

The Treasury

Reviewing the Reserve Bank Act Information Release

Release Document January 2018

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

to prevent prejudicing the entrusting of information to the Government of New Zealand on a basis of confidence by an international organisation	6(b)(ii)
to protect the privacy of natural persons, including deceased people	9(2)(a)
to prevent prejudice to the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied	9(2)(ba)(i)
to avoid prejudice to the substantial economic interests of New Zealand	9(2)(d)
to maintain the effective conduct of public affairs through the free and frank expression of opinions	9(2)(g)(i)
to maintain legal professional privilege	9(2)(h)
to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Decision-making and governance at the RBNZ

Comment on draft report

The draft report makes some useful suggestions, but there are recommendations that I would not support, good recommendations that are weakly backed by evidence or argumentation, and missing suggestions for reform. With respect to presentation rather than substance, some heavy editing is required to give the report more force.

Good recommendations

The following recommendations share important attributes. They all:

- would fix weaknesses in current arrangements, mostly through reducing exposure to the vagaries (in terms of preferences and qualities) of an individual decision-maker, and through strengthening checks and balances
- are consistent with NZ's preferred way of organizing the machinery of government, in particular with respect to attention to clarifying roles and responsibilities
- provide a good balance between codification and adaptability, using mechanisms of secondary law to suitably facilitate but also constrain adaptability
- make the best of arrangements that are observable internationally, both within central banking and more generally within government administration.

These good recommendations are: (reference to the report's numbering in brackets is in the form of Pn,Rn where P refers to proposal and R to recommendation; my own additional or conflicting recommendations are identified with blue text and capital letters rather than numbers.)

1. *Switch to committee decision-making for policy matters (henceforth policy committees), with non-executive participation, as a requirement of law (P1).*

Groups are less idiosyncratic than individuals, even after allowing for group dynamics, and have greater democratic legitimacy simply by virtue of comprising wider set of personalities than just one.

2. *Use separate policy committees for policy domains that have the potential to conflict, and that call for somewhat different skill sets (P1,R2).*

Within the macroeconomic stabilization and financial regulatory areas, various policy sub-domains have overlapping objectives that are affected by the others' instruments. Integrated decision making would seem to be the answer, but that requires more knowledge than we have, and without knowing how to optimise tradeoffs (ex ante) practical political economy considerations make integration risky. Structured, purposeful subject matter specialisation helps, at the potential cost of increasing exposure to occasional conflicts between domains. The key requirement is to recognise that tradeoffs are present, so that any tradeoff management opportunities (that would preserve second-best gains of policy specialisation) are not neglected. Separate committees go in that direction.

3. *Require secondary law instruments¹ – specifically, Policy Targets Agreements (PTAs) – that clarify and amplify primary law's stated objectives, separately for each policy domain that has its own policy committee (P1,R1), for periods that extend well beyond an electoral cycle and that are disconnected from the terms of individual actors (P1,R8).*

Secondary law instruments have the virtue of being more easily amended than primary law, while still being legally binding on those that fall within its ambit. Primary law can direct and constrain the content of secondary law while the former sets out principles that are made more concrete and public by the latter. For policy domains where society has multiple objectives of uncertain ranking across time and circumstances, such secondary law instruments have the great virtue of permitting the legislature to state those objectives without totally predetermining their treatment. Articulating standard treatment, given the current state of knowledge and for the time being, can be a requirement placed on secondary law. PTAs, Chancellor's Remits (in the UK's MPC and FPC contexts), and HM Treasury Codes of Practice (in the UK 2009 Banking Act context) are useful examples.

4. *Require secondary law instruments – specifically, committee charters – that set out rules of composition and procedure for policy committees, with parameters established by primary law (P1,R4).*

The same virtues of additional flexibility, consistent with the principles and within the constraints established by the legislature, apply.

5. *Make minutes of policy committee meetings available for accountability purposes (P1,R7) with those minutes recording individual committee member's contributions.*

Observing individual effort is crucial for incentives. Being able to hide behind collective decisions allows unwanted behaviours all the way from disruptive to overly conformist. There is the risk that members play to the audience that can observe them. That argues for (a) making the benchmarks against which contributions are to be assessed clear to all (see PTAs, Charters) and (b) making that audience as representative of the principals as possible (ie the legislature, at a minimum; preferably the public at large). [Restricting the audience to the Board, for any substantial time, increases this risk – the more so that benchmarks are weakly specified, downplayed, or ignored (the last two because the Board's own role is not well structured, incentivised).]

