Review of the Reserve Bank Act

Release Document

March 2018
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**https://treasury.govt.nz/publications/information-release/
phase-1-reviewing-reserve-bank-act**

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In the June 2018 update some previously withheld information was released.

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

[1] 9(2)(a) - to protect the privacy of natural persons, including dead people.

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

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Independent Expert Panel for the Reserve Bank Act Review
Meeting Minutes – 31 January 2018, 12.00pm-6.00pm
Meeting Rooms 5.8, New Zealand Treasury, 1 The Terrace

Attendees: Suzanne Snively, Dr Girol Karacaoglu, Dr Malcolm Edey, Grant Spencer, Geoff Bascand, John McDermott, Roger Perry, Tom Smith, Bryan Chapple, Chris White, Renee Philip, Felicity Barker, Ben Gaukrodger, Brendon Riches, Nicholas Cross, Cavan O'Connor-Close, Toby Fiennes, Dasha Leonova

The Panel met with officials between 12pm and 3pm to discuss each of the agenda items. Between 4.00pm and 5.00pm the Panel met together to discuss their views. Between 5.00pm and 6.00pm, the Panel had a subsequent discussion with officials to outline their initial views on each issue and discuss next steps.

1) Monetary Policy Objectives

- The discussion commenced with a presentation by the Treasury of the prepared materials, which focused around three substantial legislative issues:
    1. What form should the employment objective take? Including whether: employment should be hierarchically weighted or equally weighted relative to the price stability objective; whether the objective should refer to 'output' as well as employment; and the precise form of words for the employment objective and where it should appear in the Act.
    2. Should Section 1A of the Act be broadened out to recognise the high level purpose of monetary and financial stability policy - namely to support the prosperity and welfare of New Zealanders;
    3. Did Panel members have any views on the mechanism by which the PTA is set and how this would be altered in a committee decision-making model?

- The Treasury also ran through five proposed criteria against which to assess the new legislative objective – which the Panel supported.

- Following the presentation, the Chair asked officials from the Treasury and the Reserve Bank to provide their views on the pros and cons of different specifications of the legislative objective (Issue 1).

- The merits of a hierarchical vs non-hierarchal approach were discussed. Officials noted the main benefits of a hierarchical approach: it would give the Bank flexibility to prioritise other variables in the short-term while clearly maintaining a focus on price stability in the medium term; it would best reflect what monetary policy can achieve in the medium term; and it would be most consistent with the existing inflation targeting regime. Including a hierarchical mandate in the Act would also ensure the medium-term focus on price stability endures through changes of the Government or Governor. The key counter-arguments against a hierarchical mandate were that it may not be in line with the Government's objectives, and that changes to the Act should be kept broad to ensure flexibility in the future, and any hierarchies could be identified in the PTA.

- There was discussion over whether the mandate should refer to stabilising 'output and employment' or simply employment. Officials set out various arguments in favour of and against including output in the legislative mandate. Some argued that slack in both the labour market and capital utilisation were relevant, and therefore should be considered when making monetary policy. Others argued that data on output was much harder to measure, making it subject to large revision, so it could not be reliably targeted and that adding output into the legislative objective could be seen as a third objective. It was proposed that the role of monetary policy in ensuring high and sustainable output could be included in the amendment to section 1A as part of the high level purpose. Officials agreed to consider this issue further.

- At the subsequent discussion, the Panel indicated their views on how to specify the employment objective in the Act. They supported including the employment objective in Section 8 of the Act (as opposed to Section 10) so as to give it equal status alongside the price stability objective. The Panel also proposed some specific wording for the objective, which emphasised the time-dimension of when the objectives applied: "The MPC shall formulate and implement monetary policy directed to the economic objectives of achieving and maintaining stability in the general level of prices over the medium term, while also supporting maximum sustainable employment."

