HOUSE OF LORDS

Select Committee on Economic Affairs

Corrected oral evidence: Quantitative easing

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Members present: Lord Forsyth of Drumlean (The Chair); Viscount Chandos; Lord Fox; Lord Haskel; Lord King of Lothbury; Baroness Kingsmill; Baroness Kramer; Lord Livingston of Parkhead; Lord Monks; Lord Skidelsky.

Evidence Session No. 14 Virtual Proceeding Questions 139 - 147

Witnesses

I: Lord Tyrie, former Chair, Treasury Select Committee; Christina Parajon Skinner, Assistant Professor of Legal Studies and Business Ethics, The Wharton School of the University of Pennsylvania.

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Examination of Witnesses

Lord Tyrie and Christina Parajon Skinner.

Q139 **The Chair:** In this session, our witnesses are one of our colleagues, Lord Tyrie, former chair of the Treasury Select Committee, and Christina Parajon Skinner, assistant professor of legal studies and business ethics at the Wharton School of the University of Pennsylvania. Welcome to our witnesses.

Perhaps I could begin by asking the first question, which is about accountability. Has the Bank of England's QE programme been subject to sufficient scrutiny and accountability to date?

Lord Tyrie: It probably has not and probably could do with a good deal more. That is not Parliament's fault; at least, it is not the Select Committees fault. I would like to know answers to a few questions, one of which was touched on at the end of the last session. What really happened on 19 March? At one extreme, there is a conspiracy theory, which may be true—some conspiracy theories are—that there was more than a nod and a wink, and that the Bank was, effectively, instructed by the Treasury to engage in deficit financing. At the other end of the spectrum, the Bank went about its normal business of working out how to set interest rates. It had an additional challenge, which was to stabilise markets, and it allocated a very large sum of QE to achieve both tasks and succeeded. I am very glad that it did succeed.

I hope that there was co-ordination, as is suggested in the minutes, between the Treasury and the Bank of England. If they had not been co-ordinating policy at a time of crisis such as this, there would have been very strong criticism of them. The question is this: on what basis did they take the decision? If they took the decision on the basis of an instruction, the Bank of England's independence is in a very different place. I do not think that that is what happened, on the basis of what I have seen and what is in the public domain, but Parliament can allay those concerns by getting much closer to the truth of the matter.

I have some suggestions in that regard. For example, verbatim minutes are kept. They have been kept at my request. There used to be tape-recordings of these meetings, which were subsequently destroyed. I argued that they should be retained and, in the end, a compromise was reached on the basis of an independent report, whereby a verbatim transcript would be compiled and kept private for eight years. There may be, it seems to me, exceptional circumstances requiring the release of this transcript or, if not, at least access by somebody of integrity and trustworthiness who can vouch that the published minutes say what those verbatim minutes say.

It seems inconceivable that some quite independent-minded members of the MPC would just quietly lay down like lambs, having been told, Don't worry. The Treasury's just given you this instruction. We'd really like you to do this". I find that the height of implausibility. It is much more likely that the Bank's account is correct. There may be some detail to add and, although it is not the most important or pressing issue, it is certainly something that Parliament could help with by getting to the bottom of the exchanges that took place on the 19th.

I learned more from Robert Stheeman's interview in the *Times*; I do not know whether you have read it. I was impressed by its clarity. I do not think the Bank of England's independence has been compromised, but Parliament needs to ask a good number of other questions: why £200 billion rather than £100 billion or £300 billion? Parliament also needs to address or dismiss suggestions that the Bank of England's independence should have been suspended. I do not agree that that would be a good idea, but Parliament should look at it and offer a view.

We need to think through very carefully what is going to happen if interest rates rise, given current policy. There are a number of other questions, but I can see that I have been talking for too long already on this tricky opening gambit that you have offered me.

Christina Parajon Skinner: It is a pleasure and an honour to be here. I believe that the Bank has been transparent so far and has tried to hold itself accountable, as best it could, in terms of the evolving economic mechanics of QE. Right now, the Bank, and other central banks around the world for that matter, are at a crossroads, as we think about the transition from wartime uses of QE—these programmes that were executed rapidly and in exigent circumstances or in response to a shock—to peacetime uses of QE in a steady state.

In my view, this transition from wartime to peacetime uses of the balance sheet holds tremendous implications for central bank independence. Right now, we are potentially at a defining moment. To quickly summarise my view, which I will elaborate on as we proceed, the Bank could be on the precipice of entering or even being confined to a situation in which its balance sheet is used to accomplish different sorts of policy items on the agenda of government. This needs to be scrutinised heavily by the legislature and the public in deciding how large a role they want the central bank to have in British society.

