

# **Squawk and Capture**

**Clare Leaver**

**Oxford, CEPR and CMPO**

**Conference on The Governance of Central Banks  
Sveriges Riksbank, August 31 2006**

“like most people, bureaucrats don’t enjoy criticism”

James Q. Wilson, *Bureaucracy: What Government Agencies Do and Why they Do It*

# Introduction

- Governing a central bank is a high profile job; mistakes create substantial controversy.
- Only natural that governors will seek to avoid being cast in a bad light.
- Maybe a desire to maintain a good reputation encourages governors to:
  - get things right
  - take the path of least resistance.

# Theory

How might reputational concerns bias **regulatory** functions?

Paper develops a simple model with 4 key features:

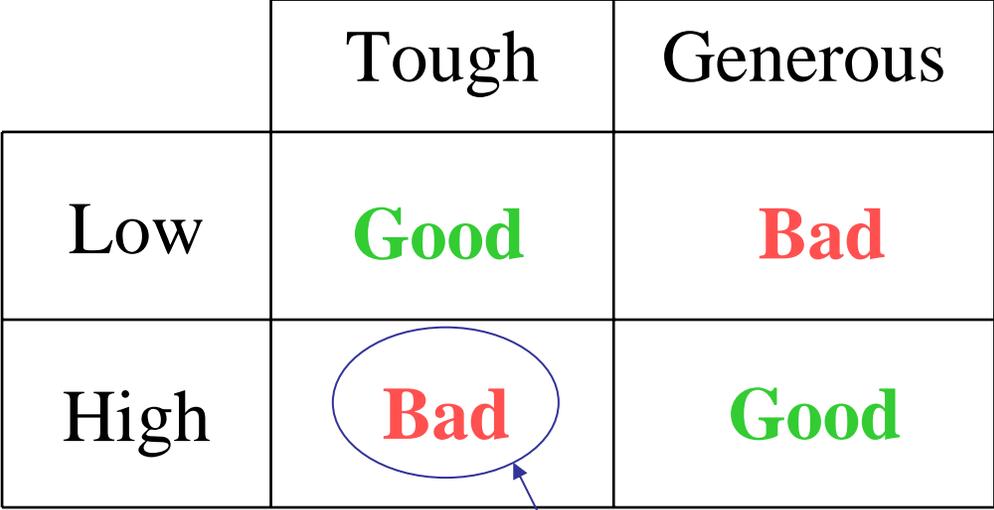
- Potential governors differ in their ability to make good decisions.
- Appointed governor's ability is her private information.
- Appointed governor cares about her wider reputation with an evaluator  
(professional peers and/or job market).
- Evaluator observes the quality of some but not all decisions
  - Regulatees 'squawk' after unfavourable mistakes
  - (Exogenous differences also possible).

