Deputy Governor of the Bank of England.

Examination of witness

Sir Paul Tucker.

Q12 **The Chair:** Apologies, Sir Paul, we are a few minutes late, but thank you very much for joining us. I believe that you want to say a few words about QE, what it was and what it was not, as an introduction.

Sir Paul Tucker: Thank you very much and thank you for inviting me to give evidence to your committee.

I think it came up in the previous session: what is QE? I am going to define quantitative easing as central banks buying government bonds with the purpose of stimulating aggregate spending in the economy. So it is a macroeconomic stabilisation tool.

I want to underline the point about the purpose, and I will give you four other reasons—there are more than four—why a central bank might buy government bonds, which I think have been apt over the last 12 months or so on both sides of the Atlantic.

The first is that you might buy government bonds to underpin and repair fracturing liquidity in the government bond market. That is generally called market-maker of last resort. You typically do not need to buy lots of bonds to do that; it is tremendously important. A senior staffer at the Bank of England, Andrew Hauser, has recently given an important speech on that; possibly one of the most important Bank of England speeches in recent years. That is the first.

The second alternative reason for buying government bonds is that you want to push up asset prices or hold up asset prices so as to forestall the failure of illiquid or overleveraged financial funds or vehicles. I would say, confining myself to the other side of the Atlantic, that there is a widely held view that that was one purpose of the Federal Reserve's actions last March, and I think that you can see more than traces of that in speeches by Bank of England policymakers such as Alex Brazier.

A third purpose would be that you want to hold down government borrowing costs, for whatever reason—to support fiscal policy, for example. You might need to carry on doing that for a while.

The fourth is that you might want to help get cash to government in an emergency.

This is rather sweeping, but I think that it is not implausible to suggest that last March, in the UK, all four of those purposes were in play in motivating the purchase of government bonds, but that it was not obviously quantitative easing, as I have defined it. This is not with hindsight—I was discussing the Federal Reserve's similar actions at the same time with a very well-known economist at Harvard when the Fed announced its "quantitative easing". We said to each other, "How can you be aiming to stimulate aggregate demand just as aggregate supply is closing down?"

The significance of these remarks will come later, but I think I would hold on to quantitative easing as buying government bonds in order to stimulate aggregate spending in the economy, and that it is important to distinguish that from the various other purposes that a central bank might have from time to time for buying government bonds.

The Chair: Sir Paul, thank you very much. For those of you who have seen your phone, a vote has just come, but we can multitask.

Q13 **Lord Stern of Brentford:** Thank you very much for coming, Paul, all the way across the Atlantic. I want to take you back to 2009 and ask about the alternative options that you saw at that time. Was the Bank of England looking at a range of things and picking QE or was there just one thing, or one class of things, that it could do?

Sir Paul Tucker: Thank you, Nick, and it is good to see you. The first thing is that the imperative in the early months of 2009 was somehow to forestall a repeat of the great depression. To that extent, what followed can be regarded as a painful success.

Secondly, the speed of action required was such that whatever one thinks about the relative merits of fiscal policy, on to which we will come later, there was not remotely time for fiscal policy. This was a moment for action by the central bank.

One other possibility was aired—I think it was aired by the then Prime Minister and some of his officials—which was that we concentrate on buying corporate bonds rather than government bonds. We did in fact act as market-maker of last resort in the sterling corporate bond market, with, I think, some success but without buying very many. The reason for that was that we thought that the simplest, easiest and quickest way to provide a good deal of stimulus was to enter the government bond market and purchase quite a lot as quickly as we could.

We were trying to do two things, and this sometimes gets lost. We were trying to push money into the economy, and I will come back to that in a moment. Secondly, we were trying to pull down not only government bond yields but corporate bond yields and the spread of corporate bond yields—corporate bond yields relative to government bonds—which worked.

The point about pushing money into the economy is important because we were in the midst of a banking crisis. Mervyn King, who at the time was governor, went on television and faced the question, which had blown up in the States: "You are printing all this money. Are you not going to ignite hyperinflation?" The answer was: "If you supply more money than the economy is demanding, then, yes, you will ignite inflation, but sometimes there is not enough money in the economy and then you risk having deflation".

The collapse in the banking system, where the banks were deleveraging, was essentially the destruction of money because most of the money that most of us use is money held with commercial banks. So we were trying to provide an increase in broad money in the economy.

