Macroeconomic Policy after the Crash
Richard Barwell

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Issues in Microprudential and Macroprudential Policy
This book is about economic policy. Perhaps before we go any further, I ought to establish my credentials and explain why I just might have something interesting to say about this subject. The short answer is that having worked at a central bank for the best part of a decade and then spent the next six years working in financial markets watching central banks, I ought to be qualified to comment on the practical details of what was done and why.

Finding the right career has a lot in common with finding the right partner in life: there is an element of luck involved and you might have to kiss a lot of frogs before you find a productive match. Lady Luck was certainly smiling on me when I landed a job at the Old Lady (or the Bank of England as she is better known).

If you are fascinated by macroeconomics, there is simply no better place to work. I had the opportunity to work with, and for, some inspirational people. Looking back, I think the Bank changed me as a person. It certainly made me a much better macroeconomist. At their best, central banks create a culture which values intellectual rigour, technical expertise, institutional memory, attention to practical detail and, above all, capacity to deliver an answer—however preliminary—to a deadline. ‘Don’t let the best be the enemy of the good’ was a motto of an early mentor of mine at the Bank, and this book was written in that spirit. I can think of no better finishing school for macroeconomists than working at a central bank (you can be the judge of whether I left too soon). I also became more passionate about the subject and more opinionated. There is a school of thought that you can have too much of those good things, but those traits do help explain how I ended up writing books on economic policy.

A central bank may be the ideal employer if you want to immerse yourself in macroeconomics and the conduct of policy, but it is not necessarily an ideal
home for those who want to express their own views on the subject. Central bank staff are there to help someone else take a difficult decision. With the best will in the world, they need answers to the questions that they think are important, presented in a form and discussed within a framework that they find useful, and they will have finite appetite for anything else that drops in their inbox (if it ever gets that far). And then of course there are the incentives. (Who would have thought that the economists who populate these institutions who spend their working lives thinking about incentives drive behaviour outside the building would ever stop to contemplate whether speaking inconvenient truths to their superiors would have consequences for their careers inside the building?) This is not to imply that I disagreed with everything that was done during the time I was there. Indeed, even when I did disagree with the outcome of the process, it was still a privilege to be in the room, to be able to hear the likes of Mervyn King, Charles Bean and Paul Tucker discuss policy. Nonetheless, most people (myself included) conclude that, regretfully, you need to leave if you want to develop and express your own thoughts about how policy should be set, and so I did.

I followed a well-worn path out of the Bank into an investment bank (in my case, the Royal Bank of Scotland [RBS]) to join the community of central bank watchers. Although we are all being paid to do the same basic job, it turns out that there are a number of different ways to watch a central bank. Once again, I had a stroke of luck. Throughout my time at RBS, I was lucky enough to have managers who bought into my hunch that there was already a more than ample supply of ‘sell side’ commentary on the endless flow of data releases that are published each day and updates of central case forecasts, so it made less sense to compete in what was low value-added terrain. I was confident that there was a demand out there among the clients on ‘the buy side’ for something else: a rigorous discussion of fundamental questions of monetary strategy and the challenges posed by puzzles in the data (after all, that was the analysis that was driving the internal policy debate within central banks), so it made sense to specialise in producing that work. I therefore spent five years of my life devoting an increasing proportion of my time thinking about economic policy. I changed job in 2015 and crossed over to the other side of the street—joining an asset manager, BNP Paribas Investment Partners—but I still find myself thinking about the interplay between economic policy, macroeconomics and markets as much as ever, only now alongside a kindred spirit (you guessed it: a former central banker).

The random walk that is my career has also involved some unanticipated detours into interesting places. My interest in macroeconomics and policy has also led me to get involved with the Money, Macro and Finance Research
Group (or MMF for short), a network of UK-based academics working in those fields. One thing led to another, and I am now on the organising committee of an annual conference on UK monetary and financial policy, designed to encourage robust and constructive debate on the conduct of policy. I have also had the good fortune to be invited to participate on the expert advisory group for a *Review of UK Consumer Price Statistics* chaired by the inimitable Paul Johnson. The subject matter of that review was not directly relevant to the material in this book, but it was a hugely enjoyable experience to sit with such esteemed colleagues and discuss the fate of the data. I presume I did something right because I was subsequently asked to join Kate Barker’s Advisory Panel for Consumer Prices.

