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Select Committee on Economic Affairs

Corrected oral evidence: Quantitative easing

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

Evidence Session No. 18 Virtual Proceeding Questions 172 - 179

Witnesses

I: Otmar Issing, President of the Center for Financial Studies and former Chief Economist of the European Central Bank from 1998-2006; Donald Kohn, former Vice Chairman of the Board of Governors of the Federal Reserve System.

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Examination of witnesses

Otmar Issing and Donald Kohn.

Q172 **The Chair:** Otmar Issing is president of the Center for Financial Studies and former chief economist of the ECB, and Donald Kohn is former vice chairman of the Board of Governors of the Federal Reserve System. Welcome to you both, and thank you for taking the time to join our committee today. What do you see as the greatest threats to central bank independence?

Otmar Issing: I am honoured by this invitation.

The Chair: It is our privilege to have you. Thank you for agreeing to come.

Otmar Issing: To start with a clear statement, I am concerned about the future of central bank independence, not so much about the legal position. Governments and parliaments will refrain from their previous decisions to give independence to their central banks.

My concern is directed towards de facto independence. Central banks are overburdened with objectives and excessive expectations. They were seen as contributors to the great moderation with low inflation and robust growth and employment. Later, in the context of the financial crisis, they contributed to preventing the world from falling into a depression like in the 1930s. From then on they were seen as saviours of the world. I think that such elevated expectations are very dangerous, because disappointment must follow.

As you indicated in your written question, I would not say that central banks would bow to political pressure. My concern has more to do with their own attitude, for two reasons. They are exposed to the risk of giving priority to political considerations—first, keeping long-term interest rates at a very low level for a very long time. By that they are losing control of money. The reason for this is that they have extended QE beyond the phase in which it was successful. I think that there is more or less consensus that the first phase of QE was successful. We saw a repetition of these interventions in bond markets. Monetary effectiveness has declined. Studies for the euro area, for example, show that in the meantime the effect of QE on prices and economic activity is more or less zero; the effect is more on financial markets. Therefore, the argument for continuing QE of such amounts for monetary policy reasons has a very weak basis.

Secondly, looking to the future, central banks now have large amounts of government bonds on their balance sheets. Exit from the zero interest rate policy will bring central banks into conflict with their Governments. It will be a very hard test for the central bank to withstand political pressure and I see a great risk that exit, once needed to nip inflationary development in the bud, might be delayed because central banks have

come closer to political decisions during the financial crisis and now in the context of the pandemic.

The Chair: Thank you for that very comprehensive answer.

Donald Kohn: Chair, thank you for the opportunity to participate, particularly with my old friend Otmar Issing.

I agree that independence is to some extent always under threat. It is a little bit of an unnatural situation to delegate so much authority to an independent authority. I think that the threat to independence rises when the central bank does not meet its objectives. The last major change to the law in the United States dealing with monetary policy occurred in 1978, when we had stagflation. The central bank was not doing what it should be doing and Congress felt that it needed to give the Fed new instructions.

When I reflect on the attacks on Federal Reserve independence after the global financial crisis—primarily from Republicans, who for a while thought that policy was too easy when a Democrat was in the White House, and then that it was too tight when the Republicans were in the White House—I think they were primarily political. But I would be concerned that they got traction because of the slow recovery from the global financial crisis. Therefore, the central bank was not meeting its legislative objectives of maximum employment and approximately 2% inflation, and that left it vulnerable.

Therefore, in that regard I disagree with Otmar that QE exposes the central bank to a risk in its independence, because if the central banks had not done QE they would have been even further from the objectives that the legislature had given it and, therefore, its competence would have been questioned and it would have been more open to attack. QE was part of doing everything you could to meet the objectives set by the democratic legislative process.

Q173 **Viscount Chandos:** Has the widening of central bank remits ironically limited their room for manoeuvre? Do you think that too many targets weaken the ability of a central bank to focus on its primary objective?