I mention that—I think we will probably come back to it a couple of times—because one thing that I want to underline is that, certainly compared with 2009-10 and even with 2012, three things have been different over the past year or so compared with the beginning of 2009.

One, there was a banking crisis then, and there is not a banking crisis now. Secondly, long-term yields were still then quite high, whereas now they are incredibly low (for reasons that are not fully understood). Thirdly, we have discovered through the path of time that underlying productivity growth has been very low. So the environment in which the Bank of England and the Treasury are making macroeconomic choices is quite different from the situation that we faced in the months and years immediately after the 2008 crisis.

Lord Stern of Brentford: Thank you, Paul. You described the intentions clearly and your description embodied, I think, the belief that the action would pursue those intentions effectively. I think that there are grounds for saying, ex post, that that was right, but at that moment for something as new as that, or as unfamiliar as that, did you have a clear understanding of what the consequences would be, bearing in mind that life is always uncertain?

Sir Paul Tucker: It was very hard to calibrate—harder to calibrate then than subsequently. It is worth saying one thing, which I think mattered more for Mervyn and me than perhaps some of the others on the Monetary Policy Committee. He and I had been knocking around—me in the Bank of England, Mervyn outside—during the 1980s when there had been overfunding of the government deficit as an instrument of monetary policy. We regarded this as underfunding—we did not regard it as quite the radical step that many others understandably did. We were confident that it would get broad money into the hands of people who might be worrying about money, because that is what you do when you buy things from them. We were confident that we would be able to pull down long yields, and if you do not pull them down very much then you just buy some more.

In other words, we were confident that the supply effects in the market would be working over and above the signalling of the path of our policy rate.

Of course, it was tremendously difficult to be sure how much any quantum of QE would affect those things, but what we and the staff did—I cannot remember how much of this was published—is that as 2009 progressed and into 2010 we set up a framework where we would try to identify the negative interest rate that we would set, were we able to do so, and then try to figure out how much QE would bring down spreads and other things in a way that somehow proxied for not being able to set a negative interest rate.

Lord Stern of Brentford: Would it be fair to say that you were reasonably confident of the directional effects and were a bit "suck it and see" to find out just how much was involved and, if it was not enough, you would do some more?

Sir Paul Tucker: Yes, I think that is very fair, and the first point is a big point. I used to say to the staff, and actually sometimes to new members of the MPC, that the big game here is getting the sign right: when we are trying to restrain the economy, are we actually restraining it rather than stimulating it, and the other way round. So, having confidence qualitatively about the direction of our measures was tremendously important in the circumstances.

Q14 **Lord Skidelsky:** My question, Sir Paul, is: how should Parliament and the public expect the Bank to communicate its decision-making process for QE? That question is motivated by the description that you gave about the primary purpose of monetary policy, which is to stabilise aggregate demand and the various policies that flow from that, and you listed four of them.[1]

Most people believe that the Bank of England was granted operational independence to hit an inflation target—that was its primary mandate. They found it, I think, quite difficult to reconcile its mandate with what it actually does. Some people would say, "Well, these were emergency measures. There was a crisis, and something had to be done". But does the crisis not give an opportunity to rethink the mandate in order to be able to communicate more transparently what the central bank exists to do, because many of the other objectives that you listed are independent of trying to hit—

Sir Paul Tucker: Yes. That was my point, in a way; thank you very much. I will come back to those other things towards the end of this answer, if I may.

The reason for a central bank's trying to stimulate or restrain aggregate demand is to keep the path of aggregate demand more or less in line with the path of the productive capacity of the economy, so as to stabilise inflation and expectations of future inflation around the target that, in Britain, is rightly set by the Government and reported to Parliament.

On this, by the way—I wanted to say this at one point—I do think it is quite important, although it might seem a small thing, that the Bank of England goes back to calling its quarterly report the *Inflation Report* rather than the *Monetary Policy Report*. The *Monetary Policy Report* invites the question, "So what do we want to use monetary policy instruments to achieve this month, or this week?" It matters to your question about how it should be explained to the public. It should always

[1] On 8 February 2021, in case he had been misunderstood, the witness clarified that he was not saying those four reasons for buying bonds flow from the MPC mandate but, by contrast, they are central banking measures that are not part of MPC's mandate, although the associated money creation might sometimes need to be approved by MPC (when its marginal monetary instrument is quantity control).

be explained—monetary policy decisions and MPC decisions—through the difference that a policy action makes to the outlook for growth over the next year to 18 months to two years and, therefore, the outlook for inflation over two years and beyond. There are two parts to that—a quantitative part and a qualitative part. Both are very important.

