

Central-banking accountability: A conversation with Sir Paul Tucker

The former deputy governor of the Bank of England discusses deciphering the *Alice in Wonderland* world of negative interest rates and central-bank accountability with senior partner Eckart Windhagen.



Central bankers have played a critical role in the global economy during and after the 2008 financial crisis, slashing interest rates and adopting “quantitative easing” policies that avoided a repeat of the Great Depression. In this conversation with McKinsey’s Eckart Windhagen, Paul Tucker discusses this role in detail, including his misgivings about unelected central bankers having unconstrained power. He calls for clearer limits and an “ethic of self-restraint” in central banking.

Peter Gumbel: Hello, and welcome to the latest podcast from the McKinsey Global Institute. My name is Peter Gumbel; I’m the editorial director. And today, we’re going to be discussing what is going on in the world of central banking and what it means.

The conversation will be between Eckart Windhagen, who is a senior partner at McKinsey, based in Frankfurt, who focuses on central banking and global banking in general, and Sir Paul Tucker, who is the former deputy governor at the Bank of England, a chair of the Systemic Risk Council, and a research fellow at Harvard Kennedy School. He’s the author of a widely noted book on central banking titled *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State*. It was published in 2018 by Princeton University Press. Eckart, over to you.

Eckart Windhagen: Paul, we have an ambitious plan for the next half hour: a tour d’horizon, covering a range of today’s really complex themes. What is the state of the economy? Are central banks part of the problem or part of the solution? What will happen with currencies and our money? How can European banks get back on track? And what is your advice for politicians? So everyone is talking about negative interest rates. Let’s start there.

In your 35 years as a central banker and policy maker, would you have ever imagined a scenario where debt is piling up while interest rates are going down, even below zero?

Paul Tucker: Well, first of all, Eckart, thank you very much for inviting me to be here.

This is an *Alice in Wonderland* world. This is a world that if you lend me money, you have to pay me some interest on the money every quarter. It’s a world in which if I’ve deposited some money with you, I need to send you interest on it regularly. This will be incredibly hard for people to understand. I think that matters. I think a world in which people were confused and alarmed would be likely to be a world in which there were more caution: greater propensity to save, lower propensity to invest. So I think the *Alice in Wonderland* quality of it matters.

The second thing I would say—and I think this is more important—is, real interest rates are negative or close to negative because productivity growth is so low. And I think the thing we should be really, really worried about is how very low productivity growth has been almost everywhere in the Western world since the worst of the crisis.

You imagine a world with no productivity growth at all, let’s say, anywhere in the world—which is utterly implausible, but just as a thought experiment. This would be a world in which I can only be better off if everybody else is worse off. That was the world in which powerful European nations went out seeking empire, initially to take wealth and resources from other countries. I mean, a zero-growth world is politically hazardous because everything is redistributive within societies and across countries.

The other part of it is, of course, the economics in a world with no growth has very different kinds of incentives to invest, both real investment and financial investment. And so it’s a world in which the guaranteed returns on long-term liabilities issued by long-term-savings institutions would be completely unviable. They would be broke.

Eckart Windhagen: How did we arrive at this point? The subprime crisis unfolded more than a decade ago in 2007 and '08, followed by the eurozone crisis in 2011. But we have seen global growth for almost a decade now. Do you think

that today's low-growth and low-interest-rate environment is still a latent effect of this crisis?

Paul Tucker: This is one of the biggest questions of all. And I don't think anyone knows the answer definitively. And the greatest part of that question is, have the difficulties we've been facing been caused by the crisis itself? Or are they a legacy of what caused the crisis?

On one story—and this is the bleakest story of all—productivity growth, underlying growth, had started to decline well before the crisis. And a credit boom was allowed or engineered in a misjudged attempt to sustain or revive growth. And now we're both confronting the debt overhang from the failed attempt to revive growth and having to confront lower, underlying growth. That's one version of the story.

Then the question would be, well, what caused that? And that's Larry Summers's secular-stagnation thesis. A variant of it is, we haven't got secular stagnation, but we definitely have a debt overhang. This is the Ken Rogoff story. And it will take years and years and years to work off. And it will look like secular stagnation for a very long time.

