CENTRAL BANKING IN A TIME OF CRISIS: THE BANK OF ENGLAND

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ABSTRACT

The role of a central bank is to ensure stable money and sound banking, a role which is defined by law, politics, history, and economics. This anchor of stability relates to the three pillars of our current monetary system: money, bank deposits, and payments. Though other private and public entities have a role in money creation, payment, and supervision, the central bank is the only institution that conducts monetary policy in pursuit of price stability. This power is formidable as it influences risk taking and price formation in the economy. If the central bank is independent from political instruction, the boundaries of its delegated mandate delineate the scope of its activities. In a democratic system those boundaries, and the design of adequate mechanisms of accountability, are essential to preserve legitimacy and credibility. The expansion of the central bank remit in response to the recent crises—the global financial crisis, the COVID-19 pandemic, and now climate change—questions the adequacy of the "narrow" mode or model of central banking, shaped by the economic consensus prevailing from 1990 to 2007, with inflation targets and independent central banks. A new mode or model of central banking—yet to be crystalized—is emerging, with multiple objectives and

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functions, and porous boundaries. The broadening of the mandate in a time of crisis also brings central banks closer to the political agenda. This is the background for questioning existing institutional arrangements, their independence, and accountability. I consider in particular the evolution of the remit of the Bank of England over the last twenty-five years though I also refer to the European Central Bank and to the US Federal Reserve System.

INTRODUCTION

Central banks are creatures of history, and their structure and powers have changed over time and across countries. Central banking is defined by the relationships of the central bank with the political authorities on the one hand and with the banks on the other hand. The central bank sits at the center of the financial system, equidistant from the government and the markets.

Stable money and sound banking (in modern parlance, monetary stability and financial stability) provide the rationale for central banking. Together with the central bank's role as both the bankers' bank and the government's bank, these objectives and functions form the anchor of our two-layered monetary system, where commercial bank money (private money) is convertible at par into central bank money (public money).

The legal study of central banking must place the law in a political and historical context, with due regard to economics (in particular, monetary economics). A central bank is a *sui generis* and powerful entity. It is both a governmental agency and a bank.[1] This dual nature is crucial to understand the central bank's constitutional framework and limits, its objectives and functions, and its governance.

The function of the central bank as an anchor of stability relates to the three pillars of our current monetary system: money, bank deposits, and payments. However, while other entities—private and public—have a role in money creation, payments, and supervision, the central bank is the only institution that conducts monetary policy in the pursuit of price stability.[2] This is a formidable power. Central banks do not simply administer a technical regulatory scheme affecting discrete industries or interests. They regulate price levels, which is one of the most fundamental powers of government, and one of the most important practical concerns

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[1] *See* ROSA LASTRA, INTERNATIONAL FINANCIAL AND MONETARY LAW (2015). Central banks perform public functions (functions delegated by the Government to the central bank in the pursuit of the public interest) and corporate or commercial functions. In the case of litigation, the central bank is entitled to sovereign immunity when it exercises central banking functions. Domestic statutes and treaties that deal with sovereign immunity address the immunity of central banks and their property as a special case.

[2] *See generally* ROSA LASTRA & GEOFFREY MILLER, *Central Bank Independence in Ordinary and Extraordinary Times*, *in* CENTRAL BANK INDEPENDENCE: THE ECONOMIC FOUNDATIONS, THE CONSTITUTIONAL IMPLICATIONS, AND DEMOCRATIC ACCOUNTABILITY, 31 (Jan Kleineman ed., 2001).

for the public at large.[3] And their remit has continuously expanded in the last fifteen years.[4]

The responsibility of banks to create money is at the core of a large number of banking and payment laws and regulations. Monetary policy operations have typically relied on the reserves of the commercial banking system, and the central bank's function as lender of last resort links monetary policy with the banking system. The involvement of the central bank in bank supervision is, for many, inextricably linked to the nature of our two-layered monetary system, though supervision is not a necessary nor an exclusive central banking function.[5] And, with regard to the other pillar of our monetary system, namely payments and the law of payments, the central bank is always concerned with its smooth operation, as money and payments oil the wheels of the economy.[6]

The function of the central bank as an anchor of stability remains valid in the digital age. Money is or becomes a public good. While central bank digital currencies are a manifestation of the power of the state in money creation, private digital money (such as stablecoins, unbacked cryptocurrencies, and tokenized deposits) and the payment systems associated with it require public regulation and supervision. Whether or not the central bank will continue to have such a close role with private digital money providers as it currently has with commercial banks will determine the future of our monetary system. The public authorities are the ultimate guarantors of money, payments, and banking.[7] The Silicon Valley Bank crisis and subsequent saga of banking troubles in 2023 evidenced that "there are few libertarians in a financial foxhole."[8]

The advent of central bank independence combined an administrative law tradition of functional decentralization with economic theories analyzing the inflationary bias of politicians. The early 1990s

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3 *Id.*

4 ECON. AFFS. COMM., HOUSE OF LORDS, MAKING AN INDEPENDENT BANK OF ENGLAND WORK BETTER 61 ("[T]he remit of a central bank (such as the Bank of England) comprises statutory objectives, functions and powers. The word remit is often used in a broad sense as synonymous to mandate.").

5 *See* ROSA LASTRA, LEGAL FOUNDATIONS OF INTERNATIONAL MONETARY STABILITY (2006).

6 *Id.*

7 Robert Hockett & Saule Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143, 1147-1148 (2017); *see* Rosa Lastra, *En defensa del dinero público digital* [*In Defense of Digital Public Money*], 89 EL TRIMESTRE ECONÓMICO 1007 – 1032 (2022).

8 *See* John Thornhill, *SVD Shows That There are Few Libertarians in a Financial Foxhole*, FIN. TIMES (Mar. 13, 2023), https://www.ft.com/content/ebba73d9-d319-4634-aa09-bbf09ee4a03b [https://perma.cc/QT5P-DGHG].

consensus around a "narrow" central banking model—delegating a price-stability-oriented monetary policy to a depoliticized technocratic entity—has been shaken since the Global Financial Crisis (GFC). In response to financial and sovereign debt crises, pandemics, and climate change, central banks have taken on the role of "crisis managers."[9] This expanded remit challenges the adequacy of the narrow mode or model of central banking that prevailed between 1990 and 2007. This period, often referred to as the "Great Moderation" or "non-inflationary consistently expansionary" (NICE) years,[10] was marked by inflation targeting and independent central banks. A key feature of this era was the stabilization of inflation at a target level around 2% increase per annum in the Consumer Price Index.

Given the inflationary excesses of events (both demand and supply driven) in the 1970s (stagflation),[11] governments needed a mechanism to restrain them from taking inappropriate action when confronting, like Ulysses at the mast. Central bank independence in the pursuit of price stability provided such restraint.[12] The Maastricht Treaty required such independence for entry into the European Monetary Union, and the International Monetary Fund made it often a "condition" attached to the programs of reform that countries submitted in order to get access to Fund financial assistance.[13] Central bank independence became a kind of "graduation issue" for countries wishing to exhibit or consolidate their credentials in monetary stability and fiscal restraint.[14] But, as with any economic theory, there were fault lines,[15] evidenced during the GFC. Central banks' main concern shifted from controlling inflation to restoring financial stability.[16]

Drawing on the evolution of the remit of the Bank of England, with references to the European Central Bank (ECB) and the US Federal

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9 *See* LASTRA & MILLER, *supra* note 2, at 33.

10 In a speech in 2003, the then Governor of the Bank of England, Mervyn King, referred to the period of Great Moderation as the "NICE" years: "So the UK experienced a non-inflationary consistently expansionary - or "nice" - decade; a decade in which growth was a little above trend, unemployment fell steadily, and, supported by the improved terms of trade." *See* Mervyn King, Governor, Bank Eng., Address at the Bank of England Dinner (Oct. 14, 2003).

11 *See* Wallace C. Peterson, *Stagflation and the Crisis of Capitalism*, 38 REV. SOC. ECON. 277 (1980).

12 *See* LASTRA, *supra* note 1.

13 *Id.*

14 *Id.*

15 *See generally* RAGHURAM G. RAJAN, FAULT LINES (Princeton Univ. Press ed., 2010).

16 Rosa Lastra, *Central Bank Independence and Financial Stability*, 18 ESTABILIDAD FINANCIERA 49, 51 (2010) (Spain).

Reserve System (the Fed), I argue in this article that a new mode or model of central banking—yet to be crystalized—is emerging, and that the structures and governance of the central bank are in need of reform.[17]

The rest of the article is structured as follows. In Part I, I examine the close relationship between the central bank and the government, through the specter of the "fatal embrace" that looms in the background. In Part II, I revisit the arguments for monetary independence that are the backbone of the narrow model of central banking. In Part III, I consider the template of accountable independence in the light of the broadened mandate. In Part IV, I draw lessons from the history of the Bank of England, considering also the parliamentary inquiries on Quantitative Easing (QE) (2021) and operational independence (2023). The article finishes with some concluding observations in Part V.

I. "FATAL EMBRACE"

The role of the central bank as the government's bank exemplifies the symbiotic relationship between law and politics in central banking. Some central banks, such as the Bank of England, were established to finance the government's needs. This original rationale sits, at times, uneasily with their economic role as an anchor of stability and their status of independence. A basic tenet of "economic independence" is that the central bank should not be under compulsion to finance government deficits.[18] But, the below cartoon from 1797 illustrates[19]—with a caricature of the Old Lady of Threadneedle Street (the Bank of England's nickname) resisting the advances of Prime Minister— that the "fatal embrace" remains a persistent challenge. The temptation to use the central bank for government purposes, whether through the "old" method of printing money for war finance or the "new" forms of fiscal and quasi fiscal support via QE, continues to pose a risk. The "fatal embrace" is a threat to the function of the central bank as anchor of stability.

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17 *See* Charles Goodhart & Rosa Lastra, *The Changing and Growing Roles of Independent Central Banks Now Do Require a Reconsideration of Their Mandate*, ACCT., ECON., L.: A CONVIVIUM 1 (2023).

