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Speech

Central Banking and Political Economy: The Example of the UK's Monetary Policy Committee

Speech given by

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CENTRAL BANKING AND POLITICAL ECONOMY: THE EXAMPLE OF THE UK'S MONETARY POLICY COMMITTEE

Over the next couple of days, this conference will take forward debates on many of the strategy issues preoccupying monetary economists and policy practitioners. The role of inflation targets and communication in anchoring inflation expectations. The place of money in central bank analysis and policy frameworks. Whether to be transparent about any expectations policymakers form about the path of their policy rate.

After more than a decade in which monetary authorities across the world have generally succeeded in maintaining price stability, it is hard to know whether these continuing debates – and, more important, the variations in central bank practices that underlie them – are vital or peripheral. Time will tell. Some architectural features of monetary regimes <u>are</u> plainly important and, unsurprisingly, are broadly shared: central bank independence; a definition of price stability that, with credibility, can act as a nominal anchor; a forward-looking 'reaction function'. Within that broad canvas, the remaining variance in central bank practice may owe something to differences in the governance structure for their decision taking, and to the genesis of those differences.

Alan Blinder has deftly set out[1] a spectrum of decision taking structures ranging from one individual, the Governor; through committees that are more or less collegial, with either a clear leader or a more collective approach; to committees, such as the Bank of England's MPC, that are individualistic. Blinder and others identify advantages in a committee approach of some kind, essentially on the grounds, based on analysis or experiment,[2] that committees will generally make better decisions.

That may leave out something rather important. Which is that in some countries a committee structure has been a pre-condition for achieving central bank independence in the first place. And that is a useful reminder of the political economy conditions in which monetary regimes are constituted and operate. Context matters, including possibly to some of the issues on your conference agenda. The UK's post-war journey to monetary credibility illustrates that rather neatly.

Environmental preconditions for independence: ideas and values

For a long time, price stability simply was not the core objective of macroeconomic policy. A Bank of England piece in the late 1960s[3] described government's twin goals as having been to improve trend growth and maintain high employment, to which was subsequently added balance of payments sustainability. When, in the mid-1970s, the UK suffered the indignity of having to borrow from the IMF, the Cabinet split over the Fund's stability-oriented programme.[4] And the Thatcher government, elected shortly afterwards, failed to command broad-based support for a medium-term framework for reducing inflation explicitly founded on 'monetarism', which became a loaded term, widely perceived across UK society as part of an ideology. In other words, sound money or price stability was not viewed as an objective that could be shared across the democratic political spectrum.[5]

This was, perhaps, apparent in the famous 1981 letter of the 364 economists which stressed that "the time has come to reject monetarist policies".[6] Whatever the merits or demerits of its conjunctural points, the letter made no mention of an objective of low and stable inflation, or of the fiscal sustainability that is a precondition for monetary stability. Indeed, it is striking that, in this country, price stability was not energetically promoted by the mainstream academy. Rather, the case was made by what seems to have been a relatively small group of public intellectuals,[7] together with a few academics and officials. Drawing on the work of US macroeconomists, UK policymakers reached four broad conclusions that have endured: that macroeconomic policy should not assume that there was a long-term trade off between inflation and output; that microeconomic policy should be assigned the task of improving the supply side of the economy; that only monetary policy could achieve and maintain price stability; and that medium-term fiscal discipline was needed for any monetary regime to be credible.[8] Elements of that were controversial at the time. And views within the official sector on the acceptable rate of inflation covered a broad spectrum. By the early-mid 1980s, some were apparently prepared to settle for inflation of around 5%, or at least were concerned about the output costs of further disinflation. Others, notably Eddie George, argued that inflationary expectations could be stabilised effectively only if inflation were lowered below that.[9] Whilst affirming a commitment to reduce inflation further,[10] politicians did not resolve these debates by articulating a medium-term goal for inflation. Money was believed to be more controllable than inflation so, during this period, objectives, targets/indicators and instruments tended to be considered together, a monetary target being expected to deliver all three. Ministers were, in consequence, drawn into highly technical debates, rather than focusing primarily on articulating high-level macroeconomic objectives. But both money targeting and, subsequently, exchange-rate targeting failed in the UK. That meant that attempts by politicians to deliver effective monetary policy by binding themselves to a policy rule based on an intermediate target had failed. So attention gradually turned to broader institutional solutions, leading ultimately to 'operational independence' for the Bank.