Q140 **Baroness Kramer:** I will ask two slightly different questions to our two outstanding witnesses.

Lord Tyrie, in a great deal of the evidence we have heard, whenever the issue of transparency and accountability is raised, somewhere there comes the phrase: "Of course, the Bank of England is accountable to Parliament". I just wondered what your thoughts were on that. You have chaired committees that have suggested some fairly significant changes to Bank of England accountability, many of which have been implemented. What are your thoughts on how adequate the accountability to Parliament currently is, and what could be done to improve it, if you think that there are gaps or shortfalls?

Lord Tyrie: First, there have been huge improvements over the last 20 years, some of which I have had a hand in, as have my predecessor and successor. Secondly, the Bank has done an outstanding job in responding to the demands of Parliament. It has complained at times, but has realised that its legitimacy and credibility are enhanced by responding to requests for trenchant scrutiny by Parliament. It has done a pretty good job in this case too, and has been engaging with the wider public and businesses in a number of ways. And over a run of years, it has increased that engagement from nugatory levels, hidden behind that huge wall built by Montagu Norman, to being a very open institution. If it was not built by Montagu Norman, Mervyn will tell me who it was, but he is on mute. The architecture is introspective, but the modern Bank is no longer so.

The central problem for Parliament is overload. We have a heap of unelected bodies being created, with more and more powers being transferred to them, of which the Bank is the most salient. Parliamentary scrutiny is needed to give the public confidence that they are being run in the public interest, and Parliament cannot keep up. When we were in the crisis together, Susan, trying to work out how to scrutinise the Bank and how to handle the challenges given the Banking Commission, we created, on a shoestring basis, much higher levels of scrutiny than had existed hitherto, for example by persuading Mervyn King to give us a couple of secondees from the Bank of England and eventually by creating a much larger cadre of temporary, very highly motivated and very able staff to help do the work, along with specialist advisers and a few other tools.

This was all a temporary hand-to-mouth operation. What is now needed is some kind of repository of expertise in Parliament that can do a much more thorough job and that can have some institutional memory. It probably needs to be answerable, at least initially, to the Treasury Select Committee, but it might be widened to take account of other bodies and to scrutinise a number of quangos that take huge decisions, which go virtually unremarked. Parliament needs to be supplied with the right questions to ask, and there is no alternative but to secure the necessary expertise on the basis of which to ask them.

Q141 **Baroness Kramer:** That is rather interesting, because, relating not to the Bank of England but to the FCA and the PRA and the change there post-Brexit on regulation, those conversations have become very active. We are right to draw the Bank of England into that same grouping.

That leads me to my question to Christina. If I look at some other countries, a good example would be Australia, which has set up an independent panel to look not at the decisions made by its financial regulators but at the way the financial regulator operates, communicates and provides necessary information to enable scrutiny to take place. You have quite an aggressive and very well-staffed strategy in the United States with its relevant committees. I wonder whether you can talk about the ways in which parliamentary scrutiny could become much more effective in this new world.

Christina Parajon Skinner: I am a firm believer that legislative accountability should remain the centrepiece. Parliament is the most democratically responsive institution. As you say, perhaps it is a matter of refining tools to get different formats and substance of information across to Parliament. Some ideas for new forms of accountability to keep pace with new tools might include some kind of burden-shifting framework that is triggered when the Bank innovates a new policy tool, such as QE in 2009, or develops an existing tool to address a new challenge, such as using green QE in 2021 or using supervision to deter banks from lending to brown companies, if, one day, the PRA pursues that.

Let me give you a quick, concrete example of what this might look like, which draws on something that I proposed to the Fed at a conference on transparency in supervision. Where a new policy initiative arises, in this case the Bank might bear some burden of proving, via an open letter, a letter to the Chancellor or, in the extreme, even an instrument laid before Parliament, four very specific things.

First, how is the Bank interpreting its statutory mandate in the Bank of England Act 1998 to encompass this new risk? For example, climate change is a very live issue right now, but one could equally see how this could apply to other issues on the horizon, such as inequality. Secondly, how would a new policy be operationalised? In particular, will new tools need to be developed?

Thirdly, what are the expected interactions between monetary policy and financial stability policy? There is a very robust discussion right now about the interactions between the two, and it would be good for Parliament to know whether, in any given case, the Bank expects them to be reinforcing or potentially counterproductive. Fourthly, what are the guardrails, statutory or conventional, to prevent mission creep? This sort of demonstration that a new approach to central bank intervention is properly a central banking function, without the need for new statutory powers, for example, is healthy for accountability and very helpful for the Bank’s own communication.