The previous evidence session was noting—I think quite recently, sometime before Christmas—that the Bank of England had done another £150 billion of quantitative easing. I heard about that at the time and wondered how much that has affected its forecast, its projection for growth in two years' time and for inflation in three years' time.

The reason that this matters—it matters for the most elemental of reasons—right now is that if one were to think that a unit of quantitative easing, of, say, £10 billion, had quite small effects, and if one were also to think that it is highly uncertain what the effects of a unit of QE are, then you can justify just about any number whatsoever. That makes it more awkward when the number that you alight upon happens to coincide with the net debt issuance of the Government.

The best way of dispelling these things about, "Oh, they are just financing the Government's deficit", is, "Look here, our forecast without the extra QE would have been for growth to be whatever and inflation to be whatever in two to three years' time, but actually with this extra £150 billion we expect to add, subject to uncertainty, this much to growth and this much to inflation". That is the quantitative part, and it is tremendously important.

I was secretary to the MPC for its first five years before I became a member in 2002, so I attended every meeting more or less between 1997 and the end of 2013. Whenever policy changes were contemplated, especially during the forecast round but also outside it, the staff always presented them to the committee in terms of what difference it would make quantitatively to the outlook for growth and inflation in two to three years' time. Of course, those are judgments, partly, but they are numbers.

The second thing is, qualitatively, there are two ways in which quantitative easing can work. This [first] view is held by many in the United States, and I sometimes hear that it is held by some people on the Monetary Policy Committee, although I am in no position to judge whether that is true or not: you will see why I am saying that. One view is that QE works by signalling the central bank's intentions about the path of its main policy rate over the coming years. If that is how it works, I just cannot believe that you need to buy £150 billion. So if there is anybody at the MPC who thinks that QE works by signalling, they should have been voting against £150 billion and in favour of a much smaller number.

The other channel, the other possibility—and this has been touched on—is that quantitative easing works through so-called portfolio balance effects, and effectively by reducing term premiums and other risk premiums on bonds, which is essentially the compensation that you get for holding a long bond, with the uncertainty that that entails, rather than a short bond. There the issue is, so, yes, you can pull term premiums down if you buy enough, but do we have a coherent story of how compressing term premiums affects spending in the economy, affects business spending and affects consumption?

The point I am making, because I do not have answers to these questions, is that, in explaining quantitative decisions, they need to be explained to you, Parliament, representing the people, and to the public in quantitative and qualitative terms so that everybody can see that what is motivating the decisions, which may prove to be mistaken in various respects, are the things that are central to their mandate.

On this, I think that everybody is concerned by the recent report that for some reason research on quantitative easing seems to have tailed off or been shut down after 2013, because, if this is your main instrument, then, for the reasons Nick was getting at, in 2009 we could maybe judge the direction but not quantify it very well. Ten years on, you would expect there to be an avalanche of research on that, the central instrument of the MPC.

Lord Skidelsky: Do you think—this is about accountability—Keynesian policy was easier to explain to Parliament than monetary policy in the days when it was the reigning macropolicy?

Sir Paul Tucker: No, I think it was easier in some respects and harder in others. I do not think that monetary policy is terribly hard to explain, and I am not sure that I am terribly good at it but I watched two men, Mervyn King and Eddie George, who were absolutely magnificent at it and they had very different styles, which I think goes to show that you can do it in very different styles. On the other side of the Atlantic, Ben Bernanke was very good at it, Janet was very good at it, and, in his very different way, Greenspan was pretty good at it on the monetary policy side.

The Chair: Thank you. We are going to go slightly out of order now and ask Baroness Kingsmill to take the next question.

Q15 **Baroness Kingsmill:** I am fascinated by the discussion that we have been having, but one thing that I am quite interested in—and I raised it a bit in the previous session—is whether we have to live with QE for ever. Is it a fixture, or has it, as you have said in the past, Paul, run its course? What are the shortcomings; what are the negatives about it? You have told us quite a lot about how it is supposed to work, but what are the downsides, the shortcomings?

Sir Paul Tucker: The first thing to say is that, however much we attribute to QE and other measures in avoiding a repeat of the great depression—thank God—it did not work on either side of the Atlantic to get inflation back to target, notwithstanding the scale of QE, forward guidance and credit easing and various other things that were done.

