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THE IMPORTANCE OF CENTRAL BANKS' COMMITTEES AND COMMUNICATION STRATEGIES IN ASSESSING THE PATHS' OF MONETARY POLICY

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Abstract. Nowadays it is very important the ways and the channels central banks' communicate. There are two issues regarding this aspect: first, if and how the communication strategies differ regarding the future monetary policy decisions and the decision making process; second, evaluating the communication efficiency due to the possibility offered to the financial markets to anticipate the monetary policy decisions and that's of a central bank to influence in a specific and important manner the asset prices in the desired direction. The central argument lies in the importance of the needed distinction between the words the committee members say, the way they communicate and the effective action – how they vote regarding the monetary policy decisions.

Keywords: central bank, monetary policy, voting process, communication strategy, central bank transparency and accountability, decision making process.

Jel classification: D72, D78, E52, E58, E61

1. Introduction

In recent years, it has established a paradigm swift regarding the ways in which central banks conceive and apply monetary policy. It is a large consensus in the economic literature who stipulates that beyond central bank empowerment, transparency can contribute to a higher efficiency of monetary policy. However, central bank confronts to a potential conflict because a minimum level of central bank transparency is not necessary optimal for the efficiency of the attaining the objectives enriched in its' mandate. This type of conflict is engaged when a high degree of information don't clarify the market situation, because there are some limits regarding the information quantity that can be effectively processed. Moreover, in the situation in which exist a high degree of information there can be a lacking process of forming individual opinions, which is relevant for the central banks and consequently for the monetary policy. Regarding this aspect, specialists like Issing (1999) and Mishkin (2004) sustain that transparency is not a goal in itself but a way of helping central bank in fulfilment its mandatory objectives. The trend towards to the committees in taking the decision represents the *vanguard* of the individual communication with the individual members of the committee.

According to Bernanke (2007), it is preferable that the several views must be revealed inside the committee, but according to Issing (2002) this will lead to less clarity. In the first case, it is preferable an individualistic approach of communication, whereas in the second case central bank can choose a collegial approach. Moreover, the central bank communication strategy is not independent from the decision process of the committee. The decision can be made collegial, more individualistic, encouraging the committee members to vote according to the personal opinion. Consequently, the communication efficiency and choosing the right communication strategy depends, largely, from the nature of the decisional process.

The economic literature regarding central banking and monetary policy remarks the essential role of communication in increasing the monetary policy efficiency (Bernanke 2004; Blinder 1998; Issing 2005). Blinder and Bernanke engage upon the fact that many countries have a single monetary policy instrument – the overnight rate – whereby the monetary authorities can indirect influence the assets prices of higher values for the economy (long term interest rates, stock prices and exchange rate). In this sense, communication is an important mean of influencing these prices but implies credibility and a good track of the monetary authorities.

A large number of empirical studies are based on the theoretical aspects of transparency and communication having as foundation the important work of Cukierman & Meltzer (1986). Defining transparency is not necessary always a simple task.

Although in general it is understand as the lack of asymmetrical information between the markets and the decision factors in the field of monetary policy, exist other elements connected with transparency as: clarity, openness and honesty (Winkler 2000). A key problem of this literature is if and when transparency can increase the economic efficiency. LeRoy and Porter (1981) and Geraats (2002) show that when there is no quality in the communication or she is sufficiently strong in order to increase market volatility it is not desirable. E second trend of this literature is the extent to which communication can replace monetary policy. In principle, a sufficiently credible monetary authority will have the capacity of influencing asset prices by communicating the desired level and signalling the changes intention in monetary policy if the asset prices deviate from the established target. It has been established a debate regarding the fact that the authorities can be stimulated to give incorrect information to the markets leading to an efficient monetary policy only if she is followed by monetary policy actions. A great number of the empirical studies in this field has emerged the strategically monetary policy games, developed especially in the research of Kydland and Prescott (1977). Nowadays, studies developed by Berk & Beirut (2011) and Neuenkirch (2011) analyze the influence of central bank transparency and informal central bank communication on the formation of the money market expectations; the authors suggest that transparency reduces the biases in money market expectations and dampens their variation and that informal communications 'facilitates' the management of financial market expectations by reducing the variation of expectations.

