



House of Commons  
The Treasury Committee

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**The Monetary Policy  
Committee of the Bank of  
England: ten years on:  
Government and Bank of  
England responses to the  
Committee's Twelfth  
Report of Session 2006–07**

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**Fifth Special Report of Session 2007–08**

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## The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue & Customs and associated public bodies.

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### Powers

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### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at [www.parliament.uk/treascom](http://www.parliament.uk/treascom).

A list of Reports of the Committee in the current Parliament is at the back of this volume.

### Committee staff

The current staff of the Committee are Colin Lee (Clerk), Sïan Jones (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jon Young and Jay Sheth (Committee Specialists), Lis McCracken (Committee Assistant), Caroline McElwee (Secretary), Tes Stranger (Senior Office Clerk) and Laura Humble (Media Officer).

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# Fifth Special Report

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The Treasury Committee published its Twelfth Report of Session 2006–07, *The Monetary Policy Committee of the Bank of England: ten years on*, on 18 September 2007, as House of Commons Paper No. 299. The Government response to this Report was received on 30 January, and is appended below. We are also publishing in Appendix 2 the response from the Bank of England, received on 17 January 2008.

## Appendix 1: Government response

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### Reform of the monetary framework

**The monetary policy framework of the last decade has been broadly successful. At least some of that success can be attributed to the Bank of England Act 1998. Continuity is an important part of this framework, allowing market participants to have faith in the stability of the system. In view of the broad level of success of the framework and of the legislation, we do not see any reason why legislation to amend the Bank of England Act 1998 ought to be accorded high priority within the Government's legislative programme. Thus, while some of our recommendations might require legislative change, we accept that the opportunity for such change may not occur in the near future. (Paragraph 7).**

The monetary policy framework has improved the credibility of policy making and continues to deliver clear benefits. CPI inflation has averaged 2.0 per cent since it became the target measure of inflation for monetary policy purposes and remains, at 2.1 per cent in January, very close to target. RPIX inflation, which was the target measure until the change to a CPI-based target in December 2003, has averaged 2.5 per cent in the past ten years, compared with 4.4 per cent in the previous decade.

GDP growth has averaged 2.9 per cent over the past decade, compared with 2.4 per cent in the preceding ten years and with figures out last week showing the economy grew by 0.6 per cent in the final quarter of last year and by 3.1 per cent in 2007 as a whole. Independent forecasters including the IMF and OECD agree the UK will continue to expand going forward.

The Government continually monitors the monetary policy framework to ensure it remains at the forefront of international best practice. Changes to the framework are implemented only when clear advantages can be established from doing so. That is the principle that has guided ongoing policy development in this area since 1997 and will continue to be the guiding principle going forward. The reforms to the appointments process announced over the summer of 2007 are a good example of this approach.

## The economic context

**While it is difficult to quantify the contribution made by the Monetary Policy Committee to maintaining a low inflation rate over the last decade as distinct from the effects of wider changes in the global economy, the Monetary Policy Committee deserves a significant amount of credit for ensuring that inflation over the last decade has been both lower, and less volatile, than in preceding decades. (Paragraph 14)**

The Government shares the Committee's view that the monetary policy framework, and the actions of the MPC, has made a significant contribution to the success of the UK economy in recent years. For example, since the new framework was introduced, GDP growth has averaged 2.9 per cent while inflation, on a CPI basis, has averaged 1.6 per cent, and on an RPIX basis 2.5 per cent. This compares with average GDP growth of 2.3 per cent in the previous cycle and average CPI inflation of 4.1 per cent and average RPIX inflation of 4.4 per cent.

The Monetary Policy Committee's forward-looking approach has been a cornerstone of economic policy over the past decade.

**Several issues, such as the recent rise in asset prices, the potential end of the tailwinds of an increasing effective labour supply and globalisation which have tended to reduce inflationary pressures in recent years, and the risk of a disorderly unwinding of global imbalances have been drawn to our attention as factors suggesting the possibility that the economic climate over the next ten years may not be as benign as that seen over the last decade. While we are sure that the Monetary Policy Committee are aware of this risk, it is important that the public are also prepared for the possibility of less benign conditions ahead. Later in this Report we examine actions that may be necessary to educate the public about monetary policy in more uncertain times. (Paragraph 18)**

**The recent period of low interest rates has seen a rise in asset prices. One possible response by the Monetary Policy Committee would be to target such rising asset prices by 'leaning against the wind'—raising interest rates to deflate the bubble in those prices. However, such a move would presuppose the successful identification of such a bubble. On the evidence we have received, this is not possible with certainty. Furthermore, the only instrument available to the MPC is moving the interest rate, and increasing interest rates to counter a rise in certain asset prices could hamper economic growth across the economy, not just in the markets with rising prices. For such a policy to be worthwhile, therefore, the risk to the economy of a rapid fall in asset prices would have to exceed the actual cost of raising interest rates to counter the rising asset prices. (Paragraph 22)**

The Government remains firmly committed to the symmetrical inflation target, based on CPI inflation, and believes that it works well for the UK. As the then Chancellor noted in his evidence to the TSC on 14 June 2007, the firm house price growth seen over the past decade has been driven by a range of factors, including limited supply in the face of strong demand. It would not have been appropriate to use monetary policy to address these very specific issues relating to one aspect of the economy.