Otmar Issing: I think so. Too many targets make it almost impossible to focus monetary policy on maintaining price stability. In his history of the Federal Reserve, Allan Meltzer has shown that already in the case of the dual mandate from time to time the central bank is in danger of underestimating the risk of inflation. Adding, for example, financial stability, climate change or other targets to the mandate of the central bank. It will in theory already be very difficult to give price stability priority. I think that the Tinbergen rule delivers a clear message.

Donald Kohn: I agree with Otmar; it is important that monetary policy does not try to do more things than it can with the tools that it has. The Federal Reserve has always been very careful to define maximum employment as what is consistent with stable prices. As long as you do that, having that dual mandate does not interfere with your ability or

willingness to produce stable prices. I agree with the general tone of the previous session and some of Otmar's comments that, if monetary policy tries to do some things that are not really well suited to the tools that it has, it could produce conflicts and it brings it into a political dimension.

As was discussed in the previous session, I think that the expansion of remits has been in the area of financial stability. In my mind, by setting up an effective financial policy committee and prudential regulatory authority the Bank of England has increased the room for manoeuvre by monetary policy. If those committees can handle the financial stability aspects of monetary policy decisions, the Monetary Policy Committee has much more freedom to focus on the 2% inflation target without worrying about the financial stability implications of focusing on that target. I do not agree that giving a financial stability mandate to a separate committee with separate tools reduces the MPC's room for manoeuvre; it increases it.

Viscount Chandos: You may have heard in the previous session a question about the climate change mandate that has been added. Would you see that as an appropriate additional focus or one that, as the previous witnesses suggested, should be addressed by other means?

Donald Kohn: Some aspects of climate change fit nicely within the financial stability mandate of the Bank of England. I was a very strong supporter of the Financial Policy Committee's efforts to undertake a climate change risk test of the financial system of UK banks. Are the banks aware of that risk, or are they managing it? If not, that will have a negative impact on financial stability.

If the Government are trying to use the Bank as a kind of independent instrument to change the price of carbon relative to other things, that is getting the Bank into an area that is not necessarily part of its financial stability or price stability mandates, and that is more a matter on which Parliament should be working.

Q174 **Lord Bridges of Headley:** Building on that and bringing it back to the debate we had about independence, first I put a simple question. Is greater co-ordination between monetary and fiscal policy desirable? If so, can that be achieved without eroding central bank independence?

Otmar Issing: This is a very important issue. First, one should define what one understands by "co-ordination". If co-ordination means that the head of the central bank and Finance Minister sit together and talk about who should do what, that would be extremely dangerous for central banks, not least because a central bank is always able to and will deliver on its commitment. Governments are under political pressure; elections might be around the corner, et cetera. Therefore, central banks would be in a delicate position, and over time I think that they would lose their independence.

If by "co-ordination" you mean that both institutions should do what they are able to do, government should know the reaction function of the

central bank and the central bank should know what government will do. If both follow their mandate, this is what I call implicit co-ordination. I am not saying there should always be a conflict between fiscal and monetary policy, not at all.

If I may make a side remark, as a German I was very much impressed by the origin of the independence of the Deutsche Bundesbank, which emerged especially in times of conflict between the central bank and the Government. Konrad Adenauer accused the central bank in 1955 of killing the economy and small businesses because of a rather modest rise in the discount rate. The central bank won the argument among the public. That was at a moment when the Bundesbank's independence was based legally on a simple law that could be changed at any time by a majority of one vote, but among the public there was such strong support for the central bank that no politician ever dared do that.

To go back to your question, I think that central banks should be very clear that they do their job. As we have seen in the pandemic, for example, both policies go in the same direction. I would call this implicit co-ordination and for that you do not need meetings of the Finance Minister and governor of the central bank.

Donald Kohn: I agree with Otmar. Quite a bit of implicit co-ordination goes on as fiscal and monetary authorities pursue their goals. That was certainly true during the pandemic with an expansionary fiscal policy and monetary policy that included QE, in my view entirely appropriately.

I am very wary of formal agreements to co-ordinate fiscal and monetary policy. It was said in the United States in the 1960s that, if President Johnson raised taxes, the Fed would cut interest rates. President Johnson raised taxes and the Fed cut interest rates, and it could be seen within months that that was a bad decision. The tax increase was not having the effect that was hoped for, it needed to reverse its interest rate cut, and it became very difficult. So each authority should pursue its objectives. Very clearly, that will give rise, as Otmar says, to implicit co-ordination, and that is sufficient. Formal agreements can be risky to central bank independence.

Lord Bridges of Headley: I would like to put a further question to Otmar on communications about unconventional monetary policy by central banks. With a number of former central bankers, in 2019 you wrote: "The suspicion that behind this measure"—that is, monetary financing—"lies an intent to protect heavily indebted Governments from a rise in interest rates is becoming increasingly well founded". The key word there is "suspicion", and it takes us back to what we were debating in the previous session about the perception of many investors and the City about the co-ordination and motive behind the Bank of England's actions. How should a central bank be communicating, given where we are now, to address that kind of suspicion and those perceptions, or should it just ignore this?

Otmar Issing: QE transgresses the borderline between monetary policy and fiscal policy, and it is very difficult to disentangle whether or not an action is monetary financing.

Sometimes I disagree with my good friend Don Kohn, and I do so about what he said in response to the first question. My argument is that if quantitative easing does not have any positive effect on growth and inflation—inflation in this case meaning bringing it up to the target of 2%—what is the motivation for continuing quantitative easing with such amounts? It is probably more financial dominance than fiscal dominance, because financial markets rely on the "put" of the central bank, in case the central bank reacts with additional quantitative easing as soon as long-term interest rates rise a bit. But the borderline in relation to monetary financing is open, because the justification in this case is no longer delivering on the mandate of price stability.

Donald Kohn: If that perception were widespread, one should see quite a spike in inflation expectations in financial markets. We can see a little bit of a spike in the United States in the implied inflation premiums between nominal and real rates, but only back to where they were a couple of years ago when the previous quantitative easing was being wound down.

There is a lot of discussion about monetary finance, but I do not think that those same people are betting on the perception that they are talking about. Central banks need to communicate very clearly their price stability objective. That is what Congress or Parliament has told them to do, that is what is embodied in the treaty in the eurozone, and that is what they will do. Whatever that means for the price of financing the deficit, when the time comes they will raise interest rates because that is their mandate. That is the key to this thing.

Q175 **Lord Skidelsky:** We were told in a previous session that QE needs to be unwound at the right time. This reminds me a bit of the cry of St Augustine to God, "Make me chaste, but not just yet". The question is: what is the right time? Is it a rise in inflation? Is it inflation expectations? Is it the approach to full employment, or the achievement of full employment? There seem to be a lot of different considerations. How does a central bank balance them?

Donald Kohn: I think that the right time to back off from QE is when in the view of the Monetary Policy Committee or Federal Open Market Committee it is no longer needed to achieve its goals for economic and price stability. All the things that you mention would be important. You would need to see that the economy was at least approaching full employment so that inflation would not drop further and economic stability was being restored, and that inflation was rising sustainably from its very low levels. If you saw inflation expectations rising above what you thought was consistent with your objective, that would be a very strong signal that it was time to back off very quickly, maybe even to raise rates.

I would not pick one particular signal. By the nature of policy-making, you have to look at these things all with respect to each other. The time to stop is when you do not need it to meet your objectives.

Lord Skidelsky: But that is a judgment, of course.

Donald Kohn: Of course, and the central bank needs to be very clear when it makes that judgment why it has made it—what its outlook is, why it is no longer needed and that this is the best way to meet its objectives.

Lord Skidelsky: Otmar Issing, would you like to comment on that? When is the right time, in your view?

Otmar Issing: It is judgment. It is not as simple as having a kind of blueprint for future action because it depends on many variables. In this respect I am a bit more critical about what central banks are doing now. My point is that, with the increasing tendency of central banks to expand their balance sheets, exit in the future will become more and more difficult, because the amount of public debt exposed to the risk of rising interest rates will increase, making it even more difficult to exit.

As for the political pressure at that time, it will not be a question of the technique—central banks are able to deal with that—but a test of political courage. I agree with Don Kohn that this will be the real test. For the time being we are talking about the risk or not so great a risk of continuing higher purchases of government bonds. But my concern is directed more to the future because the exit from these huge purchases first by stopping, then reversing, these massive purchases of government bonds and shrinking the balance sheets of central banks will be a tremendous challenge.

