Box 4

Monetary Policy Committee voting pattern: six years' experience[1]

In early 2009, changes were made to the monetary policy framework in Iceland and the current structure put into place. The Act on the Central Bank of Iceland was amended so that monetary policy formulation and decisions on the application of the Bank's policy instruments would thenceforth be carried out by a five-member Monetary Policy Committee (MPC) instead of the previous three-member Board of Governors. Sitting on the Committee are three representatives from the Central Bank – the Governor, Deputy Governor, and Chief Economist – and two external experts in the field of macroeconomics and monetary policy.

The changes in the monetary policy framework were implemented in the wake of the financial crash of autumn 2008, when over nine-tenths of the Icelandic banking system failed at a time of global financial crisis. Experience from the financial crisis, both in Iceland and elsewhere, indicated a need for further strengthening of the overall monetary and macroeconomic policy framework. In addition, the Central Bank had been unsuccessful in controlling inflation for most of the period from the adoption of the inflation target in 2001 until the onset of the crisis in 2008. There were many reasons for this. For instance, monetary policy lacked credibility, and inflation expectations were insufficiently anchored to the inflation target (see Central Bank of Iceland, 2010 and 2012, among others). As a result, it was important that the new framework should enhance the credibility of monetary policy while simultaneously ensuring its independence.

The current framework has now been in place for just over six years, and the votes of the MPC for the period 2009-2014 are publicly available (see the Bank's *Annual Reports* for this period).[2] Examining how the Committee's decision-making took place and how individual members cast their votes during this period may reveal whether there are any discernible voting patterns and whether such patterns are similar to those found in other countries with comparable frameworks.

Change in monetary policy framework

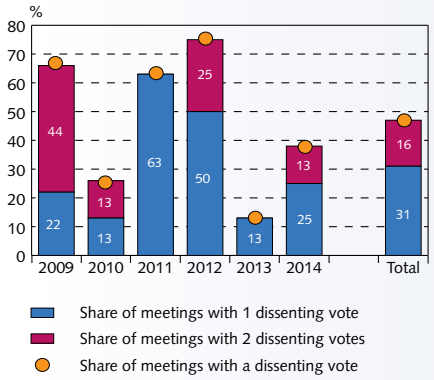
Research and international experience indicate that a monetary policy committee comprising several members is preferable to a single decision-maker (see Blinder, 2009). Such committees can vary in structure, however. They usually fall into two categories. In the first category are individualistic committees, whose members vote in accordance with their own opinions and whose results are obtained by majority vote. Such committees do not place particular emphasis on achieving unanimity on the decision, and each member is responsible for his or her vote. The monetary policy committees in the UK and Sweden, as well as that in the US since the mid-2000s, are examples of individualistic committees. Falling into the other category are collegial committees, which emphasise unanimity about decisions, at least publicly, with the entire committee supporting the decision. Formal voting does not always take place, and the voting patterns are not disclosed when they do take place. Norges Bank's

1. This Box is based on a paper by Karen Áslaug Vignisdóttir, soon to be published in the Bank's *Economic Affairs* series.

2. The experience of the current arrangement appears to have been positive: Inflation was close to 20% when the MPC was established, but it has been at or below target since February 2014. As is discussed in Box I-1 in *Monetary Bulletin* 2014/2, volatility has diminished in the Icelandic economy. Long-term inflation expectations appear to have remained at or above 4% for most of the period, however, which indicates that there is still progress to be made in ensuring lasting price stability in Iceland. Furthermore, the liberalisation of the capital controls is an unresolved issue. The controls have supported exchange rate stability and the economic recovery that has been achieved over this period.

Chart 1

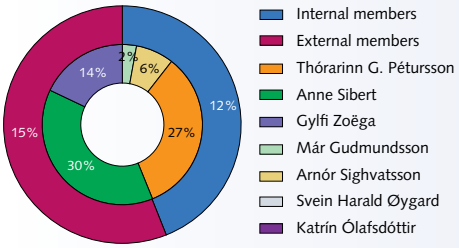
Average number of MPC votes dissenting from the majority 2009-2014



Source: Central Bank of Iceland.

Chart 2

Share of meetings where MPC members dissent from the majority 2009-2014



Source: Central Bank of Iceland.

MPC is an example of such a committee, and the European Central Bank operates under a collegial framework as well.

The change in Iceland's monetary policy framework in 2009 entailed broad-based reforms in the formulation of monetary policy and the communication of policy decisions. Current legislation stipulates that the MPC must meet at least eight times a year, and decisions are based on a thorough assessment of developments and prospects for the economy, monetary affairs, and financial stability. Each interest rate decision is preceded by in-depth one- to two-day meetings during which Bank staff give presentations to the MPC on recent developments in the economy and financial markets, as well as other topics of importance, as appropriate. Sometimes the Committee requests external presentations on topics under consideration. The objective is to ensure that all points of view are included and that decisions are based on solid professional reasoning and are as transparent and foreseeable as can realistically be expected. According to the MPC's rules of procedure, after listening to the other members' position, the Governor proposes an interest rate decision that he considers likely to garner majority support. If members are not unanimously in agreement, they vote on the proposals that have been presented, and a simple majority determines the outcome. The minutes of the Committee's meetings are made public two weeks after each decision, and the votes cast by each Committee member are revealed in the Bank's *Annual Report* the following year. The monetary policy framework in Iceland is therefore similar to that in the UK and Sweden.

