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Bank of England groupthink contributed to the inflation crisis

Ryan Bourne

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Why didn't the Bank of England initially anticipate the high inflation we are grappling with? At the time, various macroeconomic theories pointed to big risks through 2021. Monetarists observed that the money supply had ballooned, while huge Covid-19 relief programmes, coupled with enforced saving during shutdowns, had delivered record household wealth that threatened future spending surges.

Supply chain disruption was already evident, despite the Bank later blaming it for inflation as if unforeseen. Huge bailouts had raised government debt significantly, increasing the likelihood of the Bank monetising it to help out a future ailing Treasury. Why, then, was the monetary policy committee (MPC) so sanguine, when all these dangers pointed towards rising inflationary pressures through 2021?

In April that year, while launching the Meeting Varied People initiative, Andrew Bailey, the Bank's governor, lamented potential cognitive groupthink, saying: "I want the Bank to have an inclusive and open culture where people speak up, ensuring we make better decisions."

Yet at the MPC, the herding of opinion was already entrenched. Across 14 votes of its nine members from late March 2020 until November 2021, there was a sustained, unanimous consensus that the Bank rate should be held at just 0.1 per cent, even as inflation surged beyond 5 percent. By that stage, the inflation genie had long escaped the bottle.

We can speculate on the reasons for this faulty consensus. Huw Pill, the chief economist, admits issues with the Bank's macroeconomic models. No doubt the MPC was somewhat guilty of hubris too, wrongly attributing low and stable inflation post-2012 to its ability to anchor public expectations.

In his new book We Need to Talk About Inflation, Stephen King, the HSBC economist, points out another factor: the MPC's institutional composition weakens the likelihood of viewpoint diversity. All four deputy Bank governors, he notes, have worked at HM Treasury, making groupthink more probable. So too does the selection process for the MPC's four external members. The Treasury oversees all these positions' interview processes and one former external MPC member, Dame Kate Barker, has been on every selection panel since 2011.

Past Bank appointments by the government have created unhealthy incentives. Ben Broadbent was an external MPC member, yet was then made the Bank's deputy governor for monetary policy in 2014. “What incentive does such an appointment offer other external members to question the ‘received wisdom’ of the institution?” King asks. Mark Carney, a former governor, long championed the supposed benefits of gender diversity for Bank decision-making. The mechanism he had in mind was unclear. After all, a theoretical MPC of nine Keynesians would vote like Keynesians, whatever their gender.

The presence of at least one overt monetarist sounding the alarm, or even an independent-thinking New Keynesian such as Larry Summers, could have fundamentally altered recent decision-making.

Past errors appear to have ignited more vibrant discussions today. Since November 2021 there’s been more disagreement, with at least one dissenting member in every MPC vote, and two occasions with people voting in both tighter and looser directions than the decision. That said, this week the chancellor selected Megan Greene, Kroll’s chief economist, as a new MPC external member. She was arguing inflation was “transitory” early last year.

With the money supply shrinking and lags in the impact of monetary policy changes, the MPC again faces crucial yet difficult judgment calls on inflation. Prizing intellectual diversity would help the Bank better navigate such uncertain periods.

Ryan Bourne occupies the R. Evan Scharf Chair for the Public Understanding of Economics at Cato and is the author of the recent book Economics In One Virus.