

Treasury Report: Aide-Memoire: Appointment Of A Governor - Process And PTA Issues

Date:	19 August 2002	Treasury Priority:	Medium
Security Level:	IN-CONFIDENCE	Report No:	T2002/1088

Action Sought

	Action Sought	Deadline
Minister of Finance	Read and indicate on the attached table your reaction to possible PTA changes	Before your meeting with the Treasury at 3.00 pm Wednesday 21 August
Associate Minister of Finance (Hon Trevor Mallard)	Read	None
Associate Minister of Finance (Hon Paul Swain)	Read	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Struan Little	Manager, Budget and Macroeconomic Branch	471 5215 (wk)	✓
Brendon Riches	Analyst	471 5297 (wk)	

Enclosure: No

19 August 2002

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Introduction

At 3.00pm Wednesday 21 August you are scheduled to meet with Iain Rennie, Struan Little, and Brendon Riches from the Treasury to discuss the process for appointing a new Governor and drafting a Policy Targets Agreement.

This aide-memoire:

- Summarises the main points for the Treasury's recent report Appointment of a new Governor: policy targets and relationship expectations (T2002/1068);
- Proposes a process for drafting a PTA and confirming a Governor's appointment before you depart overseas on 21 September;
- Outlines two possible options for the form, content and structure of the policy targets agreement; and
- Suggests that, depending on the option for the PTA that you prefer, the Treasury, in consultation with the Reserve Bank and your office, provide you with a draft PTA for discussion with the Governor designate.

Summary Of The Treasury's Report

The Treasury report entitled *Appointment of a new Governor: policy targets and relationship expectations (T2002/1068)* may be summarised as making 3 key points:

- It may be useful to think about the Bank's inflation objective as an average rate of inflation to be maintained over the medium-term.
- Maintaining an average inflation rate of around 2% would be consistent with the average inflation rate over the last 10 years and may, at the margin, better anchor inflation expectations, which in turn may enable a less active monetary policy.
- Forming and maintaining an effective and productive relationship with the Governor through regular consultation on economic issues is an important element of sound macroeconomic coordination.

Process Issues

a) *Appointment of a Governor*

We understand that:

- you may receive a recommendation for Governor from the Board before the end of August;
- there is public speculation that the Governor and the new PTA will be made public by the end of September;
- you will be overseas from 2-9 September and 21 September to 2 October; and
- a Governor must, under the Act, assume office by 13 November 2002.

While tight, we believe that it is possible for you to confirm the appointment of a Governor and a new PTA prior to your trip overseas on 21 September.

To achieve this you will need to:

- 1) Undertake any necessary consultation about the recommended candidate before 2 September. You may also wish to consult on the PTA process and principles that you will be seeking in a PTA.

You may need to consult with: your coalition partner; your Cabinet colleagues; and United Future. Therefore it is desirable that you receive the Board's nomination sooner rather than later.

We suggest that you or your office contact the Board to confirm when a nomination can be expected.

- 2) Take a paper to Cabinet APH/Business Committee on your return – 11 September is the first possible opportunity. This paper would note your intention to appoint a Governor and could also note the principles that you will be seeking agreement on. To make the agenda you, or in your absence one of your colleagues, will need to submit a paper to the Cabinet Office while you are overseas.
- 3) Take a paper to Cabinet the following week - Monday 16 September.

You may wish to inform your Cabinet colleagues of the new PTA at the full Cabinet meeting on 16 September. It may not be feasible to provide a PTA for the APH/Business Committee, but you may wish the Committee to note that you intend to provide a copy at the meeting of the full Cabinet.

To be in a position to provide Cabinet with a draft PTA you will need to meet with the Governor designate to get agreement to the PTA (but not signed) during the week 9 – 13 September. A draft can then be taken to Cabinet on Monday 16 September.

- 4) Following Cabinet’s consideration request the Board to provide you with an employment contract for the Governor designate. You should then meet with the Governor designate to sign the PTA and the employment contract.

The alternative to this timetable is to wait until October to finalise the appointment and the PTA. In this case you may wish to make a public announcement of your expectation of the appointment timetable and reduce unnecessary speculation.