Goodfried (1986) and Stein (1989) sustain that a solution of this compromise is maintaining credibility and applying a highly efficient communication policy by providing some imprecise announcements, namely practicing an incomplete transparency policy. More recently, it has been developed a third trend in this field of research which shows how transparency influences in a negative way the information exchange equilibrium between the monetary authority and markets, by introducing an suboptimal behaviour of the financial markets.

The aim of this paper is to assess the importance and the implication of the central banks' committees for evaluating the paths' of future monetary policy directions.

The research methodology starts with analyzing the advantages and disadvantages of the monetary policy committee by the implication of central bank transparency and, subsequent, to analyze and assess the 'best practice' committees practice in five developed countries.

The final objective of this paper is to deal with the opportunity of creating and assessing the monetary policy committees in five developed countries and to give future directions upon the most important committee practices in central baking.

2. The structure and design of the monetary policy committee

Central banks' communication can be dominant throughout preventing the formulation of the independent opinions by the private sector based on the information collection (Morris, Sheen 2002; Amato, Morris, Shin 2002; Padoa-Schioppa 2004). In this sense, combining transparency with communication can have bening effects because of the elimination or reduction of an important informational source for the central bank, namely the market perspective as a distinct informational source in establishing monetary policy. The empirical studies regarding the communication at the central bank level are lacking because of the difficulties registered in the evaluation process of it as well as of the recent adopted transparency as one of the principal characteristics of the monetary policy applied by the central bank. According to Guthrie and Wright (2000) communication was used systematically and very efficient by the FED and Reseve Bank of New Zeeland in controlling the short term interest rates.

Haldane and Read (2000) offer arguments "tied" to the decreasing effect of the monetary policy decisions over the interest rates in Great Britain which might suggest the reduction of the asymmetrical information upon the economy.

There are several empirical studies which analyze the role of communication at the central bank level in different situations. Jansen and De Haan (2005) analyze for the European Central Bank and Fratzscher (2004) for the G3 monetary authorities the communication influence upon the exchange rates. The first one's ascertain an effect upon the euro volatility and the last one offers several dates which sustain the efficiency in every G3 central banks' in changing the level and the volatility in the right direction.

Another part of the empirical literature analyzes the monetary policy predictability decisions (Kuttner 2001; Ehrmann, Fratzcher 2007a, 2007b). Regarding the literature upon the role and structure of the monetary policy and the institutional factors which determines the decision process is limited. There can be remark a large consensus regarding the fact that taking the monetary policy decision by and independent committee can lead to a superior monetary policy throughout several possible reasons: the capacity of agreeing the opinions of several different persons, the committee members capacity to learn from each other, or the committee reaction flexibility at several socks with different amplitude.

Analyzing the economic literature regarding the monetary policy committees we can identify the problem called "avoiding information cascades". According to Bikhchandani *et al.* (1992) committee can take a binary decion. In the chairman of the committee make a first proposal, and if this proposal is agreed by the second person, even if the third person disagree, according to the basis of their voting behavior if the first two person receinded both the pother signal it can be assumed that the signal received by the third person is wrong. The experiments of Milgram (1974) regarding to the *psychological predisposition* applied to the decision making process of monetary policy it can be seen a very high tendency for conformity regarding the opinion and directions of the chair meeting or speaker.

The importance in avoiding the *informational cascade problem* is the sequentially process of the choices. In order to solve this problem it can be identified two possible solution: in the first place it might help letting all committee member decided simultaneously upon the problem by the voting process; in the second place, it is preferable that every other person starts the discussion session and every other person make the interest rate proposal – in this sense it is desirable a non-fixed list of speakers.

Table 1 establishes the 'preference culture' for good committees. In our opinion, the core of the table is the preference of small taking monetary policy decision groups, the importance of developing independent acting and thinking, the differences in personal backgrounds and the prevalence of the voting process upon the consensus process.

The second problem regarding the structure of the committee is the controverse between a voting operate procedure or a consensus operated procedure.

In the consensus oriented procedure is the controverse of the motivation for the public disclosure of their internal "conflicts". After all, a collegial committee wants to project an "aura of agreement" and its disclosure (Blinder, Wyplosz 2004).

In this trend the central bank monetary policy committee members must encompass and mutual agreement. However, even if they decide unanimous upon a decision, it is place for a public debate over the preference of the X option over the Y option.

