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TREASURY COMMITTEE

DR ADAM POSEN—POST-MONETARY POLICY COMMITTEE DEBRIEF

TUESDAY 22 JANUARY 2013

DR ADAM POSEN

Evidence heard in Public Questions 1 - 78

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Oral Evidence
Taken before the Treasury Committee
on Tuesday 22 January 2013

Members present:

Mr Andrew Tyrie (Chair)
Mark Garnier
Andrea Leadsom
Mr Pat McFadden
Mr George Mudie
Mr Brooks Newmark
Jesse Norman
Mr David Ruffley
John Thurso

Examination of Witness

Witness: Dr Adam Posen, former external member of the Monetary Policy Committee and President of the Peterson Institute for International Economics, gave evidence.

Mr Andrew Tyrie (Chair): Thank you very much for coming in to give evidence to us this morning and, of course, some of us had the benefit of some very interesting exchanges with the Banking Commission only a few hours ago. Can I begin by asking you a question in relation to the appointment of Dr Carney? You said on that, and I quote, “You just don’t want to put too much power in one person’s hands. And the new rules means the UK Governor has enormous amounts of power and discretion.” Is that too much power?

Dr Posen: In my opinion, yes. I want to say again for the record, Chairman, that I am very grateful for the Treasury Committee inviting me back. It is important to me to be able to continue to try to contribute to your discussion, so thank you very much for that.

Mr Andrew Tyrie: We are grateful to you for coming, as was the Commission yesterday, bearing in mind you have considerable responsibilities over at the Peterson Institute these days.

Dr Posen: I have to make sure that the lights stay on but yes, thank you for that. In terms of too much power in one person’s hands, Mr Chairman, let me be clear, it is not so much anything to do with Mr Carney specifically. It is to do with the description of the job, and then the amplification of the sense that it is this one individual through the contracting process—for want of a better word—that the Government engaged in with this person, but I think the fundamental thing is the design. One has to hope that the combination of the FPC and the MPC together puts some sort of check on any one individual having too much power. It is not “power corrupts” in a trivial sort of clichéd sense. It is that, as I think I said to some of you at some point, I know full well that the Governor and the current two Deputy Governors basically work 18-hour days, seven days a week, 365 days a year. That does not give them time to reflect. That does not give them time to assimilate. That makes them
understandably grateful, when they are in a good state of mind, for outside opinions, and resentful for being harassed by outside opinions, in their perception, when they want to just get something done, and there have been instances where, understandably, that has run up against the Committee. I think now, with the FSA folded back in under its new name in the Bank of England it is just going to get worse.

Mr Andrew Tyrie: What is the solution? Have you looked at the accountability proposals of this Committee?

Dr Posen: Yes, I have, and I think—

Mr Andrew Tyrie: Specifically, the proposal that the court be turned into a more meaningful board, which can perform more of the corporate governance duties that most other institutions’ have boards to do.

Dr Posen: Yes. If one takes the current structure as largely given, I think that is a very big improvement you can make and the Committee is right to push that. As you made clear in the hearings with the court—I think, roughly a year ago—the court has been excessively weak and has let the present Governor, but whoever was Governor, get away with whatever—

Mr Andrew Tyrie: Is that an institutional weakness, the fact that they are not given tools institutionally and by statute, or does it have other sources?

Dr Posen: It is related to the discussion we had yesterday with the Banking Commission. With any of these things there is a cultural issue, which reinforces the institutional matter and then the personnel matter. I think the important place to start is with the institutional measures you and the Committee are pushing. If you put the right people in with such a setup that then will create the culture. Without wishing or hoping for any problems, there might have to be some incident early in the new court’s term where they publically draw a line on something and send a message—not just for the sake of doing it; I am sure there will be a reason for doing it—and that will be an important precedent.

If I may add one more sentence, Chairman Tyrie, that, in addition to empowering court in the ways you are talking about doing, a key thing for you to tell the Court of the Bank of England is that, for many of the operations of the Bank, the Governor should conceive his job as more of a chairman than as an executive. The Governor should be delegating to Deputy Governors. Be it in the PRA area, the financial stability area or the monetary policy area, the Governor should be delegating more to the Deputy Governors and the staff. That is well within the remit of a refined court to say that is how they want the Bank to run.

Mr Andrew Tyrie: Given the current statutory framework, the new framework that gives the Governor so much executive leadership and authority, what is the prospect of this self-abdication you are proposing in the long run?

Dr Posen: I view it not as self-abdication. I view it as imposed job definition, which a strong court, with the backing of this Committee, can impose.

Mr Andrew Tyrie: Notwithstanding the Governor’s formal statutory powers and responsibilities?

Dr Posen: If it were up to me, I would have written the statute differently.

Mr Andrew Tyrie: We have a chance to amend it further. We have a commitment from the Government that they will take amendments from the Commission, so if you have proposals let us know.
Dr Posen: I will do so. I will prepare something because, frankly, I believe it goes too far. Prior to joining the MPC, my background as a researcher and policy adviser was comparative central banking. That was my main field of expertise and work. The current formulation of the Governor of the Bank of England would be the most powerful single central banker in a major central bank, and it is not clear that lack of centralised power at the Bank of England was the cause of any problems in the past.

Mr Andrew Tyrie: That is a very euphemistic way of putting it.

Mark Garnier: You recently wrote an article about Japan and what they should do in order to try to sort themselves out. What warnings do you think we in the UK should heed from what has been going on in Japan, and do you think we run the risk of Japanification of our economy?

Dr Posen: I don’t think the UK runs a risk of Japanification in the sense that most of us mean that. The sense that I think you and I would mean that is a decade of unremitting stagnation, near deflation, and essentially a high level of stagnation and a high level of income with very little volatility or very little change. To my mind, the fundamentals of the UK economy are different from Japan’s, in particular, because of the demographics. You have a younger population, you have a more diverse population and you have more of a free market economy in many ways.

I also think that, rightly, the Bank of England has been doing more to oppose deflation and keep the economy on a good track, or at least a better-than-it-would-have-been track. I am proud of what we have achieved in that regard, which the Bank of Japan failed to do for most of its last decade. So I do not think that is right but I do appreciate you citing my article, Mr Garnier, and I think there are a few lessons. The first is related to the things we discussed yesterday. As I have said many times in the past—and I apologise for repeating—for me the most worrisome parallel between the UK and Japan, in economic terms, is that Japan had a very concentrated banking system with a few major banks, which kept getting more concentrated, and very few alternatives to that banking system for funding business. In fact, one could argue that, as bad as that was, at present the UK system is even more concentrated, with fewer banks, and has fewer alternatives for funding in domestic currency for its companies. To me, that is a major worry going forward and a major part of the reason the UK has not recovered as well as it should have.

The second thing, taking from the fiscal side of that article, which is obviously very much in the news given today’s announcement about borrowing, is that the UK is not going to wake up one day and be Greece. The UK may or may not get a downgrade or a warning from ratings agencies. What the UK does have to face, as Japan did, is that you have to pay attention to the cycle, which cuts both ways. I am on record now—I wasn’t while I was at the Bank—as saying I think the Chancellor is overly aggressive in his plans of austerity at present. You have to take the lesson from Japan that when times get good again, and even in Japan they did get good again, you have to consolidate. That is where I feel Japan made a mistake. That is why I am on record in that article saying I do not want to see more fiscal stimulus in Japan right now.

Mark Garnier: Do you think the European problem is something that also causes great confusion, when you are comparing them with Japan, in terms of the problems going on there and, given that a great deal of our exports go to Europe, that that is also acting as a fiscal drag?

Dr Posen: Absolutely. There is no question there is a drag from that.

Mark Garnier: Which we can do nothing about.
Dr Posen: To a first approximation there is nothing you can do about it at the moment, and I am not going to deny there is a European drag. That would be ludicrous. I do think that we should be a little cautious. There is a tendency to exaggerate the size of that effect because of two things. The first is—as the Prime Minister pointed out a few years ago—the structure of UK exports is very heavily dependent on Europe, from Ireland on through. I do not want state direction but there is something not great in the economy. The UK economy has not adapted enough to exporting to new markets around the world. As these markets are trading short-term and then long-term in Europe, there has not been a shift in where the UK is exporting to. I do not think there is a switch the Government can throw, and there is nothing the Bank of England or anybody can do overnight on that, but I think that has to be viewed as something indicative of a problem. I must admit I do not understand why, but it is an issue.

The second but smaller issue is that other countries, including Spain notably, have managed to expand their exports even in the face of the contraction. The reason the UK hasn’t is in part because of dependence on Europe, in part because of confidence problems in the UK and in part because of investment problems, both in the sense I talked about the financial sector, and my former colleague, Ben Broadbent from the MPC, I believe, has said to you about his theories on how banking system problems interfere with reallocation across the UK economy.

I am sorry to give you such a long answer. I apologise. But, no question, the Euro area drag is big. It is important. No question, there is nothing we can do about it directly. There is an issue why the UK is not adapting more in terms of switching markets. One of the reasons the UK has had such a problem because of euro area export markets is because we are not reallocating capital, which goes back to the financial system.

Mark Garnier: My final question is about the banking union with the EU. Obviously we have had some announcements that have come out, but do you think the proposals amount to a proper banking union, without common deposit protection or resolution regimes?

