

**Central Bank Talk:**  
**Committee Structure and Communication Policy\***

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## **1. Introduction: Four Notable Trends**

Over the last two decades or so, central banking practice has evolved in a number of notable dimensions. Four trends stand out. While each one is distinct, the four are interrelated. And some of those interrelationships, one in particular, are the focus of this short paper.

The first trend is toward granting independence to central banks that were previously under the control of the finance minister. The case for central bank independence is both theoretical and empirical. Theoretically, the time inconsistency issue provided a new rationale for an old idea: shielding policymakers from political influence. Empirically, several studies showed that independent central banks deliver lower inflation rates at no apparent output costs.<sup>1</sup>

The second trend is the movement toward inflation targeting. This strategy began in New Zealand, quickly spread to Chile, Canada, Israel, and the UK, and has by now been adopted by more than 20 central banks--even though specific practices differ in important respects. Notably, however, none of the world's three most important central banks (the Federal Reserve, the Bank of Japan, and the European Central bank) have adopted inflation targeting *per se*, although the ECB's strategy comes close.<sup>2</sup>

The third notable trend is toward greater transparency, and not only among inflation-targeting central banks. Transparency is often seen as a corollary of independence, and appropriately so: Unelected policy makers must be accountable to the people or to their elected representatives. But the move toward transparency in central banking is part of a broader phenomenon that affects many branches of many governments. One indication of

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<sup>1</sup> Two influential studies were Alesina and Summers (1993) and Grilli *et al.* (1991).

<sup>2</sup> Svensson (2003) details the distinctions between the ECB's strategy and inflation targeting.

the power of this idea is the increased transparency of the FOMC since 1994, even though its statutes and strategy have not been changed one iota. The basic *political* belief underpinning the trend toward greater transparency is that, in a democracy, officials should not conceal useful information without a good reason (e.g., national security secrets are routinely withheld). From the *economic* viewpoint, the general presumption is that more information is better than less, unless a second-best case can be made that some information may be damaging in the presence of other distortions. Such a case has in fact been made by Amato, Morris, and Shin (2003), and we will return to it at the end of this paper.

The fourth major trend is the formal adoption of decisionmaking by monetary policy committees (MPCs), rather than by individual central bank heads. A small number of central banks--including the Federal Reserve and the Bundesbank--had long relied on committees, but the practice has spread in the last 15 years or so. For example, 29 of the 34 central banks studied in J.P. Morgan's *Guide to Central Bank Watching* (2000) explicitly delegated monetary policy decisions to committees, whose sizes ranged from 3 to 18 members.

As noted, these four trends are related. Central bank independence calls for accountability and also seems to have tilted the playing field in the direction of decisionmaking by committee. Accountability, in turn, would seem to require a higher degree of transparency. And transparency, of course, is one of the most visible hallmarks of inflation targeting. This paper focuses on an interesting interaction between the last two trends, a link that has barely been discussed. We argue here that *the appropriate*

*volume and methods of central bank communication depend crucially on the nature of the monetary policy committee.*

To begin with, the mere existence of an MPC does not necessarily call for nor deliver greater transparency. The ECB, for example, is frequently accused (perhaps unjustly) of being opaque. Nor is it the case that a high level of transparency requires an MPC. Compare, for example, the Federal Reserve and the Reserve Bank of New Zealand in the early 1990s. The FOMC, a *committee*, was studiously opaque while the lone-wolf governor of the RBNZ was remarkably open. As an empirical matter, Blinder (2004, especially Figure 2.2) finds a U-shaped relationship between transparency and what he calls the degree of “democracy” in a small sample of central banks: the two most transparent central banks are the RBNZ (a single governor acting alone) and the Bank of England (a highly “democratic” committee).

Communication is a two-way street; there must be both a transmitter and a receiver. A central bank that wants to be truly transparent must therefore listen to its target audiences so as to understand how its communications are received and what type of information is deemed useful. It also needs to adapt its communication to its various audiences, for no single method will achieve transparency in all domains. To whom, then, should a central bank talk? Two audiences seem paramount.