Q176 **Lord Monks:** That discussion answered the first part of what I was going to ask about regarding when central banks should seek to exit QE. I think that that has been dealt with. The second question, which Mr Issing said something about in his last answer, is how they do it. With this huge amount of money around, caused by QE, how do you go about returning to normalisation, and what obstacles are you likely to face?

Donald Kohn: It is important to set out a framework to tell people in advance what pattern you will follow as you exit from these unconventional policies so that they are not surprised. By that I mean, in the case of the US and pretty much in the case of the Monetary Policy Committee, although I will enter a caveat to that in a second, they have said that, first, they want to taper down their purchases and stop buying; then they will raise rates and then allow their portfolio to run off.

Setting out that framework is important. Setting it out in advance and giving markets and people good warning that you are approaching the point at which you will enter each of the stages of that framework is important. There will be some surprise—markets will react—but the more you can give them fair warning and let them build in that reaction slowly, the less volatility you will cause with the pattern of how you run off.

That framework of tapering, raising rates and running off is a good one, because raising interest rates—the bank rate or, in the case of the US, the Federal funds rate—has always been the primary instrument of monetary policy. It is one that the committees are used to dealing with and can calibrate better than they can calibrate exactly how much to buy and how long to hold it. So getting to that basic instrument of monetary policy sooner rather than later is helpful to the committees. Moreover, if they begin letting their portfolios run off so, rather than selling into the market, they let the natural maturity of the portfolios run down and get a reaction that they do not anticipate, they can adjust their policy rate, if it is already above zero. If you start selling and your policy rate is at zero and bad things happen, you have nothing you can do but turn round and start buying again. I think that makes sense.

In his speech at Jackson Hole last year, Governor Bailey raised the possibility of reversing the order of selling before raising rates because, as he pointed out quite correctly, the purchases had been made in part to help market functioning. The concern was, if you did not let the portfolio run down and ran into another episode of market dysfunction, would the Bank feel it has the space to ramp up the portfolio again to make those purchases?

In addition, I have heard in the past couple of weeks from the Governor of the Banque de France that because there is now more than one tool of monetary policy—QE and interest rates—maybe one should think about the relationship to financial stability to wind them down. Still, the basic framework is one that I think makes the most sense, although central banks need to consider carefully whether there are other factors. But being very clear about what you are doing and telling people ahead of time is how you avoid some adverse market reactions.

Otmar Issing: Don Kohn has made it very clear and explicit how important and difficult it is to organise the exit in a way that implies a smooth transition from the past system of very expansionary monetary policy in the direction of what we might call normalisation. In the case of the euro area, it becomes even more difficult because of the negative interest rates implemented by the central bank.

As for the sequencing of moving on the interest rate side or asset purchases first, there are pros and cons. Over the next year or so the arguments might change because the situation changes. What is key, as Don said, is making a clear announcement of what central banks are doing, because the risk of financial instability is extremely high. It might come to that position because financial markets have become more and more vulnerable, and the amount of public and private debt is at record highs since the Second World War. This system will be hit by the exit. It is not only the sequencing that matters but the communication and timing of it, because the longer the exit is delayed the more higher interest rate increases will be needed. This is an extreme challenge for all central banks in the world.

The Chair: Before we move on, Donald Kohn, I am looking at your

framework and wondering whether you can put a bit more flesh on what it would consist of.

Donald Kohn: The Federal Reserve has set out, “We will tell you well before we begin when we will taper off our purchases”. It is now buying $120 billion a month of treasury and agency securities. The FOMC has said, “We will give you plenty of warning about when we will taper those down. We will not begin to taper until we feel we have made considerable progress towards our goals—not that we have met them, because interest rates will still be at zero”. It has not clarified what “considerable progress” means, and maybe that will come out over the next couple of months, but it has told us that it will give warning and taper down slowly, perhaps over a year. I think that it will tend to pause then to see what the effects of that taper are and it will start raising rates. It has put out very clear guidance about raising rates. Maybe we will come to this later; it now has flexible average inflation targeting, which implies going above 2% for a little bit. It will not come off zero until inflation is at 2% and predicted to rise above 2%, and the labour markets are at about full employment, because it will overshoot full employment to keep inflation rising above 2%. So it has set out very clear criteria for when the lift-off will come and has said that it will keep interest rates accommodative until essentially it achieves its goals. So it has tried to be clear. We can come back to this discussion. I think that there are things to worry about in how it has set this up and whether it has built a bit of an inflation bias into the situation, but it has been very clear.

