HOUSE OF LORDS

Economic Affairs Committee

1st Report of Session 2023–24

Making an independent Bank of England work better

Ordered to be printed 17 November 2023 and published 27 November 2023

Published by the Authority of the House of Lords

HL Paper 10

Economic Affairs Committee
The Economic Affairs Committee is appointed by the House of Lords in each session to "consider economic affairs".

Membership
The Members of the Economic Affairs Committee are:

Lord Blackwell
Lord Bridges of Headley (Chairman)
Lord Davies of Brixton
Lord Griffiths of Fforestfach
Lord King of Lothbury
Baroness Kramer
Lord Layard
Baroness Liddell of Coatdyke
Lord Londesborough
Baroness Noakes
Lord Rooker
Lord Turnbull
Lord Verjee

Declaration of interests
See Appendix 1.

A full list of Members' interests can be found in the Register of Lords' Interests:
https://members.parliament.uk/members/lords/interests/register-of-lords-interests

Publications
All publications of the Committee are available at:
https://committees.parliament.uk/committee/175/economic-affairs-committee/publications

Parliament Live
Live coverage of debates and public sessions of the Committee's meetings are available at:
http://www.parliamentlive.tv

Further information
Further information about the House of Lords and its Committees, including guidance to witnesses, details of current inquiries and forthcoming meetings is available at:
http://www.parliament.uk/business/lords

Committee staff
The staff who worked on this inquiry were Moriyo Aiyeola (Clerk), Neil Mellor (Policy Analyst) and Gurjeet Rathore (Committee Operations Officer).

Contact details
All correspondence should be addressed to the Economic Affairs Committee, Committee Office, House of Lords, London SW1A 0PW. Telephone 020 7219 5358. Email economicaffairs@parliament.uk

Twitter
You can follow the Committee on X (formerly Twitter): @LordsEconCom.

CONTENTS

Page

Summary 3

Chapter 1: Introduction 5
25 years since independence: a time for review 5
Figure 1: Bank of England/ Ipsos Inflation Attitudes Survey: assessing the way the Bank is doing its job to set interest rates to control inflation 7
Our inquiry 7

Chapter 2: Inflation performance and the monetary framework 8
Operational independence: UK inflation since 1997 8
Figure 2: UK CPI inflation rates (monthly, year-on-year percentage changes) 9
Figure 3: KOF (Swiss Economic Institute) Globalisation Index against median inflation rates from 22 OECD countries 10
Figure 4: Annual percentage change in CPI (UK, Eurozone, France, Japan and US) 11
The price stability framework 12
Role of asset prices 14
Fiscal and monetary policy mix 15
The impact of quantitative easing 18
Figure 5: Bank of England: Combined Balance Sheet (percent of nominal GDP) 19
'Deed of Indemnity' 21

Chapter 3: The Bank's remit 23
Evolution of the Bank's remit 23
Justification for extended remits 25
Consequences of extended remits 26
Doing too much? 26
Risks to independence 27
Conflicting objectives 27
Implications for the Bank's management 29
A central bank digital currency 30

Chapter 4: Diversity of thought and culture 33
Diversity of thought 33
The Bank's approach to inflation post-2020 33
Figure 6: UK bank rate versus CPI and M4: January 2020 to January 2022 35
Figure 7: 12-month growth rates of M4ex and M4Lex 38
Forecasting 39
Figure 8: Bank of England CPI inflation forecasts versus inflation outcomes 39
Appointments 42
Role of the Court of Directors 44
Reform of the Court 45

Chapter 5: Accountability 47
Accountability and the role of Parliament 47
The Independent Evaluation Office 49

Summary of conclusions and recommendations 52

Appendix 1: List of Members and declarations of interest 55

Appendix 2: List of witnesses 57

Appendix 3: Overview of the Bank of England's remit 61
Box 1: Bank of England remit 61

Appendix 4: Overview of the remits and recommendations for the Bank of England policy committees (2022) 64
Box 2: MPC remit 2022 64
Box 3: FPC remit and recommendations 2022 65
Box 4: PRC recommendations 2022 67

Appendix 5: Bank of England organogram (November 2023) 69

Appendix 6: Bank of England Court of Directors and policy committee membership 70

Appendix 7: UK regulatory architecture (with a focus on the Bank of England) 71

Evidence is published online at https://committees.parliament.uk/work/7356/bank-of-england-how-is-independence-working/publications/ and available for inspection at the Parliamentary Archives (020 7219 3074).

Q in footnotes refers to a question in oral evidence

SUMMARY

The Bank of England Act 1998, which provides the legal framework for the Bank's operational independence, was passed 25 years ago. By removing political control over monetary policy, operational independence was seen as a means of strengthening economic confidence in the UK economy. In view of recent economic volatility, and to mark the 25th anniversary of independence, we consider it to be an appropriate time to review the operation of that framework with respect to the conduct of monetary policy.

For much of the past 25 years, the enhanced credibility of monetary policy brought about by independence has contributed to a low inflation environment. The absence of political interference is seen by many as a major component of stable inflation expectations. While external factors, such as globalisation, have contributed to favourable conditions throughout this period, the majority of our witnesses were clear that independence has been a significant factor in promoting price stability. It is our strong view that independence should be preserved.

However, while independence is an important instrument in achieving price stability, it is clear that the framework for operational independence is now being tested. Confidence in the Bank is critical if it is to preserve its independence. Yet public confidence in the Bank of England has fallen dramatically as inflation has remained well above the Bank's target over the last two years.

High and persistent inflation since 2021 is in part due to supply shocks brought about by the COVID-19 pandemic and Russia's invasion of Ukraine. Nonetheless, the persistence of above-target inflation over this period also reflects errors in the conduct of monetary policy, including an over-reliance on inadequate forecasting models. We do acknowledge that the Bank of England is not the only central bank that failed to anticipate high and persistent inflation. This may be partly explained by a sense of complacency about inflation among all major central banks given the prevalence of low-price pressures over the last decade or so. We received evidence that errors in monetary policy reflected a lack of diversity of view in the Bank of England and wider central bank community. When inflation rose, central bankers focused on supply-side shocks as the cause, and the higher inflation rate was seen as transitory. Some witnesses therefore considered that the inflationary potential of elevated rates of money supply growth were given insufficient attention by the Bank.

Given this, we have identified several key issues which need to be addressed so as to improve the Bank's performance, and thereby restore confidence in the Bank.

First, in order to safeguard economic and financial stability, we recommend that the interaction between fiscal and monetary policy requires clear lines of responsibility and effective communication between the Bank and His Majesty's (HM) Treasury. This is especially the case when interest rates fall towards their lower bound. Moreover, the repeated use of quantitative easing has had implications for the Bank's balance sheet and, consequently, for perceptions of the Bank's independence. To address this, we recommend that the Bank and the Debt Management Office publish a memorandum of understanding which clarifies how the interaction between monetary policy and debt management should operate. The Bank should also give prominence to the study and reporting

of the potential economic risks arising from the expansion of its balance sheet due to an extended quantitative easing policy. We also repeat our call for the 'Deed of Indemnity' to be published—the contractual document between HM Treasury and the Bank, which commits the taxpayer to paying any financial losses suffered by the Bank which might result from the quantitative easing programme.

Second, witnesses often expressed concern regarding the Bank's expanding remit, especially with respect to the matters it is expected to have regard to or consider—climate change being the most cited example—to support the Government's economic policy. We found that this widening of the Bank's remit risks jeopardising the Bank's ability to prioritise its primary objectives; risks drawing the Bank into the Government's wider policy agenda; and increases the potential for conflict between its objectives. We recommend that the Bank's remit should be pruned by HM Treasury, with a focus on the number of matters it is expected to have regard to and consider. The Bank's management structure, which has expanded in line with its growing remit, should also be reviewed with a focus on whether it could be made more streamlined.

Third, errors were made in the conduct of monetary policy by the wider central banking community, including the Bank of England. To address this, the Bank must do more to foster a diversity of views and strengthen a culture that encourages challenge. Areas that need attention include governance, hiring practices and appointments, especially to the Monetary Policy Committee. We welcome a recently announced review, to be led externally by Dr Ben Bernanke, into the Bank's forecasting capability. We hope this will address shortcomings in the Bank's modelling and forecasts.

Finally, and critically, an independent Bank of England must be held to account effectively. A small group of appointed Bank officials, who are not part of the elected Government, exercise significant powers which have an impact on the entire UK economy. Given that the Government is unable to challenge the Bank's decisions without compromising its independence, it is therefore imperative that the Bank and its remit are effectively scrutinised by, and its officials are held accountable to, Parliament. As the Bank's remit has grown, there has not been a commensurate increase in scrutiny or the means to hold those officials to account. We are concerned that a democratic deficit has emerged, which risks undermining confidence in the Bank and its operational independence. We therefore believe that current Parliamentary arrangements should be enhanced. In particular, we recommend that Parliament should conduct an overarching review of the Bank's remit, performance and operations. Such a review, conducted every five years, would enhance Parliament's ability to hold the Bank to account and to express its view on the Bank's performance and leadership. More scrutiny and accountability should strengthen confidence in operational independence.

Making an independent Bank of England work better

CHAPTER 1: INTRODUCTION

25 years since independence: a time for review

1. Ever since the Bank of England was founded in 1694 to 'promote the public Good and Benefit of our People'[1] it has played a crucial role in the nation's economy. In 1946, the Government nationalised the Bank and took the power to appoint the Bank's governors and directors, and to issue directions to the Bank.[2]

2. Following high rates of inflation in the 1970s, the 1980s and 1990s saw macroeconomic theories begin to favour central banks tasked with meeting an inflation target. Empirical studies which indicated that such a model led to lower inflation in developed countries contributed to this shift.[3] However, an additional contribution to this trend came from the perception that the independent central banks of Germany and Switzerland had performed better than those under political control.[4]

3. One month after the pound's departure from the Exchange Rate Mechanism in September 1992, the UK Government adopted an (RPIX)[5] inflation target, with interest rate decisions to be made by the Chancellor of the Exchequer in light of advice given by the Bank of England Governor.[6] In then Chancellor Kenneth Clark's 1995 Mansion House speech, he announced the objective of keeping underlying inflation at "2.5 per cent or less" beyond the spring of 1997.[7] However, just a few days after the 1997 general election, the Rt Hon Gordon Brown, the new Government's Chancellor, announced the operational independence of the Bank of England with respect to monetary policy. He said:

> "Price stability is … an essential precondition for the Government's objectives of high and sustainable levels of growth and employment …

---

1 Bank of England, 'Our History': https://www.bankofengland.co.uk/about/history [accessed 13 October 023]

2 *Ibid*. The Government's power to issue directions has not been used.

3 See for example Alex Cukierman, Steven Webb and Bilin Neyapti, 'Measuring the Independence of Central Banks and its Effects on Policy Outcomes', The World Bank Economic Review, vol. 6, No. 3 (September 1992): https://www.jstor.org/stable/3989977

4 Rosa Maria Lastra, 'The Independence of the European System of Central Banks', Harvard International Law Journal, *HeinOnline* vol 33, (1992), pp 475–519: https://heinonline.org/HOL/Page?handle=hein.journals/hilj33&div=24&g_sent=1&casa_token=&collection=journals

5 RPIX is the Retail Price Index (RPI) excluding mortgage interest payments.

6 BBC, '1992: UK crashes out of ERM' (September 1992): http://news.bbc.co.uk/onthisday/hi/dates/stories/september/16/newsid_2519000/2519013.stm [accessed 2 November 2023]. The Government adopted the objective of keeping the Retail Price Index excluding mortgage payments (RPIX), or 'underlying inflation', within a range of 1–4 per cent through the use of monetary policy; see Bank of England, *The inflation-targeting framework from an historical perspective* (2005): https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2005/the-inflation-targeting-framework-from-an-historical-perspective.pdf [accessed 2 November 2023], University of Warwick, *Macroeconomic Policy—'Inflation Targetry' In Practice*: https://warwick.ac.uk/fac/soc/economics/staff/jcsmith/policy/1inflationtargeting.pdf [accessed 2 November 2023].

7 University of Warwick, *Macroeconomic Policy—'Inflation Targetry' In Practice*: https://warwick.ac.uk/fac/soc/economics/staff/jcsmith/policy/1inflationtargeting.pdf [accessed 2 November 2023]

> we will only build a fully credible framework for monetary policy if the long-term needs of the economy, not short-term political considerations, guide monetary decision-making. We must remove the suspicion that short-term party-political considerations are influencing the setting of interest rates."[8]

4. The Bank of England Act 1998 formalised these arrangements, granting operational independence over monetary policy to the Bank, and establishing the Monetary Policy Committee (MPC) which was tasked with meeting an inflation target of 2.5 per cent measured by reference to RPIX (changed to 2 per cent as measured by the CPI in 2003).[9] In the decades since being granted independence, the Bank's role and remit has expanded. It has been given new regulatory roles, and its objectives have grown (see Chapter 3).

5. For the first twenty years of this century, inflation remained relatively low and stable compared with previous decades. In 2009, interest rates fell to record low levels where they remained for more than a decade while the Bank engaged in quantitative easing (increasing its balance sheet from around five per cent of GDP to around 50 per cent by late 2021).[10] However, high and persistent inflation since 2021 has prompted public debate on the Bank's performance. In the quarterly Bank of England/Ipsos Inflation Attitudes Survey, respondents are asked to assess the way the Bank is 'doing its job to set interest rates to control inflation' and a net satisfaction balance—the proportion satisfied minus the proportion dissatisfied—is recorded. While pre-pandemic figures of circa +30 per cent compare with highs of more than +50 per cent early in the millennium, the latest survey for August 2023 showed this balance to have fallen to -21 per cent, a survey low. This was a further fall from -13 per cent in the previous survey from May 2023. In general, net satisfaction has declined rapidly since May 2021 (see Figure 1).[11]

---

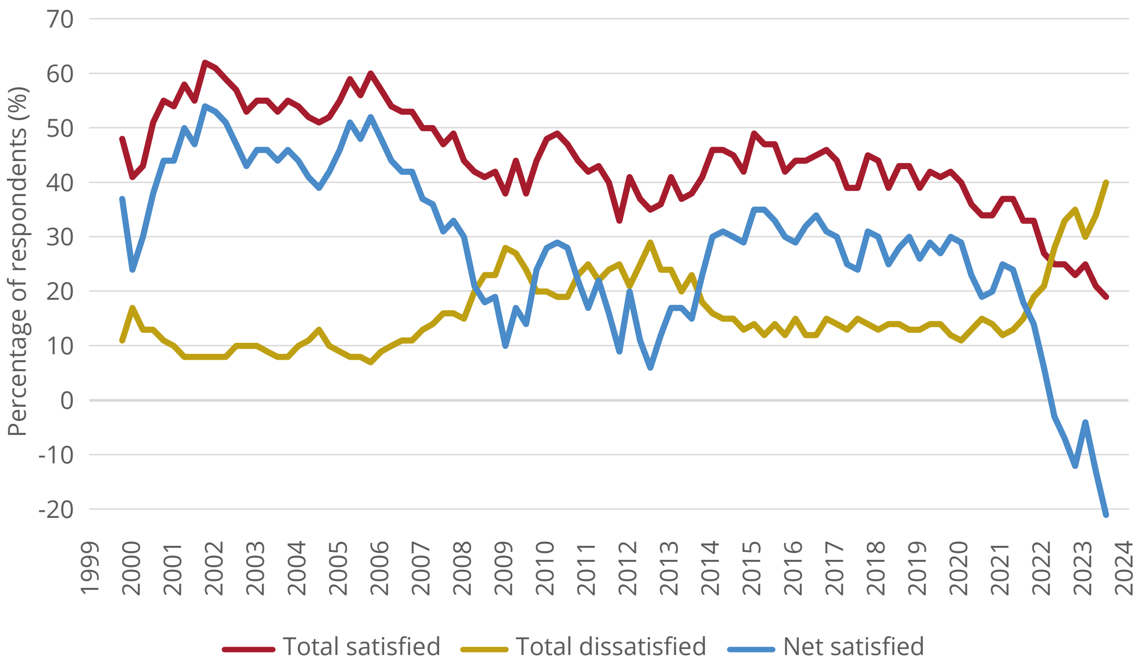
8 HM Treasury, *Statement by the Chancellor on the central economic objectives of the new government, (May 1997):* https://www.dmo.gov.uk/media/c5vfujg2/hmt060597.pdf [accessed 25 September 2023]

9 CPI is consumer price index; for an outline of the Act's provisions; see Bank of England, 'Remit for the Monetary Policy Committee—June 1997' (June 1997): https://www.bankofengland.co.uk/letter/1997/chancellor-letter-120697 [accessed 18 September 2023], Bank of England, Annex, *The New Inflation Target*: https://www.bankofengland.co.uk/-/media/boe/files/letter/2003/chancellor-letter-annex-101203.pdf [accessed 18 September 2023].

10 Bank of England, *QE as an economic policy tool—what does it do and how should we use it?* (February 2021): https://www.bis.org/review/r210303k.pdf [accessed 13 October 2023]

11 Bank of England, 'Bank of England/Ipsos Inflation Attitudes Survey—August 2023': https://www.bankofengland.co.uk/inflation-attitudes-survey/2023/august-2023 [accessed 25 September 2023]

Figure 1: Bank of England/ Ipsos Inflation Attitudes Survey: assessing the way the Bank is doing its job to set interest rates to control inflation



Source: Bank of England, 'Bank of England/Ipsos Inflation Attitudes Survey—August 2023' (August 2023): https://www.bankofengland.co.uk/inflation-attitudes-survey/2023/august-2023 *[accessed 25 September 2023]*

Our inquiry

6. Against this backdrop—25 years since the Bank was granted independence—we launched our inquiry on 3 March 2023 with a call for evidence on how the Bank of England's operational independence is working. We sought evidence on the Bank's remit, its governance and structure and how it is held accountable.

7. The focus of our inquiry (and consequently this report) has been primarily on the conduct of monetary policy. We do not examine the work of the Prudential Regulation Authority (PRA) and Prudential Regulation Committee (PRC), nor the role of the Bank as the UK's Resolution Authority. Specific policy decisions of the MPC and the Financial Policy Committee (FPC) are also not in the scope of this report. We analyse the financial stability responsibilities of the Bank only insofar as they interact with the operation, governance and accountability of the monetary policy regime.

8. In light of the above, Chapter 2 of our report assesses the Bank's performance at controlling inflation since 1997; Chapter 3 covers the appropriateness of the Bank's role and remit; Chapter 4 discusses the need for diversity of views, perceptions of groupthink and whether the Bank's governance provides for a culture of sufficient internal challenge; and Chapter 5 considers the Bank's accountability.

9. We are grateful to all our witnesses for their evidence, and to our Specialist Adviser, Professor Rosa Lastra.

CHAPTER 2: INFLATION PERFORMANCE AND THE MONETARY FRAMEWORK

Operational independence: UK inflation since 1997

10. One month after the pound's departure from the Exchange Rate Mechanism in September 1992, the UK Government adopted an inflation target of 2 per cent or less "in the long term" as measured by RPIX.[12] In 1995, the target was modified by then Chancellor Kenneth Clarke who announced the objective of keeping underlying inflation at "2.5 per cent or less".[13]

11. When the Bank was given operational independence in 1997 by the then Chancellor Gordon Brown, it inherited the 2.5 per cent target for RPIX with the added stipulation that an open letter be written by the Governor to explain any one percentage point deviation from target.[14] In 2003, Mr Brown modified the inflation target to two per cent expressed in terms of an annual rate of inflation as measured by the Consumer Price Index (CPI) (we cover this change in more detail from paragraph 22).[15]

12. With annual (RPIX) inflation having stabilised around 2.5 per cent by the start of the independence era, inflation remained relatively stable between 1997 and 2021, with RPIX/CPI staying within one percentage point of the MPC's (2.5 per cent and 2 per cent) target 87 per cent of the time[16] (see Chapter 3). However, from the start of 2021, inflation accelerated from 0.7 per cent to 5.4 per cent before reaching a 41-year high of 11.1 per cent in October 2022.[17] External factors contributed to this acceleration in inflation. However, in Chapter 4 we discuss possible reasons behind errors made in the wider central banking community, including the Bank of England, in the recent conduct of monetary policy.

---

12 RPIX is the Retail Price Index (RPI) excluding mortgage interest payments, known as "underlying inflation"; also see University of Warwick, *Macroeconomic Policy—'Inflation Targetry' In Practice*: https://warwick.ac.uk/fac/soc/economics/staff/jcsmith/policy/1inflationtargeting.pdf [accessed 2 November 2023]. While the target was initially set at "2 per cent or less", then Chancellor Norman Lamont stated that for the remainder of the Parliament, the stated objective was to keep inflation within a range of 1 to 4 per cent.

13 University of Warwick, *Macroeconomic Policy—'Inflation Targetry' In Practice*: https://warwick.ac.uk/fac/soc/economics/staff/jcsmith/policy/1inflationtargeting.pdf [accessed 2 November 2023]

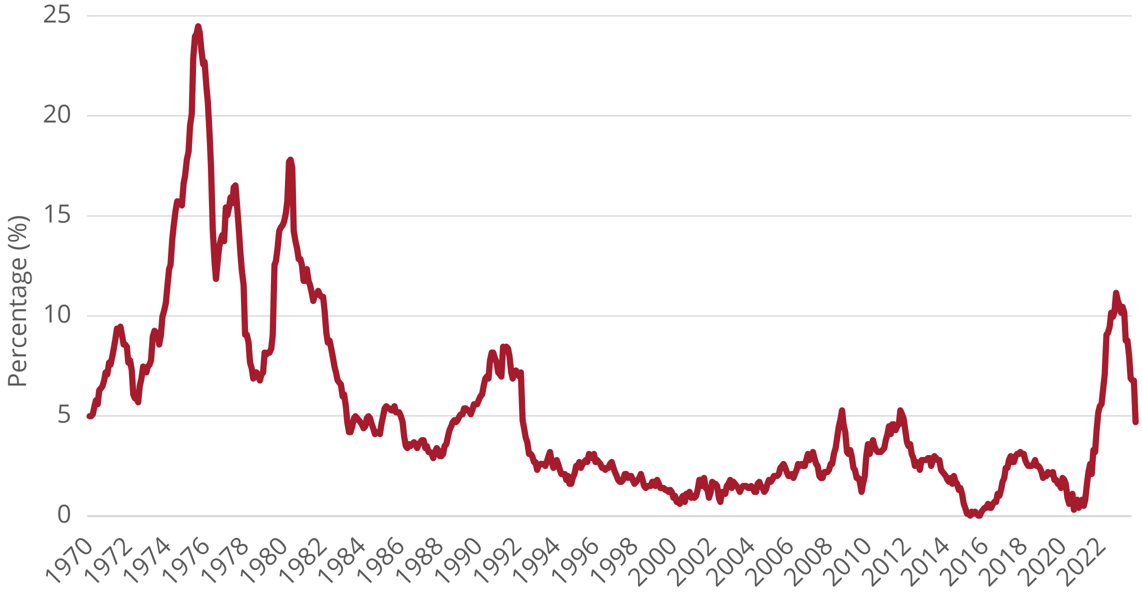
14 Bank of England, *Remit For The Monetary Policy Committee (June 1997)*: https://www.bankofengland.co.uk/-/media/boe/files/letter/1997/chancellor-letter-120697.pdf [accessed 2 November 2023]

15 Bank of England, Annex, *The New Inflation Target*: https://www.bankofengland.co.uk/-/media/boe/files/letter/2003/chancellor-letter-annex-101203.pdf [accessed 18 September 2023]

16 The figure '87 per cent' refers to above target inflation only. While inflation fell more than one percentage point below target on 30 occasions (start 1997–end 2020), outright year-on-year falls in the RPIX/CPI were only recorded on three occasions. Note that from 1970 to 1988, calculations are based on ONS remodelled CPI data. See Office for National Statistics, 'Consumer price inflation time series' (October 2023): https://www.ons.gov.uk/economy/inflationandpriceindices/datasets/consumerpriceindices [accessed 9 November 2023], Office for National Statistics, 'Consumer price inflation, historical estimates and recent trends, UK: 1950 to 2022': https://www.ons.gov.uk/economy/inflationandpriceindices/articles/consumerpriceinflationhistoricalestimatesandrecenttrendsuk/1950to2022 [accessed 9 November 2023], Office for National Statistics, 'Employment and labour market' (Census 2021): https://www.ons.gov.uk/employmentandlabourmarket [accessed 9 November 2023], Office for National Statistics, 'Consumer price inflation, UK: September 2023' (November 2023): https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest [accessed 9 November 2023].

17 Office for National Statistics, 'Consumer price inflation, UK: September 2023' (November 2023): https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest [accessed 9 November 2023]

Figure 2: UK CPI inflation rates (monthly, year-on-year percentage changes)



Source: Office for National Statistics, 'Consumer price inflation, historical estimates and recent trends, UK: 1950 to 2022' (May 2022): https://www.ons.gov.uk/economy/inflationandpriceindices/articles/consumerpriceinflationhistoricalestimatesandrecenttrendsuk/1950to2022 *[accessed 25 September 2023] and Office for National Statistics, 'Consumer price inflation, UK: October 2023' (November 2023):* https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest *[accessed 17 November 2023]*

13. The UK's continued track record of low and stable inflation after 1997 was seen by several witnesses as evidence of the success of the Bank's operational independence and its inheriting the inflation targeting framework.[18] Some considered that freeing monetary policy from short-term political decision-making is the most credible means of promoting price stability and therefore increased confidence in the UK's economic outlook.[19] Professor Charles Goodhart, Emeritus Professor of Banking and Finance at the London School of Economics, told us: "The fact that independence has been introduced … means that there is a greater likelihood of interest rates being adjusted for economic reasons, rather than to suit the political objectives of whatever Government it might be at that time."[20] Sir Paul Tucker, former Deputy Governor at the Bank, agreed, stating that it was "hard to imagine navigating the country out of grave financial crisis if a Minister had been deciding interest rates and monetary policy … Bond yields would have gone up and people would have expected inflationary finance."[21]

14. Although witnesses acknowledged a positive contribution from Bank independence to this millennium's low and stable inflation rates (prior to 2021), witnesses also pointed to other contributing factors. Radix Big Tent, a think tank, argued that it is impossible to "tease out the effects of

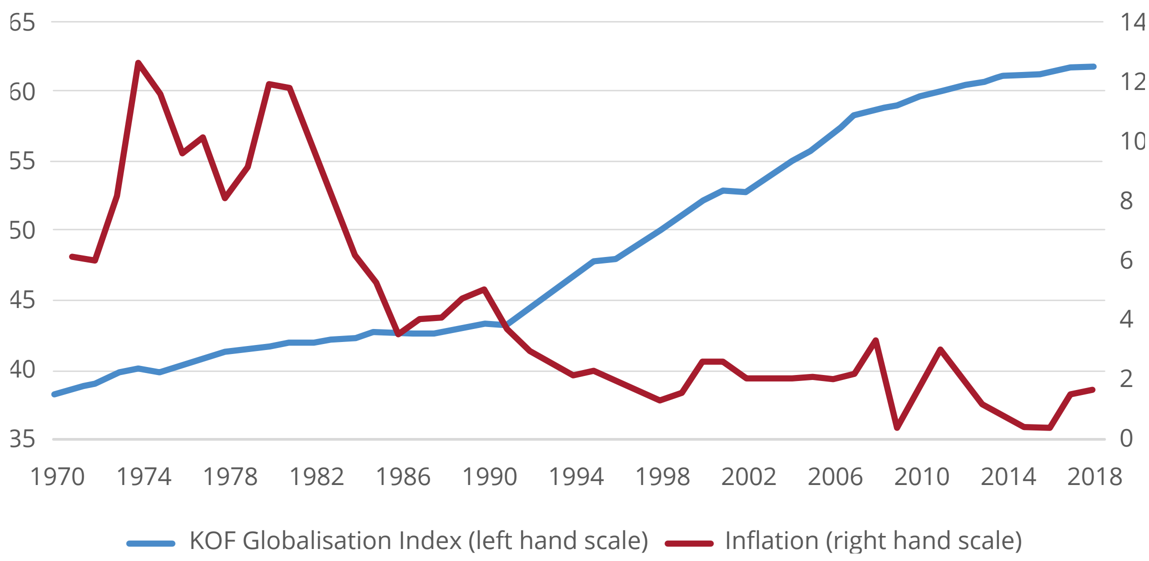
18 See for example Q 32 (Sir John Vickers), Q 44 (Rt Hon Ed Balls), Q 44 (Rt Hon George Osborne), Q 76 (Martin Wolf) and Q 76 (Donald Kohn). See also Bank of England, 'Speech-The Inflation Target five years on' (October 1997): https://www.bankofengland.co.uk/-/media/boe/files/speech/1997/the-inflation-target-five-years-on.pdf [accessed 30 October 2023]
19 See for example Q 121 (Sir Howard Davies), Q 139 (Prof Charles Goodhart) and Q 139 (Dr Raghuram Rajan)
20 Q 139 (Prof Charles Goodhart)
21 Q 32 (Sir Paul Tucker)

independence from other factors" and that the practical impact of central bank independence on price stability is "unknowable."[22] Dr Raghuram Rajan, former Governor of the Reserve Bank of India, took a similar view, stating that central banks collectively contributed to bringing inflation down from the late 1990s but that there were also other factors at play.[23]

15. Martin Wolf, Chief Economics Commentator at the *Financial Times* (FT), told us: "the general environment for low inflation globally … was relatively friendly until very recently. How far one attributes [the Bank's] success to its being given operational independence is difficult to assess, because we cannot analyse the counterfactual."[24]

16. Economists have pointed to internationally-orientated pricing dynamics or 'globalisation' as a major factor in the industrialised-world's inflation track record since the turn of the century (see Figure 3).

Figure 3: KOF (Swiss Economic Institute) Globalisation Index against median inflation rates from 22 OECD countries



Source: Available for free at ECB, 'Globalisation and its implications for inflation in advanced economies', ECB Economic Bulletin, Issue 4 (2021): https://www.ecb.europa.eu/pub/economic-bulletin/articles/2021/html/ecb.ebart202104_01~ae13f7fe4c.en.html

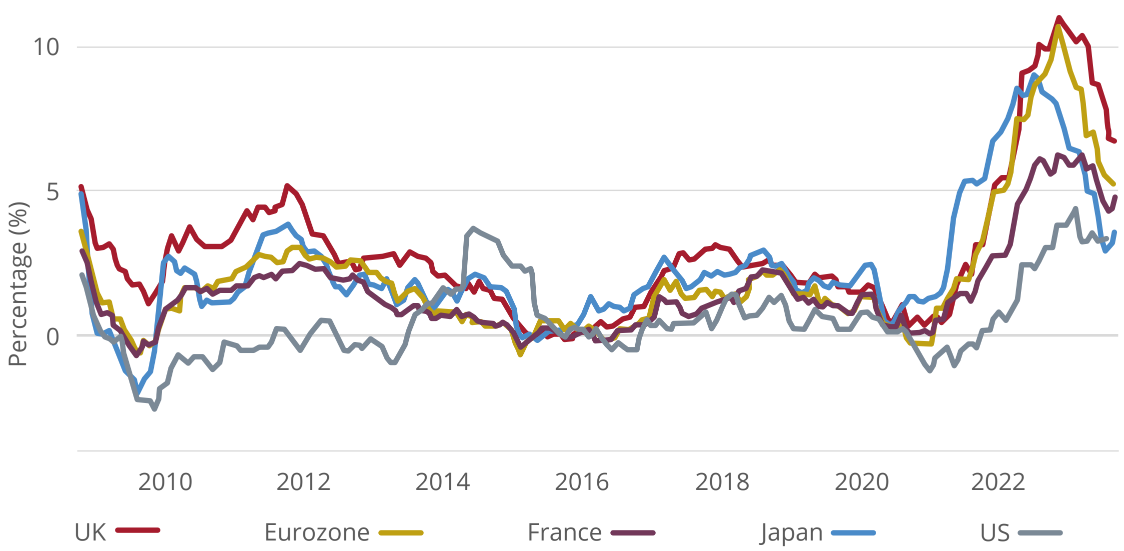
17. Several witnesses suggested that an important factor leading to low rates of inflation was globalisation.[25] Roger Bootle, Chairman at Capital Economics, said: "Global conditions were very favourable to [the Bank's] remit in getting inflation to the target."[26] Stephen D King, Senior Economic Adviser at HSBC, told us that low-cost producers "coming into the world economy with big increases in the effective labour supply of the global economy … created what I would describe as a deflationary tail-wind for the western world."[27] Related to this, Positive Money highlighted demand-side contributions to

22 Written evidence from Radix Big Tent (IBE0004)
23 Q 137 (Dr Raghuram Rajan)
24 Q 76 (Martin Wolf)
25 See for example Q 262 (Kevin Warsh), written evidence from Edward Chancellor (IBE0010), written evidence from Positive Money (IBE0013), Q 197 (Lord Macpherson of Earl's Court)
26 Q 121 (Roger Bootle)
27 Q 245 (Stephen D King)

disinflation, which they argued to be the result of an increasingly casualised workforce and the weakening of trade union strength.[28]

18. Mr King further emphasised that what has been seen in the UK is part of a global phenomenon, and that it is "not quite correct to suggest that the UK uniquely dealt with inflation in a way that was different from other countries".[29] Since the mid-1980s, the UK's inflation performance has been similar to that of many other large industrialised nations[30] (see Figure 4 for an international comparison of CPI since 2010).[31] The Office for National Statistics, having studied 17 countries including the UK, found in November 2022 that "the long period of low inflation between 1990 and 2020, can be recognised as common trends in consumer price inflation".[32] The period of low inflation ended in 2021. As Figure 4 shows, central banks in most developed countries struggled to control rising prices.

Figure 4: Annual percentage change in CPI (UK, Eurozone, France, Japan and US)



Source: 'Global inflation tracker: see how your country compares on rising prices' Financial Times (September 2023): https://www.ft.com/content/088d3368-bb8b-4ff3-9df7-a7680d4d81b2

19. When asked about the success or otherwise of independence, Andrew Bailey, Governor of the Bank of England, told us: "success in a very broad sense is two things. It is the clarity of the primary objectives and the institutional independence that goes with them; in other words, it is the institutional ability to put those objectives into practice."[33]

20. Andrew Griffith MP, Economic Secretary to His Majesty's (HM) Treasury, considered that independence had "been overwhelmingly a positive intervention, and the policy of the Government is absolutely supportive of

28 Written evidence from Positive Money (IBE0013)
29 Q 242 (Stephen D King)
30 Office for National Statistics, 'Global inflation: 1970 to 2022' (November 2022): https://www.ons.gov.uk/economy/inflationandpriceindices/articles/globalinflation/1970to2022 [accessed 3 October 2023]
31 'Global inflation tracker: see how your country compares on rising prices' *Financial Times* (September 2023): https://www.ft.com/content/088d3368-bb8b-4ff3-9df7-a7680d4d81b2
32 Office for National Statistics, 'Global inflation: 1970 to 2022' (November 2022): https://www.ons.gov.uk/economy/inflationandpriceindices/articles/globalinflation/1970to2022 [accessed 3 October 2023]
33 Q 156 (Andrew Bailey)

the continued independence of the Bank, as far as it relates to monetary policy."[34]

21. **Looking at the last 25 years as a whole, operational independence has bolstered economic confidence and credibility in monetary policy making. While the precise contribution of independence to low inflation is difficult to quantify—with globalisation widely considered a contributing factor—the conditions established by independence have provided a strong foundation for low and stable inflation since 1997. It is our view that independence should be preserved.**

The price stability framework

22. As noted above, when Gordon Brown announced the operational independence of the Bank of England in 1997, he set the Bank's new MPC a target of 2.5 per cent. In 2003, Mr Brown modified the inflation target to two per cent expressed in terms of an annual rate of inflation as measured by the 'harmonised' CPI. Explaining the Chancellor's decision, HM Treasury highlighted a paper from the ONS which stated:

> "'[A new global] consensus has helped shape the CPI during its development, meaning that it has some distinct advantages over RPIX as a macroeconomic indicator of inflation … The rate for the new target is ½ a percentage point lower than the old target because of differences in the way that CPI and Retail Prices Index excluding mortgage interest payments (RPIX) inflation are measured."[35]

23. In his Budget speech on 20 March 2013, then Chancellor, the Rt Hon George Osborne, announced the first major changes to the Bank's monetary policy remit since the 2008 financial crisis.[36] Elaborating on the changes to the inflation target,[37] the Chancellor stated: "The new remit explicitly tasks the MPC with setting out clearly the trade-offs it has made in deciding how long it will be before inflation returns to target."[38] The Budget report then emphasised: "Where shocks are particularly large and with persistent effects, the MPC is likely to be faced with more significant trade-offs between the speed with which it aims to bring inflation back to target and the consideration that should be placed on the variability of output."[39]

24. Several witnesses agreed that the framework underpinning the Bank's mandate on inflation, the two per cent inflation target, has proven successful in helping to deliver stable inflation and expectations.[40] Professor Frederic Malherbe, Professor of Economics and Finance at University College

---

34 Q 224 (Andrew Griffith MP)
35 Bank of England, *Annex: The New Inflation Target*: https://www.bankofengland.co.uk/-/media/boe/files/letter/2003/chancellor-letter-annex-101203.pdf [accessed 18 September 2023]
36 Chancellor's Statement, *Oral Statement to Parliament-Budget 2013: Chancellor's Statement* (March 2013): https://www.gov.uk/government/speeches/budget-2013-chancellors-statement [accessed 13 October 2013]
37 'Budget 2013: Changes to BoE remit expand options for activism', *Financial Times* (September 2023): https://www.ft.com/content/2697b1ca-9169–11e2-b4c9-00144feabdc0
38 Chancellor's Statement, *Oral Statement to Parliament-Budget 2013: Chancellor's Statement* (March 2013): https://www.gov.uk/government/speeches/budget-2013-chancellors-statement [accessed 13 October 2013]
39 HM Treasury, Budget 2013 (March 2013), https://assets.publishing.service.gov.uk/media/5a7c523d915d3d0e87b975/budget2013_complete.pdf [accessed 13 October]
40 See for example Q 5 (Prof Frederic Malherbe), Q 41 (Sir John Vickers) and Q 1 (Prof Jagjit Chadha)

London, told us: "The very clear target of 2% inflation helps anchor the discussions and the scrutiny."[41]

25. However, some witnesses suggested that the two per cent inflation target had served to complicate the Bank's financial stability objective during this period.[42] Edward Chancellor, a financial historian, noted that the Bank rate had been set at an all-time low due to disinflation even though this was caused by forces "over which monetary policy had no control" (that is, globalisation).[43] This, Mr Chancellor concluded, had inflated numerous asset price bubbles (housing in particular), corrupted the allocation of capital, lead to undue financial risk-taking (as investors were forced to 'chase for yield') and contributed to the ongoing pensions crisis.[44]

26. When discussing the potential for conflicts in the Bank's objectives (see Chapter 3), witnesses elaborated on alternatives to the two per cent target or the need for greater flexibility over the timeframe in meeting it. Professor Goodhart (one of the architects of the two per cent target given to the Reserve Bank of New Zealand (RBNZ)) told us that two per cent was chosen, in part, to protect the RBNZ from the zero lower bound[45] and that they "thought that 2% was a reasonable level that would satisfy Greenspan's[46] definition of inflation, which was that people would not notice it". However, he noted that with the benefit of hindsight, "considering the extent of disinflation, we would have done better had we set it even lower, at 1% or even 0.5%".[47] This implies that interest rates would have been higher through the period in question, thereby limiting the financial risks alluded to by Mr Chancellor.

27. Roger Bootle also told us that in his view, in the run up to the 2008 financial crisis, "most central banks kept interest rates too low … If you recognise that and that interest rates sometimes have to play a role in restraining the financial sector more generally, you have to permit a certain degree of flexibility with the inflation target."[48]

28. Kevin Warsh, former board member at the US Federal Reserve, advocated more flexibility surrounding the target: "I tend to prefer ranges versus point estimates, in part because of measurement error and in part because I think broad price stability can never be that precise … I broadly think that the precision is what led many of the central banks to overly stimulate economies a few years ago." Mr Warsh added: "When we are thinking about numbers to the right of the decimal point [of the two per cent target], I think we are likely to make a mistake."[49]

29. In view of the UK's presently elevated levels of inflation, discussions about possible changes to the inflation target tended to focus on it being raised. However, witnesses were firmly of the view that there was no case, currently, for making any such modification. Professor Goodhart said that now was

41 Q 5 (Prof Frederic Malherbe)
42 For example, written evidence from Edward Chancellor (IBE0010) and Q 127 (Roger Bootle)
43 Written evidence from Edward Chancellor (IBE0010)
44 *Ibid.*
45 The 'zero lower bound' is the lowest level that interest rates can fall to, Investopedia, 'Zero-Bound: Definition, Purpose, How It Works, Example' (April 2021): https://www.investopedia.com/terms/z/zero-bound.asp [accessed 2 November 2023]
46 Former Chairman of the US Federal Reserve.
47 Q 138 (Prof Charles Goodhart)
48 Q 127 (Roger Bootle)
49 Q 261 (Kevin Warsh)

"the wrong moment to try to change the target … if they were to change the target at this point, it would have a devastating effect on credibility."[50] Stephen D King said that if inflation were four per cent in a year's time, he would be uncomfortable with raising the inflation target at that time.[51] Sir Howard Davies, Chairman at the NatWest Group, considered that "at the zero bound … it might be better to centre the inflation target elsewhere" but added: "The difficulty, of course, is moving from where we are to that without creating expectations of higher inflation that you might not particularly want to create."[52]

30. Andrew Bailey told us: "The 2013 amendments to the framework did give us more flexibility over … how quickly to bring inflation back to target. It cast it in the context of a trade-off … we do, particularly in the current context, spend quite a lot of time focusing on as to how quickly to bring it back to target".[53]

31. In the remit letter for the MPC sent to the Governor on 17 November 2022 (see Chapter 3), the Rt Hon Jeremy Hunt MP, Chancellor of the Exchequer, stated that "to provide certainty, I can confirm that this government will not change the definition of price stability". The letter also said: "Any changes to this remit will be set out in future budgets and the inflation target will be confirmed alongside those events. There is a value in continuity and I will have proper regard to that, but I will always consider the case for a revised target on its merits."[54]

Role of asset prices

32. There has long been debate over whether inflation target mandates should capture movements in asset prices given that their movements can have significant effects on financial and macroeconomic stability.[55] Asset prices include housing/real estate, the value of stocks, bonds, derivatives and others. Some witnesses suggested a more prominent or formalised role for asset prices, in particular housing, in the Bank's monetary policy considerations. Professor Goodhart told us that it was a "great pity that housing does not enter into the CPI … If housing had been included in the CPI [between 2010 and 2020], I think there would have been less pressure for such expansionary policies as were entertained at the time."[56]

33. Edward Chancellor cautioned about distributional effects: "If you inflate asset prices, you benefit those who already own [assets], and you make it that much harder, particularly with housing, for people to get on to the housing ladder … Very low interest rates benefited investors, bankers and private equity people who could borrow at extremely low interest rates to buy assets that were rising in price. I do not think they were of much use to the general public."[57]

50 Q 138 (Prof Charles Goodhart)
51 Q 257 (Stephen D King)
52 Q 134 (Sir Howard Davies)
53 Q 157 (Andrew Bailey)
54 Bank of England, *Remit For The Monetary Policy Committee (MPC)* (November 2022): https://www.bankofengland.co.uk/-/media/boe/files/letter/2022/november/2022-mpc-remit-letter.pdf [accessed 6 November 2023]
55 Bank for International Settlements, *BIS Working Papers—Asset prices, financial imbalances and monetary policy: are inflation targets enough?* (September 2003): https://www.bis.org/publ/work140.pdf [accessed 13 October 2023]
56 Q 139 (Prof Charles Goodhart)
57 Q 66 (Edward Chancellor)

34. Sir Howard Davies suggested that the centre of gravity in the debate over whether central banks should look to temper asset price inflation, as opposed to dealing with the aftermath of any financial boom and bust—the "leaners versus cleaners debate", as he termed it—had shifted towards the "leaners".[58] He stated that "asset prices should be an important input into decision-making—because they can often tell you whether an imbalance is developing in the economy". However, he was not convinced that a target for asset prices is a "feasible proposition".[59]

35. Stephen D King was not certain that a central bank "is better than anyone else at trying to work out whether the valuation of the asset market at any point in time is appropriate or otherwise" and therefore was not in favour of including asset prices in the measure of inflation.[60] Mr King added, however, that he was "a fan of central banks paying attention to asset prices and balance sheets more explicitly than sometimes happens".[61] Writing in the FT, Martin Wolf was of the view that "using monetary policy to target asset prices, rather than merely take them into account, is folly". He considered that it was "not absurd to consider real activity … Happily, inflation-targeting is consistent with making real activity the ultimate goal."[62]

36. **Some witnesses made a case for reviewing the inflation target. While the Chancellor can change the target, the disadvantages of doing so when inflation is above target, outweigh the advantages. This is the case given the potential impact on the Bank's credibility. When inflation is low the Bank should be cautious about the impact of a prolonged period of loose monetary policy on asset prices and financial stability.**

Fiscal and monetary policy mix

37. The relationship between fiscal and monetary policy was a particular point of focus for witnesses. In terms of the conventional relationship, Sir Paul Tucker said: "The Treasury moves first with its fiscal policy and the monetary policymaker moves second. It is important that the regime goals and tools for the monetary policymaker … are completely clear".[63] Sir John Vickers agreed: "Monetary policy decision-makers move with higher frequency. Fiscal policy is an annual event".[64]

38. In his book, *We need to talk about inflation,* Stephen D King referred to the relationship between monetary and fiscal policy as the (Richard) Burton-(Elizabeth) Taylor problem ("occasionally separated but always destined to reconnect".)[65] King argued: "The best way of dealing with Burton-Taylor is to ensure that monetary policy enjoys primacy over fiscal policy … that means … that the central bank should be expected to comment on, and act upon, the monetary implications of any fiscal decision."[66]

58 Q 128 (Sir Howard Davies)
59 *Ibid.*
60 Q 244 (Stephen D King)
61 *Ibid.*
62 'What central banks ought to target', *Financial Times* (2 March 2021): https://www.ft.com/content/160db526-5e8d-4152-b711-21501a7fbd01
63 Q 32 (Sir Paul Tucker)
64 Q 32 (Sir John Vickers)
65 Stephen D King, *We need to talk about inflation* (Yale University Press, New Haven and London, 2023), p 142 (digital)
66 Stephen D King, *We need to talk about inflation* (Yale University Press, New Haven and London, 2023), p 329 (digital)

