Central Bank decision-making process: the Bank of England and the ECB

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The way central banks decide on monetary policy has evolved over the years. One important shift has been assigning monetary policy decisions to a committee rather than to one individual. In May 1997, the Chancellor of the Exchequer, Gordon Brown, granted the Bank of England operational independence, in other words, the independence to decide how to achieve price stability. By contrast, the Bank would not be granted target independence as the definition of price stability, the inflation target, would remain with the government. The Bank of England Act[1], which came into force on June 1st, 1998, dictates that the monetary policy measures to achieve the inflation target are to be decided by the Monetary Policy Committee (MPC). The MPC would comprise of the Governor, two Deputy Governors, two members appointed by banks, and four external members appointed by the Chancellor.

What makes for an effective decision-making process?

Table 1 below summarises the decision-making process of three central banks: the Bank of England (BoE), the European Central Bank (ECB) and the Federal Reserve Board (Fed). The pursuit of price stability by a committee is by now the standard in Central Banking.

The move towards committees coincided with the shift to central bank independence (Blinder, 2007). This was the natural consequence as Central Banks no longer took orders from their governments. Instead, they needed to pool information that would help them make better decisions in uncertain circumstances - a necessary step when performing complex tasks, like monetary policy.

But, as Blinder indicates, the decision-making by committees is not identical in all central banks. Broadly speaking, they fall into two categories: individualistic, where every member is asked to vote and those votes are then revealed; and collegial, where all members come into one decision without attributing votes. The Bank of England and the Fed System are both prime examples of the former. An individualistic system is built on the diversity of views and the methods on which such views are built reduce the risk of group thinking. On the other hand, however, when votes are split, they face the challenge of communicating to the public the rationale behind any decision effectively. The ECB, by contrast, is a collegial-based system, where the decision reached is presented as that of the whole decision body. The emphasis is on communicating one view and therefore claiming ownership by all who participate.

[1] https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/1998/the-boe-act.pdf?la=en&hash=245383B3380F691849B043BE87D31CD2E0EA1256

Table 1: The decision-making process of three main Central Banks

	BoE	ECB	Fed
Decision-making			
Decision-making body	Monetary Policy Committee (MPC)	Governing Council	Federal Open Market Committee (FOMC)
Number of members	9	25	12
Composition of the decision-making body	The Governor + 3 Deputy Governors + the Chief Economist + 4 external members	6 members of the Executive Board + the governors of the national central banks of the 19 euro area countries	7 members of the Board of Governors + the president of the Federal Reserve Bank of New York + 4 of the remaining 11 Reserve Bank presidents (1-year term on a rotating basis)
Gender distribution	7 male + 2 female (both external members)	23 male + 2 female (both in Exec Board)	4 male + 4 female**
Nationalities	Mixed but mostly British	All euro area nationalities	US citizens
Who has the right to vote	All 9 members of the MPC	6 Exec Board members vote permanently + 15 votes from 19 NCB Governors – monthly rotating basis*	The 12 members of the FOMC – yearly rotation for the RB presidents***
Reaching a decision	Voting	Collegial	Voting
Disclosure of voting	Yes	No	Yes
Frequency of meetings	8 times a year	every six weeks (~ 8 times a year)	typically, 8 times a year

Notes: The composition described is for 2022, not historical. *ECB rotating voting: since 2015, there are 15 votes gathered from the 19 National Central Bank Governors on a monthly rotating basis. There are 2 groups of countries: big (4 votes) and small (11 votes). All (6+19) participate in the discussions. **In view of the recent resignations and no replacement up to this point, the numbers do not add up to the expected 12 FOMC members. ***Note that all 12 Reserve Bank presidents attend FOMC meetings and participate in the discussions.

Many in the literature have attempted to identify what makes for an effective committee. Having clear objectives, efficient instruments and being independent are of prime importance (Maier, 2010). But having a manageable size, between 5-9 members, is also viewed as preferable (Berger, Nitsch and Lybek, 2008; Hansen, McMahon, and Velasco Rivera, 2014). In these cases, having a rotation system may help combine a manageable size with bringing in more information. The diversity of members' backgrounds, for example in the form of internal and external members, adds to the information set and can help avoid extreme ideas or indeed group thinking. Last, a voting system that attributes and evaluates members' contributions adds to the effectiveness of decisions.

