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Peer Review of "Decision-making and Governance at the Reserve Bank of New Zealand"

Overall.

The report is a well-written and well-reasoned consideration of moving to a legislated committee-based decision-making model for both monetary and regulatory policy. My experience at the Federal Reserve and the Bank of England supports the arguments for why committee based decision-making is likely to produce superior outcomes (or reduce the odds on inferior outcomes) relative to a single decision-maker. The committee offers the opportunity to bring diverse perspectives and new information to these difficult decisions; robust debate, full consideration of alternatives, and compromise where required are likely to yield better policy on average over time, in part by reducing the odds on persistent policy mistakes. And democratic accountability would be enhanced by having the parliament consider how it would like those committees to be structured—lining up de jure and de facto practice.

I say "likely" to yield better policy in part because it is critical that the committee comprise diverse perspectives and that the members of the committee feel empowered—indeed obligated—to express those views and participate fully in the decision-making. In that regard, I agree with the recommendation that the committees include externals—people with expertise who are not part of the Reserve Bank (RB) hierarchy, and that all members of the committees be accountable for their participation.

To be sure, committees make policy accountability more diffuse and can complicate clear messaging if committee members speak out about their individual views. But the most important task is making the best decision—one that has the highest odds of meeting the objectives of the RB embodied in legislation and policy agreements--and the benefits of increasing the ability of the RB to do that, as I believe properly structured committees could do, outweigh any costs.

So I strongly endorse **proposal 1**, though I will have comments on the implementing recommendations.

I agree that restructuring the decision-making will have implications for the RB Board and the Treasury—**proposals 2 and 3**--though it is difficult for someone not well acquainted with the particular circumstances in New Zealand to comment on this in detail.

The paper emphasizes the role of the board in advising the finance minister on appointments for governor and on evaluation of policy. In perusing the RBNZ website, it would appear that the board also advises the RB, putting it in between the RB and the minister. I agree that it would make sense for all the appointments to the committees to have a similar path and ultimately be made by the minister. The role of the board in making personnel recommendations to the minister is unusual. With a committee structure whose members turn over gradually with staggered appointments, the risk of politization by one party as a rationale for board involvement would seem to be diminished. And, with the RB having gained additional authorities over the year, and with policy accountability more diffuse but committees retaining considerable implementation independence, democratic accountability in the appointments process should also be considered. One option to increase the input of elected officials would be to give the minister sole authority for appointments—remove the double veto; another approach would be for the board to give the minister a set of candidates for each positon—say three—and have the minister make the final choice among that set.

In either case, the board would continue to have responsibility for advising the minister on the performance of the policymakers individually and collectively. To this end, I agree that the board should have the authority to commission outside reviews of policy and the policy process to help it, the minister, the parliament, and the people gauge the effectiveness of the RB. These sorts of reports can be very valuable and parliament should consider whether to mandate outside reports every 3 to 5 years.

Comments on the recommendations implementing proposal 1.

Recommendation 1: Continue the PTA; develop a policy statement for regulation.

I agree. Both the PTA and the new policy statement for regulation should be agreed by the minister and the appropriate committee.

Constructing a statement on regulation will be challenging because, in general, no ready metric is available for monitoring and for accountability in financial stability analogous to inflation relative to target for monetary policy. Presumably the legislation would set broad objectives in this area—say, safety and soundness of individual institutions and financial stability and resilience of the financial system--and the statement could lay out some medium term objectives to this end and address possible secondary objectives and trade-offs. One issue to be considered is whether micro and macro-prudential supervision would require separate statements—indeed, whether micro-prudential regulation would require a statement at all.

The recommendation includes a call for an annual statement from each committee about implementation. Is yet another document necessary? Each committee is expected to discuss implementation in its quarterly inflation or semi-annual financial stability reports. And the board publishes an annual evaluation. The marginal contribution of an annual statement by the committee is likely to be small and not worth the added cost of writing and reading.

Recommendation 2: Two committees with two charters agreed by the minister and the governor.

The charters allow for more flexibility in the legislation. I believe in other countries, for example the UK, the legislation deals with many elements proposed for the charter—for example, number and composition of committees, requirements for transparency. Where these decisions are made will balance flexibility and democratic legitimacy and social support.

I agree that monetary policy and regulation should have separate committees as each has a different objective and requires different expertise. Indeed, I would lean toward three committees separating micro and macro-prudential policy. These committees might even have the same people on them, but different types of oversight from the board. The micro-prudential decisions deal with highly confidential information about the businesses of individual institutions. Macro-prudential policy of course deals with the overall system and challenges of asset prices, leverage, etc.

Board and public oversight of micro prudential policy and the contributions of individual committee members would be much more constrained than for macro-prudential policy. Isolating the policy that presents such problems would help in evaluating and holding the regulatory side of the RB accountable.

