

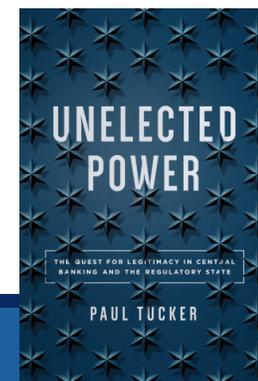
# *INDEPENDENT CENTRAL BANKS AND REGULATORS: A RISK TO CONSTITUTIONAL DEMOCRACY?*

---

PAUL TUCKER, HKS

DISCUSSION AT DIW, BERLIN

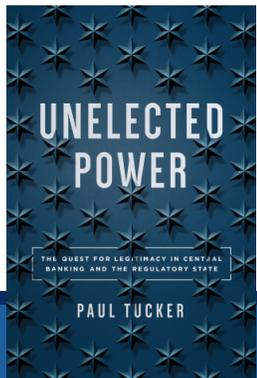
6 JUNE, 2019



# STRUCTURE OF TALK

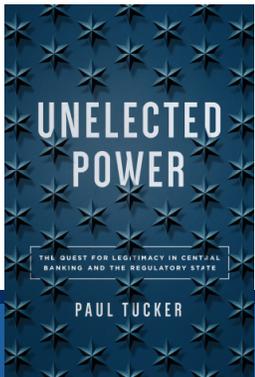
---

1. Background: welfare, legitimacy, constitutionalism, and credible commitment
2. Reconciling commitment technology with democracy
3. Our political values shape *Principles for Delegation*
4. Some consequences for ECB and central banking



---

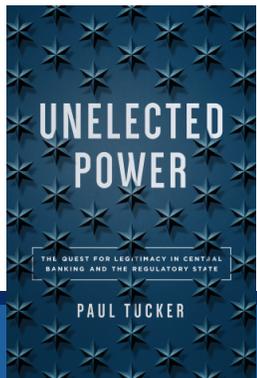
# I: BACKGROUND



# BASIC PROBLEM AND THESIS

---

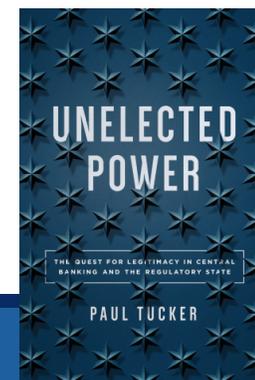
- Too much government power for comfort lies in the hands of unelected regulators and activist judges
- Government no longer designed in a principled way
  - Gap in constitutionalism bequeathed by Locke, Montesquieu, Madison
- Solution: a political norm comprising *Principles for Delegation* to independent agencies



# POWER OF THE POST-CRISIS CENTRAL BANKS

---

- Poster boys and girls of today's Unelected Power
  - New third pillar alongside Judiciary and Military
- Balance-sheet powers used like never before: latent fiscal powers
- Plus, new regulatory powers (Fed, ECB, BofE)
  - part of *law-making* state as well as fiscal state
- What constraints needed for legitimacy in a constitutional democracy?



# STANDARD ARGUMENT FOR CBI INCOMPLETE

---

Time-inconsistency problem: standard solutions incomplete

*Rules* (Kydland/Prescott):

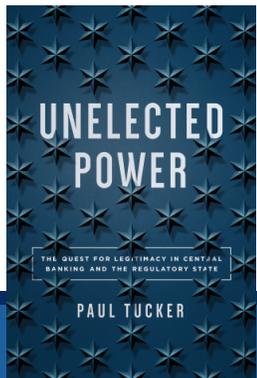
- But why would 'they' stick to the declared rule?

*Conservative central bankers* who hate inflation (Rogoff):

- But why would govt (re)appoint such a person, and what if they are only pretending to be conservative?

*Contract* allowing govt to punish CB for missing target (Walsh):

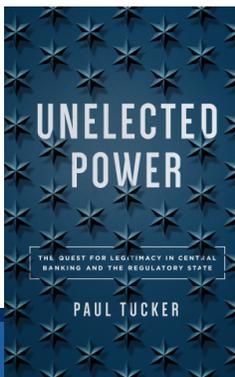
- But what if missing the target suits the govt?
- An infinite regress problem?



