vox
Research-based policy analysis and commentary from leading economists

Enough is enough: How many people should decide about monetary policy?

Helge Berger Volker Nitsch
30 May 2008

The European Central Bank's Governing Council continues to expand as new economies adopt the euro. This column presents empirical evidence that the optimal central bank committee size is seven to ten members – far fewer than the 22 members the ECB will have come 2009.

A few weeks ago, the European Commission recommended that Slovakia should be allowed to join the eurozone as of January 1, 2009. When the member states follow this recommendation and accept Slovakia's adoption of the euro, the country will become the sixteenth member of the European single currency zone. At the same time, the Governor of the National Bank of Slovakia, Ivan Sramko, will take a seat at the Governing Council of the European Central Bank (ECB), thereby increasing the membership size of the eurozone's interest-setting body to 22 members.[1] Given that the ECB's Governing Council is an already large committee that may face decision-making difficulties, this further expansion in membership size appears to be not necessarily reasonable. Central banks in other countries are typically run by much smaller committees, sometimes even by just a single person, the governor.[2] Moreover, with the expected future enlargement of the eurozone, the Governing Council will expand further, perhaps soon comprising 30 or more members.
Ultimately, the size of the central bank board is an important feature of central bank design; a large literature aims to quantify their optimal dimension.[3] While there is a broad consensus that groups make better decisions than individuals, there is much less agreement on how large a committee should be. Theory suggests that, when it comes to the efficiency of monetary policymaking, "bigger may be better" because having more people on the committee allows analyzing more relevant information. In a group, information is pooled, there may be even cooperation in information processing, and extreme decisions are likely to be avoided; Blinder and Morgan (2005) and Lombardelli, Proudman, and Talbot (2005) provide supporting evidence for this hypothesis based on experimental research. However, the benefits of committee size are likely to become smaller as more and more people sit around the table. When individual members have fewer chances to influence a decision, they may have a larger incentive to free ride on the information-processing efforts of others. Moreover, in larger committees, members will spend considerably more time "sounding each other out" before or during meetings so that the costs of decision-making are increasing (possibly exponentially) in membership size. As a result, there are a number of offsetting forces to consider when changing the number of decision-makers, which should balance each other for some (unknown) committee size.

In recent research, we contribute to the debate on the optimal size of monetary policy committees from an empirical perspective. In particular, we aim to explore whether there is a measurable association between the number of monetary policy decision-makers and the subsequent economic outcomes of monetary policy. To analyse this issue, we compiled a new data set that characterises monetary policy committees in over thirty countries from 1960 through 2000; our data set contains information on the *de jure* and *de facto* membership size, the turnover in membership and the membership composition of a central bank's decision-making body. We then use all these measures to examine the effects of committee design on inflation (and other economic outcomes), after controlling for other economic and institutional factors.

In our empirical analysis, we find a strong and significant U-shaped relationship between the size of a committee and subsequent inflation. That is, inflation first tends to fall as the number of members on the committee increases, but this effect becomes smaller and eventually turns positive as committees grow in membership size. Taken at face value, our estimates imply that the minimum level of inflation is reached at committees with about seven to ten members, after holding constant for other factors. For other measures of economic outcomes, such as inflation variability and output growth, qualitatively similar results are obtained. In contrast, there is little evidence that the frequency of membership turnover or the membership composition of the committee shape economic outcomes.

Overall, our results strongly confirm that the membership size of a central bank's decision-making body is an important feature of central bank design. These findings should be taken into account when the efficiency of decision-making in the European Central Bank's Governing Council is reviewed.

References

Berger, Helge and Volker Nitsch, and Tonny Lybek. 2008. "Too Many Cooks? Committees in Monetary Policy," CESifo Working Paper #2274.

Berger, Helge, Volker Nitsch, and Tonny Lybek. 2008. "Central Bank Boards around the World: Why Does Membership Size Differ?" *European Journal of Political Economy*. (forthcoming).

Blinder, Alan and John Morgan. 2005. "Are Two Heads Better Than One? Monetary Policy by Committee," *Journal of Money, Credit and Banking*. 37 (5): 798-811.

Fry, Maxwell, Deanne Julius, Lavan Mahadeva, Sandra Roger, and Gabriel Sterne (2000), Key Issues in the Choice of Monetary Policy Framework, in Lavan Mahadeva and Gabriel Sterne (eds.) *Monetary Frameworks in a Global Context.* London: Routledge, 1-216.

Lombardelli, Clare, James Proudman, and James Talbot. 2005. "Committees versus Individuals: An Experimental Analysis of Monetary Policy Decision Making," *International Journal of Central Banking*. 1 (1): 181-205.

Footnotes

1 The Governing Council of the European Central Bank comprises the governors of the national central banks of the eurozone member countries and the six members of the Executive Board.

2 Most of the 82 central banks surveyed by Fry, Julius, Mahadeva, Roger, and Sterne (2000) have a decision-making body with about 5–10 members. See also Berger, Nitsch, and Lybek (2008) for a description of central bank boards around the world.

3 To be sure, there are other features of importance apart from membership size such as the composition of the board, the frequency of meetings, voting rules and majorities, and whether or not there are specific requirements on individual members (e.g., nationality, educational background).

Topics: EU institutions
Tags: EU enlargement, ECB, Governing Council

Comments

VoxEU.org