

Appointing Central Bankers¹

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Executive Summary

- The ECB appears to be designed to maximise the deviation between the Governing Council's potential and actual performance and to promote the possibility of the Governing Council making extreme or risky decisions. The nomination process for Executive Board members should be designed to offset these problems.
- Allocating Executive Board positions to particular countries is counter to the spirit – and probably the letter – of the Maastricht Treaty.
- In the United Kingdom, an opaque nomination process for Monetary Policy Committee (MPC) members has led to widespread resentment and has possibly damaged the reputation of the Chancellor and the MPC.
- Executive Board vacancies should be advertised and candidates should be scrutinised before being nominated by the European Council. The European Parliament should play a larger role in the appointment process.

Article 11.2 of the Statute of the European System of Central Banks and the European Central Bank provides a partial outline of the procedure for appointing members of the ECB's Executive Board. The European Council recommends a candidate; the recommendation is sent to the European Parliament and the Governing Council of the ECB for consultation; the European Council, at the level of heads of state or government, makes a final decision. The only formal requirements for a candidate are that they be of "recognized standing and professional experience in monetary or banking matters" and that they be a national of an EU member state.² What is missing from the protocol's guidelines is a specification of how the European Council is to arrive at its initial recommendation.

Following the announced retirement of Mr. Otmar Issing from the Executive Board, Germany proposed a single candidate – Mr. Jurgen Stark – to replace him. On 14 February 2006 – without commentary or justification – the Ecofin Council of the economics and

¹Briefing paper for the Committee on Economic and Monetary Affairs (ECON) of the European Parliament for the quarterly dialogue with the President of the European Central Bank.

²The protocol only requires that Executive Board members be citizens of EU member states, not that they be nationals of eurozone countries. However, the decision to appoint Mr. Stark was taken by the heads of state or government of the eurozone countries.

finance ministers of the member states dutifully nominated Mr. Stark to succeed Mr. Issing. On 2 March 2006 the Governing Council of the ECB rendered its terse opinion that Mr. Stark is of suitable standing and that it had no objection to the appointment. On 25 April 2006 the Committee on Economic and Monetary Affairs of the European Parliament, having previously solicited the views of Mr. Stark and having held a hearing, gave its approval of the candidate. On 17 May 2006 Mr. Stark's appointment was approved by a plenary session of the European Parliament and on 26 May 2006 the heads of state or governments of the EU member countries having the euro as their currency formally appointed Mr. Stark.

The open and transparent proceedings of the European Parliament contrast with the secrecy surrounding the rest of the appointment process. Mr. Stark has a respectable central banking background, but – unlike his predecessor – he is not widely viewed as a distinguished economist. While it is impossible to verify how Mr. Stark was selected, there is a widespread belief that the four largest eurozone members each “own” a seat on the Executive Board and that the seat just filled “belongs” to Germany. Thus, Germany was entitled to select the candidate. In addition, there is a sense that Mr. Stark might have been picked for his *lack* of a track record as an economist; that the German government believed that a candidate with more pronounced views and with a history of expressing independent thought might have encountered opposition.

In this note I explain why the ECB's structural flaws make it essential that the nomination process lead to independent, forceful, intellectually adept and hardworking Executive Board members. I contrast the appointment process in the euro area with that in the United Kingdom and I briefly discuss alternatives.

Why is the Appointment Process Important for Good Outcomes?

Groupthink at the ECB

Economists tend to have a rosy view of monetary policy making by committee. In his briefing note De la Dehesa (2006), for example, says that there is wide evidence and consensus that committees make better decisions than individuals because extreme positions tend to balance out in groups. Decades of research in the other social sciences provides a different point of view: belonging to a group changes people in profound and unforeseen ways, committees polarize their members and groups of competent people can make horrendous decisions.³

Interesting early evidence of the impact of group membership is provided by the experiments of Solomon Asch, who showed groups of students two cards: one with a single vertical line and one with three vertical lines of differing heights. The students were told that Asch was studying visual perception and then were asked sequentially which of the three lines on the second card was the same height as the line on the first card. Unbeknownst to the next-to-last student in each group to answer, the other students were Asch's confederates. In some experiments the confederates were told to give the obviously correct answer, and in these experiments the students who had not been briefed gave the correct response as well. In the other experiments the confederates were told to all give the same wrong answer. In these experiments, the unbriefed students went along with the same incorrect answer one third of the time. Asch commented that, “The tendency to conform in our society is so strong that