Baroness Kramer: This is a subject that we could talk about all day, but that has been very helpful to me.

Lord Fox: On independence, I heard two different things. I heard Lord Tyrie say that he did not think the independence of the Bank was being threatened through QE, and I would like him to confirm or otherwise my assumption there. I inferred from what Christina Skinner said that there is a threat to independence. In either case, both of you talked about credibility, and Lord Tyrie talked about better scrutiny.

Is one way of bringing that in to look at better accountability for the appointment of the Governor of the Bank of England? In the US, there is an approval system that goes through the Senate, and perhaps Christina Skinner can tell us a little bit about that. Would having a more open approval process, taking it away from government and giving Parliament some role, have benefits or are there pitfalls in that process?

Christina Parajon Skinner: This would be one way to increase the Bank’s independence from Treasury, without changing other aspects of institutional design or HMT statutory powers over the Bank. In regard to appointments, the Bank's process would, at least in theory, be less susceptible to executive influence if governors were not recommended only by the Chancellor and the PM, just as our President does the initial selection, but had to pass through that additional step of approval and consent of the legislature or even a particular committee.

An independent appointments process can screen for a couple of things. It can screen for a history of impartiality, a character of impartiality and openness of thought. If you study the appointments process in the US, you will see that the Senate process has demonstrated itself to be quite sceptical of candidates for Fed board positions that seemed too beholden to the executive. This probably does, on balance, produce more centrist Fed governors, which leads to more stable policies. Importantly, it reinforces the Fed's reputation for being a force of calm and stability.

The Chair: Excuse my ignorance, but are there examples of where candidates have been rejected?

Christina Parajon Skinner: There was a recent confirmation hearing for a candidate, Judy Shelton. In that process, some felt that there was insufficient impartiality, alongside other philosophical issues that came out. That is an example you might look at to further confirm that, among those who do have Fed board positions, we have a very centrist, even-keeled leadership.

Lord Fox: Would I be right in saying that it tends to influence who gets nominated in the first place, because there is a pre-discussion process before a nominee is put forward?

Christina Parajon Skinner: Yes, of course. As with all high-level government positions, there is a vetting process, which can sometimes appear political. In that case, the political aspect of it comes in the first step, during the presidential selection. Through the Senate process, that is weeded out.

Lord Fox: Andrew, does all this sound too alien for the United Kingdom, or are there benefits in independence that could be accrued through this process?

Lord Tyrie: There are benefits. In answer to your first question, I do think that the Bank of England's independence has been compromised since QE came on the scene. It brought fiscal and monetary policy quite close together and leads to the kind of discussion that went on in the previous session. It is at risk. It always needs buttressing and it needs a lot more buttressing at times like this. Parliament can play a key role in assisting with that, or, if it turns out that there have been nods and winks, exposing them. I have given my view on whether I thought that likely, and I have told you that I think not.

On the appointments issue, yes, very much so, and this was a recommendation made by the Treasury Committee about a decade ago.

The appointment and dismissal of a governor should be subject to agreement by the TSC. It should be subject, ultimately, to a vote on the TSC, although I do not think it would come to that. The TSC would then, almost certainly, find itself in the position of needing to explain itself to Parliament. The fact that Parliament as a whole might have a government majority could have a bearing on the way it considered the decision, but the fact that scrutiny could take place will alter the terms of trade between Parliament and the Government when making these appointments.

The veto on appointment makes it very difficult for the Government to appoint a patsy or a yes-man. It would also address some concern that I have heard expressed from time to time that the Treasury has put its placemen in as deputy governors. The two deputy governors in there from the Treasury are outstanding and I have every confidence in their independence, but it would place that sort of issue beyond doubt if the deputies were treated in the same way.

The veto on dismissal would make it much more difficult to get rid of a governor who was determined to protect his or her independence in a crisis. It was for these reasons that I strongly recommended to George Osborne that the TSC have a veto both on appointment and dismissal of the three key people at the top of the Office for Budget Responsibility. That is now in place, as the head of the OBR cannot be removed without Treasury Committee agreement. The precedent has already been set. The approach has some merit and should be considered for other key government appointments.

As for pre-appointment hearings, I introduced a pre-appointment hearing for the appointment of Mark Carney. Of course, had we not liked the cut of his jib, there was nothing we could have done to stop him being appointed, but we would have flagged up the reasons why we were unhappy. As it happens, he gave outstanding evidence and we strongly supported his appointment. I think Mervyn King's reappointment was subject to a hearing, but I do not think his initial appointment was.

A precedent has been set by the Treasury Committee for rejecting an appointment. Even though it does not have the authority to block an appointment, it produced a critical report of one proposed deputy governor, and she withdrew once the report was published.

