Decision-making and Governance at the Reserve Bank of New Zealand
Peer review comments by Professor Charles Goodhart

I have now had the chance to read the report on RBNZ Governance, by Iain Rennie. This draft paper has been extremely carefully and competently done. I agree with his main recommendations, to move formally to a Committee system of decision-making, with separate Committees for monetary policy and financial stability, and external members to be appointed to participate in both. These changes will bring the governance of RBNZ into line with that practiced by the Bank of England, and could be assessed as bringing such governance into line with best practice. I could leave it at that. But when I am asked to referee, I am always inclined to offer comments, which I hope may be helpful.

First, a relatively minor point, there are two aspects of this exercise which Rennie, reasonably enough, takes for granted, but which could, perhaps, benefit by a bit more justification.

First, Rennie just assumes that financial stability, both macro and micro-pru, should continue to be the responsibility of the RBNZ. I think that this is absolutely right, because one cannot deal with financial stability problems without having the ability to inject liquidity into the ailing parts, which only the Central Bank can do. It should, however, be noted that there are those, e.g. Willem Buiter and some in the US, who argue that a separate authority should be established to deal with financial stability in order to keep the Central Bank's mandate simple and narrow.

Second, if you are to move to a committee system, with externals, there is a question what the Board would do, and whether it is still needed. The idea that the Board can assess the quality of members of the MPC strikes me as dubious: Board members will normally be part-time and have other jobs. So for reasons of confidentiality, they cannot sit in the Committee meetings, and therefore have hardly any greater ability to assess the quality of the Committee members than any other member of the public. In my view, the role of the Board is still important but rather different, which is, for example, to assess the operational efficiency of the RBNZ, and to mediate should there be a spat between the RBNZ and Treasury.

The suggestion is made, paras 138-140, that the Board should advise on Committee membership, both internal and external. I see no particular problem about having the Board advise on externals, especially if, as I later suggest, all externals be appointed for a non-renewable period of five years. But the Governor will know far better than the Board the capacity of his inside colleagues, and how easily it will be for him (or her) to work with them. So I would expect the advice of the Governor to be more important and more influential with respect to internals than that of the Board. On the duration of appointment, see paras 158-9, since one of the purposes of having externals is to prevent group think, a non-renewable appointment of five years might be best. If the appointment was renewable, there could be a risk of the external voting with the internals in order to curry favour. As for internals, five years, with one five year reappointment, is on the edge of being too long; five years followed by another three could be better, or four and four. Also, what would happen if a Deputy Governor was in post for, say, seven years, and then appointed to being Governor? Would that count as a completely new appointment, or would the previous DG only have a more limited time as Governor? A slightly tricky issue.

My main concern with the present document, however, relates to the transparency and communication of the new Committees. While it was entirely appropriate that a Governing Committee, consisting only of internals, should be collegial in public, because opening up internal dissension among the senior staff could be embarrassing, the maintenance of collegiality once you get externals into the system is, almost certainly, wrong. A major purpose of having externals is to prevent group think, and this can only be done if the externals can express their arguments for dissent in public. Even when all members of such Committees are insiders, as with the ECB, collegiality tends to break down when there are sharp differences of views, as recently with the Bundesbank and the ECB. Also note that the Fed Reserve Bank Presidents dissent far more frequently in recent years than the Governors, and in public. I would suggest that externals might *insist* on their position becoming public knowledge.

Again in line with this view, the idea that the Minutes of the Committees should not be disclosed until after a year or two, (para 168), is absolutely the reverse of what is now seen as best practice. The Bank of England has recently altered its arrangements in order to release the Minutes at exactly the same time as the MPC decision is announced. [Rennie says nothing about whether transcripts should be taken and subsequently published. I would advise against this because it stilts internal discussion. Also, the idea that there should be two sets of Minutes, one with votes available to the Board, and one without votes, (para 166), is cumbersome. Also Rennie says nothing about the possibility of the Governor holding a public press conference immediately after the decision, which is now becoming the norm in most developed countries.]