18 Rosa Lastra, *The Independence of the European System of Central Banks*, 33 HARV. INT'L L. J. 475, 490 (1992).

19 James Gillray, Political-ravishment, or the old lady of Threadneedle-street in danger! (illustration) (1797), https://www.britishmuseum.org/collection/object/P_J-3-68

Economic historians in the United States have documented[20] how, during World War I and World War II, the link between monetary policy and debt management signified that the Fed was not truly independent from political instruction but remained a vehicle for war financing. The Treasury-Fed Accord of March 3, 1951, with its stated purpose to "minimize monetization of the public debt,"[21] marked the beginning of an era in which the Fed pursued monetary policy as an autonomous authority. The Fed moved from furnishing "an elastic currency"[22] to controlling money creation to stabilize the purchasing power of the dollar.[23] But in terms of monetary stability, the history is patchy. The Fed failed to keep inflation under control in the 1970s and it was only with the appointment

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[20] *See generally* PETER CONTI-BROWN, THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE, (Princeton Univ. Press ed., 2017).

[21] Jessie Romero, *The Treasury-Fed Accord*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/treasury-fed-accord [https://perma.cc/P6Y8-RFTV]; *see also* William McChesney Martin, Jr*., Report on Conversations at the Technical Level of Treasury and Federal Reserve System Representatives*, FED. RSRV. BANK ST. LOUIS (1951), https://fraser.stlouisfed.org/archival-collection/william-mcchesney-martin-jr-papers-1341/federal-reserve-board-treasury-department-accord-472985 [https://perma.cc/P3GB-DQTV] (describing the negotiations of the Treasury-Fed Act).

[22] Federal Reserve Act, H.R. 7837, 63d Cong. (1913), ("An Act To provide for the establishment of Federal reserve banks, to "furnish an elastic currency", to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.").

[23] Stephen Slivinski, *The Evolution of Fed Independence*, 13 ECON. FOCUS 5, 6-7 (2009).

of Paul Volcker as chairman that the Fed managed to tame inflation and to restore its credibility as an independent monetary authority.[24]

A. HOW QE WORKS

The reputation of central banks in the UK, United States, Europe, and other countries has suffered a dent since the advent of QE and its extensive use during the GFC, in its aftermath and in the midst of the COVID-19 pandemic. QE brings central banks again closer to the financial needs of governments, linking monetary policy and debt management.[25]

QE is defined as large-scale purchases of financial assets by a central bank, with the aim of providing monetary stimulus by lowering long-term interest rates.[26] Central banks buy assets (typically government bonds but also corporate bonds) which are financed by the creation of central bank reserves (a form of digital money).[27] QE has resulted in large central bank balance sheet expansion, leading to an "unconventional" form of monetary policy different from the traditional interest rate policy.[28]

The House of Lords Economic Affairs Committee (EAC) conducted a parliamentary inquiry into QE in 2021, which culminated in the publication of an evidence-based report entitled *QE: a Dangerous Addiction*.[29] The website of the Bank of England mentions two transmission mechanisms of QE. First, by creating this "new" money, the Bank aims to boost spending and investment in the economy, pushing

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24 Leslie Kramer, *How the Great Inflation of the 1970s Happened*, INVESTOPEDIA (Apr. 29, 2024), https://www.investopedia.com/articles/economics/09/1970s-great inflation.asp#:~:text=The%20Great%20Inflation%20period%20would,4 [https://perma.cc/88A2-QEAB].

25 *See* ECON. AFFS. COMM., QUANTITATIVE EASING: A DANGEROUS ADDICTION?, 2021-2, HL 42, at 38, 3 (UK) (explaining that the Bank of England carries out operations through the Asset Purchase Facility, which can make profits or losses because the interest and income it receives from bonds it has bought may exceed or fall short of the cost of its operations, but is fully indemnified by HM Treasury. At its height the total size of the QE program was equivalent to around 40% of the UK GDP); *Quantitative Easing*, BANK OF ENG. (May 10, 2010), https://www.bankofengland.co.uk/monetary-policy/quantitative-easing [https://perma.cc/Y68D-SGBB] (listing actions that the Bank of England has taken, including buying £895 billion of bonds in this current round of QE); *see generally* Chris Smith, *Quantitative Easing*, HOUSE OF LORDS LIBRARY (Nov. 11, 2021), https://lordslibrary.parliament.uk/quantitative-easing/#:~:text=In%20July%202021%2C%20the%20House,of%20England%20has%20become %20politicised [https://perma.cc/7YMK-TDLJ].

26 ECON. AFFS. COMM., *supra* note 25, at 8–9.

27 Smith, *supra* note 25.

28 *See generally* BANK OF ENG., *supra* note 25.

29 ECON. AFFS. COMM., *supra* note 25, at 61.

down the interest rates offered on loans and making it cheaper for households and businesses to borrow money. Secondly, there is the "wealth effect" since QE can stimulate the economy by boosting a wide range of financial asset prices.[30] In his evidence to the EAC in 2021, Lord Turner referred to a "third transmission mechanism," not mentioned in the Bank's website: "lubricating a fiscal expansion."[31] According to Lord Turner, this form of monetary financing would make "it easy for the Government to run large fiscal deficits,"[32] blurring the boundaries between monetary policy and fiscal policy.

B. CRITIQUES OF QE

In 2009, QE achieved its original intent in the UK when it successfully "unclogged" the bank lending channel to the private sector and increased the money supply. However, experts have questioned the intent and effectiveness of subsequent rounds of QE.[33] Indeed, QE also

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[30] ECON. AFFS. COMM., *supra* note 25, at ¶ 7.

[31] Jonathan Adair Turner, Lord of Ecchinswell, Oral Evidence on Quantitative Easing to the Select Committee on Economic Affairs, Virtual Proceeding, Mar. 16, 2021, 4:00 PM ("I think that it is useful to start with the description of the transmission mechanism of QE on the Bank of England's website, where it says, "How does quantitative easing work?" It says two things: first, that the large-scale purchase of government bonds lowers the interest rates or yields on those bonds and potentially has a knock-on effect on some other bonds, such as corporate ones, and because it pushes down the interest rate on loans it stimulates the economy. It also says that there is a second transmission mechanism, which is that it boosts a wide range of financial asset prices and, therefore, it some way produces a wealth effect with wealthier people spending more money."), https://committees.parliament.uk/oralevidence/1920/html/ [https://perma.cc/D538-58AB].

[32] *Id.*; *see also* ECON. AFFS. COMM., *supra* note 25, at ¶ 44 ("Will Bateman . . . made a similar point: 'The main fiscal policy effect of [quantitative easing] is to maintain the UK Government's access to debt finance in large volumes and low cost in the face of sustained budget deficits.' In so doing, quantitative easing provides 'critical support during economic emergencies when fiscal receipts fall significantly behind public expenditure.'"); *see also* Mervyn King, *Examination of Witnesses on Banking Supervision and Regulation by the Economic Affairs Committee*, Mar. 24, 2009 ("Mr. King: Quantitative easing is not a question of getting Treasury approval. What it has to do in order to work is that it must be carried out in tandem with debt management, which is the Treasury's mandate. We are independent. The decisions on quantitative easing are our own decisions . . . However, no central bank can engage in what I prefer to call unconventional operations without having agreement with the Debt Management Office . . . Any kind of operation . . . which involves buying and selling") (UK), https://publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/9032403.htm [https://perma.cc/A5KK-5293].

[33] Mervyn King, Governor of the Bank of England, Speech to the CBI Dinner, Nottingham (Jan. 20, 2009) (QE in March 2020 addressed bond market dysfunctionality in the context of the pandemic) ("There is a fine dividing line between helping to oil the wheels in markets which are temporarily impaired, and artificially supporting markets"); ECON. AFFS. COMM., *supra* note 25, at ¶¶ 75, 88, 104, 105.

had a number of "unintended consequences," and the EAC was concerned inter alia about debt sustainability, the risk to public finances, and wealth inequality.[34] Mohamed El-Erian warned, during his oral evidence, about the distortion of market mechanisms caused by "life support measures" and the unhealthy co-dependency that has developed between central banks and markets.[35] He also highlighted how markets have developed a sense of "entitlement" to continuous support from central banks.[36] Meanwhile, Lee Buchheit referred to the destabilizing impact of "cheap money" (prolonged periods of low interest rates and QE) on financial stability, suggesting that such policies could lead to vulnerabilities in the financial system.[37] Charles Goodhart questioned the shortening of the overall duration of debt at a time in which interest rates were exceptionally

[34] ECON. AFFS. COMM., *supra* note 25, at ¶ 102. QE increases the price of assets, which primarily benefit wealthier households. By stimulating asset price growth, benefitting only those with financial assets, building a further wedge between the 'haves' and the 'have nots' (inequality) QE could also have contributed to the rise in populism; James Mitchell, *QE Could Drive Populism Rather than the Economy*, INVESTORDAILY (Dec. 4, 2019), https://www.investordaily.com.au/markets/46163-qe-could-drive-populism-rather-than-the-economy [https://perma.cc/WF84-5ZD4].

[35] ECON. AFFS. COMM., *supra* note 25, at ¶ 65.

[36] *Id.* ("The major risk is that this develops into an unhealthy co-dependency between central banks and markets. He added: 'Not only do markets expect central banks to come in and repress any volatility, regardless of the source of that volatility, but they require it. They feel entitled to central bank support.'"); *see also* Mohamed El-Erian, *Joe Biden Needs to Break the Market's Codependency with White House*, FIN. TIMES (Nov. 23, 2020), https://www.ft.com/content/55858579-800f-4132-b93e-61dbfeece554 [https://perma.cc/XTD8-ZPKD]. For a more recent contribution, see Mohamed A. El-Erian, *Fed, Markets Resume Unhealthy Co-Dependency*, BLOOMBERG LAW (Dec. 21, 2023, 5:30 AM), https://news.bloomberglaw.com/banking-law/fed-markets-resume-unhealthy-co-dependency-mohamed-a-el-erian [https://perma.cc/N2MJ-PBCJ].