6. *Keep the RBNZ Board out of executive and policy decision-making, expand its role in the appointment of policy decision-makers by giving it the duty to nominate policy committee members (P1,R3), and clarify its role in the accountability process (P2).*

Checks and balances in appointments (and dismissals) are important to reinforce any separation of responsibilities that the principals have determined to be desirable. Much economic and political theory and evidence supports a separation of active policy making from electoral politics in the policy domains under discussion, and at least for monetary policy Parliament in 1989 opted for separation with a specific form. Parliament determined that the Minister would participate actively in choosing the decision maker and setting their *strategic* policy targets, but could not act alone on either, and would not (except in highly unusual circumstances covered by directive powers) have a role in *tactical* policy decisions.² Although different ways of achieving Parliament's

¹ The "secondary law" term is being used a little loosely. I am combining regulation-making that has the force of law (these being secondary law, in a stricter sense) with other important instruments (such as contracts, agreements) that direct and constrain administrative actions, instruments that are required by primary law, making it very difficult for the signatories to ignore them (these being secondary law only in a loose sense).

² In choosing the decision maker, the Board would act first, providing a nominee for the Minister's endorsement or otherwise. In setting strategic targets, the Governor would need to agree, both having the same status. The Minister would be

desired separation of the Minister from tactical decision making could be envisaged, the use of an internal supervisory board to enhance performance monitoring, and using that board to provide a check on the Minister's potential power to influence tactical policy through unilateral appointment, both make sense. The board's ability to play these twin roles – counterbalancing political forces in appointments, and monitoring the performance of appointees – would be undermined by executive or policy responsibilities.³

Recommendations that I do not support

There are several recommendations that I disagree with, many of which reflect a different judgement on strengths and weakness but are not fundamental, two of which are fundamental. I start with the more important.

The role of the Minister

The report recommends a strengthening in the Minister's role. He or she would:

7. *Be one of the two actors appointing policy committee members in addition to the Governor (P1,R3; the other actor being the Board). Currently the Minister has no direct role in the appointment of the deputy governors who might be ex officio policy board members. The same goes for dismissals.*
8. *Have a new role in agreeing policy committee composition and procedures, within legislative boundaries (P1,R2)*

Although the role of the Minister is far smaller than some of the report's drafting appears to suggest,⁴ its strengthening is at odds with Parliament's earlier concern to limit the Minister's reach. Experience in New Zealand and elsewhere since the 1989 Act has not weakened the case for separation, and enhanced political legitimacy does not specifically require *greater* Ministerial involvement.

Indeed, there would be advantages to increasing the role of Parliament relative to that of the Minister. I would recommend that

able to recommend dismissal, on listed grounds, but could not act without the endorsement of the government (through the device of the Governor General in Council). In recognition of the Board's role in the appointment, and of the difficulties in monitoring performance from the outside (where the contribution of the decision maker to outcomes relative to agreed targets takes time to observe, and even after time remains fuzzy), the Board was tasked with monitoring performance from the inside, and given the power also to recommend dismissal.

³ Supervisory boards often have roles in setting financial strategy, writing rules for remuneration, HR and risk management, roles that could encroach on executive management and policy matters. In central banks, encroachment risk also exists, albeit in different specific forms. (The Bank of Thailand has seen conflicts at this boundary line.) As an example, risk appetite is usually the province of the peak board; in central banks financial risk is mostly a consequence of policy actions, and the key non-financial risk is the reputational risk that also flows from policy. Some attention might need to be paid in a Board Mandate to delimiting the Board's ability to influence or constrain policy through any management strategy role that it has.

⁴ In numerous ways the report appears to elevate the current role of the Minister beyond its proposed status, although the proposed position is available to the very careful reader. For example, the Minister is described several times as making key appointments; forceful checks and balances are noted separately, often at a distance. The Board is described more than once as advisory to the Minister, but only a very careful reader would note that its role in nominating a candidate for Governor is one of a veto player with the first mover advantage. With respect to the Board's ability to recommend the Governor's dismissal to the Minister, the "advisory" label probably underplays the difficulty that the Minister would have in not taking that recommendation forward to his or her government colleagues, or acting independently of the Board's views (notwithstanding the Minister's legal power to recommend dismissal, without reference to the Board). The Minister is also described as having a principal role "to set out the policy frameworks within which the RBNZ operates". While again it is noted that the Governor must agree, the relevance of the double-veto arrangement is downplayed. It is an internationally unique arrangement that offers distinct advantages in achieving parliament's clear desire to limit the Minister's reach into active policy.

