# in brief...
# Delayed doves

Do newly appointed external members of the Bank of England's Monetary Policy Committee (MPC) hide their true views on the right level for interest rates? **Stephen Hansen** and **Michael McMahon** look back at their voting records over the 10 years since the MPC was first given control of UK monetary policy-making.

On coming into office in May 1997, Gordon Brown, the new Chancellor of the Exchequer relinquished his power to set UK interest rates and passed responsibility to an independent body to be known as the Monetary Policy Committee (MPC). The central idea behind this decision was that with trained experts rather than politicians setting interest rates, there would be less scope for political manipulation and monetary policy-making would therefore have greater credibility.

Such an institutional arrangement is increasingly common around the world. What is slightly unusual in the UK case is that the Bank of England Act 1998, which established the MPC, requires the chancellor to appoint four of the nine committee members from outside the Bank. These external members join five internal members – the governor, two deputy governors, the chief economist and the executive director for market operations – to make up the MPC.

Other countries also appoint experts from outside their central bank, but the experts typically then take up a senior position within the bank. At times, such appointments happen in the UK: for example, some of the internal MPC members were appointed from outside the Bank but joined the in-house staff on their appointment.

Every month, since the first meeting on 6 June 1997, the MPC has met to decide interest rates by majority vote. With the entire UK economy affected, the MPC makes its decision on the basis of the one thing that economists agree monetary policy can control: prices. The MPC remit, as defined in the 1998 Act, is to 'maintain price stability, and subject to that, to support the economic policy of Her Majesty's government, including its objectives for growth and employment.'

In practice, the committee seeks to achieve a target inflation rate of 2%, based on the consumer price index. If inflation is greater than 3% or less than 1%, the governor must write an open letter to the chancellor explaining what has happened. In fact, the MPC has been very successful and the last 10 years have been a period of unprecedented stability for the UK both in terms of inflation keeping within target and GDP growth.

Despite the collective success of the committee, the voting differences of internal and external members (which are revealed in the publicly available minutes of MPC meetings) have been heavily scrutinised in the financial press. Those voting for higher interest rates are labelled inflation 'hawks'; those voting for lower rates are 'doves'.

Using these voting records, our research examines the behaviour of the external members. According to the Bank, 'the appointment of external members is designed to ensure that the MPC benefits from thinking and expertise in addition to that gained inside the Bank of England.'

We start from the premise that when MPC members (internal and external) vote on interest rates, they try to ensure that the inflation target is achieved. Furthermore, during the monthly meeting, members will communicate their views to the other MPC members. By taking account of every other member's view of the world, individual members can formulate their best – and possibly different – guess of what interest rates should be. Thus, the differences in voting behaviour between members, which are apparent in the voting records, are of themselves unsurprising.

But if the members are behaving according to this ideal, they will learn about the true state of the economy, and

**After a year on the MPC, external members begin voting for substantially lower interest rates**

External members may not fully express their views on interest rates when they first join the committee

begin to figure out how to interpret the views of their fellow members. If another member usually suggests interest rates that are high, then you will still listen to their views but interpret them in such a way as to factor in that member's tendency to vote for higher rates.

As all members are doing this, over time the voting behaviour of members should become more similar as everyone learns what interpretations different members will give to the same data. Therefore any differences in voting behaviour that exist initially should disappear as members adjust their views on monetary policy. Furthermore, members who begin voting for similar interest rates (and so must have the same interpretations of the data) should not diverge from each other in the future.

But our analysis of the voting records in fact shows the opposite pattern. External members initially vote in line with internal members, but after about a year on the MPC, these external appointments begin voting for substantially lower interest rates. This delayed 'dovishness' is present even when we take account of differences in members' backgrounds, age and education, as well as the current macroeconomic environment.

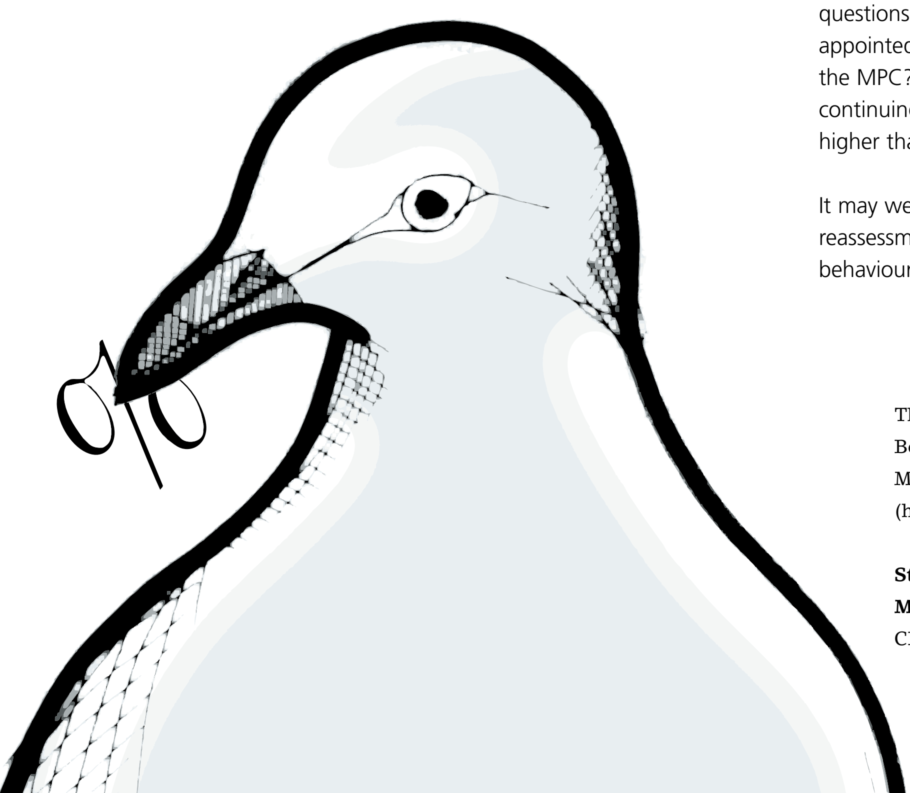
These results are especially striking considering that many of the internal and external members have very similar education and career experiences on appointment to the MPC, and many of the internal members have had no prior central bank experience until they joined the MPC and the Bank staff.

Our research explores why external members may behave in this way. We examine differences in the term lengths that they will serve, the likelihood that they will be reappointed and the possibility that external members try to differentiate themselves so as to get publicity and boost their career options on leaving the MPC. We cannot conclude that any of these factors are important.

One possible explanation that remains is that external members, on first joining the committee, do not fully express their view about the correct interest rate. It is only later, once they have gained experience, that they begin to articulate their differing views.

These results leave open a number of future research questions. For example, why would external members, appointed as experts, hide their views when they first join the MPC? And are some of the internal members continuing to hide their true views, keeping interest rates higher than necessary so as to be seen as more hawkish?

It may well be that the current structure of the MPC merits reassessment in the light of this evidence of the changing behaviour of external members.



This article summarises 'Delayed Doves: MPC Voting Behaviour of Externals' by Stephen Hansen and Michael McMahon, CEP Discussion Paper No. 862 (http://cep.lse.ac.uk/pubs/download/dp0862.pdf).

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