The MPC was granted operational independence in 1997 because the Government believes that it is essential that monetary policy decisions be decoupled from political concerns. As such, the Government does not comment on the action taken by the Committee in order to keep inflation at the target.

**The weight of evidence we have received suggests that the rise in household debt is not on such a large scale as to exert significant influence on monetary policy. However, the risk remains that future interest rate rises will see larger numbers of households in financial difficulties than anticipated. (Paragraph 31)**

The Government aims to provide a framework of macroeconomic stability and awareness of financial issues within which people can make informed, responsible decisions about how much debt it is prudent to incur. In an economy with low inflation and low and stable interest rates, borrowers are better able to budget, thereby avoiding the possibility of getting into difficulty with repayments.

As set out in the PBR, household debt should also be considered in the context of significant increases in household wealth in the past decade. Total household assets are worth £7.5 trillion and household net wealth has risen by 72 per cent in real terms since the beginning of 1997.

For those who have fallen into over-indebtedness, the Government has sought to provide support where appropriate: for example, the Department for Business, Enterprise and Regulatory Reform and Ministry of Justice provide debt advice services, while the Department for Work and Pensions oversees provision of low-cost loans.

**We have received differing evidence about the importance that should be attached to the rise in the money supply. While we acknowledge that it is difficult to assess what information such strong growth in the money supply might provide for future movements in the inflation rate, there is a possibility that, in the medium term, the current rise in the money supply might presage a higher path for inflation. (Paragraph 33)**

At the behest of the Government, the Governor of the Bank of England formally ended monetary targeting in 1986, and in 1997 all attempts at maintaining money growth within a target range were abandoned, as the unstable nature of the relationship between prices and money growth made such a rule unworkable. The then Chancellor noted in his evidence to the Committee in June 2007 that “rigid monetary rules that assume a fixed relationship between money and inflation do not produce reliable targets for policy”.

Since an explicit, symmetric inflation point target was introduced in 1997, inflation has remained low and stable, with positive consequences for growth and employment. It is for the MPC to decide how best to incorporate the intelligence it receives on broad money growth into its monetary policy decisions.

**The anchoring of inflation expectations has had an important role in ensuring that inflation has varied by less than might have been expected given the external shocks faced by the economy in recent times. However, we remain concerned that, while inflation expectations appear anchored in financial markets, the general public appear to have less understanding of the monetary policy framework. (Paragraph 35)**

We agree with the Committee's judgment that the general public should be kept as well informed as possible of economic policy, and this is an issue that deserves ongoing attention from Government, the MPC and others. The Government attaches great importance to clearly explaining economic policy and does so through a number of channels, including ministerial speeches, regional visits, media engagements, parliamentary scrutiny and a regular stream of Budget, PBR and other publications.

## The monetary policy framework

**With only a single policy instrument of interest rates available, we agree that the Bank should have as its primary objective price stability. However, subject to that, we will continue to monitor the Monetary Policy Committee's compliance with the secondary objective of meeting the Government's intention of high and stable levels of growth and employment. (Paragraph 39)**

The Bank of England Act 1998 states that in relation to monetary policy the objectives of the Bank of England shall be:

- a) to maintain price stability; and
- b) subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.

It is now widely accepted that there is no long-term trade off between inflation and unemployment, meaning that targeting one need not mean permitting the other to rise. This is evidenced by the recent behaviour of growth, employment and inflation, with GDP and employment growth stronger over the past decade compared with the previous decade but inflation lower, as the Government's response to the first conclusion sets out in detail.

**It is appropriate for the inflation target to be set by the Chancellor of the Exchequer. We consider that it would be valuable to maximise certainty about the target going forward. To that end, we recommend that the Government give consideration as to how this might be achieved. (Paragraph 42)**

The Government agrees that it is appropriate for the inflation target to be set by the Chancellor of the Exchequer.

The Government sets the MPC's remit on an annual basis, and is aware of the need to minimise the changes it makes to the framework, in order to preserve credibility and keep expectations anchored. Previous monetary policy regimes had moved from one system of making interest rate decisions to another, leading to a loss of confidence in the Government's ability to keep inflation low and stable. To that end, there has been only one change in the inflation target in the ten years of the MPC—the switch from targeting RPIX inflation to targeting the internationally recognised measure of CPI— and the reasons for that were fully explained at the time.<sup>1</sup>

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<sup>1</sup> Details of the reasons for the switch to a CPI-based target were explained in an Annex to the Remit letter sent from the Chancellor to the Governor on 10 December 2003: "Remit for the Monetary Policy Committee of the Bank of England and the new inflation target", available at [hm-treasury.gov.uk](http://hm-treasury.gov.uk)

As said above, the Government continually monitors the monetary policy framework to ensure it remains at the forefront of international best practice.

