Intelligence MEMOS

From: Martin Eichenbaum

To: Canada's next Minister of Finance

Date: September 26, 2019

Re: **MONETARY POLICY NO PLACE FOR ONE-PERSON RULE**

Canadian monetary policy is the legal responsibility of exactly one person, the Governor of the Bank of Canada. This single decision-maker structure is unique among the central banks of advanced economies.

The last review of the bank's governance structure was conducted by a parliamentary subcommittee in 1992 (known as the Manley Committee). It is time to assess the structure governing monetary policy decisions at the Bank of Canada once again.

In contrast to the Bank of Canada, monetary policy decisions in other leading central banks are made by statutory committees. Prominent examples include the US Federal Reserve, the European Central Bank, the Bank of England and the Bank of Japan. In the past, many central banks had governance structures like the Bank of Canada's. But, after careful review, those banks moved to new structures in which a committee had formal, collective responsibility for monetary policy. The most recent movers are Israel and New Zealand.

Why have so many central banks abandoned the single-decision maker structure? First and foremost is the belief that groups tend to make better monetary policy decisions than individuals. But that advantage accrues to groups only if their members can engage in genuine debate and deliberation. The right institutional setting fosters such an outcome by ensuring that those deliberating enjoy a measure of real independence from the governor. Of course, there are no guarantees. Good decisions require good people to make them. But good governance helps good people make better decisions.

As a practical matter, the Bank of Canada communicates its monetary policy decisions as if they are made by a governing council. That council consists of the governor, senior deputy governor and four deputy governors of the bank. From both a legal and practical perspective, the governing council is an advisory committee composed of individuals who are subordinate to the governor.

I have no doubt that under this governor, at this time and under current circumstances, the council is a collegial institution whose decisions reflect the collective wisdom of its members. There is also no doubt that the bank has done very well in achieving its inflation target. But good governance requires that we review the structures in place and ask: How will they perform when faced with different challenges and different governors? The answer from our peer countries is clear: The single decision-maker framework is not the best way to govern monetary policy.

This answer rests on three arguments. First, over the long haul, a statutory committee is better at pooling and processing information. Second, idiosyncratic decisions of a single decision-maker expose a country to too much risk. Third, a statutory committee can be helpful in fostering public acceptance of a central bank's independence.

There is substantial empirical evidence in the academic literature to support these arguments. But that evidence is not definitive. That type of evidence would require randomized experiments with alternative governance frameworks. Nature and the electorate don't offer policy-makers those types of experiments.

So, as with all important policy decisions, good judgment must be combined with the evidence at hand. It could be that after careful consideration, our best judgment might be that Canada is right and everyone else is wrong about the best governance structure for monetary policy. But we can't reach that conclusion until we actually assess our governance structure.

If Canadians do decide to move to a statutory committee structure, the design of that structure will require careful planning and deliberation. There are many choices to be made. How large should the committee be? Should non-bank officials be included? How transparent should deliberations be? How much independent access should members have to the bank's technical staff?

Different countries have answered these questions differently. For example, at the Bank of England, the committee consists of the governor, four members from the bank and four external members. At the Reserve Bank of Australia, the governor is joined by the deputy governor, the secretary of the treasury and six external members. At the Norges Bank (Norway), the committee consists of eight members: the governor, two deputy governors and five external members.

What is the best governance structure for the Bank of Canada? Frankly, we don't know. But we do know that it is time to systematically address that question.

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