Lord King of Lothbury: We seem to be living in a world in which whenever a piece of bad news comes along central banks feel the need to go further with additional asset purchases, so we see a ratcheting-up of central bank balance sheets. To the extent that asset purchases last spring were designed to deal with a market dysfunction, would you not have expected those asset purchases to have been unwound in the summer and autumn of last year when the dysfunction had disappeared?

Donald Kohn: When they were undertaken in enormous size in March and April of 2020, it was primarily to deal with market functioning; then they were dialled back to some extent but not all the way back to zero, and were certainly not sold off. The purpose has shifted from primarily market function to primarily financial conditions, promoting recovery from the pandemic and getting back to the 2% target. Therefore, I would not have expected the purchases to be reversed or for them to stop buying, as long as they felt QE was helping them to meet their objectives. But you are right that the purpose changed over time. They were clear about that; that was in their announcements and discussion of it.

Otmar Issing: I basically agree with Don. I would raise one caveat. One should be very careful in talking about market functioning. Big investors in the world are already arguing that markets become dysfunctional when long-term interest rates rise a bit, because they are sitting on assets that will lose value if interest rates rise further.

One should not play into the hands of the big investors in the world, which have great influence. Central banks are very cautious about losses and being exposed to a critique from such large investors. In this situation one should be very careful. Central banks should consider whether this is the dysfunctional face of financial markets or just the interest of large investors that sit on fixed-term assets and want to sell them at a decent price.

Donald Kohn: Interest rates did rise in the United States by about 50 basis points in the first couple of months of the year and the Federal Reserve did not do anything. The Federal Reserve speakers said, "We think this reflects optimism about the future because of the fiscal stimulus and the rollout of the vaccines, and it does not require any counter from the Federal Reserve". Otmar, you should be reassured by that.

Q177 **Baroness Kramer:** In the previous session we heard the phrase that we often hear about the latest economic crisis, which is that this is a once-in-a-generation event. Supposing it is not, or that the crises or recessions are smaller but not infrequent, do central banks continue to have enough space to be able to continue to use QE, particularly if they have not exited? Do they have any other tools that would let them fight another recession?

Donald Kohn: That is a legitimate concern and one that motivated the Federal Reserve to look at its framework for achieving its 2% inflation target. We seem to be in an era of very low equilibrium interest rates. When those are low and something bad happens, even a mild recession, and the Federal Reserve or Bank of England's interest rates are still pretty low, they cannot be cut very much to fight that recession. That is a very considerable concern. The concern becomes even greater if inflation and inflation expectations continue to ratchet down.

In the case of the pandemic and perhaps future recessions, for the Federal Reserve or Bank of England, if interest rates are not high enough to fight that recession with interest rates, QE should be employed. If that is not enough, fiscal policy should be employed. From the 1980s, 1990s and the first half of the 2000s to the crisis, monetary policy movements have been enough to stabilise the economy in the United States. We had several decades of very mild recessions fought by monetary policy. It was too good to be true, as Mervyn King pointed out, but now we are not in that, in part because interest rates naturally stay much lower.

QE would probably have to be used again. Central banks should be thinking about the limits of that. Certainly, when Governor Bailey was thinking about using QE for market functioning, he was worried about reversing QE before raising rates. The central banks can buy an awful lot of securities and, quite frankly, Governments all over the world are issuing a lot of securities, especially in the United States, so running out of Treasury securities to buy does not seem to be a real worry, or purchasing becomes so large that it dominates the market and impairs the liquidity of the market.