**We strongly support the symmetry of the inflation target. We will remain vigilant for any signs that there appears to be either anti- or pro-inflationary bias by the Monetary Policy Committee, and should such signs appear, we will ask for an explanation during our regular hearings on Inflation Reports. (Paragraph 44)**

A symmetrical inflation target is vital so that monetary policy is forward-looking and supports the Government's objectives for growth and employment. The achievement of price stability is a means to an end, not an end in itself. It is important that the inflation target is symmetrical—with deviations below target treated equally seriously as those above—so that monetary policy is neither unnecessarily tight nor unnecessarily loose.

**We do not believe that the move from the Retail Prices Index (excluding mortgage interest payments) to the Consumer Price Index has adversely affected the work of the Bank of England in anchoring inflation expectations. While the Retail Prices Index may be the dominant index for wage negotiation, and thus of interest to the Bank, wages are, in the main, set by market forces. (Paragraph 45)**

Inflation expectations have remained anchored to the inflation target throughout the past decade—both in the case of the RPIX target and, since December 2003, the CPI target.

In contrast to periods of higher inflation in previous decades, the credibility of the UK's monetary policy framework has kept inflation expectations anchored and earnings growth has remained subdued. The Government policy is that public sector pay settlements should be consistent with the achievement of the Government's inflation target of 2 per cent.

**We do not, at the present time, recommend changing the Consumer Prices Index to reflect housing costs, before a pan-European consensus has been achieved. However, we recommend that the Government and the Office for National Statistics (with assistance from the Bank of England if required) work with their European partners in bringing about such consensus as quickly as possible. (Paragraph 49)**

Owner-occupier housing costs are not currently included in the CPI; their inclusion is technically difficult and there is presently no international consensus on how to include these costs. However, the Office for National Statistics (ONS) is working with Eurostat, the pan-European statistics agency, to develop the CPI index in this way: the ONS is currently taking part in a Eurostat pilot study assessing the possibility of including these costs based on the net acquisitions approach. However, any extension of the Harmonised Index of Consumer Prices (HICP) and therefore the CPI to cover owner-occupier housing costs is not likely to take place before January 2009 at the earliest, and could take longer.

**We see no merit in the case for the Bank of England being given control of any elements of fiscal policy, which should properly remain the province of elected politicians accountable to the House of Commons. (Paragraph 56).**

The Government strongly agrees with the Committee's conclusion.

## The Monetary Policy Committee as a body

**We support the retention of an MPC with nine members, comprised as at present of five ‘internal’ Bank of England staff, and four ‘external’ appointees. (Paragraph 58)**

The Government welcomes the TSC’s support for the retention of the existing mix of members.

**It would be inappropriate to consider places being available for certain ‘constituencies’ among the ‘external’ membership of the MPC. For that reason, while we would welcome the appointment at some time of an ‘external’ member of the MPC with experience of economic modelling, we would not expect the presence of such a member to be a permanent requirement within the membership. However, certain attributes are important: a good understanding of economics, either via academic research or experience in the financial sector or business; a strong degree of personal independence and confidence; and, finally, the ability to communicate their view of the economy, both to specialist audiences and the general public. (Paragraph 64)**

The Government agrees with the broad attributes the Committee highlights in this respect and believes that these attributes have always had a strong presence on the MPC in the past decade.

What the reforms announced by the Government in June 2007 will do is set out explicitly in advance of any new appointment what attributes are being sought in a new member. This will increase transparency, and enable commentators and the TSC alike to measure the appointee against the selection guidelines.

In order to ensure the MPC retains the most appropriate balance of skills and backgrounds, as now, the Chancellor will take into consideration the existing balance of skills and backgrounds present on the MPC when appointing a new external member.

**We are mindful of the need to ensure that the MPC remains independent, and to allow a flexible system of terms and conditions that can enable recruitment from the widest base. We therefore recommend that, should the Bank of England Act 1998 be modified in the future, a new term of office for ‘external’ MPC appointments be instituted, based on a six-year term, with no option of reappointment, with a three-year minimum, after which continuation would take place only with the agreement of both the Non-Executive Committee of the Court of the Bank of England and the postholder. This would give the flexibility to remove those who are unfit for the job, retain flexibility for those who might wish to leave the post early, and ensure continuation was not at the discretion of the Chancellor of the Exchequer. (Paragraph 68)**

The then Chancellor set out the Government’s plans for reform of the appointments process to the TSC in June 2007, after considering the case for reform of the appointments process, including the appointment terms of MPC members. It remains the case that the Government believes that three-year, renewable appointment terms are optimal for external members. There are clear benefits to retaining the flexibility afforded by the current system. Shorter terms are more appealing to certain professions: some candidates may be deterred from taking up a post on the MPC if the term of office expected of them

were longer. And on the occasions that both the Chancellor and the incumbent are content for the term of office to be renewed for a further three years, then it can be.