39. However, prolonged periods of low inflation through much of the independence era have fuelled a debate about a more appropriate policy mix when central banks are obliged to lower interest rates toward their lower bound (and/or introduce quantitative easing).[67] With research showing that low interest rates encourage greater (financial) risk-taking[68] (and with higher interest rates potentially creating strains for debt management) the issue is therefore linked to the relationship between the Bank's inflation and financial stability objectives. This debate has grown particularly since the 2008 financial crisis. *The Economist* wrote in 2009 that the "current crisis suggests that monetary and fiscal policy cannot be driven exclusively by economic fundamentals … When interest rates are low, consumers and businesses … borrow money to buy assets, setting up a feedback loop that can eventually lead to a bubble."[69]

40. Witnesses discussed the inter-relationship between fiscal policy, monetary policy and financial stability when interest rates fall to their lower bound.[70] Roger Bootle considered that the lower bound is "undoubtedly a huge problem".[71] Mr Bootle felt there to be little reason why "one could not have a system under which the central bank was independent … and fiscal policy was bound to come in support" should the zero lower bound be reached.[72] When asked whether this would involve explicit co-ordination of short-term macroeconomic policy between the Bank and HM Treasury, Mr Bootle said: "Yes. In those circumstances that would be required, but I think that would be perfectly possible within the current framework. I do not see how one would need to revise the framework in order to make that possible."[73]

41. Professor Malherbe argued that "In the case of the zero lower bound, indeed, it makes sense then to have the Treasury stimulating the economy. I do not think it goes at all against the fundamental principles that were set [out in the Bank of England Act 1998]."[74] Likewise, Positive Money said that greater coordination [between fiscal and monetary policy] would "enable a more pragmatic (and much improved) approach towards fiscal and monetary policy."[75]

42. Despite support for more coordination, no witness advocated for a formal structure to coordinate monetary and fiscal policy. Sir Howard Davies thought such a structure was "dangerous". He told us: "Making this a structural

67 ECB, 'Pulling together: fiscal and monetary policies in a low interest rate environment' (October 2023): https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp201012~167b6b14de.en.html [accessed 19 September 2023], European Central Bank, 'Unconventional fiscal and monetary policy at the zero lower bound' (February 2021): https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210226~ff6ad267d4.en.html [accessed 19 September 2023], NBER, *Fiscal and Monetary Stabilization Policy at the Zero Lower Bound: Consequences of Limited Foresight* (July 2020): https://www.nber.org/system/files/working_papers/w27521/w27521.pdf [accessed 19 September 2023]

68 CEPR, 'A new take on low interest rates and risk taking' (March 2018): https://cepr.org/voxeu/columns/new-take-low-interest-rates-and-risk-taking [accessed 19 September 2023]

69 'Minsky's moment; Buttonwood' *The Economist* (April 2009): https://advance.lexis.com/document/teaserdocument/?pdmfid=1519360&crid=8f07100e-d331-4057-a905-093a4548f6a4 [accessed 19 September 2023]

70 See for example written evidence from Positive Money (IBE0013). See also Prof Charles Goodhart and Prof Rosa Lastra 'The Changing and Growing Roles of Independent Central Banks now do require a Reconsideration of their Mandate, Accounting, Economics' (27 February 2023): https://eprints.lse.ac.uk/118448/1/10.1515_ael_2022_0097.pdf [accessed 16 October 2023]

71 Q 134 (Roger Bootle)

72 *Ibid.*

73 *Ibid.*

74 Q 4 (Prof Frederic Malherbe)

75 Written evidence from Positive Money (IBE0013)

solution would give a more activist Chancellor a way into Bank decision-making on a continuous basis, which would not be particularly helpful … I am not sure that an institution or a framework is the right solution”.[76]

43. On the relationship between monetary and fiscal policy, Andrew Bailey explained: “[The Chancellor and I] share views on what is going on in the economy and why we think things are happening in the economy, but they are a step back from policy. We do not have trade-off type discussions and that is, I think, a crucial part of our system”.[77] In terms of other forms of communication between the Bank and HM Treasury, Mr Bailey also told us in correspondence that a Treasury representative attends MPC meetings “to ensure that the Committee is fully briefed on fiscal policy developments and other aspects of the Government’s policies, and to keep the Chancellor fully informed about monetary policy.” Beyond this, the MPC relies on the Office for Budget Responsibility’s (OBR) assessment of the impacts of announced tax and spending measures when forming its view on the economic outlook.[78] Mr Bailey had previously told us, following the Truss administration’s September 2022 fiscal statement,[79] that there was no formal communication “of the sort we normally have [from HM Treasury]” which was “quite an extraordinary process”.[80]

44. When asked whether the disinclination to explore the ‘trade-offs’ between monetary and fiscal policy was a missed opportunity, Mr Bailey responded: “I do not think it is. The value of having an independent framework is important and therefore, in a sense, it overrides anything you feel you could get from those conversations.” He considered that “such conversations would quickly undermine the value of independence and the value of the framework.”[81] He also acknowledged that “fiscal policy becomes more of an issue and has more of a profile at the lower bound. That would be natural, if monetary policy were to be constrained in that sense.”[82]

45. Andrew Griffith MP explained:

> “[The] Chancellor, before a fiscal event, will inform the Governor. There is a dialogue between selected officials in the Treasury and the Bank of England about particular moves that they may make on monetary policy. Those fall very far short of not respecting each other’s independence of action within those domains, but do not take from that that there is not a close dialogue and that each person’s action is not informed by an understanding of the other’s.”[83]

46. **The interaction between fiscal and monetary policy requires clear lines of responsibility and effective communication between the Bank and HM Treasury to safeguard overall economic stability. It is important, particularly given the constraints of monetary policy,**

76 Q 134 (Sir Howard Davies)
77 Q 165 (Andrew Bailey)
78 Letter from Andrew Bailey, Governor of the Bank of England, to Lord Bridges, Chair of the Economic Affairs Committee, (12 October 2023): https://committees.parliament.uk/publications/41842/documents/207491/default/ [accessed 30 October 2023]
79 House of Commons Library, September 2022 fiscal statement: A summary, Research Briefing, October 2022
80 Oral evidence taken before the Economic Affairs Committee, Governor of the Bank of England annual scrutiny session, 29 November 2022 (Session 2022–23), Q 9 (Andrew Bailey)
81 Q 165 (Andrew Bailey)
82 *Ibid.*
83 Q 239 (Andrew Griffith MP)

that when interest rates trend towards their zero lower bound HM Treasury promotes a fiscal stance which supports the inflation target it has set the Bank. The Government's fiscal stance and the directions given to the Bank's Monetary Policy Committee must work together. It is the Government's job to ensure they are consistent with each other, not the Bank's.

The impact of quantitative easing

47. Quantitative easing (QE) is a monetary policy tool used to inject money into the economy (via financial intermediaries) through the purchase of 'financial assets', usually government bonds. For example, by lowering yields on bonds of various maturities, QE can, in theory, help to support the economy by stimulating spending, investment and growth.[84] The 2021 Economic Affairs Committee report *Quantitative easing: a dangerous addiction?* pointed to the risks of inflation as a result of an increase in the money supply.[85] Professor Timothy Congdon, Chairman of the Institute of International Monetary Research at the University of Buckingham, told us that "In terms of understanding the latest episode [of high inflation], the quantity theory of money has been very fully vindicated."[86] Concerns about the money supply and inflation were also raised by further witnesses.[87] We cover this point in Chapter 4. Here, we focus on the impact of QE on the operational framework itself.

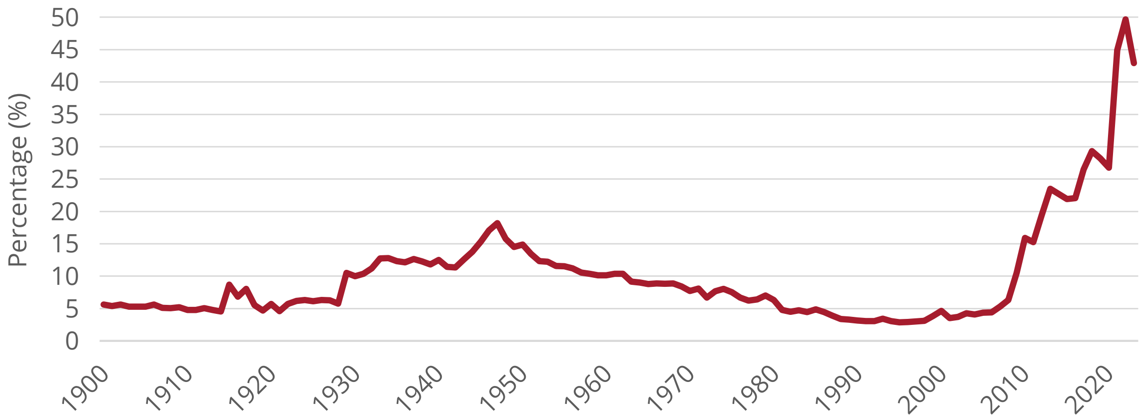
48. In 2009, when it was introduced in the UK, QE was envisaged as a short-term measure to combat a monetary contraction that threatened to reduce sharply the level of demand and output. It also raised the level of liquid assets held by banks. It would provide financial institutions with liquidity and shore-up bond prices and hence, their owner's balance sheets. Over the following decade, the QE programme expanded substantially which contributed to an appreciable increase in the Bank's balance sheet[88] (see Figure 5 which tracks the size of the Bank's balance sheet as a percentage of GDP since 1900).

49. The Bank's QE programme can be split into three broad phases. The first phase between 2009 and 2012, saw the Bank conduct seven rounds of asset purchases, totalling £375 billion by July 2012.[89] The second phase from August 2016 saw the Bank purchase a further £70 billion of asset purchases in response to market uncertainty following the UK's vote to leave the European Union.[90] The third phase of QE was launched in response to the COVID-19 pandemic. For this phase, the Bank announced three rounds of asset purchases in March, June and November 2020, totalling £450 billion in Government bonds and £10 billion in non-financial investment-grade corporate bonds—broadly equivalent to the assets purchased in the first

84 Economic Affairs Committee, *Quantitative Easing: A dangerous addiction?* (First report, Session 2021–22, HL 42). The Report and the inquiry examined the intended and unintended consequences of QE.
85 *Ibid.*
86 Q 99 (Prof Timothy Congdon)
87 See for example: Q 122 (Roger Bootle), Q 99 (Prof Timothy Congdon) and Q 80 (Martin Wolf)
88 Economic Affairs Committee, *Quantitative Easing: A dangerous addiction?* (First report, Session 2021–22, HL 42).
89 House of Commons Library, Quantitative Easing, Debate Pack, CDP 2016/0166, September 2016, p4
90 Bank of England, *Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 3 August 2016* (4 August 2016): https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-summary-and-minutes/2016/august-2016.pdf [accessed 18 September 2023]

two phases of QE combined.[91] It is estimated that the Bank's balance sheet reached a record high of just under 50 per cent of GDP in February 2022.[92]

Figure 5: Bank of England: Combined Balance Sheet (percent of nominal GDP)



Source: Bank of England, 'Research datasets' (September 2023): https://www.bankofengland.co.uk/statistics/research-datasets *[accessed 15 November 2023]. The combined balance sheet data refers to the end of February of each year expressed as a percentage of nominal GDP in the previous calendar year.*

50. Christina Skinner, Professor of Legal Studies and Business Ethics at the University of Pennsylvania, told us that in 2020 the QE programme looked a lot like monetary finance. She added: "In 2022, we have QE that looks like it is giving an assist to the Government … In both those cases, we see a world in which QE is blurring the line between monetary and fiscal policy."[93]

51. However, in its 2021 report into QE, the Economic Affairs Committee concluded that QE had made the Bank of England and HM Treasury policymaking more interdependent, blurring monetary and fiscal policy, which had eroded perceptions of the Bank acting independently of political considerations.[94] It highlighted that the "Bank may come under political pressure not to raise interest rates to control inflation because the risk to the public finances and debt sustainability would have increased significantly." The report added that if scepticism of the Bank's stated reasons for QE

---

91 Bank of England, *Minutes of the special Monetary Policy Committee meeting on 19 March 2020 and the Monetary Policy Committee meeting ending on 25 March 2020* (26 March 2020): https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-summary-and-minutes/2020/march-2020.pdf [accessed 18 September 2023], see also Bank of England, *Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 17 June 2020* (18 June 2020): https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-summary-and-minutes/2020/june-2020.pdf [accessed 18 September 2023] and Bank of England, *Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 4 November 2020* (5 November 2020): https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-summary-and-minutes/2020/november-2020.pdf [accessed 1 September 2023]

92 Estimates are calculated using the Bank's combined balance sheet figures (see Bank of England, 'Bank of England Annual Report and Accounts—2023' (July 2023): https://www.bankofengland.co.uk/annual-report/2023 [accessed 30 October 2023], adjusted by the latest, preceding nominal GDP figures, Office for National Statistics, 'Gross Domestic Product at market prices: Current price: Seasonally adjusted £m' (September 2023): https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/ybha/ukea [accessed 30 October 2023]

93 Q 117 (Prof Christina Skinner)

94 Economic Affairs Committee, *Quantitative easing: a dangerous addiction?* (First report, Session 2021–22, HL 42, Para 182)

were to continue to spread, "the effectiveness of the Bank's policies will be threatened severely".[95]

52. Kevin Warsh elaborated on the potential blurring of fiscal and monetary decisions in the era of QE, by emphasising that an ideal balance sheet is one that is no bigger than necessary to "conduct the core business of monetary policy".[96] He said that it is not ideal for central bankers to have to think about fiscal policy, which he considered to be "a blurring of lines and a blurring of responsibilities."[97]

53. As also noted in the 2021 Economic Affairs Committee's report, QE has served to shorten the overall 'duration' of the Government's liabilities.[98] Professor Goodhart told us that in view of historically low interest rates in the decade or so after the 2008 financial crisis, "shortening the duration of debt was … exactly the wrong thing to do. If interest rates are historically as low as they can ever get, you ought to lengthen the duration of debt."[99] As Professor Goodhart told us in 2021, therefore, shortening the duration constituted a "massive gamble that inflation—and, therefore, interest rates—will remain low for a very long time".[100] Professor Goodhart also observed that "The money supply as a result of QE and these purchases has been rising at rates in America that were equalled only during wartime."[101]

54. Stephen D King has written that QE reduced "the ability of government bond markets … to provide 'early-warning signals' of a potential inflationary shock."[102]

55. Andrew Griffith MP disagreed that QE had compromised the Bank's independence by blurring the lines between fiscal and monetary policy. He said:

> "The fact that the Government put an indemnity in place is true,[103] but that indemnity did not relitigate the governance arrangements over

95 *Ibid.*

96 There is evidence to suggest that when managing a large and/or growing balance sheet, a central bank's view on the suitable path for interest rates can be influenced increasingly by the need to manage its holdings of assets rather than to address inflation (see Federal Reserve Bank of St Louis, 'Central Bank Balance Sheets and Policy Rate Decisions' (May 2023): https://www.stlouisfed.org/publications/regional-economist/2023/may/central-bank-balance-sheets-policy-rates [accessed 2 November 2023]. Related to this, if a government is growing a sizeable deficit, there is a risk that central bank policy is directed increasingly at managing this debt (see 'fiscal dominance' and 'financial repression'—Nasdaq, 'Terms You Should Know: Financial Repression and Fiscal Dominance' (August 2020): https://www.nasdaq.com/articles/terms-you-should-know%3A-financial-repression-and-fiscal-dominance-2020–08-11 [accessed 2 November 2023]

97 Q 265 (Kevin Warsh)

98 Duration measures the price sensitivity of debt to changes in interest rates; Economic Affairs Committee, *Quantitative easing: a dangerous addiction?* (First report, Session 2021–22, HL 42)

99 Q 149 (Prof Charles Goodhart)

100 Oral evidence taken before the Economic Affairs Committee, inquiry on quantitative easing, 16 March 2021 (Session 2021–22), Q 94 (Prof Charles Goodhart)

101 *Ibid.*

102 Stephen D King, *We need to talk about inflation* (Yale University Press, New Haven and London, 2023), p 142 (digital)

103 The 'Deed of Indemnity' between HM Treasury and the Bank of England is a contractual document which sets out the taxpayer's liability to cover any financial losses suffered by the Bank as a result of QE. See Economic Affairs Committee, *Quantitative easing: a dangerous addiction?* (First report, Session 2021–22, HL 42, p4). As of November 2023, the Deed of Indemnity is yet to be published by the Government.

monetary policy. The indemnity was not saying, 'In return for providing it, the Treasury will reach in and dictate monetary policy for you'".[104]

'Deed of Indemnity'

56. In its 2021 QE report, the Economic Affairs Committee recommended that the 'Deed of Indemnity' be published and subject to public scrutiny. The 'Deed of Indemnity' is the contractual document between HM Treasury and the Bank of England's Asset Purchase Facility (APF) which commits the taxpayer to paying any financial losses suffered by the Bank that might result from the QE programme. Andrew Bailey told us that he did "not see anything in it when I read it that I think would excite people if it were published, but it is not my decision—it is the Treasury's".[105] The then Chancellor, the Rt Hon Rishi Sunak MP, refused to make the document public without explaining why.[106]

57. Dr Will Bateman, an Associate Professor at the Australian National University, had stated that the "secrecy" of the document is an "extraordinary feature of the UK's quantitative easing programme".[107] Lord Macpherson of Earl's Court, who was Permanent Secretary to HM Treasury when the 'Deed of Indemnity' was agreed, said that they had been focused on being as transparent as possible at the time, and hoped that it would be published to "add to the sum of human knowledge and therefore create a better debate."[108]

58. Noting the former Chancellor's decision to not publish the 'Deed of Indemnity', Andrew Griffith MP informed us in correspondence:

> "This decision has been consistent since [the] start of the Asset Purchase Facility (APF) on account of market and commercially sensitive information in the deed, for example details relevant to the Government's cash management operations. HM Treasury indemnifies the APF which means that any losses or gains from the APF accrue to HM Treasury. This is public knowledge and the publication of the deed of indemnity will not advance the public's understanding of that arrangement".[109]

59. **Quantitative easing was a powerful tool with which to combat a monetary contraction in the aftermath of the 2008 financial crisis, but its continued deployment has blurred the lines between monetary and fiscal policy. While the quantum of quantitative easing is a monetary policy decision, decisions on debt duration have consequences for debt management. In light of the concerns raised about debt duration and the effects of quantitative easing, the Bank and the Debt Management Office (which is an agency of HM Treasury) should draw up and publish a memorandum of understanding which clarifies how the**

104 Q 234 (Andrew Griffith MP)
105 Oral evidence taken before the Economic Affairs Committee, inquiry on quantitative easing, 18 May 2021 (Session 2021–22), Q 189 (Andrew Bailey)
106 Letter from the former Chancellor of the Exchequer to the Chair of the Economic Affairs Committee (2 July 2021): https://committees.parliament.uk/publications/6609/documents/71318/default/
107 Written evidence from Dr Will Bateman (QEI0017)
108 Oral evidence taken before the Economic Affairs Committee, inquiry on quantitative easing, 27 April 2021 (Session 2021–22), Q 169 (Lord Macpherson of Earl's Court)
109 Letter from Andrew Griffith MP, Economic Secretary at HM Treasury to the Chair of the Economic Affairs Committee (24 July 2023): committees.parliament.uk/publications/41220/documents/202667/default/

interaction between monetary policy and debt management should operate.

60. **In addition, although there are differing views about the impact of quantitative easing, the Bank of England should give prominence to the study and reporting of the potential economic risks arising from any significant expansion in its balance sheet resulting from an extended quantitative easing policy.**

61. **We repeat the call that the Government should publish the 'Deed of Indemnity'.**

CHAPTER 3: THE BANK'S REMIT

Evolution of the Bank's remit

62. The Bank's remit consists of statutory objectives, functions and powers. These have expanded substantially over the last 25 years, which we cover below (for an overview of the layers of the Bank's remit, see Appendix 3).

63. As mentioned in Chapter 2, the Bank of England Act 1998 granted the Bank its operational independence in the conduct of monetary policy with the primary objective of price stability.[110] Subject to that primary objective, the MPC was required, as a secondary objective, "to support the Government's economic policy, including its objectives for growth and employment". This was also set out in the Chancellor's first annual remit letter to the MPC of 12 June 1997.[111]

64. Gordon Brown announced in Parliament on 20 May 1997 that the Bank would retain responsibility for the stability of the financial system as a whole[112] (following a letter Mr Brown sent to the Governor on 6 May 1997 setting out the new monetary policy framework).[113] However, the supervision of individual banks was subsequently transferred to a new body—the Financial Services Authority (FSA).[114]

65. Following the 2008 financial crisis and the publication of the House of Commons Treasury Committee report *The run on the Rock*,[115] the Government sought to address a number of "operational failings" by reforming the UK's financial regulatory framework. This led to a marked increase in the Bank's remit, with new statutory objectives as well as functions.[116]

66. The Banking Act 2009 provided that the Bank of England would become the UK's Resolution Authority.[117] The Financial Services Act 2012 then formally established the new Financial Policy Committee (FPC) in the Bank with a primary objective of financial stability (to identify, monitor and address

---

110 The Chancellor had set out the new framework in a letter to the Governor of the Bank of England, 'The New Monetary Policy Framework' of 6 May 1997 https://www.bankofengland.co.uk/-/media/boe/files/letter/1997/chancellor-letter-060597 [accessed 18 September 2023]. In this letter the Chancellor stated that the monetary policy objective of the Bank of England would be to deliver price stability as defined by the Government's inflation target.

111 Bank of England, Remit For The Monetary Policy Committee (June 1997): https://www.bankofengland.co.uk/-/media/boe/files/letter/1997/chancellor-letter-120697.pdf [accessed 2 November 2023]

112 HC Deb, 20 May 1997, col 510 [Commons Chamber]

113 Bank of England, 'Letter from the Chancellor to the Governor-May 1997' (May 1997): https://www.bankofengland.co.uk/letter/1997/chancellor-letter-060597 [accessed 18 September 2023]; Bank of England, 'The Bank of England Act' (June 1998): https://www.bankofengland.co.uk/quarterly-bulletin/1998/q2/the-bank-of-england-act [accessed 18 September 2023]

114 Originally named the Securities and Investment Board, it was later renamed to the Financial Services Authority (FSA). See also Financial Services and Markets Act 2000.