In terms of the political economy, there were perhaps two crucial developments during the first half of the 1990s. First, there was much greater transparency. An inflation target was announced by government, making the objective clear and performance in achieving it easy to monitor. The Bank's analysis of the inflation outlook was published in the quarterly Inflation Report; and its advice to the Chancellor on the level of interest rates was published in the minutes of the 'Ken and Eddie Show'. This revolution helped to establish the legitimacy of what the monetary authorities were trying to achieve; helped to demonstrate the Bank's competence; and showed that differences of view about the level of interest rates could be disclosed without the ceiling coming down.

Second, a lot more was done, by the Bank and others, to establish support for the goal of price stability – not as a political tenet but as a technical prerequisite for a well-functioning economy. This ran through the speeches of Robin Leigh-Pemberton, Eddie George and Mervyn King in the late 1980s and early 1990s, as well as in Bank research. Analytically, energised by the current Governor when Chief Economist, the Bank put resources into analysing the costs of inflation, and into contributing to the so-called time-consistency literature on the central importance of mechanisms to underpin trust in a monetary authority's declared commitments.[11] And in more public spheres, Eddie George's speeches in the early 1990s repeatedly stressed the emergence of a consensus, domestically and internationally, about macroeconomic policy goals and means. Price stability was not just an end in itself but a precondition for macroeconomic stability more generally: for sustainable growth in output and employment and, thus, for the 'good things in life'. A precondition, but <u>not</u> a sufficient condition. The Bank took care to stress that, however effective, monetary policy could not deliver economic prosperity on its own. It was a necessary condition. And it could avoid the costs of inflation, including random and unacceptable redistributions of wealth between savers and borrowers resulting from unexpected surges in inflation caused by the authorities choosing to loosen monetary conditions.

Two observations might be made about the case the Bank was making. First, there is a conviction that the long-term health of the real economy is affected by the monetary regime. In the jargon, money neutrality but not 'superneutrality' which, put broadly, holds that monetary regimes are irrelevant to the long-run performance of the real economy.[12] The way I think about this is that low and stable inflation can bring two (related) benefits to the real economy. Relative price signals will be clearer, aiding the efficient allocation of resources. And greater macroeconomic stability will reduce risk, reflected in lower risk premia and so in a lower effective cost of capital for firms and households, as well as possibly in longer investment horizons.

Second, some of the arguments might have seemed to shade into a 'moral' case for price stability, which has recently been excoriated by Willem Buiter[13] on the grounds that it has typically come packaged with central bankers presenting themselves as akin to spiritual leaders who are above needing to explain their actions to the public. Well, I don't think we had much truck with central banking as religion, and from the early 1990s the Bank could reasonably claim to have been in the vanguard of transparency. But there did run through our corridors a sense of outrage that homes, livelihoods and businesses could be destroyed by quite unnecessary lurches from boom to bust; and that the economy's progress was being arrested by the lack of sustained and credible nominal stability. In other words, central bankers seemed not to believe research results suggesting that the welfare benefits of macroeconomic stabilisation were small.[14] Caring passionately about the benefits of price stability is part of what makes us – a bunch of 'conservative central bankers'[15] – suitable for the job.

Environmental conditions for independence: institutions

One might think that would be it; that independence would follow from a consensus being established around those ideas and values. Not at all, and for good reasons in the UK context.

I recall[16] various arguments being advanced through the 1980s and into the 1990s against independence for the Bank.

