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European Journal of Political Economy 23 (2007) 106–123
European Journal of POLITICAL ECONOMY
www.elsevier.com/locate/ejpe

Monetary policy by committee: Why and how?

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Received 12 January 2006; accepted 15 January 2006
Available online 15 December 2006

Abstract

Monetary policy committees can reach decisions either individualistically (i.e., through voting) or collegially. Committees are neither inherently more nor less transparent than individuals. Most of the advantages of group (over individual) decision-making point to the superiority of genuinely collegial or individualistic committees. One potential disadvantage of an individualistic committee, however, is that it may confuse outside observers by speaking with too many voices. The best ways of communicating with markets and the general public differ between individual central bank governors acting alone and policy committees, and across different types of committees. When it comes to transparency, one size does *not* fit all.

JEL classification: C22; D12; D84; E52; E5
Keywords: Monetary policy committees; Transparency; Central bank communication

1. Introduction

Among the most notable, but least discussed, hallmarks of what I have called the "quiet revolution" in central banking practice (Blinder, 2004) has been the movement toward making monetary policy decisions by committee. Until about a decade ago, most central banks had a single governor, who might or might not have been independent of the rest of the government. But since then, the United Kingdom, Japan, Sweden, Norway, Switzerland, and Brazil, to name just a few, have opted to establish monetary policy committees (MPCs). In addition, the committee-based ECB replaced 12 central banks, most of which had previously been run by individual governors. I am unaware of any case in which a country replaced an MPC by a single decision maker. In fact, a recent survey by Pollard (2004) found that 79 out of 88 central banks made monetary policy by committee.

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0176-2680/$ - see front matter
doi:10.1016/j.ejpoleco.2006.01.003

Thus the existence of a pronounced worldwide trend is clear. So the first question for this paper is why. Why have so many central banks switched from individual to group decision making?

But simply deciding that decisions should be made by committee does not provide a how-to-do-it manual that a central bank can follow. So the rest of the paper focuses on a few selected aspects of the "how" question. Should an MPC make decisions by majority rule, with each member voting for his or her preferred policy, as is the case at the Bank of England? Or is it better to insist on something approximating unanimity — whether the unanimity is genuine or contrived? And given this decision, how should the central bank communicate with the public, the government, and the markets? A central – and heretofore ignored – point of this paper is that the most appropriate forms of communication depend on the nature of the monetary policy committee. There is no one "right way" to communicate.

2. The presumed advantages of group decision making

Theorizing about *why* central banks might want to make decisions by committee is a relatively young intellectual industry — and still a small one. One of the reasons for the trend is institutional — and obvious. In a number of countries, the movement toward committees went hand-in-glove with the spread of central bank independence. When the central bank was just following orders communicated by the government, there was not much reason to have a committee on the other end of the phone. An individual governor sufficed — and also limited the phone bill. But as central bank independence was granted in one country after another, the choice between an individual and a committee became a live one-both in theory and in practice.

In this case, practice ran well ahead of theory. By the time economic theorists turned their attention to the question, many central banks had already made the switch from individual to group decision making. We have thus witnessed a graphic illustration of the old saw: "It works in practice; now let's see if it also works in theory." Does it?

As soon as you start thinking about the choice between individuals and committees as a theoretical problem, one major stumbling block arises: If every member of an MPC behaves like *Homo economicus*, it cannot matter whether monetary policy decisions are made by an individual or by a committee. Since every member of a committee of well-informed *Homines economici* will see the same data and process it in the same way, they will all reach the same conclusion. Every committee vote should therefore be unanimous, and the committee's decisions should be identical to what any single member, acting alone, would do.[1] That, of course, is not a promising starting point for developing a theory of the choice between individuals and committees. We had better look elsewhere.

2.1. Different information

Homo economicus notwithstanding, members of real monetary policy committees frequently do reach different conclusions — for several reasons. One is a particular favourite of economic theorists: People receive different, somewhat idiosyncratic, information. A number of papers have sought to derive the virtues of committee decision making from the virtues of information pooling. In some contexts, differential information is essential. But in the case of monetary policy

[1] There is one exception: Standard economics allows for different preferences across committee members. More on this just below.