The current system strikes the right balance between involvement of democratic institutions, and operational independence of the Bank. It is right that the four external appointments should be made and renewed by the Chancellor, a democratically-elected Member of Parliament, and not by the Court.

**We find the explanations of why the full-time option was removed for all ‘external’ members unconvincing, especially for new members of the Monetary Policy Committee. We recommend that all working patterns be available to ‘external’ members of the MPC, so that they may undertake their duties as they see fit, as their career progresses. (Paragraph 70)**

The terms and conditions under which external members are appointed are a matter for the Court.

The Chancellor will continue to seek the best possible candidates for external MPC posts and will continue to take into consideration the existing balance of skills and backgrounds present on the MPC in doing so.

**We welcome the changes to the appointments process for ‘external’ members of the Monetary Policy Committee outlined by the then Chancellor of the Exchequer in evidence to us in June 2007. We welcome the fact that Government will advertise for different qualities and skills for each new ‘external’ member of the Monetary Policy Committee. We hope that they will lead to timely appointments of experts suited to the role of Monetary Policy Committee member. We note that there is no current proposal for a confidential pool created of experts who could be nominated to the Monetary Policy Committee where posts need to be filled at short notice. We therefore recommend that the Government consider adding a note to candidates as part of the appointments process asking them if they would be willing to form part of such a pool if not selected for the current vacancy. (Paragraph 79)**

The Government notes the Committee’s welcome of the June 2007 reforms to the appointments process.

The Chancellor has set out today how the reforms to the appointments process announced in the summer will work in practice. As part of its ongoing review of the monetary policy framework, the Government will consider the Committee’s recommendation to create a pool of available candidates, and judge carefully whether the creation of such a pool could unnecessarily complicate the appointment process and compromise its capacity to recruit the best candidates, before considering it further as an option.

**We welcome the Government’s commitment to enable appointment hearings by this Committee for nominees for the post of ‘external’ member of the MPC to take place prior to formal appointment. We note that the Government considers such hearings would be “non-binding”. We consider it important that such hearings can be scheduled sufficiently far in advance of the date of the formal appointment to enable the Chancellor of the Exchequer to be able to give proper consideration to any view expressed by the Treasury Committee without there being a danger of the MPC**

**membership being temporarily reduced as a result of reconsideration of a nominee. We recommend accordingly that nominations be announced at least three months prior to the date on which the vacancy falls to be filled. We also consider that, if the Treasury Committee were to reach an adverse opinion on a nominee, which would only be after careful and considered reflection, the Committee ought to have the power to require a debate in the House of Commons on the nomination. (Paragraph 82)**

The current system—especially after taking into account the changes the Government has already announced—allows a significant degree of public scrutiny, and includes important parliamentary accountability mechanisms, on the competency of the appointees without exerting undue political influence on the process.

When a new member is to be appointed to the MPC, the Treasury will, as far as possible, publish a timetable in sufficient time to announce details of who the Chancellor has decided to appoint, consistent with allowing the Treasury Select Committee three months for their pre-commencement hearings.

**We believe that the positions of the Governor and the two Deputy Governors should be recruited by open advertisement as well as confidential search. (Paragraph 84)**

The appointments of the Governor and the Deputy Governors remain Crown appointments—they are made by the Queen on the advice of the Prime Minister and the Chancellor, under the terms of the Bank of England Act 1998.

The details, including end dates, of the appointment terms of the Governor and the Deputy Governors are freely available on the Bank of England's website, providing clarity on which appointment terms are approaching expiry.

The Government will continue to review the appointments process as part of its ongoing monitoring of the monetary policy framework.

**We have heard differing views on the need for monthly meetings of the Monetary Policy Committee. With hindsight, it would have been better if the Bank of England Act 1998 had not mandated monthly meetings, but had left the number of meetings each year to be determined by the Court of the Bank of England on the recommendation of the Governor, but subject to the following conditions: that there were to be a minimum of eight annual meetings, that Monetary Policy Committee meetings were to be evenly spaced across the year, and that MPC meetings were to be pre-announced with a year's notice, except in 'emergency' cases. We therefore recommend that, should changes to the Bank of England Act 1998 be required for any other purpose, these changes be made at that time. (Paragraph 86)**

The Government acknowledges there is a range of considerations in determining the optimum frequency of MPC meetings. What is important is that the MPC has the flexibility to act when circumstances change in unforeseen ways and the present framework affords them that flexibility. They have had to use this flexibility on one occasion: September 2001, after the terrorist attacks, when they held an emergency meeting and cut rates by 25 basis points.

The Bank already announces monthly MPC meetings for the year ahead, making the process as predictable as possible for the public and markets. The MPC is also relatively free to conduct its meetings as the Governor sees fit, depending on how much there is for the committee to discuss.