115 Treasury Committee, *The run on the Rock (Fifth Report, Session 2007–08, HC 56–1)*

116 HM Treasury, *A new approach to financial regulation: judgement, focus and stability*, Cm 7874 (July 2010): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/81389/consult_financial_regulation_condoc.pdf [accessed 18 September 2023]

117 HM Treasury, *Banking Act 2009: special resolution regime code of practice* (December 2020): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945165/SRR_CoP_December_2020.pdf [accessed 25 September 2023]. This ensured the Bank would have responsibility for managing the failure of a bank, building society or central counterparty, Bank of England, 'Resolution' (October 2023): https://www.bankofengland.co.uk/financial-stability/resolution [accessed 2 November 2023].

systemic risks via 'macro-prudential' policy),[118] and a secondary objective to support the economic policy of the Government, including its objectives for growth and employment. As with the MPC, this was outlined in the Chancellor's first annual remit and recommendations letter to the FPC of 10 April 2013.[119]

67. The Act also established the Prudential Regulation Authority (PRA), with a general objective of promoting the safety and soundness of PRA-authorised firms (micro-prudential supervision) and an insurance objective of protecting policy-holders[120] (for an overview of the UK's regulatory architecture, with a focus on the Bank of England, see Appendix 7). The Bank of England and Financial Services Act 2016 subsequently created the PRC to exercise "the Bank's functions as the Prudential Regulation Authority" and make its most important decisions.[121]

68. When discharging its functions the PRA must act in a way that advances the following secondary objectives: the competition objective, and the international competitiveness and growth objective; and it must also apply the regulatory principles set out in legislation.[122] The Financial Services and Markets Act (FSMA) 2023 introduced the international competitiveness and growth objective and added a new regulatory principle: "the need to contribute towards achieving compliance with Section 1 of the Climate Change Act 2018 (UK net zero emissions target)."[123] In addition, the Act establishes a new regulatory regime on Financial Market Infrastructures (FMIs),[124] which the Bank supervises, and it establishes a new FMI committee in the Bank, whose primary objective is to protect and enhance UK financial stability, and whose secondary objective is to facilitate innovation in the provision of FMI services (see Appendix 7).[125]

69. As referred to above, and as required by the Bank of England Act 1998, the Chancellor sends remit and recommendation letters to the Governor for the Bank's policy committees (the MPC, FPC and PRC).[126] Through these letters, the Chancellor outlines a series of matters for the Bank to consider or have regard to, which also specify the Government's economic policy to be supported (the secondary objectives of the MPC and FPC). The MPC is

118 Financial Services Act 2012. Though it was formally established by law with the entry into force (in 2013) of the Financial Services Act 2012, the FPC was created in 2011. Bank of England, 'Financial Policy Committee' https://www.bankofengland.co.uk/about/people/financial-policy-committee [accessed 10 November 2023].

119 Bank of England, 'Remit and recommendations for the Financial Policy Committee—April 2013' (April 2013): https://www.bankofengland.co.uk/letter/2013/fpc-remit-letter-april-2013 [accessed 2 November 2023]

120 Financial Services Act 2012, see also Bank of England, Paul Tucker, 'Macro and Microprudential supervision' (29 June 2011): https://www.bankofengland.co.uk/speech/2011/macro-and-mircoprudential-supervision-speech-by-paul-tucker [accessed 18 September 2023].

121 Bank of England and Financial Services Act 2016 and Bank of England, *Terms of Reference for the Prudential Regulation Committee* (August 2023): https://www.bankofengland.co.uk/-/media/boe/files/about/prc/prctermsofreference.pdf [accessed 2 November 2023]

122 Section 3B, Financial Services and Markets Act 2000

123 Financial Services and Markets Act 2023

124 Bank of England, 'Financial market infrastructure supervision' (October 2023): https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision [accessed 2 November 2023]

125 Financial Services and Markets Act 2023

126 Bank of England Act 1998

also expected to have regard to the policy actions of the FPC, and vice versa.[127] The number of matters outlined in these letters has increased over the years. As an example, the FPC remit and recommendations letter of 2022 sets out that the Committee should act with a view to supporting the Government's strategy for financial services, with particular focus on a range of matters including "Climate change and energy security"[128] (for an overview of the remits and recommendations for the Bank's policy committees, see Appendix 4). This report was finalised before the latest remit and recommendation letters for the MPC and FPC were published on 22 November 2023.

70. The general expansion of the Bank's remit has included a particular focus on stipulations to support Government policy on climate change. The Bank of England has implemented a range of measures in this regard: from "greening" the corporate bonds purchase scheme (MPC) to incorporating climate-related risk metrics into credit risk methodologies (PRA) and a host of other measures.[129] In 2021, the Bank unveiled its first ever stress test to scrutinise the resilience of Britain's biggest banks and insurers against climate change risks over the next thirty years (FPC and PRA).[130]

71. Other central banks have also seen their remits expand over the past two decades.[131] The first central bank to adopt a simple inflation target, the RBNZ, was mandated in 2021 to take into account house prices when setting monetary policy.[132] Central banks around the world are adopting different approaches with regard to climate change and sustainability generally.[133] As of June 2023, the Network for Greening the Financial System—a network of central banks sharing best practice in the development of climate risk management—had 127 members.[134]

Justification for extended remits

72. Some witnesses questioned the purpose of the secondary objectives and the justification for the extended remit letters. Chris Giles, Economics Editor at the FT, told us that it was "hard to find examples of specific policies in the MPC, for example, where you ... can … pinpoint a monetary policy decision

---

127 Bank of England, *Remit For The Monetary Policy Committee (MPC)* (November 2022): https://www.bankofengland.co.uk/-/media/boe/files/letter/2022/november/2022-mpc-remit-letter.pdf [accessed 6 ovember 2023]

128 Bank of England, 'Remit and recommendations for the Financial Policy Committee—November 2022' (November 2022): https://www.bankofengland.co.uk/letter/2022/november/fpc-remit-2022 [accessed 2 November 2023]

129 Bank of England, 'The Bank of England's climate-related financial disclosure 2021' (June 2021): https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/climate-related-financial-disclosure-2020–21 [accessed 10 November 2023]. See generally Bank of England, 'Climate Change': https://www.bankofengland.co.uk/climate-change [accessed 16 November 2023]

130 Bank of England, 'Key elements of the 2021 stress test' (January 2021): https://www.bankofengland.co.uk/news/2021/january/key-elements-of-the-2021-stress-test [accessed 10 November 2023]

131 The Economist, 'The perils of asking central banks to do too much', (March 2021): https://www.economist.com/finance-and-economics/2021/03/13/the-perils-of-asking-central-banks-to-do-too-much [accessed 18 September 2023]

132 The Economist, 'The perils of asking central banks to do too much' (March 2021): https://www.economist.com/finance-and-economics/2021/03/13/the-perils-of-asking-central-banks-to-do-too-much [accessed 18 September 2023], Brookings, 'Why is the NZ government telling its central bank to focus on rising house prices?' (April 2021): https://www.brookings.edu/articles/why-is-the-new-zealand-government-telling-its-central-bank-to-focus-on-rising-house-prices/ [accessed 18 September 2023]

133 Rosa Lastra and Christina Skinner, 'Sustainable Central Banking', *Virginia Journal of International Law*, vol. 63.3, (2023): https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4287729

134 NGFS, 'Membership' (June 2023): https://www.ngfs.net/en/about-us/membership [accessed 17 October 2023]

that was taken on the basis of the secondary objective … That then suggests that the secondary objective is redundant."[135] Mr Giles noted that "quite a lot of the additional text [since the initial 1997 remit] is simply flab" which required a "good editor".[136] Sir John Vickers, former Chief Economist at the Bank, agreed. He told us: "I like the Crick and Watson test … their paper explaining the structure of DNA … is fewer than 900 words. It ought to be possible to explain the remit of the Bank of England committee no less succinctly".[137] George Osborne commented: "[We] do not have to turn these letters into Christmas trees where you put all your baubles on them. It should be straightforward enough to say, as a secondary objective, supporting the Government's economic policy and then the Government should be able to articulate their economic policy so the Bank knows what it is."[138]

73. Several witnesses believed that some, if not all of the Bank's secondary objectives were unsuited to the tools at its disposal and could be more effectively pursued by the Government.[139] The Rt Hon Ed Balls, who was Economic Adviser to Gordon Brown and then Shadow Chancellor, said: "The idea that you start to throw in to the mix other secondary objectives which are not really directly affected sensibly by the instrument that the Bank has in front of it … concerns me."[140] According to Mr Balls, the Government should be clear that tackling climate change is a matter for the Government and that to "start expecting the Bank to lead on that does not seem, to me, to make any sense."[141] Professor Malherbe told us that while he thought climate change is "extremely important", it was hard to consider it a "natural mandate for a central bank."[142]

74. Professor Goodhart had "considerable doubts about the value or worth of including other objectives, like green, hitting net zero or … inequality." While he considered these issues important, he was of the view that they should be dealt with by another body and not the Bank of England.[143] Chris Giles said: "This is a government responsibility primarily, and it would be much better for it to stay as such."[144]

Consequences of extended remits

Doing too much?

75. Professor Jagjit Chadha, Director at the National Institute of Economic and Social Research, considered that the Bank is perhaps being asked to do too much, and "that might mean others are running away from the responsibilities for doing those things."[145] Sir Howard Davies similarly stated that he had "a sense that politicians would like to push [technical environmental standards, for example] on to the central bank because it is in the 'too difficult' box, politically."[146]

135 Q 22 (Chris Giles)
136 *Ibid.*
137 Q 33 (Sir John Vickers)
138 Q 47 (Rt Hon George Osborne)
139 See for example Q 47 (Rt Hon Ed Balls), Q 125 (Roger Bootle), Q 265 (Kevin Warsh)
140 Q 47 (Rt Hon Ed Balls)
141 *Ibid.*
142 Q 3 (Prof Frederic Malherbe)
143 Q 145 (Prof Charles Goodhart)
144 Q 22 (Chris Giles)
145 Q 2 (Prof Jagjit Chadha)
146 Q 125 (Sir Howard Davies)

76. Although he was supportive of action on climate change and a limited role for the FPC in that regard, Andreas Dombret, former board member at the Deutsche Bundesbank, said that additional objectives make it more difficult for a central bank to pursue its price stability mandate.[147] Sir Paul Tucker argued that when "senior staffers and senior policymakers are making speeches about other things there is a significant opportunity cost"[148] and Sir John Vickers argued that it "dilutes the sense that they are focused on inflation control."[149]

77. By contrast, Professor Ricardo Reis, A.W. Phillips Professor of Economics at the London School of Economics, considered that there was "no smoking gun evidence that [the expanded remit] has distracted [the Bank] or shifted its monetary policy."[150] Donald Kohn, former Financial Policy Committee member at the Bank, stated that at "no time in my 10 years on the committee did I sense that the secondary objective steered us away from the primary objective."[151]

Risks to independence

78. Many economists have argued that expanded remits can pose a risk to a central bank's political neutrality and hence, independence. During the Economic Affairs Committee's 2021 inquiry into QE, Otmar Issing argued that "Central Banks are overburdened with objectives and excessive expectations" and he warned that "Central banks have come closer to political decisions during the financial crisis and now in the context of the pandemic."[152] Stephen D King told us that "giving the central bank more objectives, when it is supposed to be independent, forces it to make changes or decisions that expose it to understandably greater political and media interest."[153] When asked whether the Bank of England was being politicised in such a way, Roger Bootle said: "I think the short answer is yes. I would argue that, although the various [secondary objectives] referred to are worthy objectives, most of them are better catered for by government".[154]

Conflicting objectives

79. Another area of concern highlighted by economists is the potential for conflicting objectives stemming from a central bank's increased responsibilities. Dr Ana Carolina Garriga, Reader at the University of Essex, emphasised that the Bank's multiple objectives, including its secondary objectives of supporting the Government's economic policy, pose risks:

> "With limited instruments, and without explicit hierarchy of objectives—particularly between price and financial stability—and with independent committees involved in the decision-making process, it is possible that these multiple objectives demand contradictory uses of the same instrument. In those cases, conflict regarding the best course

147 Q 69 (Andreas Dombret)
148 Q 34 (Sir Paul Tucker)
149 Q 34 (Sir John Vickers)
150 Q 22 (Prof Ricardo Reis)
151 Q 85 (Donald Kohn)
152 Oral evidence taken before the Economic Affairs Committee, inquiry on quantitative easing, 27 April 2021 (Session 2021–22), Q 172 (Otmar Issing)
153 Q 250 (Stephen D King)
154 Q 125 (Roger Bootle)

of action may delay actions, lead to suboptimal decision, and obscure accountability”.[155]

80. The potential for conflicts between price and financial stability objectives, in particular, has been widely discussed within the central bank community. Axel Weber, former President of the Deutsche Bundesbank, said in 2015 that inflation targeting “Does not take into account the financial cycle, and thus produces excessively expansionary and asymmetric monetary policy … Central banks’ exclusive focus on consumer prices may [even undermine] the efficient allocation of capital and [foster] mal-investment”.[156] William R White, former Chief Economist at the Bank for International Settlements (BIS) said in 2006 that lower interest rates induce investors to purchase increasingly risky assets and to use increased leverage to raise rates of return on equity. Such behaviour, Mr White noted, becomes “manifest in reductions in risk premia on lower-rated paper and sovereigns.”[157]

81. David Roberts, Chair of the Court of Directors at the Bank, said that “organisations work at their best when they have clarity and simplicity of objectives and goals … there are 31 ‘have regards’ or something close to that in the PRC. I have a lot of sympathy with the view that there is a time to stand back, look at it and have a view.”[158]

82. Andrew Bailey told us: “we must always view the objectives through the lens of the primary objective. When we have regard to other things, it should be through the lens of the primary objective”.[159] Mr Bailey also said that “[climate change] is not really an issue of monetary policy. You can think about how the economy will evolve in the future and what the climate is going to do to it, but it is not an issue in current policy setting”.[160]

83. Nevertheless, Mr Bailey conceded that secondary objectives are not without cost:

> “[The growth in the Bank’s remit] certainly creates more work … To take the … PRC—whether it is 31 going to 25 “have regards”, the staff have to spend time on them and we, as policymakers, have to spend time … It makes policy-making more complicated”.[161]

84. Andrew Griffith MP told us: “there is no ambiguity about the primary objective; indeed, labelling it the primary objective is a helpful feature, so that should resolve some of that ambiguity”.[162] He stated that the “objective of some of the secondary objectives is to try to inform and give the Bank some sort of weight to what the other important public policy objectives of the Government of the day are.”[163]

---

155 Written evidence from Dr Ana Carolina Garriga (IBE0019)
156 World Economic Forum, ‘Why we need to rethink inflation targeting’ (June 2015): https://www.weforum.org/agenda/2015/06/why-we-need-to-rethink-inflation-targeting/ [accessed 19 September 2023]
157 SSRN, ‘Is Price Stability Enough?’ (April 2006): https://papers.ssrn.com/sol3/papers.cfm?abstract_id=900074 [accessed 19 September 2023]
158 Q 191 (David Roberts)
159 Q 162 (Andrew Bailey)
160 *Ibid.*
161 Q 163 (Andrew Bailey)
162 Q 228 (Andrew Griffith MP)
163 *Ibid.*

85. **It is concerning that the Bank's remit has expanded considerably in terms of statutory objectives, functions, regulatory principles and matters to which it should 'have regard' and 'consider', in order to support the Government's economic policy. This jeopardises the Bank's ability to prioritise price and financial stability; risks drawing it into the Government's wider policy agenda; and increases the potential for conflict between the Bank's objectives. We recommend that the number of matters the Bank should 'have regard to' or 'consider', as set out in the policy committee remit and recommendation letters, be pruned by HM Treasury to ensure the Bank can focus on its primary objectives of maintaining price and financial stability.**

Implications for the Bank's management

86. The expansion of the Bank's remit and responsibilities, in particular following the creation of the PRA and PRC (see Appendix 3) has been reflected in changes to its management structure and in the rise in its headcount.[164] The Bank's overall headcount has grown from 1,904 employees in 2010 to 5,239 in 2023.[165] The number of Executive Director roles, which sit under Governor and Deputy Governor level, increased from 11 to 20 between 2013 and 2023.[166]

87. There has also been an increase in the number of Deputy Governors: the Bank of England Act 1998 increased the number of Deputy Governors from one to two, creating a Deputy Governor for Financial Stability and a Deputy Governor for Monetary Policy.[167] The Financial Services Act 2012 increased the number to three, with a new Deputy Governor for Prudential Regulation.[168] The Bank of England and Financial Services Act 2016 created a further Deputy Governor for Markets and Banking.[169]

88. Witnesses were of the view that four Deputy Governors is too many.[170] Sir John Vickers told us: "Four deputy governors seems more than the ideal number … Of course, in the very old days, before supervision was taken away from the Bank, it had one deputy governor. It did everything with one. I suppose this is another manifestation of inflation."[171]

89. George Osborne had "great respect for all the current incumbents" but considered that there may be too many and suggested creating a hierarchy amongst the Deputy Governors.[172] On this latter point, Sir Paul Tucker said: "I would move to a system with a senior deputy governor… In such a one-on-four or one-on-three organisation, only one person—the governor of

164 Written evidence from Bank of England (IBE0022)

165 Note that the headcount figures were correct as of February in each respective year: Bank of England, Annual Report 2010, p36 (May 2010): https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2010/boe-2010.pdf [accessed 30 October 2023], Bank of England, Annual Report and Accounts, p164 (February 2023): https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2023/boe-2023.pdf [accessed 30 October 2023].

166 Written evidence from Bank of England (IBE0022). The numbers are correct as of February each year, as per the Annual Report process.

167 Bank of England Act 1998

168 Financial Services Act 2012

169 Bank of England and Financial Services Act 2016

170 See for example, Q 202 (Lord Macpherson of Earl's Court) and Q 7 (Prof David Aikman)

171 Q 42 (Sir John Vickers)

172 Q 47 (Rt Hon George Osborne)

the day—is invested all the time in the whole organisation, including back offices, finance, IT, et cetera. That concentrates power too much."[173]

90. When discussing the increase in the number of Deputy Governors since independence was granted, Andrew Bailey told us:

> "The responsibilities of the Bank in those days were rather different from now … Each of the deputy governors runs quite a large area of the Bank and that is important. There are of course important parts of the Bank that are not within the statutory policy. We run part of the critical national infrastructure in payments, for instance."[174]

91. Andrew Griffith MP had "dealt with most of [the Deputy Governors] and they all wear different hats with different responsibilities." He was of the view that "there are a lot of different mandates the Bank has to discharge. I would not fundamentally start by thinking we need to reduce the number."[175]

92. **The expansion of the Bank's remit has led to a rise in the Bank's headcount and to an expansion of its management structure, resulting in four Deputy Governors and a significant number of Executive Directors. This expansion, particularly in relation to regulation, risks downplaying the importance of monetary policy amongst the leadership and staff of the Bank. We recommend that the Bank's management structure be reconsidered, with a focus on whether it could be made more streamlined.**

A central bank digital currency

93. In addition to the Bank's expanding remit, the Bank and HM Treasury are considering the introduction of a digital pound—a prospect that received a mixed reaction from some witnesses.[176]

94. In a joint consultation paper *The digital pound: a new form of money for households and businesses*, published in February 2023, HM Treasury and the Bank said:

> "A digital pound would be a retail central bank digital currency (CBDC)—digital money for use by households and businesses for their everyday payments, issued by the central bank, the Bank of England. The Bank of England (the Bank) and His Majesty's Treasury (HM Treasury) plan to accelerate our work on the technology and policy architecture for a digital pound. A significant factor in determining whether the digital pound is needed will be how the payments landscape evolves in coming years, both in the UK and abroad."[177]

95. Nonetheless, in a discussion paper, *Central Bank Digital Currency: Opportunities, challenges and design*, published in March 2020, the Bank acknowledged that

---

173 Q 42 (Sir Paul Tucker)
174 Q 171 (Andrew Bailey)
175 Q 236 (Andrew Griffith MP)
176 HM Treasury, 'HM Treasury and Bank of England consider plans for a digital pound' (February 2023): https://www.gov.uk/government/news/hm-treasury-and-bank-of-england-consider-plans-for-a-digital-pound [accessed 19 September 2023], See for example Q 96 (Martin Wolf) Q 96 (David Kohn), Q 119 (Prof Christina Skinner) Q 119 (Prof Timothy Congdon), Q 74 (Edward Chancellor) Q 74 (Andreas Dombret)
177 Bank of England and HM Treasury, 'The digital pound: a new form of money for households and businesses?' (February 2023): https://www.bankofengland.co.uk/-/media/boe/files/paper/2023/the-digital-pound-consultation-working-paper.pdf [accessed 2 October 2023]

a CBDC could present challenges for maintaining monetary and financial stability and "would need to be very carefully designed if it were to be introduced."[178] The UK is not alone in considering the introduction of a digital currency—the European Commission published a legislative package for the adoption of the digital euro in June 2023.[179]

96. Professor Skinner alerted us to a number of potential issues with a CBDC:

> "The introduction of a retail CBDC would certainly diminish or call into question the Bank's independence … If it does increase liabilities on the balance sheet, the question is what the central bank is going to buy in terms of assets to match those liabilities … If the central bank is going to buy more gilts, does that create more opportunity for pressure to engage in monetary finance? If the central bank is going to buy corporate bonds, that invites the opportunity for pressure to engage in politically motivated credit allocations. That seems like a lose-lose on both fronts."[180]

97. In its 2022 report *Central bank digital currencies: a solution in search of a problem?*, the Economic Affairs Committee argued that the case for a CBDC in the UK was far from clear. It added that "While there are design options that would provide some privacy safeguards, technical specifications alone may be insufficient to counter public concern that a government might use a CBDC as an instrument for state surveillance." It concluded, therefore, that "The Bank risks being drawn into controversial debates on privacy, which could undermine its reputation for independence from the Government."[181]

98. Andrew Bailey considered that there was "probably" a business need and case for digital money.[182] Mr Bailey said that if "the case is positive for digital money, I do not think that the outcome we should look for is that the central banks become the only game in town."[183] He concluded: "I am very supportive of the [research into the viability and implications of CBDCs] we are doing but, for me, the jury is out."[184]

99. Andrew Griffith MP advocated a cautious approach when thinking about a CBDC and emphasised that the ongoing consultation with the Bank was a part of this approach.[185] He added: "You will know that we have undertaken to give Parliament, as is right, a very significant role if this moves forward. Monetary policy and monetary independence, and all the implications for that, which can be profound, will be a key part of it."[186]

100. **If a decision is made to create a Central Bank Digital Currency, the Bank and HM Treasury will need to clarify what effect this**

---

178 Bank of England, 'Central Bank Digital Currency: Opportunities, challenges and design' (March 2020): https://www.bankofengland.co.uk/paper/2020/central-bank-digital-currency-opportunities-challenges-and-design-discussion-paper [accessed 2 October 2023]

179 European Commission, 'Targeted consultation on a digital euro' (April–June 2022): https://finance.ec.europa.eu/regulation-and-supervision/consultations/finance-2022-digital-euro_en [accessed 2 October 2023]

180 Q 119 (Prof Christina Skinner)

181 Economic Affairs Committee, *Central bank digital currencies: a solution in search of a problem?* (3rd Report, Session 2021–22, HL Paper 131)

182 Q 174 (Andrew Bailey)

183 *Ibid.*

184 *Ibid.*

185 Q 238 (Andrew Griffith MP)

186 *Ibid.*

would have on the framework for operational independence and the primary objectives of the Bank. They will also need to establish commensurate accountability mechanisms. The creation of a CBDC could raise wider public policy issues—such as breaches of privacy—which are highly political and could exacerbate risks of the Bank being distracted from its main objectives of controlling inflation and maintaining financial stability.

CHAPTER 4: DIVERSITY OF THOUGHT AND CULTURE

101. The judgment of the Bank's policy committees and officials, the robustness of models used in forecasting, and whether the Bank's governance provides for a culture of internal challenge, were all matters covered in evidence received from witnesses. The evidence highlighted that when the Bank exercises its judgement, these factors can significantly affect the Bank's performance.