There are some reasons to worry about continuously ratcheting up QE, particularly if the Treasury or gilt markets are not themselves growing. You need to think about that, but there will be a bigger role for fiscal policy going forward because monetary policy, frankly, does not have all the ammunition it needs to fight anything more than a minor recession.

Baroness Kramer: I wonder whether Mr Issing would like to comment.

Otmar Issing: I basically agree with Don. Your last remark reminded me of the discussion in the Fed 20 years or so ago that consolidation of public finance might lead to government bonds becoming an element of shortage in financial markets. You can imagine that I was never worried in that direction.

The important point you make is that on the interest rates side central banks have lost any room for manoeuvre. To some extent—we would disagree here—it is due to the fact that in the past central banks have acted to smooth any downturn in the economy too early. Fine-tuning has become more popular and has contributed to the decline and loss of the interest rate tool. But this is not the full story—I would agree on that.

On the first aspect, one should be aware that the economic downturn caused by the pandemic is not a cyclical one; it is very different from a cyclical development. The potential for an implicit recovery is much higher than in a normal cyclical downturn. Pent-up demand might lead to an explosion. For example, in Germany we saw that over Easter when people were allowed to fly to Majorca all flights were booked out within hours. We are all waiting to go to restaurants, et cetera, again. I am too old to catch up with all I have missed in the past year—but one should not compare this declining economic activity with a normal cyclical downturn. The question the Baroness raised about future recessions and the ammunition that is available to central banks is a concern.

Q178 **Baroness Kingsmill:** We have had a fascinating discussion this afternoon about the pros and cons of the tools available to the central bank. I would like to ask both of you what you think is more likely: sustained inflation or deflation. Where would you put your money if you were to bet? The subsequent point is about opening the discussion a little about the shift to average inflation targeting that the Fed has tried. Let us start with your prediction about which of the two extremes is most, or least likely.

Otmar Issing: I am not known for being too afraid about deflation. I think that discussions about deflation are mostly overdone. I am more on the side of the BIS. For example, Michael Bordo and others have studied all deflations in the past. The only case in which deflation was accompanied with depression was the global depression of the 1930s. In most cases we had neutral deflation, or what is even called good deflation, when deflation was accompanied by quite decent growth. For me, the risk of deflation is the biggest risk to the economy, it is true—but deflation is dangerous at the moment when we have a spiral of deflationary expectations, which induces the delay of purchases,

investment, et cetera, because it is expected that prices tomorrow will be even lower.

I have never seen that in any case, and I have discussed it with many experts. I have never heard that in Japan with low deflation there was ever a risk that deflationary dynamics would develop. For me, this is an indication that one should be careful about the risk of deflation. For me, the risk of deflation is the most dangerous situation, but it is relevant only when we have a deflationary process.

For the future, I refer to the new book by Charles Goodhart and Manoj Pradhan. The two have presented good arguments that we might now come out of a global deflationary situation, which means pressure on prices on the downside, and move in the direction of a more inflationary-inclined environment because of the shrinking of the labour force, globalisation losing steam, political considerations and demographics. There is a discussion on that, but I think that those arguments should be considered.

Donald Kohn: I think that the most likely outcome is of inflation remaining relatively stable and creeping up to some extent. I think that we will see some inflationary outbreaks as economies open up, because that is what we are seeing already as demand is rebounding. Otmar gave the example of flights to Majorca. I bet that the price of those flights went up pretty quickly when the airlines realised the demand.

I think that demand is expanding faster than supply in a number of ways. We can see this in commodity prices, the cost of shipping and bottlenecks of all sorts. That will give us in the near term much more of an inflation than deflation bias, but I think that will work through. As Otmar said, some of the demand comes from excess savings and, in the case of the US, very expansionary fiscal policy, which presumably will not go on for ever, and the supply bottlenecks will be worked out to some extent.

I worry that there are upside inflation risks and some of those supply bottlenecks may prove to be persistent, partly because, as Otmar mentioned, globalisation, which has been the relief valve on supply for the past two decades, is not as strong a force and to some extent is going into reverse. Part of the lessons from vaccines is self-sufficiency. I worry about that. I think that we will get through these inflation spikes. Central banks will need to look through them. As to whether it settles back down, there is a tail risk of more inflation out there. If I had to choose between deflation and inflation, at the moment, given the configuration of aggregate demand and supply going forward, I think that the risk is higher for the inflation side than the deflation side.

