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Should a board set interest rates? Not if it compromises monetary policy objectives

The Greens' idea to use the Reserve Bank Board to make monetary policy might improve decision-making but using a board designed to represent industry, risks compromising the Reserve Bank's independence and the goals of monetary policy.

The Greens have drafted a Reserve Bank Amendment Bill that wants to

1. use the Reserve Bank Board to make monetary policy decisions
2. publish board minutes to make decisions more transparent
3. make the board more representative of the wider economy.

Evaluating this alternative to New Zealand's current single decision-maker model requires weighing up costs and benefits.

Would a board make better decisions?

Responsibility for monetary policy rests solely with the Governor of the Reserve Bank of New Zealand. Twenty-five years ago, monetary policy was tied to the neck of one person to maximise accountability for inflation targeting. Today most countries have adopted inflation targeting but use a board rather than a single person to set interest rates.[1]

Groups tend to make better decisions than individuals by using a wider range of information. That often leads to less extreme decisions.[2] And decision-making by groups is more effective because members of the group contribute a greater variety of perspectives.[3]

The Reserve Bank already gathers extensive advice and information before each monetary policy decision. That includes consulting with external advisors selected for their industry insights and talking with a wide range of businesses before each *Monetary Policy Statement*.

Recently the Reserve Bank of New Zealand set-up an internal *Governing Committee*, comprising the Governor, Deputy Governors and an Assistant Governor, as a group to assist decision-making.

These innovations help the Reserve Bank form better decisions from a wide range of information and perspectives. That means the distinction between a single decision-maker and decision-making by a board is blurred by current Reserve Bank practice.

So we expect better monetary policy from a board rather than a single person. But given the way policy is currently set these gains are unlikely to be large.[4]

Would publishing board minutes help?

Moving to a board structure has practical implications. We agree that like elsewhere in the world, releasing the minutes and voting record of the committee improves transparency.

1 For example, Australia's *Reserve Bank Board*, the US *Federal Reserve Board of Governors* and the United Kingdom's *Monetary Policy Committee* are examples of boards that set monetary policy.

2 See Surowiecki, J. (2004), *The Wisdom of Crowds*, Random House Inc.

3 See Blinder, A. and J. Morgan (2000) "Are Two Heads Better Than One?: An Experimental Analysis of Group vs. Individual Decision-making" NBER Working Paper 7909, for an experiment that suggests groups are better than individuals when it comes to making monetary policy.

4 NZIER's *Shadow Board* explores aspects of how the decisions of a board might differ from the Reserve Bank, see: http://nzier.live.egressive.com/publications/browse-by-type/results/taxonomy%3A96

Most likely, some form of the existing *Monetary Policy Statement* would accompany these minutes.

But already New Zealand has a very transparent central bank. According to one measure, New Zealand ranks as the second-most transparent central bank globally.[5] Publishing the board minutes is helpful but the Reserve Bank of New Zealand does not have a transparency problem.

Would making the board more representative of the broader economy help?

It's not clear what making the decision-making board more representative of the wider economy might achieve.

If the problem is improving decision-making, NZIER's view is the Reserve Bank already receives considerable input from all parts of the economy as part of its regular information gathering process.

Including exporters and manufacturers on a decision-making board seems targeted towards a solving a different perceived problem: changing the objectives of monetary policy.

But good monetary policy is not about promoting exports: it's about targeting inflation.

Ultimately, monetary policy is a technical activity. So any decision-making board needs the professional advice and experience of career economists that understand the economy. That makes the Reserve Bank's Governing Committee a good starting point for any board structure.[6]

Is it worth the risk?

New Zealand's monetary policy framework contains many positive features. Flexible inflation targeting helped during the Global Financial Crisis when interest rates were cut quickly and early to provide support to the economy. And the Reserve Bank's independence from political objectives was critical to reduce inflation from the dizzying heights of the 1970s.

To avoid compromising these features any decision-making board needs to sign up to the rules of the game – the flexible inflation targeting objectives laid out in the Policy Targets Agreement signed between the Governor and the Minister of Finance.

Groups do tend to make better decisions. But a decision-making board that simply represents the interests of exporting and manufacturing industries – rather than best meeting the objectives for monetary policy – would only undermine the good features of our monetary policy setup.

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[5] See Dincer and Eichengreen (2009), "Central Bank Transparency: Causes, Consequences and Updates", NBER Working Paper No. 14791, which examined 100 central banks.

[6] Lars Svensson describes, "meeting the Policy Target Agreement is largely a technical activity that requires technical expertise" in his 2001 Independent Review of Monetary Policy.

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