Diversity of thought

102. Witnesses voiced concerns about diversity of thought in the economics profession, which, they suggested, may reflect the way macroeconomics is taught in universities and practiced in the central banking community.[187] The Trade Union Congress said that it was "unclear whether anything substantial has been done to access wider opinion across all important macro policy institutions since [the 2008 financial crisis]."[188] Professor David Aikman, Professor of Finance and Director at the Qatar Centre for Global Banking and Finance at King's Business School, highlighted how people are joining the Bank of England having completed master's degrees in economics, finance or PhDs in the same subject. He emphasised: "They are not joining with very heterogeneous views about how the economy works or how the transmission mechanism of monetary policy works."[189]

103. Professor Goodhart was of the view that a lack of diversity of thought was more of a wider central bank issue.[190] He considered that "diversity at the moment [in the Bank of England] may not involve the inclusion of some people with views that you would prefer, but it certainly includes people with very differing views—much more differing, in my view, than you will find in almost any other central bank."[191]

104. Endorsing this latter point, a few witnesses rejected the suggestion that the Bank has been particularly lacking when it comes to diversity of thought. Sir Paul Tucker said that he did not believe there "was a great deal of groupthink in the past."[192] Professor Reis went further: "Groupthink has not been a problem. You can see the diversity and the variety of views, as well as the large disagreement in the voting record in the MPC over the last few years. That pretty clearly rejects the view there is very strong groupthink affecting its decisions."[193]

The Bank's approach to inflation post-2020

105. As part of discussions about diversity of thought, many witnesses pointed out that throughout much of 2020 and 2021, the MPC unanimously forecast that above-target inflation would be "transitory."[194] Witnesses considered

187 See for example Q 140 (Dr Raghuram Rajan)
188 Written evidence from Trade Union Congress (IBE0018), see also Gresham college, 'Gresham's Law in Economics: Background to the Crisis' (March 2014): https://www.gresham.ac.uk/watch-now/greshams-law-economics-background-crisis [accessed 25 September 2023]
189 Q 9 (Prof David Aikman)
190 Q 143 (Prof Charles Goodhart)
191 Q 144 (Prof Charles Goodhart)
192 Q 37 (Sir Paul Tucker)
193 Q 27 (Prof Ricardo Reis)
194 Bank of England, 'Bank of England Monetary Policy Report' (August 2021): https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2021/august/monetary-policy-report-august-2021.pdf [accessed 26 September 2023]

that this highlighted the absence of any challenges (or at least publicised challenges) to the consensus from within the Bank.[195]

106. The Bank stated in its August 2021 Monetary Policy Report:

> "CPI inflation has risen markedly, to above the MPC's target of 2%, and is projected to rise temporarily to 4% in the near term. The rise largely reflects the impact of the pandemic as the economy recovers. This has led to higher energy and goods prices, which in turn reflect rising commodity prices, transportation bottlenecks, constraints on production, and strong global demand for goods. As such, above-target inflation is expected to be transitory, as commodity prices stabilise, supply shortages ease and global demand rebalances."[196]

107. The Bank rate was lowered from 0.25 per cent to 0.1 per cent in March 2020. The MPC was then unanimous in the view that above-target inflation would be "transitory", holding the Bank rate at this very low level until November 2021 when two members dissented.[197] Only in December 2021 did the Committee vote to raise the Bank rate back to 0.25 per cent. From March 2020 to November 2021, inflation accelerated from 1.5 per cent to 5.1 per cent eventually reaching 11.1 per cent in October 2022.[198]

108. The Bank was not alone in projecting inflation rates close to target during much of the period in question. As the February 2021 Monetary Policy Report noted, the average of other forecasters' central projections for 2022 Q1 and 2023 Q1 were 1.9 per cent and 1.8 per cent respectively. However, the actual respective outturns for March 2022 and March 2023 were 7 per cent and 10.1 per cent.[199]

109. The views of witnesses also focused on the Bank's apparent disregard for accelerating money supply growth. Throughout 2020—when the annual growth in the M4 money supply reached double digits[200]—until August 2022, there was no discussion of money supply measures in the Bank's Monetary Policy Reports. Professor Congdon was of the view that overlooking the quantity of money as an explanation for monetary behaviour, or for the behaviour of the economy or inflation, was a product of groupthink.[201]

---

195 See for example Q 248 (Stephen D King), Q 99 (Prof Timothy Congdon)

196 Bank of England, 'Bank of England Monetary Policy Report' (August 2021): https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2021/august/monetary-policy-report-august-2021.pdf [accessed 26 September 2023]

197 Bank of England, 'Monetary Policy Committee voting history—Bank Rate': https://publications.parliament.uk/pa/ld5802/ldselect/ldeconaf/131/13102.htm [accessed 26 September 2023]

198 Office for National Statistics, 'Consumer price inflation, UK: October 2023' (November 2023) https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest [accessed 17 November 2023]

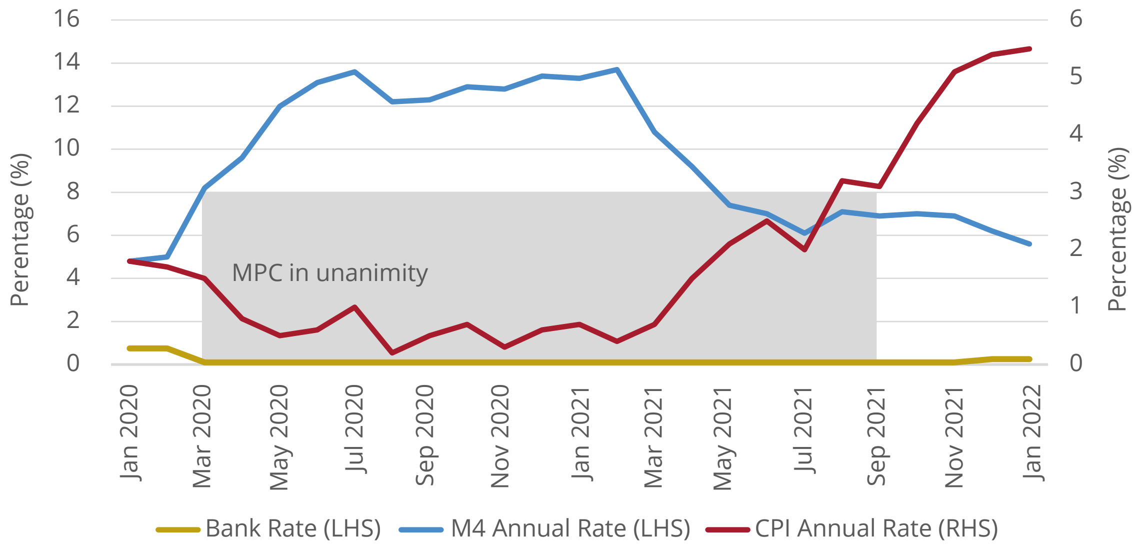
199 Bank of England, 'Monetary Policy Report' (February 2021): https://www.bankofengland.co.uk/monetary-policy-report/2021/february-2021 [accessed 26 September 2023], Office for National Statistics, 'Consumer price inflation, historical estimates and recent trends UK: 1950 to 2022' (May 2022): https://www.ons.gov.uk/economy/inflationandpriceindices/articles/consumerpriceinflationhistoricalestimatesandrecenttrendsuk/1950to2022 [accessed 30 October 2023]

200 Bank of England, 'A Money and lending': https://www.bankofengland.co.uk/boeapps/database/index.asp?first=yes&SectionRequired=A&HideNums=-1&ExtraInfo=false&Travel=NIxST [accessed 30 October 2023]

201 Q 99 (Prof Timothy Congdon)

110. From 4.8 per cent in January 2020, the annual growth rate in the M4 monetary aggregate had accelerated to 13.4 per cent by end of the year (see Figure 6).[202]

Figure 6: UK bank rate versus CPI and M4: January 2020 to January 2022



Source: Office for National Statistics, 'Consumer price inflation, historical estimates and recent trends, UK: 1950 to 2022' (May 2022): https://www.ons.gov.uk/economy/inflationandpriceindices/articles/consumerpriceinflationhistoricalestimatesandrecenttrendsuk/1950to2022 *[accessed 26 September 2023], Bank of England, 'Official Bank Rate history':* https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp *[accessed 26 September 2023] and Bank of England, 'Data viewer' (2018–2023):* https://www.bankofengland.co.uk/boeapps/database/fromshowcolumns.asp *[accessed 26 September 2023]*

111. According to Stephen D King, "money supply was ignored in a rather foolish fashion … I cannot see why policymakers did not look at that and think "This is odd". You do not have to be a monetarist to think that."[203] Professor Goodhart told us: "If you get … very large changes [in money supply] … at least you should take notice. The central bank should ask itself, "Does this have any meaning?"[204] Writing in *The Telegraph*, Roger Bootle argued that central banks appeared to downplay money supply growth rates that "would have set the alarm bells ringing not many years earlier", which, along with an over reliance on "their own credibility, built up over so long … was a case of groupthink on a global scale".[205] He told us:

> "Over the past few years … we have gone from a situation in which economic policy in general, and certainly monetary policy, was governed entirely according to what was happening to a certain definition of the broad money supply to one in which, apparently, the Bank took no notice of monetary aggregates at all. Both those extreme positions are wrong."[206]

202 The broad definition of M4 equals notes and coins in circulation (M0, or the monetary base) plus holdings in bank and building society accounts. For a more detailed explanation see Bank of England, 'Further details about M4 data': https://www.bankofengland.co.uk/statistics/details/further-details-about-m4-data [accessed 26 September 2023]. See also Forbes, 'The "Long And Variable Lag"—A Dangerous Monetary Policy Myth' (July 2023): https://www.forbes.com/sites/georgecalhoun/2023/07/08/the-long-and-variable-lag--a-dangerous-monetary-policy-myth/ [accessed 26 September 2023].

203 Q 245 (Stephen D King)

204 Q 140 (Prof Charles Goodhart)

205 'Groupthink at the Bank of England is the real driver of inflation', *The Telegraph* (April 2023): https://www.telegraph.co.uk/business/2023/04/23/groupthink-bank-of-england-real-driver-inflation/ [accessed 26 September 2023]

206 Q 122 (Roger Bootle)

112. Professor Congdon elaborated on this issue by emphasising that there "is a divergence in macroeconomics between those who want to interpret inflation entirely by looking at the labour market and to explain what happens to national income and national output by the income expenditure mode … and those like me who would defend the quantity theory of money."[207]

113. Some witnesses considered that a collective, misplaced confidence about the inflation outlook may have reflected past experience. Martin Wolf said: "I may be mistaken, but I suspect that there was nobody in the Bank of England in 2020 who had any experience of a relatively high inflation environment. This was the norm and everybody got used to the idea of low for longer."[208] Stephen D King similarly noted: "[The] idea that you can simply assert that inflation is going to be low in the future because it has been low in the past [is] not good enough. The idea that credibility is the only thing that matters is a mistake."[209] Mr King said that groupthink may have reflected "an obsession with deflation [and a] fear that the West was heading in a Japanese-type direction."[210]

114. Professor Skinner told us that it was "important to think about groupthink in the slightly broader sense of how it can contribute to inertia and, in the political economy sense of the word, how it can form a consensus view about how the central bank is used in society and its relationship with political actors".[211] The political aspects of central bank decision-making were also raised by Edward Chancellor: "With regard to the question of groupthink and the central banks' attitude to inflation, the other concept, aside from groupthink, is cognitive dissonance—people failing to see something that they do not already believe, particularly when they have made an error."[212]

115. When asked whether there had been challenge to the "transitory" view on inflation during the COVID-19 pandemic, Andrew Bailey told us:

> "That challenge built up as 2021 went on. Indeed, I would say I was myself part of that challenging. I remember making a speech in September 2021, saying that I thought the supply chain shock had transitory elements; even by then I was worried about what we were beginning to see. We were puzzled by the labour market at that point."[213]

116. When subsequently asked about groupthink in the economics profession and the Bank's limited public discussions about the money supply, Mr Bailey explained that the Bank had considered money supply growth.[214] In correspondence, he noted that two things stood out during the COVID-19 pandemic: "First, M4ex grew rapidly.[215] This was the product of the Bank's quantitative easing (QE) operations … The second point is that there was no pick-up in M4Lex. This is consistent with the limited recovery of economic

207 Q 99 (Prof Timothy Congdon)
208 Q 79 (Martin Wolf)
209 Q 245 (Stephen D King)
210 *Ibid.* In the 1990s, Japan experienced a period of economic stagnation which became known as the Lost Decade, see International Monetary Fund, 'Japan's Lost Decade' (February 2003): https://www.imf.org/external/pubs/nft/2003/japan/index.htm [accessed 17 October 2023].
211 Q 99 (Prof Christina Skinner)
212 Q 63 (Edward Chancellor)
213 Q 168 (Andrew Bailey)
214 Q 159 (Andrew Bailey)
215 M4ex is M4 excluding the deposits of intermediate OFCs (other financial corporations) which are seen as similar in nature to monetary financial institutions; M4lex is the net flow of sterling lending to private sector companies and households.

activity … and the build-up of savings by households and companies" (see Figure 7).[216] In essence, the Bank was of the view that although there had been an increase in the money supply, it had not circulated into the wider economy to facilitate inflation.

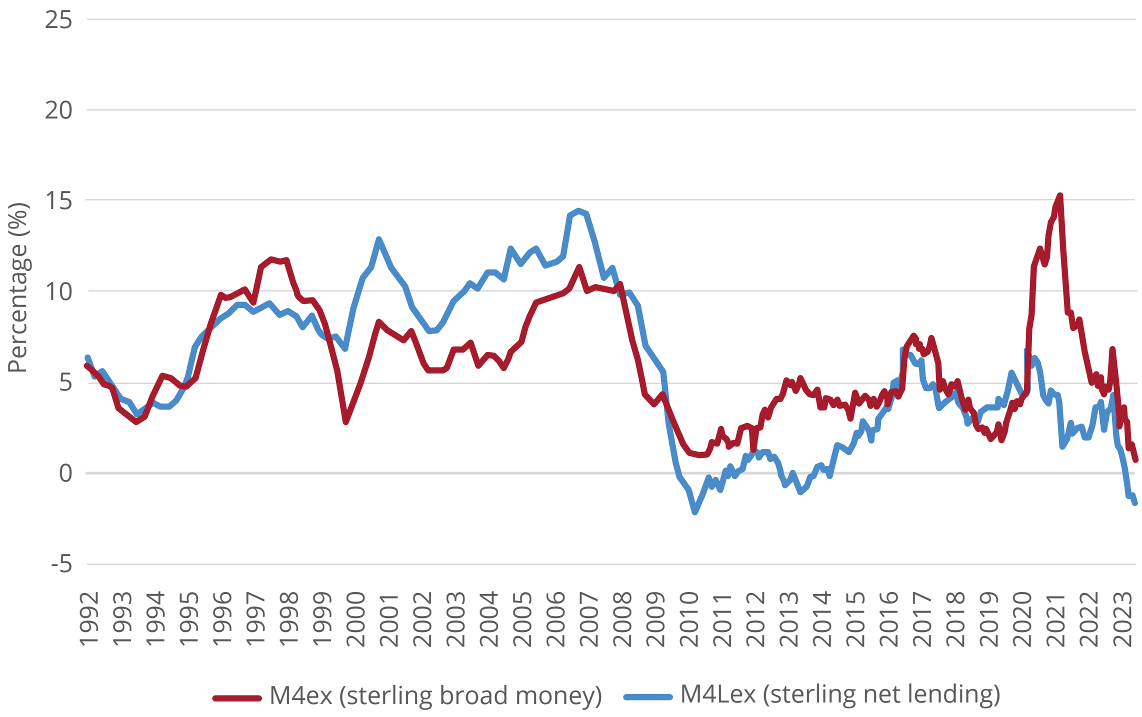
117. However, it is important to distinguish the separate roles of money and credit, and in particular the impact of a build-up of money balances on demand. Stephen D King noted that while the velocity with which money circulated during lockdown certainly collapsed, it surged once the lockdown ended resulting in an acceleration in nominal demand.[217] Mr King added that "the urgency with which support was provided in 2020 when inflation was "well below the target" was not matched by similar urgency in the opposite direction when inflation threatened to move above target."[218]

118. When asked whether it might be helpful to have the Bank's money supply considerations reflected in the Bank's Monetary Policy Reports, Andrew Bailey replied that this was a "fair point."[219]

119. Mr Bailey was also asked to elaborate on his theory of inflation. He said: "The economy is hit by all sorts of shocks but ultimately it is the balance of supply and demand … there is a money impact to that … but the balance of supply and demand across a number of parts—it is not just an activity; it is also in the labour market—is key to that."[220]

216 Letter from the Governor of the Bank of England to Lord Bridges of Headley Chair of the Economic Affairs Committee (6 July 2023): https://committees.parliament.uk/publications/41079/documents/200046/default/. For a detailed discussion of this issue, see Bank of England, 'Monetary policy: prices versus quantities—speech by Ben Broadbent' (April 2023): https://www.bankofengland.co.uk/speech/2023/april/ben-broadbent-speech-hosted-by-national-institute-of-economic-and-social-research.
217 Written evidence from Stephen D King (IBE0023)
218 *Ibid.*
219 Q 158 (Andrew Bailey)
220 Q 158 (Andrew Bailey)

Figure 7: 12-month growth rates of M4ex and M4Lex



Source: Letter from the Governor of the Bank of England to Lord Bridges of Headley Chair of the Economic Affairs Committee (6 July 2023): https://committees.parliament.uk/publications/41079/documents/200046/default/

120. Andrew Griffith MP was of the view that "one should always be concerned about groupthink … The evidence is that there are also many cases where members do not act as a group. There are split votes and there are internal and external members of the MPC."[221]

121. **According to the evidence we received, there is perceived to be a lack of intellectual diversity in many central banks, including the Bank of England. Witnesses suggested that this contributed to insufficient challenge on the MPC in 2020 and 2021 which allowed a unanimity of view to prevail about the "transitory" nature of above-target inflation. While every member of the MPC must be committed to fulfilling the Committee's objectives, it is imperative that its membership comprises people of different backgrounds and economic perspectives. The Bank must be pro-active in encouraging a diversity of views and a culture of challenge. This should be reflected in its hiring practices and its appointment procedures.**

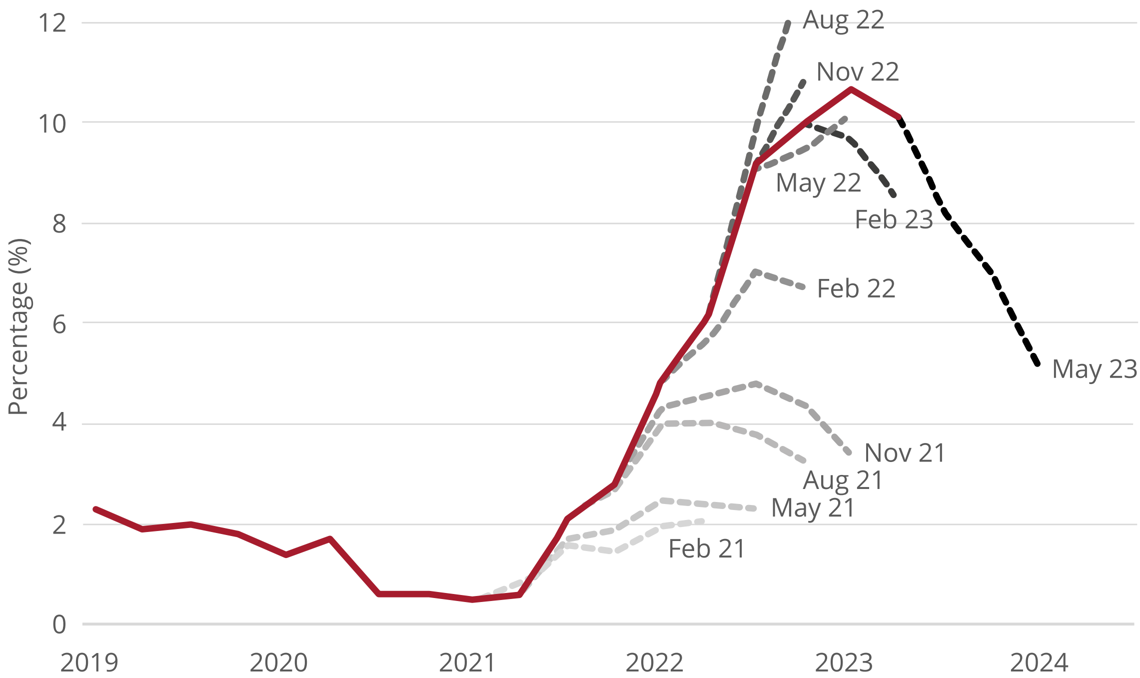
122. **There is a notable absence of any detailed discussions about money supply in the Bank's published Monetary Policy Reports. We recommend that the Monetary Policy Reports should include discussion of the main monetary aggregates, accompanied by an analysis of their relevance to the Bank's inflation outlook and the various scenarios the Monetary Policy Committee considers. This would ensure adequate transparency in how the Bank approaches its monetary policy decision-making.**

221 Q 225 (Andrew Griffith MP)

Forecasting

123. While forecasting is an important part of the process that informs monetary policy decision-making, the conventional models used[222] have been the source of much recent criticism and challenge in the last few years. Through the COVID-19 pandemic, other major central banks also saw inflation outcomes exceed their prior forecasts which may in part have reflected an over-reliance on these models (for a comparison of the Bank of England's forecasts with the inflation outcomes, see Figure 8.)[223]

Figure 8: Bank of England CPI inflation forecasts versus inflation outcomes



Source: Ed Conway, (@EdConwaySky), tweet on 11 May 2023: https://twitter.com/EdConwaySky/status/1656639947539881985

124. Andreas Dombret told us that "there were no models for the pandemic in the first place, and the structural input to the models caused it not to be understood correctly."[224] By way of international comparison, Otmar Issing said of the ECB in April 2022: "It relied on its forecasting model and this model cannot give the right signals because it is based on the past and cyclical experience, and the pandemic did not cause a cyclical downturn … You need a much broader approach to explaining inflation in a time of structural changes."[225]

222 This includes the 'dynamic stochastic general equilibrium' (DSGE) models. These models generally assume that inflation will return to target, that the supply-side of the economy remains constant, that you can ignore structural financial developments, and that expectations are either 'rational', or at least 'model consistent'. See London School of Economics, *Real Business Cycle Models:* https://personal.lse.ac.uk/vernazza/_private/RBC%20Models.pdf [accessed 26 September 2023].

223 See Table 1, Hoover Institution, Stanford University, *The Fed: Bad Forecasts and Misguided Monetary Policy* (May 2023): https://www.hoover.org/sites/default/files/2023-05/Hoover%20Monetary%20Policy%20Conference%20May%2012%202023%202-1.pdf [accessed 17 October 2023], Pound Sterling, 'How Many More ECB Interest Rate Hikes are Likely?' (July 2022): https://www.poundsterlinglive.com/economics/17290-how-many-more-ecb-interest-rate-hikes-are-likely [accessed 17 October 2023].