Mostly, they had their roots in the Bank comprising unelected officials, without a democratically elected minister as its head. Thus, the then Governor was told in the very early 1990s that if the Bank ever combined responsibility for bank supervision with monetary policy it would be 'an overmighty citizen'. More important, a number of commentators argued that it was a real obstacle to independence that the Bank would not be able to account for its monetary stewardship on the Floor of the House of Commons. In a Parliamentary system of democracy, it is Ministers who are accountable.[17]

Those circumstances are specific to the UK. Other conditions and histories act as constraints elsewhere. For example, in Germany, the institution that became the highly independent Bundesbank was established as part of the country's reconstruction after WWII and so before its new democracy was embedded. It had 'goal independence'. And in the US, while there is hesitation over giving the Federal Reserve an inflation target, as great weight is placed by Congress on the 'dual mandate', there is not concern about the scope or mechanics of the FOMC's accountability to Congress. Every member of the executive arm of the government is unelected except the President. The central bank is no outlier.[18] But in the UK it really was a novelty – in a way, a constitutional departure, foreshadowed perhaps only by the judiciary[19] – to give such a politically sensitive lever to a body of unelected technicians.

The institutional obstacles to Bank of England 'independence' therefore needed institutional solutions. Responsibility for bank regulation was transferred from the Bank in 1997. The pathway to resolution of the 'democratic deficit' problem had potentially been opened up in the 1980s by the St John Stevas reforms of Parliamentary Committees which led, over time, to a Treasury Committee with a high reputation and standing, supported by access to expert advice. In the 1997 reforms, the sphere of politics was carefully delineated. The goal of price stability is set by Parliament in legislation; and, within that framework, the Chancellor of the day sets the Bank its target for inflation. So the democratically elected executive arm of government is accountable to Parliament for the policy regime; and the Bank is accountable to the government and to the Parliamentary Select Committee for its operation of that regime. Hence, 'operational independence', not goal independence.

The goal was chosen to be a <u>symmetric</u> point inflation target, providing reassurance to the country that the Bank would not pursue a bias towards disinflation. And the credibility of the regime was underpinned by a framework for fiscal policy designed, amongst other things, to maintain a prudent debt/GDP ratio, and so avoid making inflation a tempting prospect down the road.

There was one other, vital element of the system's design, also addressing the problem of interest rates being decided by unelected officials at the Bank. As Eddie George and Mervyn King have now both disclosed, in the run up to the May 1997 election, the Bank pulled together its thoughts on a possible new monetary regime.[20] The Bank's hope was that it might be granted independence if a Committee established to advise the Chancellor on interest rates, which had featured in the Labour Party Manifesto, was seen to do a good job. In the event, the incoming government did not need the intermediate stage of an advisory committee. It created the MPC. The appointment to the Committee of four outside experts ensured that daylight would be brought into the Bank, and underlined the architectural role of democratically elected ministers.[21] It also meant that the Committee would reach its decisions on a 'one person/one vote' basis, with that going for the five Bank executive members too.

This is what I have been leading up to: an 'individualistic' committee was a necessary condition for operational independence in the UK.

In terms of solving the time-consistency problem and establishing credibility, the UK system does not rely on handing monetary policy, lock, stock and barrel, to a group of 'conservative central bankers'; in terms of the literature familiar to this conference, the system is as much Walsh as Rogoff.[22] The regime is based on combining an objective set by democratically elected politicians, with clear accountability mechanisms. One of those mechanisms was triggered for the first time recently when CPI inflation rose to 3.1% in March, requiring the Governor, on behalf of the Committee, to write an open letter to the Chancellor about what we thought was going on and what we planned to do to get inflation back to our target of 2%. As well as providing transparency to commentators and the markets who are in the business of forming views about our future actions, the letter has proved a useful focus for public debate, which has almost universally underlined UK society's continuing commitment to price stability. The 'open letter' mechanism is important to the political economy of monetary policy in the UK.

A one member/one vote committee

The open letter was an instance of the MPC acting as a collective, represented by the Governor. Much of the time, most obviously when reaching our monthly decisions on Bank Rate, we are in one person/one vote mode.

Although now well established, a committee that truly adheres to one person/one vote, and at the same time pursues its mandate with dedication and integrity, needs nurturing and skilful maintenance. After all, four of the MPC's nine members also have executive duties for which they report to the Governor of the day. And the four other, 'external' members expect to renew their careers outside central banking after a few years of service to the MPC, and so might be thought to have an interest in maintaining an appropriate profile. But – maybe alone amongst central banks, I'm not sure – no one doubts that the MPC does decide Bank Rate by a free vote. That this should be so owes a great deal to the culture of the Committee itself; a culture engendered by its first Chairman and his successor as Governor, but also by the rest of the membership. This is buttressed by the way in which the Bank's Court of non-executive directors approaches its statutory responsibility of reviewing the MPC's processes, involving annual bilateral meetings with each MPC member. And, externally, it is similarly underpinned by the Treasury Select Committee holding us individually accountable for our monthly votes, which are published as part of the minutes of our meetings.

