

**Treasury Committee Questionnaire**  
**Appointment hearing for Dr Andrew Sentance**

**A. PERSONAL AND PROFESSIONAL BACKGROUND**

*1. Do you have any business or financial connections or other commitments which might give rise to a conflict of interest in carrying out your duties as a member of the MPC? Are there any relevant personal or other factors of which the Treasury Committee should be aware in considering your appointment?*

I have resigned from my current employment at British Airways (BA) with effect from 30<sup>th</sup> September 2006. When I take up my position on the MPC, therefore, I will have no business or financial connections, or other commitments which might give rise to a conflict of interest.

Aside from my economic expertise and business experience, I am not aware of relevant personal or other factors which are relevant to my appointment to the MPC.

*2. Do you intend to serve out the full term for which you are appointed?*

Yes.

*3. Please explain how your experience to date has equipped you to fulfil your responsibilities as a member of the MPC? In particular, what areas of the MPC's work do you believe you will make a particular contribution to, and which will you have to undertake additional research on on your arrival?*

As my CV (attached) shows, I have worked for most of my career as a senior professional economist in a business or business-related environment – at the Confederation of British Industry (CBI), London Business School (LBS) and, most recently, with British Airways (BA). This has provided me with a wide range of experience relevant to the work of the MPC. This experience will help me to carry out my role as an MPC member in three key ways.

First, I am an experienced analyst of the UK and global economies, and I have observed at first hand the way in which the UK has made the transition to a low inflation economy over the last two decades. I have written numerous articles on UK and global economic developments while at the CBI and the LBS. At BA, a key part of my role has been to provide internal advice on economic developments to all levels of management and to the Board.

Second, I have first hand experience of working in and around the world of business, and I hope this experience will be helpful in judging how business will respond to changes in the economic climate. The last five years at BA has been a very good place to observe how a business reacts and responds in the face of big shifts in market conditions. However, my business experience is not limited to the airline industry, as I interacted with a wide range of businesses at the CBI and the LBS.

Third, I have experience in communicating economic issues to non-specialist audiences, both through the media and directly. I believe this experience will be valuable as a member of the MPC, in helping business, the public and opinion-formers to understand the issues we face and in explaining the decisions we have taken.

In the light of this experience, the areas I will be focussing on within the MPC will include the analysis of business trends through the use of survey information, and how the structure of the economy is changing in response to shifts in technology and global competition. I will also be active in supporting the two-way communication which the MPC has with the business community and the public through regional visits, speeches, interviews and articles.

*4. To what extent will membership of the MPC require a different approach from that required in your previous positions, with regard to the discharge of the duties and responsibilities involved?*

In terms of subject matter, I see a lot of common ground between the MPC and my previous roles. I also think the approach needed will be similar. My experience in the world of business is that success is generally based on good teamwork. I see the MPC as a team charged with a key responsibility for maintaining low inflation in the UK economy, through setting interest rates. The individuals on the team each make a distinctive contribution based on their different areas of expertise, experience and knowledge. However, we need work together effectively if we are to deliver success.

The working environment of the MPC will clearly be different to BA. However, through my career, I have adapted successfully to changes in working environment and I am confident this will also happen when I join the MPC.

## **B. ACCOUNTABILITY**

*5. How important do you think it is for MPC members to be subject to ex post parliamentary accountability? What are the strongest and weakest parts of the current procedures in the UK?*

The government sets the inflation target and it is clearly important that the MPC is able to account to Parliament how it is proceeding in delivering that target. The operational independence of the MPC is a key element in the current UK monetary policy framework.

I believe the UK procedures for monetary policy currently work well, and while that remains the case, I would not advocate any change in these arrangements.

*6. If you were to make yourself available for reappointment to the MPC at the end of your term, what criteria should be used to assess your individual record as an MPC member?*

I see the MPC as a team which has been delegated responsibility for maintaining monetary stability in the UK. So the key measure of individual success is how far each member has helped the “MPC team” to meet its objective – the inflation target. The voting record of individuals inevitably attracts a lot of attention, but just as important is how far MPC members have contributed to the debate within the committee, and therefore influenced its collective

judgements. Also, MPC members have an important role in communicating to the public the issues under consideration and the rationale for the decisions taken.

I would therefore expect to be judged not only by my individual voting record and by our collective success in meeting the inflation target, but also by my contribution to the debate within the committee and by the way I have helped with communication – through speeches, articles, interviews and regional visits..

*7. Do you believe there is merit in having an individual paragraph in the minutes of MPC decisions in which to explain your most recent vote?*

The key issue is to ensure that the MPC minutes properly reflect the discussion within the committee, and the reasons for the decision taken. The views of dissenters are also minuted, and there are opportunities for individual MPC members to express their views in speeches, interviews and articles. This looks to be a reasonable set of arrangements, and I would want to have more experience of working on the MPC before expressing any opinions on the need for change.