Table 1. Criteria for "good" committees (Source: Maier 2010)

	Clear objectives and independence	
	Clearly defined goal and efficient instruments	
	High score of central bank independence	
	Size of the monetary policy committee	
	Not much larger than five members	
	Rotation can lead to better information and limit the group size	
	Measures to avoid free-riding	
	Possibility to identify and evaluate individual contributions	
	Polarization and groupthink	
	Encouraging group members to think for themselves	
	Different personal backgrounds	
	Having a mix of internal and external members	
	No fixed speaking order to avoid information cascades	

In the case of the voting process monetary policy committee members vote upon the preference on an alternative and have the possibility of public disclosure of their voting process and voting procedure. In some cases, members of the committee make depositions or testimonies upon their voting, the paths 'of monetary policy in public or in parliament.

The best practice of these two procedures in not establish in the theoretical, empirical and practical papers (Blinder *et al.* 2008). Blinder (2007a) reflects upon the difficult process of voting; there are several opinion debates that can generate policy conflicts between the committee members. "If the result is a cacophony rather than clarity that may confuse rather than enlighten the markets and the public" (Blinder 2007b).

Table 1 presents the best practice criteria for a good track of the committees. As we can see the monetary policy committee needs a clear and ultimate goal but as well as a sample of efficient instrument with a large amount of flexibility in fulfilling their task. Consequently, central bank independence is a prior and necessary condition (both *de jure* and *de facto*) because of the need for political insulation of the monetary policy decisions, the prohibition of government lending and the autonomy in establishing the monetary policy objectives, tools, instruments and targets.

The size of the optimal monetary policy committee is an important problem regarding the efficiency of it. There is no optimal number of persons debated in the economic literature. However, it is desirable the possibility of rotating these members in order to limit a large number of persons in the structure of the committee.

In order to avoid the "free-riding" *gap* there must be the possibility to clearly identify and evaluate individual contributions within the committee. Moreover, it is important the personal and professional backgrounds of the monetary policy committee members: academics, central bank, business companies or government; an assessment of independent thinking of the group members; a mix between the internal and external members and a rotation of the order of speaking within the committee for avoiding *information cascades.*

3. Assessing central banks' communication strategies

The academic literature provides several arguments on why committees should be in charge of the monetary policy decisions. Maier (2007) defines the actual monetary policy committee in a technical sense as *the body in charge of the monetary policy decisions characterises them as a group of people sharing information and taking a decision together on the basis of the information reviewed and revealed.*

Today there is a growing consent that group decisions such as those taken by the monetary policy committee outperform individual decision (Gerdesmaier et al. 2007; Muto 2007):

- Decision made by a committee is usually better informed than made by a single central bank governor;

- Committee deliberation may reflect a broader picture of the possible interpretation of the information available at the time of the decision;

- Committees may be more transparent in the monetary policy decision making than individual decision makers (according to Fig. 1);

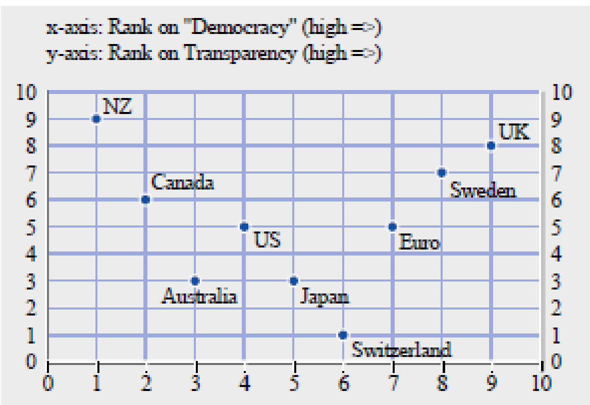

Fig.1. The transparency of the monetary policy committee (Source: Blinder 2006)

Table 2. Advantages and disadvantages of the voting systems (Source: Smidkova 2003)