This brief biography is intended as an explanation for how I reached the point where writing a book about economic policy seemed like the natural thing to do. My first effort was published in 2013 and was about Macroprudential Policy. I had spent a fair amount of time working on this particular subject in the months before I left the Bank of England, having moved over to the Financial Stability directorate in spring 2008. Once outside the building, I was struck by the fact that so few people working in financial markets were even aware of this new regime that was slowly taking shape and was intended to serve as the first line of defence in guarding against cyclical and structural risks to financial stability. Over time, I became increasingly concerned about the lack of progress within the official sector in translating the original macroprudential vision into an operational reality. Eventually, I became convinced that I had something useful to say on this subject. After all, so little was known about this subject in which I was an expert of sorts, at least in a relative sense.

When the sky didn’t fall in after the publication of that book, I started to think about writing a book for a much wider audience. It seems to me that people have always been interested in the conduct of economic policy. The post-crash period has been one of near-constant innovation in the conduct of economic policy, so a discussion of this period should be of particular interest—not least because, if you studied macro before the crash, it’s highly unlikely that you spent much time thinking through the economics of Quantitative Easing, discussing sovereign debt crises, considering the importance of bank capital or even hearing mention of Macroprudential Policy. Moreover, I am not comfortable with the version of macroeconomic events that is presented to the public. One UK academic economist has described the version of the dismal science that features in the public debate as ‘mediamacro’ (although to be clear: we have different perspectives on who is propagating the simplistic treatment of macroeconomics).
To be fair, an awful lot is written about these issues every day in the press, in publications by professional economists and the institutions which employ them, in countless blogs by the great and good (and sometimes not so good—my personal bugbear is commentary about the conduct of economic policy or the solution to economic puzzles that are prefaced with a diatribe about the dismal state of economics and economists) and even in speeches by policymakers about the particular issue of the day. Much of that material is entertaining or illuminating and sometimes both. However, the link between that particular issue and the broader debate often goes unspoken, and in any case, the conversation all too quickly moves onto another topic, leaving much of the value added lost in the electronic ether. Then there are weighty tomes which explore a specific question in great depth or provide an academic, but all too often abstract, treatment of a given literature. Unfortunately, these contributions will almost always focus on one aspect of the debate—it’s unusual to find ‘serious economists’ who writes about the systemic risk buffer in the Basel III capital structure and Quantitative Easing and certainly not in the same place (except perhaps the serious economists working within central banks). Even within the confines of a book dedicated to one or other branch of economic policy, the text may skirt over the ‘tedious’ detail of what policymakers actually did in order to model the salient stylised features, and may not have a clear focus on what was done in the UK.

As far as I am aware, there is no comprehensive treatment of the post-crash policy debate that has a deliberate UK focus; there is no one-stop shop if you want to learn about these issues. To be fair, I fail that test too, since my story is spread across two volumes although that was not the original intention. The objective of this book and the companion volume is to plug this gap: to provide a comprehensive treatment of the UK policy debate since the crash.

It was not hard to figure out where to pick up the story of UK economic policy; we begin with the outbreak of stress in financial markets in the summer of 2007 and only discuss what went before to the extent that it is essential to understand what came after. However, it was far less clear to me where the story should end as I was in the process of writing. At one point, it seemed as though the first increase in Bank Rate and the first increase in the counter cyclical capital buffer would represent a natural bookend, marking the UK’s exit from the post-crash malaise. However, politics would ultimately intervene and write a very different ending. The UK voted to leave the European Union after the first drafts of these two volumes had been put to bed, and that decision precipitated a fundamental shift in the direction of UK economic policy. The economics of Brexit—the cyclical and structural implications for the UK economy and the appropriate policy response—is far too complicated
a subject to be swept up in marginal additions to this text. So these books end up telling the tale of UK economic policy between two momentous events: the crash of 2007 and the Brexit referendum of 2016.

