



BANK OF ENGLAND

News release

Press Office

Threadneedle Street

London EC2R 8AH

T 020 7601 4411

F 020 7601 5460

press@bankofengland.co.uk

www.bankofengland.co.uk

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The Institutions of Monetary Policy - Speech by Mervyn King

The Ely Lecture is one of the centrepieces of the Annual Meetings of the American Economic Association. The Lecture is named after Richard T Ely, one of the founder members of the American Economic Association, founded in 1888. The American Economic Association was set up for the purpose of encouraging economic research and discussion, and its membership is predominantly academic. The Annual Meetings will be held between 3 and 5 January 2004 in San Diego, California.

In his lecture, Mervyn King, Governor of the Bank of England, sets out for an academic audience some key theoretical questions lying behind current approaches to monetary policy, and in particular, the nature of monetary institutions.

In the introduction, the Governor sets out the problem,

"I want to argue that the core of the monetary policy problem is uncertainty about future collective decisions resulting from the impossibility and the undesirability of committing our successors to any given monetary policy strategy. The first stems from the fact that it is impossible to commit to future collective decisions; the second reflects the fact that we cannot articulate all possible future states of the world. So it is not possible collectively to commit to enforce a monetary policy contract with an institution such as a central bank. And, even if we could, we would not want to because that would prevent us from exploiting new knowledge about the world".

And in his conclusion, the Governor says,

"Suitably designed, monetary institutions can help to reduce the inefficiencies resulting from the time-consistency problem and can incorporate new ideas into a discretionary monetary strategy constrained by a mandate that has widespread support in the population as a whole. A central bank needs to explain to the population both what it knows and what it does not know. Such a framework of "constrained discretion" for central banks is far-removed from the world of 1930 when the Deputy Governor of the Bank of England explained to the Macmillan Committee that "it is a dangerous thing to start to give reasons"."

The lecture illustrates these issues using three case studies. The fixed exchange rate regimes of Brazil and the United Kingdom; the recent monetary history of Iraq; and the effect of the zero bound to nominal interest rates on the relationship between the Government and the central bank.

Key Resources

The Institutions of Monetary Policy - The Ely Lecture 2004

Lecture by Mervyn King, Governor at the American Economic Association Annual Meeting, San Diego

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2004/speech208.pdf>