Dr Posen: I am not sure whether the right way to phrase it is yes or no, so I will just say I think a banking union without common deposit protections of some sort, and especially without a common resolution regime, will be at best a halfway house and cannot function for the long term.

Mark Garnier: That is very helpful. Thank you.

John Thurso: My apologies, again, for having had to leave yesterday and miss most of what you said. I will read the transcript. If I end up asking questions that were already asked, I ask for your forgiveness on that.

Through 2011 and 2012, you made a number of speeches highlighting the structural failures of the UK financial system, in relation to domestic credit and also the credit availability for SMEs, and you just touched on it a bit in your answers to Mark Garnier. How fundamental a problem is this, and what should we do about it?

Dr Posen: To me, it is a very fundamental problem. The analogy I would make is similar to when Baroness Thatcher came in in 1979 and had to confront long-seated but peaking problems in labour markets, which were exacerbated at the time but reflected deep structural problems. I think the analogy is valid, depending how you count it—40 years, 50 years, 100 years—that domestic business finance, particularly for small and new businesses, has been relatively neglected in the UK. The breadth and diversity of financing sources in the UK has been pretty meagre, particularly, as someone mentioned yesterday, since the euro-dollar markets made the City into something that makes money doing export of financial services and not so much money from the high street. It is a structural long-standing problem and, in mainstream economics terms, I view it as a market failure. It is not a market failure in
the abstract sense, which, say, pollution is, in that you do not capture the full price of what you are doing. It is a market failure, in the sense that if we look around at comparable countries—France, Germany, US, Italy, Japan, which for various reasons we could compare or not compare, and Ireland even—the degree and depth of small business financing and new business financing is just paltry in the UK, compared to these countries. There is no a priori reason that should be the case, except through accident of historical development.

What should be done about it? I hope you will not catch me out if I give a slightly different list than yesterday, although I am assuming it will be about the same. You need more new entrants into the banking system, which I know this Committee and also the Parliamentary Commission are looking at. You probably should at least break up the banks that are currently in Government public control. I don’t mean smash them; I mean in a rational way turn them into multiple units. You need to look at the players.

**John Thurso:** Can I just double-check on that? What we are saying is this is nothing to do with the argument about universal banks. It is nothing to do with the argument about “too big to fail” or complexity. It is about the competition issue. As the owner of RBS, you have an opportunity to re-create NatWest and Bank of Scotland as two players. You have an opportunity to take a chunk out of the Lloyds Banking Group and re-create it. So you end up doubling the number of high street players. Therefore, the policy goal is nothing to do with the arguments about casinos or utilities or anything else. It is purely about creating a more competitive landscape in the domestic UK credit market.

**Dr Posen:** You said that very well. I would completely agree. Let me make just two tweaks. First is, yes, you justify this solely in terms of having a more competitive banking system within the UK, thereby ideally leading to lower prices, more innovation and more diversity of products. You do this on a consumer basis, the same way any good liberal economist would look at any oligopolistic situation. The consumer here means not just household consumers, but small and medium business borrowers.

The second thing is—and I am sure you did not mean it this way, Mr Thurso—I do not want to say that it necessarily has to be NatWest, RBS, HBOS or Lloyds. There may be a more rational way to break it up. As was discussed at one point, the best thing might be to sell off a bunch of Lloyds branches to The Co-operative or for some rising alternative. I do not hold a brief for The Co-operative. The key is to get some new players over the barriers of entry that are inherent in setting up competing banks. I agree with you, there is the “Too big to fail” argument and the Vickers Commission splitting up banks argument that supplement this, but it is ultimately a competition.

**John Thurso:** In your March 2012 speech at the NIESR—I think it was called, “Why is their recovery better than ours?”—you contrasted the US and the UK. On investment, you noted in particular that, for the timeframe you were talking about, investment in the US had been 1.7% while the comparable figure in the UK was 0.6%. You were very much looking at competition and the lack of credit as being that. You have made one suggestion, which is to create more players in the high street. What other things should the Government and policymakers seek to try to do?

**Dr Posen:** I think there are a few. I do not want to cause bad feeling but, in a sense, I think the UK—you policymakers—should be thinking essentially the same way that Malaysia or Brazil did 10 years ago. They went to the World Bank and said, “What is best practice? We have an underdeveloped financial system. What can we do to create the institutions that give us a more developed financial system?” There are literally playbooks that you can get.

What is involved in that? A key point is not just the competition and entry we were talking about, but also thinking in terms of diversity. That was a point I tried to make in that
speech, which I appreciate you referencing. Despite all the brilliance of the City, the venture capital market domestically in the UK is rather small. The commercial paper market is rather small. The bond market for sterling denominated corporate bonds is exceedingly thin. That is part of the reason the Bank of England MPC did not buy corporate bonds as a measure of QE, because we were worried we would buy up the whole market in no time flat. That is not a reason for changing it but that is just an indicator of how thin it is. Junk bonds basically do not exist.

In terms of types of banks, right now we have the four huge banks, or arguably five, if you include HSBC, which does not have much of a domestic presence, plus Nationwide, and then a smattering of small banks. One of the things that Germany and the US do is they have a variety of types of banks. In Germany you have the Sparkassen and the Volksbanken and so on. In the US you have community banks, credit unions and so on. You can talk about chartering all kinds of new institutions. That would be something else you could do.

Finally there is the proposal that I made, which others have made and a number of people have supported, including the Liberal Democrat and Labour parties, and it has been mooted in the Chancellor’s Autumn Statement, and that is to have a business bank in the public sector for small and medium business. As I discussed with Lord Lawson in the Committee yesterday, once it is set up and functioning you will probably want to privatise it. Because of the historical development of institutions and the state the UK financial system is in, I do not think you can just naturally get there from here—there being having a fully functioning small and medium business lending apparatus—without some sort of Government intervention to take it from the current state to the future state. As I said, I think, to Baroness Kramer yesterday, there are a few flowers blooming of alternative finance, but I do not think it is a thousand flowers and they are not perennials. You may have to tear up the whole field before you can plant your thousand flowers. My arguments for such a business bank and a securitisation entity are separate from and do not depend on a Government subsidy, the Government subsidising loans to new business, just making them available, so there is no reason you could not privatise it some years down the road.

**John Thurso:** Good, thank you very much.

**Chair:** If you could speak up just a little.

**Dr Posen:** I apologise. I am always worried I speak too loudly. I will try to speak up. I am terribly sorry.

**Chair:** It is well worth listening to.

**Mr Ruffley:** Dr Posen, you have articulated a powerful argument for there being a massive structural problem with the credit market in the UK, and you contrast it with America, Germany and other countries. I was quite interested by what you have just said now, but also by what you wrote in your *Prospect* article, where you suggest that the British Government, the politicians, should benefit from the handbooks that the IMF and World Bank have written for creating new markets, to actually make markets in commercial paper, and you refer to Southeast Asia and Latin America, indeed. Could you give one or two examples of how such a new structure was got up and running, how quickly that would work, and what are the models you are invoking there?

**Dr Posen:** Thank you, Mr Ruffley, I will try and I will try to speak up. Let me be clear, I am not suggesting the UK has the distance to climb that some of these Southeast Asian countries have to climb from where they were coming. It is just that the thought and institutional process should be one of saying, “Okay, we need to put in some effort of building,” or as you say, “making markets”.

What would be examples? You can look particularly at Brazil right now as a success story, or Mexico, if you want to look in Latin America, where you go back 10 years and there
were simply nonexistent domestic denominated bond markets for business, and they now exist. What are the key things? One of the things that happened in these countries that of course is not an issue here in the UK, is you needed some sense of price stability, basic stability. You got that.

The second thing that happened in these countries is you did have specific Government encouragement, to either charter new institutions—and this goes to the point about where you want to draw the line on what institutions can do—or that new lines of business should be pursued. Part of that was you initially had some Government guarantees, very briefly, for why portfolios have this stuff. You did not guarantee any specific issue. For example, a regional food processor in Lancashire, the Government did not get in and guarantee the specific issue of that food processor. However, they might come in and guarantee a variety of issues and say, “Okay, on balance, you’re not going to lose money on this whole portfolio.”

A third thing that I think is important, which the Bank of England can contribute, is that you make it so that the Bank of England is willing to accept these securities for discounting, and that helps. Repeatedly, both in British financial institutions and throughout the world, when the central bank is willing to accept a security for discounting, that helps create the market. That goes back to the proposal I made before—which frankly was not the case in Southeast Asia or in Brazil/Mexico—of creating something for securitised bundling, and securitising the debt of what are inherently illiquid, small loans and small bond issues.

I must admit that there are other things. There is a lot of knowledge out there that is more detailed than mine, and I am very happy to provide a list of people and references to the Committee, if you are interested. The basic idea is you create specified charters, you make these markets liquid, you help get the first issuance out there without trying to back any particular company’s borrowing, and you get the central bank involved in making the market. Those things together usually are enough to make it take off.

Mr Ruffley: In an earlier answer, you said that one of the reasons the asset purchase facility was restricted to bonds was because there was so little commercial paper to buy up. Because of that, your proposals—which you have outlined, I think, very powerfully—must have been a subject for discussion in the MPC. Is that right? If so, how were your proposals met?