The third version says, no, no, it's nothing to do with either of those things. But actually, there was too much debt: it caused a collapse in confidence. The banking system completely imploded almost everywhere in the Western world and with spillovers to other parts: to Asia and Africa, to Latin America. And that was the shock to confidence, and such has been the balance of microeconomic policy that the recovery is very, very slow.

I've set out three possible theses. Of course, I don't think anyone knows. The important thing for policy makers is, since you can't tell for sure which of those it is, in the jargon of economists, what's the robust response? And this is where some people would say, actually, there should have been much more fiscal stimulus and much more public-sector stimulus or contribution to infrastructure expenditure in the United States, in

Germany. The interesting thing about the United States and Germany is that they're by far the two most important economies in the Western world because they're the biggest. And both of them have fiscal space, for different reasons, to do more.

The debate about whether there should have been more fiscal stimulus isn't just, if you like, a spat about ECB [European Central Bank] versus the German Finance Ministry [Federal Ministry of Finance] or something. It's a deep debate about what the best mix of monetary and fiscal policy response is to the kind of circumstances that we have been facing, when you don't really know what the deep cause is.

Eckart Windhagen: Let's talk about central banks: your home turf. Central banks have become main actors since the crisis. And they received a lot of acclaim for how they fought the crisis. Did central bankers get the immediate crisis response right?

Paul Tucker: My generation of central bankers avoided a repeat of the Great Depression. And that's quite a thing. For all of the hardships that people have faced—and they have faced great hardship with great social, political, even constitutional consequences—it has not, thank God, so far at least, been anywhere near as bad as the Great Depression and, in various ways, the political turmoil which it unleashed in parts of Europe and the United States of America.

So that part—the QE, the quantitative easing response, the reducing interest rates from basically 5 percent to 0 percent in a few weeks or months in late 2008, beginning of 2009—I think that was good. We did not repeat the same mistakes as our predecessors had sadly committed in the 1930s.

Having said which, I'd make two or three points where the next generation can do better. First of all, even through 2007, when it was a liquidity crisis, I think that we all, but perhaps especially the Americans, should more quickly have provided

liquidity directly to so-called shadow banks as well as directly to the core part of the banking system.

Secondly—perhaps more importantly—providing liquidity: sometimes it works. Sometimes it was just an unwarranted panic, and providing liquidity calms things down. That didn't work this time. But it always does something else. It gives you time. It gives you time to deal with some of the fundamental problems. And I think the central bankers were not tough enough on the bank supervisors during that period in terms of saying, "We're providing this liquidity. We're providing a breathing space. We're providing time. You should be going into the banks and the dealers and checking whether they're OK, ruthlessly, and making them raise capital or whatever."

To make this graphic for your listeners, after Bear Stearns fails in March 2008, why aren't the floorboards taken up in the other broker-dealers in the United States? And I don't have much truck with the explanation, "Well, we didn't have the powers," because the SEC [Securities and Exchange Commission] would have had that power. So that's the second thing.

And then thirdly, I'm going to pick out one thing from macroeconomic policy, which is, in Europe, my view has been that the ECB embarked upon quantitative easing roughly 12 months too late.

Eckart Windhagen: How central banks should deal with the global economy now is a hotly debated topic. Are central banks running out of ammunition? Some voices are asking for the next escalation of quantitative easing, using central-bank balance sheets to fund investment and consumption. How do you weigh the long-term benefits and risks of such concepts?

Paul Tucker: They've blatantly got less ammunition than we had in the beginning of 2009. We were all basically reducing interest rates from 5 percent to around 0 percent. And we were increasing our balance sheets, lending money into the system, from very small balance sheets to very large balance sheets. So then people talk about, well,

going into negative interest rates, which would repair that a bit already.

Before I come to the points about lending directly to consumers, households, and firms, some people say, "Well, maybe the central bank could buy equities." What this means is that if you do it on scale, and you hold it on your balance sheet for quite a long while, it means that the central bank, the state, becomes the owner of a great chunk of the business sector of the economy. Even if you do it via exchange traded funds, indirectly.

There's a question about, how are you going to exercise your votes? I don't think Mervyn King would mind my saying the next thing. At one point, when we'd lent against mortgage bonds—not bought outright; we had lent against mortgage bonds in the Bank of England, as did all the other central banks—we were saying, "Well, how could this go badly wrong?" Probably there are some economic aspects to that. But there are some quasi-political ones as well.