[37] *See* ECON. AFFS. COMM., *supra* note 25, at ¶ 66 ("The global scale of QE could potentially compromise financial stability. The extra liquidity in the global system from quantitative easing 'means that you have an investor community flush with liquidity that must be re-deployed in some fashion . . . This is the kindling for the proverbial search for yield.' One of the consequences is that 'the normal risk aversion of private sector lenders has not been eclipsed, but it has been "anaesthetized" by the fact that they are stuffed with liquidity that they must re-deploy and, therefore, they have implicitly revisited their normal risk aversion.'"); Enda Curran & Chris Anstey, *Pandemic Bubbles*, 30 BLOOMBERG MKTS., at 70, 72 (2021). Michael Howell, *The Federal Reserve is the Cause of the Bubble in Everything*, FIN. TIMES, https://www.ft.com/content/bc83fda6-3702-11ea-a6d3-9a26f8c3cba4 [https://perma.cc/DXK6-8L76].

low.[38] The peril of picking winners and losers ("green QE") was emphasized by Adam Posen and Christina Skinner.[39]

QE is an example of how policies can be easy to introduce, but hard to remove or unwind. This is further exemplified by current efforts to eliminate Quantitative Tightening, a measure that a recent parliamentary report called a "leap in the dark."[40]

C. JUDICIAL REVIEW

During the twin financial and sovereign debt crises in the Eurozone, the ECB also expanded its toolkit of monetary policy instruments into QE and other unconventional measures.[41] While monetary policy decisions are not justiciable in the United States since *Raichle v. Federal Reserve Bank of New York* (1929),[42] they are judicially

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38 *See* Charles Goodhart, Oral Evidence on Quantitative Easing to the Select Committee on Economic Affairs, Virtual Proceeding, Mar. 16, 2021, 4:00 PM (UK), https://committees.parliament.uk/oralevidence/1920/html/ [https://perma.cc/86KK-WPAZ]; ECON. AFFS. COMM., HOUSE OF LORDS, THE BANK OF ENGLAND: HOW IS INDEPENDENCE WORKING? ECONOMIC AFFAIRS COMMITTEE LAUNCHES INQUIRY 6 (2023) (QE has served to shorten the overall 'duration' of the Government's liabilities. Professor Goodhart told us that in view of historically low interest rates in the decade or so after the 2008 financial crisis, 'shortening the duration of debt was . . . exactly the wrong thing to do. If interest rates are historically as low as they can ever get, you ought to lengthen the duration of debt.'"); *see also* ECONOMIC AFFAIRS COMMITTEE, *supra* note 25, at ¶ 4; ECON. AFFS. COMM., *supra* note 25, at ¶ 59 ("While the quantum of quantitative easing is a monetary policy decision, decisions on debt duration have consequences for debt management"); *see also* ECON. AFFS. COMM., *supra* note 25, at ¶¶ 4, 59 ("While the quantum of quantitative easing is a monetary policy decision, decisions on debt duration have consequences for debt management").

39 *See* ECON. AFFS. COMM., *supra* note 25, at ¶ 94 (quoting Skinner); *see also* Adam Posen, Oral Evidence on Quantitative Easing to the Select Committee on Economic Affairs, Virtual Proceeding, Mar. 16, 2021, 3:00 PM, https://committees.parliament.uk/oralevidence/1919/html [https://perma.cc/V92A-YKFV].

40 *See Bank of England has Taken a Leap in the Dark on Quantitative Tightening*, Treasury Committee Concludes, UK PARLIAMENT (Feb. 7, 2024), https://committees.parliament.uk/committee/158/treasury-committee/news/199797/bank-of-england-has-taken-a-leap-in-the-dark-on-quantitative-tightening-treasury-committee-concludes/#:~:text=Quantitative%20tightening%20(QT)%20is%20the,875%20billion%20of%20new%20money [https://perma.cc/BZ78-KY3T].

41 CHARLES GOODHART & ROSA LASTRA, CENTRAL BANK ACCOUNTABILITY AND JUDICIAL REVIEW 5 (2018).

42 It would be an unthinkable burden upon any banking system if its open market sales and discount rates were to be subject to judicial review. Indeed, the correction of discount rates by judicial decree seems almost grotesque, when we remember that conditions in the money market often change from hour to hour, and the disease would ordinarily be over long before a judicial diagnosis could be made. Raichle v. Federal Reserve Bank of New York, 34 F.2d 910, 915 (2d Cir. 1929); In the US, however, banking supervision, payment systems and financial stability related decisions are reviewable. For the UK, see The King v The Governor and Company of the Bank of England

reviewable in the European Union.[43] The Court of Justice of the European Union is the only competent court to assess whether the ECB has exceeded the contours of its mandate in the conduct of monetary policy.[44] And the Court has not shied away from reviewing ECB's monetary policy decisions. Via referrals from the German Constitutional Court,[45] the Court of Justice of the European Union has assessed the legality of QE programs, with regard to the Outright Monetary Transactions program[46] in its ruling on *Gauweiler*[47] and, later on, the Public Sector Purchase Program in its ruling on *Weiss*.[48] In both cases the European Court of Justice developed guidelines for sovereign bond purchase programs. At stake was whether the challenged QE program[49] constitutes an act of monetary policy within the ECB's mandate, or an act of economic policy outside the mandate.[50] Given that fiscal policy remains a national competence, this is a key issue in the jurisdictional divide. The Court was asked to judge whether or not the ECB had acted within the contours of its mandate, as stated in the treaty and in the statute.[51] Judicial review does not extend to the content of the monetary policy decision; courts should not supplant or replace the

(1819) 2 Barnewall and Alderson 620 [106 ER 492] (UK) (holding that the major public remedy of 'mandamus' cannot be obtained against the Bank of England); *see also* ECB Legal Conference, *Shaping a new legal order for Europe: a tale of crises and opportunities* (Sep. 2017), https://www.ecb.europa.eu/pub/pdf/other/ecblegalconferenceproceedings201712.en.pdf [https://perma.cc/C5KQ-QNC6].

43 Monetary policy decisions are indirectly reviewable in the context of preliminary rulings and directly reviewable in inter-institutional litigation. I thank Karl Philip Wojcik for observations on this point. *See* D. Sarmiento & M. Hartmann, *European Monetary Union and the Courts*, *in* THE EU LAW OF ECONOMIC AND MONETARY UNION 526, 531 (F. Amtenbrink & C. Herrmann eds., 2020); Notwithstanding *Pringle*, *Gauweiler* and *Weiss*, some argue that the Court has been strict (due to the admissibility conditions) in admitting challenges against ECB monetary policy decisions and has not sought ways to open them for direct review (notably, *see* Première chambre [1e civ.] [First Chamber], Dec. 10, 2013, T-492/12, https://curia.europa.eu/juris/document/document.jsf?text=&docid=146461&pageIndex=0&doclang=FR&mode=lst&dir=&occ=first&part=1&cid=3409886 [https://perma.cc/AW7E-KEQ4]).

44 GOODHART & LASTRA, *supra* note 41.

45 *See* European Union, *Preliminary ruling proceedings – recommendations to national courts* https://eur-lex.europa.eu/EN/legal-content/summary/preliminary-ruling-proceedings-recommendations-to-national-courts.html [https://perma.cc/C94L-JN99] (last updated April 26, 2022).

46 Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Jan. 14, 2014 (Ger.), https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/01/rs20140114_2bvr272813en.html [https://perma.cc/3WQM-VENJ].

47 Case C-62/14, Peter Gauweiler v. Deutscher Bundestag, ECLI:EU:C:2015:7 (Jan. 14, 2015).

48 Case C-493/17, In re Weiss, ECLI:EU:C:2018:1000 (Dec. 11, 2018).

49 The Outright Monetary Transactions program was never activated.

50 Fiscal policy via the backdoor?

51 2016 O.J. (C 202) 4.

decisions taken by the central bank, nor speculate on what the central bank should have done. Judicial review does, however, extend to the parameters and legal framework that surround such decisions in order to determine whether or not the central bank has exceeded its mandate.[52] The Maastricht Treaty was drafted and signed in 1992 and reflects the narrow model of monetary control that was prevailing at the time. The main provisions related to monetary policy—Article 127 of the Treaty on the Function of the European Union (TFEU), Article 18 of the Statute of the European System of Central Banks and of the European Central Bank (ESCB) on open markets and credit operations and Article 20 of the ESCB Statute on other instruments of monetary control—are formulated in broad and sparse terms and, by the art of interpretation, they have provided the legal basis for QE and other unconventional instruments of monetary policy.[53]

The treaty, however, delineates clearly the limits applicable to the ECB in the exercise of its powers. For example, Article 123 of the TFEU provides a limit by prohibiting direct monetary financing of national governments, while Article 130 provides a guarantee by protecting central bank independence.

> Balance sheet policy measures are of special relevance with regard to the relation that is built between the financial situation of the central bank and the fiscal situation of the debtor. If the Member State is not able to pay back its debt, the central bank incurs losses on its balance sheet. While central banks in the national context have the sovereign as a fiscal backstop to compensate losses, the ECB does not have such a fiscal counterpart. That makes the ECB more vulnerable and also more vigilant when it comes to losses and the creditworthiness of its creditors.
>
> . . . A situation where fiscal interests take precedence over monetary policy objectives, is described as *fiscal dominance.* In such a situation, the central bank not only assumes the role of the main creditor of states with large balance sheet measures; it also assumes political responsibility for those states. The danger of fiscal dominance is omnipresent in the case of sovereign bond purchase programmes.[54]

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52 *See* Charles Goodhart & Rosa Lastra, *Populism and Central Bank Independence*, 29 OPEN ECON. REV. 49, 63 (2017).

53 2016 O.J. (C 202) 4.

54 Kerstin Bernoth et al., European Parliament, ECO Comm., *The ECB's Transmission Protection Instrument: A Legal & Economic Analysis*, 17, 30 (2022). In this article, which we wrote in our condition as experts of the monetary panel that advises the European Parliament (ECON) in its monetary dialogue with the ECB, we questioned the legal and economic case for the yet to be activated Transmission Protection Instrument (TPI), which constitutes the third time that the ECB announces an instrument to curb bond market fragmentation. It was announced by the ECB on 21

II. CENTRAL BANK INDEPENDENCE

As stated above, the advent of central bank independence married an administrative law tradition of functional decentralization with an economic theory based on the inflation bias of politicians. The arguments of time inconsistency, political business cycles, and the vertical Phillips curve provided the economic justification for delegating pursuit of price stability to depoliticized technocratic entities. Further justification was provided by empirical evidence from countries that adopted inflation targeting in the early 1990s and the anti-inflationary record of the Bundesbank since its establishment in 1957.[55]

This consensus influenced a wave of legislation around the world granting independence to the central bank.[56] Thus, a narrow central banking model in line with the Tinbergen rule[57] with one agency (the central bank), one primary objective (price stability), and one main instrument (interest rate policy), became embedded in central bank laws

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July 2022 to "ensure that the monetary policy stance is transmitted smoothly across all euro area countries" allowing for secondary market purchases of securities "issued in jurisdictions experiencing a deterioration in financing conditions not warranted by country-specific fundamentals."