## A 2x2x2 Example

- Two ability types, four decision-making outcomes

		Decision Variable	
		Tough	Generous
State Variable	Low	Good	Bad
	High	Bad	Good

Squawk



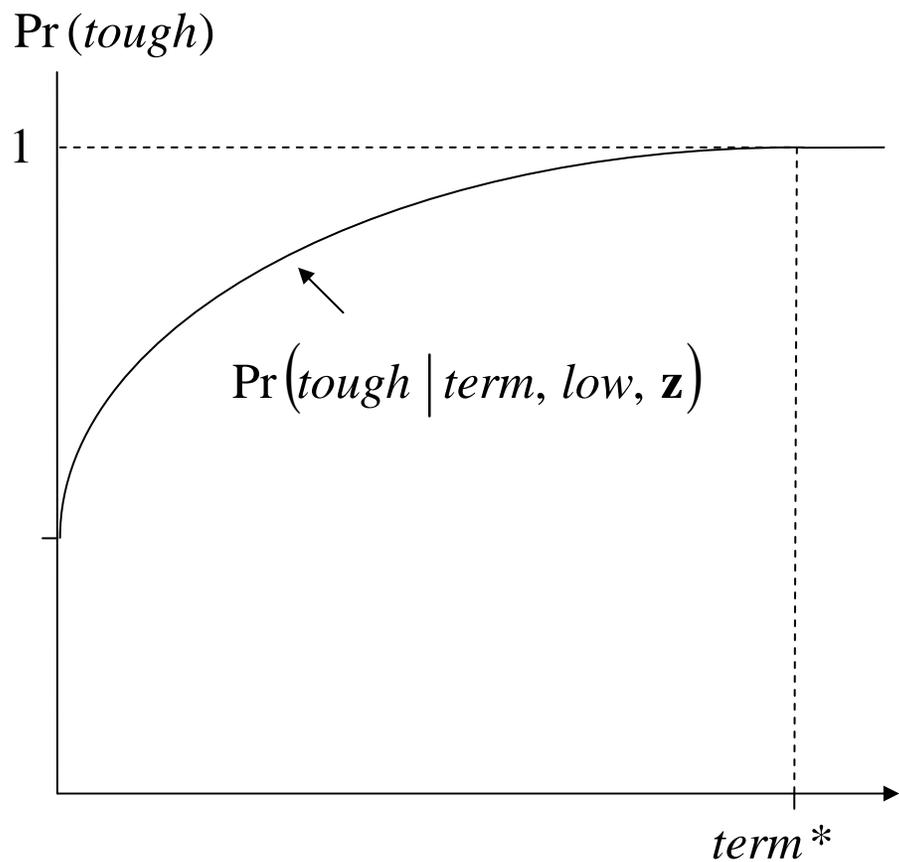
# Equilibrium in the 2x2x2 Example

- Above average type tries to get things right. Below average type drawn into taking the path of least resistance (minimal squawk behaviour).
- Force 1:
  - If both types try to get things right, evaluator expects to see good decisions with a frequency determined by *average* ability.
  - Below average type knows she can't live up to this expectation, so path of least resistance is attractive.
- Force 2:
  - If only the above average type tries to get things right, mistakes are no longer bad news...
- Comp Statics: MSB increasing in reputational concerns.

# Term Length Effects

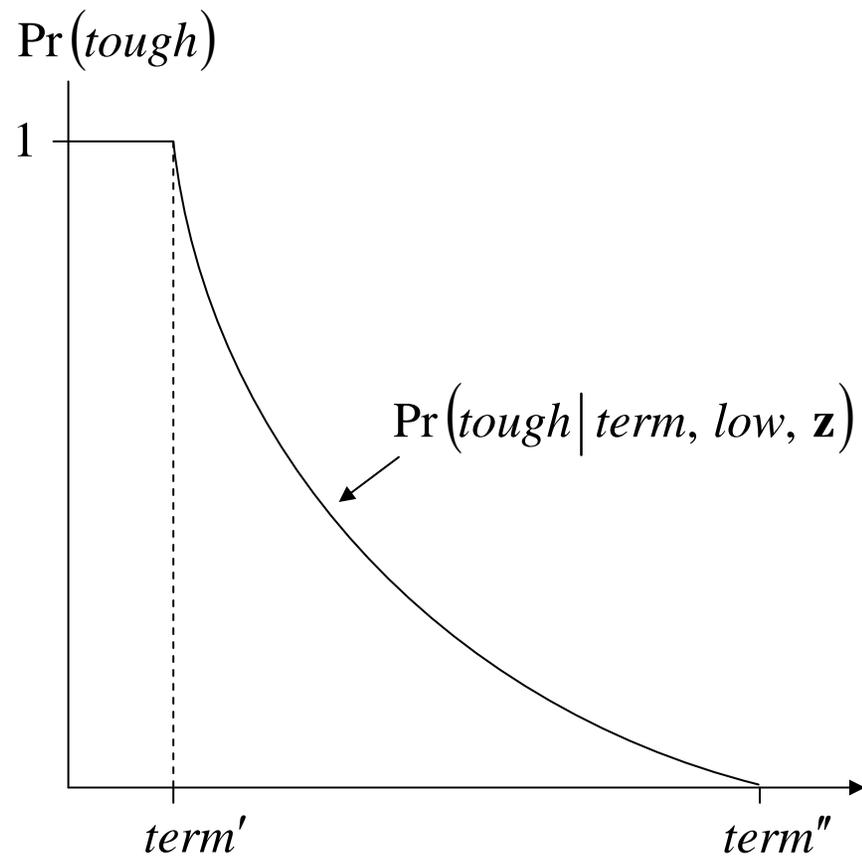
- Various governance institutions likely to increase the strength of reputational concerns:
  - Revolving door (closed=strong)
  - Board size (small=strong)
  - Term length (short=strong).
- Do short terms of office:
  - Remove the spectre of regulatory capture (the “Fazio problem”)
  - Foster minimal squawk behaviour