This establishes very powerful incentives for each member to reach their own considered view. There is no free-riding in the MPC; and our policy debates are full and free. That lies at the very heart of the MPC's operation, performance and communications.

Indeed, it might be wondered whether the tone of some of the public scrutiny could set up incentives to cast minority votes with the aim of demonstrating independence of thought and action.[23] That, of course, would be perverse. Each member wants their individual decisions to matter – to the current Bank Rate, and to the expected path of policy and so the monetary conditions embodied in the money market yield curve. One votes in a minority when one disagrees with the immediate decision and the strategy it might convey. Occasionally, doing so, with the reasons disclosed in the minutes, can be an effective way of influencing monetary conditions.

The make-up of the MPC's majorities and minorities shifts around over time. There are no 'blocs' on the Committee. And there is no distinction between 'internals' and 'externals' in that respect. Indeed, apart from the defining characteristic that the internals have full-time executive responsibilities at the Bank, the main distinction to date is that internal members tend to serve for longer; an average of around five and three quarter years, compared with just over three years for the external members.[24] That seems to me to be consonant with the political economy considerations behind the design of the Committee. The internal members provide a bedrock of accumulated policy expertise and commitment. The externals, coming from outside the Bank and turning over more frequently, keep the debate and the process fresh.

Three issues around the communication of monetary strategy

Against that background, how does the MPC's constitution, and in particular our one person/one vote decision-making structure, affect our approach to some of the issues on your conference agenda?

<u>Communication of decisions: how individualistic should we be?</u>

The MPC has employed four main communication mechanisms: the announcement of our monthly decision on Bank Rate; the minutes of those meetings, including details of our individual votes; the quarterly Inflation Report, containing projections for output and inflation; and public testimony, to Parliament and via speeches, interviews etc.

This differs in various respects from the practice of some other, more consensual central banks.[25] For example, we do not routinely include an explanatory statement in the notice of our monthly decision, preferring to do so only when Bank Rate changes or when we judge that the reasons for a 'no change' decision cannot wait until the minutes are published a fortnight later. And when we do include an explanatory statement, it is kept as short and simple as possible. That is obviously different from the ECB and, in degree, from the FOMC.

These choices reflect different circumstances and structures; in the MPC's case, our 'one person/one vote' governance. I can assure that members of the committee, including the chairman, do not know what we will decide until it is decided. Ours is not a system that lends itself to the tabling of a draft statement around which views will coalesce. Rather, any statement has to be crafted to reflect the view of the majority that emerged at that particular meeting, not an easy task at speed.

We are, in fact, very conscious of the distinction between collective and individual statements. We try to be clear about which communications are collective, on behalf of a majority or the Committee as a whole, and which are made by an individual member speaking for themselves. The Inflation Report projections, for example, represent a 'best collective view' or centre of gravity in the Committee, admittedly not a well defined term. Individual views, when departing from that best collective view, have occasionally been published. At the Inflation Report press conference, the Governor, Charlie Bean and I are speaking for the Committee, not for ourselves. By contrast, we speak as individuals when we give testimony to Parliament or set out our views in speeches.

That this should be understood is, of course, terribly important given that the effectiveness of the regime depends on the Committee decisions and 'policy reaction function' that emerge from our individual deliberations. Conscious of the need to maintain a delicate balance between centripetal and centrifugal forces, most past and current members – including me – have opposed incorporating individually labelled paragraphs into the minutes. To do so would put beyond doubt each month where each of us stands, but it would also affect the dynamic interactions amongst Committee members. My reluctance to go down that route stems from a concern that we would slip towards a degree of individualism where members were no longer listening to each other. It would not be possible for members to polish their statements after the meeting, as they would then be able to tweak their text, ever so slightly of course, in the light of the market reaction to our decision and so on. So highly polished statements would be brought to the meeting, with perhaps even a degree of competition in the depth of the analysis or the beauty of the prose. But the very point of a committee is that we should listen to each other, and then make up our own minds.[26] That includes trying to persuade one's colleagues. Over the years,[27] I have definitely seen occasions where individual members have altered their position during the course of a meeting.