55 *See generally* Rosa Lastra, *The Independence of the European System of Central Banks*, 33 HARV. INT'L L.J. 475 (1992); ROSA LASTRA, CENTRAL BANKING AND BANKING REGULATION, (Fin. Markets Grp., London Sch. of Econ. and Pol. Sci. 1996). The IMF Managing Director, Kristalina Georgieva recently extolled the economic virtues of central bank independence of March 21, 2024 quoting two IMF studies. Kristalina Georgieva, *Strengthen Central Bank Independence to Protect the World Economy*, IMF BLOG (Mar. 21, 2024) https://www.imf.org/en/Blogs/Articles/2024/03/21/strengthen-central-bank-independence-to-protect-the-world-economy?utm_medium=email&utm_source=govdelivery [https://perma.cc/9MQJ-4ZYV]. One IMF study by D. Filiz Unsal, Chris Papageorgiou "Monetary Policy Frameworks: An Index and New Evidence" of November 7, 2023 looking at dozens of central banks from 2007 to 2021, and showing that those with strong independence scores were more successful in controlling inflation; and another IMF study by Luis Ignacio Jácome and Samuel Pienknagura, "Central Bank Independence and Inflation in Latin America - Through the lens of History" of September 16, 2022 tracking 17 Latin American central banks over the past 100 years also finding that greater independence was associated with lower inflation. D. FILIZ UNSAL & CHRIS PAPAGEORGIOU, MONETARY POLICY FRAMEWORKS: AN INDEX AND NEW EVIDENCE (1st ed. 2022); Luis I. Jacome & Samuel Pienknagura, *Central Bank Independence and Inflation in Latin American – Through the Lens of History* (IMF Rsch., Working Paper WP/22/186, 2022).

56 Kristalina Georgieva, *Strengthen Central Bank Independence to Protect the World Economy*, IMF BLOG (March 21, 2024), https://www.imf.org/en/Blogs/Articles/2024/03/21/strengthen-central-bank-independence-to-protect-the-world-economy?utm_medium=email&utm_source=govdelivery [https://perma.cc/9MQJ-4ZYV].

57 JAN TINBERGEN, ECONOMIC POLICY: PRINCIPLES AND DESIGN (J. Tinbergen et al. eds., 1st ed. 1956).

around the world, including the Maastricht Treaty of 1992, which established the European System of Central Banks.[58]

The arguments for central bank independence were arguments for monetary independence, built around the narrow model of central banking, with price stability as the main objective and monetary policy, understood in the conventional way of interest rate policy, as the main function.[59] Political authorities are tempted to succumb to inflationary temptations and, like Ulysses at the mast, they must restrain themselves by delegating the control of inflation to an independent central bank. The time inconsistency literature brought the debate on central bank independence back to a key discussion in monetary policy: the issue of rules versus discretion. Time inconsistency emphasized the need for a credible and binding pre-commitment to a particular mandate that effectively prevents violations ex-post.[60] Without such commitment, rational agents would disbelieve the authorities and behave in ways that prevent them from achieving their original goals. As regards the acceptance of the vertical longer-term Phillips curve, the unexploitable trade-off between inflation and unemployment in the medium or longer term ignited support for a monetary policy directed towards price stability, with or without central bank independence. Milton Friedman, for instance, opposed the independence of the Fed, favoring instead legislated monetary rules to achieve price stability.[61] The premiership of Margaret Thatcher was characterized by a commitment to price stability but not to central bank independence.[62] The literature on the costs of inflation does not per se justify the need for independence. Monetary independence is one way (though not the only way) of formulating a credible and binding commitment to price stability. Other ways can include legislated monetary

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[58] I have discussed elsewhere extensively the legal measurement of central bank independence, namely the institutional, functional and financial guarantees of independence (and corresponding accountability). One of the key measures in this regard concerns the powers of appointment and appointment procedures of central bankers. *See* Rosa Lastra, *The Independence of the European System of Central Banks*, 33 HARV. INT'L L.J. 475, 489 (1992); LASTRA, *supra* note 55; ROSA LASTRA, THE LEGAL FOUNDATIONS OF INTERNATIONAL MONETARY STABILITY (2006).

[59] *See* Lastra, *supra* note 55, at 477.

[60] *Id.*

[61] "Should there be a truly 'independent' monetary authority? A fourth branch of the constitutional structure coordinate with the legislature, the executive, and the judiciary?" Paul Tucker, *How the European Central Bank and Other Independent Agencies Reveal a Gap in Constitutionalism: A Spectrum of Institutions for Commitment*, 22 GER. L. J. 999, 1000 (2021).

[62] G.K. Shaw, *Fiscal Policy Under the First Thatcher Administration 1979-1983,* FINANZARCHIV: PUB. FIN. ANALYSIS 312, 314 (1983).

rules *à la Friedman*, an exchange rate peg, a currency board, and a constitutional amendment binding the government to price stability.[63]

Episodes such as the hyperinflation in Germany during the Weimar Republic, and in Argentina in the 1980s, highlight the importance of monetary stability, of non-political money as an essential, quasi-constitutional part of the general economic order—*Ordnungspolitik* in German—and not just one of several objectives of economic policy.[64] Politicians tend to focus on the near future, risking the long-run destabilization of the economy, and are likely to be subject to the pressures of public opinion and special interest groups, with an inflationary bias when elections approach. But if politicians cannot be trusted with monetary policy, should they be trusted with fiscal policy? Holtham wrote in 1993:

> If monetary policy can be taken out of politics, why not take fiscal policy, too? In fact, there is much more international evidence of fiscal policy being manipulated for electoral ends than in the case with monetary policy. Yet, no one proposes that fiscal policy should be put in the hands of independent functionaries.[65]

Toma and Toma also pointed out that the political authorities may have an interest in maintaining independence as it allows them to blame the central bank for unpopular policies.[66] Following this line of thought, the Fed may often be portrayed as the villain and used as a scapegoat by the government. Goodhart has argued that central bank independence actually throws the central bank back into the political arena, for an independent central bank in fact becomes another political actor, that needs to justify its actions "with the full gamut of political and presentational skills."[67] In short, non-political, non-partisan positions can contribute to the credibility and long-sightedness of a monetary policy geared towards price stability.

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63 Goodhart & Lastra, *supra* note 52.

64 LASTRA, *supra* note 55.

65 Gerald Holtham, *No Case for Independent Central Bank*, FIN. TIMES, Sep. 3, 1993, at 15; *see also* Bryan Hokpin & Douglas Wass, *The Flaws in Central Bank Freedom*, FIN. TIMES, Jan. 22, 1993, at 11. The authors maintained that if monetary policy is to be taken out of the hands of politicians, because they cannot be trusted to give inflation the priority that it deserves, then other instruments of policy, which have a bearing on inflation (they cited government borrowing, taxation and public sector pay) should also be taken out of their hands. *Id.*

66 EUGENIA F. TOMA & MARK TOMA, CENTRAL BANKERS, BUREAUCRATIC INCENTIVES, AND MONETARY POLICY (Dept. of Econ. Auburn University & Dept. of Econ., Miami Univ. eds., 1986).

67 CHARLES GOODHART, CENTRAL BANK INDEPENDENCE 12 (Fin. Markets Grp. Special Papers 57 1993).

So far, I have discussed the economic/political arguments. But the theory of functional decentralization adds another dimension to the rationale for agency independence or for technocracy generally, as I have argued since 1992.[68] This technical argument is rooted in the need for specialization. The rigor and expertise needed to deal with complex matters and the importance of establishing incentives to focus on the delegated mandate (be it monetary policy or nuclear policy) are arguments in favor of the creation of agencies. The politicization and the slow and heavy machinery of government departments lack the necessary flexibility and swiftness to adapt to changing circumstances. The skills, expertise, and superior qualifications of central bankers compared to politicians (and their incentive structure) recommend an independent central bank, better able to guarantee a more objective, more neutral, and faster decision-making process.

Agency independence gives officials a degree of discretion in the pursuit of their delegated mandate, subject to a framework of rules. Discretion entails the freedom to act within the limits of a legal framework. In 1942, in the context of the proposals that eventually led to the establishment of the International Monetary Fund, John Maynard Keynes famously noted: "Perhaps the most difficult question is how much to decide by rule and how much to leave to discretion."[69] This is an issue that is ever present both in administrative law and in monetary policy.

Independent central banks can seldom choose their own objectives as they are usually defined by statute.[70] Central banks do not typically have goal independence.[71] Independence is an instrument in the pursuit of a goal or set of goals set out in the law (typically an act of Parliament, though ECB was established by a treaty).[72] In the case of the Bank of England, there are three primary statutory objectives: price stability, financial stability, and safe and sound banking.[73] The Bank also has as a secondary objective the need to support the Government's economic policy,

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[68] *See also* Peter Conti-Brown et al., *Towards an Administrative Law of Central Banking,* 38:1 YALE J. ON REGUL. 1, 60-61 (2021).

[69] Lord Keynes, Proposals for an Internation Currency (or Clearing) Union 6 (Feb. 11, 1942) (unpublished fourth draft of The Keynes Plan).

[70] Stanley Fischer, *Modern Approaches to Central Banking* 4, (Nat'l Bureau of Econ. Rsch., Working Paper No. 5064, 1995).

[71] *Id.* at 40-41.

[72] *Bank of England Market Operations Guide: Our Objectives,* BANK OF ENG. (Oct. 21, 2022), https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/our-objectives [https://perma.cc/WJ6Q-2DN4] (Oct. 16, 2024).

[73] *Id.*

including its objectives for growth and employment.[74] In addition, it has a range of other objectives, regulatory principles, and "have regards" outlined in the annual "remit letters" that the Treasury gives to the Bank as discussed in further detail below.[75] In contrast, the ECB has one primary objective: price stability.[76] The ECB's secondary objective is to support the Union's general economic policies.[77] Achieving financial stability is merely a contributory task for the ECB,[78] not an established objective.[79] The US Federal Reserve System has a dual mandate of price stability and employment, though safe and sound banking has been at the core of what the Fed does since its formation.[80]

When monetary policy is conducted through an independent central bank, the central bank avoids the day-to-day vagaries and whims of politicians. Thus, the process of formulating monetary policy is partially depoliticized, though not completely apolitical. Just as the central bank is placed institutionally in the context of the governmental or intergovernmental structure, monetary policy does not operate in a political vacuum. It operates within the general design of economic policymaking. These considerations become ever more important as the mandate widens.

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74 *Id.*

75 Rosa Lastra, *Accountability Mechanisms of the Bank of England and of the European Central Bank,* MONETARY DIALOGUE PAPERS. 1, 14 (2020).

76 2016 O.J. (C 202) 1.

77 *Id.*

78 *Id.* at 5.