A. Policy committee appointments, including that of the Governor, be made by parliament – or at least endorsed by parliament.⁵

If any sense of obligation feels owed by appointee to appointer, for both democratic legitimacy and de-politicisation it would be better for that to be directed to Parliament than the Minister. Parliaments are oriented to longer time frames than are Ministers, and appointees presumably understand that. It is harder for backroom deals that would have the effect of subverting parliament's will to be done with Parliaments than Ministers. In the context of the executive members of the policy committees in particular, it will be difficult to dispel completely a sense of hierarchy that would constrain dissenting views. For deputy governors appointed by a Minister with whom a Governor may enjoy a special relationship, the risk that hierarchy gets in the way is notable. The risk can be reduced if Ministers have less power over reappointments (which presumably matter more to executives than non-executives, given typical career paths).

An intermediate step along this path would be to have Parliament appoint or endorse candidates nominated jointly by the Minister and the Board. Such a 3-way veto would retain Ministerial involvement to a greater degree, possibly leading to more resources being spent (by Treasury and perhaps the State Services Commission) on scrutinising candidates offered by the Board. Higher costs would possibly (probably?) be recouped in the form of fewer mistakes been made. A continued prominent place for the Minister would also align with their responsibility to carry the nomination through the Parliamentary process, both in its formal and informal aspects.

Considering the proposed role of the Minister in agreeing policy committee composition and procedure within the context of committee Mandates:

B. The greater the role of the Minister in appointments, the tighter should be limits to the Minister's power to manipulate committee structures and processes.

Limitations on discretion over the content of Mandates can come in the form of more and tighter guidance in primary legislation. To illustrate, the law might state the permissible ranges of committee size as 5 to 7, of proportions of executives within the committee as 0.17 to 0.43, of lags before publication of minutes as 1 to 3 weeks, of staff resources available to non-executive members as 2 to 5 each (if not allowed as-of-right access directly to Bank staff, or as-of-right access to Bank staff meetings) etc.⁶ With Parliament making or endorsing appointments, somewhat more latitude could be given with respect to Mandates, but not much. One constraint that should not be left aside concerns the frequency with which Mandates can be changed. Experience in Hungary shows that tactically varying the policy committee's size can be a weapon used to influence the course of policy decisions.

C. Committee and Board Mandates should be subject to restrictions on frequency of change.

Having said all this, it may well be that political opinion in New Zealand has moved since 1989 to favour less separation of the Minister from active policy making in the relevant policy domains. If so, the report should point explicitly to reasons to believe that Parliament would prefer less separation now than it did in 1989. Otherwise, it risks appearing like your preferences for Ministerial prominence are the driving consideration.

⁵ Governors are commonly appointed by the legislature in Eastern Europe (Bulgaria, Croatia, Lithuania, Macedonia, Romania, Russia, Serbia, Slovenia), and are often subject to parliamentary approval in many other parts of the world (Argentina, Brazil, China, Indonesia, Japan, Mexico, Peru, Slovakia and the United States). In the UK and for the ECB, the relevant parliaments hold hearings that do not legally have full veto powers but which come close in practice. The wide range of parliaments that have a determinative role in appointments show that it can be done. Indeed, in Bulgaria, full open hearings for all candidates in select committee precede full debates on the floor of parliament on the appointment of the select committee's shortlist.

⁶ Such details can be placed in Schedules to the Act, recognizing their detailed nature.

The role of the Governor

The report recommends greatly reducing the power of the Governor by moving to committee decision making and by the Minister's participation in determining procedures for decision-making. That diminution in power is appropriate, for reasons already noted. Still, the report

9. *gives the Governor a special role in determining the composition of policy committees and their rules of procedures (P1,R2).*

Although, as the report notes, research is not conclusive on how much composition and procedure affect outcomes, most observers agree that composition and procedure can be manipulated by chairs to their advantage. The objective of introducing committee decision making is to add diversity and reduce exposure to an idiosyncratic view strongly held by a key individual. Adding diversity that has traction – ie, is more than window dressing – is not to the advantage of a most people who end up as a chair. Constraints should be placed on the chair's ability to alter committee composition and procedure.