In summary, the political economy case for one person/one vote does not entail the equivalent of postal voting, which I believe would impair the quality of our discussions and so, probably, of our decisions.

Communication of the Committee's reaction function: whether to publish an expected path of Bank Rate

Central bankers know that expectations matter. So they know that delivering their goals requires more than being able to set the overnight money market rate from one policy meeting to the next. It matters where agents – businesses, households, financial markets – expect the policy rate to be set in the future. More than that, it matters that agents have a broad understanding of how the monetary authority will react to unforeseen developments in the economy; their 'reaction function'.

That being so, some central banks have started publishing their expected future path of rates, or a range for the future path.

This could have advantages. For example, absent a clear agreement and statement of the strategy being pursued by the Committee, differences amongst members about the monthly decision can occasionally stem from judgments about how the precise timing of Bank Rate changes would affect perceptions of the Committee's future course and so monetary conditions.

But in my book, there are two reasons for not publishing a planned policy path – both related to the political economy context in which the MPC operates.

First, in a one person/one vote system, I very much doubt that a sufficiently stable majority could be relied upon to exist to vote, as a majority, for the entire future path of rates (and then to stick to it if conditions had not changed). And I am not convinced that communication would be aided by publishing a path made up of segments supported by majorities comprising different groups of members. In those circumstances, it would be hard to make sense of how individual statements related to the supposedly collective expected path.

Second, any such statements would be conditional on a whole host of judgments about what was going on in the economy and about how the economy works. I doubt that, in the UK, our communication with the public and Parliament would be judged a success if we announced a path, only to have to explain that we had departed from it because conditioning assumptions A, B …. or X and Z had been invalidated by the passage of time. Getting across the conditionality might be hard, but also very important: there could be disquiet if the public felt that it had been misled. There is a premium, in our polity, of keeping the debate focused on the outlook for inflation.

As I have said to the Select Committee,[28] I would not myself say 'never'. I think we must learn from experience elsewhere.

But that does not mean sitting on our hands. The real need is to convey our reaction function, which publishing a path for Bank Rate would not obviously accomplish. We need to communicate how we are likely to react to the different types of shock that can drive the economy away from its steady state path. A complete specification is not feasible. We do not have a 100% correct model of the economy. And policy cannot sensibly be described by a simple mechanical rule but, rather, is determined by the judgment of policy makers, with the composition of the one person/one vote committee evolving over time. But at any particular time, some possible shocks – and so sources of risk to the inflation outlook – seem more important than others. As the Governor has announced,[29] the MPC is therefore planning to do more to explain our collective assessment of risks.

Communications about the transmission mechanism, and the place of money within it

Grasping our reaction function requires an understanding of how we think the economy works.

In its early years, the MPC published a collective document on the monetary transmission mechanism.[30] And, as part of its evidence to the Select Committee's 'Ten Years On' enquiry, we recently submitted a collective document on how the economy has developed over the past decade.[31]

Much of it is uncontroversial. One issue has, though, come to the fore recently: money. Money is a good example of how the political economy context affects the outward form of policy regimes. In the euro area, it was vital for the ECB to do what it could to inherit the credibility of the Bundesbank, and so it was understandable that the special place of money in the Buba's communication strategy was adopted by the ECB. I had first hand evidence of this when I was a member of the Monetary Policy Sub-Committee of the EMI during the mid-late 1990s (and so before the UK had decided not to join EMU). A colleague from one of the national central banks said to me after one of the deliberations, "Of course you guys have the better arguments about monetary strategy, but we will back the Bundesbank. Their policy record has been outstanding for a quarter of a century. Yours has been good since 1992, around five years, which just isn't long enough".