**We believe that the present Court of the Bank of England is too large and should be reduced in size. We note the role played by the Court in the accountability process of the Monetary Policy Committee. We will continue to monitor the decisions of the Court, and at times may request additional information from it relating to the Monetary Policy Committee to ensure that it is undertaking its proper functions as related to the Monetary Policy Committee. (Paragraph 91)**

The Government is today publishing a consultation document, which includes proposals regarding the Tripartite arrangements, the Bank's financial stability objective and the Court of the Bank of England. To ensure its effective operation the consultation seeks views on the possibility of reducing the Court's size from its current 19 members.

### **The transparency of the Monetary Policy Committee**

**We acknowledge the efforts the Monetary Policy Committee has made in educating the public, especially via its programmes for younger people, about its role, and the need for low inflation. However, certain of the Bank's own measures of the public's understanding remain low. We recommend that the Monetary Policy Committee and the Bank of England consider what the public need to know about the monetary policy framework, and then, with assistance from the Treasury if needed, consider a public education campaign to put across those points. It is important that if there are more uncertain times ahead, the public must understand and support the reasons behind movements in interest rates. (Paragraph 99)**

The Government attaches great importance to clearly explaining economic policy and does so through a number of channels, including speeches, media engagements, parliamentary scrutiny and a regular stream of Budget, PBR and other publications.

We agree that ensuring the general public is as well informed as possible of economic policy is an important issue that deserves ongoing attention from Government, the Bank of England and others.

**We are firmly of the view that the letter writing process should be regarded as part of the accountability mechanism of the framework, rather than a sanction. While the experience has been limited, at some point a Chancellor of the Exchequer and the Monetary Policy Committee may disagree about the steps to be taken to bring inflation back to target. In such a scenario, we would expect the reply from the Chancellor of the Exchequer to set out the Treasury's view of the reasons for inflation breaching the target, as well as their suggested timeframe and policy for bringing inflation back to target. This would allow both the House of Commons and the public in general to see clearly the areas of disagreement. (Paragraph 104)**

The Government strongly agrees that the open letter is not a sanction but an important part of transparency and accountability in monetary policy. The Pre-Budget Report

acknowledged the value of the open letter process as a communication tool, noting that it is “an integral part of the macroeconomic framework”.

Receipt of an open letter provides an opportunity for the Chancellor to engage in an open dialogue with the MPC. Such a dialogue enhances and reinforces the credibility of the framework, and ensures the public is kept fully informed. As the then Chancellor remarked in his evidence to the TSC in June: “the experience of the exchange of letters [in April] was a good one”.

### *HM Treasury*

January 2008

## Appendix 2: Bank of England response

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The Monetary Policy Committee (MPC) and the Court of the Bank of England welcome the Treasury Committee’s Report into “The MPC of the Bank of England: ten years on”. Both the MPC and Court acknowledge the thoroughness with which the Committee has undertaken its task. The MPC would also like to take this opportunity to thank the Committee for the manner in which it has conducted its regular scrutiny of the MPC’s decisions over the past decade. Those hearings have been an essential ingredient in establishing the legitimacy of the present monetary framework.

The first part of the Committee’s Report contains reflections on the economic context and on the monetary policy framework. The MPC’s views on the economic context were conveyed at length in the Bank’s original submission to the enquiry and further commentary here is unwarranted.

With regard to the monetary policy framework, the Committee endorses the present symmetric inflation target for the Consumer Prices Index, with the numerical value for that target set annually by the Chancellor of the Exchequer. While the framework is a matter for the Government and HM Treasury rather than the Bank of England, the MPC welcomes the Committee’s support for the current framework, which the MPC believes has served the country well over the past decade.

The rest of the Committee’s Report contains a number of recommendations relating to the MPC as a body and the transparency of the MPC. These are more directly addressed to the MPC or Court and MPC/Court’s responses are recorded below. For ease of reference, the Committee’s recommendations are re-iterated (in bold, numbered paragraphs), with the MPC/Court’s response following, as appropriate.

**We are mindful of the need to ensure that the MPC remains independent, and to allow a flexible system of terms and conditions that can enable recruitment from the widest base. We therefore recommend that, should the Bank of England Act 1998 be modified in the future, a new term of office for ‘external’ MPC appointments be instituted, based on a six-year term, with no option of reappointment, with a three year minimum, after which continuation would take place only with the agreement of both the Non-Executive Committee of the Court of the Bank of England and the postholder. This**

**would give the flexibility to remove those who are unfit for the job, retain flexibility for those who might wish to leave the post early, and ensure continuation was not at the discretion of the Chancellor of the Exchequer. (Paragraph 68).**

The length of term for all members of the MPC is a matter for Government and Parliament. However, both the MPC and Court believe that the spirit of the Committee's recommendation for longer, but non-renewable, terms for the external members is desirable. From the MPC's perspective, some turnover of external members is desirable in order to ensure regular injections of fresh thinking, but longer terms help to build and maintain the MPC's experience; the particular length of term chosen should balance these two considerations. But it would not be sensible to expect all external members to commit to serve a longer term, as that might make some candidates unwilling to join the Committee. That is particularly the case for academics, who are generally unable to secure leave of absence for more than three years.