- D. *The policy committee as a whole should agree its Mandate with the Minister, perhaps also with a requirement for a formal Board assessment of draft mandates.*

Policy committee composition, procedures

The report recommends:

10. *policy committee sizes in the range of 5 to 9 (P1,R4);*
11. *at least some non-executive ("external") members (P1,R4);*
12. *with both executive and non-executive members having 5 year (staggered) terms with just one renewal allowed (P1,R5); and*
13. *minuted voting but lagged publication of minutes so as to allow the presentation of a single committee view, with unspecified methods to promote a collegial presentation of that view in public (P1,R6 and R7);*

all of these being subject to specific determination by the Minister and Governor in the context of Mandates (see Recommendations 8 and 9 on my numbering).

Given the problem created by a small pool of unconflicted talent, I would lean towards smaller maximum committee sizes, especially as the additional 2 members beyond 7 are unlikely to add materially to diversity of perspective, once increased risks of shirking (predominantly through coat tail-riding) is allowed for. For a similar reason, I would consider extending the standard term to 7 years. Limiting to one renewal makes even more sense with 7 year terms, both with respect to the number of years potentially served, and with respect to reducing the power of the threat of non-renewal (after serving 5 or so years by the time that the question of renewal starts to arise, members may be more likely to feel they have already made a decent contribution than a member who has only served 3 or so years, of which the first 1+ may have been about learning).

- E. *Terms for policy committee members (including the Governor) should be 7 years, with a maximum or one renewal.*

More importantly, I think the balance of internals and externals to be a sufficiently important matter that it should not largely be left to the discretion of those agreeing Mandates. And I am not persuaded by Maier, Blinder or many other serving and former central bankers that monetary policy performance is harmed by the visibility of disagreements over policy tactics.

Turning first to the balance of internals and externals. The tendency to groupthink, with the most powerful member of the group being the “seed” of the group view, is the biggest impediment to harnessing diversity. The probability of groupthink increases with the presence of hierarchy.

F. [The law should restrict the proportion of executive insiders to below half](#), by a big enough margin that these tendencies have a chance to be offset.

Turning now to the public presentation of committee decisions, claimed improvements in policy transmission mechanisms flowing from singular official views about future policy are ephemeral. Apparent unanimity is quickly shown to be untrustworthy spin. The essential reason is that the future is largely unknowable, and it is foolish to pretend otherwise. Consider the records of the few central banks – including the RBNZ – that publish forward policy interest rate paths. Forecast paths are almost always poor predictors of reality, even in the RBNZ case where unanimity about the outlook exists by construction. Being honest about the limited predictive powers of even highly paid specialists is likely eventually to increase their trustworthiness, at least relative to the results of repeated false marketing of ostensible consensus.

With unknowable future shocks, the real predictability problem relates to how policy will react to new events. To predict that, one has to know policy preferences and the mental frameworks used to process new information (as well as forming a view on what new information might arrive). Given clear legal objectives supplemented by PTAs, the range of policy preferences in play should be constrained. The main thing then is to allow people to observe the variety of analytical frameworks being deployed. That is not helped by delaying the publication of minutes.

Gains in withholding minutes are thus small, if they exist at all. At the same time, requiring members to withhold from expressing their true views in public, at least for non-trivial periods around policy decisions, may damage their ability or willingness to articulate alternative perspectives.

How can cacophony in communications be avoided without some formal constraint? One approach would be focus members’ attention on agreeing minutes that accurately reflect their individual contributions. Fairly full minutes, with attributed reasoning, can provide a better public platform for dissenters’ subsequent public utterances than can the soundbites of “managed” disclosures about policy decisions. If such minutes will be available soon, members are more likely to refrain from immediate but partial expressions of their views. A nice variant of this “Swedish” approach is one proposed by Andrew Levin, who suggests that:

G. [Policy committees should adopt a Supreme Court model for expressing their divergent views.](#)⁷

Where there are dissents, and dissenters share enough of the reasoning for their dissent, a single dissenting opinion can be written on behalf of a group of dissenters by one of their number. Such dissenting opinions can reflect a range of reasoning, where notable variations exist. Where those variations are too large, the dissenters have the option of writing more than one dissenting opinion.