Q142 **Lord King of Lothbury:** I cannot resist telling Andrew that, of course, the person who built the curtain wall around the Bank was none other than Sir John Soane, not Montagu Norman. More importantly, in the US, we have seen the power of the Senate to reject a candidate used with Judy Shelton. She was a controversial candidate. There is no evidence that the fact that that process would have to take place persuaded the Administration not to propose someone of that kind.

You and your committee in the House of Commons, when you were chairman, as you have just mentioned, had the power of appointment hearings. Before you took over the chair, the committee did, indeed, produce a critical report on a proposed member of the MPC. Do you not think that the power of the committee to express its opinion has at least some effect? This distinction between where we are now and giving a formal right of veto to the committee may not be quite as strong as you suggest.

Lord Tyrie: It may not be quite as strong as some people might think, at first glance. I gave examples of the action we took when I was chairman with respect to a deputy governorship and to pre-appointment hearings for Mark Carney. These suggest that the capacity of the committee to contribute something while it exists is not strong enough to deliver the full weight that would come with a veto, and which the head of the OBR benefits from.

The Chair: Christina, I know you have written on this subject. Did you want to comment?

Christina Parajon Skinner: I am happy to leave it there, thank you.

Q143 **Viscount Chandos:** Lord Tyrie, you have flagged your scepticism about a conspiracy theory, but a number of witnesses have said in their evidence that the Bank has practised monetary financing in this last period during the pandemic. Do you, therefore, disagree with that or is there a version of monetary financing that does not require a conspiracy theory?

Lord Tyrie: I will not linger on this for long, because I have already given my view. I stand to be corrected, of course, if all the evidence is put before us. Parliament has the capacity to obtain that evidence: for example, a record of all the exchanges between the Treasury and the Bank of England on those crucial days, as this crisis broke, and examination of the verbatim minutes, as I have just described. Quite a lot of this scrutiny work has already taken place. There has been a report by the IEO. I hope that it has looked at the verbatim transcript. I note that the chair of court was not present for the meeting of 19 March. I would hope that he too has read that verbatim transcript.

There is a lot of material already available in the public domain to answer this question or at least to give us some guidance. If it turns out that we have all been sold a pup, the Bank of England's independence is in a poor way and quite a bit of damage has been done, not least, as the previous witness pointed out, in terms of a real cost to the servicing of long-term debt.

Viscount Chandos: You said that there are questions: for example, why £200 million rather than £100 million? It is uncanny how the purchases have tracked the debt issuance.

Lord Tyrie: Keep investigating. I am an outsider and not in a position to give you full confidence on this issue. My judgment of the published material may turn out to be erroneous. I cannot be sure, but I am suggesting ways of getting closer to this. It is a legitimate area of public inquiry.

Christina Parajon Skinner: On this question about monetary financing, it is too soon to make a final ruling. As other witnesses have told you, that does not seem, at face value, to have been the intent of QE. Still, the intent at the inception of the APF cannot necessarily dispel the possibility that QE is going to evolve into monetary finance, if it continues to grow and deficits continue to rise. It will all depend on how and when normalisation happens. Here, I have some concerns about the Bank's commitment to co-ordinate its exit from QE with HMT. It is unclear what, in practice, the Bank has committed itself to in that statement.

As other witnesses have alluded to, there was a point in the Fed's history where it was stuck under the thumb of the US Treasury for some time after the world wars. It was not until the famed Fed-Treasury Accord of 1951 that the Fed was able to extract itself from the Treasury's pressure to continue engaging in monetary finance. It is important to appreciate the historical differences there. Those were the days that central bank independence was just a loose construct, and it was understood and accepted that a Treasury would be more meddlesome in central banking affairs. Today, central bank independence is almost a household concept, so there would be tremendous impact on the perception of the Bank's independence, were it to appear or be confirmed that the Bank was financing the deficit.

Q144 **Lord Skidelsky:** May I follow on, Andrew, from Viscount Chandos's line of questioning? The Treasury Select Committee, of which you were then chairman, recommended in 2011 a clarification of the lines of accountability between the Treasury and the Bank. We have an accepted framework of macro policy defining two sets of responsibilities. Monetary policy should be the dominant tool for achieving economic stability, and fiscal policy should follow some version of a balanced budget rule, modified by automatic stabilisers. There was a division there, but we have heard in evidence that the strict separation between monetary and fiscal policy is becoming more meaningless and difficult to justify.