Dr Posen: To be totally honest with you, it was not a subject for discussion in the MPC because it was not defined as part of monetary policy, and it was not—

Mr Ruffley: Having a market in commercial paper that you could tap into in the asset purchase facility, that is part of monetary policy.

Dr Posen: Yes. Let me be clear, I am not saying it should not have been discussed because it was not part of monetary policy. I thought you were asking me an historical question of, “Was it discussed?”

Mr Ruffley: Yes.

Dr Posen: The answer is, no, it was not discussed because it was deemed not part of monetary policy. The decision was made by the Bank’s executive that the MPC should not be talking about anything to do with the nature of the markets, because we had no legislative authority to do anything about them. We were told it was not our place to propose and ask for new measures, although I chose to do so independently in my speeches. So it was not discussed in the MPC. The only thing is that, on a few occasions over the three years that I was on the committee—as I think I have said to this Committee before—a couple of members would say, “Gee, if we are worried about the effectiveness of monetary policy, wouldn’t it be nice if we could buy something other than gilts?” Then in very short order we would have a
discussion, and the executive of the Bank would make it clear, “We do not think it is a good idea for this committee to buy anything other than gilts. We are opposed to that. Just take it as a reality, these markets are thin and, if that is the reality, you should not be buying them.”

Mr Ruffley: Understood. Is it your understanding that under the soon-to-be effective FPC, when it comes out of its interim status, when the full panoply of powers are in place, that they would be able to discuss issues of the kind you have described?

Dr Posen: I would hope so. Frankly, during the period I was on the MPC, I think it was a question of the executive of the Bank’s interpretation of both the law and what they felt were the political dangers. As I have said before this Committee and elsewhere, there was a religious belief that if the MPC was to buy anything other than gilts, except in very small quantities on an emergency basis, we would be straying into something defined as fiscal policy and would politicise the Bank. I do not believe that was anywhere in the remit. I do not believe it was inherent. I believe that the MPC as well as the FPC is fully within its rights to talk about these things, but during the time I was on the Committee that was ruled out.

Mr Ruffley: On the question of this interface between monetary policy and fiscal policy, under the new arrangements the Governor of the Bank of England will be chairman not only of the MPC and the FPC but also chairman of the PRA. Going back to one of your earlier answers at the start of this session, could I ask you: do you think there should be two individuals, one with ultimate executive responsibility for monetary policy and a different person with commensurate executive power over fiscal policy? Do you think there should be two individuals, or are you happy—

Dr Posen: I am sorry. By “fiscal” do you mean fiscal or financial stability policy within the Bank?

Mr Ruffley: Chairing the Financial Policy Committee.

Dr Posen: Financial policy.

Mr Ruffley: Two individuals?

Dr Posen: Yes, in my opinion, I would set up two individuals. Let me be clear—and perhaps this is a minority view—I have always believed, even before I joined the MPC, that too much was made of the tripartite structure as the cause of the problem. There is just too much variety of central banks. There are central banks that have the equivalent of the FPC or something like it, with less macroprudential innovation within the central bank, and they do not seem to have done a notably better job of preventing the crisis. The Federal Reserve is a perfect example of that. In my opinion, they did not do any better at preventing the crisis in the US even though most of the banks, and certainly the systemically important banks, were all under the supervision of the Federal Reserve. To me, there is no loss in having separate executives running the separate parts of the Bank. Yes, I would be in favour of that.

Mr Ruffley: All right. A final question, Chairman. Do you think the court of the Bank of England is fit-for-purpose, and do you think a supervisory body would be the way to go in terms of scrutinising the performance of the executive?

Dr Posen: Yes. The place where I know the Bank of England executive has pushed back at this Committee in the past, and where I am aligned with them, is I think having active court membership viewing of FPC/MPC deliberations, and mixing into that is an inappropriate crossing of a boundary. I fully support that. Perhaps this is now a dead issue, but I remember when this was an issue. I fully support the Bank standing up and saying, “No, we do not want that”. Short of that, some very close retrospective supervision of performance, of behaviour, some very close supervision of operating procedures and how the staff is used,
and what the very powerful Governor does and does not do, I fully support. I think the
direction this Committee is going, to strengthen the court or replace the court, is the right one.

**Mr Ruffley:** Thank you.

**Chair:** On this question of QE, when it was raised in the MPC, and whether one
should buy a broader range of assets, there are four independents. Why can’t the dependents
fight their corner? Okay, the executives push back and say, “We would really rather buy in
deep and liquid markets, and we do not want to be distorting private sector asset prices. This
is what it is all about. Therefore, we should operate in secondary sovereign markets,
preferably our own.” Fine, but you are perfectly capable of arguing the other side to that
point. Why does that not take place?

**Dr Posen:** Without wanting to be cute, Chairman Tyrie, I did fight that corner. That is
clear, I would hope, from many of my speeches and statements before this Committee.

**Chair:** I am talking about in the meetings. The impression you gave a moment ago
was that you raised it and then this was brushed aside by the executive. Have I—

**Dr Posen:** You have. Would it have been possible, should it have been possible to do
that, to fight it? Yes, subject to conditions. First, that you had unity on this point among the
four independent members and all of them felt it was worth making a fight over. You never
had that complete unity and commitment during my time on the Committee, even though
various other independent members at various times were sympathetic, but we never had
more than three at any given time, at most, who would pursue the issue.

Second, as Members of a Committee like this recognise, the Chairman reserves certain
rights to set the agenda for the committee. I can throw a bit of a tantrum at a given time, in
very polite ways, and say, “We have to discuss this”.

**Chair:** I am just a servant of the Committee you know, Dr Posen.

**Dr Posen:** That is very good governance. Perhaps that is a model that the Bank of
England could pursue.

**Chair:** Do you think that it would be helpful if the MPC had a ratio 5:4 in favour of
independence, given what you seem to be describing as the occasionally overbearing,
disproportionate influence generated among the executives in a united way against
suggestions?

**Dr Posen:** That is very interesting. I am pausing for a moment because I genuinely
had not thought about that, because I had genuinely taken the regime as given.

**Chair:** It was a proposal of this Committee in its accountability report, which was not
accepted by the Government, but to which the Commission may decide to return in its report.

**Dr Posen:** Yes. I would support that, full stop. I would support that; a 5:4 majority.
The issue is the executive of the Bank of England will make a plausible and reasonable
argument that, when push comes to shove, independent members, like myself, are only there
for three years or six years and, perhaps might not even be UK citizens at times, so they do
not have the long-term interests of the Bank at heart in the same way. Presumably, if the
executive was doing something wrong you could find one member of the internals willing to
vote with the externals. I think in reality that is not likely to ever happen in practice.

**Chair:** Is there a good technical reason why the executives might need more than the
Governor, the two Deputy Governors and the chief economist, being the four?

**Dr Posen:** Not that I can think of. There may well be but not that I can think of.
Chair: If there may well be and you do think of it, would you let us know because that also should weigh with any decision on this?

Dr Posen: Yes.

Andrea Leadsom: Good morning, Dr Posen.

Dr Posen: Good morning.

Andrea Leadsom: Going back to what Mr Ruffley was just talking to you about with regards to should the Bank only buy gilts. Can you expand a little on that? Since you clearly do not think that it was the case that the Bank should only buy gilts, can you tell us a bit about what other assets you think the Bank should have been considering buying?

Dr Posen: Despite the realities of the limits on the domestic, sterling denominated corporate bond market in the UK, we had a facility in place, set up by successive Chancellors, that allowed the Bank to buy corporate bonds and I think there would have been ways of putting in effort to do it, such as to minimise problems. You could not zero out, but minimise market disruption from that. As my then colleague, Martin Weale, had proposed it, prior to joining the MPC—and I believe continued to support—he had a proposal about essentially discounting bankers’ acceptances, bringing back a measure from the past that had worked in past UK matters. I thought that had some merit.

Going back again to what Mr Ruffley was saying, there was room for the Bank of England, with the permission and co-operation of Her Majesty’s Government, to try to build some of these markets to announce, “We’re going to create a facility that does X and we will discount”, so like the commercial paper. In reality, there is this tiny facility the Bank of England does have that can intervene in that market, but it was always designed and intended as an emergency measure, such as if there was a lockup in the markets, à la late 2008, we would have a means of intervening to try to keep the market from completely locking up. That is very different from the kind of more proactive long-term commitments we were talking about, in which the Bank of England would try to create a larger more liquid market on a given security.

The final thing—I am sorry, please go on.

Andrea Leadsom: No, carry on.

Dr Posen: I was just going to say the final thing—and I am sorry to be a broken record—as I had advocated for some time, I would like to see deeper securitisation markets in the UK. Securitisation is not inherently evil. You just have to regulate it so people do not lie about what is in those securities, which of course a lot of people did in recent years, but prior to that securitisation worked.

Andrea Leadsom: When I interrupted you I was going to say to you, what about securitised mortgage assets? Because clearly one of the big problems in the UK is the problem with home loans. So you would support that?

Dr Posen: Absolutely. I do not need to expand on that. Absolutely, I think that would be a good idea.