# FIVE HIGH-LEVEL THEMES OF BOOK

---

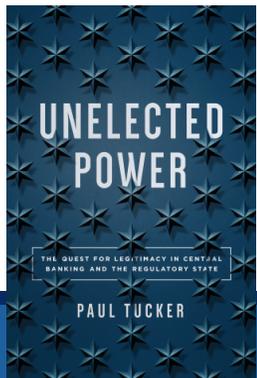
- Legitimacy up there with Justice
- Technocracy v. Populism:
  - Technocracy should retreat a bit
- Legal liberalism is insufficient:
  - Judges guarding against the arbitrary exercise of power cannot cure a democratic deficit: our republican values matter too
- Gap in constitutionalism concerning points on a **spectrum of commitment devices**
- Our deep (shared) political values should constrain Rational-Choice Institutional Design: the book's **Political Values Robustness Test**



# WHY LEGITIMACY MATTERS

---

- Legitimacy makes a system of government resilient in the face of inevitable policy failures and disasters. *OUTPUTS CANNOT SUFFICE*
- Representative democracy special partly because
  - It separates how we feel about the government of the day from how we feel about the *system of government*
  - Because we can sack (vote out) our governors
- Except we cannot vote out our unelected governors
- IA-regimes liable, in slow motion, to erode trust in govt unless they are principled and widely understood



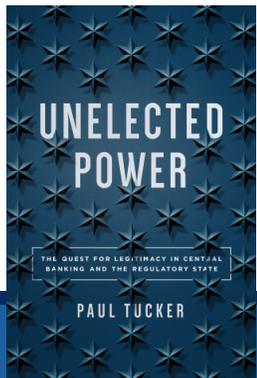
# INDEPENDENT AGENCIES: DEFINITION

---

Definition: *Insulated from the day-to-day politics of both elected branches of government*

Attributes of independence:

- Control over delegated policy instruments
- Job security of policymakers
- Budgetary autonomy (or at least not an *annual* budget process)



# ADMIN STATE AND CONSTITUTIONALISM

---

Germany a rare exception among advanced-econ democracies:

- Under German Basic Law, formally can be no IAs (other than BUBA post Maastricht). Not obviously true *de facto*

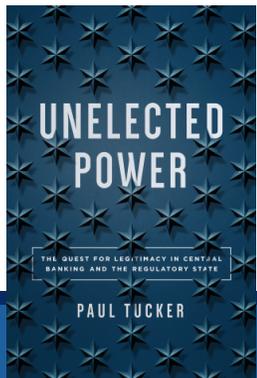
France: Written constitution puts admin under PM, but IAs carved out by Const Court

- IAs now structured under a generic statute, following critical Senate report

USA: Empty non-delegation doctrine, sprawling variety of structures

UK: flexibility (of course)

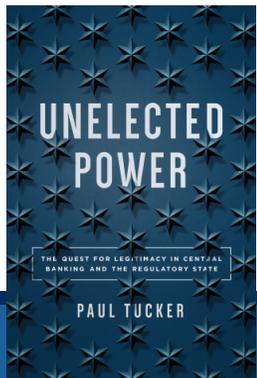
- Long resisted o/a doctrine-cum-tradition of parliamentary accountability
- Partly solved through Select Committee system; now lots of IAs



# CONFUSION IN USA

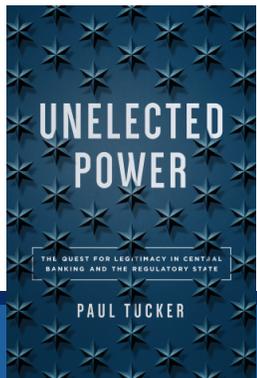
---

- SEC, CFTC, FTC, FCC not IAs on this definition: annual budget appropriation process gives Congress ongoing leverage
- CFPB is an IA on this definition (does not satisfy *Principles*)
- Fed and FDIC are IAs
- UK: FCA, OfCom, utility regulators are IAs
- Sweden: Riksbank an IA; FSA semi-independent



---

# II: RECONCILING IAs WITH CONSTITUTIONAL DEMOCRACY



# JUDGES v. EXECUTIVE ADMINISTRATION

---

- Benchmark of modern administration is a detailed legislative code applied, case by case, via the courts.
  - Where technical expertise is needed, the adjudicators can be specialist judges, subject to judicial review by generalist courts.
- Departures from benchmark need to be justified.
- Policy-making by the executive branch is, given our democratic values, preferable where:
  - a) society desires consultation on general policy (eg regulatory rules), and
  - b) wants to keep both the regime and the exercise of delegated power under public review.
- But that does not make a case for regulatory rule-making and other policy making beyond the day-to-day control of elected ministers

# JUSTIFICATIONS FOR DELEGATION-WITH-INSULATION

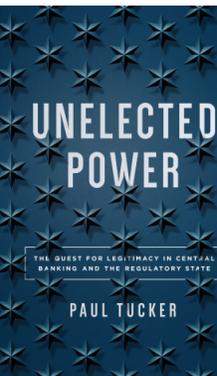
---

## *Expertise*

- Landis during 1940s: separation of powers is redundant
- Does not work: could have an independent body that gives public advice to a political decision maker
- Necessary but not sufficient