Who is responsible for what? Do we need a new framework of macroeconomic policy that would bring the accepted lines of responsibility, as we have inherited them, more in line with what happens in the real world? Otherwise, as I hinted at earlier, we are in a world of quasi-fiction, in which no one is quite sure any longer who is responsible for what. Responsibility is the same as accountability.

Lord Tyrie: There are a lot of interesting thoughts bound up in that question, which I cannot try to do justice to in a short reply. When the Bank of England Act was passed in 1998, nobody thought we would be here. There probably is a case for re-examining the way we describe macroeconomic policy, and probably a realignment of those responsibilities as well.

In the middle of this crisis, I would not recommend attempting it, but it is certainly something to which I would expect policymakers to return. We may discover that we have been running a policy all along that is somewhat different from the one we imagined we had, at various points in this extended crisis, since the financial crash.

I am concerned about what you are alluding to, but I do not have a readymade package of solutions on macroeconomic policy as an alternative to what we have. I am less sceptical than you about the current descriptions being provided by the Bank of what is going on, while accepting that, although it has tried very hard, there is still more explaining to do. I have alluded to three or four of the questions that it would be helpful for them to answer. It might be a good start to ask, "Why £200 million rather than £100 million or £300 million?"

Christina Parajon Skinner: As Lord Tyrie mentioned, the question, "What is monetary policy?", is not new. It is an unsettled one that is as old as the Bank's statutory monetary policy mandate itself. QE has just awakened latent anxiety among central bank independence watchers about the line between fiscal and monetary. These concerns should be distinguished and vary, depending on two things: first, what is being bought as part of a QE programme and, secondly, in what kind of ambient economic circumstances? I will take each of these in turn.

In terms of what is being bought, the line is most blurred, and concerns will be at their height, when the central bank's asset purchase facility is buying private sector bonds. To be fair, the corporate bonds were just a small part of the APF, £20 billion out of nearly £900 billion, but it has created a beachhead for using QE to do things that are fiscal in nature, all the while seeming to be under the monetary policy umbrella. That creates some discomfort. We know that the Bank has confirmed an approach that invests in sectors that are proportional to the total outstanding issuance in the UK. Technically, the APF has committed itself only to buying bonds that make a material contribution to economic activity in the UK. That is a pretty broad definition and it certainly seems malleable. We do not know what happens behind closed doors with HMT and the Bank.

This brings me to the second aspect and the wartime versus peacetime dichotomy again. It does not take much to envision a slippery slope that departs from this paradigm of sector neutrality, given that HMT has considerable influence in the design, even if not in the execution, of the APF and can, generally, flesh out what price stability means through its annual remit letter to the MPC. The public and the legislature could do with some further insight as to why, for example, using the APF to make the financial system greener or, as phrased in the remit, focusing on bond buying that is environmentally sustainable is monetary and not fiscal. That is just one example.

After all, that will have the direct effect of skewing the £20 billion programme towards certain kinds of green sectors, and potentially the secondary impact of raising the cost of credit for fossil fuel producers and similar corporates via a signalling channel. A quick point of contrast with the Fed's large-scale asset purchase programme here might be useful to the committee as well. The Fed does a pretty good job of steering clear of this morass, at least as best it can in the circumstances, by limiting all its asset purchases in its QE programme to risk-free products, treasuries and agency-guaranteed MBS.

To the extent that the Fed started buying bonds in 2020 during the Covid crisis, this was not QE. It used its lender of last resort authority under Section 13(3) of the Federal Reserve Act. There are important statutory and institutionally designed constraints on the use of that power. For one, 13(3) is time limited to unusual and exigent circumstances. Therefore, there is not the potential for creep from a wartime use of the balance sheet to buy corporate assets to a peacetime situation that at least appears to become enmeshed with Treasury priorities.

Secondly, related to those features, the Fed's corporate bond ETF purchases in 2020 were all done through highly diversified indexes that were sector neutral. Thirdly, the Fed stopped buying corporate bonds in December 2020 when the financial crisis seemed more or less over and they are already in run-off mode. It is clear that these 13(3) facilities are beasts of monetary-fiscal co-ordination, but they are clearly limited to that state of the world and QE is kept separate from private bonds.

Lord Skidelsky: What you are saying suggests, to my way of thinking, that one should narrow the Bank's responsibility so that it can be more clearly defined rather than broaden it along the slippery slope that you were talking about. For example, our Chancellor has just added to the Bank's mandate a responsibility to help with green policy. That is making the Bank a partner, explicitly, in a Government's political agenda. Who is going to be responsible for fulfilling that agenda? It is going the other way towards further confusion of responsibility rather than clarifying the different roles played by the two institutions. Does that sort of creep worry you?