- Officials and the Panel also discussed potential reforms to section 1A (Issue 2). The Panel agreed that there would be a benefit to updating section 1A to recognise that the Bank's activities are ultimately directed at improving the welfare of New Zealanders, but noted that the section should continue to be treated as a high level purpose statement. Some wording for the new section had been proposed in the Panel papers. Officials noted that while there was a consensus on the need to reform 1A, and the direction in which to reform it, more discussion was needed on the precise wording. In particular, the focus of section 1A is on the purpose of the Act, not of the Bank as a whole, and that this distinction should be maintained. The Panel requested further advice from Officials on the precise wording for this section.

- The issue of whether it would be necessary to amend section 9 of the Act (the setting of the PTA) was also discussed (Issue 3). The PTA is currently signed between the Governor and Minister, but the move to a committee decision-making model suggested this process should be reviewed. Several issues were discussed, such as the process for setting the policy target and timeframes for a policy target to be set, changed and reviewed. It was widely agreed that setting a numerical target for price stability was essential to maintain inflation expectations but a numerical target for employment should be avoided given the uncertainties over defining the maximum sustainable level of employment. Reserve Bank officials noted that it was important to retain a role for the Bank in advising the Minister on the appropriate policy target to guard against inflation bias in future. No formal proposals were presented at the meeting. Treasury and the Reserve Bank agreed to do more work on this and bring proposals for the third Panel meeting.

2) Reserve Bank Decision Making

- Discussion focused on the specific design choices that needed to be made to codify a Monetary Policy Committee, as set out in the prepared materials. The Chair asked Officials to run through each issue, highlighting differences of view where appropriate.

- **1. Committee size and composition**: Officials presented a unified view that the Monetary Policy Committee should consist of 5-7 members, with a minority of external members. Officials also advised that external members should be employed in their roles on a part time basis, in order to continue to bring an outside perspective and maintain their independence from the Reserve Bank.

  At the subsequent discussion, the Panel fed back their own view, and largely agreed with official's advice, but suggested that the MPC should consist of 7 members, with four internals and three part-time externals. The rationale for a slightly larger Committee was to enable greater diversity and allow a quorum to exist when there were vacancies.

- **2. Types of external members:** A number of issues were discussed regarding desirable characteristics of external members. Officials agreed that external members should be experts with knowledge and experience in relevant policy areas, and not representative of particular groups, industries or regions. That said, officials did note that external members could come from a range of backgrounds, including the public sector, banking or other parts of the business world. In the discussion, officials also highlighted the importance and potential difficulty of finding candidates that don't face conflicts of interest – a particular issue for NZ given the small size of the economy.

  At the subsequent discussion, the Panel indicated they agreed with officials' views that external members should be experts not representatives. But the Panel also stressed that as well as adequate qualifications and experience, potential candidates also needed to be fully engaged and active in their roles.

- **3. Appointment processes:** Officials outlined a view that the existing appointment process for the Governor should be retained (where the Board nominates and the Minister appoints). Officials were also in agreement that external MPC members should be appointed by the same method as the Governor. However, there was a divergence of views as to how other internal members of the Committee should be appointed. Treasury indicated a preference for a one-size fits all model of appointment, where the Board nominates and Minister appoints all members. The rationale for this approach was to avoid any implicit hierarchies within the Committee. The Reserve Bank argued for maintaining the status quo where the Governor recommends the Deputy Governor and the Board appoints. The rationale for this method was to ensure that the Governor had some role in appointing their senior management team so as to ensure institutional cohesion. There was also a discussion of whether the appointment process for the Deputy Chief Executive should be reviewed as part of Phase 1 of the review. Treasury officials suggested that all issues related to the Committee were within Phase 1, and that because this issue impacted the degree of Ministerial influence, inevitably it had to be addressed. Reserve Bank officials suggested that since the Deputy Chief Executive role existed primarily for business continuity purposes it was not directly relevant to Phase 1.

- At the subsequent discussion, the Panel fed back that they agreed with officials that the Governor and External members should be appointed using the existing process for the Governor (Board nominates, Minister appoints). For the Deputy Chief Executive they recommended that the Governor recommends a candidate and the Minister appoints. For other internal members, the Panel recommended a process where the Governor nominates and the Board appoints.