## *Credible commitment*

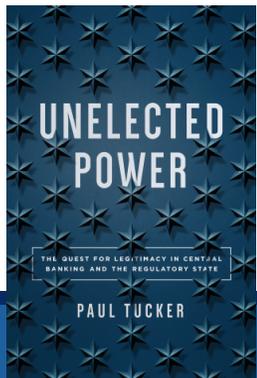
- *Politician*: re-election/current popularity: pursues welfare *today*
- *Technocrat*: professional and public reputation for delivering mandate
  - Requires mandate that constrains, and
  - To generate audience costs, ***a society capable of bestowing esteem (republican honour)***



# COMMITMENT v. DEMOCRACY

---

- But do institutionalised commitment devices violate our democratic values?
  - *Our freedom to change our minds about ends and means*
- On the one hand, delegation is designed to help the democratic state deliver better results by sticking to the people's purposes: in that sense credible commitment is enabling of democratically generated purposes.
- On the other hand, the people have to remain free to change their purposes.
- The resolution has to be either that there are some commitment problems where democracy, as ordinarily understood, should be suspended or, alternatively, that *institutional technology designed to enable credible commitment can come in degrees*.

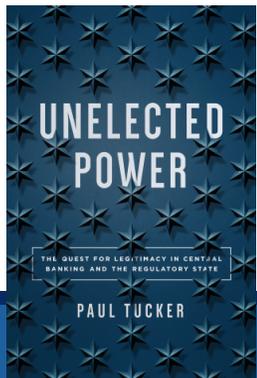


# LAW IS A COMMITMENT DEVICE

---

We have long employed other commitment devices:

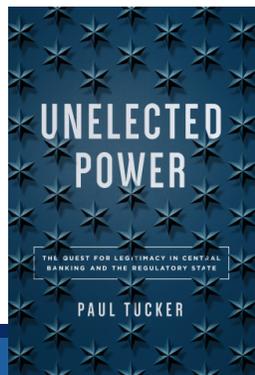
- All law is a form of commitment device
- Deeply entrenched judicial independence is a device for committing to adjudicatory fairness and consistency
- Separation of powers commits to balancing individual freedom with collective self-government (Moellers)



# HIERARCHY OF COMMITMENT INSTITUTIONS

---

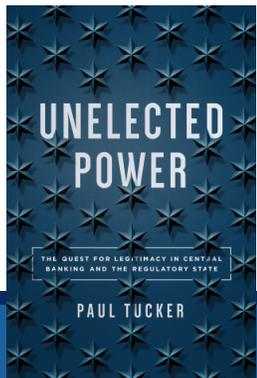
- 1) Mechanical rules on the structure/procedures of politics
- 2) Institutions for applying interpretative rules on the structure/procedures of democratic politics and government
- 3) Institutions for applying interpretative rules on any 'fundamental' or 'basic' rights beyond democratic political rights
- 4) Institutions for adjudicating legal cases under (and with the final word on the meaning of) the ordinary law
- 5) Public-policy commitments? **Different because 1-4 deliver institutionalized constraints on majoritarian power according to values of rule of law, liberalism, and constitutionalism.**



# ABUSES v. MISUSES OF POWER

---

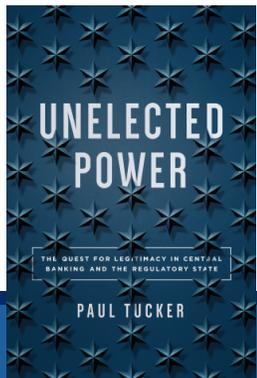
- Escape from thinking that hazards to our system of government are only:
  - A. extra-legal acts that can be remedied via the courts, and
  - B. within-law policy failures that can be remedied via the ballot box.
- Neither suffices where all political parties have incentives to renege on a substantive promise (for example, low inflation) and, further, the social costs of their doing so are long-lasting (because they become embedded in people's expectations and behaviour).
  - Those are serious *misuses of power*.



# IA REGIMES AS NON-ENTRENCHED COMMITMENT TECHNOLOGY

---

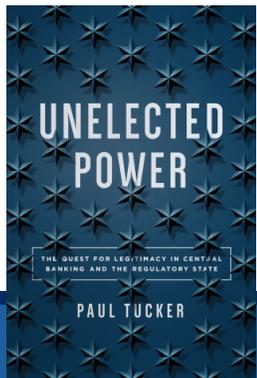
- Think of an IA as a commitment device *pro tem*, but only *pro tem*:
  - Suspension of “trial and error” policy-making *for the time being*
  - *Not formally entrenched, but grit that politicians put in their own way*
- Trustees for a clear public purpose
  - statutory mandate is the ‘trust deed’
  - as such, it could be vague or constraining
- More codified, less room for welfarist learning
- **More entrenched the independence, tighter constraints needed**