Andrea Leadsom: Thank you. Going back to the issue of governance of the Bank of England, are you satisfied with the bank’s own internal review of the impact of QE on the markets in the UK? Do you think that was an adequate conclusion to draw that, well, in the end it pretty much balances out and there is no impact? Finally, do you agree with the Governor that this is just a monetary tool like any other?

Dr Posen: I am sorry, Ms Leadsom, I need to ask you to repeat the first part of that because in my mind I read the bank’s report on QE differently than I think you just characterised it. Could you say again how you saw it?
Andrea Leadsom: The Bank has carried out its own internal review into the impact of QE on the economy, and has broadly concluded that it has not harmed or massively benefited any particular sector. Do you think it was appropriate that the Bank carried out the review itself, and do you think that the conclusions are sufficiently forensic?

Dr Posen: I think on this issue, whether or not it was appropriate for the Bank to carry it out itself, this was done in a perfectly objective and technocratic fashion. I am perfectly comfortable with the way that report was run. Whether, ex ante, you would have wanted it to be done on the outside or not, I think in this case the question of impact of QE, on the economy and on specific sectors, I do not view as a governance issue. I view that as it was very much a technical issue. It was very much something that the Bank itself, the staff under chief economist, Dale, was trying very hard to evaluate in real time in the best possible ways. It was asking outside academics and the central bankers for input.

To me, for all my concerns about the Bank of England governance, I do not think that report has been tainted in any way. As it happens, I broadly agree with the conclusions, but that it isn’t why I do not feel the report has been in any way biased or tainted. Just to add one more sentence on that, had the Bank not done such a report the governance issue would have been entirely appropriate for this Committee or for court to say, “We need such a report. We need such a stock take”. I do think, of all the things you could ask the Bank to do internally, this was at least as appropriate as any of them, because this is really an econometric assessment, and the evidence and the methods were open to scrutiny, so I am very comfortable with the report.

Andrea Leadsom: There are accusations from some commentators of leakage because of buying gilts from non-British entities, and also the potential impact on rising commodity prices through pushing up the emerging markets because of switching. Those issues are not investigated in the bank’s report, nor are the impacts on, for example, individual pension funds, where perhaps they were underfunded to begin with, and so the impact for them of having to pay out more for gilts as a result of the bank’s actions. There have been very specific impacts that have not been investigated. Are you happy with that?

Dr Posen: They may not have been included in that report but they have been investigated, both by the Bank staff and by outside academics and other central bankers. Just on the substance, my understanding of the evidence—to which in some part I have contributed—is that the commodity price argument cannot be linked to the UK, because the size of the UK gilt purchases are so small compared to the world commodity markets. One might want to try to link that to the US activities. Even there, there has been direct research on it and it really seems to be dwarfed by such matters as Iran/Israel tensions, amount of demand in China, fracking. The supply side seems to dominate a lot of occasional political panic.

In terms of leakage from buying gilts, of all the things you listed that is something I would have thought they would put in the report, just as a technical matter. You can come up with an estimate on that. The essence I have seen is there is no question it diminishes the effect of QE, but it is relatively small because the amount of foreign held gilts, which are not held in central bank reserves, is relatively small.

Finally, the impact on individual pension funds: that is less about the evidence and more about—in a sense, I do not want to say the ethics—who you think is accountable for what. The Bank of England and the MPC, I think rightly, are supposed to look at the UK economy as a whole and say, “We don’t want to do something that on balance we don’t think is good for the UK economy as a whole,” which I frankly think it was, “because certain pension funds have not provisioned properly or are underfunded.” That is a strange—I don’t want to say hostage taking—sort of prioritisation.
Andrea Leadsom: It is, except—and this goes back to what the Chairman was saying—for the grey area between fiscal and monetary policy. If you are simply cutting and raising interest rates then clearly you are not picking winners or losers, and what people choose to do, if they have borrowed too much or saved too much, is their outlook. If you are choosing to get involved in a market instrument, where the market did not have the expectation that that might be the case, then surely either you are involved in fiscal policy or you are putting pressure on the markets that they have had no opportunity to anticipate.

Dr Posen: I respectfully completely disagree with that. On that point, I am sorry I lost track of your initial comment and I apologise, Ms Leadsom. You had said about the Governor saying the impact on the economy is okay. I completely agree with the Governor on this point. Here I am not saying the Governor, I am saying myself. I am going to be speaking on this on a panel tomorrow, so this is directly from the talking points tomorrow. I think the difference between quantitative easing and what is often referred to nowadays as unconventional monetary policy vastly exaggerates the difference between this and so-called normal monetary policy and interest rate cuts or rises. This is the way central banks behaved for many decades up until the late 1970s. You are acting on quantities instead of prices that, in basic economics, are just duals of one another. When a central bank sets interest rates it still does so as much by buying and selling in open market operations, Government bonds, as it does by announcing an interest rate.

Investors who make bad decisions or who are simply unable to predict what happens in the world—that is part of being an investor. The uncertainty is not that somehow the Bank of England, or any central bank, woke up one day and said, “Oh, let’s do something in the gilt market because we just want to do something in the gilt market.” It was a genuine uncertainty that there was a financial crisis and there were problems. I know you understand that, I just want to be very clear that, to me, this whole bundle, that QE is inherently more fiscal or inherently more disruptive or inherently more dangerous or misleading to markets, I find frankly bizarre. I have said that several times.

Andrea Leadsom: Then let me press you on one more point, which is the unwinding of QE. Clearly, if you hold the gilts to maturity and then the Treasury reissues them and repays you with the proceeds, then that is one matter. But if you go back into the marketplace, so you bought them at a price, probably a cheaper price, you push the market all the way up by buying a third of all outstanding supply, and then suddenly you become a seller. Do you not think that that is going to have an enormous impact on the yield curve, on the price of bonds? Do you not anticipate, by virtue of it being a market rather than an interest rate, that that is going to have a fundamental impact?

Dr Posen: Again, I have to disagree with the premise and the question. When the central bank moves its instrument interest rate, whatever that instrument is, which is transmitted through fixed income markets, which is transmitted as an enforced price at one end of the yield curve and communication about future expectations of the economy and policy, that then has effects all the way up the yield curve. I agree with you completely, there is an operational issue if the Bank had to sell off a significant quantity of its accumulated gilt holdings. There would be an issue of trying to minimise the short-term disruption to markets and to co-ordinate some of the DMO, not about financing the Government debt but about when they are doing auctions and not trying to disrupt markets. That said, first, what is going to happen—what the MPC voted for and explicitly said would happen, unless the next Governor changes it—is that any tightening of policy would take place first with moves in interest rates; and second, any sales of accumulated assets would be pre-announced over a multi-month period and smoothed.
Just to underline my point, I think the biggest thing is I do not find these two all that different. If we get to an inflationary situation and the Bank of England is forced to raise rates that is going to cause pretty much all the things you said. It is entirely possible something else might happen and, as I have said, I think there is a small amount of operational things about the specific structure, which bonds get sold at what times, in my expert opinion—and on this I actually am an expert—the raising in interest rates will cause essentially the same things that you are talking about.

Andrea Leadsom: Okay. Thank you.

Mr Mudie: I am sorry if I touch on things you may feel you have answered, but I find when you get most interesting you get quieter.

Dr Posen: I am sorry. I will try to speak up.

Mr Mudie: I think you think it is a conspiracy and so you had better whisper. One of the questions I want to ask you, now you have left, is: I am baffled that both Darling, and then Osborne, when signalling to the Bank of England that they wanted quantitative easing and the terms of it, gave a long list of things that they could buy. Why was the Governor given the power to end up doing nothing but gilts, particularly after it looked to decline in effectiveness after the first tranche?

Dr Posen: I will try to speak up, Mr Mudie, and still be interesting. It comes down to two very simple things: court and supervision of the executive was very lax. There was a very strong culture and precedent that, if the Governor and/or the broader Bank executive made a decision on something and dug in their heels, there was no point in challenging them. That was the widespread belief of the court, of many staff in the Bank, and of some external members of the committee. I have to just say that was a recurring problem. I complained directly to a couple of members of court—you can probably guess who—saying, “The Governor is insisting we should not do this. I don’t think that is fair or right that the Governor can just say that.” I was told by members of court, “We cannot do anything about that until the Governor leaves. That’s the way it is.” I said to those members of court that I thought that was an abdication of what court should be doing, and no one individual should have that sway. I was told, “Sorry that’s the way it is.” The same thing happened when I said that to members of the Bank’s executive.

The second thing that supported this culture is that, as you rightly say, Mr Mudie, the current and preceding Chancellor both wanted extreme QE—no, not extreme, they wanted to see strong monetary easing and at least contemplated these alternative asset purchases. They were unwilling to take on the Governor in either an internal or a public fight. The Governor had legitimately one line of defence, which is, “This is an independent central bank, and therefore you don’t mess in.” But an independent central bank is not the same thing as one individual official being able to block discussion, so I complained about this. I complained about this internally. I complained about this to court and I complained about this to the people in the Treasury. They all said, “Sorry, we just can’t move him. We can’t do this. We can’t do that.”

So, part of the reason there was such a mess and misunderstandings and lack of communication to the broader MPC, when the FLS proposal came through in spring, was because there were all these incredible machinations going on, between the Treasury and the Bank executive, to get this through, since it was clearly going to involve a perceived reversal on the part of the Governor and, therefore, we couldn’t all know about it and we couldn’t all gang up on him. It had to be done delicately. We had to do this and we had to do that.