And I remember saying, "Well, you know, something that would be very difficult for us would be if the counterparties default—they're not rescued or whatever—and we end up owning a big mortgage portfolio. And even if we manage that mortgage portfolio really well, it will mean that we are essentially the lenders to household UK and that we are in the debt-collection business with the UK. And that will be a moment that we would need to think about very carefully.

In those circumstances, you probably want to shift the mortgage portfolio to the government in exchange for holding government bonds. Because if you're going to be directly intervening in household finances, it is a highly political thing, which brings me to the questions about, well, couldn't central banks intervene, in People's Quantitative Easing or the kind of fiscal facility advocated by some people at BlackRock? Because typically, when you cut through, it involves central banks printing money and sending it to households. And then what does that mean? So should we send it to residents or citizens? Should we send

it to households or to all adults? What age counts as an adult? Should we send everybody the same amount of money or depending upon whether they're rich or poor? Should we base it on wealth, or should we base it on income?

When I describe all of those things, what I'm hoping that your listeners are thinking is, "My God, that's taxation policy," although in reverse because you're sending out money rather than requiring it to be sent to you. So you need all those decisions to be taken by government.

The burden of my book is that there should be limits: we, as healthy constitutional democracies or aspiring healthy constitutional democracies, limit the powers we're prepared to delegate or can decently be delegated to unelected technocrats. When I was in office, I would not have wanted to be making those kinds of decisions. And I don't think my colleagues would have wanted to be. The way I put it in my book is, we need to be quite careful that this doesn't become an economic coup d'état. If you control the printing press, there are an awful lot of things that you that you could do. So that doesn't make it sustainable.

Eckart Windhagen: Central-bank independence was, for a long time, widely recognized as a prerequisite for successful monetary policy. This belief is increasingly challenged by some politicians on both sides of the Atlantic. In your new book, *Unelected Power*, you assess the issues of central-bank governance in the context of their unprecedented power. Should we continue to defend central-bank independence, or should we worry about lack of control?

Paul Tucker: I think we should worry about both and we should continue to want central-bank independence. And let me give you a political argument for that, a constitutionalist argument. One of the deepest values in all of our societies is the separation of powers. And I don't mean here the separation of powers between the judiciary and politicians but the separation of power between the executive government and Parliament, the Bundestag, Congress.

And why do we do that? In the country where we're recording this, England, this goes back many, many centuries. And it was that the taxation power should only be used with the consent, assent, of representatives of the people. Now over those centuries, we've moved from property representation and aristocratic representation to full-franchised democracy, thank goodness. But nevertheless, the principle has always been the same. The king, prime minister, chancellor should not be able to levy taxes under their own will. They should be decided by an elected assembly.

Then what is the monetary lever, if you sit in the central bank, and suddenly you print an enormous amount of money—not to stimulate the economy, but just hand it out or whatever? You can finance the government, you can help out your friends, you can support projects that you want, without going to Parliament or Congress or the Bundestag for what, in England, we call "supply." The last people that should control the monetary power are [those in] the executive branch of government.

The 19th century cured this problem, I now think, through the gold standard. And as it happens, I don't think the gold standard is viable in a full-franchised democracy, because it makes jobs and output too volatile. I see central banks now as a corollary. The independence of central banks is a corollary of the separation of powers. So it runs very deep. Say that's broadly right. Precisely because it is such a grave power, it needs to be constrained. And so the design of the central-bank regimes so that they are properly constrained and can be properly monitored is immensely important.

In a sense, my book is about what those should constraints be, given the values of democracy and the values of the rule of law and constitutionalism. But the other thing: even if somebody does a great job in devising those constraints, you need self-restraint as well. I mean, we live in societies, thank goodness, where our top judges live by an ethic of self-discipline, of self-restraint. And this has evolved over hundreds of years. Judiciary independence goes back a long way.

We need the same ethic of self-restraint in central banking. The monetary power is hugely alluring to any aspirant authoritarian government of left or right. If you aspire to be an authoritarian government, by God, you want to get hold of that money power because that's going to make your life a lot easier. And it's going to make your citizens' lives a lot less so.