Whatever length of term the Government chooses, Court does not believe that it should play a role in the appointment or re-appointment of MPC members, as that would usurp the proper role of Government in determining the make-up of the MPC, as well as potentially weakening the independence of members approaching re-appointment. But in the unlikely event that an individual's behaviour is unfit or incompatible with their continued membership of the MPC, Court should be able to remove them at any time, a power that it has already under the existing Bank of England Act.

**We find the explanations of why the full-time option was removed for all 'external' members unconvincing, especially for new members of the Monetary Policy Committee. We recommend that all working patterns be available to 'external' members of the MPC, so that they may undertake their duties as they see fit, as their career progresses. (Paragraph 70).**

The terms and conditions for external members is a matter for Court. The Chairman of NedCo holds annual meetings with individual MPC members and has discussed this matter with the 'external' members.

Court is of the view that the formulation of monetary policy is not a full-time occupation. 'Internal' members of the MPC spend a significant part of their time executing line management responsibilities, rather than setting interest rates; it is not practical to try to provide such additional line responsibilities for the 'external' members. Moreover, it is not their previous employment that distinguishes 'external' members from 'internal' members—a majority of the current group of 'internal' members were, for instance, appointed from outside the Bank. Rather, it is that the 'external' members continue to have links outside the Bank after they have taken up membership of the MPC, thus facilitating the injection of fresh thinking into the MPC's deliberations.

Court therefore believes that 'external' membership should normally be part time—typically the equivalent of three days/week. However, Court recognises that some flexibility may be required while an appropriate additional role external to the Bank is secured, when external members come from a business or financial market background and cannot continue their existing employment on a part-time basis. Consistent with this, Court notes that securing suitable additional external employment would be facilitated if appointments

to the MPC are made in a timely fashion and would ask that the Treasury also recognise this issue at the time of appointment.

**We welcome the changes to the appointments process for ‘external’ members of the Monetary Policy Committee outlined by the then Chancellor of the Exchequer in evidence to us in June 2007. We welcome the fact that Government will advertise for different qualities and skills for each new ‘external’ member of the Monetary Policy Committee. We hope that they will lead to timely appointments of experts suited to the role of Monetary Policy Committee member. We note that there is no current proposal for a confidential pool created of experts who could be nominated to the Monetary Policy Committee where posts need to be filled at short notice. We therefore recommend that the Government consider adding a note to candidates as part of the appointments process asking them if they would be willing to form part of such a pool if not selected for the current vacancy. (Paragraph 79).**

Court and the MPC believe that the maintenance of a confidential pool of candidates with the appropriate skills and experience would be valuable and would help facilitate vacancies being filled in a timely fashion. Court and the MPC therefore support this recommendation and would welcome the opportunity to work with the Treasury on succession planning.

**We welcome the Government’s commitment to enable appointment hearings by this Committee for nominees for the post of ‘external’ member of the MPC to take place prior to formal appointment. We note that the Government considers such hearings would be “non-binding”. We consider it important that such hearings can be scheduled sufficiently far in advance of the date of the formal appointment to enable the Chancellor of the Exchequer to be able to give proper consideration to any view expressed by the Treasury Committee without there being a danger of the MPC membership being temporarily reduced as a result of reconsideration of a nominee. We recommend accordingly that nominations be announced at least three months prior to the date on which the vacancy falls to be filled. We also consider that, if the Treasury Committee were to reach an adverse opinion on a nominee, which would only be after careful and considered reflection, the Committee ought to have the power to require a debate in the House of Commons on the nomination. (Paragraph 82).**

Court and the MPC believe that it is important that vacancies are filled in a timely fashion after due process has been fulfilled, including appointment hearings before the Committee. Court and the MPC therefore welcome the recommendation that nominations be announced at least three months in advance in order to allow these to take place before a new member joins the MPC. The suggestion that the Committee should have the power to require a debate in the House of Commons in the event that it considers a nomination unsuitable is a matter for Parliament.

**We have heard differing views on the need for monthly meetings of the Monetary Policy Committee. With hindsight, it would have been better if the Bank of England Act 1998 had not mandated monthly meetings, but had left the number of meetings each year to be determined by the Court of the Bank of England on the recommendation of the Governor, but subject to the following conditions: that there were to be a minimum of eight annual meetings, that Monetary Policy Committee**

**meetings were to be evenly spaced across the year, and that MPC meetings were to be pre-announced with a year's notice, except in 'emergency' cases. We therefore recommend that, should changes to the Bank of England Act 1998 be required for any other purpose, these changes be made at that time. (Paragraph 86).**

While the MPC does not see the need for change as pressing, were the Bank of England Act to be amended for other reasons, the MPC would welcome scope for greater flexibility in regard to the timing of its meetings. It agrees that the stipulation of a minimum of eight meetings each year would be sensible, although the requirement that they be evenly spaced would mitigate against them being held at optimum points in the data release cycle.