# IAs AS RULE-WRITERS

---

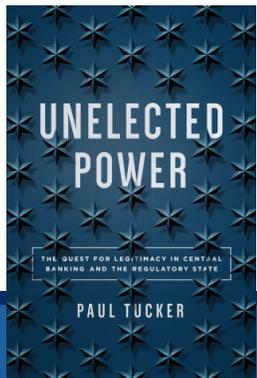
- Credible commitment problem can infect the legislative process itself
- Take a case of a major regulatory overhaul following a financial crisis. Because it will take some years, legislators worry about whether their resolve, and that of their backers, will hold as memories of crisis fade and the short-term allure of easy credit and asset-price inflation reasserts itself.
- Conscious of that risk, the legislators decide to bind themselves to the mast by delegating to an independent agency the job of filling in the detail of the reformed regime.
- Legislators trying to commit to their *own* high policy. They have not formally bound their successors (or their future selves), because they cannot. But they have made any future backtracking more visible --- to commentators, the public, etc.



# A HIERARCHY OF AGENCIES

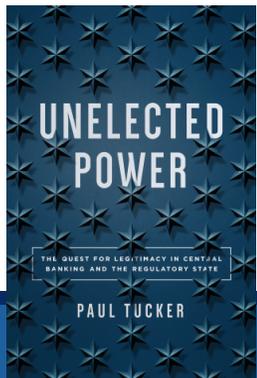
---

- Delivery agencies under Ministerial control
- Regular policy agencies under political control
- Independent agencies that are *Trustees* for some carefully mandated public purpose
  - *normal monetary authorities fit here*
- *Guardians* of a constitutional value
  - 4th/nth branches: if the *only* way of securing that value



---

# III: *PRINCIPLES FOR DELEGATION*



# INSTITUTIONAL DESIGN: OUR POLITICAL VALUES

---

## ***Freedom:***

- *republican* freedom from domination
- *liberal* freedom from interference exceeding what's needed to deliver public purposes

## Values of the ***rule of law:***

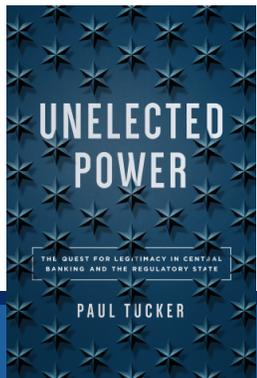
- predictability, generality, clarity, etc
- fair and open adjudication

## ***Democratic*** values:

- participation, representation, public deliberation, transparency, contestability, etc

## ***Constitutionalism:***

- separation of powers, etc

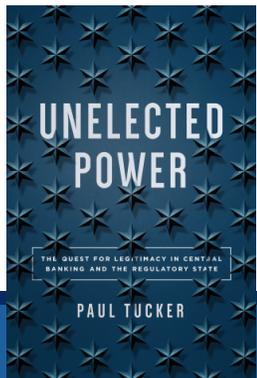


# *PRINCIPLES FOR DELEGATION TO IAs*

---

- Delegation Criteria for *Whether* to delegate
- Design Precepts for *How* to delegate
- Multiple-Mission Constraints

*Rational-choice institutional design constrained by deep political values*



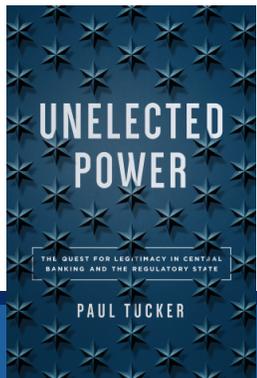
# WELFARE v LEGITIMACY

	<i>Satisfy Principles</i>	<i>Could satisfy Principles</i>	<i>Cannot satisfy Principles</i>
<b>Delegated to an IA</b>	Democratically legitimate welfare enhancement	Remediable legitimacy problem	Unremediable legitimacy problem
<b>Under political control</b>	N/A	Welfare opportunity cost	Sensible.

# *PRINCIPLES FOR DELEGATION TO IAs*

---

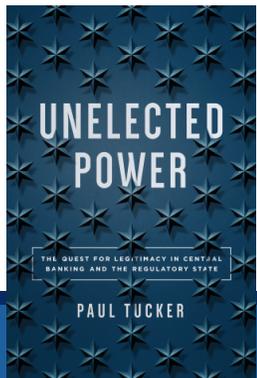
- 1) Broadly settled public preferences re purpose**
- 2) Problem of credible commitment
- 3) No big *choices* re distributional issues or high-level values**
- 4) Legislature to set a clear objective that can be monitored**
- 5) Decisions via one person-one vote committees, after deliberation
- 6) Transparency enabling public debate and accountability**
- 7) Clarity re powers in emergencies
- 8) Multiple-mission agencies: separate committees with 'dedicated' majority