The central bank needs, first, to communicate with the broad public and its political representatives. There are several reasons for this, the most obvious being the need for democratic accountability. But in addition, the virtues of central bank independence and price stability may not be self-evident to the body politic.<sup>3</sup> The central bank must

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<sup>3</sup> King (2004) emphasizes the inherent fragility of any collective institution.

therefore constantly make the case that its job matters and that it is doing that job properly. To do so, it must address the concerns of ordinary citizens.<sup>4</sup> This broad audience is best reached through the mass media, chiefly television.

What should this audience hear? The central bank needs to communicate its basic objectives, its strategy for achieving them, and its successes or failures—complete with reasons for the latter. Consistency over time is crucial if public understanding is to develop. But that should not be misinterpreted to require inflexibility in the face of unforeseen shocks, for the central bank may need to display an understanding of the hardships its policies may imply for particular segments of society. For instance, it is nearly impossible to avoid the first-round effects of an oil shock, such as a temporary increase in headline inflation. But it may be essential to avoid second-round effects, which means stopping the pass-through into nominal wages despite (temporarily) higher inflation. Unfortunately, the need for even a temporary decline in real wages may tax the communication skills of even the most gifted central banker.

The second essential audience, and the one we focus on in this paper, is the financial markets. Because monetary policy operates through markets, policy effectiveness will be greatly assisted by open and clear communication between the central bank and the markets. Since most assets that matter for the transmission of monetary policy have maturities that exceed the horizon over which the central bank formulates concrete interest-rate plans (which may be only a month or two), good communication must carry implications for a longer period. To that end, the central bank needs to teach the markets

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<sup>4</sup> Of course, only a small percentage of the public will pay any attention to the behavior of the central bank.

to think and process information as it does itself. This probably means sharing with the markets the broad contours of the bank's strategy, and possibly even the tactical details.

Central banks once prided themselves on surprising the markets, and occasionally still do so today. But the modern goal (under normal circumstances) is to be so predictable that monetary policy decisions normally ratify market expectations—expectations that the central bank itself has managed successfully. According to Mervyn King (2000), “transparency should lead to policy being predictable. Hence a successful central bank should be boring.”

In this short paper, we offer a series of *normative* judgments about what central banks should and should not do with their communications strategy. But these judgments are not *ad hoc*. They all derive from the presumption that the main purpose of central bank talk is to help markets “think like the central bank,” and thus to anticipate the central bank's actions better.

## **2. A Typology of Monetary Policy Decisionmakers**

Since our claim is that the appropriate communication strategy depends on the type of MPC that is doing the communicating, we must begin with a typology of monetary policy decisionmakers. We use the one first introduced in Blinder *et al.* (2001) and developed further in Blinder (2004). As we noted in Section 1, more and more central banks are making monetary policy by committee. (Some notable exceptions to this trend are the Reserve Bank of New Zealand and, to an extent, the Bank of Canada.) The committees, in turn, come in three basic varieties.

Members of a *collegial committee* arrive at a group decision that somehow springs from the collective wisdom of the group and is embraced by all of its members.<sup>5</sup> Members of such a committee agree that their differences of opinion must be subordinated to the common good, lest the authority of the group be undermined. There may or may not be a formal vote at each MPC meeting. But if there is one, it is expected to be—and normally is—unanimous or nearly so. A dissenting vote is likely to be seen as a noteworthy event, as is the case on the FOMC today.<sup>6</sup>

A collegial committee may reach agreement in a variety of ways. We limit ourselves to two polar cases. On what we call a *genuinely-collegial committee*, members may argue strenuously for their own points of view behind closed doors, but they ultimately compromise on a group decision, of which each member then assumes ownership. There may or may not be a formal vote. But, in any case, there are no (or negligible) public disagreements. The ECB's Governing Council appears to be such a committee.

In what we call an *autocratically-collegial committee*, by contrast, the chairman more or less dictates the group "consensus." He may begin the meeting with the decision already made and simply inform the other members. Or he may listen to the debate and then announce the group's consensus, expecting everyone else to fall in line. But in either case, the group's decision is essentially the chairman's decision, hopefully informed by, and perhaps even influenced by, the views of the other committee members. The Federal Open Market Committee under Alan Greenspan is such an autocratically-

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<sup>5</sup> Even an individual central bank head may have an advisory committee of top monetary policy officials, as for example in New Zealand and Canada.