I was quite furious at the time, but not at the Governor. The Governor was just advocating what he thought was right, frankly. My anger in this case was in no sense at Governor King. It was at the people around Governor King and at the Treasury and in court,
who let him get away with that. Of course, the Governor who believed in his policies was
going to fight his corner and I respect him for doing that. The fact that everybody around him
said, “We are just going to allow him to do that, allow that to be a block and not allow you, an
external member, to challenge that,” that was the failing. That was not a failing of the
Governor. That was a failing of the governance of the Bank and it was a failing of the will of
the Treasury.

Mr Mudie: You came before us on more than one occasion. I certainly had that long
public harangue in this Committee with the Governor, about waving at him Darling’s letter
and Osborne’s letter. Why were you not prepared to say anything? Was it just a question of
you were not asked, or why did you not say something, because this is the body that is at the
parliamentary end of the accountability?

Dr Posen: Mr Mudie, excuse me, I am not quite sure what you mean. Would you have
wanted me, after having spoken to court, to officials at Her Majesty’s Treasury, and officials
in the political part of various parties—

Mr Mudie: Yes. The answer is yes, before you finish off.

Dr Posen:—to have just come to you?

Mr Mudie: Yes, absolutely. In fact, that is the whole argument that is going on in
terms of accountability of Government, accountability of the Bank. At any stage they pay lip
service to the Treasury Select Committee that, “Oh, you are so powerful we can come to
you.” But we are always met with this uniformity of behaviour, “We are in this club. We stay
in the club and, regardless of the damage it is doing out in the country, that is the rules of the
club.” That is just a straightforward question in terms of trying—

Dr Posen: I am giving you a straight-on answer. I was hardly a conformist member of
the club. I think my public record, both before the Committee and in general, bears that out.
After I had done everything I could, was I going to give up whatever other effectiveness I
might have?

Mr Mudie: Ah, so that’s it. If you broke ranks in here—

Dr Posen: No, it is not breaking ranks.

Mr Mudie:—you would lose your effectiveness in the Treasury. I mean, in the—

Dr Posen: No. Let us be clear. There were no threats made, and there is no—

Mr Mudie: There is no doubt, threats are made.

Dr Posen: No. I do not get bullied, okay, as I think my record shows. I made a call, a
judgment call that after I had repeatedly gone to many, many, many different parts of this
Government, and the organisation in and around the Bank of England, that was I getting no
traction and there was no point in trying when there was no majority of members on the MPC
who would be willing to fight this issue.

Mr Mudie: Yes, all right.

Dr Posen: I was not willing to give up my ability to work within the MPC and pursue
positive policies.

Chair: Just to be clear, you could have come to the Treasury Select Committee. You
could have written to the Committee. You could have said you were going to write to the
Committee even. That might have changed the terms of trade. You could have seen the
Chairman of the Committee privately, but you did none of those things.

Dr Posen: Mr Chairman, I do not want to contradict you, I did come to see you
privately a year and a half—
Chair: Yes. But you did not raise this issue—

Dr Posen: Yes, I did.

Chair: —telling me that you had failed to get any change and you would like the Treasury Committee to look into it.

Dr Posen: To the best of my recollection, Mr Tyrie, the main agenda point I had in meeting with you one-on-one was that issue. Maybe your staff notes reflect something different, because you did have a note taker in the meeting, but to the best of my recollection, that is why I asked to meet you.

Chair: All I can say is, had I received that message, I think, on the basis of other activity of this Committee, there would have been some action.

Dr Posen: To the best of my recollection, all I can say is that is the reason I asked for a personal meeting with you, because I was concerned about the fact there was no governance on the committee.

Mr Mudie: I am sorry to land you in that because it is not really a criticism of you. That is the question on debriefing about what happened behind the scenes. This is a key matter of economic debate at the moment, because of the new Governor coming in having different ideas, why the Bank executives were allowed to get away with what they have for the last two or three years.

Can I just ask you about the business banks? In one of your speeches you said we should have two new public entities: one a business bank for lending to small firms; and secondly, another entity to bundle and securitise loans. The first thing is, would that not be a function, anyway, of a business bank, to introduce securities, to do all the formalities and so on? The second thing is—and I raised this with the Chancellor—I am wondering whether this is just paying lip service to the need to get a new delivery method to small and medium-sized enterprises. He envisages one central business bank, whereas the argument I put to him was that he should at least consider taking the 300 or so branches, which RBS have to dispose of, and form them as the basis of a regional and, certainly in the big cities, a local business bank so you could have the big business bank but it would have a regional presence.

Can you run a sensible delivery method to small and medium-sized enterprises without having regional and local bases where you, as a small businessman, can come in and speak to the person who is lending you the money, so that it becomes a real relationship, a sensible relationship, and a lasting relationship through good and bad? Did you get a question out of that?

Dr Posen: Well, with all due respect, I was pausing to try to make a question out of that. Mr Mudie, let me put it this way. The reason for the securitisation entity as I proposed, is that, while there are certainly private sector incentives to bundle and securitize—as we have seen with Fannie Mae and Freddie Mac in the US, or SallyMae, which handles student loans in the US, before they got corrupted by their full profit motive in the last years—there is a useful purpose to having a quango or semi-Government entity. That entity being separate from the Bank itself, which has the securities, goes through them and decides, “Do they make sense? Can you bundle them in a useful way? Is what is in the tin what that says on the tin?” An entity that has something of a financing guarantee from the Government, so it can hold these loans temporarily on its books while it bundles them. Whereas, for the private bank or the business bank, or however you want to do it, there is a public interest rather than an incentive to take some of the loans off the books quickly so that they have more lending capacity. That is why I argue for that. It is not to say there is no other way you could get securitisation. It is just that, on balance, I think that is the best way to do it.
In terms of the Chancellor saying to you he would like to see a spinoff of some of the branches of RBS, which could be sold and should be sold, and create a business bank network, and your statement that you need local interaction to make loans, all that is absolutely correct. I think that that is an entirely reasonable way to go. To be fair, in his Autumn Statement the Chancellor announced he was going to do such a bank.

As I said to the Parliamentary Committee on Banking yesterday, from what I have seen coming out of the Autumn Statement, it was going to be done on too small a scale, with too little build up of human capital and impetus behind it, to achieve what I would hope. If he has said to you what you just said—and perhaps he said that in public and I am not aware of it; I am not saying it is a secret thing, I just had not been aware of it until now—that is a good first step. If you create a branch network then, as you say, you can interact with local businesses, and presumably in the branch network are the employees that one would hope would include people skilled at local business credit assessment. So I think it is a perfectly constructive and reasonable step.

Mr McFadden: Thank you, Dr Posen. As you can see, we are interested in the limits of the policy decisions that were taken during your time on the MPC. Can I ask you whether the MPC ever discussed its central remit of the 2% inflation target, whether that was still the right tool in the extraordinary circumstances that you have faced in recent years?

Dr Posen: I can answer that very clearly and bluntly. The committee never discussed that. Here I completely agree with the Governor, we were quite right never to discuss that. That is for the Government to set. As I have said, anyone who was on the committee basically took the equivalent, in my opinion, of an oath of office. They were serving on the committee under the terms of the given inflation target. Were the Government to change the regime, either in terms of the level of the target or the nature of the target, they could decide whether to resign or stay on, but it was not discussed in committee. As opposed to what we were talking about a minute ago, I think it was entirely right that it was not discussed in the committee.

Mr McFadden: Now that you have left, can I ask you a little bit about the delay around this?

Dr Posen: Yes.

Mr McFadden: Obviously there has been significant interest in this, mainly because of the arrival of the new Governor and some of the speeches he has made weighing up the pros and cons of nominal GDP targeting. I want to take you through two ideas he has talked about. The first one is longer-term signalling. The MPC has tended to take its decisions a month at a time. In recent years we have been used to this announcement on a particular Thursday of every month that interest rates remain unchanged. Mr Carney adopted a different stance in Canada when he said, “Interest rates will be low and will remain low for a particular period of time.” Do you think there are benefits—particularly in a crisis situation, as we have been in—of signalling that not only are rates low but they are going to stay low for the foreseeable future?

Dr Posen: I am a bit of an iconoclast on this. I think it is a gimmick for the most part. I am very sceptical that such pre-commitments make much difference. There is a building up of steam of academic and central bank work on this notion of pre-commitment. I was the discussant this summer at the Jackson Hole conference of the leading academic paper on this topic. At the time I expressed my view that is, you go back through the history of the Riksbank in Sweden, which was very big on making these pre-announcements, the Bank of
Canada, the Bank of Japan, past records of the US and UK, and I have found that it is ineffective. It is not counterproductive but it does not really work.

Let me give you just three quick examples. The Bank of Canada made this announcement and at various times, despite this announcement, the market would move in large ways as though they thought this announcement was being rescinded, based on economic data being released in the commentary and economic data from Bank of Canada officials. In fact, there was one point at which the market moved in the exact opposite direction from where clearly the Bank of Canada wanted it to go. Similarly, the Riksbank, where my friend Lars Svensson is the Deputy Governor, and is the mind behind much of these arguments about pre-commitment, has been at the forefront of pre-committing what the path of interest rates will be and being transparent about that. There is ample evidence that this has not been consistently effective. The market does not find it fully credible. They discount it and the interest rates fluctuate quite a bit, despite the Riksbank doing this.

We just saw this more recently with the Federal Reserve, that the Federal Reserve announced—I think quite rightly—that they were going to this thresholds model, where they would not be planning to raise rates until at least unemployment was down, unless the inflation threshold was violated. I think that was the right stance of policy. Then we saw the next month, based on some comments in the minutes from the FOMC meeting, the market sold off. The bottom line lesson for me is that talk is cheap and people have always believed that about central bankers. It is more important what you do and your reputation earns reaction.

While I think it is useful not to talk in contradiction of the direction you want to go—which was one of the problems of the Bank of Japan in the 1990s and early 2000s, that they would say one thing and do another—I do not think that talking, without making purchases or commitments, does much.

Mr McFadden, going back to the beginning of your question, quite right, the Bank of England MPC does not pre-commit, and it is the explicit ethos of the committee that its each month is new. All the econometric evidence, including the fitness report Ms Leadsom was referring to, is that our impact of QE was exactly comparable to that of the US and larger than in some other central bank situations without the pre-commitment, so I just find this a gimmick.

Mr McFadden: You would disagree with the claims made by Mr Carney last month in a speech where he said, “The Bank’s conditional commitment succeeded in changing market expectations of the future path of interest rates, providing the desired stimulus and thereby underpinning a rebound in growth and inflation in Canada”?

Dr Posen: I would disagree in part. I expect that the Bank’s statement initially had impact in the desired direction, just as any statement from the officials of any central bank would have a market impact. It may be because at that time Governor Carney and the Bank of Canada said, “We are doing this for multiple months,” or whatever, it was seen as a stronger statement of their preference to go for growth than something else. That is not the same as my believing that it is an independent tool of monetary policy by just jawboning that it has a lasting and credible effect. It is just another form of rhetoric. It may be a slightly more intense form of rhetoric and, therefore, may have a slightly larger and more lasting impact, but to my mind it is still not an actual policy tool or commitment, which has the large effects that Mr Carney and others seem to think is the case.

Mr McFadden: Let me try the other one.

Dr Posen: Please.
Mr McFadden: Nominal GDP targeting, I do not want to put all this on Mr Carney because it is a discussion.

Dr Posen: No. It is a widespread discussion in central banks, certainly.

Mr McFadden: It is a little unfair to put it on him.

Dr Posen: Absolutely right.

Mr McFadden: Given that the combination of a policy, like our inflation target and QE, a lot of people are saying if it had an effect it is that the effect of additional QE is diminishing. We have not seen the growth we want to see. People are looking at whether there are other policy instruments or regimes for the MPC that might have a greater effect. You have been quite critical of nominal GDP targeting. Do you want to tell us why you think that would be a potentially better regime?

Dr Posen: I am glad of the opportunity. I appreciate your asking me that question, Mr McFadden. I am going to speak up, but I think this is an important point. I will try to give you a brief critique of nominal GDP targeting in general terms, and then let me say to you why I think it would be a serious mistake for the UK, if it were undertaken in 2013 or 2014 specifically.

My critique of nominal GDP targeting in general terms is, it is an unnecessary complication and confusion beyond an inflation target, especially if you have a flexible inflation target, as the Bank of England has, or you choose to, say, have a dual mandate the way the Federal Reserve does. In theory, the advantages of having a nominal GDP target are the pre-commitment announcement aspect that you mentioned, and that it ideally forces the central bank to take into account past undershoots and try to make up for them in future.

I am sympathetic to this sentiment as a good guide to policy. I am completely sceptical that nominal GDP targeting achieves this in any way in practice. First, as we just discussed, I do not think the waving the wand of what we label the policy is going to be somehow makes it a more credible long-term commitment.

Mr McFadden: This is a critical point. You are saying that the claimed advantage of this policy, of taking history into account and providing a catch-up factor, is illusory?

Dr Posen: I think it would be illusory in practice because two things would happen. First, unlike the inflation target, which for all the issues of communication that this Committee has discussed, it is reasonably well understood and the Bank of England makes a reasonably good effort of being transparent. A nominal GDP target inherently is going to be incredibly fragile, non-robust to changes in definition and time period. It depends at what exact time you decide is the point to start catching up. It depends how many revisions there are to the data in the intervening period, and we know the GDP data is repeatedly revised and, particularly in this country, has a relatively high size and frequency of GDP data revisions. It is going to be arbitrary, in terms of trying to get the general public to understand what a nominal GDP number is as opposed to an inflation number, because you go to the store and you may not accurately perceive core CPI but it is something in a sense that is tangible you can expect. Nominal GDP is not something you can communicate often. The error bands, where we talk about the accuracy of our “rivers of blood” in the Bank of England in the fan charts for nominal GDP target, would be wider and more difficult. Alternatively, if you think you are going to hit the nominal GDP target, the error band of how much of it is going to be new growth versus inflation would be extremely wide. So you would be increasing the volatility of inflation by a large measure, versus when you are targeting an inflation rate with reasonable accuracy.

I have said this on past occasions, and I am very grateful that I have the chance to say this in front of this Committee. I realise this is a fad right now. I realise there are a lot of
serious central bankers and very smart academics who are pushing it, but I view it as a complete practical non-starter and counterproductive. If I may go further, in the case of the UK right now, so let me be very clear, I am perceived by many—perhaps rightly—as a dove in the parlance of the markets, that I wanted stimulative policy repeatedly. But in line with something I was saying to you earlier, I did so in the context of fully wanting to achieve, on average, the 2% inflation target at the medium term. The reason I was dovish was not because I wanted a higher rate of inflation. It was because I had a forecast for the UK economy that turned out to be more accurate than many of my colleagues’ and that was more weak and, therefore, necessitated easier policy to achieve the 2% target, or allowed easier policy, because I was convinced that the spikes of inflation would come back down. But everything I did was consciously consistent with the 2% target.

I make no brief for this country at this time that the country would be better off with a period of sustained above 2% inflation. I have never done so. I may be wrong, but I firmly believe that if the Government were to tell the Bank of England its remit has changed and we now have a nominal GDP target, inflation in this country would go up quite a bit and this would not serve any useful public purpose. Say we have now, as we do, perhaps in part due to the euro area, perhaps in part due to the financial factors I was talking about, perhaps, as I believe is likely over the next two years, a complete dearth of business investment out of fear of what might happen with an EU referendum. You will have a nominal GDP target of 4 or 5 whatever and very low growth, and you will end up with an inflation rate of 3% or 4% as an intentional policy. In which case, the markets will rightly say, “Oh my God, this is a much less credible inflation regime, and the Government and the central bank are consciously choosing a higher inflation rate than they have been for years.” Therefore, not only will you end up with higher inflation, in my opinion you will not have the anchoring effect that I and my colleagues counted on, that when inflation shot up to 5% it would come back down to 2% as it did, broadly speaking. That anchor will be eroded.

In my opinion, it would be a grievous mistake for this country, for this Government to adopt a nominal GDP target in the coming next couple of years. It is entirely legal and legitimate for the Government, particularly on the occasion of a new Governor, to say, “We want to reconsider the Bank’s target.” I am not denying their right to do that, but the failure of achieving the large growth that we would have liked to have had in the UK over the last couple of years, larger growth, was not the result of the inflation target. I do believe QE was reasonably effective and, for the reasons we have discussed in organisational terms, some other forms of quantitative easing that I think could have added to effectiveness were not pursued. The reason they were not pursued had nothing to do with the inflation target. They had to do with governance, organisational decisions and ideological beliefs on the part of other members of the committee and the executive. They were never argued against on the basis of, “We can’t do that because there will be hyperinflation and that will be contrary to target.”

To my mind, we could have pursued more aggressive monetary policy, achieved better goals and been totally consistent with the current inflation target without incurring all the risks, dangers, confusion, and non-robustness of the regime that would be associated with a shift to a nominal GDP target.

**Chair:** I am going to move on, if I may. That is a long and interesting reply.

**Dr Posen:** I apologise. I felt it was a very important issue.

**Mr Newmark:** I am going to pick up on a point you made about Mr King. You said that, “Like Greenspan, he probably stayed too long and was probably too set in his ways when history changed,” i.e. he was past his sell-by date. Do you—

**Dr Posen:** I don’t think I said, “Past sell-by date”.
Mr Newmark: No, I said that.

Dr Posen: Thank you. Let us just be clear.

Mr Newmark: That is the implication of what you said, though—he was past his sell-by date. Listening to you, it sounds to me like you are also sticking with pretty much the old policies, which is that we have been busy pumping money into the system, we keep doing QE, and yet I have heard nothing that you have said today that convinces me that the marginal impact of QE is going to lead to a better outcome, other than taking it to its logical extension that we will get inflation ultimately and debase our currency. I am trying to understand why you think pumping in £50 billion or £100 billion more in is going to help UK plc grow out of its problem and create jobs?

