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Is the structure of the ECB Adequate to the New Challenge?

I. Introduction

The intend of this paper is to look at how various institutional features of the European Central Bank's Governing Council affect the quality of the monetary policy making process. In particular I claim that the Council is too big and has too poorly defined a goal to be an effective technical decision-making body. Moreover, the eventual enlargement of the euro area is likely to exacerbate the situation. The main reason that the Governing Council's attributes might produce unsatisfactory outcomes is that its structure is unlikely to be conducive to either individual members exerting effort in the collection of information or to the efficient aggregation of the information collected. The paper is primarily intended to be a survey; to make my argument I apply some results from the game theory literature; I cite existing results from the macroeconomics and political economy literature; I discuss empirical results from the psychology literature.

The first feature of the Governing Council I consider is its size and I argue that at eighteen members, and perhaps thirteen additional future ones waiting in the wings, it is probably far too large. I consider two game theory models to suggest why an increase in committee size can be harmful. The crucial assumption in both of these models is that the performance of the committee depends on the costly effort expended by individual members. I view effort as time spent collecting information about the state if the economy. The first model is related to an example in *Mukhopadhaya* (1999) and is used to show that if information is a public good in a committee, the outcome is that members of larger committees are less apt to become informed than members of smaller committees. The second model is a variant of *Dewatripont/Jewitt/Tirole* (1999) career–concerns model. In this framework, if the individual contributions of members cannot be disentangled from the performance of the committee as a whole, then an increase in committee size will cause individual members to exert less effort. This is likely to be a particular problem in the Governing Council, where the decision-making process is unusually opaque, with neither individual votes or transcripts published.

These theoretical results, as well as other results derived in the economics literature, are, by themselves, inconclusive in showing that larger committees are worse than smaller committees. The two models described here show that less effort is exerted in large groups than in small ones, but this does not necessarily imply that larger committees are worse than smaller ones. It is unclear whether small groups with more committed individuals produce more output than larger groups with less committed members. It is easy to find examples, using the first model, where larger groups do worse than small groups, but the results are not general. It appears difficult to appeal to theoretical models to determine a precise optimal size for a group. The second model predicts that group performance is decreasing after a certain point, but it is difficult to use the model to