## Minimal Squawk Hypothesis



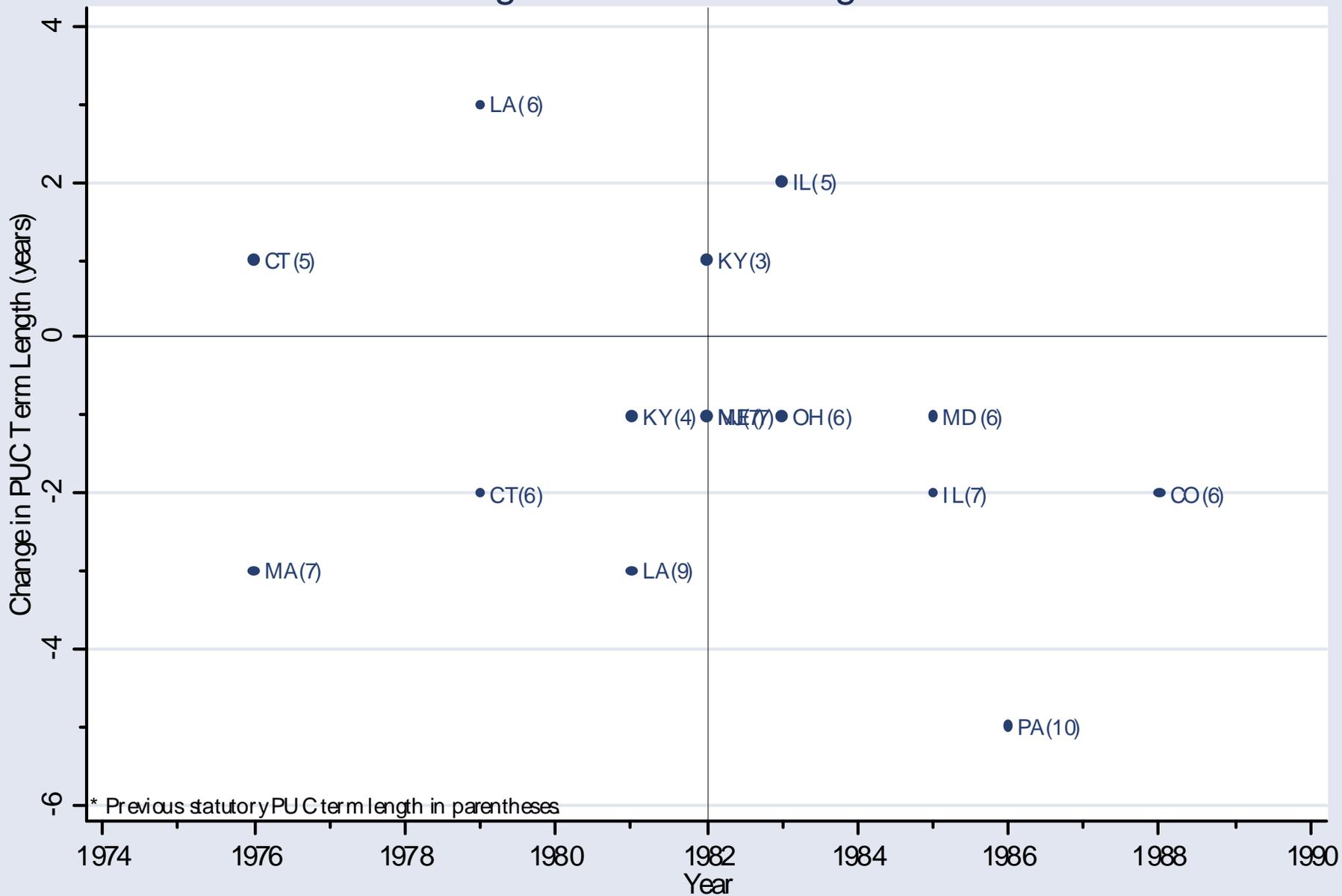
$$\Pr(\text{tough} \mid \text{term}, \text{high}, \mathbf{z}) = 0$$