79 Lastra, *supra* note 75, at 118.

80 In my opinion, financial stability is implied or implicit as an objective of its supervisory and lender of last resort responsibilities. Financial stability and "safety and soundness" are close cousins. *See* ROSA LASTRA, *Supervision, Regulation, and Financial Stability, in* INTERNATIONAL FINANCIAL AND MONETARY LAW (2015) noting that "[f]inancial stability has long been an elusive idea, difficult to define in positive terms"; *see also* Thomas C. Baxter, Jr, Keynote Address at BIS Central Bank Legal Experts Meetings: Resolution Experiences in the United States—the Measures, the Challenges, the Way Ahead (Feb. 5, 2016). Baxter argues that financial stability can be seen in the penumbra of the Federal Reserve Act, as part of the Fed's legal mandate (derivative). He writes: "The answer is found in the penumbra of our monetary policy mandate in Section 2A of the Federal Reserve Act (. . .)[dual mandate]." "Because you may not achieve maximum employment or stable prices in an environment of financial instability, the Federal Reserve has the derivative objective of financial stability." "Moreover, financial stability is also a component of the Federal Reserve's activity as a prudential supervisor, and Dodd-Frank expanded the Federal Reserve's responsibility in a number of ways for systemic non-bank financial companies, bank holding companies, and financial market utilities."; *see* 12 U.S.C. §§ 5163, 5165, 5361-62, & 5464. The strengthening of these prudential standards makes systemically important firms more resilient and reduces the probability of disorderly failure, thus enhancing financial stability.

The dominant argument against central bank independence is the counterpart of technocracy: an institution that is free from the direct effect of political control lacks democratic legitimacy. However, from a normative perspective, statutory independence does provide a degree of formal legitimacy since one statute may be removed by another. In any case, the key institutional arrangement to prevent, counteract, and balance a potential democratic deficit is to provide adequate sources of accountability so that the independent entity is held to account and brought back to the checks and balances that sustain a democracy.

The legitimacy of independent institutions may also be understood by reference to the "Robinson Crusoe" paradigm. Just as an individual—recognizing his own imperfection in the face of possible temptations—imposes constraints upon himself in order "to channel his own expedient behavior toward rationally selected norms," a government—recognizing its own weakness in the face of temptation—"limits itself by allowing or creating autonomous or independent bodies."[81] But as central banks' mandates broaden, their legitimacy requires rethinking the rationale and the content of the delegation. Is good central banking policy (in terms of price and financial stability) a quasi-constitutional part of the economic order, of the *Ordnungspolitik* to which I referred to above? Or should central banks adapt to the changing economic needs of the sovereign, to the demands of the *demos*, even if that means drifting away from their anchor of stability rationale?[82]

The German Constitution of 1949 forbids the elimination of democracy via democratic means;[83] the demands of the *demos* cannot change the nature of democracy. In a similar vein, if we consider the costs

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[81] James M. Buchanan, THE LIMITS OF LIBERTY 93 (1975); *see also* Paul Tucker, UNELECTED POWER: THE QUEST FOR LEGITIMACY IN CENTRAL BANKING AND THE REGULATORY STATE 547 (2018).

[82] As Peter Conti Brown wrote to me in private correspondence: "A central bank that drifts *on its own* presents the problem of legitimacy that you envision here. But many of the issues that you identify, including response to Covid-19 and climate, are places where central banks are instructed by the sovereign to respond. What does that mean for your theory of legitimacy? I think it means that we are moving into a normative theory about what constitutes good central bank policy – your focus on price and financial stability – but that is a normative theory that needs more drawing out to explain why it is better than the democratic theory that the paper currently espouses. In other words, there are two versions of the good Lastrian central bank: one that is clearly accountable to the demands of the *demos*, not its own; and the other that is clearly accountable to a particular version of historical central banking, whatever the *demos* has to say about it."

[83] Grundgesetz [GG] [Basic Law] ART. 21(1), translation at https://www.gesetze-im-internet.de/englisch_gg/index.html [https://perma.cc/25X5-UURJ] ("Parties that by reason of their aims or the behavior of their adherents, seek to undermine or abolish the free democratic order to endanger the existence of the Federal Republic of Germany shall be unconstitutional.").

of inflation[84] and instability, we may be leaning towards a theory of legitimization that permits constitutional limits on central bank activities.[85] In this context, accountability is ever more relevant.[86]

The second major objection to the independence of central banks is that it hinders the maintenance of a consistent economic policy, with potential friction losses resulting from uncoordinated monetary and fiscal policy. If the central bank is subordinated to the government, there is no more central bank independence. Coordination has acquired a new dimension post-GFC and post-COVID as central banks in the developed world resorted to massive programs of QE. The quasi-fiscal nature of these programs blurs the boundaries between monetary and fiscal policy and compromises debt sustainability. The coordination arguments are very important since, under the Keynesian economic policy modalities from the 1950s to the 1970s, fiscal policy had primacy. In contrast, independent central banks prioritize monetary policies aimed at achieving price stability. The discussion about consistency in economic policymaking relates to the debate about the conflicting or complementary character of the various macroeconomic goals, in particular, to whether the strict pursuit of price stability implies a sacrifice in attaining growth and

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[84] For an excellent analysis on the costs of inflation *see* Brian Griffiths, *Inflation is About More Than Money*, CT. FOR ENTER., MKTS. & ETHICS (forthcoming Sept. 2025).

[85] Rosa Lastra & Sara Dietz, *Communication in Monetary Policy*, MONETARY DIALOGUE PAPERS, E.U. PARL. DOC. PE 703.339 (2022).

[86] Peter Conti Brown and David Wishnick advocate 'technocratic pragmatism'. They state: "To be legitimate, however, this technocratic form of pragmatism must be constrained by vital norms of legality, accountability, and noncoercion. Legally, the Fed's technocratic pragmatism must serve the statutory delegation granted by Congress and embodied in the Federal Reserve Act, but construed broadly and with purpose. Norms of statutory interpretation—albeit not narrowly textual ones—should police that boundary, even and especially in the absence of judicial review. The emphasis against narrow textualism but in favor of broad legality is crucial. While the Fed can be broad in its legal interpretations, it cannot—contrary to other theories of executive action in a crisis[5]—justify lawlessness. Law matters to long-run legitimacy, especially given the absence of judicial review for the most important of the Fed's actions." *See* Peter Conti Brown & David A. Wishnick, *Technocratic Pragmatism, Bureaucratic Expertise, & the Fed. Rsv.*, 130 YALE L. J. 546 (2021).

employment objectives.[87] Central banks, in their role as the anchor of stability, inhabit a world of policy.[88]

III. ACCOUNTABLE INDEPENDENCE IN THE NEW MODEL OF CENTRAL BANKING

The consensus that developed in the early 1990s around a "narrow" model of independent central banks committed to a price stability-oriented-monetary policy has been shaken since the GFC, a Black Swan event in the words of Nassim Taleb.[89] Central banks faced unprecedented challenges from providing massive assistance as a lender of last resort to expanding balance sheets through QE. These challenges also created new and complex dynamics between monetary, fiscal, and sovereign debt policies.[90] The GFC also reminded us that the banking system is both powerful and fragile. The extraordinary provision of emergency liquidity assistance and the deployment of unconventional instruments of monetary policy (notably, QE) during the GFC tested the boundaries between monetary, financial, and fiscal support, and signified a move away from a system of monetary dominance to one of financial and fiscal dominance.[91]

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[87] *See* Charles Goodhart & Rosa Lastra, *The Changing and Growing Roles of Independent Central Banks now do require a Reconsideration of their Mandate*, ACCT., ECON., LAW: A CONVIVIUM (DE GRUYTER) Feb. 2023. Consistency is also needed between interest rate policy and exchange rate policy (which is almost invariably in the hands of Treasury/minister of finance), between domestic and international considerations. Fischer, *supra* note 70, at 54 contended, the very effectiveness of CBI will depend on the government's choice of exchange regime. Under floating rates, monetary policy affects the exchange rate. Whereas a system of fixed exchange rates greatly curtails an independent central bank's 'room for manoeuvre' in the conduct of monetary policy.

[88] *See* LASTRA, *supra* note 1, at 30-31; LASTRA, CENTRAL BANKING AND BANKING REGULATION, *supra* note 55, at 266 (noting that central banking law has national, regional, and international dimensions, which inspired the first and second edition of Legal Foundations of International Monetary Stability).

[89] NASSIM NICHOLAS TALEB, THE BLACK SWAN: THE IMPACT OF THE HIGHLY IMPROBABLE, at xvii-xviii (2007).

[90] Goodhart & Lastra, *supra* note 87.

[91] Leonidas Zelmanovitz wrote to me in private correspondence: "The central bank is the agent of the sovereign and that its primary function, the reason for its creation, has been to support the sovereign in its fiscal needs. However, it performs better that function when it provides an institutional arrangement that may supply the economy with money of stable value and regulate finances in a way that reduces the political allocation of credit, allowing the existing savings in the economy to be applied to the most profitable investment opportunities, as guided by the profit motivation of individual commercial bankers. So, the "narrow central banking" era you describe, from the 1990s to 2007, was, like the banking in England from the Peel's Act of 1844 to 1914, an era that the "constitutional limitations" on the state made for clear boundaries between monetary and fiscal policies. The return to "fiscal dominance" after 2007, as you pointed out in your paper,

Having overlooked financial stability considerations in the years prior to the GFC, the crisis led the pendulum to shift. Financial stability became an overarching consideration for central banks, and a statutory objective in the case of the Bank of England. The broadening of their role as "crisis managers" continued during the COVID-19 pandemic,[92] and the tension between objectives (price stability, financial stability, and debt sustainability) is present as central banks confront other systemic challenges, in particular, climate change and sustainability.[93] The extent to which new objectives and functions threaten the primary mandate of keeping inflation under control has been the subject of much debate in the last five years.

With regard to climate change, in *Sustainable Central Banking*, Christina Skinner and I question what should be the best distribution of tasks between political authorities and independent central banks with narrower mandates and more limited tools.[94] We conclude that it depends on the central bank function (we warn about the use of "green QE" and other tools of monetary policy, but we see the benefits of climate risk metrics and other instruments in the exercise of supervision),[95] and that the answers vary depending on the respective central bank mandates. While the US Federal Reserve System has been rather skeptical so far, with Fed

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reduces the efficiency of the economy in general and reduces democratic accountability by evading the budgetary process to fund this or that policy through the use of monetary instruments. If we accept that a sovereign state cannot live without monetary prerogatives, the only hope against abuses is to rely on the same "constitutional" mechanisms that protect the individuals against breaches of their other individual rights, that is, constitutional limits on the state. In this sense, what has been happening since 2007 is nothing new; it is a return to less enlightened times, to times in which constitutional limitations were weaker. In establishing the time frame starting in the 1990s, I think you allow the supporters of those policies, be that climate change or whatever, to evade the discussion of why they are not submitting their policy choices to the consideration of the representatives of the people in parliament and asking them for the funds to implement those policies."