224 Q 63 (Andreas Dombret)

225 "'Living in a fantasy': euro's founding father rebukes ECB over inflation response' *Financial Times (*12 April 2022): https://www.ft.com/content/145b6795-2d21-48c6-984b-4b05d121ba16

125. According to Martin Wolf, there are "profound intellectual problems with [DSGE] models".[226] He emphasised that they work well when "things do not change very much … once they are calibrated to past data these [models] are going to be pretty good". However, when economic conditions do change significantly, he said that "they are likely to give you bad advice."[227] Mr Wolf added: "One feature of these models … is that inflation expectations are self-validating, which is wonderful except when they are not, which happens to be where we are now."[228] Stephen D King made a similar point stating that it "sounds like an Alice in Wonderland argument. [The Bank] is simply saying: 'We have a target of 2 per cent; we forecast it will be at 2 per cent; there is nothing that is going to happen in the near term that will change that'".[229]

126. The efficacy of models in the face of shocks was an issue addressed by David Stockton, Senior Fellow at the Peterson Institute for International Economics, in his 2012 *Review of the Monetary Policy Committee's forecasting capability*:

> "Virtually all regular economic forecasting exercises exhibit a degree of inertia … [some of this] simply reflects the slowness with which forecasters spot deeper structural problems with the stories underlying their forecasts. In the MPC's forecasting process, there are few mechanisms capable of acting as a trigger for a fundamental reassessment of the outlook".[230]

127. Dr Rajan told us that the prevailing macroeconomic view in central banks is associated with DSGE models, which rarely have a role for the financial sector or money.[231] He noted that students are taught this view in universities and schools and they go from there to the research departments of universities before moving to central banks. Dr Rajan added: "It may make sense [for the MPC] to mix it up a little once in a while and have a labour economist, who understands monetary economics but is not wedded to the same models, or a financial economist, who may pay more attention to the financial sector".[232]

128. Dr Rajan also elaborated on his experiences with forecasting models and their flaws: "I used to be at the IMF and we used to run our models there. There was nothing monetary policy could not cure." He intimated that in the face of economic shocks, such models would routinely forecast a return to 'normality' with only minor adjustments to interest rates.[233] Dr Rajan also noted that the assumptions feeding such models go unexplained and yet are unquestioned. He said: " everybody believes [your policy statement] and, therefore, you can influence expectations whichever way you want."[234]

129. Edward Chancellor told us: "If everyone is using the same model, it does not matter where they come from; there is no underlying diversity of opinion. My view is that we live in an extremely complex world and a highly financialised

226 See footnote 222
227 Q 81 (Martin Wolf)
228 *Ibid.*
229 Q 246 (Stephen D King)
230 Bank of England, *'Review of the Monetary Policy Committee's forecasting capability—Report by David Stockton' (October 2012):* https://www.bankofengland.co.uk/-/media/boe/files/news/2012/november/the-mpcs-forecasting-capability.pdf [accessed 2 October 2023]
231 Q 140 (Dr Raghuram Rajan)
232 *Ibid.*
233 Q 141 (Dr Raghuram Rajan)
234 *Ibid.*

economy, and theoretical economist models are not particularly good at describing what is going on."[235]

130. The Bank's Independent Evaluation Office (IEO) conducted an inquiry into the Bank's forecasting capabilities in November 2015.[236] It found a number of areas where the Bank's core forecasts had performed well. However, it recommended investigation into discrepancies in the accuracy of the Bank's two-year projections relative to one year and it recommended a review of the Bank's forecasts for unemployment.[237] In June 2023, the Bank announced another review of its forecasting capabilities. Unlike the last, this review will be externally led, albeit supported by the IEO (see Chapter 5).[238] It subsequently confirmed that the review would be led by Dr Ben Bernanke, former Chairman of the US Federal Reserve.[239]

131. When asked about the Bank's use of models, Andrew Bailey said:

> "We do not have a single model. We have … a suite of models that we can put to work. We develop new ones as time goes by … The job of the [monetary policy] committee is to … introduce its own judgments and form those into changes to the forecast that seem appropriate, given the economic situation we are in. The idea that there is a sausage machine that you stick things into at one end and a forecast pops out the other end—it is really not like that at all."[240]

132. Mr Bailey added that a problem is that the models the Bank has currently tend to be "highly linear and highly symmetric". He noted that "if you were to leave the [model] to run on its own and take it as it was, the forecast would deliver a very rapid fall in inflation, back to and well below target, driven by this linear symmetry condition that it is in there. We have aimed off that".[241]

133. When asked whether a fresh investigation into the Bank's forecasting capabilities by the IEO could increase the sense of independent analysis and increase confidence in the Bank, Andrew Griffith MP said: "I think we arrive at that conversation with a slightly different starting point as to whether there are any deficiencies in the status quo. I try to keep an open mind and seek to see what we can learn. I would not go so far as to think there is a problem that needs to be addressed."[242]

134. **In 2021 the Bank of England, like many central banks, incorrectly forecast that above-target inflation would be "transitory". This was in part thanks to a lack of challenge as regards its modelling and forecasts. We therefore welcome the Bank's new externally-led review into its forecasting capabilities. This review should seek to explain the value of models that seldom predict anything other than a return**

235 Q 64 (Edward Chancellor)
236 Bank of England, 'Evaluating forecast performance November 2015' (November 2015): https://www.bankofengland.co.uk/independent-evaluation-office/forecasting-evaluation-november-2015 [accessed 17 October 2023]
237 *Ibid.*
238 Letter from David Roberts, Chair of Court to Harriet Baldwin, Chair of the Treasury Committee 14 June 2023: https://committees.parliament.uk/publications/40407/documents/197180/default/
239 Bank of England, 'Ben Bernanke to lead review into forecasting at Bank of England' (July 2023): https://www.bankofengland.co.uk/news/2023/july/ben-bernanke-to-lead-review-into-forecasting-at-bank-of-england [accessed 2 October 2023]
240 Q 156 (Andrew Bailey)
241 Q 158 (Andrew Bailey)
242 Q 235 (Andrew Griffith MP)

to the two per cent target over their forecast horizon. We hope the review also considers whether appointments, both of officials of the Bank and members of the MPC, are creating sufficient diversity of thought.

Appointments

135. The issue of diversity of thought, and the overall matter of Bank independence, was linked by several witnesses to the process by which individuals are appointed to the Bank overall, and to the MPC specifically. Four members of the MPC are external appointees, while the remaining five comprise the Governor, three Deputy Governors and the Chief Economist of the Bank.[243]

136. The Governor and Deputy Governors are Crown Appointments, made by the Monarch on the advice of the Prime Minister and Chancellor. For the four external members of the MPC, they are appointed directly by the Chancellor.[244] Such appointments have been advertised publicly, with an Advisory Assessment Panel chosen,[245] and hosted by HM Treasury, to assist the Chancellor with the decision-making.[246] The Chief Economist is appointed to the MPC by the Bank's Court of Directors, with the Governor required to consult the Chancellor on the appointment.[247] The House of Commons Treasury Committee also holds hearings on the appointment of each new policy committee member (see Chapter 5).[248]

137. Witnesses expressed concern about the role of HM Treasury when appointing to such positions within the Bank.[249] Stephen D King said, "the Treasury has an awful lot of influence in the appointments process in a way that has created an MPC that is dominated by people who were, at some point, at the Treasury." He added: "All four deputy governors have spent time at the Treasury, quite extended periods of time in some cases. So although one thinks of the Bank of England as being independent, it is independent but with the Treasury still casting a shadow over it".[250] According to Roger

243 Bank of England, 'Monetary Policy Committee' (November 2023): https://www.bankofengland.co.uk/about/people/monetary-policy-committee [accessed 6 November 2023]. By way of comparison, the FPC normally has thirteen members: six of them are Bank of England staff (and include the Governor, four Deputy Governors and the Executive Director for Financial Stability Strategy and Risk); the remaining seven members comprise five external members, the Chief Executive of the Financial Conduct Authority and one non-voting member from HM Treasury.

244 Bank of England, 'Monetary Policy Committee' (November 2023): https://www.bankofengland.co.uk/about/people/monetary-policy-committee [accessed 6 November 2023]

245 According to the Governance Code of Public Appointments, the role of the Panel is "to assist Ministers in making Public Appointments. The Panel's role is not to choose candidates for the appointment in question but to provide Ministers the candidates who are capable of undertaking the appointment—from which Ministers can make their selection for appointment." Ministers should consider the advice of the Advisory Assessment Panels but are not bound by their views. The Commissioner for Public Appointments, 'Governance Code on Public Appointments' (December 2016): https://publicappointmentscommissioner.independent.gov.uk/publications/accessible-formats/governance-code-on-public-appointments/ [accessed 30 October 2023]

246 See HM Government, 'Deputy Governor for Monetary Policy at the Bank of England' (November 2023): https://apply-for-public-appointment.service.gov.uk/roles/7794 [accessed 30 October 2023] and HM Government, 'Deputy Governor for Monetary Policy at the Bank of England' (November 2023): https://apply-for-public-appointment.service.gov.uk/roles/7794 [accessed 30 October 2023]

247 Bank of England, 'Huw Pill appointed Chief Economist of the Bank of England' (September 2021): https://www.bankofengland.co.uk/news/2021/september/huw-pill-appointed-chief-economist-of-the-boe [accessed 30 October 2023]

248 House of Commons Treasury Committee (IBE0007)

249 Q 100 (Prof Timothy Congdon), Q 122 (Roger Bootle) Q 122 (Sir Howard Davies)

250 Q 249 (Stephen D King). This was the case when Sir Jon Cunliffe was Deputy Governor for Financial Stability. His term ended on 31 October 2023, and he has since been replaced by Sarah Breeden.

Bootle, this was "not a very good thing from the point of view of avoiding groupthink or even avoiding criticisms of full independence."[251] Professor Congdon told us that "the real problem here is that the Treasury is too powerful… [it] dominates and controls the appointments process. I think the deputy governors at present have all worked in the Treasury ... In my view, there is a bit of a racket going on. Essentially, friends are appointing each other."[252]

138. Lord Macpherson of Earl's Court, former Permanent Secretary to HM Treasury, considered it unsurprising that HM Treasury "ends up populating some of the Bank." He argued that the two big economic policy institutions in the country are the Bank of England and HM Treasury. He added: "You only have to look at France. Jean-Claude Trichet was head of the French Treasury. He went on to run the French Central Bank and then the European Central Bank."[253]

139. Sir John Parker, former Chair of the Court of Directors at the Bank, stressed that for the appointment of Deputy Governors, for example, "there should be a proper process that is well defined. What are the criteria? What is the process by which we will go about interviewing, and what are the process by which we will make the final interview and appointments?"[254] The Institute of International Monetary Research at the University of Buckingham said that the "task of making appointments to the MPC should be taken away from the Treasury and transferred to a newly-appointed committee with the best interests of the MPC at heart."[255]

140. David Roberts, Chair of the Court of Directors, told us: "the critical factor here is the right people, core skills and diversity of background." He concluded: "Would I worry if people had the same background and experience? Yes, I would … but I do not rule in or rule out the very fact that they might have spent some time in their career in the Treasury as being either a big advantage or a big disadvantage."[256]

141. Mr Roberts highlighted certain practicalities to consider when making appointments to the MPC, including conflicts of interest, ethics and the availability of candidates. He said the Bank has to "work hard" to find candidates and that he was interested in diversity of thought and of experience. When asked whether HM Treasury should continue to lead on appointments, he told us:

> "[The] Treasury has an accountability and a responsibility. The critical thing is that … we are clear about what we want, on both the hard skills and the interpersonal or interaction skills … If it is not going to be done within the Bank … the other model is something like the Judicial Appointments Commission. That is quite different, because [the role of the judiciary] is to hold the Government of the day and future days to account. That requires you to be outside of government. We are part of

251 Q 122 (Roger Bootle)
252 Q 100 (Prof Timothy Congdon)
253 Q 202 (Lord Macpherson of Earl's Court)
254 Q 201 (Sir John Parker)
255 Written evidence from the Institute of International Monetary Research at University of Buckingham (IBE0008)
256 Q 190 (David Roberts)

the executive line, which is why the Chancellor and the Prime Minister should do that."[257]

142. On Deputy Governors of the Bank having a Treasury background, Andrew Griffith MP considered that "one is fishing in a fairly narrow gene pool." He noted "the likelihood is that people arriving in those positions will have had a lifetime of service in the Bank, possibly some time in the Treasury." He said that rather than looking at the executive for difference, focus should be placed on the external members of the MPC and [the Court of Directors] itself.[258]

143. **Members of the Bank's policy committees make decisions which have an immense impact on the UK economy. However, being led by HM Treasury, the process for appointing members to the Monetary Policy Committee has contributed to perceptions of both bias and a lack of diversity of thought. It is notable that three of the four current Deputy Governors have a Treasury background. While they are undoubtedly able, this does not strengthen the perception of independence. HM Treasury and the Bank's Court of Directors should commission an independent review to address this: that review should look at how other public appointments are made, such as to the judiciary; consider best practice in other central banks; and propose measures to ensure the appointments process is transparent.**

Role of the Court of Directors

144. The Court of Directors (Court) has an oversight role in the Bank. It is a unitary board, responsible for managing the "affairs of the Bank as a corporation" while the policy committees retain responsibility for monetary policy, financial stability and prudential regulation. It provides a source of challenge through its approval of the Bank's risk tolerance framework and its frameworks for monitoring and managing risk, including those related to the Bank's balance sheet. It also reviews the Bank's performance in relation to its objectives,[259] the Bank's operational capability, and its skills and culture (see also Chapter 5).[260]

145. The Court comprises five executive members: the Governor and the four Deputy Governors. The Chief Operating Officer of the Bank also attends each meeting of the Court. There are currently eight non-executive members, including the Chair of the Court, with a further non-executive member due to be appointed. The non-executives are considered by the Court to be a "vital source of independent challenge" and they help to ensure that "the Bank maintains its operational independence at all times." We were told that the non-executive members of the Court have the right to meet separately and commission reviews independently.[261]

146. Some witnesses suggested that the Court had limited effect. Sir Howard Davies told us that the Court "looks like a hygiene body" and is therefore

257 Q 180 (David Roberts)
258 Q 236 (Andrew Griffith MP)
259 Bank of England, 'Governance of the Bank of England including Matters Reserved to Court' (July 2022): https://www.bankofengland.co.uk/about/people/court-of-directors/governance-of-the-bank-of-england-including-matters-reserved-to-court [accessed 2 November 2023]
260 Written evidence from The Court of Directors (IBE0020)
261 *Ibid.*

"not useless but it does not do very much".[262] Sir Paul Tucker argued that "all the Bank's powers are best viewed as vested in the Governor and company. In other words, that is the Court of Directors, which reserves a few things for itself such as signing off on budgets but otherwise delegates everything to the person of the Governor."[263]

Reform of the Court

147. Following the Financial Services Act 2012, a sub-committee of the Court, the Oversight Committee, was established.[264] The Oversight Committee was made up exclusively of non-executive members. In 2014, the Bank called for a series of reforms to its governance, which included recommending a simpler governance structure by establishing a unitary board, believing that it "could be more effective both in managing the Bank and in delivering a more convincing framework for accountability."[265] Accepting the Bank's recommendation, in 2015 the Government introduced the Bank of England and Financial Services Bill to abolish the Oversight Committee and to turn the Court back into a unitary board. During the passage of the Bill through Parliament, concerns were raised that the abolition of the Oversight Committee might limit the opportunity for non-executive members of the Court to hold the Bank's executives to account and challenge executives' decisions.[266] In the end, the Oversight Committee was abolished by the Bank of England and Financial Services Act 2016.[267]

148. Lord Macpherson said that as a unitary board, the Court "works relatively well, especially now that it is a smaller board" and that a "critical role of any board is to ensure that the institution learns the lessons of both successes and failures". Despite this, he was a "fan of the oversight committee as a way of very mildly, just occasionally, challenging the executive to understand why [things had] turned out as they had".[268]

149. On the Court's current composition, some witnesses expressed concern about the number of executive members, which include the Governor and the four Deputy Governors. Roger Bootle said: "There is a problem with the Court … in that it is so heavily stuffed with executives of the Bank that it is almost marking its own homework".[269] Sir Howard Davies noted that in other countries "there is a governor and a first deputy, and the others are not on the overall body."[270]

150. David Roberts told us that "In terms of both statutory responsibilities and the remit [that the Court fulfils], our ability to influence and execute change is high." He emphasised that the Court is responsible for the operational effectiveness of the Bank of England, "so everything up to but not including the policy decisions."[271] He also said that in his view a corporate board

262 Q 131 (Sir Howard Davies)
263 Q 43 (Sir Paul Tucker)
264 The Oversight Committee was introduced by the Financial Services Act 2012
265 Bank of England, 'Transparency And Accountability At The Bank of England' (December 2014): https://www.bankofengland.co.uk/-/media/boe/files/news/2014/december/transparency-and-the-boes-mpc-response [accessed 2 October 2023]
266 House of Commons Library, The Bank of England and Financial Services Bill (HL) (Lord stages), Number 7338 (January 2016)
267 Bank of England and Financial Services Act 2016
268 Q 218 (Lord Macpherson of Earl's Court)
269 Q 131 (Roger Bootle)
270 Q 131 (Sir Howard Davies)
271 Q 176 (David Roberts)

was a unitary board: "Decisions and discussions are enhanced by having management there, as long as the non-execs have the capacity, capability, information and the climate of that board to be able to challenge". He added that it was "wrong to characterise the operation of the board as being executive-led and executive-heavy":

> "The way the Court operates is driven extensively by the non-execs, clearly, in consultation with the Governor, because there are things he wants to talk about and things we want to talk about. It is always valuable to have executives around the table. There are occasions I have seen where, if you have only two, it can become very dominated."[272]

151. Andrew Griffith MP told us that in his "limited time experience of the Court" it was working well. He said: "I have seen different views, and it is right that there are different views".[273]

152. **Within the boundaries of its terms of reference, the Bank's Court of Directors plays an important role in terms of holding the Bank's Executives to account and providing internal challenge. Its ability to commission performance reviews of the Bank's policy committees provides a key means of doing so. However, we note that the Bank of England and Financial Services Act 2016 not only abolished the Oversight Committee but also reduced the number of non-executives on the Court. While there were mixed views from witnesses on the Court's current composition of non-executive and executive members, the Court must be able to provide a source of effective challenge within the Bank. The Chair of the Court should consider how to enhance the role of the non-executive members so they are as effective as possible.**

272 Q 180 (David Roberts)
273 Q 235 (Andrew Griffith MP)

CHAPTER 5: ACCOUNTABILITY

Accountability and the role of Parliament

153. As a public body owned by the UK Government, the Bank of England is answerable and accountable to the people of the UK through Parliament.[274] The Bank is mainly held to account by the House of Commons Treasury Committee and the Economic Affairs Committee in the House of Lords.[275] The Treasury Committee holds accountability hearings relevant to the work of the three policy committees (the MPC, FPC and PRC), with the Governor often in attendance. It also holds hearings on the appointment of each new MPC, FPC and PRC member and for the Chair of the Court of Directors. The Treasury Committee and the Economic Affairs Committee also undertake ad-hoc inquiries, hearings and engage in correspondence with the Bank.[276]

154. With respect to monetary policy, the Bank of England makes itself accountable through the publication of the MPC's decisions and minutes.[277] It publishes quarterly Monetary Policy Reports,[278] which is one of the principal ways in which the explanations of the MPC can be scrutinised. The Governor is also required to send an open letter to the Chancellor which explains the time horizon over which the MPC intends to bring inflation back to target, if inflation is above or below it by more than one percentage point.[279] The MPC is also accountable to the Court for its processes and for the performance of its objectives.[280]

155. Some witnesses acknowledged that the Bank is also subject to significant public and media scrutiny when it comes to monetary policy.[281] Sir John Vickers highlighted that the community which "follows inflation would be the public at large" and a "large commentariat [including] … press, economists, academics and others".[282] Professor Chadha likewise highlighted that the Bank is "heavily scrutinised by the media and households".[283] Much of this scrutiny and commentary is often concentrated around the MPC's monetary policy decisions, announced eight times per year, with recent decisions to raise interest rates receiving heightened attention.

156. Nonetheless, witnesses also emphasised a fundamental need for, and often enhanced levels of, accountability. Sir Paul Tucker stated that "the mission

274 Bank of England, 'Governance and funding': https://www.bankofengland.co.uk/about/governance-and-funding [accessed 14 September 2023)

275 As with this inquiry, the Economic Affairs Committee can choose to undertake an inquiry considering matters related to the Bank of England. In addition, the Committee holds an annual scrutiny session with the Governor of the Bank of England.

276 House of Commons Treasury Committee (IBE0007)

277 Bank of England, 'Monetary policy summary and minutes': https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/monetary-policy-summary-and-minutes [accessed 3 November 2023]

278 Bank of England, 'Monetary Policy Reports': https://www.bankofengland.co.uk/monetary-policy-report/monetary-policy-report [accessed 3 November 2023]

279 HM Government, *HMT open letters between the Governor of the Bank of the England and the Chancellor of the Exchequer* (February 2012): https://www.gov.uk/government/collections/inflationary-targets [accessed 3 November 2023]

280 Bank of England, 'Governance of the Bank of England including Matters Reserved to Court' (July 2022): https://www.bankofengland.co.uk/about/people/court-of-directors/governance-of-the-bank-of-england-including-matters-reserved-to-court [accessed 3 November 2023]

281 Q 9 (Prof Jagjit Chadha), Q 28 (Chris Giles) and Q 37 (Sir John Vickers)

282 Q 37 (Sir John Vickers)

283 Q 9 (Prof Jagjit Chadha)

of the Bank of England is to be steward of the regimes bestowed upon it by Parliament and to be accountable to Parliament for that."[284] Positive Money said: "Central banks responsibilities in the twenty-first century necessitate enhanced approaches to accountability. Some tools have more tangible distributional effects, therefore leading to a more prominent discussion of central bank policies in the public discourse."[285] Professor Reis emphasised that "an institution that has been given great power by elected bodies, but which does not answer to the electorate directly, must be transparent and accountable."[286] Others have also highlighted that, with expanded remits, commensurate levels of accountability are required.[287]

157. Several witnesses commented on how the Bank and its remit is scrutinised by Parliament.[288] Ed Balls said that "on monetary policy and on fiscal policy, parliamentary scrutiny of government decision-making is effective and has become markedly more effective over the last 30 years … Part of the effect of the 1997 reforms on monetary policy was to enhance the debate and scrutiny."[289] However, when asked about Parliament's role in holding the Bank to account, Martin Wolf said that it was his sense that "detailed, potent, credible analysis of the decisions [the Bank is] taking" was not being produced.[290]

158. According to Professor Aikman, there has not been sufficient scrutiny of the policy committee remit letters by Parliament. He stated that based on his research, this was an area that "has [not] received the attention it deserves."[291] Positive Money acknowledged that the Chancellor "currently has the opportunity to clarify the Bank's objectives in their remit and recommendation letters" but highlighted that "there could be more scope for thorough appraisals of the central bank's role."[292] Sir Paul Tucker similarly observed:

> "What has not worked well are the cumulative changes to the remit, with hardly any public discussion of them. Public discussion might have ended in applause. This is fine, but, instead, really important changes to the regime for the Bank were made without a great deal of debate. I think that has been somewhat costly."[293]

159. On the accountability of the Bank, David Roberts emphasised that "external accountability is to Parliament … it is for Parliament to decide how it wants to effect that accountability." He also acknowledged that there are "many sources of accountability, including the press and the commentators, who are certainly exercising their accountability muscles to the full at the moment. That is good and we should not be defensive about that".[294]

---

284 Q 34 (Sir Paul Tucker)
285 Written evidence from Positive Money (IBE0013)
286 Written evidence from Prof Ricardo Reis (IBE0003)
287 See for example Rosa Lastra, *Accountability mechanisms of the Bank of England and of the European Central Bank* (September 2020): https://www.europarl.europa.eu/cmsdata/211623/1_LASTRA-final.pdf [accessed 3 October 2023]
288 See for example Q 30 (Chris Giles), Q 214 (Lord Macpherson of Earl's Court)
289 Q 49 (Rt Hon Ed Balls)
290 Q 95 (Martin Wolf)
291 Q 3 (Prof David Aikman)
292 Positive Money (IBE0013)
293 Q 37 (Sir Paul Tucker)
294 Q 186 (David Roberts)