Voting patterns

During the period 2009-2014, the MPC held 49 rate-setting meetings. The Committee chose to keep interest rates unchanged at just over half of these meetings; it lowered them in 35% of instances and raised them in 12% of instances. The decision was unanimous in just over half of the instances, including eight meetings featuring a unanimous decision to reduce rates and one unanimous decision to raise them.[3]

An examination of the decisions with split votes reveals that ¾ of the decisions taken in 2012 were disputed, followed by ⅔ of the decisions from 2009. Decisions with split votes were fewest in 2013, when there was only one that was not unanimous (Chart 1). In addition, analysis of the voting pattern over the entire period shows that one member dissented from the majority at nearly a third of the meetings, and in about ⅙ of instances there were two dissenting votes. It is therefore clear that individual members have held divergent points of view in the six years since the MPC's establishment, as the objective of a committee comprising several members is to present differing views, thereby increasing the likelihood that the decision will be an informed one.

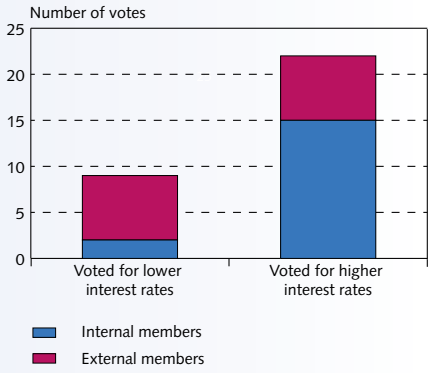
Closer examination of the dissenting votes reveals that Anne Sibert, one of two external members from February 2009 through February 2012, was most often in the minority, or in 30% of instances (Chart 2), followed by Thórarinn G. Pétursson, Chief Economist of the Central Bank, in 27% of instances. An internal member has been in the minority in 12% of instances and an external member in 15% of instances. Már Gudmundsson, Governor of the Central Bank, was in the minority once and Deputy Governor Arnór Sighvatsson three times. No external member has been in the minority since November 2012, when the monetary tightening cycle came to an end. Further-

3. There were six interest rate increases during the period, including three instances where one member preferred to keep rates unchanged and another two instances where one member wanted to raise rates by more than was ultimately decided.

more, when there has been a decision with a split vote, the majority has consisted more often of internal and external members than of internal members only. In the instances when two members dissented from the majority, internal members constituted a majority in only one-fourth of cases. Therefore, there do not appear to be signs of bloc voting among internal and external members, and furthermore, the Governor's position does not seem to be excessively strong, given the frequency of dissenting votes from other internal Committee members. On the other hand, closer examination of minority votes seems to reveal some difference in the voting behaviour of internal versus external members. When internal members dissented from the majority, they chose rates higher than the Governor's proposal more often than lower rates (Chart 3). This is not true of the external members, whose dissenting votes were split equally between higher and lower rates than were chosen by the majority. Internal members therefore appear to have tended towards a tighter monetary stance than external members did.

Chart 3

Pattern of votes dissenting from the majority 2009-2014



Source: Central Bank of Iceland.

Voting pattern in Iceland similar to that in other countries

The MPC's voting pattern over the past six years appears to be well in line with those in other countries with a similar decision-making framework. In 2007, Mervyn King, then-current Governor of the Bank of England (BoE), gave a speech on the ten-year experience of the BoE's monetary policy committee. In that speech, he mentioned members' divergent opinions on monetary policy, stating that he considered those opinions to reflect differing interpretation of economic developments. Sometimes the economic situation had been extremely unclear, complicating the interpretation of data and leading to divergent views within the committee, thereby leading to a larger number of meetings without a unanimous decision. On the other hand, a situation could arise where the state of the economy and the nature of shocks to the economy is undisputed and the response to them obvious, giving rise to a period of consensus among MPC members. King also shows that minority votes are far more numerous at the BoE than in, for example, the monetary policy committees in the US, Sweden, and Japan, and the same was true of the ratio of meetings where at least a fourth of members were in the minority. A comparison of the voting pattern in Iceland with the information revealed in the speech shows that the relative frequency of instances with one dissenting vote was similar to that in Sweden in 1999-2007, and about half that in the UK over the same period. On the other hand, the percentage of instances in which at least a fourth of Icelandic members voted against the majority is similar to that in the UK and higher than in Sweden.

The results of Gerlach-Kristen's (2009) study of the voting patterns at the BoE indicate that, as in Iceland, external members have a tendency to vote for lower interest rates than internal members do, particularly during economic contractions. Unlike in Iceland, she also finds that external members were in the minority at the BoE more often than internal members were. Gerlach-Kristen considers it likely that this stems from external members' tendency to be more recession-averse than internal members. Differences in loss functions from one member to another could also explain the difference in voting patterns, and it was possible that internal members placed greater emphasis on price stability than external members did. This appears to be in line with the findings of Jung (2011), whose study of the voting patterns of several MPCs indicates that internal members at the BoE respond more aggressively than external members to the risk of elevated inflation following economic shocks.

Conclusion

The changes made to Iceland's monetary policy framework in 2009 have probably improved monetary policy conduct and enhanced its credibility. Transparency has also been greatly increased, and the procedure for decision-making seems consistent with best practice.[4] The voting patterns of the Icelandic MPC and the differences in the voting behaviour of internal versus external members during the Committee's tenure also appear to be similar to those prevailing in neighbouring countries with the same MPC structure.

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4. See, for example, Dincer and Eichengreen (2014), who compare developments in monetary policy transparency at a number of central banks, including Iceland's, in recent years. They find, for example, that Iceland has seen one of the greatest improvements in monetary policy transparency over the last few years.