92 Goodhart & Lastra, *supra* note 87.

93 *Id.* at 9.

94 *See generally* Rosa Lastra & Christina Skinner, *Sustainable Central Banking*, 63 VA. J. INT'L L. 397 (2023).

95 In private correspondence, Peter Conti Brown questions: "Should a central bank without statutory authorization be at liberty to navigate the risks posed to the banking system by climate change? I think the answer is clearly yes, no problem: these statutes are broadly written and should be interpreted in the name of defending the ultimate policy goals set by the sovereign. But I don't think you agree – why not?". My response is that I agree that supervision allows for establishing climate risk metrics and adjusting the instruments of supervision, for example CAMELs. I have written a contribution in this regard with Kern Alexander. *See* Kern Alexander & Rosa Lastra, *International Banking Regulation and Climate Change*, FACULTY BLOGS, U. OXFORD (Jan. 9, 2023), https://blogs.law.ox.ac.uk/oblb/blog-post/2023/01/international-banking-regulation-and-climate-change [https://perma.cc/FPC2-3JSW].

Chairman Jerome Powell stating that it is not its role to be a climate fighter,[96] the ECB has embraced the green agenda. The Bank of England follows the government's economic policy agenda in this regard, according to the remit letters from the Chancellor to the Governor; however, enthusiasm for the "green agenda" lost a bit of its sparkle with the return of inflation in 2021.[97] A broader central banking mandate brings the institution closer to the political agenda. Otmar Issing told the EAC during the House of Lords QE inquiry that "central banks have come closer to political decisions during the financial crisis and now in the context of the pandemic."[98]

The law relating to the supervisory role of central banks diverges across jurisdictions and changes over time, with the pendulum shifting, bringing supervision in and out of the central bank's hands, depending on economic and political circumstances. Post-GFC, the pendulum has now shifted towards keeping supervision in. As detailed in Part IV of this article, the Bank of England is the most significant example of this shift as it now has a broad range and scope of responsibilities in the areas of micro and macro prudential supervision, supervision of financial market infrastructures (FMIs), and bank resolution.[99] In the United States, though the Fed has always been in charge of supervising depository institutions, its role in the pursuit of financial stability is implied,[100] and the role of

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96 Colby Smith, *Fed will not become a 'climate policymaker', says Jay Powell*, FIN. TIMES (Jan. 10, 2023), https://www.ft.com/content/6abb5562-59a0-49a7-8cc0-8fb48e5d6fe9 [https://perma.cc/R68X-6VQ4].

97 I have also discussed the need for adequate accountability for greening central banking, with emphasis on the ECB in an article co-authored with Sara Dietz. *See* Rosa Lastra & Sara Dietz, *Accountability of Greening the ECB*, 30 MAASTRICHT J. EUR. & COMPAR. L. 377, 378 (2024). The remit letters are further explained in Part IV below.

98 HL Deb (15 Nov. 2021) (816) cols. 11GC-12GC (UK).

99 Bank of England Act 1998, c. 11, § 11, (UK) (noting that the objective of the bank is price stability); Bank of England Act 1998, c. 11, § 2A, (UK) (noting that financial stability is an objective of the bank).

100 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 112, 12 U.S.C. § 5322(a); Thomas Baxter, Fed. Rsrv. Exec. Vice President and Gen. Couns., in a contribution entitled "Financial Stability: The Role of the Federal Reserve System," presented at the Future of Banking Regulation and Supervision in the EU Conference, held at the ECB in Frankfurt on November 15, 2013, pointed out that "[t]he Federal Reserve's financial stability mandate is seen in the penumbra of the Federal Reserve Act," and that "that is legally sufficient" (deriving implied powers from the penumbra of other express powers). (Transcript available at https://www.newyorkfed.org/newsevents/speeches/2013/bax131120.html) [https://perma.cc/5F2K-2F77]. See also Baxter, *supra note* 80. In my opinion, the legal basis for such financial stability mandate can already be found in the preamble to the Federal Reserve Act, in the words "effective supervision of banking in the United States" and in other provisions of the original Federal Reserve Act. Pub. L. No. 43, ch. 6, 38 Stat. 251–75 (codified as amended in

macro-prudential policy is entrusted to the Financial Stability Oversight Council, set up by the Dodd-Frank Act of 2010. Financial stability has always been a key central banking goal, often in the guise of other expressions: effective supervision of the banking system, sound banking, prevention of financial crises, smooth running of the payments system, and so on. In the case of the ECB, the activation of Article 127(6) of the TFEU,[101] with the adoption of the Single Supervisory Mechanism Regulation,[102] transferred responsibility for the micro-prudential supervision of significant credit institutions from the national competent authorities to the ECB's Single Supervisory Mechanism.

Monetary independence differs from supervisory independence as does monetary accountability from supervisory accountability due to the central bank's closer ties with political authorities in the management of banking and financial crises and the potential role of the government in providing guarantees or recapitalizing troubled institutions.[103] When answering the question of independence from whom, monetary independence has generally been predicated as independence from the government.[104] But independence from the banking and financial institutions to avoid regulatory capture is another dimension that is particularly relevant in the case of central banks entrusted with supervisory responsibilities.

The intellectual edifice of central bank independence has been constructed upon the conduct of a price-stability-oriented monetary policy: monetary independence.[105] If independence is extended to other central bank functions, we need to reassess its foundations. For example, if public funds are at stake, central bank independence in the pursuit of financial stability is limited by the government's necessary involvement in the destiny of the financial institutions that have received government assistance.

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scattered sections of 12 U.S.C.). In his presentation, Baxter further pointed out that the express terms of the Dodd-Frank Act place financial stability within the Federal Reserve's legal mandate.

[101] *See* Rosa Lastra & Georgios Psaroudakis, *Prudential supervisory tasks (Art. 127(6) TFEU, monetary policy vs. prudential supervision): 'Kissing awake the Sleeping Beauty provision*,' *in* THE EU LAW OF ECONOMIC AND MONETARY UNION 751–784, (Fabian Amtenbrink, Christoph Herrmann & René Repasi, eds., 2020).

[102] 2013 O.J. (L 287/63) Council Regulation (EU) No 1024/2013 (conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, which entered into force in November 2014).

[103] *See* Lastra & Miller, *supra* note 2; *see also* LASTRA, *supra* note 5, at 34–79; *see also* LASTRA, *supra* note 1.

[104] *See* Lastra & Miller, *supra* note 2, at 31.

[105] *Id.* at 31–32.

During COVID-19, furlough schemes and fiscal largesse, together with loose monetary policy through extensive QE programs, constituted an extraordinary response to an extraordinary set of circumstances.[106] They also signified a close coordination between central banks and governments.[107] Yet, the challenge for central banks is to move from the extraordinary, crisis mode, to the ordinary, stability mode. The Bank for International Settlements' 2022 Annual Report questioned the consistency between fiscal and monetary policy, proposing a "region of stability," meaning "the region that maps the constellation of the two policies that foster sustainable macroeconomic and financial stability, keeping the inevitable tensions between the policies manageable."[108]

The return of inflation in 2021 suggests the need to question the emerging broadened mode or model of central banking.[109] Climate change, energy security, and sustainability are important governmental goals, but, at times, there can be tensions or inconsistencies between these objectives and the primary goal of price stability. These goals are often interrelated, and action in one field will have an impact on another.

The law provides normative legitimacy, predictability, and certainty to the position and operations of a central bank. In democratic countries, the law must ensure that the central bank's powers are clearly delineated and carried out in a manner consistent with existing checks and balances to avoid an undesirable undemocratic state within the state. That is why accountability is always of the essence in the context of central bank independence. In 1992, I developed the model of accountable independence as a way of articulating independence within government and explaining why independence and accountability go hand in hand.[110] I have likened the procedural and substantive guarantees that frame the structure and powers of central banks to the chains that the Lilliputians placed to restrain Gulliver, and I have argued that any increase in central bank powers needs to be matched by adequate mechanisms of accountability.[111] With power comes responsibility. The first edition of

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[106] *See* Mario Fortin, *The Fiscal Impact of Quantitative Easing*, 48 CANADIAN PUB. POL'Y 490, 490 (2022).

[107] BANK FOR INT'L SETTLEMENTS, ANNUAL ECONOMIC REPORT, (2023), https://www.bis.org/publ/arpdf/ar2023e.htm [https://perma.cc/FE83-KY3F].

[108] *Id.* at 45.

[109] *See* ECON. AFFS. COMM., *supra* note 4, at 3–4, 17–18. Regarding climate change, monetary policy, and impact on inflation, see EUR. PARL. DOC. (ECON PE 755.708) 9, 17.

[110] *See generally* Lastra, *supra* note 18, at 475.

[111] *Id.*

Hobbes' *Leviathan* in 1651 portrayed, in the front page, an absolute sovereign overlooking his kingdom, a powerful image of the power of the state.[112] In a democracy, this power must be restrained and constrained. Independence without accountability would be like freedom without responsibility.

Accountability is essential to reconcile the freedom granted to unelected officials with the needs of a democratic society, hence the term "accountable independence."[113] Accountability helps reconnect normative legitimacy with societal legitimacy.[114] The mechanisms of accountability should always be commensurate with the nature and extent of the delegated powers.[115]

If the central bank oversteps its mandate, or if it is perceived to do so, credibility is damaged and legitimacy is endangered, thus undermining the public's trust in the central bank's commitment to controlling inflation. If public trust is eroded, it will only be a question of time until the public begins questioning the degree of independence enjoyed by central banks. After all, independence is not a goal in itself, but an instrument in the pursuit of a goal (or set of goals).[116]

When the central bank falls short of achieving its primary mandate,[117] it needs to explain and justify, in front of Parliament, why and how it failed. Was it the result of groupthink? Was it a failure of the models? Was it because of ignorance of money supply considerations? Or what other elements influenced their decisions?[118] Central banks also need to manage the expectations of financial markets and households and explain the reasoning leading to their decisions.[119] Such reasoning and proportionality assessments become crucial in jurisdictions where central

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112 THOMAS HOBBES, LEVIATHAN (1st ed. 1651).

113 *See* Lastra, *supra* note 18, at 481–82.