  4. Term lengths and dismissal processes: The length of terms and dismissal processes for MPC members were briefly discussed. Officials proposed MPC member terms should be staggered, to avoid periods of high turnover, with longer terms for internal members than external members, and that external terms should be renewable once. Officials also suggested that if an MPC member departed before the completion of their term, that a replacement should fill the remainder of that member's term in order to retain the staggered order of appointments.

  At the subsequent discussion, the Panel agreed that terms should be staggered and suggested that externals should have terms of four years (to be longer than the political cycle) and should be renewable once. The Panel also suggested that internals should have longer terms of around 5-6 years, with the Governor's term renewable once, but for other internal members terms could to be renewed indefinitely. The Panel also noted it was important to identify a dismissal processes that enabled poor performers to be removed early in their terms, whilst protecting MPC members from political interference. The panel noted that 'poor performance' could include penalising behaviour that did not engage effectively with the rest of the committee and disrupted the cohesive dynamics of an effective team. The Panel suggested that the performance of external members should be reviewed annually by the Board (rather than the Minister), to provide a breakpoint for dismissal that was free from political interference.

- **5. Resourcing the MPC:** There was a brief discussion of how a new MPC, with external members, would be adequately resourced to ensure it was effective. Various international models were discussed, including the Bank of England model where external members have their own staff resources. Given existing funding arrangements, the Reserve Bank indicated a preference for collective resourcing, as the Bank currently does not have sufficient resources to support individual research agendas. Bank officials noted that committee members could collectively influence the Bank's research programme and that the Board's monitoring role should ensure requests by individual members are given sufficient attention by Bank staff. Treasury officials noted that individual resources for committee members were an option.

At the subsequent discussion, the Panel indicated that external members should retain a degree of separation from the Reserve Bank, so as to preserve their independent view and avoid groupthink. The Panel did not propose giving external members their own staff resources. The Panel also noted that while external members should be employed part time, they should be involved slightly more in Bank processes than is currently the case for the Bank's existing external advisors.

- **6. Decision making model and communications strategy:** The appropriate decision-making model (consensus versus voting) and the associated issues of how best to communicate information to the public were discussed extensively. Treasury expressed a preference for decision-making by vote, with votes and minutes published that highlight the range of views on the MPC. They argued this would improve transparency and individual accountability, and that the minutes could still reflect a consensus view if that were genuine. The Reserve Bank expressed a preference for decision-making by consensus where possible. Bank officials acknowledged the need for there to be an outlet for externals to express their views in public, but argued that this should be balanced against the desire to keep communications clear and cohesive. Publishing the details of split votes could potentially add to market volatility, particularly in NZ, where financial markets are relatively small and less sophisticated than other countries. Bank officials also noted that voting may not be appropriate for the whole range of decisions that the MPC has to make, such as agreeing an interest rate track. Treasury officials suggested that consensus was not the only way to publish an interest rate track, and that multiple possible tracks could be published – as the US Federal Reserve does with its 'dot plots'. Officials also raised the issue of whether communication rules should be legislated in the Act or agreed by other means. Treasury expressed a preference for MPC communication rules to be stated in a MPC Charter rather than in Primary legislation, and for the Charter, to be agreed between the MPC and the Minister.

- At the subsequent discussion, the Panel acknowledged the range of communication models on offer, with models that favour individual accountability and the release of more information at one end of the spectrum, and those that retain a cohesive committee that speaks with one voice at the other. The Panel also noted that external communications could impact the role externals play on the Committee, and there was a risk that an individual accountability model could polarise views, leading to less productive discussions and genuine debate. On balance, the Panel favoured a semi coordinated to coordinated model of communications, where minutes / communiques were used to convey the balance of views and give an indication of whether the decision was unanimous or not, but to stop short of individual votes being published. All agreed that it would be undesirable to publish word-by-word transcripts of monetary policy meetings as this would stymie debate. The Panel noted that jumping to full individual accountability at the outset brought considerable risks, and their proposed method was an incremental change that allowed for processes to be reviewed over time. The Panel also supported communication rules being set out in a Committee charter, but for Primary legislation to define specifics around what constitutes a quorum, and in cases where a consensus can't be reached, that the Governor has the casting vote.