Calendar

Key dates	Events/Actions required
<i>21 August - 1 September</i>	<ul style="list-style-type: none"> • Meet with the Treasury • Discuss appointment/PTA process and timetable with the Board • Receive nomination • Undertake and complete consultation
<i>2-9 September</i>	Overseas
<i>10-15 September</i>	<ul style="list-style-type: none"> • Cabinet Business Committee/APH considers appointment (Wednesday 11 September) • Discuss and confirm PTA with Governor designate
<i>16-20 September</i>	<ul style="list-style-type: none"> • Cabinet considers appointment and PTA (Monday 16 September) • Caucus consideration • Sign PTA and employment contract with Governor • Public announcement
<i>21 September</i> <i>2 October</i>	Overseas
<i>13 November</i>	<ul style="list-style-type: none"> • Governor’s takes office (at latest)

b) *The Policy Targets Agreement*

Should you wish to revise the existing PTA there are two broad options:

Option 1:

Retain the form, content, and structure of the existing PTA to the largest extent possible and modify only where necessary to achieve the desired outcome.

The key reasons for making only limited change are that there is a value in continuity and that the risk of inflation expectations rising can best be managed by retaining a strong link to previous targets.

Or

Option 2:

Retain the intent of the existing PTA but alter its form and content to include, for example, the following elements:

- the Government's economic policy objectives and the role of monetary policy within that;
- the specific inflation objective;
- the nature of the relationship you expect to have with the Governor; and
- the accountability of the Governor.

The key reason for making more extensive change would be to signal to the Board and the public that a more consultative approach, consistent with operational independence, is to be adopted.

Clearly, if you favour the latter option, considerably more attention will need to be given to drafting a suitable agreement. One approach could be for the Treasury to work through your office and in consultation with the Reserve Bank, to undertake this work during your first absence overseas.

The Treasury has given some thought to how an agreement under each option might look. To assist in progressing this further the following table seeks your feedback on the main issues raised in this PTA and on the options for a PTA.

Some possible changes to the PTA	Agree/disagree or indicate alternative preference
The inflation objective be expressed and interpreted as a medium-term objective such as “over the medium-term ahead”.	
The policy target (over the medium-term ahead) be an average of about 2% per year.	
The target have bounds of +/- 1% where the Bank must take particular care to explain the circumstances for the divergence and how inflation will get back to target.	
The PTA recognise that while the Bank has a duty to act independently, this does not mean acting alone or in isolation, and that the Bank will undertake regular consultation with the Government and other external parties (such as employer and business groups, and employee groups).	
Options for the form, content and structure of the PTA	
Changes to the PTA be limited to the inclusion of the amendments proposed above.	
<p>The PTA be revised more substantially to reflect a move towards a more relationship oriented agreement, while retaining continuity where appropriate.</p> <p>Elements of this agreement could include:</p> <ul style="list-style-type: none"> • a statement of the Government’s economic policy objectives, the role of monetary policy within that; • the relationship of the Government and the Bank; • specification of the price stability target and recognition of the flexibility implied by that specification; and • how the Governor will be held accountable for his/her performance, including the role of any bounds around the target, the role of the Board, Parliament and transparency in achieving that. 	

Recommendations

We recommend that you:

- a **note** that a new Governor needs to assume office by 13 November 2002.
- b **note** that it is feasible to confirm the appointment of a new Governor and a new PTA by mid-September, but that the timeframe is quite tight and will require consultation to be completed prior to your departure abroad;
- c **note** that it is feasible to inform your Cabinet colleagues of the new PTA and of your intention to appoint a Governor at the Cabinet meeting on 16 September. It may not be possible to provide a PTA for the APH/Business Committee the preceding week, but you may wish to note your intention to provide a PTA to the full Cabinet;
- d **note** that the alternative is to wait until your return in early October to confirm a new PTA and the appointment of a new Governor; and
- e **agree** that you or your office contact the Board to confirm when a nomination can be expected.

Struan Little
for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance