Comments on Alan Blinder and John Morgan's

"Do Monetary Policy Committees Need Leaders? A Report on an Experiment"

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Motivation & Method

- Motivation from the field:
  - "While serving on the FOMC, I was vividly reminded of a few things all of us probably know about committees: that they laboriously aggregate individual preferences; that they need to be led; that they tend to adopt compromise positions on difficult questions; and—perhaps because of all of the above—that they tend to be inertial."
    - Blinder 1998, *Central Banking in Theory and Practice*

- Method: Experimental monetary economics
  - "FOMC in the lab" (Founded by Blinder and Morgan, 2005)
    - Economy driven by simple (but unknown) model
    - Undergrad "policymakers" minimize a well-defined loss function

Research Program: Experimental Monetary Economics

- How best to structure monetary policy <u>decision-making</u>?
  - Observation: Monetary policy committees are supplanting governors
- Research questions:
  - "Are two heads better than one?" (Blinder & Morgan 2005)
    - Yes.
  - "Are eight heads better than four?" (Blinder & Morgan 2007)
    - Yes.
  - "Are many heads, headed by a head, better than many heads not headed by a head?" (This paper)
    - Do committees with leaders outperform those without?
    - No discernible difference

Results: No significant effects of leadership

- No influence of leadership on any possible outcome:
  - Group loss function (deviations of U and π)
    - And no effect when only looking at small (4 person) committees
    - And no effect when only looking at large (8 person) committees
    - And no differential effect on large v. small committee
  - Lag in responding to macro shocks
  - Whether response to shocks is in correct direction
  - Frequency with which interest rates are changed
  - Learning: Group play relative to earlier individual play
  - Learning: Individual play before and after group play
  - No differential effect of female leaders v. male leaders
  - No differential effect of leadership on larger groups
- Real surprise: 11 hypotheses tested, and <u>none</u> significant
- Bonferroni adjustment:
  - Truly insignificant results
  - Authors lack power

What is Committee Leadership?

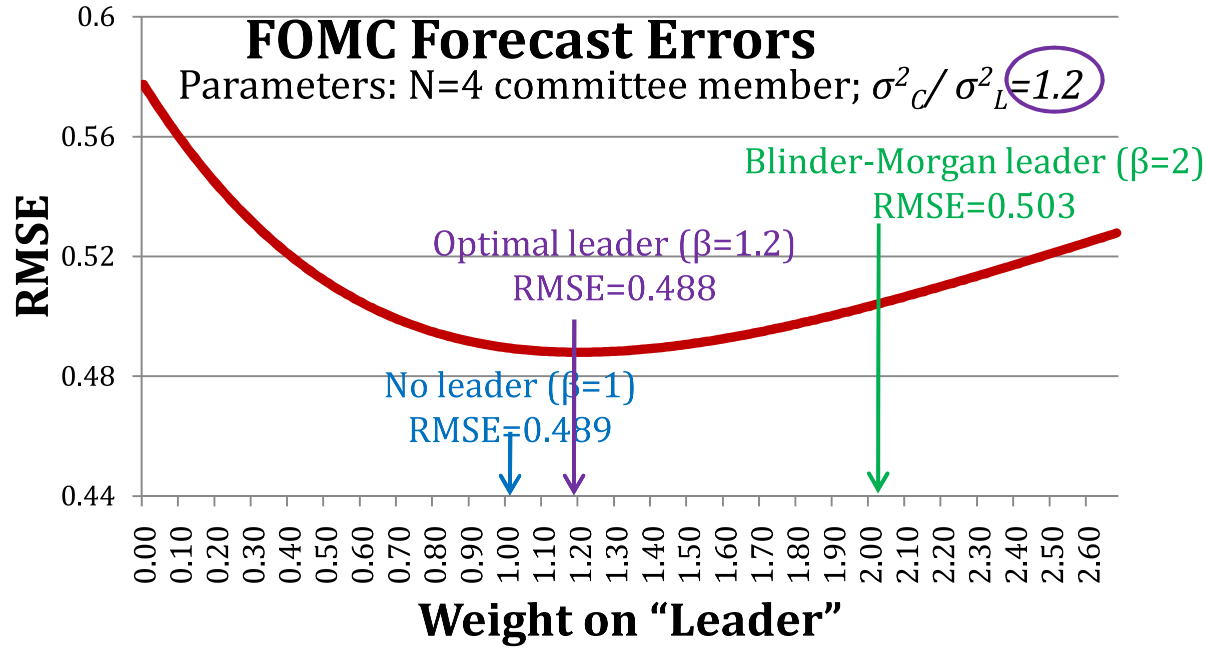
- To Blinder-Morgan, leadership involves:
  - The best player in (prior) individual play
  - Responsible for communicating the group's decision
  - Given double payoffs (and double incentives)
  - A tie-breaker vote
- Which model of committee leadership is this?
  - Greenspan Fed: "Autocratically-collegial committee"
    - "the chairman came close to dictating the committee's decision"
  - Intermediate cases: "Genuinely-collegial committees"
    - ECB Governing Council prefers consensus
  - Bank of England MPC: "Individualistic committee"
    - Strict majority vote; Mervyn King sometimes in minority

Leadership as Greater Influence

- Consider an FOMC:
  - Each member forecasts: *Outcomes | policy action = truth +* e_i
    - *N-1* typical committee members: $e_i \sim N(0, \sigma^2_C)$ and $E[e_i e_j]=0$
    - Leader has smaller errors: $e_L \sim N(0,\sigma^2_L)$ and $\sigma^2_L < \sigma^2_C$
    - Aggregation: *FOMC forecast = (β *Leader + Σcommittee members) / (N+ β-1)*

FOMC forecast error

$$\sim N\left(0, \frac{\beta^2\sigma_L^2 + (N-1)\sigma_C^2}{(\beta + N - 1)^2}\right)$$

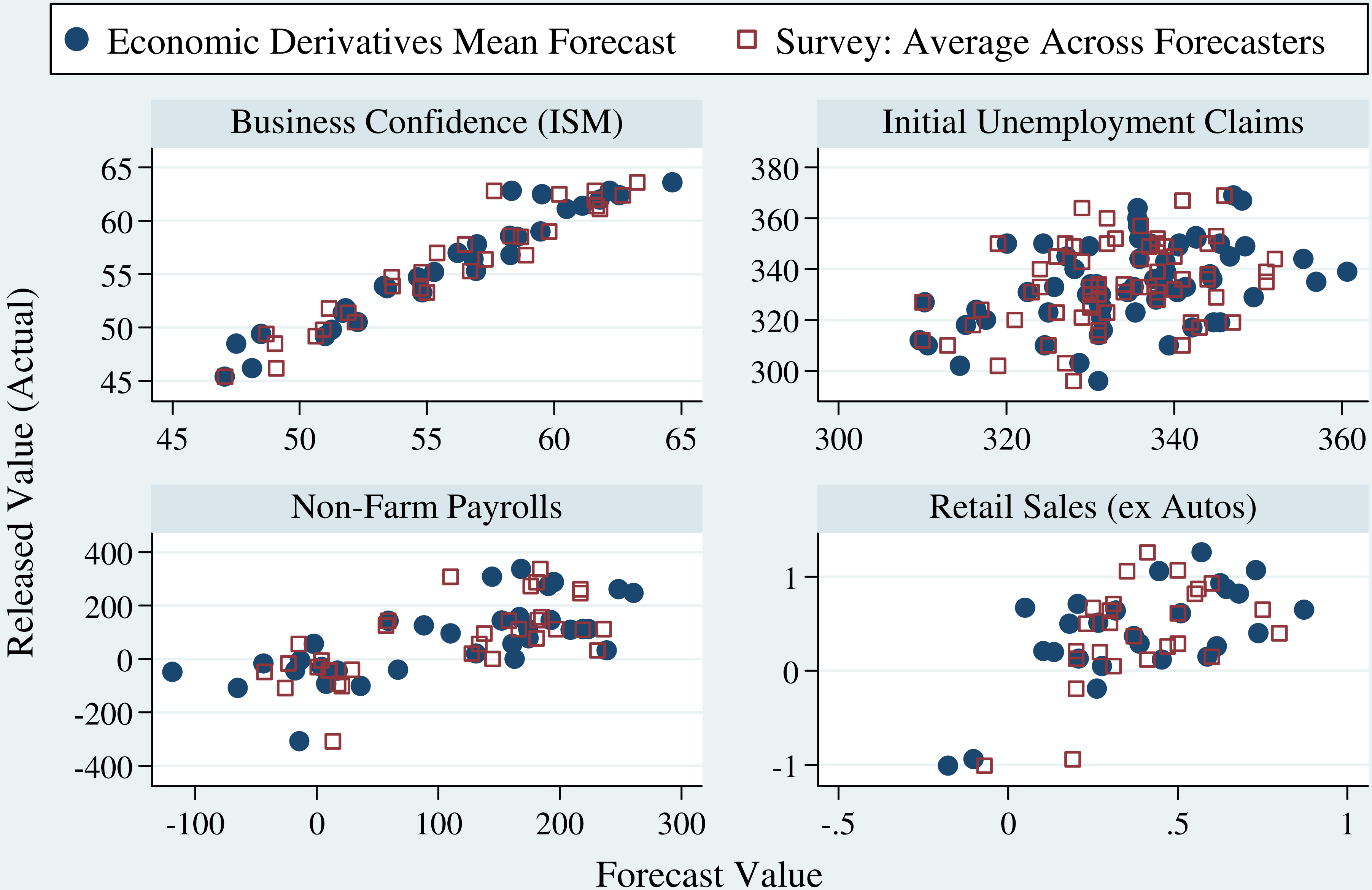


- Alternative notion of leadership: Making disagreements honest
  - Why do doves always forecast low inflation and hawks high inflation?
  - Preference variability pollutes information aggregation

Alternative Information Aggregators: Markets

- An FOMC meeting involves:
  - Information aggregation
  - Preference aggregation: Makes decisions given info
- Blinder-Morgan agenda is about information aggregation
  - How to run a better meeting?
    - Large committee or small?
    - Strong chairman or weak?
  - Small suggestion: Elicit pre-meeting information
    - Can actually trace how intervention changes information aggregation
- Consider alternative information aggregators
  - Prediction markets *versus* meetings (*versus* other formal mechs)
  - Well known pathologies of meetings: boss echo; amplification of cognitive errors; common knowledge effect; social pressures; cascades; reputational concerns; group polarization

Comparing Forecast Performance



Source: Refet Gurkaynak and Justin Wolfers, "Macroeconomic Derivatives: An Initial Analysis of Market-Based Macro Forecasts, Uncertainty and Risk", NBER International Seminar on Macroeconomics, 2005.

A Proposal

- Supplement existing Fed forecast procedures with an experimental prediction market
- Set up web-mediated *internal* prediction markets
  - As per Google's prediction markets
- Give each economist $500 to trade on various "economic derivatives"
  - Market prices can be interpreted as forecasts
- Compare accuracy of
  - Meeting-mediated staff forecast *versus*
  - Market-mediated staff forecast
- An important hint from Romer & Romer (this session)
  - Meeting-mediated FOMC forecast worse than staff forecast