Bank of England

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House of Commons
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Andrew Bailey
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Bank of England monetary policy independence at 30: Still fit for purpose?

Dear Dame Meg,

The legitimacy of the United Kingdom's monetary policy regime is strengthened by scrutiny – not only of day-to-day policy decisions, but also of the framework itself. We welcome the opportunity to submit evidence to the Treasury Committee's inquiry, which we enclose with this letter.

Low and stable inflation is a foundation for a healthy economy, in which money holds its real value and households and businesses can plan with confidence. It allows people to work, save, make purchases, invest and enter into contracts with greater assurance about what a pound will be worth in the future. In this way, price stability supports sustainable growth and, with it, long-term improvements in living standards.

Effective policies to stabilise inflation – bringing it back to a target when events push it away – can help to reduce the inflation-risk premium in market interest rates, contributing to lower borrowing costs over the long term. They can also help to reduce the size of economic fluctuations and avoid "boom-and-bust" dynamics.

Since 1997, the United Kingdom's answer to how to provide price stability has been operational monetary policy independence at the Bank of England, supported by a wider set of institutional arrangements.

The central argument for independence is that an independent central bank can take difficult monetary policy decisions in the long-term public interest, protected from political pressures that might otherwise put short-term considerations ahead of lasting price stability.

Alongside operational monetary policy independence, the framework comprises a set of institutional arrangements that determine how the objectives for monetary policy are set by Parliament and the Government, how decisions are taken and by whom, and the democratic checks and balances to which those decisions are subject. In our submission, we have also compared these institutional arrangements in the UK with those of our peers.

Our judgement is that the essential principles of the framework remain sound. Over the past thirty years, operational independence has protected day-to-day monetary policy decisions from short-term political pressures, while leaving the objectives and overall framework under strong democratic control.

The Treasury Committee rightly draws attention to the scale of economic developments since the framework was established. Since the global financial crisis, the economy has been hit by larger and more frequent global shocks which have tested this framework.

Most recently, inflation has been well above the 2% target for much of the past five years. No monetary framework can prevent shocks from moving inflation temporarily away from the target. Indeed, it is exactly during such periods that the independence of the monetary policy framework proves its worth: inflation rose very substantially above the target, as it did in other economies, but longer-term inflation expectations remained comparatively stable and the subsequent reduction in inflation did not require the large increase in interest rates and unemployment associated with some previous UK disinflations. This record compares favourably with previous monetary regimes.

The experience of recent inflation nevertheless reinforces the importance of ensuring that the MPC is able to recognise changes in the economy, consider competing interpretations of unusual events and make robust decisions in conditions of acute uncertainty. As detailed in our submission, the continuing programme of work following the Bernanke Review is intended to strengthen the Bank’s capabilities in these areas and should continue to be evaluated as it is embedded.

There are also further lessons that go beyond the Bernanke Review. For example, there are important questions around the MPC’s composition and voting structure which, while providing important safeguards against groupthink, also has limitations as well as advantages given its individualistic basis.

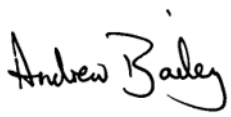
Similarly, the recent prevalence of large and repeated supply shocks raises the question of the trade-off between inflation and economic activity. This trade-off cannot be avoided, and the combination of the Bank of England Act 1998 and the Chancellor's annual MPC Remit provides guidance on how the MPC should respond to such shocks. But the MPC is also exploring the feasibility of producing a periodic monetary policy strategy statement within its individualistic committee structure, to sit in-between the high-level monetary policy objective and the justifications of individual policy decisions.

In a more volatile world, ensuring the return of inflation to target has also required the use of unconventional monetary policy tools. When interest rates reach their effective lower bound, none of the available monetary policy instruments is without limitations. For the reasons laid out in our submission, the MPC chose to use quantitative easing as its principal additional monetary policy instrument, in common with peers at the ECB and Federal Reserve. But the recent higher levels of government debt raise questions about the balance between protecting long-term focussed independent monetary policymaking when QE is in use, and the democratic checks and balances upon it.

Ultimately, it is for Ministers and Parliament to determine the framework in which the Bank operates. Inquiries like this one are an important means through which we can learn lessons for the future. In our attached contribution, we have detailed the arguments as we see them for the Treasury Committee to consider alongside the evidence it receives from others.

As ever, we stand ready to discuss these questions in further detail and would welcome the opportunity to follow-up on any of the matters raised.

Yours sincerely,





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