

Who guards the guardians of monetary stability and financial stability? That is the key question behind the debate about the accountability of the Bank of England

Rosa Lastra unpicks the debate surrounding the accountability of the increasingly powerful Bank of England. She argues that the Bank of England should be made accountable to Parliament, and calls for a better understanding of how we should assess the Bank's role in creating financial stability.



According to the [new framework](#) proposed by the government the Bank of England is to become a very powerful institution. It will have several hats: as monetary authority, lender of last resort, supervisor on a macro and micro level, administrator of the Special Resolution Regime and general guardian of financial stability.

With power comes responsibility. Though accountability is an evasive concept, it can be defined as an obligation owed by one person or institution (the accountable) to another (the accountee) according to which the former (in this case, the Bank of England) must give account of, explain and justify the actions, omissions or decisions taken against criteria of some kind, and take responsibility for any fault or damage.

Accountability thus presupposes that the accountable and the accountee cannot be the same institution. The question then arises: to whom should the Bank of England be accountable? Parliament is best suited to guard the guardians of monetary and financial stability in a parliamentary democracy. However, MPs need to be well-versed in monetary and financial affairs to act as an effective counterweight. And they need time, information and resources.

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That is why I have, since 1997, advocated that the Treasury Committee could appoint a sub-committee with the specific task of monitoring the Bank of England. All the members of this sub-committee (three or five) should have the technical expertise required to deal with monetary matters and it should be a multi-partisan body. The stakes are too high to leave this issue in the hands of politicians or parliamentarians for whom the intricacies of financial markets and monetary policy may hinder the proper exercise of accountability.



The Bank of England should be accountable to parliament (House of Commons), to judicial review and to audit control. And it should also be accountable to the Treasury. Of course, one problem in the design of an 'accountable independence' lies in the possible reversal of the intended objective of 'depoliticising' the pursuit of monetary and financial stability. Indeed, if too much independence can lead to the creation of a democratically unacceptable 'state within the state,' too much accountability threatens the effectiveness of independence.

With regard to monetary policy, it is the chancellor who sets the inflation target (with an obligation imposed on the Monetary Policy Committee to report back to the chancellor if inflation deviates from the target by exceeding the bands imposed upon it); with regard to financial stability, it is a goal that transcends institutional boundaries: the Treasury must be involved, in particular when public funds are committed.

Any form of accountability presupposes that there are objectives or standards according to which an action or decision might be assessed. In other words, accountability implies an obligation to comply with certain standards in the exercise of power or to achieve specific goals. The more complex the activity, the more difficult it is to establish clear standards of conduct and specific outcomes. And complexity frustrates

accountability.

Given this, according to which criteria or targets should we measure the accountability of the Bank of England? When it comes to monetary stability, the measurement of inflation (the inflation target) provides a clear quantifiable indicator. But when it comes to financial stability, we have not reached a consensus yet as to which are the best indicators. And if we do not have criteria of assessment then the content of the obligation becomes vague, and accountability becomes ever more evasive.

That is why Charles Goodhart, economist and former MPC member, in his written evidence to the House of Commons Treasury Committee proposed the adoption of early warning indicators which tend to precede financial crises, including:

1. 'A rate of growth of (bank) credit which is significantly faster than average, and above its normal trend relationship to nominal incomes;
2. A rate of growth of housing (and property) prices which is significantly faster than normal and above its normal trend relationship with incomes.
3. A rate of growth of leverage, among the various sectors of the economy which is significantly faster than usual and above its normal trend relationship with incomes'.

Any recent discussion of accountability often includes a reference to transparency and vice versa. This poses the question of the relationship between the two concepts. Accountability is an obligation to give account of, explain and justify one's actions, while transparency is the degree to which information on such actions is available.

A downside of transparency concerns panics. Certain supervisory decisions require a degree of confidentiality, given the psychological connotations of bank panic and contagion. For instance, the need for covert assistance in the case of lender of last resort operations is of particular importance to contain a crisis, since the belief in a panic is self-fulfilling and the fact that an institution is known to require official assistance may trigger the very run the authorities are keen to prevent, and thus 'stigmatize' the provision of such assistance.

These considerations put transparency for supervisory decisions and the accountability of those taking such decisions in a different category from transparency for monetary policy decisions, where the arguments are overwhelmingly in favour of disclosure.

Safe money and sound banking (in modern terminology: monetary stability and financial stability) are the twin goals of central banks. Insufficient attention to financial stability issues in the years that preceded the crisis was one of the many causes that triggered the 'retreat from sanity' (in Galbraith's words) that the events in 2008 signified.

But the supervisory failures were rooted in failures of 'how to supervise', not in failures of 'who supervises'. That is why all supervisory structures failed in their duty, whether one, two or many supervisors, and whether or not central banks were in charge of supervision, like in the US, where the Federal Reserve System had and has supervisory powers.

In the UK, the FSA is now being dismantled and the government is tinkering with reform of supervisory structure, once again. Surely the Bank of England is the institution best suited to undertake both monetary policy and macro prudential supervision (given its view of the forest), but the arguments for micro supervision (view of each tree) are more finely tuned and there is a compelling case for not having the Special Resolution Regime (SRR) under its umbrella, considering its lender of last resort mandate, since an institution might be reluctant to approach the Bank for liquidity assistance if it fears it might be subject to SRR.

And while the Bank, as equidistant between the government and the financial system, is best suited to control systemic risk, it cannot do it alone. Like a tsunami, episodes of financial instability do not respect geographic borders.

Hence the need for adequate supranational (at the EU level) and international co-operation, co-ordination and exchange of information. The issues of parliamentary accountability and the degree of transparency that is needed with regard to the disclosure of central bank decisions are complex and difficult issues. However, with the increased powers given to the Bank of England they must be addressed and solved in an appropriate manner.

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