The role of the Board⁸

I have noted my agreement with recommendations to keep the Board’s role focussed on appointments and performance monitoring. I also agree that:

⁷ As far as I am aware, this suggestion has not been made in a published document. It was conveyed to me in conversation.

⁸ The repeated references to the Board’s role as being primarily to provide advice are misleading. The Board “advises” the Minister only in the rare case of recommending the Governor’s dismissal. Under S.53(2) it may advise the Governor on any

14. *there is room to clarify the Board's roles and responsibilities* (P2, around paras 179-81); and
15. *that the Minister appoint the Chair and Deputy Chair of the Board* (P2), subject to the Minister's role not otherwise being increased (see earlier discussion).

The argument for Ministerial appointment in this case follows from one of the Board's two⁹ advisory functions (as suggested in the report), specifically advice with respect to dismissal for poor performance. But the logic is slightly different from that suggested by the report. Within the current construction, the Minister is key to any dismissal. As the Board can only act through the Minister when recommending dismissal, the Board is best thought of as the monitoring agent of the Minister, with the Minister being the appointed authority responsible for monitoring on the public's behalf.¹⁰ That makes sense even in the context of parliament making (or endorsing) appointments; there is no "logical requirement" for symmetry. It makes sense because parliament as a whole would find it difficult to be an active enough performance monitor. Delegation to a select committee or a Minister increases the probability that someone feels responsible enough to act. Focusing that responsibility on the Minister of Finance has parallels with other state sector arrangements, as the note indicates, as well as having the advantage of being able to harness the technical advisory resources of the Treasury. With respect to the optimal monitoring methods for the Board to use (see especially para 179 of the report), there is merit in the near real-time approach currently used¹¹, merit that would also apply to financial stability and regulatory policy domains. The RBNZ makes policy decisions "in the short term", against medium term targets. The consistency of periodic decisions with medium term targets warrants evaluation, and near real-time evaluation has a valuable place.

That said, policy making (for all the policy domains relevant to this discussion) consists of *three* levels, of which short term or tactical decisions is but one. Framework choice is the highest level, and includes: objective setting (in economist-speak, the specification of the loss-function, on society's behalf) and associated target selection; identification of the range of permissible instruments, and any limitations on their use; and determination of high level roles and responsibilities of those who will implement. These are the matters covered by law and PTAs, and might be subject to Board monitoring only to the extent that the Bank has an advisory role with respect to the law, and its policy committees have roles in agreeing PTAs. The Bank's performance in these areas that warrant Board monitoring mostly relate to process, rather than substance. That is, how did the policy committees go about forming their advice, or their joint position on the ideal PTA, rather than did their position make sense, in terms of the best available economic knowledge? The Board is not equipped to assess content, and commissioning external reviews by experts of framework construction would involve duplication of Treasury work and others' contributions provided in the context of public consultations over law changes.

matter, but providing advice is not obligatory and is clearly subsidiary to the other duties it "shall" perform. As elsewhere noted, its primary roles are making appointments and performance monitoring. Paragraph 177 starkly illustrates the problem. That paragraph says that "the Board's governance role would create a conflict with a number of its advisory functions". The prime governance roles are appointing and monitoring, which are entirely consistent with – indeed largely needed for – the prime advisory role (to recommend dismissal when performance has been inadequate). (Referring to the roles that the Board does not currently discharge, but hypothetically could, as relating to "executive" or "strategic management" rather than "governance", could help avoid this confusion.)

⁹ See preceding footnote.

¹⁰ Note that the language of S.53(3) suggests more than "mere advice" is being called for. The Board, once it forms a view that performance has been inadequate (in one of the forms specified), shall advise the Minister in writing and may recommend dismissal. Advice in writing fixes the Minister with knowledge, and places an onus on them to act in some formal manner. Recommending dismissal is optional, being clearly the more significant step. Note that the appointment role of the Board under S. 40(1) involves a recommendation, not mere advice.

The middle level between tactical decisions and framework choice involves policy strategy: the systematic components of instrument adjustment for the purpose of hitting agreed targets. In the monetary policy domain, this level involves the research that goes into modelling the economy and the choice of policy reaction function to embed in models to best represent optimal pursuit of agreed targets. (The analogues in the financial regulatory domain are work in progress.) Monitoring of this work by the Board also confronts the question of Board skill sets. Here, periodic external reviews by experts might make sense.¹² As would simply asking searching questions about sequences of model prediction failures, and apparently odd behaviours of projected policy. Policy committee members are likely to focus a significant proportion of their contributions on aspects of policy strategy that they disagree with, and these can be used by the Board to trigger searching questions. It is monitoring of this level that seems most in need of beefing up.