160. On scrutiny of the remit letters, Andrew Griffith MP told us that "the Chancellor who is writing that remit letter is regularly held to account through the Treasury Committee, as are other Ministers and officials." He added that "the Treasury Committee, as indeed this committee, has the opportunity, as in every other domain, to hold Ministers to account … Those letters themselves are on the public record, so there is plenty of opportunity for people to scrutinise the contents of those letters."[295]

161. **The independence of the Bank, and the expansion of its remit, means that significant powers are delegated to, and exercised by, a small group of appointed officials who are not part of the elected Government. To meet HM Treasury's inflation target, the Bank may act in such a way that counteracts the economic impact of the Government's fiscal policy. It is therefore imperative that the Bank's activities and its remit are effectively scrutinised by, and its officials are held accountable to, Parliament. Current parliamentary arrangements should be enhanced to achieve this.**

162. **We recommend that the annual remit letters for the Monetary Policy Committee and Financial Policy Committee should be published in draft to allow sufficient scrutiny of them. The final remit letters should be laid before both Houses of Parliament and accompanied by an oral statement in each House. We believe this would enhance both parliamentary scrutiny and public debate on the remits of the Bank set by the Chancellor.**

163. **We recommend that every five years Parliament conducts an overarching review, supported by expert staff, of the Bank's remit, operations and performance (excluding individual policy decisions). This would enhance Parliament's ability to hold the Bank to account and express its view on the Bank's performance and leadership.**

The Independent Evaluation Office

164. The Bank's Independent Evaluation Office (IEO) is tasked with supporting the Bank's Court of Directors in its governance responsibilities, "enabling the Bank to operate more effectively across the full range of its policy areas."[296] The IEO was set up as a core initiative of the "openness and accountability" pillar of the Bank's 2014 strategic plan.[297] It provides the Court with "objective assessments of the Bank's policy functions, making recommendations on any improvements."[298]

165. The IEO sits within the Bank on Threadneedle Street. It is headed by a director who leads a small permanent team. The team is supplemented, when needed, with seconded staff from the Bank and with external expertise as appropriate.[299]

295 Q 230 (Andrew Griffith MP)

296 Letter from Andrew Bailey, Governor of the Bank of England to Lord Bridges of Headley, Chair of the Economic Affairs Committee (7 June 2023): https://committees.parliament.uk/publications/40346/documents/197274/default/ [accessed 3 October 2023]

297 Bank of England, 'Transparency and Accountability At The Bank of England' (December 2014): https://www.bankofengland.co.uk/-/media/boe/files/news/2014/december/transparency-and-the-boes-mpc-response [accessed 3 October 2023]

298 Letter from Andrew Bailey, Governor of the Bank of England to Lord Bridges of Headley, Chair of the Economic Affairs Committee (7 June 2023): https://committees.parliament.uk/publications/40346/documents/197274/default/ [accessed 3 October 2023]

299 *Ibid.*

166. Reviews conducted by the IEO have been numerous and have included an evaluation of the Bank's approach to forecasting in 2015 and an evaluation of the Bank's approach to quantitative easing in 2021. There have also been a number of externally-led reviews that have been conducted by the IEO. In July 2023, the Bank announced a review of its forecasting capabilities would be led externally by Dr Ben Bernanke, former Chair of the US Federal Reserve, and supported by the IEO.[300]

167. Knowledge of the IEO and its work was limited amongst our witnesses.[301] Sir Howard Davies commented that it "was not there when I was there, and I do not recall seeing anything that has emerged from it. Perhaps there has been something, but I have not seen it."[302] Other witnesses who were aware of the IEO expressed concerns about its location within the Bank. Professor Aikman argued that there is "a case for having more external scrutiny … There are a lot of inside committees and activities providing that assessment role and I think it is very hard to do that if you are an insider."[303] Professor Chadha opined that the IEO was "a good innovation", but similarly considered that it was "a little bit too much like [the Bank] marking their own homework … That is not to say that we think it is necessarily doing a bad job, but if you are continually marking your own homework there is a danger that your mark might, over time, slide up."[304]

168. Lord Macpherson said that "I am told the people who work for this office are very good", but he considered that "it should probably be strengthened in some way, because it could genuinely be helpful. Whether it should be detached from the Bank of England and live in some sort of space like the OBR [Office for Budget Responsibility] does in relation to the Treasury, I do not have a view on at this stage, but it is definitely worth contemplating."[305] However, Sir John Parker generally considered that "There is always a danger that we feel that we need another independent layer somewhere. If you recruit good people, make them responsible, clarify what you expect of them and hold them accountable for delivery, that, to me, is the way to run a modern organisation."[306]

169. Professor Chadha said: "If we believe that the OBR is a way of marking the Treasury's homework, we might want to think of different institutions or processes whereby the Bank is prepared to be examined by external bodies more obviously than it currently is."[307] However, Martin Wolf was against the idea of an OBR-like body separate from the Bank. He said: "A running assessment by an outside official body of the Bank of England's forecasting analysis of monetary policy would create a lot of confusion."[308]

---

300 Bank of England, 'Ben Bernanke to lead review into forecasting at Bank of England' (July 2023): https://www.bankofengland.co.uk/news/2023/july/ben-bernanke-to-lead-review-into-forecasting-at-bank-of-england [accessed 2 October 2023]
301 See for example Q 131 (Roger Bootle), Q 131 (Sir Howard Davies)
302 Q131 (Sir Howard Davies)
303 Q 9 (Prof David Aikman)
304 Q 9 (Prof Jagjit Chadha)
305 Q 218 (Lord Macpherson of Earl's Court)
306 Q 218 (Sir John Parker)
307 Q 9 (Prof Jagjit Chadha)
308 Q 82 (Martin Wolf)

170. When asked about the independence of the IEO, David Roberts told us that the Office "reports directly to me, so it is not in the executive line".[309] He added:

> "It has a small expert staff. They are drawn from the Bank, but quite often they are people who have gone out to do other things and are looking to come back, so there are people with some external experience … The really important point is, however, that it is always supplemented externally. It always has external advisers and a large external network that it uses, because we are all prisoners of our own experience and therefore, we need to challenge ourselves."[310]

171. **Impartial, independent analysis of the Bank's performance should help build confidence in the Bank and enable it to be held to account by Parliament and others. The Independent Evaluation Office's (IEO) remit is to scrutinise the performance of the Bank and we have received evidence that the IEO is both professional and has exemplary capabilities. However, its perceived independence is undermined by the fact it is located within the Bank, its staff are drawn from the Bank, albeit with some external experience; and its work is commissioned by the Bank's Court of Directors. This underscores the need for Parliament to conduct a review of the Bank's performance every five years.**

309 Q 182 (David Roberts)
310 *Ibid.*

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

1. Looking at the last 25 years as a whole, operational independence has bolstered economic confidence and credibility in monetary policy making. While the precise contribution of independence to low inflation is difficult to quantify—with globalisation widely considered a contributing factor—the conditions established by independence have provided a strong foundation for low and stable inflation since 1997. It is our view that independence should be preserved. (Paragraph 21)

2. Some witnesses made a case for reviewing the inflation target. While the Chancellor can change the target, the disadvantages of doing so when inflation is above target, outweigh the advantages. This is the case given the potential impact on the Bank's credibility. When inflation is low the Bank should be cautious about the impact of a prolonged period of loose monetary policy on asset prices and financial stability. (Paragraph 36)

3. The interaction between fiscal and monetary policy requires clear lines of responsibility and effective communication between the Bank and HM Treasury to safeguard overall economic stability. It is important, particularly given the constraints of monetary policy, that when interest rates trend towards their zero lower bound HM Treasury promotes a fiscal stance which supports the inflation target it has set the Bank. The Government's fiscal stance and the directions given to the Bank's Monetary Policy Committee must work together. It is the Government's job to ensure they are consistent with each other, not the Bank's. (Paragraph 46)

4. Quantitative easing was a powerful tool with which to combat a monetary contraction in the aftermath of the 2008 financial crisis, but its continued deployment has blurred the lines between monetary and fiscal policy. While the quantum of quantitative easing is a monetary policy decision, decisions on debt duration have consequences for debt management. In light of the concerns raised about debt duration and the effects of quantitative easing, the Bank and the Debt Management Office (which is an agency of HM Treasury) should draw up and publish a memorandum of understanding which clarifies how the interaction between monetary policy and debt management should operate. (Paragraph 59)

5. In addition, although there are differing views about the impact of quantitative easing, the Bank of England should give prominence to the study and reporting of the potential economic risks arising from any significant expansion in its balance sheet resulting from an extended quantitative easing policy. (Paragraph 60)

6. We repeat the call that the Government should publish the 'Deed of Indemnity'. (Paragraph 61)

7. It is concerning that the Bank's remit has expanded considerably in terms of statutory objectives, functions, regulatory principles and matters to which it should 'have regard' and 'consider', in order to support the Government's economic policy. This jeopardises the Bank's ability to prioritise price and financial stability; risks drawing it into the Government's wider policy agenda; and increases the potential for conflict between the Bank's objectives. We recommend that the number of matters the Bank should 'have regard to' or 'consider', as set out in the policy committee remit and recommendation letters, be pruned by HM Treasury to ensure the Bank can focus on its

primary objectives of maintaining price and financial stability. (Paragraph 85)

8. The expansion of the Bank's remit has led to a rise in the Bank's headcount and to an expansion of its management structure, resulting in four Deputy Governors and a significant number of Executive Directors. This expansion, particularly in relation to regulation, risks downplaying the importance of monetary policy amongst the leadership and staff of the Bank. We recommend that the Bank's management structure be reconsidered, with a focus on whether it could be made more streamlined. (Paragraph 92)

9. If a decision is made to create a Central Bank Digital Currency, the Bank and HM Treasury will need to clarify what effect this would have on the framework for operational independence and the primary objectives of the Bank. They will also need to establish commensurate accountability mechanisms. The creation of a CBDC could raise wider public policy issues—such as breaches of privacy—which are highly political and could exacerbate risks of the Bank being distracted from its main objectives of controlling inflation and maintaining financial stability. (Paragraph 100)

10. According to the evidence we received, there is perceived to be a lack of intellectual diversity in many central banks, including the Bank of England. Witnesses suggested that this contributed to insufficient challenge on the MPC in 2020 and 2021 which allowed a unanimity of view to prevail about the "transitory" nature of above-target inflation. While every member of the MPC must be committed to fulfilling the Committee's objectives, it is imperative that its membership comprises people of different backgrounds and economic perspectives. The Bank must be pro-active in encouraging a diversity of views and a culture of challenge. This should be reflected in its hiring practices and its appointment procedures. (Paragraph 121)

11. There is a notable absence of any detailed discussions about money supply in the Bank's published Monetary Policy Reports. We recommend that the Monetary Policy Reports should include discussion of the main monetary aggregates, accompanied by an analysis of their relevance to the Bank's inflation outlook and the various scenarios the Monetary Policy Committee considers. This would ensure adequate transparency in how the Bank approaches its monetary policy decision-making. (Paragraph 122)

12. In 2021 the Bank of England, like many central banks, incorrectly forecast that above-target inflation would be "transitory". This was in part thanks to a lack of challenge as regards its modelling and forecasts. We therefore welcome the Bank's new externally-led review into its forecasting capabilities. This review should seek to explain the value of models that seldom predict anything other than a return to the two per cent target over their forecast horizon. We hope the review also considers whether appointments, both of officials of the Bank and members of the MPC, are creating sufficient diversity of thought. (Paragraph 134)

13. Members of the Bank's policy committees make decisions which have an immense impact on the UK economy. However, being led by HM Treasury, the process for appointing members to the Monetary Policy Committee has contributed to perceptions of both bias and a lack of diversity of thought. It is notable that three of the four current Deputy Governors have a Treasury background. While they are undoubtedly able, this does not strengthen the perception of independence. HM Treasury and the Bank's Court of

Directors should commission an independent review to address this: that review should look at how other public appointments are made, such as to the judiciary; consider best practice in other central banks; and propose measures to ensure the appointments process is transparent. (Paragraph 143)

14. Within the boundaries of its terms of reference, the Bank's Court of Directors plays an important role in terms of holding the Bank's Executives to account and providing internal challenge. Its ability to commission performance reviews of the Bank's policy committees provides a key means of doing so. However, we note that the Bank of England and Financial Services Act 2016 not only abolished the Oversight Committee but also reduced the number of non-executives on the Court. While there were mixed views from witnesses on the Court's current composition of non-executive and executive members, the Court must be able to provide a source of effective challenge within the Bank. The Chair of the Court should consider how to enhance the role of the non-executive members so they are as effective as possible. (Paragraph 152)

15. The independence of the Bank, and the expansion of its remit, means that significant powers are delegated to, and exercised by, a small group of appointed officials who are not part of the elected Government. To meet HM Treasury's inflation target, the Bank may act in such a way that counteracts the economic impact of the Government's fiscal policy. It is therefore imperative that the Bank's activities and its remit are effectively scrutinised by, and its officials are held accountable to, Parliament. Current parliamentary arrangements should be enhanced to achieve this. (Paragraph 161)

16. We recommend that the annual remit letters for the Monetary Policy Committee and Financial Policy Committee should be published in draft to allow sufficient scrutiny of them. The final remit letters should be laid before both Houses of Parliament and accompanied by an oral statement in each House. We believe this would enhance both parliamentary scrutiny and public debate on the remits of the Bank set by the Chancellor. (Paragraph 162)

17. We recommend that every five years Parliament conducts an overarching review, supported by expert staff, of the Bank's remit, operations and performance (excluding individual policy decisions). This would enhance Parliament's ability to hold the Bank to account and express its view on the Bank's performance and leadership. (Paragraph 163)

18. Impartial, independent analysis of the Bank's performance should help build confidence in the Bank and enable it to be held to account by Parliament and others. The Independent Evaluation Office's (IEO) remit is to scrutinise the performance of the Bank and we have received evidence that the IEO is both professional and has exemplary capabilities. However, its perceived independence is undermined by the fact it is located within the Bank, its staff are drawn from the Bank, albeit with some external experience; and its work is commissioned by the Bank's Court of Directors. This underscores the need for Parliament to conduct a review of the Bank's performance every five years. (Paragraph 171)

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Lord Blackwell
Lord Bridges of Headley (Chair)
Lord Davies of Brixton
Lord Griffiths of Fforestfach
Lord King of Lothbury
Baroness Kramer
Lord Layard
Baroness Liddell of Coatdyke
Lord Londesborough
Baroness Noakes
Lord Rooker
Lord Turnbull
Lord Verjee

Declarations of interest

Lord Blackwell
No relevant interests to declare
Lord Bridges of Headley (Chair)
Adviser to and shareholder in Banco Santander
Lord Davies of Brixton
No relevant interests to declare
Lord Griffiths of Fforestfach
No relevant interests to declare
Baroness Kramer
No relevant interests to declare
Lord Layard
No relevant interests to declare
Baroness Liddell of Coatdyke
No relevant interests to declare
Lord Londesborough
No relevant interests to declare
Lord King of Lothbury
Former Governor of the Bank of England
Baroness Noakes
No relevant interests to declare
Lord Rooker
No relevant interests to declare
Lord Turnbull
No relevant interests to declare
Lord Verjee
No relevant interests to declare

A full list of Members' interests can be found in the Register of Lords' interests: https://members.parliament.uk/members/lords/interests/register-of-lords-interests

Specialist Adviser

Professor Rosa Lastra

Member of the monetary expert panel that advises the European Parliament (ECON)

Previously collaborated [pro bono] with the IMF on issues related to digitisation and climate change.

[Occasional] Specialist Adviser to the Bank of England on Digital Assets

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at https://committees.parliament.uk/work/7356/bank-of-england-how-is-independence-working/publications/ and available for inspection at the Parliamentary Archives (020 7219 3074). Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with ** gave both oral and written evidence. Those marked with * gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

Oral evidence in chronological order

*	Professor David Aikman, Professor of Finance and Director at the Qatar Centre for Global Banking and Finance at King's Business School, King's College London	QQ 1–20
*	Professor Jagjit Chadha, Director at the National Institute of Economic and Social Research	QQ 1–20
*	Professor Frederic Malherbe, Professor of Economics and Finance at University College London	QQ 1–20
**	Chris Giles, Economics Editor at the Financial Times	QQ 21–31
**	Professor Ricardo Reis, A.W. Phillips Professor of Economics at the London School of Economics	QQ 21–31
**	Neil Williams, Chief Economist at the Official Monetary and Financial Institutions Forum	QQ 21–31
*	Sir John Vickers, former Chief Economist at the Bank of England	QQ 32–43
*	Sir Paul Tucker, former Deputy Governor at the Bank of England	QQ 32–43
*	Rt Hon Ed Balls, former Shadow Chancellor	QQ 44–61
*	Rt Hon George Osborne, former Chancellor of the Exchequer	QQ 44–61
*	Andreas Dombret, former board member at the Deutsche Bundesbank, and former supervisory board member at the European Central Bank	QQ 62–74
**	Edward Chancellor, Financial Historian, Journalist and Investment Strategist	QQ 62–74
*	Martin Wolf, Chief Economics Commentator at the Financial Times	QQ 75–96
*	Donald Kohn, former Financial Policy Committee member at the Bank of England and former Vice Chair at the US Federal Reserve	QQ 75–96
*	Professor Christina Skinner, Professor of Legal Studies and Business Ethics at the University of Pennsylvania and former legal counsel at the Bank of England	QQ 97–119

**	Professor Timothy Congdon, Chairman of the Institute of International Monetary Research at the University of Buckingham	QQ 97–119
*	Sir Howard Davies, Chairman at the NatWest Group	QQ 120–135
*	Roger Bootle, Chairman at Capital Economics	QQ 120–135
*	Dr Raghuram Rajan, former Governor of the Reserve Bank of India	QQ 136–155
*	Professor Charles Goodhart, Emeritus Professor of Banking and Finance at the London School of Economics	QQ 136–155
*	Andrew Bailey, Governor of the Bank of England	QQ 156–174
*	David Roberts, Chair of the Court of Directors at the Bank of England	QQ 175–195
*	Lord Macpherson of Earl's Court, former Permanent Secretary to His Majesty's Treasury	QQ 196–220
*	Sir John Parker, former Chair of the Court of Directors at the Bank of England	QQ 196–220
*	Andrew Griffith MP, Economic Secretary to His Majesty's Treasury	QQ 221–240
**	Stephen D King, Senior Economic Adviser at HSBC	QQ 241–259
*	Kevin Warsh, former board member at the US Federal Reserve	QQ 260–269

Alphabetic list of all witnesses

*	Professor David Aikman, Professor of Finance and Director at the Qatar Centre for Global Banking and Finance at King's Business School, King's College London (QQ 1–20)	
	William Allen, Visitor at National Institute for Economic and Social Research	IBE0014
	Professor Ignazio Angeloni, Professor and Senior Policy Fellow at the European University Institute and SAFE	IBE0015
*	Andrew Bailey, Governor of the Bank of England (QQ 156–174)	
*	Rt Hon Ed Balls, former Shadow Chancellor (QQ 44–61)	
*	Roger Bootle, Chairman at Capital Economics (QQ 120–135)	
	Bank of England	IBE0022
*	Professor Jagjit Chadha, Director at the National Institute of Economic and Social Research (QQ 1–20)	
**	Edward Chancellor, Financial Historian, Journalist and Investment Strategist (QQ 62–74)	IBE0010

**	Professor Timothy Congdon, Chairman of the Institute of International Monetary Research at the University of Buckingham (QQ 97–119)	IBE0021
	The Court of Directors, Bank of England	IBE0020
*	Sir Howard Davies, Chairman at the NatWest Group (QQ 120–135)	
*	Andreas Dombret, former board member at the Deutsche Bundesbank, and former supervisory board member at the European Central Bank (QQ 62–74)	
	Alfred Duncan at the University of Kent	IBE0016
	Dr Ana Carolina Garriga, Reader at University of Essex	IBE0019
**	Chris Giles, Economics Editor at the Financial Times	IBE0006
*	Professor Charles Goodhart, Emeritus Professor of Banking and Finance at the London School of Economics (QQ 136–155)	
*	Andrew Griffith MP, Economic Secretary to His Majesty's Treasury (QQ 221–240)	
	Institute of International Monetary Research at the University of Buckingham	IBE0008
**	Stephen D King, Senior Economic Adviser at HSBC (QQ 241–259)	IBE0023
*	Donald Kohn, former Financial Policy Committee member at the Bank of England and former Vice Chair at the US Federal Reserve (QQ 75–96)	
*	Lord Macpherson of Earl's Court, former Permanent Secretary to His Majesty's Treasury (QQ 196–220)	
*	Professor Frederic Malherbe, Professor of Economics and Finance at University College London (QQ 1–20)	
	Professor Costas Milas, Professor of Finance at the University of Liverpool	IBE0001
	Mr Peter James Rhys Morgan, Macroeconomist at PJR Morgan	IBE0009
	Professor Charles Nolan, Professor of Economics at University of Glasgow	IBE0016
*	Rt Hon George Osborne, former Chancellor of the Exchequer (QQ 44–61)	
*	Sir John Parker, former Chair of the Court of Directors at the Bank of England (QQ 196–220)	
	Positive Money	IBE0013
	Radix Big Tent	IBE0004
*	Dr Raghuram Rajan, former Governor of the Reserve Bank of India (QQ 136–155)	

**	Professor Ricardo Reis, A.W. Phillips Professor of Economics at the London School of Economics	IBE0003
*	David Roberts, Chair of the Court of Directors at the Bank of England (QQ 175–195)	
*	Professor Christina Skinner, Professor of Legal Studies and Business Ethics at the University of Pennsylvania and former legal counsel at the Bank of England (QQ 97–119)	
	Treasury Committee of the House of Commons	IBE0007
*	Sir Paul Tucker, former Deputy Governor at the Bank of England (QQ 32–43)	
*	Sir John Vickers, former Chief Economist at the Bank of England (QQ 32–43)	
	Professor Ph.D. Casper De Vries, Professor at Erasmus University Rotterdam	IBE0012
*	Kevin Warsh, former board member at the US Federal Reserve (QQ 260–269)	
**	Neil Williams, Chief Economist at the Official Monetary and Financial Institutions Forum	IBE0002
*	Martin Wolf, Chief Economics Commentator at the Financial Times (QQ 75–96)	
	Mr Tim Young, retired Bank of England official and academic	IBE0017
	Trade Union Congress	IBE0018

APPENDIX 3: OVERVIEW OF THE BANK OF ENGLAND'S REMIT

Box 1: Bank of England remit

The remit of a central bank (such as the Bank of England) comprises statutory objectives, functions and powers. The word 'remit' is often used in a broad sense as synonymous to mandate.

The 'mission' of the Bank of England is "promoting the good of the people of the United Kingdom by maintaining monetary and financial stability."[311]

Statutory objectives

According to the current version of the Bank of England Act 1998,[312] the Bank's primary objectives are price stability (through the MPC) and financial stability (through the FPC). Price stability has been the primary objective of the Bank of England since 1998 according to Section 11 of the Bank of England Act 1998. Financial stability was added as an objective of the Bank in 2013, according to Section 2A of the Bank of England Act 1998, as amended. The Bank shall aim to work with other relevant bodies (including HM Treasury and the FCA) in pursuing the financial stability objective. The primary objective of the FPC according to Section 9C of the Act is to contribute to the achievement by the Bank of the financial stability objective.[313] The secondary objectives for both the MPC and the FPC are to support the Government's economic policy, including its objectives for growth and employment.[314]

The PRA was set up in 2013 by the Financial Services Act 2012[315] (and the PRC of the PRA was set by the Bank of England and Financial Services Act 2016).[316] The PRA's general objective, in line with financial stability, is the safety and soundness of PRA authorised firms, set out in Section 2B of the Financial Services and Markets Act (FSMA) 2000, as amended by the Financial Services Act 2012.