114 *See* AMARYLLIS VERHOEVEN, THE EUROPEAN UNION IN SEARCH OF A DEMOCRATIC AND CONSTITUTIONAL THEORY 10–11 (Kluwer Law International 2002); *see also* PAUL TUCKER, UNELECTED POWER: THE QUEST FOR LEGITIMACY IN CENTRAL BANKING AND THE REGULATORY STATE*,* 11–12, 15 (Princeton Univ. Press 2018).

115 This is one of the main conclusions and recommendations of the House of Lords Report. *See* ECON. AFFS. COMM., *supra* note 4, at 52.

116 Goodhart & Lastra, *supra* note 52.

117 *See* ECON. AFFS. COMM., *supra* note 4.

118 As stated above, this was the subject of the recent inquiry on the operational independence of the Bank of England conducted by the Economic Affairs Committee of the House of Lords, which led to the publication of the report in November 2023, entitled "Making an independent Bank of England work better." *Id.*

119 Lastra & Dietz, *supra* note 85.

bank monetary policy decisions are justiciable, as is the case with the ECB, as explained earlier.

The optimal balancing act between independence and accountability varies from country to country, depending upon the political structure of government, the existing system of checks and balances, the centralized or decentralized (both geographically and functionally) structure of the state, the level of development of the financial system, the respect for the rule of law, and the ordinary or extraordinary nature of the times. As I wrote in 2015: "We need to remove the dust from our old ideas and realize that central banking in ordinary times is not the same as central banking in extraordinary times. We also need to understand that after living in extraordinary times, the return to ordinary times is challenging."[120]

IV. CENTRAL BANK GOVERNANCE IN THE UNITED KINGDOM

The Bank of England was established as a private bank in 1694 via a Royal Charter signed by King William and Queen Mary. That Charter incorporated the Governor and the Company of the Bank of England to act as banker to the government and raise money to fund the war in France.[121] The Royal Charter stated that is mission was "to promote the public Good and Benefit of our People."[122] This language is actually still used today in the mission statement of the Bank: "Promoting the good of the people of the United Kingdom by maintaining monetary and financial stability."[123]

After its incorporation, the Bank issued a new coinage (in 1725, it would issue the first denominated banknotes); and, in line with its nature as a bank, it started accepting deposits from the public. The seeds of our

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[120] *See* LASTRA, *supra* note 1; *see also* LASTRA & MILLER, *supra* note 2, at 41.

[121] *See Our History*, THE BANK OF ENG. (September 11, 2024), https://www.bankofengland.co.uk/about/history [https://perma.cc/AK9P-R6ZF] (stating that King William and Queen Mary of the time, William and Mary, were two of the original stockholders amongst 1520 separate names); *Who Were the Original Owners of the Bank of England?*, THE BANK OF ENG. (May 19, 2020), https://www.bankofengland.co.uk/explainers/who-owns-the-bank-of-england [https://perma.cc/VCS9-MLZJ]; BANK OF ENG., INDEX TO THE BOOK OF SUBSCRIPTIONS, (Bank of England Archive, 2023 1690).

[122] THE BANK OF ENG., s*upra* note 121.

[123] *Id.*

current monetary system were already visible. And not long after, the Bank experienced its first financial crisis: the South Sea Bubble in 1720.[124]

The nickname, The Old Lady of Threadneedle Street, first appeared in print in James Gillray's cartoon published in 1797 during the wars against Revolutionary France (to which I referred in Part I when introducing the "fatal embrace").[125] The government continually demanded gold from the Bank, which ultimately forced the Bank to suspend paying its own notes in gold. In its place, the Bank began to issue £1 and £2 notes for the first time. The Prime Minister, William Pitt the Younger, is shown in the cartoon attempting to obtain gold from the Bank, which is represented by an old lady in a dress made of the new £1 notes and seated on a money chest.[126]

The Bank Charter of 1844 gave the Bank of England a range of new powers and placed restrictions on any banks, companies, or persons in England and Wales that issued their own banknotes.[127] The Charter also stopped any new banks from starting to issue notes across the UK. The Overend Gurney Financial Crisis of 1866 evidenced the importance of the lender of last resort role of the Bank of England, a role that owes its original theoretical justification to Henry Thornton in 1802[128] and that became "popularized" in Walter Bagehot's *Lombard Street* of 1873.[129] The making of a modern central bank had begun, and with it came the extension of the Bank's powers as the bankers' bank.

In 1946, the government nationalized the Bank of England and took the power to appoint the Bank's governors and directors, and to issue directions to the Bank.[130] This contributed to the institutionalization of the Bank as an agency, while still being a bank.

With regard to the genesis of the narrow model of central banking in the UK, the commitment to price stability predated the granting of operational independence to the Bank. Indeed, sound money had been one

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[124] *South Sea Bubble: The First Financial Crisis in the Bank of England's History*, THE BANK OF ENG. (September 11, 2024), https://www.bankofengland.co.uk/about/history [https://perma.cc/326A-HMZQ].

[125] *The Restriction Period*, THE BANK OF ENG. (Sept. 11, 2024), https://www.bankofengland.co.uk/about/history [https://perma.cc/UH9W-DU24].

[126] Gillray, *supra* note 19.

[127] Bank Charter Act 1844, 7 & 8 Vict. c. 32, (UK).

[128] HENRY THORNTON, AN ENQUIRY INTO THE NATURE AND EFFECTS OF THE PAPER CREDIT OF GREAT BRITAIN 70, 198 (F.A. Hayek ed., 1939) (1802).

[129] WALTER BAGEHOT, LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET 91, 124 (London: Henry S. King ed., 3rd ed. 1873).

[130] THE BANK OF ENG., s*upra* note 121.

of the tenets of Thatcherism, since rampant inflation had been blamed as a contributing factor to Great Britain's decline.[131]

As noted in paragraph 3 of the House of Lords Report on "Making an Independent Bank of England Work Better,"

> One month after the pound's departure from the Exchange Rate Mechanism in September 1992, the UK Government adopted an (RPIX) inflation target, with interest rate decisions to be made by the Chancellor of the Exchequer in light of advice given by the Bank of England Governor. In (then) Chancellor Kenneth Clarke's 1995 Mansion House speech, he announced the objective of keeping underlying inflation at "2.5 per cent or less" beyond the spring of 1997. However, just a few days after the 1997 general election, the Rt. Hon Gordon Brown, the new Government's Chancellor, announced the operational independence of the Bank of England with respect to monetary policy. He said:
>
>> Price stability is . . . an essential precondition for the Government's objectives of high and sustainable levels of growth and employment . . . we will only build a fully credible framework for monetary policy if the long-term needs of the economy, not short-term political considerations, guide monetary decision-making. We must remove the suspicion that short-term party-political considerations are influencing the setting of interest rates.[132]

The Bank of England Act of 1998[133] granted operational independence to the Bank of England and established the Monetary Policy Committee (MPC) with the primary objective of achieving price stability.[134] To preserve the single-mindedness of the Bank's role as monetary authority and the credibility of its focus on controlling inflation, banking supervision was transferred from the Bank to a newly created Financial Services Authority (a single regulator for the entire financial sector in the UK).[135]

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[131] Shaw, *supra* note 62 ("[P]ost-war macro policy[. . .] was essentially interventionist, Keynesian in spirit[. . .] accompanied by a marked preference [of] fiscal [over] monetary policy. [. . .] Following the general election of 1979[] all was changed. First and foremost, inflation became the number one priority objective. [. . .] If control of inflation is the overriding policy objective, then control of the money supply [(M3)] is the overriding policy instrument.").

[132] ECON. AFFS. COMM., *supra* note 4, at 5-6; *see also* Chancellor, Statement by the Chancellor on the central economic objectives of the new government, https://www.dmo.gov.uk/media/c5vfujg2/hmt060597.pdf (May 6, 1997). [https://perma.cc/MNJ3-GVNQ].

[133] Bank of England Act 1998, c.11, §11, (UK).

[134] *Id.*

[135] *See* Financial Services and Markets 2000, c.8, (UK).

The GFC led to a major reform of the supervisory and regulatory framework in the UK and resulted in a significant expansion of the Bank's statutory objectives and functions. First, with the passage of the Banking Act in 2009, which established a Special Resolution Regime for banks,[136] the Bank became the UK's resolution authority. In 2012, Parliament passed the Financial Services Act which abolished the Financial Services Authority and adopted a twin-peak approach to supervision. Under this approach, Bank supervision was divided according to the regulatory objectives of prudence (safety and soundness) and conduct of business. The Bank of England became the macro and micro prudential supervisory authority. Financial stability was added as an objective of the Bank in 2013.[137]

The Financial Services Act of 2012 established a new Financial Policy Committee whose objectives were to assist the bank in achieving its financial stability objective and to identify, monitor, and address systemic risks via "macro-prudential" policy.[138] The secondary objective for the FPC, which is also the secondary objective for the MPC, is to support the economic policy of the government, including its objectives for growth and employment.

The Financial Services Act of 2012 also created the Prudential Regulation Authority (PRA) in the Bank of England with the general objective of promoting the safety and soundness of PRA-authorized firms[139] and an insurance objective of protecting policy-holders.[140] The PRA's secondary objectives are to facilitate competition[141] and international competitiveness and growth.[142] The Bank of England and Financial Services Act of 2016 subsequently created the Prudential Regulation Committee to exercise the Bank's functions as the PRA.[143]

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136 Banking Act 2009, c. 1, pt. 1, § 65, (UK).

137 Bank of England Act 1998, c.11, § 2A, (UK), *amended by* Banking Act 2009, c.1, §238, (UK).

138 *Id.* at 9C.

139 Financial Services and Markets Act 2000, c.8, §2, (UK), *amended by* Financial Services Act 2012, c.21, § 6, (UK).

140 *Id.* at c. 8, §§ 2B, 2C (UK).

141 Financial Services and Markets Act 2000, *supra* note 135, at § 2H.

142 This latter objective was introduced by the Financial Services and Markets Act 2023. *See* Financial Services and Markets Act 2023, c. 29, § 25 (UK).

143 The PRA was originally set up as a subsidiary of the Bank of England. The Bank of England and Financial Services Act 2016 ended the status of the PRA as a subsidiary of the Bank and established a Prudential Regulation Committee in the Bank to exercise the functions of the PRA, as of 1 March 2017. *See* Bank of England and Financial Services Act 2016, c. 14, § 12 (UK).

