

Squawk and Capture

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“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

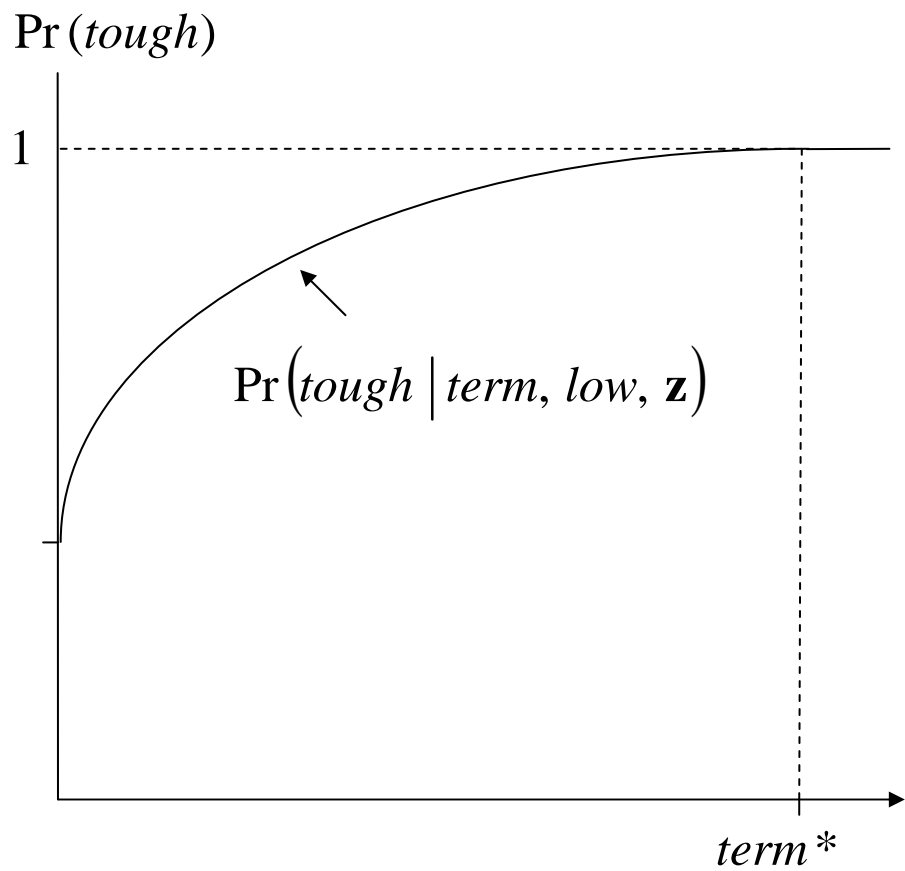
Equilibrium in the 2x2x2 Example

- 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

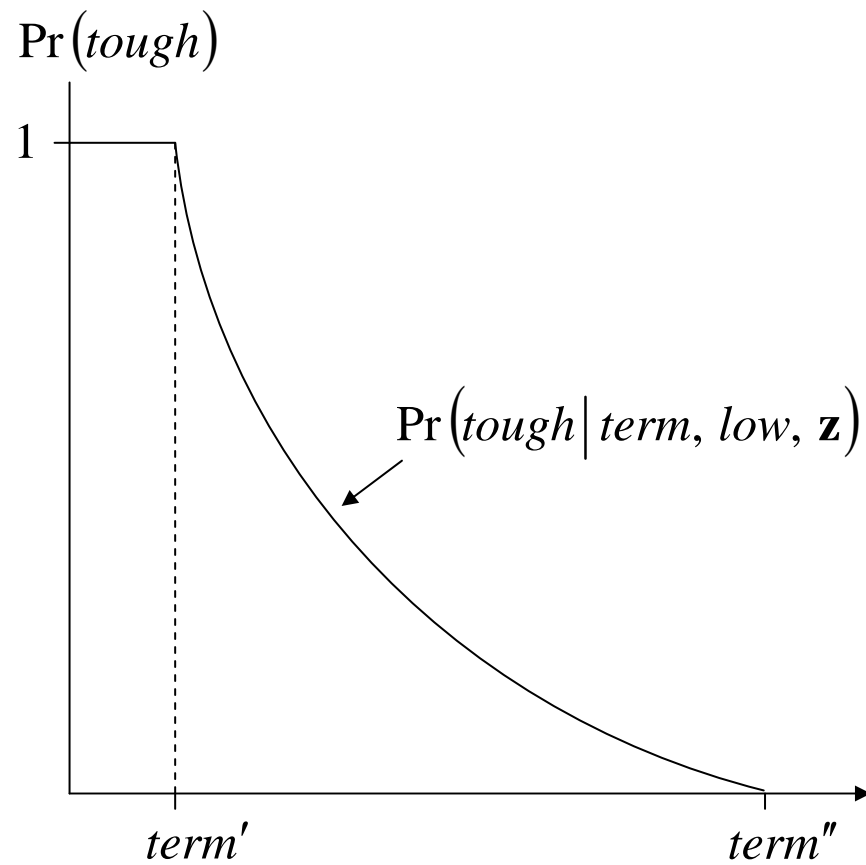
- Various governance institutions likely to increase the strength of reputational concerns:
 - Revolving door (closed=strong)
 - Board size (small=strong)
 - Term length (short=strong).
- Do short terms of office:
 - Remove the spectre of regulatory capture (the “Fazio problem”)
 - Foster minimal squawk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