It has an additional objective of policy holder protection (section 2C of the FSMA 2000, as amended). The PRA's secondary objectives are to facilitate competition (section 2H of FSMA 2000) and international competitiveness and growth (this latter objective was introduced by the Financial Services and Markets Act 2023).[317]

The Financial Services and Markets Act 2023 also created a new Financial Markets Infrastructure (FMI) Committee whose primary objective is financial stability, and whose secondary objective is to facilitate innovation in the provision of FMI services (see Appendix 7).[318]

311 Bank of England, 'Bank of England' (November 2023): https://www.bankofengland.co.uk/ [accessed 2 November 2023]
312 Bank of England Act 1998
313 *Ibid.*
314 *Ibid.*
315 With the entry into force of the Financial Services Act 2012
316 The PRA was originally set up by FSMA as a subsidiary of the Bank of England Financial Services (Banking Reform) Act 2013. The Bank of England and Financial Services Act 2016 ended the status of the PRA as a subsidiary of the Bank and established a Prudential Regulation Committee in the Bank to exercise the functions of the PRA, as of 1 March 2017. See Financial Services (Banking Reform) Act 2013
317 Financial Services and Markets Act 2000
318 Financial Services and Markets Act 2023

Remit letters

As required by the Bank of England Act 1998, the Chancellor issues annual remit letters to the MPC.[319] It also issues remit and recommendation letters to the FPC[320] and recommendation letters to the PRC of the PRA at least once in each Parliament.[321] The letters include a number of issues to consider or have regard to in the discharge of the Bank's functions and in the pursuit of its objectives (see Appendix 4). For example, in the December 2022 remit and recommendations letter to the FPC, pertaining to the secondary objective (to support the economic policy of His Majesty's Government (Section 9D of the 1998 Act)), it also includes "increasing long term energy security and delivering Net Zero".[322]

The remit for the MPC since 1997 requires an exchange of open letters between the Governor of the Bank of England and the Chancellor of the Exchequer if inflation moves from the inflation target by more than one percentage point in either direction.[323]

Regulatory principles

The PRA (as well as the FCA which is external to the Bank) is bound by some regulatory principles included in Section 3 of FSMA 2000.[324] A new regulatory principle added by Section 27 of the Financial Markets and Services Act 2023 is the requirement for the PRA and FCA to support the transition to net zero. The regulatory principles of the climate and environmental targets do not apply to the FPC although they do apply to the Bank as FMI supervisor by virtue of Section 30E of the Bank of England Act 1998, which was amended by the Financial Services and Markets Act 2023. Section 30D states that in exercising its FMI functions in a way that advances the Financial Stability Objective, the Bank must have regard to the regulatory principles in section 30E.[325]

319 HM Government, *Monetary policy remit: Autumn Statement 2022* (November 2022): https://www.gov.uk/government/publications/monetary-policy-remit-autumn-statement-2022
320 Bank of England Act 1998
321 HM Government, *Recommendations for the Prudential Regulation Committee* (December 2022): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122895/CX_Letter_to_andrew_Bailey_0812_WITH_COVER.pdf
322 HM Government, *Remit and Recommendations For The Financial Policy Committee* (November 2022): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1118204/Financial_Policy_Committee_Remit_and_Recommendations_Autumn_Statement_2022.pdf [accessed 2 November 2023]
323 HM Government, *Open letters between HM Treasury and Bank of England* (June 2023): https://www.gov.uk/government/publications/open-letters-between-hm-treasury-and-bank-of-england-june-2023 [accessed 2 November 2023]
324 Financial Services and Markets Act 2000
325 Financial Services and Markets Act 2023

Functions

The Bank of England is currently in charge of the following functions: monetary policy, resolution (since 2009), macro prudential policy and micro prudential supervision (since 2013) and the supervision of FMI entities (since 2013). It is also in charge of note issue (currency), and it is the lender of last resort and conducts other tasks in its role as the bankers' bank (such as payments systems oversight) and Government's bank. In the exercise of its functions, the Bank of England has powers, instruments and tools, which have also considerably expanded in the area of supervision, monetary policy and lender of last resort during and post the 2008 financial crisis. Further expansion of the Bank's role as issuer of currency would be expected if a digital pound were to be issued.[326]

326 For a list of central banking functions, see Prof Rosa Lastra, International Financial and Monetary Law, 2nd edition (Oxford Press University, 2015), Chapter 2

APPENDIX 4: OVERVIEW OF THE REMITS AND RECOMMENDATIONS FOR THE BANK OF ENGLAND POLICY COMMITTEES (2022)

This report was finalised before the latest remit and recommendation letters for the MPC and FPC were published on 22 November 2023.

Box 2: MPC remit 2022

The Chancellor sets out the remit for the MPC in a letter to the Governor of the Bank of England. The Bank of England Act 1998 requires HM Treasury to specify at least once every 12 months how price stability will be defined and the Government's economic policy objectives. This remit sets out what price stability shall be taken to consist of and what the economic policy of the Government shall be taken to be.

1) **To maintain price stability**—

> "I confirm that the operational target for monetary policy remains an inflation rate of 2 per cent, measured by the 12-month increase in the Consumer Prices Index. The inflation target of 2 per cent applies at all times. This reflects the primacy of price stability and the inflation target in the UK monetary policy framework … In the event of exceptional shocks … the Committee may judge it necessary to deploy unconventional policy instruments … Where those instruments involve unconventional interventions in specific markets or activities, with implications for credit risk or credit allocation, I shall expect the Committee to work with the government to ensure the appropriate governance arrangements are in place to ensure accountability in the deployment of such instruments."

2) Subject to the above, **to support the Government's economic policy**, including its objectives for growth and employment. To achieve this objective, the Government's economic strategy consists of:

- "operationally independent monetary policy, responsible for maintaining price stability and supporting the economy;
- responsible fiscal policy where debt as a proportion of GDP falls over the medium term, supported by strong and independent institutions, and a credible macroeconomic framework maintaining sustainable public finances, while providing the flexibility to support the economy;
- supply side reforms to promote investment, skilled employment, infrastructure, and enterprise to create a more pro-growth environment in all parts of the UK, increasing long-term energy security and delivering Net Zero;
- maintaining a resilient, effectively regulated, and internationally competitive financial system that supports the economy, while protecting consumers and safeguarding taxpayer interests."

The letter also refers to coordination between monetary and macroprudential policy:

> "The MPC and the Financial Policy Committee should continue to have regard to each other's actions, to ensure coordination between monetary and macroprudential policy. This coordination has enhanced the strength and resilience of the UK's macroeconomic framework."

The full letter can be read on the Bank of England's website.

Source: Bank of England, 'Remit for the Monetary Policy Committee—November 2022' (November 2022): https://www.bankofengland.co.uk/letter/2022/november/mpc-remit-2022 *[accessed 6 November 2023]*

Box 3: FPC remit and recommendations 2022

The Bank of England Act 1998 ("The Act") sets out the objectives of the Financial Policy Committee (FPC). The Chancellor sets out in full the remit for the FPC in an annual remit and recommendations letter. The letter states that the FPC should exercise its functions with a view to:

> "a) contributing to the achievement by the Bank of the Financial Stability Objective (to protect and enhance the stability of the financial system of the United Kingdom); and
>
> b) subject to that, supporting the economic policy of His Majesty's Government, including its objectives for growth and employment.
>
> Section 9C of the Act makes clear that it does not require or authorise the Committee to exercise its functions in a way that would in its opinion be likely to have significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term.
>
> Section 9D of the Act allows me to specify what the economic policy of the government is to be taken to be. Section 9E of the Act also allows me to make recommendations to the Committee about:
>
> - matters that the Committee should regard as relevant to its understanding of the Bank's Financial Stability Objective; or
> - the responsibility of the Committee in relation to the achievement of that objective.
> - the responsibility of the Committee in relation to support for the economic policy of His Majesty's Government, including its objectives for growth and employment; and
> - matters to which the Committee should have regard in exercising its functions.
>
> …
>
> "The government's economic policy objective is to achieve strong, sustainable and balanced growth. Price and financial stability are essential pre-requisites to achieve this objective in all parts of the UK and sectors of the economy.
>
> To achieve this objective, the government's economic strategy consists of:

- "operationally independent monetary policy, responsible for maintaining price stability and supporting the economy;
- responsible fiscal policy where debt as a proportion of GDP falls over the medium term, supported by strong and independent institutions, and a credible macroeconomic framework maintaining sustainable public finances, while providing the flexibility to support the economy;
- supply side reforms to promote investment, skilled employment, infrastructure, and enterprise to create a more pro-growth environment in all parts of the UK, increasing long-term energy security and delivering Net Zero;
- maintaining a resilient, effectively regulated, and internationally competitive financial system that supports the economy, while protecting consumers and safeguarding taxpayer interests."

…

"The Committee should act with a view to supporting the government's overall strategy for financial services, where doing so does not conflict with the achievement of the Committee's primary objective—covering, in particular:

- Openness and Competitiveness. The government aims to promote an open and internationally competitive UK financial services sector by facilitating, subject to alignment with relevant international standards, the competitiveness of the UK economy (including in particular the financial services sector). This includes attracting and retaining internationally active financial services firms and activity, and encouraging trade and investment into the UK.
- Competition and innovation. The government is keen to see competition and innovation in all sectors of the UK financial services industry, particularly in the retail banking sector and through the promotion and support of FinTech and its technologies (including distributed ledger technologies).
- Climate change and energy security. The government aims to align private sector financial flows with environmentally sustainable and resilient growth, in a manner that is consistent with the important role that the financial system will play in supporting the UK's energy security—including through investment in transitional hydrocarbons like gas—as part of the UK's pathway to net zero.
- Home ownership. The government is committed to supporting first-time buyers looking to access the mortgage market.

The Committee should regularly review how it is able to proactively support the areas highlighted above in a manner that is consistent with its objectives. In its assessment of the costs and benefits of its policy actions, the Committee should, wherever practical and relevant, take these considerations into account."

The full letter can be read on the Bank of England's website.

Source: Bank of England, 'Remit and recommendations for the Financial Policy Committee'—November 2022' (November 2022): https://www.bankofengland.co.uk/letter/2022/november/fpc-remit-2022 *[accessed 6 November 2023]*

Box 4: PRC recommendations 2022

The Bank of England Act 1998 requires HM Treasury, at least once in each Parliament, to make recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard, when advancing the objectives and discharging the duties of the PRA. This is set out in the Chancellor's recommendations letter to the PRC:

> "The PRA has a general objective, set out in section 2B [of the Financial Services and Markets 2000], of promoting the safety and soundness of the firms it regulates, through ensuring that firms' business is carried out in a way which avoids any adverse effect on the stability of the UK financial system and minimising the risk they pose to financial stability.
>
> The PRA has an additional insurance objective, in section 2C of the Act, of contributing to the securing of an appropriate degree of protection for those who are or may become policyholders.
>
> The PRA has a secondary competition objective, set out in section 2H of the Act, which requires it, when discharging its general functions in a way that advances its objectives, so far as is reasonably possible, to act in a way which facilitates effective competition in the markets for services provided by the firms it regulates."

Subsequent to this letter, with the passage of the Financial Services and Markets Act 2023, a new secondary objective to promote international competitiveness and growth was added.[327]

> "In discharging its general functions, the PRA must also have regard to the regulatory principles set out in Section 3B of the Act."

Subsequent to this letter, with the passage of the Financial Services and Markets Act 2023, a new regulatory principle to contribute towards achieving compliance with the Government's net zero emissions target and environmental targets was added.[328]

> "Section 30B of the Bank of England Act 1998 allows the Treasury to make recommendations to the Prudential Regulation Committee (PRC) about aspects of the economic policy of His Majesty's government to which the Committee should have regard when considering:
>
> - how to advance the objectives of the PRA, and
> - the application of the regulatory principles.
>
> This document contains HM Treasury's recommendations to the PRC under section 30B of the Bank of England Act 1998."

327 Financial Services and Markets Act 2000
328 *Ibid.*

…

"When the PRC considers how to advance the objectives of the PRA, have regard to the regulatory principles and discharge its other relevant duties, it should, where relevant and practical, take these considerations into account, in its assessment of the costs, burdens and benefits of potential rules or policies.

i. Supporting the government's objective of medium to long-term economic growth in the interests of consumers and businesses

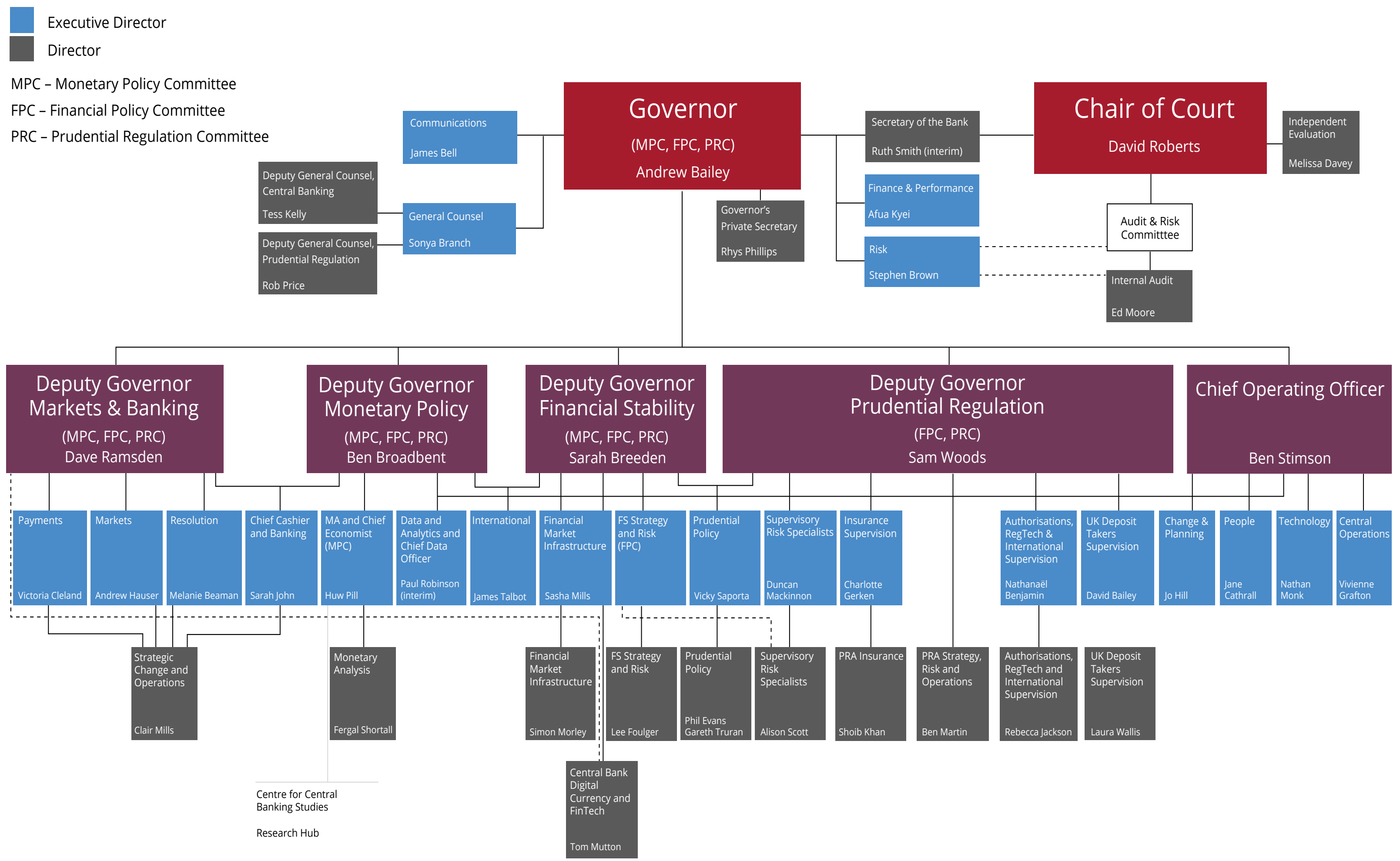
…

ii. Supporting the government's objective to promote the international competitiveness of the UK"

The full letter can be read on the UK Government website.

Source: HM Government, 'Recommendations for the Prudential Regulation Committee: December 2022' (December 2022): https://www.gov.uk/government/publications/recommendations-for-the-prudential-regulation-committee-december-2022 *[accessed 6 November 2023]*

APPENDIX 5: BANK OF ENGLAND ORGANOGRAM (NOVEMBER 2023)



Source: Bank of England, 'Official Bank organogram' (November 2023): https://www.bankofengland.co.uk/-/media/boe/files/about/people/orgchart.pdf *[accessed 15 November 2023]*

APPENDIX 6: BANK OF ENGLAND COURT OF DIRECTORS AND POLICY COMMITTEE MEMBERSHIP

Membership of the Bank of England's Court of Directors

According to Section 1 of the Bank of England Act 1998, the Court of Directors membership includes the Governor, the four Deputy Governors for Financial Stability, Markets and Banking, Monetary Policy, and Prudential Regulation, and no more than nine non-executive directors.

The Governor serves for an eight-year non-renewable term. The Deputy Governors are appointed for five-year terms and are limited to two terms.

The non-executive directors are appointed for a period of four years, "or such shorter period as may be specified in the appointment."[329]

Membership of the Monetary Policy Committee

The MPC has nine members, comprising the Governor of the Bank, the Deputy Governor for financial stability, the Deputy Governor for markets and banking, the Deputy Governor for monetary policy, the Chief Economist and four external members appointed by the Chancellor of the Exchequer.[330]

The external members of the MPC and the Chief Economist are appointed for three years.[331]

Membership of the Financial Policy Committee

The FPC normally has 13 members, comprising the Governor, four Deputy Governors and the Executive Director for Financial Stability Strategy and Risk. Also included is the Chief Executive of the Financial Conduct Authority and one non-voting member from HM Treasury. There are also five external members.[332]

The external members of the FPC are appointed for three years.[333]

Membership of the Prudential Regulation Committee

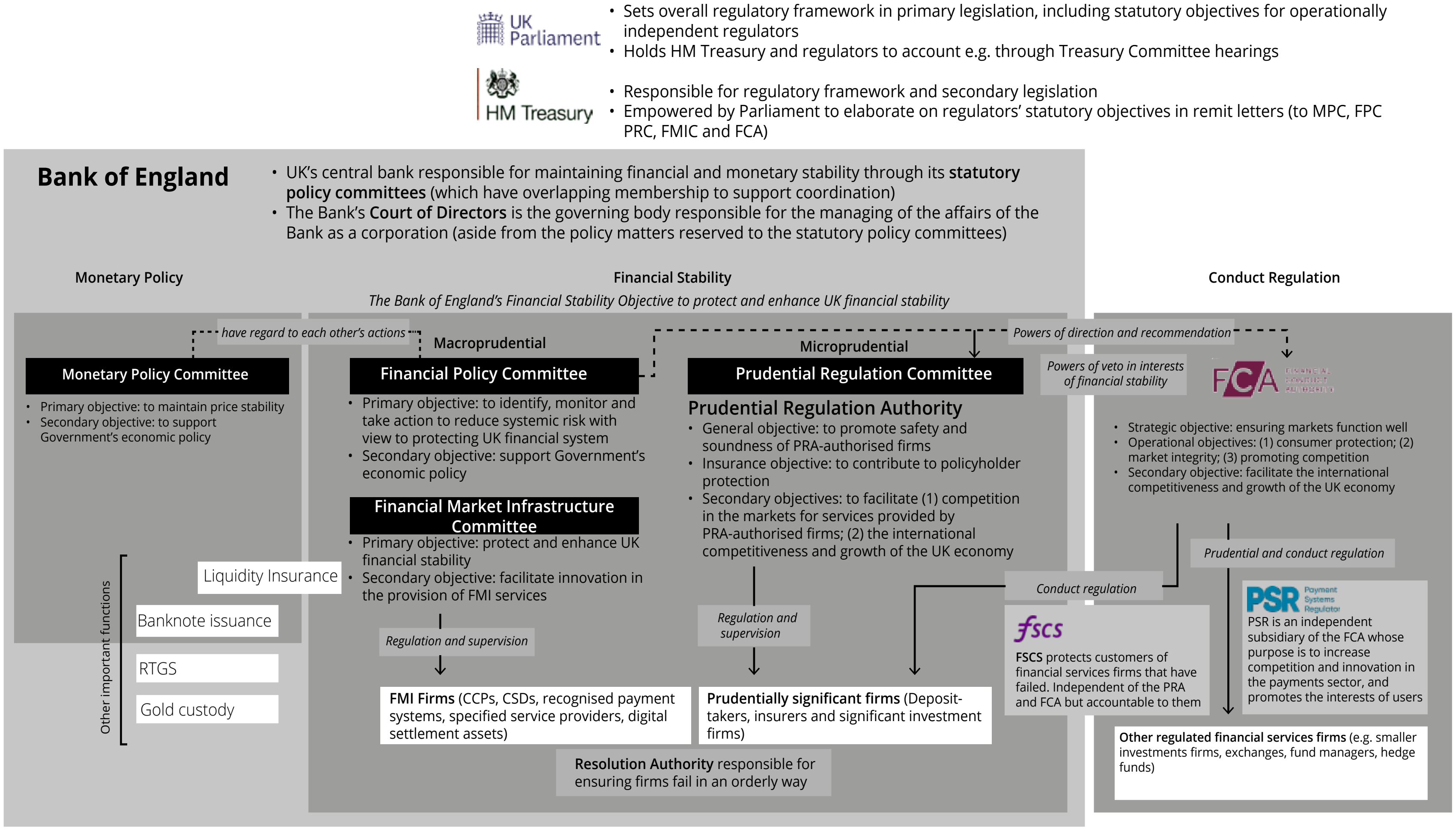
The PRC has 12 members, comprising the Governor, the Deputy Governors for Financial Stability, Markets and Banking and Prudential Regulation, the Chief Executive of the Financial Conduct Authority, a member appointed by the Governor with the approval of the Chancellor and six other external members.[334]

The external members of the PRC are appointed for three years.[335]

---

329 Section 1 and Schedule 1 Bank of England Act 1998
330 Bank of England, 'Monetary Policy Committee': https://www.bankofengland.co.uk/about/people/monetary-policy-committee [accessed 10 November 2023]
331 Section 13 and Schedule 3 Bank of England Act 1998
332 Bank of England, 'Monetary Policy Committee': https://www.bankofengland.co.uk/about/people/monetary-policy-committee [accessed 10 November 2023]
333 Section 9 (B) and Schedule 2A Bank of England Act 1998
334 Bank of England, 'Prudential Regulation Committee': https://www.bankofengland.co.uk/about/people/monetary-policy-committee [accessed 10 November 2023]
335 Section 30A and Schedule 6A Bank of England Act 1998

APPENDIX 7: UK REGULATORY ARCHITECTURE (WITH A FOCUS ON THE BANK OF ENGLAND)



Source: Provided by the Bank of England to the Economic Affairs Committee