Christina Parajon Skinner: It does worry me, generally speaking, because it creates a larger role for the central bank that has not necessarily been decided by Parliament or society. Really, it is done in this mission creep way. It also confirms society's expectation that the central bank should be taking care of all these other things that have economic impact.

I am happy to elaborate on the climate piece later. The more generalisable point is that there are a lot of significant economic issues that have historically not been allocated to the central bank to devise monetary policy solutions for. Think about the economic impacts of trade or immigration. The line between national and economic security is quite thin, especially in the US. Can you imagine the Fed being strongarmed into penalising banks that lend to Chinese companies, for example? I am sure you can imagine a UK analogue. The question becomes where you draw the line when you start to enlarge the mandate. There is a lot at stake in scrutinising the question. Ultimately, do you want a central bank leviathan?

Lord Tyrie: I agree with everything that has been said. The job we have given central banks is quite difficult enough without handing them further tricky responsibilities that would also drag them into public controversy. They may also create the conditions in which it is unclear who is really responsible for what.

I will go back to an earlier point made by Christina about the APF. Either a huge bill is going to come the way of the Treasury, to enable the Bank to carry on paying interest on those reserves, or there will be some reneging of that commitment, in which case you are effectively creating a tax on the banks. That is also fiscal policy by the back door and that needs a lot of careful thought. I would be interested to know how that would score and I would want to know what the ONS had to say. We would also need to go and take a look at definitions supplied by the IMF and others about what constitutes a tax, but it looks to me like a tax and a very large tax on the banks.

QE, in so many ways, is bringing fiscal and monetary policy together, and, in a sense, muddying the waters and making it difficult for that delineation you described at the start to be sustained. Right now is probably not the moment to try to create what amounts to a different type of macroeconomic policy or to redefine the one we have more clearly.

Q145 **Lord Livingston of Parkhead:** On this issue of the Bank mandate, I do not want to get caught again in the fiscal and monetary financing discussion. There are two bits to my question.

First, green financing is all very laudable et cetera, but is this not just a slippery slope and, once you start moving, you have a problem?

Secondly, there is one area that neither of you has mentioned. To the extent one has an inflation target, is it still right to just say that it is a number or should it be a range? The Fed has moved. There has been talk of averaging, so I am interested to know two things. How do you avoid going on a slippery slope where everything gets included? Secondly, do you move the issue regarding the target for inflation?

Christina Parajon Skinner: I generally agree with your slippery slope assessment. I bring it up when we talk about the Fed's mandate and its potential entrée into climate issues. Big political economy questions arise in connection with this slippery slope argument. Once you start with green goals, exactly as you say, the spectre of politicisation arises. Which sector could be next? How political could things get? What would it take to make a sector so disfavoured as to be singled out for adverse treatment?

Other witnesses have said this and I would reiterate it. In connection with the green mandate, it puts the central bank in the position of choosing and making value judgments about green winners and losers. Deciding what is and is not in the green perimeter seems like a difficult task to take on with objectivity. The genie is out of the bottle at this point, but the discretion at least is a bit unhelpful to independence.

As regards the Bank of England's mandate more generally and inflation targeting versus average inflation targeting, I think about this question as a legal scholar in terms of how the Bank's mandate is interpreted. I am happy to give you my thoughts now, unless you would prefer for me to hold those for a bit.

Lord Livingston of Parkhead: Give a quick view.

Christina Parajon Skinner: I will continue. I have been thinking about the suitability and ideal size of the mandate. There are two issues to consider in the Bank's case. The first is whether an employment arm should be mandated on equal footing with price stability and whether this has any implication for whether it is a solid 2% target or an average target. The second is what to make of the secondary mandate that requires the Bank of England to support the economic policy of the Government subject to maintaining price stability. Both of these issues can be answered by focusing on this secondary mandate.

My read on the history surrounding the addition of the statutory mandate to the Bank of England Act suggests that a secondary mandate was never intended as an entrée for executive priorities into central banking. Rather, it was intended to be a proxy for employment along the lines of the Federal Reserve Act, and as an early statutory effort to become harmonious with an EU legal framework at a time of burgeoning European integration. As evidence of this, it is interesting to quote a remark that Gordon Brown made at the time. "I wanted the Bank to have a dual mandate to keep inflation low and employment high, one that was similar to that of the American Federal Reserve, but the lawyers advised that it was too difficult legally to have two primary objectives. We got around this as best we could".