Minimal Squawk Hypothesis



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

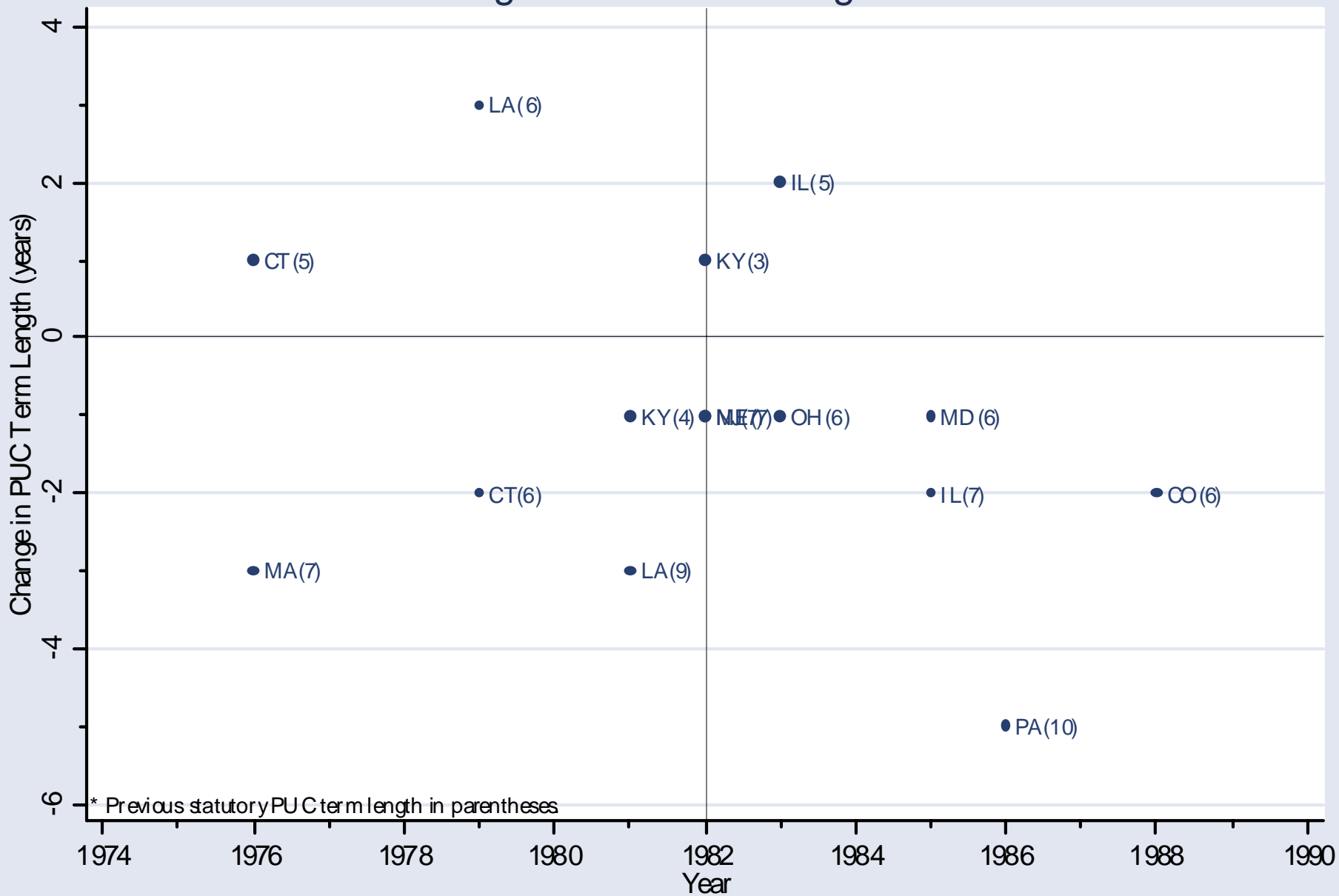
Capture Hypothesis



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

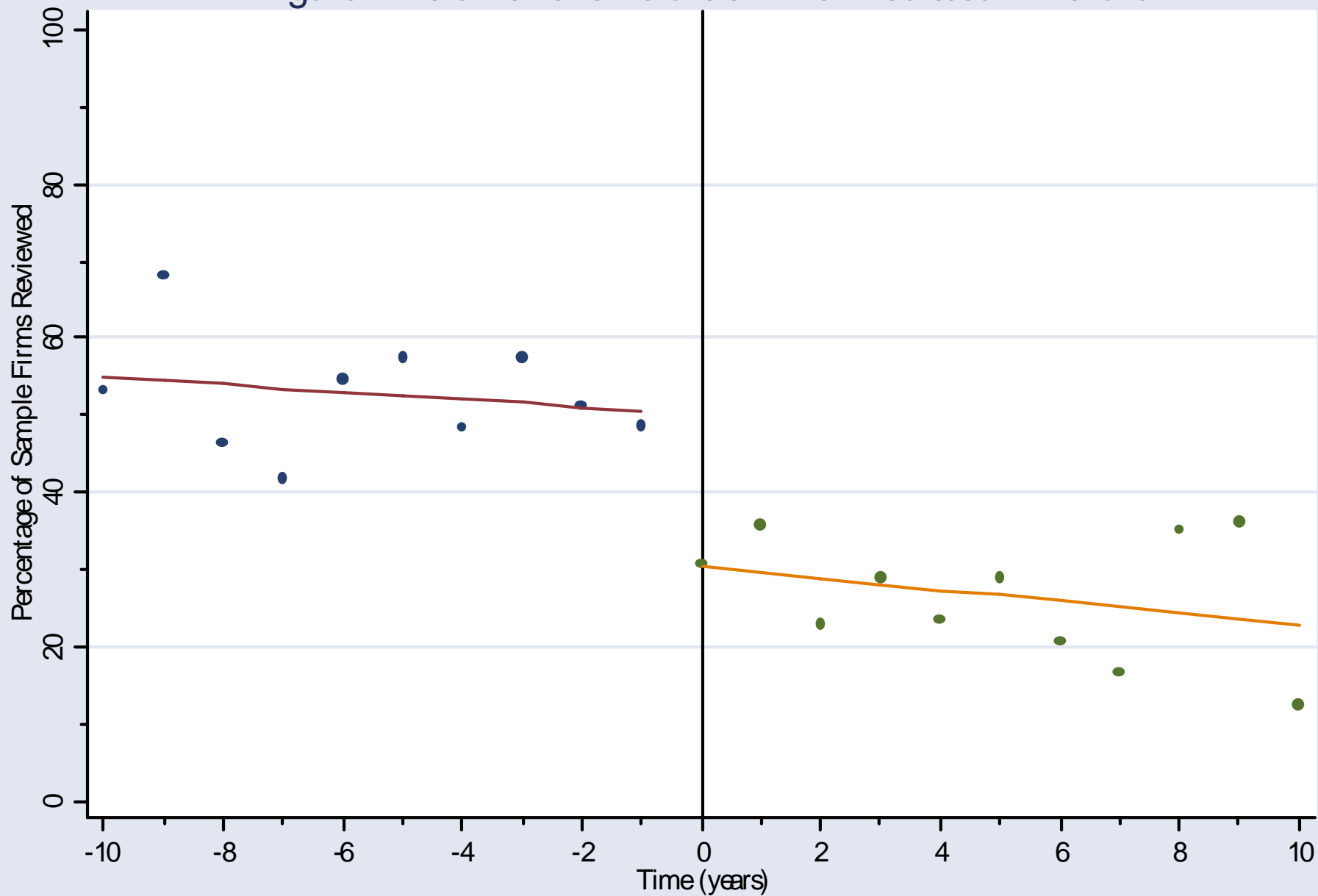


Table 1: The Partial Effect of Term Length on the Prob. of Rate Review

		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	-.0307
	Top 10% (17.29)	.4312	.4569	.0257*
	Mean (6.051)	.4452	.5086	.0634*
	Bottom 10% (-4.085)	.4579	.5551	.0972*
	Bottom 1% (-12.41)	.4684	.5928	.1244*

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