Dr Posen: I fear, Mr Newmark, based on the evidence that is already in the public record, which this Committee has heard or at least been exposed to through the years, that you remain completely unconvinced. There is nothing I am going to say that will change your mind. The—

Mr Newmark: No, I am looking at the evidence.

Dr Posen: No, sir, you are not.

Mr Newmark: What is the evidence?

Dr Posen: The evidence is very straightforward. It comes in four forms. Form one is during the periods in which the Bank, MPC, in my mind inappropriately eased off on quantitative easing, ceased to add more, the economy did worse, full stop. Second, the evidence is in the countries where they had more constrained monetary policies, such as in southern Europe and in Ireland, where they had similar sized financial crises but did not have the benefit of loosening monetary policy, their performance was worse, full stop.

The third piece of evidence is that every time that new initiatives and quantitative easing have been undertaken by the Bank or they have been continued on and as announced, the markets have reacted in the ways that one would hope and expect that they would: asset prices have reallocated, spreads have come down, currency has weakened slightly, equities have gone up slightly, and real estate prices have gone up slightly. These are not massive effects nor are they permanent effects, but they are reflections that the markets are responding to quantitative easing in the way you would intend. The total assessment, at the end of the chain of logic of how much impact it has on the economy as a whole, is difficult to do and requires some judgment. But at least the intermediate step of, “Does it have the impact on the markets in the direction that should lead to the good outcomes?” is, yes.

Then the fourth and final point of evidence why I would argue that QE works is that—and this goes back to the report that Ms Leadsom was talking about, as well as a number of other publications—we have more technical econometric studies, which are by no means perfect or inviolable but which do look, as best anybody can, at whether the impact of monetary policy, done through quantitative easing, looks at all like the impact of monetary policy done through rate cuts or rate rises. The answer is it is less effective but still effective in the same ways.

You can deny or not be persuaded by any of those four pieces of evidence. You are entitled to do that. But those are all quite strong. If you would like more documentation, and you want somebody outside—

Mr Newmark: No, I am trying to engage in a debate with you. One could argue that the Treasury or the Chancellor dealing with the structural deficit issues, and attacking that, gives confidence in what the UK is doing, as opposed to what other, southern European countries did. Secondly, your argument as to the effect of QE, when further rounds came, the
UK was impacted by a second exogenous variable, which was: first we had the Bank collapse then we had the collapse of the euro zone. Instead of looking at endogenous variables, you should be looking at what is going on on the outside.

**Dr Posen:** It is very—

**Mr Newmark:** Let me just finish. The big issue, when I speak to businessmen—and I come from a business background—when I get out there, people do not say, “Gee, we want another 0.25% off interest rates,” or “We want interest rates to remain exactly as they are.” That is not what is stopping people investing. What is stopping people investing is confidence as to what is going on, just not in the UK but in Europe as a whole. It is the need to increase confidence and give people the confidence that is going to help the UK to grow.

I guess I am curious as to why you think focusing on GDP growth, as opposed to just inflation, may not lead to a better outcome; and secondly, associated with that, does the Bank of England itself really have the tools, or will Mr Carney have the tools, to target GDP growth when much of that is in the hands of the Chancellor with fiscal policy, i.e. he can deal with the problem by lowering taxation, in the form of encouraging businesses and individuals to invest in invested capital by lowering taxation, i.e. lowering the risk, the risk reward that people have?

**Dr Posen:** Wow. All right. I commend you on your use of endogeneity and exogeneity. Let me try to be responsive to the substance rather than trying to guess which points are your opinions versus which points you are asking me—

**Mr Newmark:** They are all my opinion.

**Dr Posen:** No, because you seem to contradict yourself. Your first point was about the beneficial effects on confidence of budget consolidation and your last point was about the beneficial effects on confidence of tax cuts.

**Mr Newmark:** They are two different issues but, yes, go on.

**Dr Posen:** Okay sorry.

**Mr Newmark:** They are separate issues. Okay, so let me take them in order. First, confidence in fiscal policy. As Larry Summers pointed out in a speech last September, and various others of us have pointed out, the idea that the fiscal austerity package of the Government is improving confidence seems to be false on any market evidence we have. When there are announcements of new austerity measures, it seems to diminish confidence in the markets and have a negative effect on equities and on investment figures. When growth numbers come in that are negative and are associated with some of these austerity measures—certainly not all growth numbers are associated with them, you are quite right—that also seems to have a negative effect on the markets. When you look at the ratings agencies, as they just restated recently, and they say, “Why is it that we are worried about the ratings of the UK?” it is not about the fiscal commitment—in fact some of the ratings agencies, and the IMF, have suggested the UK could slow down its rate of consolidation helpfully—it is about the growth. When you say that the confidence is there, that may be true of the people you talk to but in the evidence that most of us look at in markets, it does not work that way.

In terms of endogenous versus exogenous and the European issues and so on, you are absolutely right, that is an important thing that one has to look at. As we already discussed, we cannot affect directly what happens in Europe. Again, you are absolutely right there is a general issue for businesspeople in the western world. There is a lot of cash sitting on the sidelines. As somebody pointed out, quoting my earlier speech comparing the UK and US economies, the rate of investment growth in the US was three times that of the UK in a given
period. That has roughly remained the same over the last couple of years. So there is also something specific to the UK. Similarly, despite the fact that a lot of the UK gets exports, that remains a small minority of the share of our total economy in the UK. So, if these confidence effects and other effects were going on, you would expect them to show up in domestic fixed capital investment and domestic consumption, and it is not showing up there.

Then comes your question about focusing on GDP. Does the BoE have the tools? As I said—I probably did not say this well enough, and I apologise for being unclear—what nominal GDP targeting, inflation targeting, all of these tools are about, is the idea that by shifting relative asset prices, as well as affecting confidence in some broad but vague sense, the way monetary policy works is that it affects aggregate demand, it affects the sentiment to invest. If it does not affect those variables and if, as you are saying, QE is not working, and let us say you are right. Let us say, despite everything I said in respect of—

Mr Newmark: The marginal impact of QE.

Dr Posen: Marginal, whatever it is. Let us agree. For the sake of argument, let us agree that that is the case. Shifting the Bank of England’s remit to be GDP, it in no way changes the effectiveness of it. That is another way of saying what I was saying about pursuing the inflation target. It is either the QE works through the channel of promoting confidence, promoting asset prices, promoting aggregate demand and reallocation of the riskier assets, or it does not. If it does not do that, then it does not do that for GDP any more than it does for inflation. So there, I think, we agree. Or I don’t know whether we agree or not, but that is where it is.

Mr Newmark: I guess I would turn back to your US example—and don’t forget Larry Summers got fired—which is ultimately that the US at the moment has achieved what it has in part because it is continuing to run unsustainable budget deficits. It is continuing to print money at an extraordinary rate. The third thing it is doing, it has blown through its debt ceiling and is heading to $20 trillion or $22 trillion. I am not saying today, but over time, that catches up with you unless you deal with that problem. I think that is the big challenge that President Obama has over the next two to four years.

Dr Posen: Fact: Professor Summers was not fired. I am not here to defend him but he was not fired.

Mr Newmark: Yes, he was.

Chair: Are there any other points that you would make?

Dr Posen: Yes. I just don’t like getting into personalities and that sort of thing. Much more importantly, I am in no sense a blind defender of the US. I have been quite critical of US policy on a number of grounds. If you go to my Op Ed in the FT last week, you will find that I wrote that one of the lessons for Japan, explicitly for Italy, US and UK, is that you cannot afford to ignore consolidation in good times. I explicitly said that, I acknowledged that. That is not the same thing as saying the US should prematurely cut back. What is about to happen is you are going to see a fiscal consolidation over the next several years that is going to lead to roughly a 2.5% to 3% reduction in the structural budget deficit of the US, 2.5% to 3% of GDP. That does not fix the healthcare problem but that does meaningfully, if not totally, close most of the non-healthcare gap in the budget. It will lead to growth in the US being somewhat slower over the next couple of years than it otherwise would have been. In fact, it may prove to have been the right balancing of the short versus the long term because it is a measured, slow, drawn out form of consolidation, not an abrupt form of consolidation.
**Jesse Norman:** Thank you, Dr Posen, for your very interesting comments on the Bank, on QE and on inflation targeting. Can we just talk a little bit more about QE? You have said that the Bank had a “religious belief”—those are your words—that it should not be buying non-gilt assets.

**Dr Posen:** I said the executive of the Bank and certain officials at the Bank had that, yes.

**Jesse Norman:** Thank you, yes. To quote Alistair Darling’s original letter to the Governor in which he says of the objective, “It is to increase the availability of corporate credit”? Far from not just being gilts, it has a specifically different purpose, which is to help the real economy rather than to support the Government’s own borrowing. Why do you think everything diverged so radically from that?

**Dr Posen:** I do know that former Chancellor Darling did intend that, and my understanding was that current Chancellor Osborne supported that view of the facility. Mr Norman, I want to be responsive but I am worried that I am just going to repeat things I have said earlier. There was a functional majority of the MPC that accepted that it was either the Governor’s role to define what we were allowed to buy or that it was not worth it or possible to fight with the Governor about such things, and court and others and the Treasury also did not wish to fight that issue. As I said before, the Governor has every right to his personal strong beliefs and it was a failure of the system and the institution and the people around it that those beliefs, although challenged occasionally by me and a few others, were never pursued.