	Board members reach consensus	Board members vote individually	Governor decides
Description	Policy-makers must reach consensus about the best policy reaction. They consider all available information + their individual judgments + the judgment of other board members.	Policy-makers vote on the basis of all available information, including expert views on probabilities and pay-offs + their individual judgment.	Governor decides on the basis of all available information including expert views on probabilities and pay-offs + his own judgement.
Major advantages	Indirect disclosure of pay-offs and probabilities to other decision-makers and consensus are respected methods for dealing with uncertainty.	Averaging of probabilities and pay-offs, helps to deal with uncertainty.	Easy and transparent – pay-offs and probabilities of the Governor are disclosed indirectly.
Major disadvantages	Time consuming. Lower transparency due to pay-offs and probabilities not being disclosed externally (policy bias can be indicated to compensate).	Differences between board members' opinions are only averaged. If the voting pattern is not announced, transparency not so high.	In experts are not valuable patterns in the policy debate, no other method for dealing with uncertainty is added on the second stage of the decision-making process.

- Decision-making by committees can be understood as a means of buying insurance against pressure from the government or the media which would aim to influence the monetary policy decisions.

Table 2 reveals the advantages and disadvantages of the monetary policy committee voting process identifying some trade-offs between different voting systems. The main issue of the table can be summarized as following: the more the voting system helps to deal with uncertainty, the less transparent it may ultimate be for external observers.

Figure 1 reveals the democracy versus transparency of the monetary policy committees. The figure show the ranking of nine central banks based on the Eijffinger & Geraats (2006) index against Blinder (2004) subjective index of the degree of democracy. Overall this comparison illustrates that in practice, exist several factors other than the size of the committee and its procedures and communications that determine the preference for central bank transparency. Such factor may be related to cultural aspects of the society, traditions and common values.

4. Evidence of monetary policy committee in practice in five developed countries

In this section we want to present a qualitative overview of five committee structure in practice.

For this purpose we have taking into account the following central banks: European Central Bank, Bank of England, Bank of Japan, Reserve Bank of New Zeeland and Federal Reserve of the United States of America. The rational behind analyzing these central banks monetary policy committees is the observation of advantages and disadvantages of their committees and establishing the most efficient and recommendable monetary policy committee by following the best practice path.

Table 2 presents the structure of monetary policy committee and Table 3 reveals the organization on monetary policy committee in the five developing country central banks' mentioned above.

Table 3. The structure of monetary policy committees in five developed countries (Source: made by author)

Country	Size	Background	Consensus/Voting	Votes
UK	9(4/5)	CB, ACA	V	Yes/Yes
Euro Area	18(0/18)	CB (different nationalities)	C (V)	NO
Japan	9 (0/9)	CB, ACA, BC, GOV	V	Yes/Yes
New Zeeland	9 (2/7)	CB, BC	C	NO/NO
US	12 (0/12)	CB	V	Yes/Yes

As we can observe, in case of Japan, from the total of nine monetary policy committee all of them are internal members. These members have all the possible backgrounds: central bank (CB), academics (ACA), business community (BC), government (G). The decision within the committee is taken throughout the voting process and the votes are published.

The organization of the meeting has the following agenda: the order is changing on every other meeting; we can observe that all board members make proposals regarding the interest rate. The Bank of Japan Governor hasn't lost during the last five years and the technical structure of the votes induced members to think individually.

Regarding the Euro Area (European Central Bank) the total number of monetary policy committee is eighteen from which all are internal members. The background of all monetary policy committee members is central bank (CB) but from different nationalities with the possibility of both consensus or voting system and not publishing the decision or the individual votes. Regarding the organization of the meeting it can be observe that the Chief Economist starts always the discussion, the proposal upon the interest rate paths' is made only by the Chief Economist and it cannot be remarked any lost of the vote. The independence of this committee is represented by the fact that the governors are informed by their own staff by the different models they used.

Table 4. The organization of monetary policy committees in five developed countries (Source: made by author)

Country	Organization of meeting	Interest rate proposal	Vote lost	Independence
UK	No fixed order, any person can raise any issue	Governor	Yes	Members make personal speeches and appear in Parliament
Euro Area	Chief Economist starts the discussion	Chief economist	---	Governors briefed by own staff (with different models)
Japan	Order changes every meeting	All board members	No	Voting induces members to think individually
New Zeeland	No fixed order	Governor	---	No apllicable
US	No fixed order	Chairman	No	FED Presidents briefed their own staff; limited scope for dissent

New Zeeland central bank monetary policy committee has a total size of nine members from which two are external members and seven are internal members; these members have the following background: central bank (CB) or business community (BC). Their decisions are taken by consensus, the Governor is solely responsible for the decision and there is no publication of their decision or individual votes.