# EMERGENCIES

---

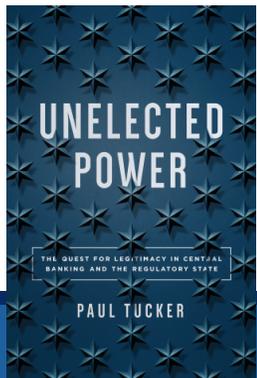
- Clarify ex ante what happens when an IA could help contain a disaster but is at boundary of powers:
  - eg temporary formal extension of powers granted by elected politicians
  - in practice, probably relies on a delegated power to exec branch
- If IA could act within existing powers but in ways not remotely contemplated by public or legislators, consult elected politicians
  - [eg ECB should have done so]



# *MULTIPLE-MISSION CONSTRAINTS*

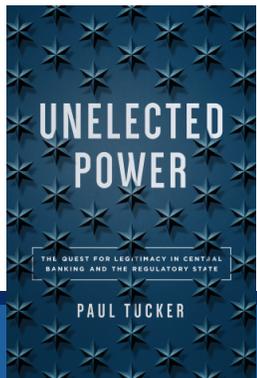
---

- 1) Missions are intimately intertwined
- 2) Better results expected from joint production
  - eg, o/a info flows
- 3) Each mission meets tests for IA status
  - do not delegate a non-independent mission to a IA
- 4) Separate statutory policy committees for each mission
  - with a majority of members of each committee on only that committee



---

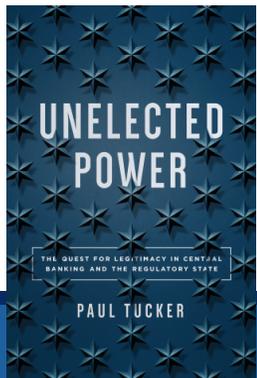
# *SOME GENERAL CONSEQUENCES*



# VAGUE AND MULTIPLE OBJECTIVES

---

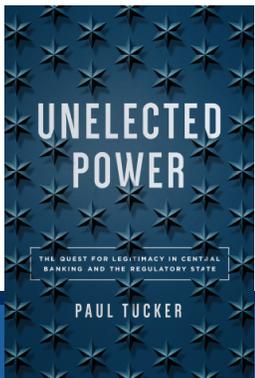
- FCC: in “the public convenience, interest, or necessity” and “so as to provide a fair, efficient, and equitable distribution [of radio services]”
- Federal Energy Regulatory Commission: to ensure that utility-type charges are “just and reasonable”
- EPA: to set a policy for air pollutants “requisite to protect the public health” with an “adequate margin of safety”, and with a secondary requirement to deliver policies “requisite to protect the public welfare”
- SEC: to deliver a combination of investor protection, fair, orderly and efficient markets, and capital formation
- Federal Reserve: safety and soundness of banking groups.



# SOME CONSEQUENCES FOR UK

---

- FCA: should not be an independent agency
- Utility regulators: need commission structure
- OfCom: at least needs separate statutory Chambers for Content and Economic regulation
- Electoral Commission: may need more insulation and power (and prestige)
- BofE: needs statutory objective, constraints and committee for LOLR



# JUDICIAL REVIEW OF IAs

	<i>Principles-compliant</i>	<i>Principles-deficit</i>
No 'basic rights' at stake	Thin review: Eg, not unreasonable	Less thin review: Eg, clearly reasonable
'Basic rights' at stake	Thicker review: Eg, proportionality	Thick review: Eg, proportionality and merits

# EXAMPLE: INCIPIENT CRISIS IN SECS REG?

---

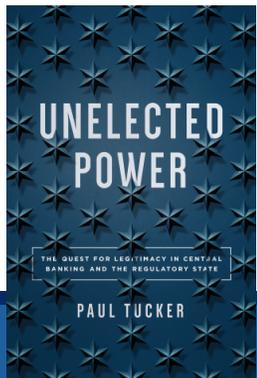
SEC is responsible for: protecting investors; maintaining fair, orderly and efficient markets; and facilitating capital formation

- Trump Administration has appointed a chair who plans to shift the emphasis to the last, in hope of reinvigorating the economy.

UK's Financial Conduct Authority has a strategic objective of ensuring that financial markets function well, and three operational objectives:

- securing an appropriate degree of protection for consumers
- protecting and enhancing the integrity of the UK financial system
- promoting effective competition in the interests of consumers.

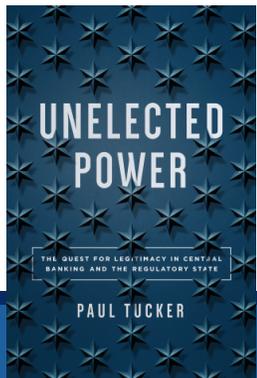
No standard is set and no weighting is given for trading off the operational objectives.