Linked to these two different types of committee decision-making is also the role of statements and minutes as part of the communication process. Individualistic committees use the minutes a lot more as a way of communicating both the decision reached as well as possible disagreements. Detailed statements, on the other hand, are a more effective tool in collegial central banks. This is because, as Paul Tucker, a former BoE MPC member, puts it "*it is more difficult for us than for some of our peers to release an informative statement immediately after the policy meeting: if you don't know what you're going to decide, it is pretty hard to prepare a draft in advance!*" (Tucker, 2008).

A number of studies then examine how the characteristics of members of monetary policy committees play a role in decision-making. The literature that investigates the FOMC look at educational and career characteristics as well as differences in behaviour between political appointments (like the Governor who is appointed by the US president) and Bank Presidents. Eichler, Lähner and Noth (2018) find that FOMC members who have a financial industry background or represent a region with a large banking sector are more sensitive to local banking instability. Smales and Apergis (2016) find, on the one hand, that the FOMC's Chair tenure and the experience in Government lead to more dovish decisions. By contrast, the longer the time working as bank staff, the greater the preference for hawkish decisions. And indeed internal disagreements are very much attributed to the background characteristics of FOMC members as well as to political influence (Bennani, Kranz and Neuenkirch, 2018).

Authors that study the workings of the Bank of England's MPC also analyse the relevance and importance of dissent. Given the set-up of the MPC, many have studied how the distinction between internal and external members plays out. Harris, Levine and Spencer (2011) show that external members are more likely to dissent when there are deviations of the MPC's inflation forecast from the target. Gerlach-Kristen (2009) argue that insiders typically attach greater weight to inflation stabilization than external members, who are more dovish. They attribute this to fact that externals are appointed (and potentially re-appointed) by the Governor, which gives them an incentive to be more "recession averse". Harris and Spencer (2009) show that insiders tend to vote as a block and are typically on the winning side of policy decisions, provided their numeric superiority. Hansen, McMahon and Velasco Rivera (2014) also find that internal MPC members have superior expertise when compared with externals which casts some doubt on the value-added of external members. However, they and others, particularly Downward and Mearman (2007) caution such a statement as they point to the importance of triangulation, in other words, the use of diverse sources of information to inform decisions. Such diverse sources could range from different methods and data to different theories and investigators.

Last, other streams of literature have focused on different aspects such as the relevance of nationality, particularly in the context of the ECB, and gender. Badinger and Nitsch (2011) study the ECB and show that indeed beyond a certain management level, nationality does affect the formulation of monetary policy. The issue of gender has been subject to growing attention and there is an increasing number of studies trying to examine to which extent gender affects monetary policy decisions. Rieder (2021) shows that there is mixed evidence in the literature and warns for caution given the current small proportion of women in the samples used to investigate this topic.

Individualistic vs collegial: are they really that different?

While many in the literature have attempted to understand what makes for an efficient decision-making set-up, much less is known and understood as to why Central banks might opt for one system or the other.

The answer often lies in reasons that have probably little to do with our knowledge of optimal design and more to do with culture or broader political economy reasons. Malmendier, Nagel and Yan (2021) show that, with reference to the FOMC, differences between FOMC members' inflation expectations and Fed staff forecasts can be explained by personal inflation lifetime experiences and do affect voting outcomes.

Arguably, this link between preferences and experiences is the one reason why the ECB opted to pursue a consensus model in its decision-making (Claeys and Linta, 2019). The idea was that if the ECB was to speak for the euro area, as indeed dictated by its mandate, then it had to ignore national preferences. And to be able to convince the public, it would have to speak with one voice. The decision process and the communication of that decision would therefore not provide any information on possible disagreements or how strong a consensus would lead to it. Also, even if the optimal size of a committee is shown to be between 5-9, the ECB could not afford not to include all national central banks in its decision body.

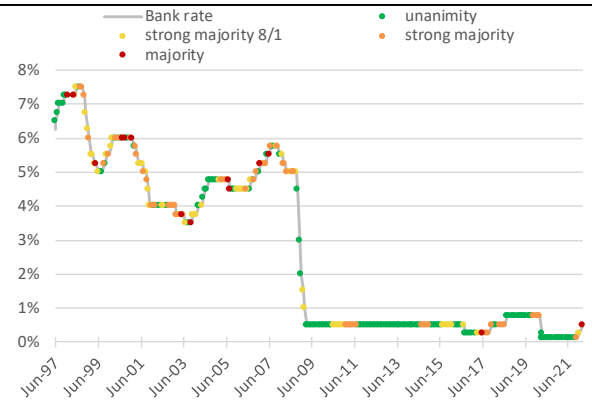
But the question that we then ask is whether the set-up of any given committee actually leads to very different ways of deliberating. Ehrmann and Fratzscher (2007) show that there is not a single best approach for central banks to adopt. Different ways of combining more or less individualistic communication and decision-making strategies may deliver similarly good results in terms of financial markets responsiveness and policy decisions' predictability. Similarly, Riboni and Ruge-Murcia (2010) look at five different Central Banks (BoC, BoE, ECB, Fed, SRC) and indicate that, despite having different formal committee types, all central banks seem to follow a consensus model in the way they take actual interest rate decisions.