- H. The law should identify the monitoring of policy strategy selection by policy committees as a prime role of the Board, and a factor in any consideration of dismissal.
- I. A Board Mandate could usefully articulate specific expectations about how that responsibility would be discharged.

The report suggests that:

- 16. *the Secretary to the Treasury could help Board monitoring through participation in Board meetings in an ex officio, non-voting role (P2, para 182).*

The arguments provided for this proposal are weak. The Treasury's advice on the RBNZ should be an independent stream, rather than coordinated. The Bank's Board should not be attentive to the ebb and flow of political anxieties, but restrict itself to doing its statutory job with its medium to longer term orientation. And with respect to the Board's role in appointments, there is much merit in specialisation: the Board on candidates' technical and managerial capabilities, the Minister to political acceptability. It would be a mistake to ask the Board to be more attuned to the Minister's political sensitivities that it already is (partly by virtue of the Board being appointed by the Minister).¹³

A better argument for the Secretary's presence is the Minister's need to monitor the Board itself, and the contributions of its individual members. The existing mechanisms for doing this are weak. The Secretary could observe the Board in action without running into the problems just noted of mixing the streams of advice to the Minister by adding the Secretary to the Board in a non-speaking, non-voting capacity.

- J. The Secretary to the Treasury should be added to the Board, without right of vote or voice.

¹² The report refers in para 180 to reviews of the Riksbank commissioned by parliament. A closer parallel is the newly-provided power of the Bank of England's Court – its equivalent to the RBNZ Board – to commission external reviews (see Section 3C of the Bank of England Act 1998, as amended by Section 3 of Chapter 21 of the Financial Services Act 2012). The Bank of England has also created an Independent Evaluation Office to assist the Court's Oversight Committee in monitoring the Bank's performance. Such an innovation has a lot to recommend it, but it might not be a good fit with the smaller scale of the RBNZ. There are related questions about the access of the Board to an independent secretariat, however. I have not given this question enough thought.

¹³ My experience with the transition from Don Brash to Alan Bollard is illustrative. The Board suddenly became hypersensitive to the Minister's anger at Brash's decision to go into politics, an anger which overlaid the Minister's mistaken suspicion that the Bank, under Brash, had held back New Zealand's economic progress by driving real interest rates higher than they needed to be. I, along with other internal candidates for the Governor role, was asked by the Board to provide an analysis of where Bank policy had been wrong. As it happened, the appointee – Bollard – shared the Minister's view that the Bank was unnecessarily holding interest rates up. Bollard's move to cut interest rates was, he subsequently acknowledged, a policy mistake. I do not know how much the Minister's preferred policy analysis affected the choice of Governor, but the episode illustrates that having "a richer context as to the Minister's priorities and objectives" in the course of making appointments is not necessarily beneficial to the process.

Policy Targets Agreements and associated requirements on Policy Committees

PTAs create an opportunity for parliament's range of concerns to be expressed in statute while leaving the matter of reflecting those concerns within the operative policy framework open to expert technical assessment with respect to feasibility, and hence policy efficiency. Absent the availability of such a secondary law instrument, a narrower range of objectives than consistent with political concerns could end up in primary law, as multiple (and potentially overlapping) objectives create opportunities for policy agencies to pick and choose which to focus on when presenting ex post rationales for delivery failures. Simultaneously, PTAs provide the opportunity to pre-shape expectations for – note, NOT predefine – policy tradeoff making, in light of both issues of policy efficiency and societal preferences. PTAs on price stability policy fit this model fairly well. PTAs on financial stability and financial regulatory policy could also. The UK Banking Act (2009) provides the template for listing parliament's core concerns; requirements for a "Code of practice" to put flesh on the bones ("how the objectives are to be understood and achieved", in the words of the Banking Act, S.5(2)) is already familiar to New Zealanders who know about the PTA.

K. Policy objectives should reflect parliament's core concerns in a manner emulating the Banking Act model, and be mandatorily be treated in PTAs.

