Reducing the power

__Paul Tucker__ examines the issues around unelected power and legitimacy in central banking, arguing that there is a lack of accountability

More and more of our government seems to be in the hands of technocrats insulated from day-to-day politics: activist judges, independent regulatory agencies and, of course, central bankers, who have become the poster boys and girls of unelected power.

After the twentieth century's Great Depression, politicians did the heavy lifting. This time round, central banks have led the way in reviving the economy and redesigning the financial system. They have used their balance sheets on a truly gigantic scale to influence credit conditions across markets, steering the allocation of resources and taking risk in ways that blur the boundary between them and fiscal authorities.

In the US, the Federal Reserve has yet to shed the perception, however inaccurate, that it overstepped the mark in some of its crisis-fighting measures a decade ago. In Asia, the Bank of Japan sits, in close partnership with its government, in the antechamber to monetising the country's vast debt. And, in Europe, the ECB finds itself acting as the existential guarantor of the project it serves – an accidental economic sovereign.

On top of all that, central banks have been given many new regulatory powers, both microprudential and macroprudential, making debates about the legitimacy of the regulatory state as pertinent to their position in government as the more familiar arguments about monetary policy.

In *Unelected Power*, published by Princeton University Press in May, I try to make sense of this: how we could make the extraordinary power of the post-crisis central banks, and other independent regulators, safe for our democracies.

Avoiding undemocratic liberalism

There is little doubt that unconstrained unelected power could be a big problem. Imagine an independent agency that had many powers but only the vaguest purpose and objective. Who would be able to tell whether it had succeeded in its mission if it set its own goal posts? That is at odds with some of our deepest values: just as "no taxation without representation" was a rallying cry a couple of centuries ago, why do we not today demand "no regulation without representation"? However much politicians might be tempted to shed blame by delegating, it is likely to infect our system of government in the long run.

None of this is local, confined either to the UK or central banking. Even in the US, where the modern shape of the administrative state goes back to the New Deal and beyond, opponents continue to protest that the separation of powers and the Constitution have been violated. In France, a new statutory framework for independent agencies was introduced a couple of years ago following an excoriating report from the Senate. In the UK, by contrast, reservations during the 1980s about how independence could be squared with accountability to parliament have given way to a striking combination: an almost casual attitude to who holds the instruments of state power coupled with scepticism about "experts".

This is all part of the broader debate about technocracy versus populism. On the one hand, independent agencies can sometimes achieve better results by avoiding the swings in public policy associated with electoral politics. This is the core of the case for independent monetary authorities. On the other hand, they can seem to be a form of undemocratic liberalism associated by some with a dilution of democratic governance entailed by globalisation and economic liberalism.

> *As a rallying cry today, why do we not demand 'no regulation without representation'*

The Principles for Delegation

For our democracies to remain healthy and resilient, we need norms for whether and how to delegate power to independent agencies that measure up to the deep political values associated with democracy, the rule of law and constitutionalism. My book proposes and defends just such a set of Principles for Delegation.

Among the most important are:

• power should be delegated only where the public's goals are broadly settled, better results could be achieved via enhanced credibility, and the technocrats do not have to make big choices on values and distributional issues;

• the agency should be given a clear objective that can be monitored;

• decisions should be taken by one person, one vote committees; and

• where an independent agency has multiple missions, each one should be the responsibility of a distinct policy body within the agency, with a majority of each committee's members serving on only that body.

That short summary highlights some of the issues concerning the legitimacy of the regulatory state. Many regulatory agencies around the democratic world have vague objectives and only one real decision taker. In the UK, for example, the Financial Conduct Authority has more formal independence than the Bank of England (BoE), and also more than its US peers, but it has multiple, equally ranked objectives, all of which are vague. The various economic regulators, such as Ofcom, Ofgem, etc, each have a single director-general overseen by lay and part-time boards whose members do not testify to parliamentary committees on their personal policy choices and votes, so that power over policy is, in effect, highly concentrated.

In the central banking world, it is not obvious that anyone knows how to frame macroprudential policy in terms of a clear objective for "managing the credit cycle" that lends itself to being monitored. That is why independent stability authorities should be confined to preserving the resilience of the financial system, with politicians deciding general policy on how resilient core intermediaries and infrastructure should be.

Then there is the familiar worry that a multiple-mission central bank has incentives to put much more effort into its most salient function – monetary policy – while relegating banking supervision. In the decade or so before the Great Financial Crisis, that risk seemed to crystallise in the Fed under Alan Greenspan. And worries about it, reflected in once fashionable New Public Management doctrines, helped to motivate detaching responsibility for banking stability from the BoE in the late-1990s.

This was a major influence on the design of the UK's post-crisis financial regulatory architecture. Specialist committees were established within the BoE for stability policy (Financial Policy Committee) and microprudential supervision (Prudential Regulation Authority), each having a majority of specialist members. It is they who should be summoned first to account to parliament for their prior votes and actions whenever serious stability problems occur in, respectively, the system as a whole, or individual intermediaries.

Central banking today

Where does this leave central banking? Advanced-economy democracies need a money-credit constitution governing the central banks and the banks. It would cover the constraints on the business conduct of and risks in banking, including shadow banking; what central banks must do (their mandate); and what they may and may not do.

The mandate should be monetary system stability. It has two components: stability in the value of central bank money in terms of goods and services; and also stability of private-banking system deposit money in terms of central bank money. The constraints would cover the balance-sheet interventions known as credit easing, and would, at last, give the lender-of-last-resort function a statutory objective.

The prohibitions would rule out responsibility for competition policy; the structure of the financial services industry, as it involves high-level trade-offs between efficiency and resilience; its external competitiveness, as that invites political pressure to adopt "light touch" regulation; consumer protection; and market regulation. Staying out of those fields is not yet a standard norm for central banking across the world's main democracies.

> *"People may react especially badly when let down by their unelected governors*

Conclusion

Around the world, most obviously in the US and continental Europe, central banks' independence and/or the extent of their power is being redebated. This is not happening in isolation. As *Unelected Power* discusses, it is part and parcel of broader discomfort with the reach and scale of delegated technocratic governance.

Facing up to this will mean finding ways of combining the benefits of credible commitment (the key social benefit of delegation-with-insulation) with constraints on functions, objectives and processes that recognise our deep political values and traditions.

Since every part of government goes wrong eventually and since people are likely to react especially badly when let down by their unelected governors, it is worth the effort. ■

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