# WHAT ABOUT THEIR ROLE IN STABILITY?

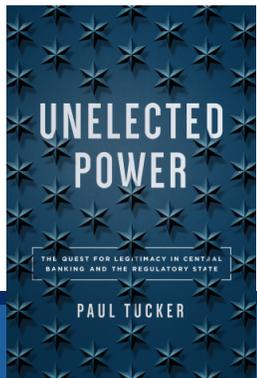
---

- If monetary authorities are independent so as to help solve society's problem of making credible commitments to maintain stability...
- And if, at least in the wake of the financial crisis, securities regulators are integral to maintaining financial stability....
- Then securities regulators need, in their stability role, the same degree of independence as monetary authorities and to be subject to the same kind of constraints.



---

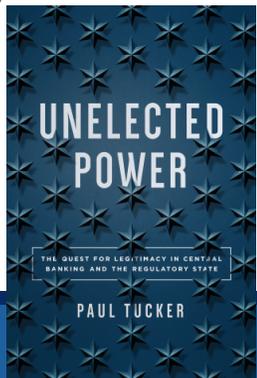
# IV: CONSEQUENCES FOR ECB AND CENTRAL BANKING



# CONSTITUTIONAL CENTRAL BANKING

---

- Under fiat money, independence for the monetary authority is a corollary of the higher-level separation of powers between the fiscal authority of the legislature and the elected executive government
  - Doubt whether the volatility in output and jobs entailed by gold standard would be tolerated under *full-franchise* democracy
- Central banks a solution to the problem of not giving the monetary levers to the elected exec

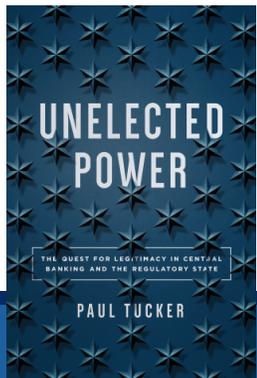


# CENTRAL BANKS AND PRUDENTIAL STABILITY

---

*“I insist that neither monetary policy nor the financial system will be well served if a central bank loses interest in, or influence over, the financial system.”*

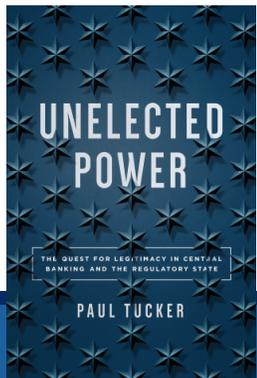
Paul Volcker, “The Triumph of Central Banking?”, 1990



# ONE FUNCTION LEADS TO ANOTHER

---

- LOLR needs information to judge soundness of potential borrowers
  - in circumstances where prophylactic sup and reg have “failed”
- Will want to be able to influence policy on minimum resilience requirements, and to be assured supervision is professional
- BofJ and BUBA do this *de facto* but not *de jure*
  - not in accord with today’s application of political values: accountability in the public sphere
  - ***Principles* require function be formalized, with objective, constraints etc.**

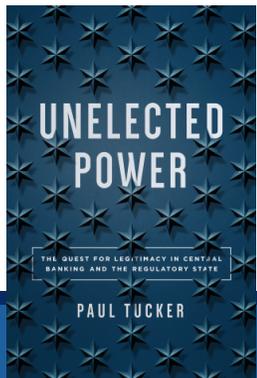


# *MONETARY SYSTEM STABILITY*

---

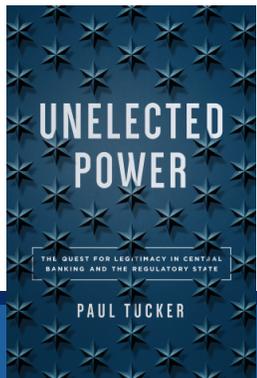
Mission with two parts:

- Stability of the value of central bank money in terms of goods and services
- Stability of the value of private banking-system money in terms of central bank money



---

# THE ECB AND SSM



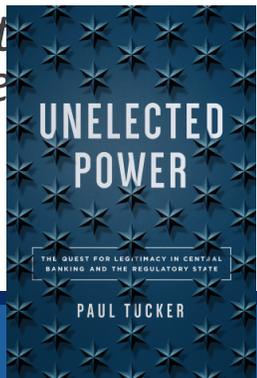
# NOT A REGULAR CENTRAL BANK

---

*“Simultaneously more and, perhaps, less than a regular central bank” (p.393)*

*“The true power of the state (sovereignty) lies with whoever wields the power to act in emergencies. If, then, in an emergency the elected executive steps aside, leaving an independent agency, say...the ECB, to act alone, they are revealed as the true sovereign” (pp.243-4)*