³See Sibert (forthcoming) for a survey.

reasonably intelligent and well-meaning young people are willing to call white black.”⁴

A potentially worrying way in which group membership affects people is that it polarizes their expressed views. After deliberation with their group, group members tend to be more extreme than prior to deliberation. This phenomenon is known as *group polarization* and it has been documented by more than 300 studies.⁵ Social psychologists offer two main explanations for this outcome: one has to do with individuals’ desire to be accepted by the group; the second, called the *persuasive argument theory*, has to do with informational influence.⁶ Group polarization leads to group members becoming less risk averse in situations where they are already willing to take relatively large risks⁷ and it causes them to be more willing to commit to losing courses of action.⁸ A particular form of group polarization, known as *groupthink*, emerges when group members’ striving for consensus leads them to stop giving due consideration to alternatives. Groupthink has been blamed for apparently competent committees making terrible choices: the Bay of Pigs, the Watergate coverup and the decision to launch the space shuttle *Challenger* are examples.

The way to avoid harmful group polarization and groupthink is to get committee members to act as individuals. A monetary policy committee can do this by having short terms in office, appointing members from outside of central banks, appointing people with a history of independent thought and the intellectual capacity to effectively oppose other group members, by permitting evaluation of individual members and by allowing external scrutiny of the group’s decision-making process. As Executive Board members have long terms in office (eight years) and the ECB allows no scrutiny of the decision making process or of any individual’s contribution to it, it is especially important to the eurozone that the appointment process lead to intellectually heavyweight and independent-minded members.

Are Two Heads Better than One at the ECB or Are Too Many Cooks Spoiling the Broth?

In addition to committee decision making sometimes producing disastrous outcomes, more than 125 years of research in the other social sciences documents that committee outcomes are not as good as one might expect, given the talents of the individual members. Unless their individual contributions are observable and can be evaluated, group members tend to shirk and the extent of the shirking is increasing in the size of the committee. In addition, there is substantial empirical evidence that committees do not share information well⁹ and that larger committees are subject to coordination problems.¹⁰

Monetary policy committees ought to be designed to minimise the process losses

⁴Asch’s experiments are described in Napier and Gershenfeld (1999).

⁵See Buchanan and Huczynski (1997) for a discussion of this.

⁶See, for example, Friedkin (1999).

⁷The original article documenting this is Stoner (1961).

⁸See Whyte (1993).

⁹See Stasser and Titus (1985).

¹⁰See Stroebe and Diehl (1991)

associated with shirking, the failure to properly share information and coordination problems. The Bank of England is an example of how this can be done. The MPC is relatively small, it has a clearly defined goal and individuals' votes are published. The ECB contrasts with its ludicrously large (and growing) Governing Council and its opacity. Given that the ECB appears deliberately designed to make decision making by the Governing Council subject to serious process losses, it is especially important that the appointment process lead to competent and hard working Executive Board members.

The Appointment Process in the United Kingdom

“The procedures for identifying a new Pope or a new Dalai Lama, are less opaque than those which precede the appointment of a Chairman of the Federal Reserve, a Governor of the Bank of England or a President of the ECB.” Howard Davies (2005)

While a model of democratic accountability in most of its operations, the appointment process at the Bank of England is possibly even more inscrutable than it is in the eurozone. In practice, the Chancellor simply appoints whomever he feels is most qualified for the job; how he arrives at a decision is unknown. Many of the candidates report surprise at being chosen: Sushil Wadwhani said that the approach came "totally out of the blue"¹¹, while David Blanchflower said that his appointment was a shock.¹² Appointments appear rushed: Sushil Wadwhani's appointment was announced five days after the phone call offering him the position; Chris Allsop's appointment was announced two days after an initial call and Stephen Nickell said that he was rung on a Tuesday and invited to participate in a meeting on Wednesday. He said accepted the job on Thursday and his appointment was announced on Friday.¹³ Sir Andrew Large was told only hours before his first MPC meeting that he had been chosen.¹⁴ Subsequent to appointment, a select committee of the House of Commons holds hearings and publishes a report. It can – and has – voiced disapproval of a choice but it has no power to veto it.