I have come to the view that it would be better to rely on fiscal policy to provide stimulus with an independent central bank as a check on fiscal excess. In a way, I think policy is the wrong way round, or risks being the wrong way round over the coming years. The best way of thinking about this is that there is now widely discussed and documented uncertainty about how much more quantitative easing or monetary measures can do, whereas no one really doubts that fiscal policy could provide a spur to spending. What is more, fiscal policy can sometimes do something about underlying productivity growth—the dynamism in the economy, the infrastructure of the economy—in ways that really monetary policy cannot.

The history of fiscal policy, and Robert and others are more expert on this than I am, is that it sometimes went to excess and led to inflationary spirals and so on, but that was a world without independent central banks. The one thing that we can be sure that the central bank could do in macroeconomic policy, if needed, is raise interest rates so as to restrain an overheating economy.

I worry that we are in a position where we are depending on an instrument that might work but might not, and potentially, in some jurisdictions, with some fiscal retrenchment, whereas we might be better off the other way round.

We might come to this under another question, but central to that judgment is how very low long-term interest rates are. I am not sure I would be expressing that judgment if governments were not able prospectively to finance themselves at historically extraordinarily low rates of interest.

Baroness Kingsmill: We must not forget the political implications of fiscal policy versus monetary policy. An element of that has been evident over the last 10 years as well.

Sir Paul Tucker: I agree, and of course I have written a book about it in part. Something that has happened almost everywhere—this is by no means restricted to the UK—is that fiscal policymakers have worked out the strategic game involved in fiscal/monetary policy-making, and it is quite different from the literature of a quarter of a century ago. The politician realises that if she or he sits on their hands because of the political friction of having to get fiscal measures through Cabinet, through Parliament, through coalitions and donors and so on in other jurisdictions, then monetary policymakers will reinvent themselves as a provider of subsidised credit. I could go on, but I think that we have seen some of that: the central banks have been extraordinarily innovative over the past 10 years—not something one would necessarily associate with my tribe.

This is conditioned on: if you have a legal objective to pursue an inflation target and fiscal policy is not doing very much, then you had better have a deep think about what else you could do. You could put the Funding for Lending scheme (in my time, in 2012), which was adopted by the ECB and latterly by the Federal Reserve, absolutely in that bracket.

Baroness Kingsmill: Thank you. That is very interesting.

Q16 **Lord Monks:** I do not think that the previous witnesses thought that QE had undermined the Bank's independence, but it might have led to a perception in some quarters, perhaps even a misapprehension, that the Bank's independence was being undermined by QE. Some commentators occasionally seem to reflect that view. I am interested in your view about the perception. Has the Bank managed to maintain its sense of independence in the eyes, generally, of people, or is there a problem on perceptions?

Sir Paul Tucker: I think that your previous witnesses are probably better placed to advise you than I am about that. The conclusion that you reach is tremendously important. Independence relies to a significant extent on the credibility of independence—that all that is going on is the pursuit of the mandate conferred by Parliament and the Executive.

Previous witnesses mentioned the coincidence of the scale of QE with net issuance by the Government. If that was just a coincidence, it is perhaps slightly unfortunate in perception. If it was not coincidence—if it was a judgment about the best course of action—it would have been better to say so. I believe very strongly in central bank independence. The last people who should hold the monetary instrument are the Executive branch, because the monetary instrument is always latently a fiscal instrument, and therefore if the Executive branch—if the President of the United States—controlled the monetary lever, she or he would not have to go to Congress to get supply, and you can flip that into a UK context fairly easily.

It is no accident, I think, that the Bank of England was created in 1694, six years after the so-called Glorious Revolution that created—constitutionalised—the separation of powers in our country. These are big issues.

But neither do I think that central bank independence is sacrosanct. I think that it is better to suspend it openly than to qualify it in a behind-the-scenes way. That is fine if you get away with it, but if you qualify it in an opaque way and you get found out, the markets will not believe in independence for many years afterwards. I was the country's debt manager in the mid-1990s and it was a hell of a thing to persuade Scottish and English fund managers that Governments were serious about inflation because they had seen time and again that they were not. I think that the perception is serious.

I mention one small thing as well. Every last detail of this has passed most of us by but is picked up in the market. When they announced in March or April last year that they were making what is called the Ways and Means overdraft facility available to the Government—a perfectly fine thing to do, and I did that in 2008—they issued a press release and it did not say that it would need the permission of the Monetary Policy Committee, which it should have done, because that is money creation in circumstances where it was relying on quantity control rather than price control, and I thought that was interesting.