<sup>6</sup> Over the five-year period 2000-2004 inclusive, there were 43 FOMC meetings, and therefore  $11 \times 43 = 473$  recorded votes, excluding those of the chairman. Of these, only six were in dissent.

collegial committee, although Greenspan is a gentle autocrat--meaning that he cajoles rather than browbeats.

The third type of committee is what we call an *individualistic committee*. Each member of such a committee not only expresses his or her own opinion verbally, but probably also acts on it by voting. The group's decision is made by majority vote—literally. And unanimity is not necessarily expected; it may not even be sought. The Bank of England's MPC is a prime example of such an individualistic committee.

Thus, ranked in terms of closeness to the classic individual decisionmaker of economic theory, our four archetypical central bank decisionmaking systems (with a real-world example of each) are:

- individual central bank governor (e.g., Reserve Bank of New Zealand)
- autocratically-collegial MPC (e.g., Federal Reserve System)
- genuinely-collegial MPC (e.g., European System of Central Banks)
- individualistic MPC (e.g., Bank of England)

While the recent worldwide trend toward committee decisionmaking in monetary policy is unmistakable, the reasons behind it are less clear. Why did so many countries apparently decide that group decisionmaking on monetary policy is superior to individual decisionmaking? *In practice*, much of the force behind the trend may simply be a desire to emulate the success of the FOMC and, during its lifetime, the Bundesbank Council. But rather little has been written on why group decisionmaking in monetary policy is expected to be superior *in principle*. Blinder (2004, Chapter 2) describes the small

theoretical literature on this question and adds some thoughts of his own.<sup>7</sup> His list of reasons to favor group decisionmaking (p. 48) boils down to:

- Committee decisions are likely to be less volatile.
- Committees are less likely than individuals to adopt extreme positions.
- A committee pools the knowledge of its members.
- Different committee members bring different heuristics to what is a very difficult decision problem.

This list can be further boiled down to a familiar maxim: *diversification pays*.

Blinder and Morgan (2004) provide clear experimental evidence to support the hypothesis that groups, on average, make better monetary policy decisions than individuals.<sup>8</sup> They also show that these superior decisions stem from genuine group interactions: The whole performs better than the sum of its parts in the sense that the group's (superior) decisions do *not* simply mimic those of (a) the average voter, (b) the median voter, or (c) its most skillful member. Lombardelli *et al.* (2004) at the Bank of England not only replicate several of Blinder and Morgan's results, but go on to demonstrate that members of a group learn by observing the interest-rate decisions of the others.

If diversification pays off in the form of better decisions, then an individualistic committee, which takes full advantage of the committee's diversity, would seem to have a clear edge over a collegial committee, which exploits diversity much less. But there is a hazard when it comes to communications. A collegial committee, especially one that is

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<sup>7</sup> See also Gerlach-Kristen (2003a).

<sup>8</sup> But their more surprising finding is that groups do not systematically require more data on the economy before deciding to act—that is, contrary to popular belief, groups are not more inertial than individuals.

autocratically collegial, not only wants to but actually can afford to submerge differences of opinion among its members. After all, it is the group's decision (which may well be the chairman's decision) and the reasoning behind it that need to be communicated to the markets—not the personal views of individual committee members. But on an individualistic committee, the views and arguments of individual members are part of the essential information that needs to be communicated. Such information may, for example, be the best basis on which to project what the MPC is likely to do in the future.

That is all well and good, if information on individual differences is communicated in an orderly and informative way. The danger arises if an individualistic committee is undisciplined and speaks with too many voices, especially if those disparate voices carry conflicting messages. In that case, central bank transparency can degenerate into central bank cacophony, leaving outside observers more befuddled than enlightened.

### **3. Committee Structure and Communications**

The central point of this paper is that the “right” amount and types of central bank communication depend sensitively on the type of decisionmaker. The major items that a central bank might want to disclose are:

- *the monetary policy decision.* It may seem silly even to put this item on the list, but until February 1994 the FOMC did not publicly disclose its interest-rate decisions. Now, however, we believe this basic aspect of transparency is entirely non-controversial, and we will not mention it further.