We take a closer look at the way the BoE and the ECB reach their decisions and actually confirm that, irrespective of the set-up, they both show a very similar trend in consensus building when they take decisions.

Figure 1a and 1b plot all rate decisions since the late 90s for both the Bank of England and the ECB. Also, we report the degree of agreement reached in each decision. Data is available for the Bank of England as votes published after each meeting. This, however, is not available for the ECB, since it does not publish votes. Hence, we rely on the methodology by Claeys and Linta (2019) who gather information from various sources on how decisions were taken.[2] We observe that in the current juncture the BoE faces greater disagreements than in earlier times.

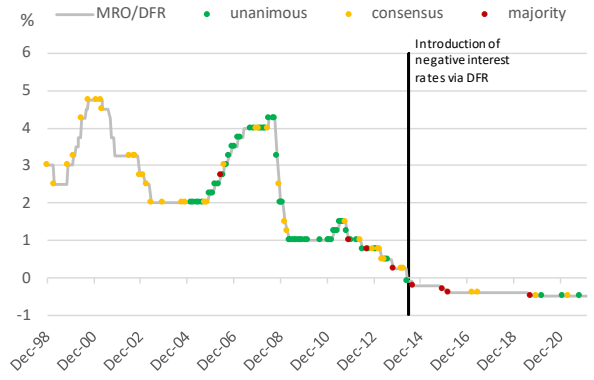
[2] These include the transcripts of the press conferences following the governing council 'monetary policy' meetings which also include transcripts of the Q&A with journalists, and, since 2015, the 'accounts', i.e. the summaries of the discussion of the monetary policy meetings published by the ECB. Exceptional press releases may also be considered.

Figure 1a: MPC voting decisions on the bank rate



Source: Bruegel based on Bank of England.
Notes: period from June 1997 to Feb 2022. Unanimity = all votes in support, Strong majority 8/1 = all - 1 one vote, Strong majority = between strong majority 8/1 and majority, Majority = half + 1 votes in support.

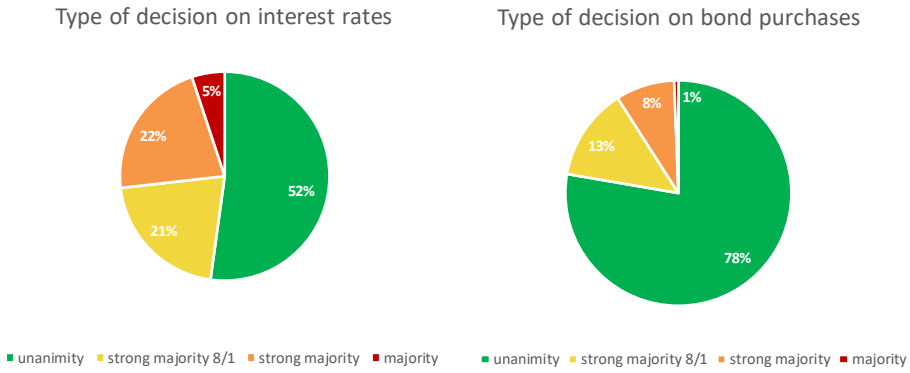
Figure 1b: ECB Governing Council voting decisions on the interest rates - main refinancing rate (MRO) and deposit facility rate (DFR)



Source: Bruegel based on ECB.
Notes: period from Dec 1998 to Feb 2022. Before 5 June 2014, rate plotted corresponds to the MRO, after that to the DFR. The classification of the decision was made according to what was indicated by the ECB president in the press conferences and by the monetary policy accounts, based on Claeys and Linta (2019).