Meanwhile, you have Margaret Thatcher who was very sceptical of statutory independence, so the then Chancellor may have tried to win her to the cause by explaining that the Bank would be obligated to conduct its monetary policy within the framework of the Government's economic policy as a whole. Then you have the European influence. A textual comparison of the mandates reveals that it is nearly identical to Article 105(1) of the Maastricht treaty, which refers to price stability: "Without prejudice to the objective of price stability, it"—the ESCB—"shall support the general economic policies in the community". Given the unique framework of the EU, it would have made sense to make the ESCB hyper-accountable to members states.

The upshot of all that is that the desired and intended effect of the secondary mandate was to accomplish an employment and growth objective while appeasing and co-ordinating various political factions at home and abroad. Today, it seems that the secondary objective may be an open door to the politicisation of the Bank by allowing for this subtle subterranean import of Government's now more wide-ranging economic priorities to shape the direction of monetary policy.

Lord Livingston of Parkhead: That was a very impressive answer.

Thank you.

Lord Tyrie: I thought that was an extremely good résumé. Of course, the Bank's job is to protect its primary objective, and that is why it needs to have and be capable of demonstrating independence. If it thinks that it is compromised or at risk of being compromised by this Trojan horse of the secondary objective now leading it to take decisions other than those that it would have taken to secure its primary objective, it needs to speak up. It needs to say that it feels under pressure and that it does not want to succumb to that pressure. We have not arrived at that point.

In fact, a good number of people over the years have felt that the Bank is not remotely responsive enough to its secondary objectives and that the secondary objectives have become window dressing. That argument has all gone into reverse for the time being. The general point that I wanted to make in this area remains that the Bank should not be given even more headaches just now. It has quite enough to handle.

Q146 **Lord Monks:** I have a quick question, because Lord Tyrie has already given his view on it. Can either of you envisage any circumstances at all where the operational independence of the Bank of England would be curtailed, almost certainly temporarily? Perhaps Christina could express her view about whether and in what circumstances the override powers that the Treasury ultimately has in this situation might be used.

Christina Parajon Skinner: I would be happy to comment on this, which is something that I have written about with a co-author and former colleague of mine. The operational independence of the Bank can lawfully be suspended in four different situations. Three but more likely two could have been triggered by Covid and QE. I will give a very high-level overview. I am happy to follow up with any further questions.

First, there is a general power of direction in Section 4 of the Bank of England Act 1946. There is no limit on its scope, only that the direction be in the public interest and the governor be consulted. It is on the statute book, but it is a nuclear option and has never, to my knowledge, been used. It does not apply to monetary policy any more. The 1998 Act carved out monetary policy from the general power to reinforce independence. In theory, if we really thought that the Treasury was directing the Bank to do purely fiscal things in 2020, that could be covered under this power.

More pertinently, the 1998 Act gave HMT a reserve power to direct monetary policy in extreme economic circumstances provided that it is in the public interest. This seems like it could cover the Covid situation and justify direction of QE. The Financial Services Act 2012 added a new power of override, but it was very specific to threats to the public fisc. Whether this power could apply to Covid is a bit tricky. It is really supposed to be about the Bank's use of its LOLR facilities or a decision to put a firm into resolution.

On the one hand, because HMT is indemnifying the Bank's APF purchases, that same rationale might apply to this power. On the other hand, the power is not supposed to be able to override decisions by the MPC. Of course, the APF is not managed directly by the MPC, so we might be able to evade that restriction. I will answer your question more directly. Should the power have been invoked during Covid, and are there any circumstances in which the operational independence of the Bank should be suspended? I think it is grey enough, at least, that it could have been publicly debated or explained. Here is why.

The facts, in some sense, paint a picture of direction and this has been picked up a little in our prior answers. HMT announced the facility. It sets the terms of risk control with the Bank. It provides this indemnity with some strings attached about the kinds of assets that it will approve as eligible. I cannot say who had the idea of setting this up, how it could be done or how it operates on the ground. Lord Tyrie has raised this issue already in his testimony.

I will say that if direction is in any sense happening, and I am not necessarily saying that I think it is, Bank independence would be stronger and better off if these powers were invoked or publicly debated, at a minimum, because the rationale behind the suspension powers can be seen as preserving independence. Why is that? There are important processes and limits built into both the reserve power and the financial stability power. Both have to take the form of a statutory instrument that is laid before Parliament. The reserve power is also time-limited. After 28 days, it is not in effect any longer unless both Houses of Parliament hold a debate and each approves it by resolution. With the financial stability power, the Bank has to provide a report to HMT about how it is complying or intending to comply with the direction.

The point is that, with the powers in use, it is all very transparent and integrates parliamentary oversight at each step along the way. The framework could be useful as a check on creep or drift, to constrain QE from drifting in ways that society would perhaps find unacceptable. For these override powers to pull off that nifty trick of enhancing Bank independence while at the same time suspending it, there has to be a credible commitment to their use. It is at least worth being transparent about whether the Bank and HMT felt that the framework was appropriate in this situation and, if not, why.