The report endorses the Canadian approach to renegotiating PTAs (see recommendation 3 on my numbering and the associated discussion) but at 6 year intervals, and I agree strongly. The report also proposes – and I endorse the proposal – that:

17. the relevant policy committee be responsible for agreeing the PTA with the Minister (P1,R8).

The selection of policy frameworks and strategies – the stuff of primary law and PTAs – is of much greater importance than tactical decision making. Frameworks and strategies, when properly articulated and given force, guide and constrain tactical decisions.¹⁴ Policy committee participation in devising PTAs that best contribute to meeting statutory objectives is, in this context, the most important task of these committees. This task should accordingly guide choices on the selection of policy committee members.

Most of the literature on group decision making concentrates on information aggregation by groups, by comparison with individuals. Groups acquire a fuller, and more likely stable through time, view of the information needed for good decisions. In the economic policy context, however, the extra contribution of additional members to conjunctural analysis is marginal at best, and possibly negative. The anecdotal character of information acquired through personal contacts is a weak basis for understanding the state of the world, relative to systems deployed by professional statisticians (especially as those statisticians reach into more timely and wider-reaching digital information sources). Reading current information may benefit somewhat from the diversity of personal experience and information processing heuristics, but an understanding of relevant economics is necessary to translate conjunctural information into messages about the continued relevance – or otherwise – of the policy strategy. Time for a discretionary departure from the strategy embedded (imperfectly) in the policy reaction function used in the forecasting model? If so, what are the grounds for believing that the PRF–strategy–targets–legal objectives chain has broken down, or is not capturing enough?

¹⁴ For these reasons, continued political involvement in determining the policy framework – parliament in writing primary law, the Minister jointly in writing PTAs – is a major ingredient of political legitimacy of RBNZ independent determination of decisions at the tactical level.

Thus even for the tactical task, economic expertise is (nearly) mandatory. But economics has diverse perspectives on how best to understand the workings of economies. These diverse perspectives are of most value for the most important task of the policy committees: PTA construction.

- L. [The law should direct that policy committee Mandates place a high priority on diversity of economic perspectives in the selection of members.](#)

Additional matters

How many policy committees? And their interactions.

The report is undecided on two or three committees. I would argue for three, as institutional regulation and supervision is sufficiently distinct from macroprudential policy for systemic financial stability purposes. To be sure, institutional regulation may contribute to the stability of the financial system, but (a) as we now know rather than just suspected, individual institutions may all be sound in most circumstances but still subject to externalities that create negative feedback loops within the system as a whole, (b) it is useful for both owners of financial intermediaries and financial service suppliers, and their creditors and customers, to know which parts of the regulatory imposts are applicable because of the specific characteristics of an individual financial institution, and which parts are being applied for reasons external to that institution, and (c) the nature of the tools and skills brought to bear on macro and microfinancial analysis is very different.¹⁵

- M. [Establish in law separate policy committees for macrofinancial stability policy and institutional regulation and supervision.](#)

With three policy committees, finding enough qualified and unconflicted members is a greater challenge than with two, especially if the recommendation to seek out diverse expertise on economic frameworks is taken seriously. This speaks to smaller committees – eg a maximum size of 7 rather than 9; longer terms – 7 years rather than 5; and a willingness to bring in foreigners.

Overlaps in membership of committees and the formal requirements for information sharing and powers to direct, or request action on a comply-or-explain basis, need detailed consideration.¹⁶

Dismissal provisions for policy committee members

The Central Bank of Chile's law allows a qualified majority of board members to recommend the dismissal of other board members, including the chair. Such an arrangement would add to incentives to contribute rather than free ride, and in a non-disruptive way. But it would make it even more desirable that grounds for dismissal be tightly linked to well-understood benchmarks, and that those benchmarks encourage members to offer diverse opinions. With PTAs there to establish the benchmarks for policy performance, and Mandates there to articulate expectations of members' behaviour, the vehicles exist.

¹⁵ In addition, there may be merit in transferring the provisions of the RBNZ Act dealing with banking regulation and supervision into a separate piece of legislation that also deals with regulation and supervision of NBDTs, insurance companies, and other entities for which the Bank has responsibility. The RBNZ Act would concentrate on the governance of the institution and the discharge of its policy responsibilities. That would make the (recommended) integration of the structure of policy governance easier to see, and provide an easier route to passing the responsibility for regulation and supervision to another body should that be desired some time down the road.