These tiny things, Lord Monks, chip away at the perception and they need to be dispelled over the coming months and years. As I think Chris Giles said, you can never tell. Lack of independence works two ways: the central bank doing something that it did not want to do, and you are never going to be able to really discover that; and the central bank doing something that the Treasury, the President or the Prime Minister do not like, and you will eventually discover if that is happening because your tribe would not keep that to themselves.

Q17 **Lord Bridges of Headley:** Thank you, Sir Paul, for coming to give evidence; it is very interesting indeed.

May I approach the question from Lord Monks in a slightly different way? It is a related point. How, therefore, does QE interact with the Government's management of their debt? Has it not really blurred the distinction between monetary and fiscal policy? I note, for example, that in November the governor said: "We do not ... set a level of quantitative easing and asset purchases in any way related to what the government is going to borrow". That gave rise to the piece that Chris Giles wrote showing that a number of investors believed that the Bank's quantitative easing programme is a "thinly veiled attempt to finance the government's deficit". What is your reaction to that, and specifically this point about the blurring of distinction between monetary and fiscal policy?

Sir Paul Tucker: This is a massive issue. It is a very important issue for every advanced economy today. It may be the most important issue that comes up in this evidence session.

For simplification, let us imagine that QE does not work at all for macroeconomic issues, which I do not quite believe, but imagine that; and, of course, the central bank pays interest on reserves. In those circumstances, quantitative easing is a debt swap; it is part of debt management that has flipped the Government's debt from being fixed interest—borrowing at 20 years for a yield that is fixed and you pay that yield over the life of the 20-year bond—to being a 20-year debt which is serviced at a floating interest rate, which varies each month (or six weeks, as perhaps it is now) with the Bank of England's policy rate.

One question to ask is whether that is good debt management strategy. I do not know the answer to that as I am busy writing a book about international system and order, not thinking about these things, but it is a quite different set of circumstances from those that I, Mervyn and Charlie Bean and our colleagues faced in 2009-10 or 2012 --- for this reason, which is that long-term yields in real terms are now around zero or below zero.

If you think it is good debt management to swap into the Bank of England's floating rate, you are saying that you think that, on average, the Bank of England's policy rate over the next 20 years is going to be zero or below zero. So, from a debt management point of view, if you are keen on quantitative easing, you are an enormous pessimist on the outlook for the economy.

One thing that I find interesting about the independence debate—where, you know, I have no idea—is: was the Bank of England pressed to buy government bonds because there was a risk of failed auctions? I am reading things that are in newspapers and I have no idea whether they are true or not. There is that kind of debt-management consideration, which is kind of worth it for a few days or weeks, but the issue I am raising is: are they locking into financing that is going to be horribly expensive over 20 years? I am deliberately putting it in a way that implies that I think it will be, just to get the point across to you. Of course, actually, I do not know.

QE was recognised as being at the boundary with debt management from the beginning. In 2009 --- I remember very clearly where I was --- over a weekend, Mervyn spoke to the then Prime Minister and to the Chancellor a number of times, and to me a number of times, and we insisted that, if we were going to do quantitative easing, the Government, the Treasury, should make a statement that they were not going to lengthen the maturity of their debt. The Bank of England goes in, buys gilts, pulls down debt yields, to stimulate economy, and the Government extend the maturity of debt to lock in cheap debt, unwinding some of the macroeconomic effect!

That [agreement] was announced in an exchange of letters between Mervyn and Alistair Darling. I think that they need to return to the question of, "What is the best combination of debt management and QE right now?", because we were facing long-term yields of 4% and then 3.5%, not zero—a completely different set of public finance choices.

As I say, one can make a case, which I am deliberately egging up just to get you focused on the issue, that if government and DMO have been keen on quantitative easing, then they must be pessimists about the outlook for the economy. If I was counsel making the case, I would say that of course the Government should be against quantitative easing because they should want to lock in very low, long yields.

This touches on something else that is tremendously important and that I think Phil Aldrick touched on, which is that, say, QE remains as it is, the economy does recover and the Bank of England's policy rate rises. There must be a chance at some point that the Government will say to the Bank of England, "For God's sake, can you not stop paying interest on reserves?"

A really important feature in the history of QE is, why did we not stop paying interest on reserves in 2009? The answer was that we did not want to take the interest rate below 50 basis points because we thought if we did that there were going to be some failures in the broader banking sector.