Eckart Windhagen: Governance is a particular challenge in Europe. In 2011 and 2012, at the peak of the eurozone crisis, I remember touring the world and trying to explain how the eurozone is supposed to work and why failure was not a given, as many believed at that time—in particular, in Asia and in the US. In simple terms, instead of the usual value adjustment between the franc, lira, peso, deutsche mark, gulden, and others, we expected to see productivity adjustments and some labor migration and some transfers. However, it became evident that these mechanisms were not activated sufficiently. In the first decade, productivity adjustments were limited, and labor migration was low. And transfer from north to south was a political no-go. What is the situation today? Is the eurozone finally properly activated?

Paul Tucker: The eurozone still has, and I say this with a heavy heart and great regret, faulty foundations. One of the things that worries me is that I would say that my tribe of central bankers, in office and out, understand this. And I worry that diplomats and politicians, for understandable reasons, think Mario [Draghi] got us through the crisis. The crisis has gone away. Whereas the eurozone crisis was as severe as it was partly because of faulty foundations.

There's a very important political theorist in your country's history, the very devious Carl Schmitt, who said, "He or she who calls the state of exception is the sovereign." Mario Draghi called the state of economics exception, and he was the only person that could save the euro area in its dire crisis in 2011, 2012. This is unthinkable in the United States or the UK. It's unthinkable

in Germany or France before the euro. I'm not criticizing the euro-area project at all. I think it is inevitable that, at some point, monetary union will be accompanied by some kind of fiscal system.

Eckart Windhagen: Does the ECB have an impossible task, navigating 19 eurozone countries, with all their diverging conditions?

Paul Tucker: It certainly has a hell of a difficult job. During the crisis, towards the end of the worst of the crisis, when I was still in office, people would say, "Who do you think has done the better job, the Fed [Federal Reserve Board] or the ECB or the Bank of England?" And I'd say, "What do you mean? This is a crazy question." The Fed or the Bank of England, we've just been dealing with circumstances that we'd never envisaged, and we didn't quite know what to do. The ECB's job has been much, much harder than that, because they've faced that problem plus all the constitutional constraints, institutional constraints, that come with it. And I'm completely serious.

I think that one of the great problems for central bankers everywhere, but perhaps especially in the euro area, is, quite rightly, they want to say, "Governments should be doing more. We should be doing less." In my experience, lecturing governments, from speeches or whatever, in public doesn't work. It's more important to get across what you cannot do.

Of course, it's very easy for me to sit here saying that because it's a prescription that, if communicated in a candid way, would amount to saying, "We're naked now," which, of course, would terrify citizens, let alone the financial markets. I think that is what needs to happen. This reliance on central banks is a great mistake in the medium to long run but tremendously tempting for the politicians. And I have no criticism in that. I think if you and I were politicians, we would feel the same temptation. I could do some policy that would help in the long run, but it would be unpopular in the short run. What happens if I do nothing? Oh, the

central bank will do more. Well, that seems like a good answer, then. You know, they're professional.

So these things are very, very difficult. And the leadership in these central-banking institutions carry a great burden, to be honest.

Eckart Windhagen: What about other currencies? Will the [US] dollar remain the global reserve currency forever? What are the forces at work, and what would need to happen to trigger a major rebalancing toward the euro or the renminbi?

Paul Tucker: It is a privilege to be the issuer of the world's reserve currency. My country had that privilege for a very long time. But with it goes enormous responsibilities. And those responsibilities need to be accepted and recognized in the United States but also remembered here. And as the United States finds itself more stretched around the world because of the geopolitical changes, I think all our countries should understand why they are pressing us to spend, to increase our share of expenditure on defense. I do think the dollar's position as a world reserve currency matters to their ability and willingness to do that.

That doesn't mean that the euro or even sterling can't also be a reserve currency. And they are. But the extent to which the dollar is used for invoicing, as sterling used to be many years ago, is a tremendously important part of the world in which we live and not just a matter of economic policy.