- **7. Including a Treasury representative as an observer on the Committee:** The issue of a Treasury representative on the committee was discussed. Treasury officials argued that a non-voting Treasury representative would enhance co-ordination between fiscal and monetary policy by providing an alternative perspective, or bring information to the committee about government policies to coordinate policy responses to shocks, should this be required in future. Any model would make clear that the Treasury representative does not vote. The Reserve Bank suggested that shifting to having a Treasury presence at monetary policy meetings after three decades without such an observer risked signalling a reduction in the Bank's independence, which could be costly, particularly when other more effective channels already existed for sharing information across the institutions. Bank officials also noted that Treasury officials could face a conflict of interest if they attended MPC decisions, as they would have a duty to inform their Minister of new developments but that would breach the confidence of committee discussions. Other international models were also discussed. Reserve Bank officials noted that in the UK model, a Treasury representative does sit on the MPC as an observer, but is mainly there to provide fiscal information to the MPC. Bank officials also reiterated the point about path dependency – a Treasury representative had been part of the UK system since BoE Independence in 1997, which is a significant difference to the proposal here, which is suggesting a change after a prolonged period. In Australia the Treasury Secretary had sat on the RBA Board since 1959, and again their role was mainly to inform the Board about fiscal policy developments.

- At the subsequent discussion, the Panel recognised the importance of co-ordination and information exchange between the Treasury and Reserve Bank, but indicated there was insufficient evidence that a Treasury representative was the best way to achieve that aim. Officials were tasked with developing other options to enhance fiscal/monetary coordination and report back at the third panel meeting.

3) Governance Paper

- Treasury discussed the paper it presented on governance issues. It noted that the phase 1 reforms did not necessitate significant shifts at a governance level, and that more significant governance shifts were likely to be in Phase 2 of the review, particularly if it was judged that a Financial Policy Committee needed to be established. It noted that given the new MPC model would provide for divergent views, the Board might want to focus more on monitoring the MPC decision-making processes rather than individual decisions themselves. Treasury officials also suggested the Board could review other aspects of Reserve Bank performance, such as a high level look at the Reserve Bank approach to forecasting. Treasury noted that the Board currently had no resources of their own and could not compel the Reserve Bank to give it information, and there was a question about whether they needed to be assigned independent resources – similar to the Independent Evaluation Office at the Bank of England. The Reserve Bank indicated that the implications of Phase 1 were for the Board to continue to have a monitoring role in addition to taking on a more substantial role in appointing new members roles, and that it may need more resources to take on these additional responsibilities. There were options as to whether those resources sat with the Bank or were independently controlled by the Board.

4) Phase Two of the Review

- Officials noted that the panel had been tasked with giving the Minister advice on what issues should be in the scope of Phase 2 of the review. Treasury officials favoured a wide focus, arguing that the changes to the Reserve Bank's role in the decades since the Act was written supported a full review of the underlying framework. By contrast, Reserve Bank officials favoured a more targeted review, so as to keep the process manageable within a reasonable legislative timeframe. The Reserve Bank outlined some areas that should be in scope of Phase 2, including: whether to establish a Financial Policy Committee and its potential role; how the Minister expressed their preference for balancing risk aversion and efficiency in the financial system; macro-prudential policy; crisis management policy; and the Reserve Bank funding model.

- Time and resource constraints were discussed in the context of Phase 2. It was noted that the Terms of Reference did not precisely define the scope of Phase 2 of the review. The bigger the scope, the more resources and time would be required. It was important to get an indication from the Minister on his preferred scope: he may for example be interested in looking at the FSAP recommendations.

- It was noted that the Minister's timeframe for legislation may influence the scope of the review. While a shorter timeframe could limit the scope, Treasury noted that if there was a clear idea of what needed to be achieved, legislation could be made over shortened timeframes.

- At the subsequent discussion, the Panel asked officials to come back with additional thoughts on how best to scope Phase 2 at the third Panel meeting.