- *the statement* that accompanies the decision and, presumably, explains it. What should (or should not) be said in these statements is a matter of continuing controversy, and practices differ enormously across central banks.
- *the vote*. Voting, of course, is only relevant when a committee makes the decision. MPCs around the world vary greatly in whether they take an explicit vote on the interest rate decision, whether they announce the results of the vote (and whether promptly or with a long delay), and whether, in doing so, they name names.
- *important inputs to and reasons for the decision*, such as forecasts of the economic outlook, major factors germane to the decision, models (econometric or otherwise) used for supporting analysis, and so on. We think it is fair to say that most central banks have been loathe to reveal much in this domain.
- *what is said at meetings*. Here there is a wide variety of choices and practices, ranging from nothing (at the ECB) to verbatim *transcripts* (at the FOMC, but released with a five-year lag). Many central banks release *minutes* of MPC meetings, which may or may not be heavily sanitized and which may or may not attribute specific comments to individuals.
- *plans for the future*, especially intentions for interest rates. As far as we know, the RBNZ is the only central bank that, in a sense, “forecasts” its own future behavior,<sup>9</sup> but the Bank of Norway now comes close.<sup>10</sup> But many more

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<sup>9</sup> The forecast is conditional on quite a few factors, however, as the RBNZ makes clear.

<sup>10</sup> The “Strategy Notes” in its Inflation Reports give clear indications of its views on future interest rates.

central banks give some indication, explicit or implicit, of the “tilt” or “bias” in their policy stance going forward. Because the major purpose of communicating with the markets (as opposed to communicating with the public) is *to condition expectations about future monetary policy*, we see this aspect of transparency as essential.

So what, then, should a central bank say? The simplest case to deal with is that of a single central bank governor acting alone. With no monetary policy meeting, there is, of course, no vote and no minutes to report. That puts the burden of explaining the reasoning behind the decision squarely on the explanatory statement--whether written or verbal--that is released with the policy decision. So releasing a substantive statement, one that goes beyond mere boilerplate, is probably the most critical ingredient in transparency in this case. If necessary, a more detailed report can come later.<sup>11</sup> But a single mind ought to be able to make up its mind--right away.

The choices for a committee are both more numerous and more subtle. Remember that a *collegial* committee wants to project an aura of agreement in its disclosures. That in itself might be deemed to constitute a lack of transparency, if it masks disagreements within the committee. But we view that particular departure from transparency as quite permissible as long as (a) the committee has decided to make decisions collegially, and (b) the group’s reasoning is clearly explained. Where there are disagreements, a truly transparent MPC can, and probably should, present dissenting views (e.g., those which failed to win the internal argument) as arguments that the committee considered but rejected—which would, once again, help the market to think more like the central bank.

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<sup>11</sup> Subsequent speeches can, of course, clarify anything left unexplained in the statement.

The situation is different on an *individualistic* committee, however, where differences of opinion are an essential part of the information that should be conveyed to the markets.

So let us consider each type of disclosure separately.

*The statement and the minutes:* We group these two types of communication together because there is a tradeoff between providing information in the statement or in the minutes. Committees have a choice, as if the “production function” for transparency had two inputs (information in the statement and information in the minutes) with a strongly negative cross-derivative. If the statement is very spare, then much of the burden of explanation falls on the minutes, which must therefore convey a great deal of information. (This is the FOMC model.) But if the immediate statement is sufficiently clear and detailed, no one but historians will be much interested in the minutes, which become available only weeks or months later, if ever. (This may approximate the model of the ECB, which issues no minutes.)

The three types of committee can and, in our view, should choose different “optimal” points along the imaginary production-indifference curve for information. A *genuinely-collegial committee*, having just argued things out, may find it difficult to agree on a detailed statement in real time. So it may opt for a terse statement, with fuller explanations delayed until the minutes are released.<sup>12</sup> The problem of producing an immediate statement is even more acute for an *individualistic committee*, which (unlike a collegial committee) may not have carried its arguments through to a consensus. Such a committee may find it difficult to produce any real-time statement at all (as is true at the Bank of England), although we think it should try very hard. An *autocratically-collegial*

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<sup>12</sup> But maybe not. The ECB President often holds a press conference immediately after the meeting, at which he speaks (at length) on behalf of the committee. There are no subsequent minutes.