We might come on to this in another question, but I do think that central banks have one monetary instrument left—probably more than one—which is to stop paying interest on reserves. I cannot possibly do justice to that issue here: because it will reduce government debt servicing costs, it will transfer the costs to the banking sector, and the Bank of England would have to find a way to set a rising interest rate as the economy recovered.

I am giving you, Lord Bridges, a rather inadequate map of a really central set of issues about the fiscal-monetary mix, debt management and QE and the Bank of England's monetary operational framework; and, in a sense, these high-level issues are much more important for the next few years than any one month's decision made by the MPC.

Lord Bridges of Headley: Thank you very much indeed. I will let others go on to ask questions and we may pick up on what you have just said.

The Chair: Before we pass over to Lord Haskel, who will ask about unwinding all this, Sir Paul, in fact I asked Philip Aldrick about his article and the issue about paying or not paying on the reserves, which I take from your comments you think should be seriously considered. Particularly, the other area is negative bank rates, and if one does not pay any debt and we go negative. Do you want to say a few words about that or is that just too many—

Sir Paul Tucker: No, not at all. I think it is worth thinking through, and I am not saying this would be a good thing or not. Let us be clear about this: were the central banks of the world to stop paying interest on reserves, the monetary overhang would be greater and, if you like, the inflationary impulse from central banking measures would be qualitatively greater as the banks tried to get rid of the reserves, particularly as the policy rate started to rise.

Phil made one small slip, by the way, if I may, which is that the Bank of England did not move to paying interest rates on reserves during the crisis; the Federal Reserve did. I recommended and implemented the introduction of paying interest on reserves in 2003/2004-05 for reasons I can explain.

The Chair: He got it wrong in his article in the *Times*, I think, as well.

Sir Paul Tucker: On negative rates, I think that the big thing to say to you is that on the big issues—the big macroeconomic framework issues the country faces—there is a need to distinguish between moving down to minus a quarter of a percentage point or minus half a percentage point on the one hand, and on the other going the whole hog to minus 3, minus 4 and minus 5. I am not saying that would be sensible, but just imagine if it were feasible and sensible, a lot of the issues about relying more on fiscal policy, and monetary policy being out of ammunition, would completely go away. But it may be completely crazy because it would be passing through the mirror into an Alice in Wonderland world.

The debate that is taking up quite a lot of column inches and speeches and so on, I gather, in the UK is about whether to move to minus 25 basis points or minus 50 basis points. From the point of view of an individual MPC member, given their statutory responsibilities, I think that it is perfectly sensible to have that debate and have different positions on it. It absolutely would not transform the capabilities of monetary policy come the next recession. Something that I did not perhaps get across to Baroness Kingsmill is that the really great debate—and this has been so since 2015-16, I would say—is that when the next recession comes, another pandemic, God help us, or a collapse in the financial system in the States, China or it does not matter where it comes from, a spike in oil prices: is monetary policy capable of stabilising the economy on its own? Moving from 0.1 to minus 0.50 does not transform that picture, however important it is within the MPC at the moment given its mandate.

The question you ought to be interested in is: have they got the overall apparatus to address another recession wherever it comes from? which is not about tinkering.

The Chair: Thank you. I realise that we missed out Baroness Kramer and then Lord Haskel.

Q18 **Baroness Kramer:** I feel slightly bad that I am taking this conversation in a different direction, which has been fascinating, but, Sir Paul, I would be interested to know what your views are on what the main distributional effects of QE have been on the real economy in contrast to the effects on markets and the issue of intergenerational equality.

Sir Paul Tucker: The best answer—and you will get richer answers as you proceed than you will get from me today—is that it is best to think about it in terms of the counterfactual, but not only the counterfactual that Chris Giles posited of, "What if they had done nothing? Well, that would have been a lot worse for absolutely everybody", but what about the counterfactual where there had been more fiscal stimulus or less fiscal retrenchment, and less monetary policy?

My best guess is that, in those circumstances, the effect on unemployment and incomes would not have been hugely different, but that the effects on wealth disparities, particularly at the upper end of wealth, and ignoring housing, which one cannot ignore but putting it to one side, would have been different. Although you concentrated on the real economy, the financial economy might have served the real economy better with an upwards sloping yield curve, and without the search for yield that monetary policy almost inevitably fuels as one of its side-effects.

I regret that one of my babies, the Financial Policy Committee, did not step in to choke off some of the leverage in financial markets, although I should make it clear that I have exactly the same regret about the Federal Reserve; it is not a point about the UK's central bank in particular.