Lord Tyrie: It is the first time I have disagreed with you, Christina. Near the end there, you said that achieving suspension while entrenching independence would be to pull off a nifty trick—I'll say, in spades. We have to think about the behavioural response. Once you open up a debate about whether you should do this, you are already on a very slippery slope to uncharted territory, and you need to know very clearly what your new resting place is going to be and to have explained it extremely well. Once Parliament gets an appetite for running the Bank, operationally, we are in a very different place.

The general point on this subject remains that, once the power has been used—you described it as a nuclear option at the start—the belief that it might be used again will always be around. It is quite difficult to reconstruct full independence in that environment. It might be possible, but it would be a struggle. You have to be very confident that it is worth the candle. So far, I have not seen the evidence to support the view that we need to do this.

One last point occurs to me. I have not been on the inside, as you and others in this hearing have, but I am confident that the fact that this power exists influences the Bank's behaviour. The fact that the Bank has to justify everything it does by reference to its statutory obligations and its mandate is constantly being entrenched by the possibility that, if it did not, the Government might intervene or could take it over effectively, using one of these powers. I am extremely cautious about suspension and I do not think we are at that point.

Q147 **Lord Livingston of Parkhead:** Thank you to both witnesses. This is a good place to end. We want to unwind QE one day. We have spent a lot of time talking about the Bank of England's inflation mandate. It looks to unwind it consistent with the inflation mandate because inflation is going up, so the opportunity is there. The market has a taper tantrum, times a number, threatening financial stability. What is the resolution of the conflict between the Bank's duty towards financial stability and its duty towards its inflation target?

Lord Tyrie: I would like to know what the relative allocations were notionally in the discussion that led to the £200 billion between those two responsibilities. They will give me a first indication of some of the information I need to answer your question.

Lord Livingston of Parkhead: They were both pushing in the same direction in that case. In this case, they are pushing in different directions.

Lord Tyrie: Yes, they certainly will be, and I am very concerned that we had not thought through what we do next. Of course, it is a problem that the UK will not face in isolation. This debate will be all around the world. I have not seen a coherent answer yet that does not carry considerable economic and political costs. It was a mistake that we did not begin unwinding earlier. We would then not have had such a huge QE overhang to handle. There is that risk of the trade-off in the question that you have described ending up doing a lot of damage. Handling it is not an immediate problem; we have a bit of time to think about it, but that is an area of legitimate scrutiny and public debate by Parliament.

It is exactly the sort of issue on which you need a sizeable group of experts in Parliament to help you to put together the kinds of questions that would need to be asked to make an investigation of that issue meaningful. A parallel, perhaps, can be drawn with how we scrutinise government departments and their public spending generally through an independent body called the NAO. It was set up in the 1980s to provide the reports and questions that would enable the PAC to do a much more thorough job. We are dealing with the same set of problems here. Parliament will struggle to get to the bottom of this.

Lord Livingston of Parkhead: Ms Skinner, have you any insight into this particular knotty one?

Christina Parajon Skinner: It is very difficult. I agree with everything that Lord Tyrie just said. The monetary policy arm will need to be talking to the financial stability arm when the policy tools for normalisation are developed and then operationalised. Resilience is really going to be a key foundational question to the exit strategy. Having well-capitalised banks that are awash in liquidity and subject to the very robust resolution regime that we currently have should, in theory, give the Bank a bit more comfort when the time comes, a higher tolerance for stepping back from QE and less concern about the so-called addiction to QE.

It is not going to be a cure-all, but the resilience question will need to be integrated with the normalisation question. Of course, it is not a complete answer, because that is just the banking sector, but I do believe it is a key question to start thinking about now: how resilience and normalisation fit together.

Lord Livingston of Parkhead: Lord Tyrie, we might ask you for some more details on your thoughts on setting up the equivalent of the NAO for the PAC, if you had any. Thank you.

The Chair: Lord Tyrie, that is a very good point. If you feel able, please give us a note on your thoughts on how we could enhance parliamentary scrutiny.

Lord Tyrie: I wish I had not come forward to give evidence.

The Chair: It is too late now.

Lord Tyrie: I will do my best while earning a living. I will give it some thought and try to write something down.

The Chair: Thank you. With your experience, you have been an excellent witness and very helpful to the committee. Christina Skinner, thank you so much. The depth of your knowledge and the precision of your answers have made this a really useful session, which is much appreciated. Thank you for taking the time to join us. That concludes this session, and I wish everyone a good evening.