Law and the Economy   Exam Exercise   Andrew Hinstridge

A Bank of England free to set interest rates is a fundamentally undemocratic development. This is precisely its attraction

"*On 6th May 1997, the Chancellor of the Exchequer announced changes to the operation of monetary policy in the United Kingdom: the Government would continue to be responsible for setting the objectives of monetary policy but the Bank of England would be given immediate operational responsibility*".[1]

One of the main elements of these reforms, implemented by the Bank of England Act 1998, was the creation of the Monetary Policy Committee (MPC), a nine-member body with the independent responsibility for determining UK base interest rates. Prior to the reforms the task fell into the hands of the Chancellor and the Treasury.

The 1998 Act was formulated with reference to the central bank systems in operation in other countries, notably Germany and the USA. Section 10 removes the Government's power to issue directions to the Bank in this area, a residue of its status as a nationalised industry (although it should be noted that these powers were never used, the delegated legislation provided for, for formalising their use was never implemented, the Government preferring to rely on less formal means of guidance). However the discretion of the MPC over interest rates is not unfettered. It is bound, under s. 11 of the Act to work towards clear objectives and strict procedures. The MPC is charged with ensuring price stability, by meeting the target inflation rate, a task which so far it has managed to do fairly well, and also to follow Government Economic Policy in general. The MPC consists of the Governor of the Bank, his two deputies, two appointees of his office, and four treasury appointees. These appointed members serve on a three-year term, and at present are all Academics. Their appointment is subject to a non-statutory review procedure by the Treasury Select Committee, although this amounts to little more than a simple interview, and to date, no appointee has been refused. There is no parallel with the Senate Confirmation hearings (or grillings, as the case may be) that take place in the US for similar appointments to their Federal Reserve Bank.

The Act (s. 14) provides for the minutes of MPC meetings to be published within six weeks although this is now done within two. Each individual's votes are noted, but otherwise there is no provision for their respective positions to be published, but ordinarily these are leaked to the press anyway (by various interested parties!).

Notably the Government, by virtue of s. 19, retains a power of special action. If there is an extreme economic necessity short term measures may be put in place by the Treasury for three months, using the expedited

[1] Treasury Select Committee, "*Accountability of the Bank of England*" 1997-98 HC 282

Parliamentary affirmative resolution procedure. Many commentators consider that it is unlikely this power will be used, as such behaviour would amount to an effective admission of failure on the part of the Government.

The changes to the procedure for setting interest rates serve to create a degree of independence for the Bank in determining the economic climate of the country, and many have argued that this transfer of powers from traditional democratic controls creates problems of accountability. It is though a peculiarly British situation. Other European nations have a long tradition of powerful, independent central banks. Indeed the successful functioning of a European Central Bank is fundamental to the progression of Monetary Union. Where the British economy differs greatly from other European states is in the culture of home ownership, based on variable rate mortgages. Monetarist economic doctrine suggests that high interest rates mean that there is less money in circulation as a result of the disincentive to borrow (amongst other factors, such as increases in investment) and as such there will be little inflation and greater price stability. Thus the vesting of a power to affect the financial lives of so many people in faceless ‘technocrats’ is understandably controversial.

However, economists have argued that there is no need for accountability in this decision making process, stating that it is a purely economic issue that should not be influenced by the concerns of politics and politicians. The fact of the matter though, is that it is not a simply a technical decision. There is an important political element. There is also the argument that there are many other considerations that are far from technical, notably commercial imperatives (low rates being better for industry than high ones) and social concerns (regional and employment issues). Economists would counter that the control of inflation is the paramount consideration and as such there is no need for ensuring that other considerations are taken into account. Others counter this by claiming that this aim can in itself be counterproductive, as high interest rates can discourage economic growth.

Aside from intractable economic wrangling, there were and are strong arguments of accountability for the depoliticisation of this decision making procedure,. This decision has been made by the Chancellor consistently since the mid - 1980’s, and many would argue that it has been entirely his decision for many years prior to this. This state of affairs was argued to be perfectly defensible, and indeed perfectly democratic. The reforms have resulted in the loss of the ability to question the Chancellor in Parliament. This means of accountability, whilst lobbied for on some sides, existed effectively only in theory. There was a general reluctance to answer questions, particularly about the decision making process. A Parliamentary censure motion over the issue was also never likely to succeed given the power of the whip system.

Many would argue though that since the reforms, Parliamentary accountability has in fact increased. The power to question the Chancellor on matters of general policy, notably the objectives under which the MPC works, remains, although the same limitations apply. The role of the Treasury select committee has increased, with specific hearings being held on each rate variation. In its report "The Monetary Policy Committee-Two Years On", it expressed a general satisfaction with the MPC, noting that it had in part been responsible for staving off recession.

The increases in openness brought about by greater publicity in the decision–making procedure has served to drag the issue out of the 'smoke-filled rooms' and into the public domain. A related development to greater openness is the increase in legal accountability. Aggrieved persons may go before the courts and use judicial review procedures. In England this is especially important, given the fact that pressure groups have standing in such cases.

Despite the debated improvements in accountability, the issue of the political neutrality of the MPC could be questioned. The decision is neither purely economic nor purely political but there is a chance that political influence could be used in such a way as to limit the independence of the decision making body. The Treasury's power to appoint to the MPC is an example of the lack of independence in this area. The lack of any sanction over the MPC for failure to meet the price stability criteria, other than compulsion to publish reasons has also drawn critic's attention.

The effectiveness of the MPC as an internally democratic body has also been questioned. Several of the appointees have complained that they have not been listened to and not given adequate resources and support to contribute. These criticisms have been taken on board and have been dealt with to a degree now.

The work of the MPC has been criticised in many quarters though. Some feel that the process has been too academic and detached and has resulted in overly high interest rates. Indeed the President of the European Central Bank has noted over this past weekend that the UK's rates sit at a level twice that of the EMU states, and that this will be a one of the factors that may set the UK back in meeting the convergence criteria within the next ten years.

Membership of EMU may also create further questions of accountability within the UK. The transfer of these powers to the European Central Bank would represent a clear departure from traditional and more modern means of accountability. Within the ECB there is a reluctance to publish minutes of meetings, with the latest suggestion being that they should be subject to a publication delay of 16 years, although in future there may be further scrutiny before the European Parliament.

One development in accountability that has also been derived from the American and the German systems is the representation of commercial interests and regional considerations in the Court of the Bank, its policy formulating body. The representation of regional concerns is a new development, given the lack of a strong regional state banking system in the UK, but given the growth of regional government in Britain, and the geographic polarisation of economic performance, it seems to be necessary and desirable development.

So whilst the decision making procedure has certainly become more independent of Government, there remains some Government influence over it through the criteria the MPC is bound by. The decision making process could be seen to be undemocratic in the traditional sense, which is undesirable to many, but to pure monetarists it is profoundly attractive. The reforms can also be seen as desirable, insofar as they have lead to what can be seen objectively as an improvement in accountability, albeit in less traditional terms. However the reforms are viewed though, there seem to be great concerns about the accountability of the European Central Bank's equivalent decision making processes, and these remain very real, whatever the timescale for UK membership of EMU.