Recent appointments have included Sir John Gieve, a senior official at the Home Office with no obvious expertise at monetary policy, Richard Lambert, an editor of the *Financial Times*, and David Blanchflower, a labour economist who intends to remain resident in New Hampshire – appearing at the Bank of England for only a third of each month. The recent selections have led to regular articles in the British press bemoaning the choices and the process. Last November, the House of Lords rebuked the Chancellor, saying, "None of the recent external appointments is an acknowledged expert in monetary economics."

The consequences of secrecy and questionable choices have been a loss of respect for the MPC and a suspicion of cronyism. As a column in the *Guardian* put it, “Inevitably, there were whisperings that ... nudge, nudge, wink, wink – Ed Balls, Brown's right-hand man at

¹¹Monetary Policy Committee of the Bank of England, UK House of Lords (2001).

¹²Watts (2006)

¹³Monetary Policy Committee of the Bank of England, UK House of Lords (2001).

¹⁴Brummer (2005).

the time, had been hired ... by, you guessed it, Lambert. There's no evidence to suggest that this was the case, but that's what happens when the method of appointment is opaque."¹⁵ This autumn, a Treasury Select Committee of the House of Commons is to launch an inquiry into the way the Chancellor makes his appointments.

How could the process be improved?

There is not a large amount of research on central bank governance, but recent sweeping changes in central bank legislation have provoked some interest in the topic. Lybeck and Morris (2004) suggest that a double-veto process encourages the appointment of qualified people: one body nominates a candidate while another body appoints the candidate. The two bodies must be of comparable influence and power so that they balance one another. Thus, in the United States, the Governors of the Federal Reserve Board are appointed by the President with the advice and consent of the Senate. It might be preferable in the eurozone if the European Council were required, not just to consult, but to seek the consent of the European Parliament. Within what is specified by the protocol, the European Parliament could follow the lead of the UK House of Commons and shame the Council for a less-than-excellent choice by publicly and strongly voicing its disapproval of the nomination.

The protocol does not specify how the European Council is to arrive at a nomination. It is clear, however, that allocating seats on the Executive Board to the four large countries is counter to the spirit and possibly the letter of the Maastricht Treaty. Article 7 of the protocol says that no member of the ESCB's decision-making bodies shall take instruction from any member state government and that no member state should seek to influence any member of the ESCB's decision-making bodies. If a government insists on a right to appoint one of the Executive Board members, this invites suspicion that the government seeks to influence that member. In addition, it drastically limits the pool of available applicants if the candidate must be of a particular nationality.

Monetary policy making at the ECB is primarily a technical activity: choosing an interest rate such that, given the current and expected future path of the fundamentals, inflation will remain close to, but below, two percent. Thus, the appropriate people to carry out such an activity are professional economists. In addition, to avoid the groupthink referred to earlier, it is essential that some of these professional economists be academic, or other research, economists who are not connected to central banks, particularly the central banks of large eurozone countries. As academic economists and politicians typically inhabit different spheres, there needs to be a way for the politicians to learn about which economists might be qualified for the job. Restricting attention solely to candidates whom they or their advisors might know personally invites suspicions of cronyism. Consequently, it seems desirable that vacancies on the Executive Board should be publicly announced and that there should be an advertisement for candidates.

As both good governance and good outcomes requires candidates who are not just able but also possess integrity and a willingness to live up to responsibility the pool of candidates should be interviewed and carefully assessed prior to nomination by the European Council. It might therefore be desirable for the European Council to appoint a committee of both Council members and academic economists to evaluate the candidates. While it is reasonable that the ECB be consulted about the appropriateness of a candidate nominated by

¹⁵Elliott (2006).

the European Council, it is also important that the Executive Board of the ECB not be overly involved in selecting the candidate. There is a danger that the Board will favour like-minded candidates or candidates who are unlikely to oppose its favoured policies and this promotes groupthink.¹⁶

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¹⁶The current UK government has argued against such an open appointment process on the grounds of market secrecy. However, it is difficult to see why a transparent process is worse for markets than a process which leads to insider information and rumours.

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