### **C. OTHER PROFESSIONAL ACTIVITIES**

*8. What other professional activities do you expect to undertake in addition to your position on the MPC and how do you intend reconciling these activities with your position as a MPC member?*

I have been appointed to the MPC on the understanding that this will be my main occupation and that I will avoid actual or apparent conflicts of interest in other activities. However, the MPC is a three day a week appointment - and remunerated as such. Therefore, I plan to develop other activities which will take up the other 40% of my normal working week, subject to the rules laid down for MPC members.

I am currently a member of the Commission for Integrated Transport, a government advisory body on transport policy. This is expected to take around 2 days a month. I am also a visiting professor at Cranfield University, linked to their Air Transport Group. I would like to use this connection to keep in touch with the aviation sector, though currently my commitment to Cranfield involves delivering 1-2 lectures each year.

I therefore have room for another part-time commitment, as long as this does not conflict with my MPC role. My current thinking is to secure a part-time academic appointment. I will seek permission for any further appointments from the Chancellor of the Exchequer and the Bank Governor, in line with the rules laid down for MPC members.

*9. Outside of MPC meetings, what activities do you intend undertaking in order to add to the public's understanding of the role and decisions of the MPC?*

I envisage giving regular speeches and interviews, and making visits to local businesses facilitated by the Bank's regional agents around the country. I am keen to develop these aspects

of my role as a MPC member, and have a fairly full programme of regional activities already planned for my first year on the MPC.

In terms of major public speeches and interviews, these will probably not get underway until the New Year. I would like to spend time familiarising myself with the MPC processes and thinking before making major public statements in my new capacity.

#### **D. MONETARY AND ECONOMIC POLICY**

*10. How might the system of control over monetary policy in the UK, in place since 1998, be improved? Is the framework of an explicit symmetrical inflation target the best within which to conduct policy?*

I believe the system of controlling monetary policy in place since 1998 has worked well. It has kept inflation close to the target set by the government and has been associated with a period of steady and sustained economic growth. Broader international conditions have been helpful, with low inflation worldwide and global competition helping to contain price rises of tradable goods and services. However, the structure and processes of the Monetary Policy Committee have also proved effective and resilient. As a result, I have no specific changes to propose to the framework.

The existence of an explicit symmetrical inflation target has been a key element contributing to the success of policy. An explicit target is helpful in providing clarity about the policy framework and in providing a guide for inflation expectations. Given the importance of expectations in the inflation process, this should reduce the output cost of containing inflation if it does move away from the target. We have seen in the case of Japan that deflation can be damaging as well as inflation, so this provides a basis for a symmetrical target. I can see no case, therefore, for moving away from the current approach.

*11. How great is the risk to UK growth and inflation posed by high nominal oil prices? How should monetary policy react to higher inflation caused by increased oil prices?*

A significant rise in oil prices – such as that seen over the last three years – does pose a threat to growth and inflation. In the mid-1970s and the early-1980s, a sharp rise in the oil price was one of the factors which led to accelerating inflation and recession in the UK. However, there are important differences between the situation now and then.

First, the economy is now less dependent on oil – both because of improvements in energy efficiency and a diversification towards other energy sources (especially natural gas).

Second, inflation expectations are more securely grounded – because of the experience of low inflation and the monetary policy framework currently in place. This reduces the risk that a temporary rise in inflation due to higher oil prices feeds through into a wage-price spiral. Low world inflation and competitive pressures in the global economy help to reinforce these expectations.

Third, we have a better monetary policy framework now than in those earlier episodes which helps to reduce the risk of policy mistakes. There were significant policy mistakes in the mid-1970s and around the time of the second oil price shock. In the mid-1970s, policy was initially too relaxed in response to the inflationary shock and this significantly increased the output costs of getting inflation under control – which was not properly achieved until the early 1980s.

There is no hard and fast rule about how policy should react to an oil price shock. The judgement will depend very much on the broader economic background against which the price change takes place. In the mid-1970s, the rise in oil prices occurred against a background of very strong domestic demand and the subsequent policy relaxation poured fuel on the fire. The economic background is now much more stable. The key issue for policy-makers is to ensure that the first round - or initial impact - effects on inflation, eg through higher petrol prices, do not feed through into a more sustained rise in inflation, by affecting price expectations and wage increases.

*12. What consideration should be given to the exchange rate and to asset prices, including house prices, within the framework for inflation targeting? In particular, how should monetary policy react to asset price bubbles?*

The exchange rate and asset prices are all part of the mix of economic factors which the Monetary Policy Committee must take into account in its interest rate judgement. However, it would be wrong to treat either of them as the sole factor, or even the dominant influence, on monetary policy.