In the UK, it was almost the other way round given the series of failed attempts to base monetary policy on a money target during the 1980s. Not only in terms of the substance but also in terms of building and maintaining support for the regime, the UK has been much better served by an objective expressed in terms of a target for inflation. It is easier to explain.

But that leaves open the question of what role money should play in our analysis. Some commentators <u>want</u> money to be important in the transmission mechanism because, after all, inflation is a monetary phenomenon; others feel that it can be placed to one side on the grounds that it is essentially endogenous and, after all, the dual of the quantity of money – interest rates – is in our models (more or less). This is an area where, given our individualistic governance structure, views on the Committee cannot be expected to be monolithic.

My own view is that it is useful to recover the concept of shifts in the <u>supply</u> of broad money.[32] But such shifts do not have much in common with the proverbial helicopter drop; households and firms are not forced to hold the extra money, but respond to the terms and conditions on deposits offered by banks. The consequences for the macroeconomic outlook therefore depend on the nature of the underlying shock. For example, if a shock – say to the monetary regime – caused perceptions of macroeconomic risk to decline, there could plausibly be shifts in <u>both</u> the supply of and demand for credit. Other things being equal, bank balance sheets – and so broad money – would expand, but it might be hard to judge the extent of any inflationary impulse coming through a 'shock' to the supply of broad money over and above that stemming from a relaxation in credit constraints and higher asset prices. Also, although a 'counterparts' approach to the monetary aggregates would incline one to think that shocks to the supply of credit would flow into broad money, changes in the 'technology' of banking and financial intermediation might in some conditions make the connection tenuous. After all, the intermediation of credit occurs via capital markets and not just across bank balance sheets. That could matter, for example, if an increase in the supply of credit happened to occur at much the same time as an increase in incentives or the means for banks to securitise – ie sell – the loans they originate. In the limiting case, a big positive shock to the supply of credit could coincide with shrinking bank balance sheets and so negative broad money growth. That is, of course, not at all what we have seen recently.[33] But the thought experiment underlines two things.

First, we need to attend carefully to the underlying drivers. As part of that effort, the Bank has recently launched a new Credit Conditions Survey, which should enrich our grasp of what is going on. Reflecting changes in the structure of the financial system, we have included questions on demand for credit from hedge funds and structured finance vehicles, as well as on the terms and conditions on bank lending to households and firms. Second, we need to be careful in distinguishing the implications of credit conditions and asset prices from any extra role played by the rate of growth in banking sector liabilities (broad money). It is plausible that we are capturing all that we need to via the incorporation of asset prices – and so, at one remove, credit conditions – in mainstream macreconomic models and analysis. But we cannot be sure, not least because banking intermediation does not feature in those models, and now do risk premia. As I have said before,[34] we must look at money, as it can be an 'amber light', but analysis of the monetary aggregates, which means the analysis of the banking sector balance sheet, often needs to be especially detailed. Sitting at the juncture of the real and financial economies, central banks should be especially well placed to undertake that analysis.

To be clear, those are my individual views. Our governance structure provides constructive incentives for each of us to reveal our views on issues of this kind – to each other, and in public.

Conclusion

Much of the world economy has been enjoying a period of sustained macroeconomic stability. Reforms under a series of governments to enhance the flexibility of product and labour markets have helped our economies to absorb shocks. But few people doubt that stability requires credible monetary institutions.

The practice and theory of monetary policy has travelled a long way over the past 15 years or so. As performance has improved, so more refined questions have emerged about the optimal conduct and communication of policy. Many of those issues will feature in this conference. My purpose this morning has been to cast those questions in the context of the political economy conditions in which individual central banks are constituted and operate, using the UK's MPC as an example. Central bank independence is a solution to a political economy problem – time inconsistency. Precisely how that problem is resolved may legitimately vary from country to country. In the UK, it was achieved only after democratically elected politicians had done some of the politically contentious heavy lifting in bringing inflation down, and after a period in which the case for price stability had been made. The monetary regime introduced in 1997 was necessary to embed credibility. Its detailed design properly reflected UK circumstances. Circumstances elsewhere differ, and so details in central banking practices vary.