*committee*, however, should find it much easier to prepare a detailed statement to be issued at the end of the meeting. Indeed, the chairman may walk into the meeting room with a draft of the statement in his pocket. Since sooner is better than later where market-sensitive information is concerned, such a committee should rely more on the statement and less on the minutes. Thus, for example, we believe that the FOMC should issue much fuller statements than it does at present.<sup>13</sup>

*The vote:* As previously mentioned, the vote on monetary policy is an essential piece of forward-looking information when decisions are made by an *individualistic committee*. Therefore, such a committee should always announce the vote promptly, probably naming names. We say this for two reasons. First, there is individual accountability on an individualistic committee. Second, naming names should help market participants forecast the committee's *future* decisions.<sup>14</sup>

The case is a bit more equivocal for collegial committees. Obviously, if there are any dissenting votes, announcing them will impair the committee's ability to project an aura of consensus. If doing so is considered important, as it is for example at the ECB, there may be a case for keeping the vote secret—or even for not having a vote.<sup>15</sup>

Perhaps more important, the formal vote may be a poor indicator of the true amount of disagreement on a collegial MPC, one that prizes—or, in the limit, forces--consensus. According to longstanding FOMC tradition, for example, a member is expected to vote in

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<sup>13</sup> But the trend is clearly in the right direction. FOMC statements are much more informative now than they were a decade ago, when they often stated that the purpose of the rate change was to “sustain non-inflationary growth” regardless of whether the funds rate was raised or lowered .

<sup>14</sup> For some evidence that this is the case for the Bank of England, see Petra-Gerlach (2003b).

<sup>15</sup> The ECB, as a supranational institution, has a special reason for suppressing voting: It might highlight disagreements among nations

favor of the chairman’s policy proposal unless he or she “cannot live with it”—which is a much sterner test than mere disagreement.<sup>16</sup> So a unanimous FOMC vote does not necessarily indicate 100% agreement, and the markets know that. More generally, the number of dissenting votes clearly underestimates the amount of disagreement. Still, we believe that *some* information, even if imperfect, is better than *no* information at all. So, on balance, we are inclined to believe that even collegial committees should normally take a vote and make the result public.

*Inputs to the decision:* When it comes to discussing the considerations that enter into monetary policy decisions, MPCs are more similar to individual decisionmakers than they are *different*. Both, we believe, should reveal quite a lot about their internal forecasts, the models they use to appraise policy effects and/or to generate forecasts, and so on. Frankly, we are a bit baffled by why some central banks, including the Federal Reserve, seem to treat their internal forecasts like state secrets when revealing them would not only help the central bank explain its decisions, but would probably also get the financial markets thinking more like the central bank. So we believe that nearly-complete disclosure in this domain is probably the preferred policy.<sup>17</sup>

One frequently-raised objection is that an MPC composed of  $N$  members may have  $N$  different forecasts. Should it reveal them all? We are tempted to answer yes, but that may be neither practical for the central bank nor useful to the markets. Failing that, we recommend that central banks release their *staff forecasts* as frequently as they are made.

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<sup>16</sup> For a fascinating attempt to model this behavior, see Chappell *et al.* (forthcoming), especially Chapters 4 and 6. As noted above in footnote 5, the rate of *dissent* on the FOMC over the past five years has been just 1.3%. We can be sure that the rate of mere *disagreement* was higher. The minutes, for example, make this clear.

<sup>17</sup> Exceptions need to be made for confidential information provided to central banks by, e.g., foreign governments or private businesses.

Markets will quickly learn (provided they are told) that these staff forecasts are not necessarily accepted by all members of the MPC. Alternatively, if the MPC takes the time and effort to reach consensus on an MPC forecast, then that forecast should be revealed instead, for it uniquely conveys some of the key assumptions behind the decision. If there is useful information about the *uncertainty* that surrounds the forecast (e.g., as in the Bank of England’s fan chart), then that should probably be released, too.