**We believe that the present Court of the Bank of England is too large and should be reduced in size. We note the role played by the Court in the accountability process of the Monetary Policy Committee. We will continue to monitor the decisions of the Court, and at times may request additional information from it relating to the Monetary Policy Committee to ensure that it is undertaking its proper functions as related to the Monetary Policy Committee. (Paragraph 91).**

Court concurs with the Committee's recommendation to reduce its size. Court welcomes the Committee's interest in its oversight of the MPC and its processes and is ready to provide additional information when requested.

**We acknowledge the efforts the Monetary Policy Committee has made in educating the public, especially via its programmes for younger people, about its role, and the need for low inflation. However, certain of the Bank's own measures of the public's understanding remain low. We recommend that the Monetary Policy Committee and the Bank of England consider what the public need to know about the monetary policy framework, and then, with assistance from the Treasury if needed, consider a public education campaign to put across those points. It is important that if there are more uncertain times ahead, the public must understand and support the reasons behind movements in interest rates. (Paragraph 99).**

The MPC fully concurs with the Committee about the importance of educating the public regarding the case for low inflation and the Bank's role in securing price stability. The MPC believes that it has been reasonably successful in reaching the professional and business audience, through both its speaking programme, regional visits and the activities of the Agents, though of course there is always more that can be done. And the widespread use in schools of the Bank's general teaching resources and the success of the Target 2.0 Competition have helped to get the message out to the young. But reaching a much wider audience is significantly more challenging, though we are deliberately trying to increase our involvement in events with such an audience. We are also planning to have a special exhibition on inflation and its control in the Bank's museum this year. And the Bank's website is being developed in order to make it more informative for the general public. The MPC will continue to place a high priority in advancing this agenda.

**Whether or not the Monetary Policy Committee provides a forecast of future interest rates, there appears to us to be a need for more information to be provided by the Monetary Policy Committee to aid both financial markets and the general public. We therefore welcome the Governor's thoughts on providing more information around**

**possible policy reactions should certain risks crystallise. However, we also recommend that the Bank undertake regular work to assess the current academic thinking on the feasibility and desirability of publishing an interest rate forecast, and keep this matter under review. (Paragraph 108).**

The MPC is continually trying to improve the presentation of the thinking behind its interest rate decisions, both in the Minutes and in the quarterly *Inflation Report*. In this respect, in Section 5 of the August 2007 *Report*, the MPC expanded its coverage of the risks to the conjuncture and the associated implications for policy. With regard to publishing a forecast for interest rates, the MPC is watching with interest the small number of other central banks that have recently begun to do this. Bank staff are in regular contact with their counterparts at these central banks and also seek to keep abreast of academic thinking on this issue. The MPC keeps its own procedures under constant review in the light of experience elsewhere, as well as developments in academic thinking.

**We have heard different views on the need for immediate transparency on the voting pattern of the MPC. We have concluded that the balance of arguments supports the need for immediate transparency of MPC voting, which would allow financial markets to assess the strength of the support within the MPC for any given decision. We recommend accordingly that the Bank of England publish, alongside the interest rate decision, the outcome of the vote, indicating which individual MPC members voted which way. (Paragraph 112).**

The MPC remains doubtful of the wisdom of revealing the vote before the associated explanation. Knowledge of which way someone voted does not explain why they voted that way. Given that a member could not expand on the reasons for his/her vote until after publication of the minutes, releasing the vote at the time of the decision runs the risk of encouraging media speculation on the reasons for an individual's vote and increases the simple-minded tendency to portray members as 'hawks' or 'doves'. Moreover, the vote does not always provide a good guide to how close a rate decision was. Each member could agree that a decision is extremely finely balanced, yet the result turn out unanimous. Conversely, if the MPC is quite polarised, a 5-4 to hold would not indicate that a vote to change rates is necessarily near at hand. So in the MPC's view, little value should be attached to individual votes without the accompanying explanation that appears in the Minutes. The MPC therefore continues to believe that the current arrangements are to be preferred.

**We were pleased to hear that the Bank is considering a structured set of discussions between professional economists and staff members of the Bank, and members of the Monetary Policy Committee. We recommend that the Bank provide to this Committee within six months an outline of a plan for such meetings, that allows for a diverse membership of participants, and allows for an open and transparent record to be kept. (Paragraph 113).**

MPC welcomes the Committee's endorsement of moves to strengthen contact with professional economists external to the Bank. We are presently deliberating over the most suitable format and frequency for such events and will be in touch with a range of potential outside participants to gather their suggestions. We expect to host the first such event sometime in the first half of 2008.

**We are concerned about the effects on the debate within the Monetary Policy Committee of having a paragraph assigned to each member. However, we believe greater thought should be given by the Monetary Policy Committee to ensuring that the balance of views of members is more identifiable with particular individuals, rather than just identifying how individual members voted. We therefore recommend that, whenever the minutes at the moment refer to “one member”, that member be named within the text. (Paragraph 116).**

The Committee’s own Report amply covers the disadvantages of associating views in the minutes with particular members, namely that it may discourage free debate and the exposure of arguments in order merely to test them. The MPC believes that these reasons apply just as much to arguments advanced by one member as to those advanced by more than one member, and that speeches, media interviews and appearances before the Committee offer plenty of opportunity for the exposure of the views of individual members.