Baroness Kingsmill: What do you think of the Fed using average inflation targeting as a tool? Do you think that we should adopt it here? Would it work in both an inflationary and deflationary situation that could arise?

Donald Kohn: I think that it is necessary for central banks to look at how they will operate in this environment of very low equilibrium interest rates and, as we discussed just a few minutes ago, the lack of ammunition. Flexible inflation targeting is an attempt to put in place something that maintains the 2% inflation target but reacts to the asymmetrical downside risks presented by having very low interest rates. It does that by saying, "If we miss our inflation target to the downside, we should miss it to the upside to make sure that inflation expectations remain anchored at the 2% target". Having those expectations anchored is absolutely key to future flexibility.

Look at Japan, and Japanification. As Otmar said, it is true that Japan did not go into a deflationary spiral, but it has been sitting there at zero interest rates for decades. Its quantitative easing has ventured even further into purchasing equities and things such as that. Boy, it would be nice to avoid that. I think that what the Fed has done means that it will keep interest rates lower for longer in an effort to get them higher later. It is not an easy message. I do not know what the right answer is for the United Kingdom, but it is a problem. The Chancellor needs to be talking about this with the Monetary Policy Committee. Should its remit be rewritten in some way to adapt to this low interest rate environment? How does it get to 2%?

Q179 **Lord King of Lothbury:** I start by thanking you both for demonstrating yet again, if it were needed, that good central bankers, like good wine improve with age? We have heard a lot today about the independence of central banks. Of course, the quid pro quo of independence is accountability. You have both been on the receiving end, as it were, of accountability in representing your respective central banks to various forms of accountability. Do you think that in current circumstances there are ways to improve accountability, or are the current arrangements satisfactory?

Otmar Issing: I think that accountability and communication should go together. For me, the ambition to communicate on every detail has gone too far. Communication should be more streamlined and concentrated on achieving the mandate and reasoning behind policy decisions. With too many targets, communication and accountability will be totally blurred.

Instead of continuing with my poor words, I ask your permission to read a short quote from a publication by Jacob Viner back in 1964: "If you were to ask me what are the professed goals of most central bankers, I would say on the basis of what I have heard them say that if they were appearing before a commission … they would either include a wide range of goals, including virtue and motherhood and also everything they could think of which is nice and good, or insist on the lack of power of central banks to serve effectively any specific important goal".

Donald Kohn: I agree with Otmar that central banks need to be clear about what they can and cannot do and what they should and should not be held accountable for because they do not have anything to do with

those outcomes, and they should not promise to do things that they really cannot do.

I worry a bit—my friends in the Federal Reserve may not like this—about where the Fed is going with its maximum employment mandate. It has started to define it in terms of relative prices and wages of one group and another and relative unemployment rates between groups, and it just does not have the tools to do that. That is the job of the fiscal authorities. You are trying to keep your eye on that sort of thing, but it is really the aggregate labour market and the consistency of maximum employment and stable prices that is important.

One trend that I like—I am not sure whether Jacob Viner would have approved of this—is central banks reaching out to more and more people, not just talking to financial professionals, legislators and academics but trying to explain themselves to ordinary folks. One benefit of that is that you have to come up with a story about what you are doing, and why, which an ordinary person of average intelligence without an economics or finance degree can understand. That is a tremendous discipline and one that I always tried to work within myself as I was making policy, not always successfully. But I think that the effort of both the Federal Reserve and Bank of England to reach wider audiences is an important one that should be encouraged.

Lord King of Lothbury: Our own report is obviously a step in that direction, too. Thank you both very much.

The Chair: May I add to Lord King's thanks to both of you for giving evidence to our committee today? I never thought that I would say this, but it has been very entertaining to hear from three central bankers, one as a member of the committee and two as witnesses. It has not only been entertaining but very informative. We are extremely grateful to you for taking the time to give us the benefit of your experience and wisdom in these matters, which I am rapidly beginning to learn are not that easy to deal with.