Regarding the organization of the meeting it can be observed that is no fixed order, the Governor being solely the artisan of the interest rate proposals. The Governor has no vote lost history and there is no observable independence of the in the voting proceedings or procedures.

The monetary policy committee of the Bank of England is formed by nine members from which four are external members and five are internal members; these members derive both from central bank (CB) and from academics (ACA). Regarding the voting process, within the central bank committee of the Bank of England it can be observed the voting procedure and the publication of the decision and the individual votes. The organization of the meeting has no fixed order any person might raise any issue. The Governor is solely the person who makes the interest rate proposals, within the last five years the Governor has been lost a vote. Taking account the independence of the committee it can be seen that the members of the Bank of England monetary policy committee make personal speeches and appear in Parliament.

The FED's monetary policy committee is gathered by twelve members, all of these members been internal members and having the solely background the central bank (CB). The voting procedures follow the path of voting and the publication of the decision or the individual votes. In the organisation of the meeting of the FED's monetary policy committee it is no fixed order, the Chairman probably dominates. The Chairman also makes the proposals regarding the interest rate paths' without any lost of the vote during the last five year period. Regarding the independence of the monetary policy committee of the FED's it can be seen that there exists a limited scope for dissent FED Presidents being briefed by their staff.

5. Conclusions

Over the last five years, it can be noticed that many central banks around the world reported major advanced reforms in the field of communication: the publication of endogenous interest rate forecasts, votes of minutes, a reduction in the release time of minutes, a higher frequency of communications more frequent appearance of legislative bodies.

Central bank communication can de identified as the provision of information by the central bank to the public regarding such matters as the objective of the monetary policy, the monetary policy strategy the economic outlook, the outlook for future policy decisions.

Analyzing the five developed central banks' monetary policy committee structures we can observe several interesting institutional arrangements. The bank of Japan is the solely central bank from the five developed country group that explicitly changes the order of the speaking person in every meeting. Within this measure the central bank of Japan can limit the informational cascade and facilitate the better information of all members. Another important point is the every member possibility of making the proposals for the interest rate. The good track is the central banks official exclusively presence in the board although many of these members have previously worked in the government structures or in the business community.

The structure of the FED's and the European Central Bank has several disadvantages:

– There are no individual contributors within the committee the number of committee is, according to my opinion too large.

– The FOMC hasn't an explicit inflation target and the ECB external transparency has some lover levels.

– Both committees are conduced by the Chairman in case of the FED and the Chief Economist in case of the ECB.

The structure of the FED and the European Central Bank has some advantages:

– Each National Central Bank in case of the Euro Area has a Governor, which is informed by different staff having different procedures and models.

– The hub-and-spoke structure of the FED's facilitates the gathering and processing the information with a higher accuracy.

– Both the FED's FOMC and the ECB Governing Council have encompassed members' with diverse background – diverse path of experience, different nationalities but all derived from the central bank.

Analyzing all of the five central banks' we can observe that the Bank of England followers the best practice structure of the monetary policy committee. There are several features indicating this view, namely:

– The central bank has a clear and ultimate goal.

– The background of the committee members is diversified: academics, central bankers, business representatives.

– The number of the monetary policy committee on nine members it is the proper one.

– The individual members are encouraged to think individually, with identifying and evaluating individual contributions.

– We can observe the non – dominance in the Bank of England's monetary policy committee because in 2005 and 2007 the Governor has lost votes.

Nowadays, central banks are more capable of communicating with the public and financial markets, raising also the quality of information on the timelier basis. It can be identified the need for strengthening central bank communication strategies for: raising central bank accountability, enhance public understanding of the objective of policy and the decision-making process, guide market expectations.

In this paper we have focusing upon the main "technical structure" of the monetary policy committees and their implication upon the future paths of future monetary policy. In our opinion, the best practice of the Bank of England monetary policy committees structure has created a panacea for other central banks' for creating an efficient symbioses between the words, the effective actions and the structure of voting upon the monetary policy committees with direct influence upon future paths' of monetary policy.

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