¹⁶ The general framework used by the Financial Services Act (2012) to establish the Financial Policy Committee and Prudential Regulatory Authority at the Bank of England provides a reasonable starting point, but the specifics of the legal drafting can be greatly improved.

N. Provide for board members to monitor each other's performance.

Any recommendation for dismissal coming from policy committee members could be directed to the Board in the first instance, or bypass the Board to the Minister. There are arguments supporting both possibilities.

Encouraging policy committee members to express concerns

Especially when it comes to financial regulation and supervision, there is much scope for gaps and flaws in policy frameworks to exist unchallenged, or weakly challenged, for long periods. That is until the gaps and flaws lead to (preventable) problems, at which point participants in the policy process are usually able to point to various documents in which their concerns had been expressed, or at least alluded to. A Dodd-Frank Act device applied to Financial Stability Oversight Council members could be used to encourage members to speak up. Individual FSOC members are required to attest annually to Congress that they believe that the regulatory system is fit for purpose. If they cannot bring themselves to do that, they must articulate where gaps and flaws exist. Being required to attest that the current regime is fit for purpose puts the onus in the right place.

O. Consider requiring policy committee members to attest that policy frameworks are fit for purpose.

Annual attestations seem too frequent, and too likely to become routine (as might be happening in the US). A requirement to make such an attestation one year after joining the policy committee – allowing time to evaluate the situation from the inside – then at 2 yearly intervals might provide stronger incentives to take the attestation seriously.

Drafting and presentation

As a final comment on the draft report, it is in much need of heavy editing. There is far too much preamble that leads nowhere.

- Three “frameworks” for the subsequent analysis are presented to the reader before he or she gets to the analysis – the NZ state sector organisational model; risk management and institutional resilience; outcomes of institutional arrangements (they should maximise the prospect of low inflation and financial system soundness and efficiency, and enhance the Bank’s “social licence”) – yet none provide a clear organising structure for the analysis.
- Coverage of literature of the survey of others’ experiences is very partial,¹⁷ and accordingly is too prominent in its current placement. It would be better to relegate such details as there are to supporting annexes, and restrict the introductory material to listing the priors that are carried to the analysis (with pointers to the supporting material).
- Much of the preamble material can be presumed to be well known, especially by a Treasury audience and most likely also by any moderately informed reader. Nothing is added by, for example, paras 80–84 (though this is just one of several examples).
- Overall, a maximum of about 6 pages of preamble should be a limit before the reader starts to encounter recommendations. Any framework offered to help the reader understand the approach

¹⁷ Two particular gaps stand out. The first relates to the extensive economic literatures on time (in)consistency and on political economy (incentive) problems in moving beyond electoral cycles, which gets too little mention. The second relates to the administrative law and political organisation literature on different institutional arrangements for independent and executive agencies of state. The literature, which was initially US-centric but which has been applied increasingly to analysis of European institutions, draws a strong – but not uniform – connection between independence and the use of boards rather than individual CEOs.

taken should be prominent in the organisation of the discussion of recommendations, and the specifics of that discussion.

- One potential framework that could be used to organize the discussion would link risk management, institutional resilience and political legitimacy¹⁸. This framework would lead naturally to the question of what would best encourage working in society's interests when unexpected conditions are encountered, and when Trump-like individuals come to office? Such a framework would bring the de jure/de facto question into much sharper focus – this question being a biggie for the review, but one that is encountered late and only briefly on pp11 and 16-17.¹⁹

Introductory material also contains descriptions of current arrangements that could set the fast reader down the wrong path. As already noted, the representations of the Minister's and the Board's roles are misleading in material respects, with a lot of that to do with drafting (very careful readers will find important clarifications at a later, often a lot later, point in the document). The descriptors should be chosen to convey the right impression even to skim readers.

The question of the places where RBNZ arrangements fit and don't fit within the range of state sector models is crying out for some kind of schematic or tabular presentation. A simple matrix that shows the generic types of state sector entity and the institutional arrangements typical of each might be able to be devised.

David Archer

May 2017

¹⁸ A more recognisable term, internationally, than "social licence".

¹⁹ A useful illustration of the risks associated with relying on the robustness of de facto arrangements comes from Canada. Governor Thiessen effectively delegated his legal responsibility to a committee and subsequent Governors followed suit. But Governor Carney (apparently) told colleagues that his conscience would probably not allow him to make what he sincerely believed to be the wrong decision. In such circumstances, he would take back his legal authority.