For very small open economies, the exchange rate is a key factor driving inflation whereas for a large economy where trade is a much smaller proportion of GDP – such as the US – it will be a relatively minor factor. The UK lies somewhere between these two extremes. The exchange rate is important, but its impact can be offset by other factors. How the economy responds to an exchange rate change also depends on the factors which are causing that change.

Asset bubbles provide a significant challenge for policy-makers. The first problem is identifying them – often a “bubble”, such as the dot.com boom in the United States, is not apparent until it has burst. The second challenge is understanding the impact they are having on demand – and hence on inflation. Within the framework operated in the UK, the appropriate response depends on how inflation is likely to be affected.

*13. To what degree do you consider the recent rise in personal insolvencies to be of significance when considering the vulnerability of UK household balance sheets? What impact will this have, in your opinion, on setting interest rates?*

A rise in personal insolvencies is clearly unwelcome, not least because of the difficult personal circumstances for the individuals and families affected. However, while it is one of the factors which the MPC should take into account in assessing household finances and consumer behaviour, it is not the most important factor. Even at current levels, personal insolvencies affect around 0.1% of households in the UK. There is much more direct evidence available on consumer spending and household finances, relevant to a much wider cross-section of the population, to which the MPC should give greater weight in its decisions.

*14. How would you describe the state of the UK labour market at present? In particular, how has net migration impacted on growth and inflation in the UK?*

The UK labour market is clearly functioning a lot better now than it was in the 1970s, 1980s and the early 1990s. Then, it was not possible to achieve a low and stable rate of wage increases without a high level of unemployment, sustained for many years. In recent years, the UK economy has been able to operate with unemployment of around 5% on the Labour Force Survey (LFS) measure, and around 3%, on the claimant count measure, without inflationary wage pressures developing.

This improvement over the last decade or so partly reflects the fact that the labour market has not had to absorb the type of shocks we saw in those earlier decades, with more stable economic growth and better economic management. It also reflects the beneficial impact of labour market policies pursued from the mid-1980s onwards - including better training and support for those out of work, and changes to the benefit structure to incentivise employment.

Over the last year, the unemployment rate has risen – on both the LFS and claimant count measures. The slowdown in the economy in the second half of last year may have contributed to this shift - as employment trends often lag economic growth. However, we should now expect the demand for labour to pick up in response to the stronger performance of the real economy in the first half of this year - moderating the rise in unemployment. The most recent data available - showing that the claimant count measure of unemployment has stabilised over the summer months - supports this view.

Labour supply developments also appear to have played a part in the recent rise in unemployment. In a well-functioning labour market, employment should rise to absorb an increase in labour supply – boosting economic activity. But the process of adjustment may take some time, so unemployment could be pushed up temporarily by a rise in the labour force. Net migration is one of a number of factors which could be helping to raise the labour supply at present. In the medium term, a larger labour force should have a positive impact on economic growth, by boosting employment without raising the rate of inflation. In the short-term, unemployment could rise while the labour market finds ways of absorbing the increased supply of workers.

*15. How would you describe, and account for, the recent performance of business investment growth in the UK?*

The latest official figures show reasonably healthy growth in business investment in both volume and value terms – up by 4.5% on a year ago in value terms and by 4.2% in volume terms. In my experience, it helps to look at both volume and value data because of the difficulties in measuring the prices of some investment goods (eg information technology). Recent data can also be subject to significant revisions. I would not be surprised to see some upward revision in future estimates.

Of more interest is the composition of investment, with the growth being driven mainly by construction and the service sector. Manufacturing investment is more subdued, reflecting the weak growth in manufacturing production over many years. This may also reflect the shift in some sectors of manufacturing to lower cost production facilities in Asia and Eastern Europe.

Manufacturing investment now accounts for about 12% of total business investment, so the non-manufacturing element is much more important in terms of its impact on demand.

There is a certain level of business investment which will take place for replacement purposes and to embody new technology, which will be relatively unaffected by economic factors. The two main economic factors affecting business investment are demand prospects and the health of company finances. I would see both factors as reasonably supportive of business investment growth at present.

Business investment is one of the more volatile elements of demand – and a sharp downturn in investment intentions can often be an early warning indicator of a broader economic downturn. Investment intentions should therefore be watched closely by the MPC.

*16. To what extent should fiscal policy play a demand management role alongside monetary policy in the short run?*

Fiscal policy clearly affects demand and must be taken into account in the setting of monetary policy. With government spending and taxation both accounting for around 40% of GDP, movements in both, and the balance between them, have significant impacts on demand – and hence inflation.

There is a self-correcting element to fiscal policy – the so-called “automatic stabilisers” that should help to stabilise the economy and the growth of demand. It is generally sensible to allow these stabilisers to operate and to focus on maintaining a sound medium term fiscal position. Fiscal policy can support monetary policy by ensuring that it does not generate large destabilising swings in demand. But trying to fine tune the economy through the use of fiscal policy has not generally proved successful in the UK.

*Andrew Sentance*  
*25 September 2006*