But not every central bank practice everywhere may be optimal, and what is feasible for each country's monetary system alters over time. We therefore need to learn from each other, without imagining that all design features travel safely: learning without proselytising. Academic research plays a huge role in keeping us intellectually honest, and so in progressing those debates.

ENDNOTES

[1] See Chapter 2 in Blinder, A. S., 2004, The Quiet Revolution: Central Banking Goes Modern, Yale University Press.

[2] Lombardelli, C., J. Proudman and J. Talbot (2005), 'Committees versus individuals: an experimental analysis of monetary policy decision making', *International Journal of Central Banking,* May 2005.

[3] 'The operation of monetary policy since the Radcliffe report: text of paper presented at a conference 'Radcliffe – ten years after', Bank of England *Quarterly Bulletin*, volume 9, number 4, 1969.

[4] Burk, K. & and A. Cairncross, 1992, "Goodbye, Great Britain": the 1976 IMF crisis, Yale University Press.

[5] I say democratic, because enemies of democracy have seen debauching the currency as a means to their ends. For example, "The best way to destroy the capitalist system is to debauch the currency" is attributed to V. I. Lenin by J. M. Keynes in The Economic Consequences of the Peace, 1920, p. 235.

[6] See Letter to *The Times* from 364 Academic Economists, April 1981.

[7] Notably Samuel Brittan and Peter Jay. See, for example, Sir Samuel Brittan's 1981 paper 'How to end the 'monetarist' controversy: a journalists reflections on output, jobs, prices and money', London: IEA.

[8] See Lawson, N., 1984, 'The British Experiment', The Fifth Mais Lecture at City University Business School, June.

[9] These differences of emphasis emerged during the review of macroeconomic policy objectives and instruments discussed in Chapter 36 of Lord Lawson's book "A View from Number Eleven".

[10] See Nigel Lawson's 1984 Mais Lecture, op. cit..

[11] In 1992, Governor Leigh-Pemberton gave a lecture entitled: 'The case for price stability'. As well as reviewing the costs of inflation, the lecture reprised the early-1980s debate on the rate of inflation the authorities should settle for (see Note 9), in a section entitled "Why not settle for 5%?". These issues were also the centrepiece of the Bank's tercentenary conference in 1994 on the future of central banking. See Fischer, S, 'Modern Central Banking', in Capie F., C. Goodhart, S. Fischer and N. Schnadt (eds.), 1994, The Future of Central Banking: The Tercentenary Symposium of the Bank of England, Cambridge University Press. See also Briault, C., 1995, 'The costs of inflation', Bank of England *Quarterly Bulletin*, February. And Haldane, A. (ed.), 1995, Targeting Inflation: a conference of central banks on the use of inflation targets organised by the Bank of England, March.

[12] O. Blanchard and S. Fisher in 'Lectures on Macroeconomics', MIT Press 1989, state that "money is said to be neutral if changes in the level of nominal money have no effect on the real equilibrium. It is said to be superneutral if changes in money growth have no effect on the real equilibrium." (note 8, page 207). Given the relationship between money growth and inflation in the very long run, that means that the rate of inflation has no effect on the real equilibrium. In practice, high rates of inflation have proved highly variable, injecting uncertainty into the economy, which can have real effects.

[13] Buiter, W. H., 2006, 'How Robust is the New Conventional Wisdom in Monetary Policy? The surprising fragility of the theoretical foundations of inflation targeting and central bank independence', paper presented at the 2006 Central Bank Governors' Symposium "Challenges to Monetary Theory", at the Bank of England.

[14] For example, Lucas, R. E., 1987, 'Models of Business Cycles, 1985 Yrjö Jahnsson Lectures, Basil Blackwell, Oxford.

[15] For the genesis of this term in the literature, see Rogoff K., 1985, 'The optimal degree of commitment to an intermediate monetary target'. *Quarterly Journal of Economics*, November, volume 100, number 4.

[16] From the vantage point of being Private Secretary to Governor Leigh-Pemberton (1989-1992), and later as an official implementing policy and then heading the Bank's Monetary Assessment and Strategy Division.

[17] Thus, a whole chapter of Lord Roll's pamphlet on the case for independence was devoted to solutions to this problem. 'Independent and accountable: a new mandate for the Bank of England', report of an independent panel chaired by Eric Roll, Centre for Economic Policy Research, 1993.