Also, there is an interesting question about the balance between internals and externals in terms of numbers. I think that it would be wrong to enable the externals taken together to outvote the internals, if the internals are all in agreement. So I would favour something like a 4/3 division. Again Rennie does not discuss the balance of numbers between insiders and externals.

Also, another similar point, relating to externals, concerns the question of what the externals should do, when not participating in the work of the Committees, which can only take up a portion of their time; what do they do with the rest? Because of confidentiality issues, and the need to be available to participate in meetings whenever suits the Governor's timetable, about the only candidates who could continue to maintain a part-time job outside the RBNZ would be academics working at a university within about 20 miles of Wellington. This is actually fairly rare, and virtually every external at Central Banks elsewhere remains full time at their Central Bank. So what do they do there, when not in Committees? At the BoJ, the externals have been incorporated into line management, but I rather doubt whether the RBNZ would find this suitable. There was, as you may recall, and I could send you documents, quite a lot of upset and dispute about the staffing of externals when they were introduced at the BoE in 1997. This was largely resolved by giving each external a staff of one fairly senior bank official, (usually an economist), and one or two junior support staff. So, this would add to RBNZ staffing requirements, and appointments and costings would have to be revised to take account of that. Again much of their time is spent writing papers and presentations, which makes collegiality more difficult for externals.

Finally, on externals, in paras 99 and 114, Rennie seems to emphasise that the externals should be drawn from a skill set that mostly relates to professionals, especially monetary economists. Only in paragraph 144 does Rennie indicate that it would be desirable to include some specialists in financial markets. There is a growing view that the reliance of central banks on monetary economists, and the exclusion of those with market and banking experience, has perhaps gone too far. It might be a good thing if Rennie would read the book, *Fed Up*, by Di Martino Booth; while this has an agenda and is somewhat exaggerated, there is a grain of truth in it.

Let me end with a few minor issues that might be worth thinking about. First, the decisions of the MPC revolve very closely around the internal forecast that is made for the country over the next two or three years. Who should be responsible for that forecast? At the ECB, and Fed, where the externals (the NCB Governors and the Regional Fed Presidents) all have their own staffs, the key forecast is done by the staff at the ECB and the FRB respectively, and the externals do not have to subscribe to it. At the BoE, the externals do not have a sufficient staff to do a forecast themselves, but they have much more time and incentive than the internals to involve themselves in the conduct of the BoE forecast. So at the BoE the forecast is signed off as being the responsibility of the MPC as a whole, including the externals. In that sense, the forecast is collegial, though the internal discussions about that forecast are private. That has worked pretty well at the BoE, and perhaps the same could be done at RBNZ.

Next, Rennie suggests a published mandate for both Committees. That is OK, but the definition of financial stability and the instruments for achieving it, are so amorphous that the Charter for the Financial Policy Committee is likely to be so generalised, and in favour of motherhood and apple pies, as to amount to rather little. In para 121, Rennie suggests a policy statement on financial regulation implementation. While this is fine as far as it goes, one of the key features of an FPC should be forward looking to assess possible future points of fragility. The FPC will be judged largely on whether it was able for foresee arising dangers, and it would be as important for the FPC to set out a Record or an Assessment of the current state of financial risks, as on an account of implementation of policy.

Finally, in para 182, Rennie suggests having the Secretary to the Treasury joining the Board. I think that this is quite wrong, because, as earlier noted, one of the key functions of the Board might be to mediate between the RBNZ and the Treasury in the case of spats. What has been done in the UK, with complete success so far, has been to have the Treasury send an official to sit in at the meetings of both the MPC and the FPC, under quite stringent, but I believe unwritten, rules. These rules are that the Treasury representative *never* speaks, except to answer questions that may be put to him (her) about e.g. fiscal policy, and has no vote. The Treasury representative then returns to brief the Minister about what transpired. But a further rule is that the Minister never uses that inside knowledge, nor allows anyone else in government to do so, in any public statement. So, the confidentiality of the Committee is entirely maintained, but at the same time, the Minister is made completely aware of everything that transpired there and the views of each member.

I hope that this has been helpful. I would suggest that you show this to Rennie and I would have no concern if you wish to release my comments to anyone whom you think might benefit from them.