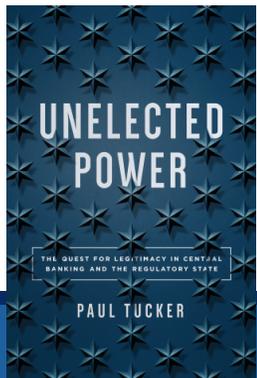
*“Monetary technocrats adrift in the constitutional order of things, precariously perched as existential guarantors. Hence the legal and political dilemmas posed by the ECB’s Sisyphus-like labours to preserve Europe’s monetary union and the wider Project it represents.” (p.563)*



# NOT A REGULAR CENTRAL BANK

---

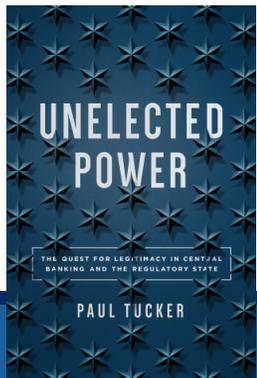
- ECB much more deeply entrenched than regular central bank
  - **narrower constraints, normatively**
- ECB has no counterpart EA fiscal authority but has same latent quasi-fiscal capabilities as any central bank
  - ***de facto*, EA's existential guarantor (Schmittian economic sovereign)**
- Deep tension. Compounds wider OGIT problem



# ECB IN EMERGENCIES

---

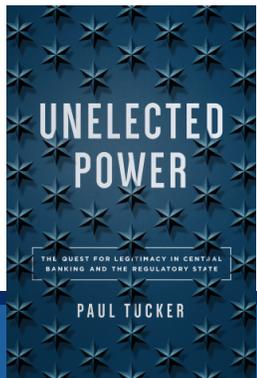
- ECB should publish its contingency plans for extreme events.
- The political branches (Council and Parliament) should edge towards greater codification of the ECB's crisis repertoire



# SINGLE SUPERVISORY MECHANISM

---

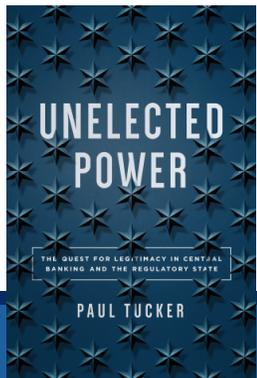
- As the LOLR, the ECB needs some role in regulation and supervision of EA banking system
- SSM is one decent way of delivering that. Good that:
  - formalised
  - distinct from Governing Council



# SSM REFORMS

---

- Pity that national reps are in majority:  
reintroduces quotidian politics via back door
  - EBA same
- No member of ECB should also be a member of industry-sponsored or funded bodies
- **BIG: Should articulate a monitorable objective**

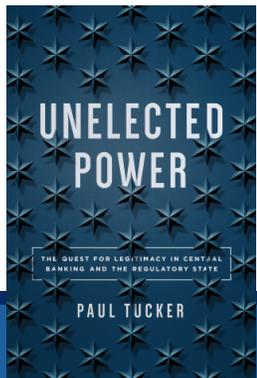


# *UNELECTED DEMOCRATS*

---

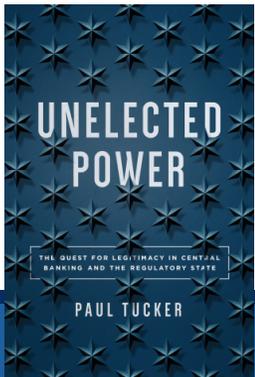
THANK YOU FOR LISTENING,

PAUL TUCKER, DIW, BERLIN, 6 JUNE 2019



---

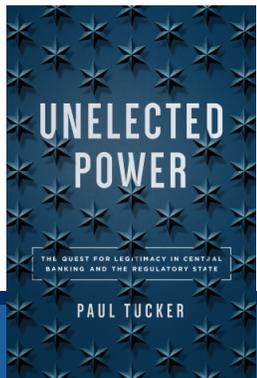
# SUPPLEMENTARY SLIDES



# A HIERARCHY OF INSULATED AGENCIES

---

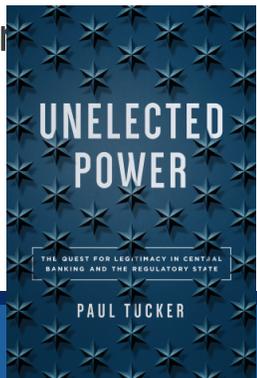
- A. *Trustee-type IAs* that are established in ordinary statutes to deliver credible commitment to a public policy purpose for purely consequentialist reasons.
  - For example, a regulator established to write rules to flesh out a standard for financial system resilience)
- B. *Trustee-type* independent agencies that are not established by the constitution but are a corollary of the higher-level separation of powers
  - For example, independent monetary authorities)
- C. *Guardian-type* agencies that are established by the constitution to preserve democracy and the rule of law generally.
  - Canonically, constitutional courts and, perhaps, some electoral commissions).