**We have listened with care to the arguments against each member of the Monetary Policy Committee providing an annual report to this Committee. We have particularly reflected upon the concern that such reports might focus attention on a particular date. However, we are persuaded that regular reports by each member of the Monetary Policy Committee to this Committee would further enhance their individual accountability and enhance the value of our regular hearings with members of the Monetary Policy Committee about inflation reports. To overcome concerns about timing, we will request each member to prepare his or her report for a 12-month period ending with a different month. We wish to receive a report on that basis from each member of the Monetary Policy Committee which:**

- **lists the work they have undertaken to promote transparency in and wider understanding of monetary policy in the preceding year;**
- **assesses their own voting record in the Monetary Policy Committee over that period; and**
- **sets out their thoughts on monetary prospects for the coming year. (Paragraph 119).**

There are now (at least) four appearances annually by the MPC before the Committee. Together with the increased questioning by the Committee of all MPC members, that has improved the accountability of the MPC to Parliament.

The MPC notes the Committee’s desire for annual individual reports in order to enhance individual accountability and the value of the hearings. However, the suggested content of these reports does raise some issues. In particular, the MPC has tried to strike a balance between its collective and its individual communications with the markets, media and general public. That balance would potentially be disturbed if members were each to provide a lengthy written individual annual report containing an evaluation of their voting records and an assessment of monetary policy prospects, detracting from the collective message that is embodied in the *Inflation Report* and MPC Minutes. Moreover, because of the lags in the effects of monetary policy on inflation, members cannot in any case properly assess their voting record over the past year. And because interest rate decisions are taken

one month at a time, neither is it possible for MPC members to set out their thoughts on the prospects for interest rates.

MPC members can, however, explain the reasons for their votes over the past year. And linked to that, they can explain their view of the outlook for inflation and the risks they see to that outlook. But the MPC believes that the voting record and speeches given by each member already provide the necessary background for scrutiny by the Committee. Individual accountability would then be best enhanced by the Committee using its ability to probe viewpoints and differences among members in oral questioning rather than through the provision of additional written reports.

The MPC therefore suggests that, in the future, individual members will provide a standard form to the Committee containing a record over the previous year of: votes cast; on-the-record speeches (with web links); and other activities promoting understanding and transparency.<sup>2</sup> Members could provide this information to any timetable that the Committee desires. But perhaps the most effective arrangement would be for each of the five members called to appear before the Committee at a regular hearing to submit such a form. In that way the information would be fresh and up-to-date and thus a suitable point of departure for the Committee's oral questions.

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<sup>2</sup> It is worth noting that the level of such activities should be expected to vary across MPC members, given the range of their other responsibilities.

## List of Reports from the Treasury Committee during the current Parliament

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First Report	The 2007 Comprehensive Spending Review	HC 55
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Fourth Report	Climate change and the Stern Review: the implications for Treasury policy	HC 231
Fifth Report	The run on the Rock	HC 56
<b>Session 2006–07</b>		Report
First Report	Financial inclusion: the roles of the Government and the FSA, and financial capability	HC 53
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Fourth Report	Are you covered? Travel insurance and its regulation	HC 50
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Eighth Report	Progress on the efficiency programme in the Chancellor's department	HC 483
Ninth Report	Appointment of the Chair of the Statistics Board	HC 934
Tenth Report	Private equity	HC 567
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Thirteenth Report	Financial inclusion follow-up: saving for all and shorter term saving products	HC 504
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Fourteenth Report	Globalisation: prospects and policy responses	HC 90
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## Session 2005–06

Report

First Report	The Monetary Policy Committee of the Bank of England: appointment hearings	HC 525
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Second Report	The 2005 Pre-Budget Report	HC 739
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Third Report	The Monetary Policy Committee of the Bank of England: appointment hearing for Sir John Gieve	HC 861
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Fourth Report	The 2006 Budget	HC 994
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Fifth Report	The design of a National Pension Savings Scheme and the role of financial services regulation	HC 1074
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Sixth Report	The administration of tax credits	HC 811
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Seventh Report	European financial services regulation	HC 778
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Eighth Report	Bank of England Monetary Policy Committee: appointment hearing for Professor David Blanchflower	HC 1121
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Ninth Report	Globalisation: the role of the IMF	HC 875
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Tenth Report	Independence for statistics	HC 1111
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Eleventh Report	The Monetary Policy Committee of the Bank of England: appointment hearings for Professor Tim Besley and Dr Andrew Sentance	HC 1595
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Twelfth Report	Financial inclusion: credit, savings, advice and insurance	HC 848
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Thirteenth Report	“Banking the unbanked”: banking services, the Post Office Card Account, and financial inclusion	HC 1717
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