Remarks on Clare Leaver's Bureaucratic Minimal Squawk Behavior

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Preliminary comments

Paper achieves quite a bit

- refreshing alternative to regulatory capture approach
- new theoretical insights
- convincing empirical application

My remarks

- repeat main argument
- highlight essential driving forces of results
- speculate on lessons for CB governance

Model formulation

Regulator

types and states of the world

R_S more accurate signals than R_D

about $\omega \in \{l, h\}$ low, high costs of regulated firm

actions

$a \in \{t, g\}$ initiate lower rates, or not

motivations

intrinsic: "do (socially) right thing" $a = \begin{cases} t & \text{if } \omega = l \\ g & \text{if } \omega = h \end{cases}$

$u(t, l) > u(g, l)$

extrinsic: "reputation", career concern $\mu = \text{Prob}[R_I = R_S]$

overall objective

$\max E[u(a, \omega)] + \delta\mu$

Model formulation (continued)

Firm

- private information
  - about costs ω
- disclosure
  - F may report on cost, contingent on a
- objective
  - conflicting interest with society
    $v(t, l) < v(g, l)$

Evaluator

- interpretation
  - peer group, future employers and colleagues
- passive role
  - evaluates R's type $\mu = \text{Prob}[R_I = R_S \mid a, F'\text{s report}]$

Model results

Equilibrium

F squawks

commits to partial disclosure: report $\omega = h$, if $a = t$

R_S does right thing

R_D takes flawed decisions

generosity bias: sets g too often when s says $\omega = l$
avoid report $\omega = h$ of type-I error hurting its reputation

Comparative statics on δ

higher weight on reputation, career concerns
increases the generosity bias in regulatory decisions

Empirical work

Application

regulation of electrical utility firms in US states during the 1980s

Model counterparts in data

a : initiate review with purpose of decreasing rates (t), or not (g)

ω, s : correlated with falling (l), rising (h) operating expenditure

δ : higher δ, shorter term length of regulatory commissioners

Findings

reforms that cut term length followed by fewer tough decisions
effect more pronounced in times of falling expenditures

Evaluation

Modelling as such?

framework simple and elegant

conveys intuitive insight about perils of risk-avoidance
by regulators who worry about their future careers

Model vs. reality?

assumptions plausible, given specific empirical application

Empirical investigation?

identification issues, handled with best-practice methods

External validity?

interpretation of model building blocks, depends on
(i) public policy context, (ii) institution design

illustrate by examples closer to central banking

Financial regulation

Building blocks may fit pretty well, as they stand

a : stance on capital requirements; raise (t), or not (g)

ω, s : financial health of banks; low (l), or high (h)

F : banks, likely to have private info about ω

E : peer group is financial community
if regulator recruited there

Importance of career concerns and recruitments

time allowed on job: might have an effect

perhaps more important: age (time to retirement)
δ lower (less left of career)
μ less sensitive to performance (less to learn)

Monetary policy

Building blocks have to be more drastically reinterpreted

a : stance on interest rates; raise (t), or not (g)

ω, s : risk of recession vs. inflation; low (l), or high (h)

F : whoever provides solid information about state of economy
(costly state verification more important than private information)

E : depends on institutions and recruitments (more below)

New source of inflation bias ?!

suppose public report of type-I error more likely if (t, h) than (g, l)
short run labor, business, government interests more vociferous

policy subject to generosity bias
same direction as traditional Kydland-Prescott inflation bias,
but proximate source risk-avoidance, not time-inconsistency

Monetary policy (continued)

Possible trade-off in appointment of policymakers

short-term, part-time posts for (younger) academics (BoE MPC) or long-run, partly administrative, posts (Riksbank Board) ?

which group to target depends on selection (share of R_S vs. R_D) vs. incentives (size of δ) inflation; low (l), or high (h)

Principles for institution design?

Avoid biased public reporting

- try to give voice to squawkers with opposing interests

Emphasize regular public audits of policymaker performance

- long-run mission should emphasize "doing the right thing"
  and audits emphasize this aspect of performance
- purpose is to reinforce intrinsic motivations

Strike balance in appointments

- avoid mid-career members of tournament-like professions
- incentives vs. selection
  - young vs. old., academics vs. civil servants...