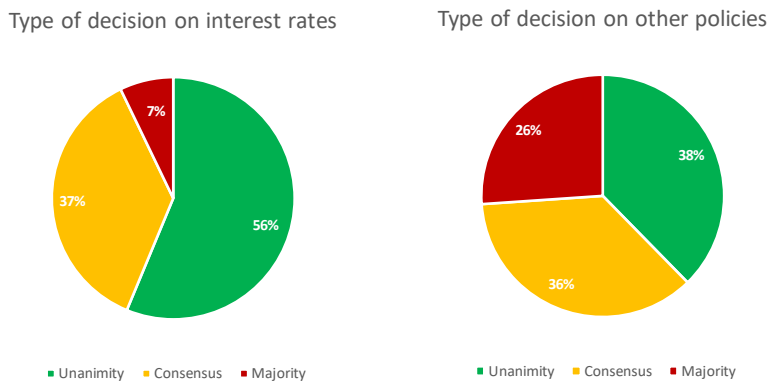
For more than half (61%) of the ECB meetings we have no information on the degree of consensus reached. Figure 2 presents the summary of the degree of disagreement in both central banks deliberations. Despite the ECB decision-making process relying on consensus, we observe that the degree of unanimity reached in the two banks is quite similar when it comes to interest rate decisions. When it comes to the unconventional measures, the BoE members reach consensus much faster. That is to be expected as when it comes to bond purchases the ECB buys a much wider portfolio of bonds with different risks.

Figure 2a: BoE MPC bank rate and bond purchase decisions and direction of the policy



Source: Bruegel based on Bank of England. Notes: period from June 1997 to Feb 2022. Unanimity = all votes in support, Strong majority 8/1 = all - 1 one vote, Strong majority = between strong majority 8/1 and majority, Majority = half + 1 votes in support.

Figure 2b: ECB Governing Council interest rates and other decisions and direction of the policy

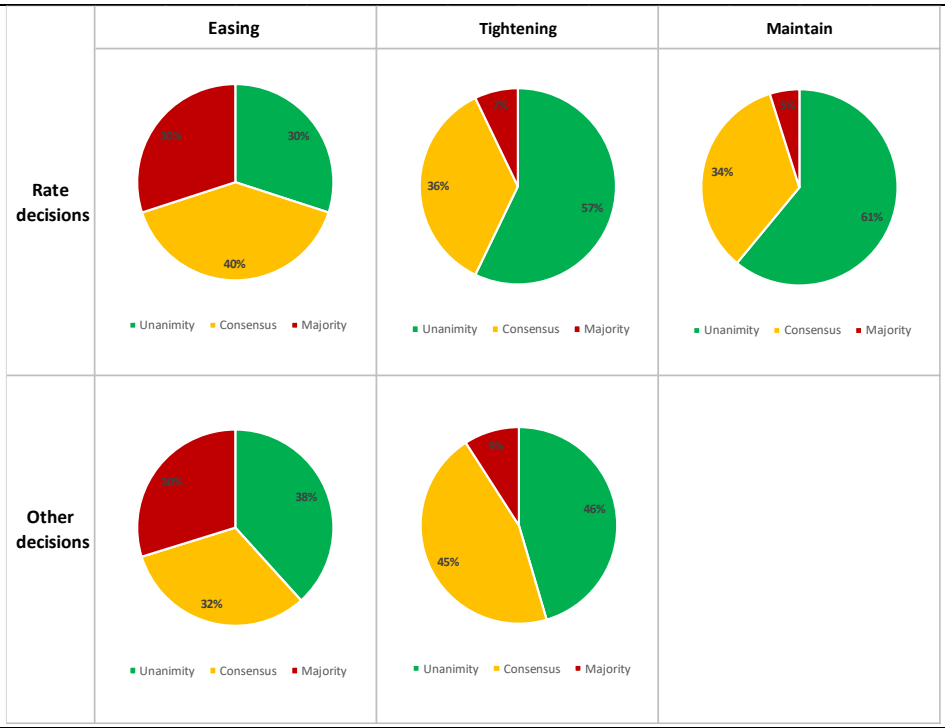


Source: Bruegel based on ECB and Claeys and Linta (2019). Notes: period from Dec 1998 to Feb 2022. The classification of the decision was made according to what was indicated by the ECB president in the press conferences and by the monetary policy accounts. Note that, for the BoE chart we show decisions on bond purchases, while for the ECB "other" includes more policies, e.g. forward guidance or credit operations.

The one characteristic the two Central Banks share is that they reach tightening interest rate decisions more unanimously than easing decisions as Figure 3 shows. We can also see that, when it comes to maintaining the policy unchanged, the decision is backed by mostly all members.

