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A new regulatory relationship: the Bank, the financial system, and the wider economy - speech by Paul Tucker

Speaking in London today, Paul Tucker reflects on the changing relationship between central banks and the business community. He says that the traditional roles of central banks – "for the first time ever reflected in UK legislation – touch every household and business in this country and, in truth, more widely".

Paul Tucker focuses on three facets of the relationship; first, the supervision of the safety and soundness of banks, and the place of rules and discretion in that. He emphasises the public policy purpose: that, in contrast to traditional conceptions of securities regulation, it is impossible to write down a complete (or even adequate) set of binding rules on the financial health of a bank. He says the challenge is how to make a judgment-based approach to supervision acceptable when it is used in earnest: "is our society really ready again for judgments from the Old Lady?" Part of the solution, he says, is public law and the pursuit of due process in the deployment of statutory powers. But, he says, there is a wider question about how society as a whole will keep the Bank accountable during years when the financial waters are calm – or seem to be.

In that vein, Paul Tucker goes on to discuss expectations of what the central bank can and should achieve as a macro policymaker, and how society can monitor that role. He emphasises that the central bank is charged with achieving and preserving stability – in the value of the currency and in the financial system: "medium-term goals requiring a medium-term solution". But since central banks' decisions affect the path of the economy in the short-run, society is rightly hugely interested in how unelected central bankers manage any short-term trade-offs, and how to satisfy itself that they are not deviating from the medium-term goals they have been given. In the monetary sphere, he says, the solution has been a quantified, well-defined medium-term objective for inflation combined with transparency. The case for operational independence in financial policy is, he says, just as strong as for monetary policy. And although the objective is not quantified, the FPC is required by Parliament to be as transparent as possible. This, he says, is the background to the FPC calling on the Bank to develop a regime for stress testing to be used for both micro and macro prudential supervision; "part of a much bigger project that is needed for policymakers to gauge just how much stress our economy can take at any time without serious adverse consequences, and what to do about it". But it raises the question of what happens when a firm 'fails' a stress test, which in turn speaks to the international context.

To that end, Paul Tucker considers how the central bank's relationship with the business community plays out in a global setting. The UK, he says, "believes in free trade and open financial markets", underlining that the UK financial system is highly integrated with the global system. So a level playing field internationally is a common interest of business and the authorities, and gives the UK a massive incentive to achieve good outcomes in international standards for financial regulation. But, he acknowledges, by prioritising an international playing-field that is as level as possible and as sound as possible, speed is sacrificed. And some key policy discussions end up being taken away from home, away from the Westminster Parliament. There is, he says, a "trilemma" about the compatibility of domestic and global objectives: we "cannot combine cross-border banking, and an integrated international financial system more generally; financial stability; and national policies focused solely on domestic stability". This issue, he says, came home to roost in the crisis. But "financial autarky is not the answer". Rather, the solution is co-ordination and co-operation on the resolution of global banks, where the Financial Stability Board has led the way and "real progress" has been made. As a trading nation, he says the UK should welcome the fact that the key policies are "unavoidably international, global".

Concluding, Paul Tucker says central banks need to be clear about what they can do and cannot do; "we need to operate consistently within our remit; and above all we must be sufficiently transparent to make proper accountability realistic. That is what trust requires, and we are in the business of trust – trust in the value of money."