**Jesse Norman:** The Governor sets the agenda for the committee.

**Dr Posen:** Yes. That is correct but this was more things like the Governor saying, “That is fiscal policy. We will not get involved in fiscal policy” and someone like me would say, “But the remit of the actual facility is to do corporate bond purchases. A bunch of other central banks have done this. We have done this in small amounts. It’s probably a good idea. I am willing to listen to practical arguments about the market being too thin but if that is the case, let’s do something about it”. To which the response was, “No, we will not put the independence of the Bank of England in such danger. We will not put us in that politically vulnerable position”.

**Jesse Norman:** A lot of discussion around this?

**Dr Posen:** Recurrent discussion. No discussions were terribly long, but every time a new member came on the committee, pretty much, the discussion resurfaced.

**Jesse Norman:** Were you able to put things onto the agenda yourself?

**Dr Posen:** I was able to put onto the agenda of non-MPC meetings. The committee had the formal MPC meetings, as you are aware, the first Wednesday and Thursday of the month. There are numerous other occasions when the committee interacts with each other and discusses policy. We were able to recurrently get this issue into those discussions. We were never able to get this issue into the formal MPC meetings.

**Chair:** If I could clarify, are you saying that the independents are not permitted to add an item to the agenda of the formal MPC?

**Dr Posen:** We are permitted to suggest an agenda. What happens is the way the committee works—at least during my time there—is that there is a set order of general generic topics. There are financial markets, UK domestic—
Chair: I understand that, but you could have put this on the formal agenda?

Dr Posen: Let me be clear. The Chief Economist sends around, several days before the committee meets, what specific things he suggests be covered or focused on under those headings. All members of the committee, internal and external, are free to comment. Sometimes suggestions made by members of the committee are adopted, sometimes they are not.

Chair: You could insist to put something on the agenda.

Dr Posen: I could insist and then we would have a discussion.

Chair: But you did not?

Dr Posen: No, I did insist but then you would have a discussion that would consist of a two-minute interchange that I just recounted to Mr Norman.

Jesse Norman: Thank you for that. The point I am trying to make is that there were recurrent discussions outside the formal meetings.

Dr Posen: Yes.

Jesse Norman: Because this matter was not discussed in the formal meetings, it was not recorded in the minutes. Therefore, the public had no idea of these recurrent discussions or of the concerns of a significant subsection of the committee on a vital issue relating to the conduct of quantitative easing?

Dr Posen: You are right. That was not my intent but you are right, that would be a fair characterisation.

Jesse Norman: I am grateful for that. When you say that there would need to be unity among the non-executive members of the MPC. That suggests a political operation in the committee. Isn’t the point of the committee to have economists independently reflecting on these issues in order to minimise deference and get the benefits of collective wisdom?

Dr Posen: Again, I have been out here carrying water on this point for some time, so you will forgive me for trying to be careful here. I am not afraid to say the truth but I just want to be sure the truth is clear. I know you appreciate that, Mr Norman.

There is no other central bank committee in a major country, of which I am aware, that allows the independent expression of views of its members, both publicly and privately, as much as the Bank of England MPC. That does not mean it satisfies the things you are raising. But just let me be clear, the reason I came to join the MPC—one of the very foremost reasons, and it proved to be—was my understanding that I would have more freedom to speak, to argue, to debate, both publicly and privately, than I would if I had had the similar job at the Federal Open Market Committee or at the ECB, and that remains true. That is a fact, and that said I did not mean literally you would need a 4:0 vote of unity among the—

Jesse Norman: Sure.

Dr Posen: No, just to be clear, I meant that if you have a chairman of a committee who vociferously is opposed to something, you need a group of people—they could be internal, they could be external—to make a sufficient amount of noise weighted from the number of people, it may not need to be an official majority but you would need three or four who felt strongly enough about the issue to make things happen. There were issues on which the Governor was not given deference, was very strongly argued with. Some of these issues were ones where it was a couple of the external members and a couple of the internal members, which includes the Deputy Governors and the executive directors. Those issues did exist.
On the particular important issue that you have raised—that again, you rightly point out, did not make it into the minutes because it was not discussed at the MPC—on the particular issue that you raise, the Bank executive closed ranks on this one particular issue. There may have been others but the only one I am very conscious of was this issue, and in part it was defended as: this is the privilege of the bank’s executive to define what we buy, not of the MPC as a whole. That was presented as a legal opinion. That was questioned by me and others but court chose not to address that.

**Jesse Norman:** That is very interesting. An actual legal opinion was presented to you that—

**Dr Posen:** No, it was presented to me as a legal opinion. There may indeed be something from the Bank’s counsel somewhere in the files. I am not a lawyer. I don’t know where it is. But it was presented to me that this—

**Jesse Norman:** As a legal argument that might or might not have been based on a QC or a sufficiently qualified lawyer’s opinion?

**Dr Posen:** Right.

**Jesse Norman:** From what you have seen of the Bank of Canada, do you think Mr Carney is going to have a culture shock when he arrives at the Bank of England?

**Dr Posen:** I don’t know about Mr Carney, per se. I think anyone who has been Governor of a central bank, when they are not a member of a committee structure, and everyone reports to him and there are not votes, will have a very big culture shock. As I said, notwithstanding our discussion, there is more open debate in opposition and ability of the Governor to lose a vote in the Bank of England setup than in any other central bank I am aware of.

**Jesse Norman:** I am grateful for that. I have a final question if I may. You have pointed towards the Bank operating in a very—as you might imagine—economically, almost econometrically driven way, and ignoring its own potential power over institutions and its capacity to create institutions, and you might imagine the institutional dimension of intelligently conducted economic policy. Could you comment a little bit on the way in which a revamped, revived bank, which took its governance responsibilities over the banking sector as seriously as it is going to have to do, what are the kinds of things it would do? You have talked about stimulating small business lending, new activity creation, breaking up existing monopolies, lobbying for opening up the banking system. Are there any other kinds of things that you can see in that area, because I think it is an extraordinarily interesting and unexplored area of policy that the Bank is going to have to reflect on really quite hard over the next few years?

**Dr Posen:** Absolutely. Mr Norman, you have put your finger on a very important dual issue that is, given the much greater powers and remit, what they can do with it in a positive sense, and the issue that it is not trivial to figure out, it is intellectually difficult and it is not self-evident. To be honest, the recap you gave of some of the things I have offered is, in a sense, the intellectually low hanging fruit. You look at the UK financial system and you can say that these are the apparent problems. These are things that are precedent for other central banks and the Bank of England in its history to do, such as making markets, buying, encouraging certain kinds of discounting or making markets by working with the Government to issue charters or recognise different kinds of financial institutions.

**Jesse Norman:** That historically the Brits have been really good at.
Dr Posen: Exactly, and it is historically entirely within the tradition. I do not have a full answer for you because, as I indicated, in all honesty, I think you have posed a very serious and difficult challenge. Two things that I think would be important, and I would encourage the incoming Governor and whoever is with him to put at the top of the agenda. The first is—as you have heard several times before in this Committee—quite rightly, we have this FPC that is supposed to do what is called macroprudential policy, but none of us are really sure what those instruments are, how well they work or how to use them. Frankly, some of the stuff Mr Newmark was saying about QE, that is how I feel about macroprudential policy. I genuinely do not know how effective it would be or what is the right tool. It is because it is genuinely new.

Jesse Norman: But you do think that consolidation has to happen at the top of the cycle, so you absolutely recognise the requirement for it?

Dr Posen: I guess I am a little wary of the words, “absolutely recognise” but, yes, I do accept that, given the errors that the Bank and all of us in the economic policy community made in the previous decade, it is worth trying this. As I think I said the last time I appeared before this Committee—while I was still a member of the MPC—and as I said yesterday before the Banking Commission my strong predilection is for big dumb rules rather than discretion.

As I advocated in a speech a couple of years ago, I personally would, for example, not want the FPC arbitrarily moving up and down loan-to-value ratios or capital requirements for real estate. I would want to build in counter-cyclical, pretty automatic taxes on boom/bust real estate, for example. That is just my opinion.

In response to your very strong question, what should the next Governor be doing with this new thing, besides building the institutions of the financial system, trying very hard to think ahead, and be extremely transparent about what the tools of this macroprudential policy, this FPC, are going to be? I must admit, while I sympathise with my former colleagues at the Bank who have appeared before you and said, “We are learning as we go. We are not sure yet” Frankly, I think it is more important they err on the side of—again, it is in the spirit of something Mr Newmark said—not causing uncertainty about policy. It is less that there is this sense they have in their heads that there is going to be some optimal, right, complicated policy, “If we can just figure it out it will be the right toolkit”. I am more of the opinion it is going to be a very blunt instrument and partial instrument, whatever they choose. So spend less time trying to finesse it and spend more time making clear what it is going to be, how it is going to be used, what to expect.

Chair: Thank you very much for coming to give evidence to us this morning. It is now about to become this afternoon, so we have run a little over time. We have one further small bit of private business to do after this meeting. We are very grateful to you for coming, as we were yesterday.

Dr Posen: Thank you very much for your time. I appreciate it. Thank you very much.

Chair: We hope to see more of you in the future.