Baroness Kramer: That is really interesting. I think, though, that people are more interested in the other issues, so I will hand back at this point in time.

Q19 **Lord Haskel:** Sir Paul, from your responses, you are obviously a strong believer in the Bank's independence. You have said in the past that the Bank should revert to the role for which it was given independence in 1997 to act as a check on fiscal excess. Does this mean that we should end quantitative easing and, if so, unwind it, and, if we unwind it, how?

Sir Paul Tucker: I think that it depends entirely on the choices that the Treasury and Parliament make about fiscal policy, so if the Treasury choose, for good or ill, to rely more on fiscal stimulus, then monetary policy could gradually retreat and let some of the bonds roll off and so on. If the Treasury—and this is not a point especially about the UK but about other big jurisdictions—or treasuries do not provide stimulus, then the central banks will be left trying to think of ways to provide stimulus. Where the rubber will hit the road is when the next recessionary shock comes from somewhere.

I would encourage you, if I may, to see this issue not just through the lens of Covid and the last year. This is not an issue that has suddenly cropped up because there had to be a resumption of QE and extraordinary fiscal relief to keep food on tables and people in shelter, thank God. But people in my tribe—people out of office, of course—started talking about unempowered monetary policy at conferences in 2015-2016, which is what prompted the Federal Reserve's review of its operating regime.

In a way—I do not want to make too much of this—an opportunity was missed a few years ago to conduct a similar review here. Should the inflation target be raised to 3%? Although those are formally decisions for the Treasury, it is probably still the case that most of the intellectual heft is in the other building.

I do not know the answer to your question. I would like the fiscal/monetary policy mix to change. If it does, independence is precious because, compared with the 1970s, and even the 1980s, the Bank could act as an important check on fiscal excess. But that is only important if the country chooses—the elected Government; it is entirely their choice—to shift the balance of macroeconomic stimulus to fiscal policy. If they do not, central banks here and elsewhere will be left not acting as a check but trying to find more ways to stimulate, which will be ever more granular versions of credit policy.

Lord Haskel: If we change, should we unwind QE?

Sir Paul Tucker: You should not unwind QE if fiscal policy at some point bears down on spending in the economy. Daniela Gabor said something that I rather disagree with when she said that there was monetary dominance. The first mover in the game is the fiscal authority. Nick will forgive me, but I think that it is a Stackelberg structure: Nick can explain that to you on the Floor of the House. The first mover in the game is the fiscal authority, and the monetary authority follows, and nothing has changed that—and actually more or less nothing can change that.

One of the very interesting things—I think this is a really deep issue about not just central banking but macropolicy—is that central banks were made independent essentially so as to stop Governments doing certain things, but actually there is a problem of getting Governments to do certain things that only they can do. You see this massively in the United States over the past perhaps 15 to 20 years.

Q20 **Lord Fox:** I think that we have covered some of the ground about what options the Bank has in the event that QE proves ineffective, and you have talked about stopping paying interest as one option. Then you corrected yourself and said that there were options other than QE. What do you think those might be?

Sir Paul Tucker: There is the negative rates issue where the point is not, is it feasible to go to 0.5%? It is really—

Lord Fox: No, it is a bigger—

Sir Paul Tucker: They should be clear where they are on that, and if they are ruling that out, rule it out.

There is ever more granular credit policy, which essentially amounts to setting different interest rates for different parts of the economy. We introduced a version of this in 2012 called Funding for Lending, which is a joint Treasury and Bank of England scheme. It effectively said—I am going to forget the details—that the more you lend, commercial bank, the less interest the Bank of England will charge on our loan to you. That was trying to subsidise loans to the real economy, but you could take that much further.

You will see how it immediately becomes political: which industries, which regions, which firms? I knocked around long enough—and there is no reason why you should know this—as a staffer for over 20 years before I was a policymaker for a dozen years or so, and I can absolutely assure you that politicians, and mandarins on their behalf, are immensely sensitive to which businesses are in which electoral constituencies. So if fiscal policy takes a particular course and it were concluded that quantitative easing had run its course, or whatever—and maybe I am wrong on that—then the Bank would have to be very careful and rather tough in negotiating the parameters of any richer credit scheme so that it did not find itself having to make judgments between winners and losers and, frankly, so that it did not get calls in the middle of the evening or the middle of the night about this idea that, if you could just take it 5 miles to the west, it would go much better.