# A MONEY-CREDIT CONSTITUTION

---

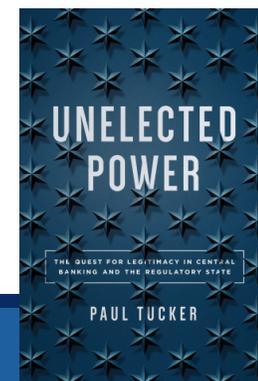
- Others have argued for a Money Constitution
  - Because need to know it won't chop and change
- Given FRB, must be a Money-Credit Constitution. Five broad elements:
  - an objective for price stability;
  - a standard of resilience for the private banking system, with consequent constraints on balance sheets;
  - a lender-of-last-resort regime to provide liquidity insurance to sound intermediaries;
  - a statutory framework for resolving fundamentally bust firms in a more or less orderly way, so that the LOLR doesn't bailout such firms but sticks to its job of providing liquidity reinsurance;
  - and, crucially, constraints on the use of central banking's latent fiscal and regulatory power



# LIBERAL CONSTRAINT BITES ON MACROPRU

---

- “An IA’s rule-making should not interfere with individual’s liberal rights more than necessary to achieve the legislated purpose and objective (proportionality)”
- Problem for, eg, across-the-board LTV and LTI caps for borrowers: not proportional because other, less invasive options



# BALANCE-SHEET POLICY

---

Time consistent: central banks should not deny that they will do things that in fact they would do. So any absolute constraints must be in primary legislation and incentive-compatible for law-makers.

Balance-sheet operations should at all times be as parsimonious as possible consistent with achieving their objectives, in order to aid comprehensibility and accountability.

Minimize risk of loss consistent with achieving statutory objectives.

*If* permitted to operate in private-sector paper, should be in as many sectors as possible; with selection of individual instruments as formulaic as possible; and valuation methodology published.

# BALANCE-SHEET SIZE

---

Following paying interest on reserves, could in principle have three instruments:

- policy rate (and talk about reaction function)
  - size of balance sheet
  - composition of asset portfolio.
- Principle of parsimony means not all are needed all of the time
  - Under normal circumstances, let balance sheet size be determined by banks choosing the level of reserves they each wish to target over a monetary maintenance period

# THREE PILLARS OF UNELECTED POWER

---

*"I don't hate [him]...I do love him, but the day that I say that I agree with him when I don't, is the day he must get rid of me because I am no use to him anymore."*

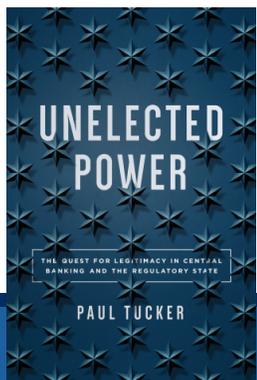
Field Marshal Alan Brooke after a row with Winston Churchill, Spring 1944

*"The Justices have their being near the political marketplace, in which the effects of their judgments are felt...A number of controls are built into their craft, which they practice under the scrutiny of a profession whose expectations and approval must matter to them."*

Alexander Bickel, 1962

*"Central bank governors require three qualities above all. A deep commitment to price stability. An ability to be clear and direct to politicians about the policies that are required to produce economic stability. And the ability to be unpopular when circumstances require."*

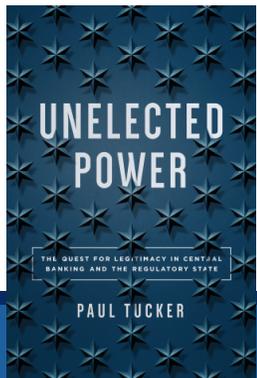
Mervyn King at a retirement dinner for Jean-Claude Trichet, 2011



# SELF-RESTRAINING CENTRAL BANKERS

---

- Like the military but unlike the judiciary, the central bankers must be ready to advise in private on the wider government policies that are *necessary* for monetary-system stability
- Unlike the military, precisely because they have job security, they must not press and press, while not equivocating in their advice
- Unlike the military, they can repeat this advice in public at their own initiative, but in doing so the intimate connection with their formal mandate must be explicit and able to withstand tough scrutiny;
- They cannot be in the business of offering their opinion, in private or public, on things they happen to know about or are interested in but do not rely upon in fulfilling the trust placed in them by legislators;
- Like the judiciary, they must not be drawn into offering specific private advice or public remarks about things they will or might have to decide
- Like the judiciary, as legitimacy seekers, they can (and, rationally, ought to) explain their institution to the public
- Like the judiciary, they must be ready to take criticism.



# *UNELECTED DEMOCRATS*

---

THANK YOU FOR LISTENING,

PAUL TUCKER, DIW, BERLIN, 6 JUNE 2019

