King of Threadneedle Street

How Mervyn King reshaped the Bank of England.

BY DIANE COYLE

There can scarcely ever have been an appointment to high office less controversial than the choice of Mervyn King as governor of the Bank of England. This is not to say he is without critics—more on this later. Nevertheless, he is profoundly respected as one of the key individuals who transformed British monetary policy after the humiliation of the pound's ejection from the European Exchange Rate Mechanism (ERM) in September 1992.

To call the subsequent changes a transformation is no exaggeration. The Bank of England now heads the international league tables in terms of central banking theory and practice. The structure of its formal independence (put in place in May 1997 by the incoming Labour chancellor of the exchequer, Gordon Brown) and its successful implementation of inflation targeting are widely admired. For the Bank's success can be enumerated precisely: 43 consecutive quarters of GDP growth, at a year-on-year rate close to trend, and with inflation an average of just 0.1 percentage point away from the 2.5 percent target since 1997. All this in a country that previously had the highest inflation and most volatile growth rate in the G7.

Before Mervyn King's promotion from deputy governor to the top job was announced last November there was some press speculation about rival candidates. His well-known hesitation about taking Britain into European Monetary Union was thought to be an obstacle for the

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King Mervyn

Bank of England Governor **Mervyn King's** *well-known hesitation about taking Britain into European Monetary Union was thought to be an obstacle to his appointment for the Prime Minister, Tony Blair. But it would have been bizarre for the government to choose anybody else. Why force out one of the architects of the United Kingdom's remarkable economic success in recent years?*

Prime Minister, Tony Blair—for like all those who were at the heart of economic policy in 1992, King was scarred by the ERM experience.

But with hindsight, it would have been bizarre for the government to choose anybody else. Why force out one of the architects of the United Kingdom's remarkable economic success in recent years by appointing someone else over his head? And with the other of the two deputy governors leaving at the same time, that would have meant newcomers filling all three of the Bank's top jobs; why risk such instability? Continuity triumphed.

Yet King is not at all typical as governors of the Bank of England go. He grew up in the ugly and unfashionable Midlands city of Wolverhampton, and still avidly supports the local soccer team, Aston Villa. He has never worked in the financial markets and wasn't previously a grandee of the City of London establishment. Unlike his predecessor Sir Edward George, he wasn't a life-long Bank of England man either, joining from the London School of Economics only in 1991.

It is his glittering academic career that got King where he is today. He earned a first-class honors degree from Cambridge University followed by a Kennedy Scholarship to Harvard University. He

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taught at Cambridge, Birmingham University, and the LSE as well as holding visiting posts at Harvard and MIT. He has to this day the true academic attitude, being inspired by what David Hume described as "the spirit of accuracy" in seeking to understand—

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and change—the world around him. Before he knew he would be appointed governor, and even after being offered the post, he seriously considered returning to a life of research and writing. This was more tempting to him than the other plum jobs he was offered from time to time. After all, senior central bankers lack the time to read and ponder, and he has felt that lack.

While those of us who are professional economists welcome the fact that a fellow economist is in a position of such power, others have been critical of what they see as the narrow view from the ivory tower. There is much in this carping of the conventional British distrust of anybody who reads books for fun rather than, say, chases foxes across the countryside or drinks many pints of beer in the pub. A typical Mervyn King speech will be laced with apt quotations from obscure old texts, and they'll flaunt an awareness of history, music, and literature as well as soccer. And this rich intellectual hinterland does inform his day-to-day work—which goes clear against the grain of our culture of preferring practical know-how and hands-on experience.

No wonder, then, that in a high-profile interview with *The Times of London* after his appointment, King put great emphasis on the practical. He said the theme of his term as governor would be a visit to a different country or region of the United Kingdom every month—the arithmetic works out so that each one will get an annual visit. He would be "listening and learning," he said. It's one of the most frequently voiced criticisms of the Bank that it runs monetary policy to suit London and the South East and ignores the needs of most other regions, where Britain's traditional manufacturing industries are located. Its very name is felt to be a perpetual insult by some people in Wales and Scotland.

At the same time, King is rightly proud of the fact that he has turned the Bank into one of Europe's intellectual powerhouses in economics. Although keen to make sure people understand he's "not just an academic," he also boasts about recruiting the best economists from around the world to the Bank. It is indeed a unique research center in its combination of brainpower and diversity, and the number of economists employed there has climbed steadily. Visiting academics are impressed by the quality of participants in its seminars, not to mention their number, and compare it favorably with their experience of most university seminars. This academic weight helps keep it at the cutting edge of monetary theory.

The new pre-eminence of economic research in the Bank of England hasn't been uncontroversial. It has affected traditional career structures, aiding those who are economists rather than generalists. Access to research resources has become so important that in 2000 there was an unseemly public row between King and some of the external members of the Monetary Policy Committee about the research budget available for the outsiders. (The external members won, thanks in part to their astute use of the press.)

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The Bank's forecasts have been criticized as systematically biased (although it seems picky to argue with an inflation outturn so very close to target year after year).

Above all, King is often criticized for an abrasive manner or arrogant style or described as a difficult, controlling boss. These all seem very out-of-character for a man who, outside the office, is calm and unpretentious with a dry sense of humour. They also seem inconsistent with his evident skill in steering through the shoals of politics and handling the media. So it's most likely that he shares with many brilliant people a certain impatience with others whose minds work more slowly—not an ideal characteristic in a manager but not the most serious flaw either. He's also always described as a workaholic, which is true in its way but misses the point that he loves the work. One newspaper profile described his only relaxation as watching Aston Villa matches—it was written by someone who didn't understand that doing economics (not to mention listening to a concert) can be just as relaxing as watching soccer.

The marriage of intellectual rigor and practical policy—for all this effort in the Bank supports the monthly interest rate vote of the Monetary Policy Committee—is a great achievement, a contribution to public service of the highest order. King's driving motives for having spent twelve years building a resilient monetary framework for the United Kingdom are set out in a brilliant 1996 speech, "Monetary Stability: Rhyme or Reason?" It argues the case for low and stable inflation as the *raison d'être* of central banks. That case is social as well as economic, and reflects his deep concern with the effects of uncertainty and instability on everyday lives. He concludes: "Few people enter politics to keep inflation low. Nor should we expect them to do so. Price stability should be part of our economic constitution, common to all parties, providing a degree of macroeconomic stability to enable governments to devote both time and energy to debate the great issues of the day."

All macroeconomists of the generation which came of age professionally in the 1970s place a high value on stability. King has spent more than a decade now helping put that lesson into practice, and persuading others of the need to change. And it has involved an impressive degree of change in the management of the British economy. The independent Bank of England, inflation targeting, and the Monetary Policy Committee represent a remarkable institutional achievement, a real break with the past.

King has come to enjoy the Bank's idiosyncratic traditions, still weighed down as they are by the burden of history, and will thrive as governor. However, it will be a still more remarkable achievement if he can sustain the post-1997 record of UK stability in the face of extraordinary global economic turmoil. Not surprisingly, he has expressed concerns about the challenges ahead—such as rebalancing the UK economy away from over-dependence on consumer demand, keeping inflation on target if the pound depreciates substantially, and proofing the international economic system against further instability. He must have been just a little bit tempted to leave the front line of policy and get back to the books and music. But it's hard to think of anybody who would be better at steering the Bank of England through the challenges. ◆