Eckart Windhagen: We have to talk about the banking sector for a moment. In Europe, the sector appears to be in permanent recovery mode. European banks lost significant share to the US and Asia and competitors. Valuation levels show a fundamental lack of trust in banks' abilities to earn their cost of equity and to grow. And now, bankers are realizing that the next decade might be much harder than the previous one. We might just reach the end of a benign credit cycle and face further margin compression from low interest rates. Are

regulators to blame? Did regulation overshoot in the aftermath of the crisis?

Paul Tucker: In continental Europe, bank regulators, supervisors, indulged in forbearance far too much. I think one can overestimate this or overemphasize this point, but the Americans tackled their banking system pretty damn quickly, and their economy recovered first. The UK tackled its banking system more slowly than America but faster than almost every country in continental Europe. And it recovered faster than most of continental Europe.

And there are smaller economies that also were pretty fast. Ireland is one, actually. Ireland didn't have a productivity problem: Ireland had a banking problem. And they gripped it. I think it would've been harder in the circumstances of the euro area. But I think the instinct to forbear is strong in parts of the continent.

I hope this doesn't get too "inside baseball" for your listeners, but I would like to see the banking supervisory authority in Frankfurt under the ECB have more power and be less dependent upon the votes of national representatives. Because if I'm one national representative, and you're another, and we each desire to slow down the rate at which we're being forced to deal with our banking systems, well, I can scratch your back, and you can scratch mine, and we'll vote against tough action. And there isn't enough transparency from the body to know whether that's happened. But it seems to be plausible that it has. And I think, sometimes, officials do things in good faith that aren't in the best long-term interests of the people they're there to serve.

Eckart Windhagen: Central banks have been the only game in town after the crisis, as you write in your book. Do you see signs of governments and politicians returning to the game? What role should they play to shape a prosperous future for our society?

Paul Tucker: The really, really big decisions on the prosperity of our society should be taken by people that we elect. I mean, all of us are absolutely committed to democracy—constitutional democracy, democracy with constraints. But we can't have the biggest decisions taken by people that we didn't elect, including central bankers. And I think it's been too easy for the politicians to step back.

Let me give you an image of this. If I ask, which face do you associate with the world, and particularly the United States, coming out of the Great Depression and reforming everything after the Great Depression? Many people are going to say, "Oh, Franklin D. Roosevelt." Which faces are today associated with getting us through the crisis of 2008 and '09 and beyond that in Europe? I'll suggest that they are Ben Bernanke, Tim Geithner, Hank Paulson, Jean-Claude Trichet, Mario Draghi. All of whom, of course, I'm fortunate enough to know. But none of whom, like me, ever ran for election—or should they have done—for the jobs that they were doing.

This is a remarkable change. It is remarkable that, in many countries—including the United States—our elected politicians didn't even step up and take responsibility for explaining to the public the actions that were being taken in their name and for their sake. This isn't just a purist point. Believe me, those politicians, they're better at it. They're better at finding the words, the images, the metaphors that resonate in people's sitting rooms and kitchens and cars when they're driving to work.

I've been lucky enough to know many—or certainly, quite a few—very, very articulate central bankers. But none of them have the magic that the great politicians do of finding this word: a way of

explaining things that make regular people, citizens, the people who it's all for, say, "Yeah, I get it. I get it."

In America, in particular, I think the suspicion was that this was all to help Wall Street—and against the interests of Main Street—rather than a well-intentioned attempt to help, in that the most effective way of helping Main Street was to rescue parts of Wall Street. I don't think that's something you could ever expect a central banker to be able to get across. Whereas I think Franklin Roosevelt could've done it. And I think politicians in my country of the past could have done it. And actually, in Britain because of our system of government, the prime minister did have to go into the House of Commons and explain what we were doing in late 2008, 2009. And I do think that the Bank of England hasn't carried quite the burden of some of the other central banks, politically, because politicians here stood up and owned it and took the heat. And so I think they should do it because of our deep values. And I think they're better at it.

Eckart Windhagen: Thank you. Thank you, Paul.

Paul Tucker: Thank you very much.

Peter Gumbel: Thank you, gentlemen, for that very interesting conversation.

You have been listening to a podcast by the McKinsey Global Institute with Eckart Windhagen, a McKinsey senior partner based in Frankfurt, and Sir Paul Tucker, the former deputy governor at the Bank of England, who's the author of a book titled *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State* that was published in 2018 by Princeton University Press. Thanks for listening.

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