## Capture Hypothesis



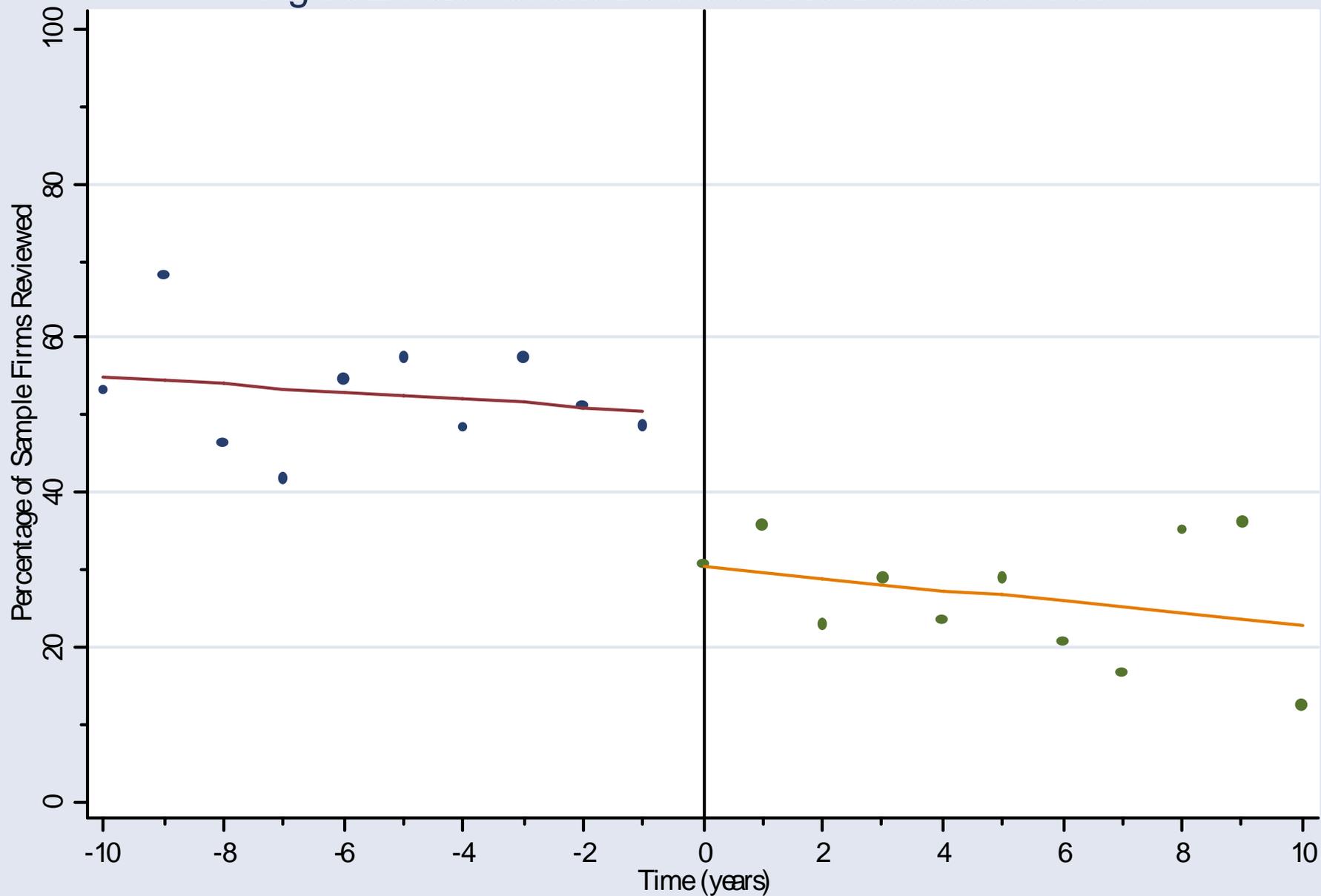
**Some Suggestive Evidence**  
**(From US Utility Regulation in 1970/80s)**

# Figure 1: Term Switching States



\* Previous statutory PUC term length in parentheses

Figure 2: Rate Reviews Before & After Decrease in Tenure



**Table 1: The Partial Effect of Term Length on the Prob. of Rate Review**

		Predicted probability of review		Partial Effect
		$term_{it} = 5$	$term_{it} = 6$	
Lagged % change in operating expenses ( $opexlpch_{it}$ )	Top 1% (34.59)	.4098	.3791	<b>-.0307</b>
	Top 10% (17.29)	.4312	.4569	<b>.0257*</b>
	Mean (6.051)	.4452	.5086	<b>.0634*</b>
	Bottom 10% (-4.085)	.4579	.5551	<b>.0972*</b>
	Bottom 1% (-12.41)	.4684	.5928	<b>.1244*</b>

Coefficients from dynamic pooled Probit. \* denotes significant at 1% in an auxiliary regression with  $(opexlpch_{it} - \text{quantile}) \times termit$ .