The reality of Central Bank Independence

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I have been accused of many things in my time, many of them untrue. Of late it has been suggested that I have posed a threat to the Central Bank Independence (CBI) of the Bank of England. This is, apparently, a spin-off from People's Quantitative Easing.

Let me come to the core of my argument first, then explain why I think that core argument is right. What I have argued is that the UK needs a National Invetsment Bank (I once called it a Green Investment Bank in the days when PQE was Green Infrastrxuture QE, but the semantics do not matter). And I have argued that this NIB will be financed by bonds, some of which (and it is a proportion to be determined as appropriate at the time when these events happen in the future) might be bought by the Bank of England to represent, as Paul Krugman has out it, an investment by the Bank of England in 'stuff' and not 'financial assets'.

And for the record, I do not think this does in any way challenges the current structure of CBI. Ignore the myths when saying that: I am saying it does not challenge the reality.

So let's also be clear what I have not said. I have not said that the NIB would only be funded by PQE: others opposing the idea have assumed that, but I have not said it.

And then let's be clear about what I have said, such as explicitly saying (to the FT in early August) that PQE would not be needed if there was a ready market for NIB bonds and QE itself was not required. I have heard, for the record, Jeremy Corbyn say the same thing since then, although that is not material to what I am saying here.

I have also said, quite explicitly, that I do see an advantage to NIB bonds being explicitly marketed as a pension product in an ISA-style wrapper: I would envisage this as an NS&I product, and think it could be very attractive. That is explicitly a debt sale.

In that case let's summarise the unambiguous message I have given, which is that the Treasury could, and in my opinion should, include bonds issued by the NIB in any future QE mandate it issues to the BoE.

As I have shown by publishing on this blog letters issued by the Treasury to the BoE the

Treasury does, with regard to QE specifically authorise the sums to be spent, the time scale for spending and the asset classes to be invested in and in the process explicitly underwrites the risk to the Treasury of the transactions in question. So let's be clear: under any normal contractual interpretation of the arrangement entered into this relationship is at best a nominee arrangement with the BoE acting as agent for the Treasury and in the broadest possible interpretation is a limited form of blind trust where only the precise timing of engagement is devolved to the BoE by the Treasury. Legally no other interpretation is possible in my view. And in neither case can the BoE be considered independent in any meaningful sense. I think such cold analysis useful, and appropriate. Economists might dream what they wish but in the real world facts matter,

And bar the inclusion of new asset classes, such as PQE or helicopter money (which many of my critics espouse) in QE authorisation from the Treasury nothing I have said change those facts in any way. All that the Treasury would be doing if either such class were authorised for use would be extending the options available to the BoE if the Treasury also decided QE was necessary.

Now the contentious point in what I have just said is that it is the Treasury decides QE is necessary. Please refer back to the letters I have published from the Treasury on this point. They are explicit: the decision on QE was the Treasury's. If they were taking the risk it could not have been anyone else's. I could rest my case there. But for those in doubt please read the Bank of England Act 1998, which sets out the terms for CBI in the UK (without ever mentioning QE, of course, as it had not been thought of then).

Section 10 makes clear the BoE has some responsibility for monetary policy.

Section 11 says its obligation with regard to monetary policy is to maintain price stability. But it also makes clear that the BoE has a duty to support the government's economic policies including those for employment and growth.

Section 12 makes clear that the Treasury specifies policy and the BoE does not.

Sections 13 to 18 set out how the MPC works when considering interest rates and what they must publish, and nothing changes here as a result of what I have suggested.

Section 19 makes clear if the MPC does something the Treasury does not like it can be over-ruled.

So, in summary, the MPC is given delegated power within strict limits to set interest rates, about which it will, in any event, talk frequently to the Treasury, and now within even tighter limits it makes decisions on the management of QE programmes. I stress, that is management and not the strategy or even policy: because the risk lies with the Treasury it is obvious that the strategy and policy decisions on QE lie with the Treasury. And PQE does not change that, at all.

One final point then: as has been widely agreed, PQE is fiscal policy, not monetary policy. That's important: the Bank has a legal duty to support government fiscal policy. Whether we are arguing about something over which the BoE or MPC really have any choice at all is a very good question. Legally I would suggest they have probably got none at all.

Now I am well aware that no one would want relations between the BoE and Treasury to be run on the basis of legal threats: that would be deeply undesirable. But in that case it is also wise to look at reality. I fear those who are claiming CBI is so important have not looked at the facts of what has actually happened on QE, what the real legal relationships are, how my suggestions really change them and have no, as a consequence realised they actually change nothing.

It would be good if they did because then we might have a more meaningful debate. Unless, of course, I have missed something. Please then point out what it is, but can we stick to the facts?