Having written in detail about *what* should be said, let us now briefly consider *who* should say it. The key question here is whether the chairman should be the only person who speaks about monetary policy, or whether other members of the MPC should also speak publicly?

We start with an obvious point. A single spokesperson for an *individualistic committee* will certainly *not* suffice because intra-committee disagreements, including their intensity, are part of the essential information set that markets should have. Multiple voices help convey that information, and so should certainly not be suppressed. Of course, they also raise the danger mentioned early in the paper: that transparency may degenerate into cacophony. This is a genuine hazard that individualistic MPCs should take pains to minimize.

That said, the talk that emanates from the Bank of England’s MPC, which certainly comes from many voices, does seem to inform markets much more than it confuses them—although it took a while for markets to get used to it. Similarly, the Swedish Riksbank’s individualistic MPC seems to have “solved” its potential cacophony problem, or at least managed it well. So we view the problem of multiple voices as manageable for

an individualistic MPC--one that requires some thought, and perhaps some coordination, but certainly not anything that constitutes a serious retreat from transparency.

The single- versus multiple-voice issue is more complicated for *collegial* committees, however. If a collegial MPC is highly *autocratic*, it would seem easy to get by with a single spokesperson (the chairman) without sacrificing much in the way of transparency. After all, the committee's views are, in essence, the chairman's views. But suppose the autocratic nature of the decisionmaking process suppresses dissenting votes, giving a superficial (but false) appearance of unanimity. In that case, disparate talk may be the only way for markets to learn about disagreements within the committee.<sup>18</sup> And if there are dissenting votes, the dissenters ought to explain their reasons for disagreeing with the chairman. So perhaps multiple voices are appropriate for even an autocratically-collegial committee. But, unlike the case of an individualistic committee, markets need to understand that, when it comes to forecasting the committee's likely future actions, only one voice really counts: the chairman's. The others merely convey information on the strength or weakness of the consensus supporting him.

Ironically, it seems to be the *genuinely-collegial committee* that may sacrifice the least in terms of lost transparency, if it speaks with only one voice. If a true consensus has been reached, the chairman will presumably convey that consensus to the public, rather than express his personal (possibly idiosyncratic) views. If other members talk as well, they will presumably stick to "the party line"—a line to which they have all agreed. Thus we seem to have the following non-monotonic ranking of the appropriate number of public voices on a monetary policy committee:

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<sup>18</sup> And similarly, disparate talk may be the only way for committee members other than the chairman to make their views known.

Individualistic MPC: definitely requires multiple voices

Genuinely-collegial MPC: a single voice may suffice

Autocratically-collegial MPC: may benefit from multiple voices.

#### **4. The role of the policy strategy**

While we have emphasized the importance of committee structure, the central bank's policy strategy is also, of course, relevant to its appropriate communications policy.

*Inflation targeting:* Transparency is one hallmark of the inflation targeting strategy. A central bank that adopts that strategy commits itself to revealing two essential pieces of information: (a) its target rate of inflation, including the associated margin of tolerance and the horizon that it considers as relevant, and (b) its own up-to-date forecasts over the relevant horizon. Few central banks that are not explicit inflation targeters have been willing to disclose those two pieces of information, which are of keen interest to markets and to other observers of central banks.

In the terminology of Svensson (2003), most, if not all, inflation targeting central banks practice the flexible (rather than the strict) version of that strategy.<sup>19</sup> As he explains, flexible inflation targeting requires judgment on how quickly the target is to be achieved. Many considerations may justify temporary deviations from the inflation target, including recent shocks, the cyclical position of the economy, the exchange rate and, quite possibly, the evolution of asset prices. A flexible inflation-targeting central bank must therefore disclose much more than just its target and expected inflation rates. It must give some indication of the intended *path* of inflation and explain the *reasons* for

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<sup>19</sup> Svensson (2003) takes this term to mean that the loss function assigns some positive weight to output-gap deviations.

interim departures from the target. Thus flexible inflation targeting requires more communication than strict inflation targeting; but it also provides a natural framework for organizing that communication. For example, after a short period, observers of the “new” Bank of England came to understand that the BoE saw its mission as limiting inflation to the target without becoming “inflation-nutters”—and that the MPC would explain clearly how much and for how long they were willing to diverge from their inflation target.