Lord Fox: Point taken. We are not surprised to hear that politicians are sensitive about these things.

Sir Paul Tucker: How could it be otherwise? By the way, when I say things like that, there is absolutely—and similarly about fiscal assessment—no criticism intended.

Lord Fox: No.

Sir Paul Tucker: It is the glory of democracy. The challenge is to design institutions that enable government as a whole to stick to its best intentions.

Lord Fox: If you were going to start to have differential interest rates, what design criteria would you recommend?

Sir Paul Tucker: I think you are probably now—this is going to sound lame—asking me questions that I have not thought about recently and sufficiently. I would not want to mislead you.

Lord Fox: Okay. Thank you.

Q21 **Viscount Chandos:** May I go back to the Bank's mandate? In your book, you wrote that the fiscal state and the regulatory state now overlap and so must satisfy common principles. Would I be right in interpreting that as implying that you do think that the mandate should be broadened, or is it that the different policy objectives are not so much independent as interdependent and therefore, in a sense, that the mandate is broad anyway?

Sir Paul Tucker: Thank you, and it is very nice to see you. It is not quite what I intended to convey. These people are unelected and insulated from day-to-day politics and therefore, on the whole, I think their mandates should be narrow in a specific way, which is that they should have reasonably clear targets that you and Members of the Commons and interested members of the public can track, both to see whether they are trying to do what they have been told to do and whether they are succeeding in what they have been told to do. So, on the financial stability side, I think there is a need for greater precision in the degree of resilience that they are trying to achieve in the financial economy.

Let me give you an example on the monetary side that is quite topical. On the continent of Europe, Christine Lagarde's ECB is having a debate about whether it should lead on climate change. Climate change is a dreadful problem—maybe existential—and I certainly think that if Governments want central banks to help they should help, but I do not think that they should decide quite what the nature and quantum of that help is. I think that should be in the parameters set for them by government.

On the reason for this, let me put it again in the context of the ECB: if Christine does X and Y, you can be sure that some people will say that it is not nearly enough, and others will say that it is far too much. Then you quickly get to the question: why should it be an unelected person, a member of my tribe, who judges rather than an elected person sitting in Parliament? The rubber would really hit the road if they stopped buying bonds, or whatever, or lending against bonds from a particular industry, and firms failed and there was a local recession. This is why we elect people.

I believe in democracy much more than I believe in independent central banks. This debate has gone on in the UK for a year and I have just been hoping, "God, I pray that the Bank of England is telling them behind the scenes, `Just tell us what to do or what not to do, but you decide'".

Let me give you a graphic example of what one gets otherwise. One thing that is said about climate change and central banking is that climate change could be very bad for financial stability, and I agree. Wars are very bad for financial stability, too, including civil wars. Should central banks ration the provision of credit to suppliers of arms manufacturers? When I put that to a group of central bankers, they were amazed and they said, "We have not thought about that". The point is that they should not think about that—but you should, you people who sit in Parliament, and in particular the elected people in the other House. I do not think that you want people such as me being philosopher kings.

So I think it is really important that central banks are responsible for monetary policy and financial stability --- I think that it was a farce to have the lender of last resort with no role in prudential policy for banking --- but I think that you need to keep the mandates narrow.

If I may, Lord Chandos, add that I think that there are governance issues, including in the Bank, that need fixing. On getting away from the chair, the governor, being able to take major decisions on her or his own, which I think is still actually technically the case with lender of last resort and with market-maker of last resort. And this is not the first time I have said this, in a very different set of personal circumstances: I would much rather those powers were shared by the governors and the deputy governors formally, with votes. I would much rather the lender of last resort function be given objectives in statute, and repeal the shadow of the Treasury directing the Bank to conduct lender of last resort. It is far better for the Treasury to give the Bank a statutory responsibility than to be in the background with a directive power.

The reason I say this to you in the context of QE is that the more functions the Bank has, the more there can be behind-the-scenes negotiations where the Executive branch holds back something that the Bank needs in order to get something. I was private secretary to a governor before independence, and fending off such things was what I did every day for four years.

A few years ago, there were suggestions that the governance of the Bank had been improved. Mervyn and I are great mates, but we had a really big fight in 2007. The governance issue at the centre of that, which is who decides lender of last resort and liquidity insurance policy, has never been addressed.

The Chair: Thank you, Sir Paul, so much for your time; we have very much appreciated your excellent evidence. We shall take great note of it.

Sir Paul Tucker: Thank you.