There is no original research here—no theoretical exposition which improves our understanding of some feature of the economy or empirical analysis which refines our estimates of the efficacy of some aspect of the transmission mechanism. Instead, the book aims to review the current state of knowledge on the questions of interest and hence there are plenty of references to research throughout the text which should be of interest for those looking for more detailed analysis of a particular issue. In many cases, those references are to the speeches made by policymakers and research published by official institutions. This is not to imply that academic research can shed no light on the questions in hand (rest assured there are plenty of references to journal articles too), but in some cases, academic research necessarily abstracts from the interesting institutional detail of policymaking.

There are no equations, charts or regression results breaking up the text. Ideas are presented in as simple and straightforward a fashion as the author is able to muster. Mervyn King is a past master in the art of decoding a complex argument and then revealing it to the masses with a simple turn of phrase (and more often than not, a sporting metaphor). This book does not measure up to the standards Lord King has set any more than it would satisfy his demand for brevity when he was a consumer of economic analysis, but the principle that you do not have to choose between explaining a point clearly and explaining a point properly is one that I have tried to apply. Jargon and acronyms are unavoidable in the world of economic policy—particularly because one of the key objectives of this book is to document the details of the policy innovations and the institutional arrangements during this period—but explanations and introductions are provided along the way.

Finally a health warning: opinion will creep into the text at points—whether on the appropriate monetary–fiscal mix during the crisis or the optimal mode of communication for a central bank—but hopefully the reader will find that both sides of the debate are presented and the conclusions are backed up by solid argument. In my defence, it is hard to write about economic policy without expressing opinions, and even harder to motivate yourself to write about economic policy if you do not have an opinion. A Professor I once knew used to tell his students (including yours truly) that you ought to have a preliminary opinion on the key issues of the day, but stand ready to revise those views in light of new evidence. If the book serves its purpose, then it ought to prompt you the reader to do precisely that.
When you have spent a decade and a half in a never-ending conversation with friends, colleagues and clients about economics and economic policy, it’s hard to be sure which ideas and opinions are truly your own and which belong to someone else. The prudent approach is to assume that all the good ideas belong to someone else if you talk to smart people and therefore thank everyone while retaining responsibility for any errors that have crept into the text. In crude chronological order and given the available space constraints, I would therefore like to thank Richard, Merxe, Pablo, Mark, Mike, Guillermo, Jens, Colin, Charlotta, Conall, Simon, Emilio, Sally, Andrew, Mark, Lea, Rob, Katie, John, Jamie, Charlie, Tony, Spencer, Ryland, Mick, Jamie, Fergal, Jack, David, James, Rohan, Konstantinos, Jens, Paul, John, Niki, Andy, Andrew, Marnoch, Paul, Gareth, Oliver, Matthias, Matt, Roland, Lewis, Geoff, Ben, Riccardo, Peter, Jacques, Nick, Alberto, Gareth, Prateek, Brian, Michelle, John, Chris, Jens, Arnaud, Jef, Jagjit, Paul, Guy, Cedric, Boriana, Colin, Sven and Steve. I am sure I have left many people off this list who deserve a mention, but thanks to each and every one of you.

I would like to pay particular thanks to Riccardo Rebonato. Riccardo is a distinguished author in his own right and has set a very high bar when it comes to what they call ‘thought leadership’ in my industry. He was the one who encouraged me to write my first book and made the dream a reality by matching me with a willing publisher. I would also like to express my thanks to the good folks at Palgrave Macmillan for seeing the manuscript through to publication. Most of all I want to thank Katharine for the unstinting support in the three month window of gardening leave when the lion’s share of the work was done and providing impeccable proof reading in a short space of time at the last minute.

Finally, I want to thank my friends and family. I want to thank my mum and dad for their unstinting love and support; whatever success I have had in life, they ought to take the lion’s share of the credit. My older brother and my friends should be thanked for inadvertently encouraging and indulging, respectively, a belief that there is no better way to refine your view of the world than through rational, relentless argument. But above all, I want to thank Katharine, Layla and David for filling my life with love, laughter and the occasional roller-coaster ride.

Dartford, UK

Richard Barwell
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