[18] In another example, Ulrich Kohli has discussed how the SNB's consensual approach to monetary policy making is 'to do with' the culture flowing from Switzerland's multi-cantonal federal political structure. See Kohli, U., 2005, Comment on 'The monetary policy committee and the incentive problem: a selective survey' by Fujiki, H., at conference on 'Incentive Mechanisms for Economic Policymakers', Institute for Monetary and Economic Studies, Bank of Japan, May.

[19] The parallel with the judiciary was made in the early 1990s in a speech by Governor Leigh-Pemberton, drawing on work by Ralph Dahrendorf.

[20] See transcript of interview on 1 May 2007 of Mervyn King by C. Giles and S. Daneshku for the The Financial Times on the occasion of the 10th anniversary of the Bank of England's operational independence (published 11 May 2007); and transcript of interview on 30 March 2007 of Lord George by C. Giles and S. Daneshku for the The Financial Times on the occasion of the 10th anniversary of the Bank of England's operational independence (published 4 May 2007). As a further gloss on that piece of history, I should perhaps disclose that, working to Eddie, Mervyn and the then DG , Howard Davies, I was the Bank official who 'held the pen' during that work.

[21] As stated in Balls, E and G. O'Donnell, 2002, Reforming Britain's Economic and Financial Policy, "The role of the Chancellor in appointing the four outsiders was part of the delicate constitutional balance that was struck in a move towards a legitimate model of central bank independence consistent with British-style accountability to Parliament." (page 99)

[22] Walsh, C. E., 1995, 'Optimal contracts for central bankers', *American Economic Review*, volume 85, number 1, sets out how a contract between government and the monetary authority can give the latter the incentive to pursue society's macroeconomic goals in a time-consistent manner. Rogoff's 'conservative central banker' relies on the central bank being more averse to inflation than society as a whole.

[23] See Gerlach-Kristen, P., 2003, 'Insiders and outsiders at the Bank of England', *Central Banking*, volume 24, number 1.

[24] To date, the time on the Committee served by externals has ranged from a minimum of 1.4 years to a maximum of 8.9 years. For internals, the corresponding range is from 2.25 years to 11 years. These ranges are calculated by including the unexpired parts of the terms of existing Committee members, but do not include the terms of Howard Davies and David Walton.

[25] For example, Weber, A., 2007, 'Monetary policy strategy and communication', speech at the Deutsche Bundesbank/Federal Reserve Bank of Cleveland conference on 'Monetary policy strategy: old issues and new challenges', Frankfurt, May 2007.

[26] See section on 'Does discussion help?' in Lombardelli, Proudman and Talbot, op. cit., page 199.

[27] Before I was a member of the MPC, I was on the secretariat, so I have attended nearly every MPC meeting since 1997.

[28] See response to question 285 in oral evidence to the House of Commons Treasury Select Committee inquiry on 'the Monetary Policy Committee of the Bank of England: Ten years On', April 2007.

[29] King, M. A. 2007, 'The MPC ten years on', lecture to the Society of Business Economists, May.

[30] 'The transmission mechanism of monetary policy', a paper by the Monetary Policy Committee, April 1999.

[31] 'The Bank of England's submission regarding the economic context', memorandum submitted in evidence to the Treasury Select Committee inquiry on 'The Monetary Policy Committee of the Bank of England: Ten years On', April 2007.

[32] See Goodhart, C. A. E., 2007, "Whatever Became of the Monetary Aggregates?", Peston Lecture at Queen Mary College, London, and King M. A. K., 2007, 'The MPC ten years on', lecture to the Society of Business Economists, May.

[33] See Tucker, P. M. W., 2006, 'Macro, asset price and financial system uncertainties', Roy Bridge Memorial Lecture to the ACI – The Financial Markets Association, Bank of England *Quarterly Bulletin*, Spring 2007, page 127 for discussion on growth in financial sector money holdings, and page 129 for discussion of the composition of balance sheets of large banks.

[34] See Tucker, P. M. W., 'Reflections on operating inflation targeting', speech at the Graduate School of Business, University of Chicago, July 2006.