The Financial Services and Markets Act of 2023 established a new regulatory regime for FMIs, which the Bank supervises.[144] It also established a Financial Market Infrastructure Committee whose primary objective is financial stability, while its secondary objective is to facilitate innovation in the provision of financial market infrastructure services.[145]

The Bank of England provides a clear example of the broadening of the remit of the central bank in response to crises, with expanded statutory objectives, functions, and instruments.[146] In addition to the statutory objectives, an idiosyncratic feature of the UK regime of accountable independence is the "remit letters" that, in accordance with the Bank of England Act of 1998, the Chancellor sends to the Governor.[147] The Chancellor sets out the remit for the MPC in a letter to the Governor of the Bank of England. The Bank of England Act of 1998 requires the Treasury to specify, at least once every twelve months, how it will define price stability and pursue the government's economic policy objectives.[148] This remit thus sets out what price stability is considered to consist of and defines the government's economic policy. The Bank also issues letters and recommendations to the FPC and to the Prudential Regulation Committee of the PRA at least once in each Parliament.[149] The remit for the MPC since 1997 requires an exchange of open letters between the Governor of the Bank of England and the Chancellor of the Exchequer if inflation moves from the inflation target by more than one percentage point in either direction.[150]

Through remit letters, the Chancellor can encourage the Bank to consider or "have regard to" certain matters that specify the government's economic policy.[151] As previously noted, supporting such policies is a

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[144] Financial Services and Markets Act 2023, *supra* note 142, at § 48 (UK).

[145] *Id.* at § 48.

[146] *See* ECON. AFFS. COMM., *supra* note 4, at 63; *see generally* LASTRA & MILLER, *supra* note 2; *see also* LASTRA, *supra* note 1, at 30–55.

[147] Bank of England Act 1998, *supra* note 99, at 62.

[148] *Id.* at c. 11, § 12.

[149] HM Treasury, *Open letters between HM Treasury and Bank of England,* (June 22, 2023), https://www.gov.uk/government/publications/open-letters-between-hm-treasury-and-bank-of-england-june-2023 [https://perma.cc/L9PG-MCYF].

[150] HM Treasury, *HMT open letters between the Governor of the Bank of England and the Chancellor of the Exchequer,* (Mar. 21, 2024), https://www.gov.uk/government/collections/inflationary-targets [https://perma.cc/N797-USHT].

[151] *See, e.g.,* Letter from Hon Jeremy Hunt, Chancellor of the Exchequer, to Andrew Bailey, Governor (Nov. 22, 2023), https://www.bankofengland.co.uk/-/media/boe/files/letter/2023/november/fpc-remit-letter-2023.pdf [https://perma.cc/TQ5S-F39R].

secondary objective for both the MPC and the FPC.[152] In addition, the MPC is expected to have regard to the policy actions of the FPC, and vice versa. As stated in the 2023 House of Lords report, these remit letters have expanded over the years, like balls on the Christmas tree,[153] leading the EAC to recommend their necessary "pruning."[154] For example, with regard to climate change, the Bank of England has "greened" its corporate bonds purchase scheme (monetary policy), has incorporated climate-related risk metrics into credit risk methodologies (micro-prudential regulation), and has undertaken other initiatives.[155] The extent to which green initiatives transcend the boundaries of what central banks should do in the area of climate change is the subject of intense debate, in particular, with the return of inflation since 2021.[156]

The PRA (as well as the Financial Conduct Authority) is also bound by regulatory principles set out in Section 3B of the Financial Services and Markets Act of 2000.[157] A new regulatory principle was added by Section 27 of the Financial Services and Markets Act of 2023[158] with requirements for the PRA and the Financial Conduct Authority to support the transition to the UK's net zero emissions target.[159]

One of the problems identified in the 2023 inquiry into the operational independence of the Bank of England was groupthink amongst central bankers and in the economics profession generally.

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[152] Bank of England Act 1998, *supra* note 99, at c. 11, § 9C.

[153] ECON. AFFS. COMM., *supra* note 4, at 26 (quoting George Osborne, "[We] do not have to turn these letters into Christmas trees where you put all your baubles on them. It should be straightforward enough to say, as a secondary objective, supporting the Government's economic policy and then the Government should be able to articulate their economic policy so the Bank knows what it is") (emphasis added).

[154] ECON. AFFS. COMM., *supra* note 4, at 4.

[155] BANK OF ENG., *The Bank of England's climate-related financial disclosure 2021* (June 17, 2021), https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/climate-related-financial-disclosure-2020-21. [https://perma.cc/K34Y-NXWS]. *See generally* Bank of England, *Climate Change* (Oct. 11, 2024), https://www.bankofengland.co.uk/climate-change. [https://perma.cc/8FRU-85AL].

[156] *See generally* Lastra & Skinner, *supra* note 94.

[157] Financial Services and Markets Act 2000, *supra* note 135, at § 3b.

[158] Financial Services and Markets Act 2023, *supra* note 142, at § 27.

[159] "The climate and environmental targets do not apply to the FPC although they do apply to the Bank as FMI supervisor by virtue of Section 30E of the Bank of England Act 1998, which was amended by the Financial Services and Markets Act 2023. Section 30D states that in exercising its FMI functions in a way that advances the Financial Stability Objective, the Bank must have regard to the regulatory principles in section 30E." *See* ECON. AFFS. COMM., *supra* note 4, at Appendix 3.

> It is important to think about groupthink in the slightly broader sense of how it can contribute to inertia and, in the political economy sense of the word, how it can form a consensus view about how the central bank is used in society and its relationship with political actors [. . .] With regard to the question of groupthink and the central banks' attitude to inflation, the other concept, aside from groupthink, is cognitive dissonance—people failing to see something that they do not already believe, particularly when they have made an error.[160]

Groupthink was nurtured, the EAC heard in oral evidence, by the way economics is taught. Raghuram Rajan explained the prevailing macroeconomic view in central banks associated with Dynamic Stochastic General Equilibrium (DSGE) macroeconomic models, which rarely have a role for the financial sector or money.[161] He noted that students are taught this view in universities and schools, and they go from there to the research departments of universities before moving to central banks. And he added: "It may make sense [for policy committees] to mix it up a little once in a while and have a labour economist, who understands monetary economics but is not wedded to the same models, or a financial economist, who may pay more attention to the financial sector."[162] We need diversity of thought in central banking and in macroeconomics in general.

To counteract an expanded remit, we need adequate accountability. The key mechanism of institutional accountability for the Bank of England, as a public body owned by the UK Government, is parliamentary scrutiny. The Bank is answerable and accountable to the people of the UK through Parliament,[163] through appearances, reports, and occasional inquiries conducted both by the House of Commons Treasury Committee and by EAC.[164] The Bank of England publishes the MPC's

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[160] ECON. AFFS. COMM., *supra* note 4, at ¶ 114.

[161] *Id.* at ¶ 127.

[162] *Id.*

[163] BANK OF ENG., *Governance and Funding* (Sept. 17, 2024), https://www.bankofengland.co.uk/about/governance-and-funding. [https://perma.cc/6DWA-GG3T].

[164] ECON. AFFS. COMM., *supra* note 4, at ¶ 152.

decisions and minutes,[165] as well as quarterly Monetary Policy Reports.[166] The Governor is also required to send an open letter to the Chancellor explaining the time horizon over which the MPC intends to bring inflation back to target, if inflation is above or below it by more than one percentage point.[167] The MPC is accountable to the Bank's Court of Directors for its processes and for the performance of its objectives; this constitutes a form of "internal accountability."[168]

Whether these mechanisms are enough, in light of the expanded responsibilities of the Bank, ought to be questioned on an ongoing basis. Though this was one of the recommendations of the 2023 House of Lords report on "Making an Independent Bank of England Work Better," the government, in its response to the report, decided not to go ahead with some of the recommendations.[169] This is a missed opportunity. To preserve its credibility and legitimacy in the light of its expanded mandate, the Bank of England needs further and innovative forms of parliamentary accountability, as well as new forms of accountability, for example, via Independent Evaluation Offices, audits, and others. The Bank also needs increased transparency in decision making, diversity of thought, and more effective communication.

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[165] U.K. PARLIAMENT, *Reforms Needed to Improve the Bank of England's Performance and Accountability, Says New Lords Report* (Nov. 27, 2023), https://committees.parliament.uk/committee/175/economic-affairs-committee/news/198648/reforms-needed-to-improve-the-bank-of-englands-performance-and-accountability-says-new-lords-report/ [https://perma.cc/5CEX-N9ZF]; *see also* Bank of England, *Monetary Policy Summary and Minutes* (Jan. 31, 2023), https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/monetary-policy-summary-and-minutes [https://perma.cc/M2SL-X3WB].

[166] BANK OF ENG., *Monetary Policy Reports* (Jan. 31, 2023), https://www.bankofengland.co.uk/monetary-policy-report/monetary-policy-report [https://perma.cc/M2SL-X3WB].

[167] HM Treasury, *HMT Open Letters Between the Governor of the Bank of England and the Chancellor of the Exchequer* (Feb. 2012), https://www.gov.uk/government/collections/inflationary-targets [https://perma.cc/U7H6-6RFQ].

[168] BANK OF ENG., *Governance of the Bank of England Including Matters Reserved to Court* (June 1, 2024), https://www.bankofengland.co.uk/about/people/court-of-directors/governance-of-the-bank-of-england-including-matters-reserved-to-court [https://perma.cc/S6PB-UR5H].

[169] U.K. PARLIAMENT, *Special Reports and Government Responses*, https://committees.parliament.uk/committee/175/economic-affairs-committee/publications/ [https://perma.cc/FGW4-DL2B].

V. CONCLUDING OBSERVATIONS

The role of a central bank as an anchor of stability, safeguarding stable money and sound banking (monetary and financial stability), is defined by law, politics, history, and economics. The central bank has a unique role in the conduct of monetary policy, which is a formidable power that influences risk taking and price formation in the economy. The conundrum of being independent from political instruction can only be reconciled in a democratic system through the establishment of adequate mechanisms of accountability. These are essential to preserve legitimacy and credibility in the fight against inflation and instability. The expansion of the central bank remit in response to the recent crises—the GFC, the COVID-19 pandemic, and now climate change and debt sustainability—questions the validity of the traditional intellectual justification for monetary independence and calls for a reconsideration or reform of central bank structures and governance, since a broader policy agenda brings them also closer to the political arena. The emerging mode or model of central banking, with multiple objectives, functions and powers, and porous boundaries is exemplified in this article through the evolution of the remit of the Bank of England over the last twenty-five years. To alleviate concerns about "mission creep," the need for commensurate measures of accountability is ever more relevant.