Figure 3a: Bank of England – Direction of policy move

Figure 3b: ECB – Direction of policy move



Source: Bruegel based on ECB and Bank of England. Notes: period from June 1997 to Feb 2022 for BoE, from Dec 1998 to Feb 2022 for ECB. For the ECB, the classification of the decision was made according to what was indicated by the ECB president in the press conferences and by the monetary policy accounts.

Last, Table 2 summarises the degree of disagreement together with how successful the banks are at the time of the meeting. As the Bank of England reveals not only the target but also the tolerance bands, it is easy to define success as the inflation rate being inside those bands (inflation between 1 and 3 per cent). For the past 25 years[3], inflation in the UK has been within those rates 67% of the time. Since the ECB does not have such a clear definition, we present three alternative definitions. All three of them are much tighter than the one that the BoE uses and success is also less frequent.

We make the following general observations:

- The most relevant result is that the degree of Unanimity vs Majority in decisions is very similar despite the very different decision-making set-up. Admittedly, we have a lot less observations for the ECB and in any case, our numbers are at best a proxy rather than a measurement given the absence of votes.
- What we label as consensus has a rather different meaning for the two Central Banks. For the Bank of England, it is clearly a measurement of the strength of majority. But for the ECB it is truly consensus in that it represents where the members find and agreement that is acceptable to all, and not necessarily a vote between two options. In this respect they are not directly comparable.
- Also, neither of the banks is affected in the way they reach a unanimous decision, by whether they observe at time t, a successful inflation rate (i.e. conditional probability of unanimity given that they observe S or NS). Observing a successful inflation rate, members come into the meeting with a 50-50 chance of reaching unanimity.

[3] We are aware that there was a change in the target in 2003, but given that it was a technical adjustment, we considered the current indicator (Consumer Prices Index) and the 2% target and extended it backwards in our calculations.

Table 2: Bank of England and ECB - voting patterns and success

		ECB			BoE
		Success classification 1	Success classification 2	Success classification 3	
Considering all Governing Council meetings	**S**	**17%**	**24%**	**36%**	**67%**
	B	40%	34%	22%	17%
	A	42%	42%	42%	16%
	NS	**83%**	**76%**	**64%**	**33%**
Considering only known decisions	**U**	**56%**	**56%**	**56%**	**53%**
	SM 8/1	-	-	-	21%
	SM 6-7	-	-	-	22%
	SM / C	**37%**	**37%**	**37%**	**43%**
	M	**7%**	**7%**	**7%**	**5%**
	P(U&S)/P(S)	**53%**	**61%**	**50%**	**53%**
	P(U&NS)/P(NS)	**57%**	**55%**	**59%**	**52%**
	P(M&S)/P(S)	**0%**	**0%**	**3%**	**5%**
	P(M&NS)/P(NS)	**8%**	**9%**	**9%**	**5%**

Sources: Bruegel based on ECB, Eurostat and Bank of England.
Notes: S = Success in keeping inflation within the target band, B = Below the target band, A = Above the target band, NS = A+B.
For ECB (Dec 1998 to Feb 2022): There was a change in the target due to the revision of the ECB strategy announced on 8 July 2022 and effective as of the GovC meeting of 22 July 2022 - change in range presented in (brackets). Success classification 1 considers 'success' if the observed inflation rate is between 1.8 and 2 (2.2), Success classification 2 if between 1.6 and 2 (2.4), Success classification 3 if between 1 and 2 (3). U = Unanimity, C = Consensus, M = Majority. When considering all decisions: 289 observations, when considering only known ones: 112 observations.
For BoE (June 1997 to Feb 2022): It is considered 'success' when the observed inflation rate is between 1 and 3, as officially set by the BoE. U = Unanimity (9-0 votes), SM 8/1 = Strong Majority (8-1 votes), SM 6-7 = Strong Majority (7-2 or 6-3 votes), SM = SM 8/1 + SM 6-7, M = Majority (5-4 votes). Nr observations: 259.

Conclusions

Decision-making in Central Banks is done by committees as the institutions became independent from their governments. Beyond that, there are many differences in the way the committees are set-up and decisions are taken. Observing the ECB and the Bank of England, we conclude however, that they value equally reaching decisions by unanimity. This is perhaps not surprising given the impact that Central Bank actions have on the economy. Central Banks want to provide a clear signal in order to be convincing.

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