*Other monetary policy strategies:* Transparency under other strategies, especially those that allow for multiple objectives, requires even more extensive communication. Most obviously, a central bank with multiple goals must explain and justify what those goals are. Some of the objectives other than inflation may be quantifiable (e.g. the unemployment rate or the growth rate), but making them numerical may be highly controversial. It is far easier, for example, to enunciate the central bank’s definition of the inflation target than its estimate of the natural rate of unemployment. Shunning quantification may therefore be reasonable—or even necessary. But if so, the goal of transparency must be pursued in other ways. In addition, the central bank needs to explain how it weighs the various objectives at any moment of time. This can become a very demanding exercise.

## **5. Can There Be Too Much Talk?**

We have taken the view in this paper that, when all is said and done, the quality of monetary policy is enhanced by greater transparency. But is it possible to reveal too much information? Amato, Morris, and Shin (2003) use the Morris and Shin (2002) model to argue that too much transparency can actually *reduce* policy effectiveness.

Their argument rests on two seemingly-reasonable premises: (a) that both central bank and private signals are noisy, and (b) that the weight assigned to the central bank's signal is likely to exceed the weight assigned to private signals because the former is common knowledge. If the central bank signal is noisy relative to private signals, they show, attaching too much weight to the noisier signal may distort the quality of the market's treatment of information.

This is indeed a *theoretical* possibility. But is it empirically relevant in the case of monetary policy? Little concrete is known about the answer—after all, real-world signals do not come with variance-labels attached. But both *a priori* reasoning and circumstantial evidence make us extremely doubtful.

First, in our experience, very little private information is of great relevance to monetary policy. Rather, almost all of the important facts, whether or not they originate with the central bank, are in the public domain. Second, when it comes to interpreting signals that are to be used to divine *the central bank's intentions*, it is hard to imagine how the central bank's signal could be “noisier” than private signals. Third, if we interpret the “signals” as forecasts of the economy, Romer and Romer (2000) have shown that the Federal Reserve's staff forecasts of inflation—on which they expend an enormous amount of resources—are systematically and substantially more accurate than private sector forecasts. This finding strongly suggests that, if the Fed would release its inflation forecast, that particular signal would be notably *less* noisy than private signals. Fourth, and related, Svensson (2004) has shown that, for reasonable parameter values, Morris and Shin's (2002) counterintuitive result does not apply. Fifth, Gerlach-Kristen (2003b) finds that the voting record of the Bank of England's MPC helps the markets

when they form expectations of future policy decisions. Importantly, she finds that dissent improves the accuracy of the forecasts—which strongly suggests that even noisy central bank signals can be adequately deciphered by the markets. And sixth, Fratzscher (2004) shows that oral statements from the central bank affect the exchange rate in the desired way, at least temporarily.

It can perhaps be argued that none of these “facts” constitutes a direct test of the Amato *et al.* (2003) hypothesis. After all, their idea is that central bank communication can, in a sense, “crowd out” valuable private information. But we don’t know of any evidence that this happens in practice, and we are not inclined to accept the hypothesis without evidence.

## **6. Conclusion**

We have argued that the trends toward more committee decisionmaking and greater transparency in central banking are, and ought to be, related. The communications needs—and therefore the most appropriate forms of delivery--of individual monetary policymakers, collegial committees, and individualistic committees differ systematically and in important ways. But we are not persuaded that there are any cogent arguments against the view that more transparency in monetary policy is better than less.<sup>20</sup>

Assuming that this is so, and also assuming that a more vigorous debate improves policy decisions (as the evidence suggests), points toward the conclusion that an *individualistic* MPC pursuing a highly *transparent* strategy may be the best arrangement for making monetary policy decisions. In stark contrast to King’s (2000) assertion that

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<sup>20</sup> Subject, of course, to the usual caveats about protecting confidential information and preserving the right of the committee to deliberate in private.

boring central banks are best, it may well be that noisy individualistic MPCs conducting intense internal debates that sometimes spill over into the media—as happens at the Bank of England—may achieve the highest degrees of both effectiveness and accountability.

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