Funding the Future

The role of the Bank of England - the debate continues

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I wrote my blog on the objectives of economic policy and the role of the Bank of England within it yesterday for a reason. It contributed to a debate I was having with others.

An economist replied in that debate, saying:

I really do not understand this rejection of the almost universal received wisdom of mainstream economics over the last 40 years. We do have evidence of an extremely successful policy regime when interest rates are not at their lower bound.

In other words, the claim is that opinion does not matter on this issue: we should continue with Bank of England independence because the policy worked, and still will if we do not have interest rates at the lower bound (or near enough 0% in plain English).

I made a four-part response, arguing in summary that:

a) We do not have Bank independence now. What we have instead is a charade of independence, because the Bank of England Act 1998 makes clear that the Chancellor can take back control whenever they wish;

b) Granting control of economic policy within a democracy to an elite is a dangerous thing to do;

c) There is substantial empirical evidence that the system does not work: 2008 was proof of that, and the comments of Alan Greenspan and Adair Turner both provide evidence that the assumptions underpinning the arrangement were found to be at fault at that time;

d) It is now likely that we are living in an era of near-perpetual low-interest rates, and events in the USA do not, for example, prove otherwise: when their 50 year bond rate is lower than the 30 year rate there is some indication that markets are reacting to current circumstances, and that movements are politically, and not economically driven.

I was curious to receive a response suggesting:

1) If it is a charade don't worry about;

2) We grant power to elites throughout society: for example, we expect doctors to set drug policy for the NHS and so an elite should set interest rates as they are better able to do so than politicians who do not have the technical skill to do so;

3) The evidence of the post-2008 era cannot be used to dismiss the evidence of the pre-2008 era because in the post-2008 era monetary policy has not been possible. That does not prove that it isn't a superior policy tool.

4) Fiscal policy is needed when at the zero bound, but we are moving out of that era now and so the argument that it is more useful now falls away.

I summarise of course. But I do think a response is appropriate.

Do charades matter?

I was astonished to be told that charades do not matter. The whole field of political economy looks at the ways in which relationships of power influence the allocation of resources in society, and in the process considers the ways in which those relationships of power are created, including by artifice, subterfuge and charade to achieve results that are inconsistent with the underlying supposed principles on which actions are claimed to be based. We look at these issues because they matter. The whole of offshore is based on games of misrepresentation. If the supposed state of Bank of England independence is as well then the consequences are significant because the real agenda has to be established. The substance of the relationships has to be considered, and not just the form. It is not acceptable for economists to consider form alone.

The role of elites Experts have a very clear role in society: I hope no one would suggest otherwise. But I have a real problem with the suggestion that elites are experts. And as far as I can see being a banker, or being an economist, is not a qualification for having expertise in making the political judgement on the stimulus or otherwise needed to direct an economy, which is always a political choice. The suggestion that bankers and economists do have such expertise is not just misguided but is closed minded to the possibility that alternative opinion exists to the mainstream economic wisdom of the last 40 years. Such mainstream opinion, which did create the situation that led to the 2008 crash, is a contestable wisdom in that it is based upon assumptions, and so prejudices, that not all might accept and as a result the exercise of judgement within the boundaries it sets is not about the expression of expertise in some impartial fashion but is instead about the operation of power within a particular framework that is pre-disposed to favour certain interests, including those of bankers and mainstream economists, over others. This is not then the exercise of expertise: it is the expression of elite power, which is something very different indeed. **Empirical**

evidence I am entirely willing to accept empirical evidence, within the boundaries within which the research took place. Extrapolation beyond those boundaries is always dangerous. It is my contention that the pre-2008 economy has gone for good: there will be no return to the old 'normal'. Most informed opinion seems to think we will face perpetual low-interest rates. That is because it is apparent that the experience of QE has changed the role of central banking and interest rate setting forever, but that use of QE only happens (and this is true despite the new Hammond / Carney agreement, which if anything reinforces my suggestion) within the boundaries of acceptable political consent. And in that case it cannot be argued that what held true in one circumstance pre QE now holds true in another post QE. When the only two instruments of monetary control were fiscal policy and the interest rate empirical results indicated one thing. Now we have three instruments: fiscal policy, monetary policy and QE, with the latter being capable of use to support either fiscal or monetary policy: it is quite specifically not a pure instrument of monetary policy. To restore the old regime when QE has, to coin a phrase 'changed everything'; makes no sense at all. The empirical evidence is that monetisation via QE is here to stay. But in that case the use of that power to support broadly based economic policy is essential and central banks quite specifically do not have the expertise to do that. **The zero bound** I would argue that even if things are changing in the USA, and the evidence of that is ambiguous (The Krugman v Baker debate on full employment is some indication of that, as is that fact that long-term US markets are ignoring short-term interest rate policy as if they see this as a temporary political aberration, which I suggest that it is) they are not changing in the UK, which is my concern. Nor, come to that, are they changing much in Europe. The zero bound is here to stay. Why on earth build an economic policy on a scenario that has been inoperative for a decade and is likely to be so for time to come in that case? What is the point of putting dogma ahead of the requirement for arrangements that have a chance of working? I have no objection to there being arrangements where the Bank can advise on (but not control) future interest rate changes. Such a policy would make sense. But to pretend that monetary policy has any significant likely role for some time to come makes no sense at all: the UK economy simply cannot afford that it might, excepting a response to a crashing out from the EU, when any decision would have to be politically led in any event and is bound to replicate the futility of Black Wednesday, come what may. I will be sharing my opinions with my correspondent.