Another question is whether the governor or the committee should be the signatory to the charter. A meaningful shift to a committee structure might limply that the whole committee should agree its charter, even if it is the governor as chair who signs on behalf of the committee.

Recommendation 3: Appointment process.

I agree, but see above about giving the minister more choice.

Recommendation 4: Size and composition of the committees.

I agree that 5 to 9 voting members spans the optimal size of a committee. I also agree each committee should have external members to better assure a diversity of views. I would think two externals are a minimum and they should be part time to attract a variety of potential members. Yes, conflicts of interest are a challenge, but with care can be handled. At the Bank of England, on rare occasions a member of the Financial Policy Committee excuses him or herself for a discussion that might affect their outside business interests. Transparency about investments and other positions is essential to give public visibility to potential conflicts and how they are being handled. I note that the RB already uses outside experts in the preparations for its monetary policy meetings; I assume that even though these people don't sit in on the policy decisions themselves there is possible access to inside information, if only in the questions asked and topics covered, so the RB must have some experience dealing with this issue.

The government and parliament should give consideration to including a nonvoting observer from the Treasury on the monetary policy and macroprudential committees. In my experience on the FPC at the Bank of England, the Treasury representative doesn't intervene much, but is a valuable resource for information on the government's policy and plans for the future, aspects of which can have a bearing on risks to financial stability. I believe he plays a similar role on the MPC, without compromising independence. This person also has been a helpful liaison between the FPC and the government when the FPC has discussed possible new powers.

Recommendation 5: Terms of members.

I agree with the basic recommendation, but five years renewable seems a long time for an external member. Some potential externals might not be interested even in as long a term as five years, and a total of ten would impede turnover. I would go with either one five year term or even better a shorter term—3 years?—renewable.

Recommendation 6: Collegial in public; individualistic in private.

As the report notes, Individualistic behavior in private is essential for realizing the advantages of a committee. I suspect that performance of committee members in this regard is enhanced, and certainly accountability of members would be, when public and private behavior is congruent. With respect to *monetary policy,* the advantages of explicitly expecting individualistic behavior in both public and private should pass the cost-benefit calculus despite the possibility of muddying the message. Monetary policy decisions are often finely balanced. The public should be reassured knowing that diverse views were brought to bear on any decision, even if markets are occasionally confused by public statements. Clear rules of the road for communication—such as blackout periods before and after decisions and only the governor speaking for the whole committee—can help minimize, though not eliminate, such confusion.

For *regulation*, the recommendation of differentiating internal and external behavior probably needs to be followed. The microprudential regulators are dealing with individual institutions, which should have clear unambiguous guidance or orders that are going to be in effect for the foreseeable future to protect their safety and soundness. The macroprudential regulators are setting the parameters for capital, lending terms etc., which should not be changed frequently. To be sure, limited aspects of macroprudential policy, say the countercyclical capital buffer, are subject to adjustment with changing evaluations of the credit cycle, much as interest rates are for the economic cycle. But most of the macroprudential policy settings will be in place for some time, and consensus driven public discussions will help assure banks of this in their business planning.

Recommendation 7: Meeting minutes.

If the board is tasked with evaluating the contribution of individual members, it needs some way to meet this objective, and attributed minutes, as in this recommendation, would provide the needed background material. Access to private information about meeting behavior will be especially important if public and private behavior is not aligned, as suggested in recommendation 6, as it probably must be for regulation. Another method of getting the same information would be to allow one or two board observers into each meeting.

I have some concerns about the suggestion for public release of attributed minutes based on my experience at the Federal Reserve, where in the early 1990s we began to publish transcripts of FOMC meetings with a five-year lag. That decision had the effect of inhibiting, rather than encouraging, the free flow of ideas, and it greatly lengthened the meetings. Participants, aware their words would be examined and second-guessed in five years' time, wanted to be sure their views were on the record for each topic and that they controlled how those ideas were presented, so they began to read lengthy statements at each round of discussion; Informal give and take diminished. Although attributed minutes aren't transcripts, I am concerned that some of the same incentives and behaviors would be present. At a minimum, if the attributed minutes are produced, I would hold them or much longer than 1-2 years. Any minutes of microprudential discussions bearing on individual institutions and containing private business or supervisory information would need to be kept confidential for considerably longer than two years, and perhaps never released.

I suggest that for public consumption instead non-attributed minutes of the meetings be released a few weeks after the meetings of the monetary policy and macroprudential committees. These minutes could cover the range of positions discussed and the analysis behind each position and behind any consensus. This sort of minutes would help to assure the parliament and the public that a full range of options was on the table and considered without provoking some of the adverse effects possible with attributed minutes. Minutes, even non-attributed, of microprudential discussions would be very hard to construct without causing more harm than good, and this differentiation between the possible accountability regimes for micro and macroprudential policies was a major reason I suggested three committees, not two.

Recommendation 8: PTA as a time-dependent, rather than person-dependent, agreement between the minister and the committee.

I agree.