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BOJ Policy Board appointments

Nomura Research Institute, Ltd.

In light of the importance of the Policy Board of the BOJ, it is natural in a democratic state that elected legislators play a role in the selection. There are devices to prevent their excessive influences, and enhanced policy dialogue will be more efficient for achieving the necessary coordination. In order to attract attention from the markets, whether the current framework of the Policy Board is adequate for active policy debate should be revisited. Central banks in developed economies may share the challenge of the design of decision making process when policy coordination with the government is all the more required.

Policy Board vacancies

A pair of vacancies was created on the Policy Board of the Bank of Japan when two members' terms expired on 4 April. The Cabinet had nominated one replacement, but the confirmation was denied by the Diet. No efforts to resolve this situation appeared to have been made until the time of this writing. And the monetary policy meetings, including the important one on April 27, have been convened with seven members in the meantime.

Needless to say, Policy Board members play a key role in deciding Japan's monetary policy. It was reported that the Upper House's rejection of the nominee was based on opposition to the candidate's policy positions. Specifically, they reportedly criticized the nominee because the nominee have been arguing that our deflation should be eliminated by the structural reforms of our economy rather than by the simple injection of base money. Yet there is little sense that people in and around the markets are especially concerned about the appointments.

In this report I would like to discuss the implications of the Policy Board vacancies from both a theoretical and a practical perspective, which may be increasingly important for the nomination of a new governor of the BOJ next year.

Framework for Policy Board appointments: theoretical perspective

News coverage of the two appointments was notable for its focus on the Diet's right to vet all nominees. In other words, if the Diet only approves the nominations of their favorite person, monetary policy will to all extents and purposes follow the will of the Diet, undermining the independence of monetary policy. Some argue that this underscores a deplorable lack of consensus on the importance of central bank independence in Japan.

But inasmuch as the Policy Board has the final say on monetary policy decisions, it is only natural in a democratic state that elected legislators play some role in the selection process. If nothing else, it would be difficult to envision the selection process being managed by some other body. And having the Diet approve nominees proposed by the Cabinet is a democratic process in the sense that it provides a check on the actions of ruling party.

But at the same time, this framework has clearly contributed to the current state of affairs—in part because the ruling party and opposition are so evenly matched in the Diet. As a developed economy, Japan is not the only country that has the challenge of this sort. In the US, with its two-party political system, nominees for the Federal Reserve System's Board of Governors are frequently rejected, leading to vacancies on the Board. This situation is aggravated by the historical tendency for the ruling party to do poorly in the mid-term elections. Until most recently, the Fed's Board of Governors had two vacancies. That the US has chosen to keep this framework in spite of the system's imperfections may be an indication of the importance placed on having the people's representatives be involved in the selection process.

How does the current framework affect monetary policy independence in Japan? The first important thing to note is that Policy Board members are protected under the Bank of Japan Act. And as a technical consideration, their term expiration dates are staggered to prevent a simultaneous exodus of Board members. These structures prevent the ruling party or the Diet from replacing all members of the Board with individuals holding more amenable views. Given enough time, of course, they could do so, and as Japan does not have a two-party system where power tends to shift back and forth, that possibility may need to be considered.

The crucial issue then is what sort of shared understanding exists on the issue of monetary policy independence. The concept of central bank independence emerged because it was deemed wise to leave decisions regarding monetary policy —which greatly influences price stability — to experts at the central bank given the tendency of politicians —who face elections at relatively short intervals — to prefer accommodative policy. Inasmuch as the Bank of Japan Act entrusts monetary policy to the central bank, the Diet is supposed to approve the nominations of people deemed capable of filling the role asked of the BOJ, as in other developed nations. The requirements for Policy Board members laid out in the Bank of Japan Act can be viewed as the conditions needed for them to carry out this role.

It is also clear that monetary policy independence does not mean the central bank can implement monetary policy based solely on its own judgment. Together with fiscal policy, monetary policy constitutes one of the two pillars of a nation's economic policy and must be consistent with other policy initiatives. You may like to add “financial policy” as the third pillar. Anyway, as for the monetary policy goal of price stability, the central bank as a practical matter needs to achieve a shared understanding with the government on what is to be targeted, whether there is an inflation target or not.

At the same time, it is not necessarily efficient to use Policy Board appointments as a tool for achieving necessary coordination on monetary policy. Efforts to coordinate policy must be undertaken much more frequently than at the expiry of Policy Board members' terms. Nor are these simple yes-or-no issues. From this perspective, the creation of opportunities for the BOJ governor to meet more frequently with the prime minister and to discuss deflation measures with economic ministers, as has been launched, may bring good results.

Framework for Policy Board appointments: practical issues

While the selection and appointment of Policy Board members raises a variety of issues, it has not, as noted at the beginning of this report, attracted much attention from those in and around the domestic financial markets. One notable comment was that changing two members on the Board could not be expected to produce significant change. A point often noted in conjunction with this view is that Monetary Policy Meetings are not characterized by active debate. While it is difficult to discern the true state of affairs from outside the Bank, the official minutes of these meetings and the speeches of individual Board members seem to lend some weight to this position.

Such views, if they become dominant, diminish interest in the Policy Board member selection process, reducing the incentives for capable individuals to join the Policy Board and making it more difficult for voters to exercise checks on the decisions of Cabinet and Diet members. That outcome should be avoided at all cost. Under the current framework, things are left largely up to individual Policy Board members. But it would be worthwhile to ask whether there are adequate systems in place to support the activities of Board members, and from a longer-term perspective it may be useful to reconsider the benefits and costs of separating the framework for deciding monetary policy from the framework for overall administration of the central bank —including personnel— given the different kinds of insight and expertise that may be required for each.

It should also be noted that the significance of the monetary policy decision-making process itself —ie collective decision by Policy Board members— is being challenged in a certain perspective. A key reason is that coordination with economic policy has become more important than ever for the central bank. In Japan, where the BOJ itself has argued repeatedly that ending deflation will require not only monetary policy but a broad-based policy response that includes government efforts to promote growth, the central bank clearly needs to work closely with the government to deliver an effective policy package. In the long run, it goes without saying that maintaining stability in the JGB market is an important issue for Japan as it moves ahead with efforts to clean up its finances, and that this will require the central bank and the government to work together to develop mutually consistent policies. In such an environment, coordination of policy decisions between the central bank and the government naturally becomes more important.

These changes in the policy environment are not unique to Japan and are certainly nothing to be ashamed of. Ensuring government bond market stability is crucial at a time of fiscal consolidation, as both the countries of Europe and the US will attest. And while circumstances may have improved in some areas, the countries of the west face numerous issues in terms of cleaning up the financial system that cannot be addressed by the central bank alone, resulting in greater coordination with the government.

From a pre-financial-crisis perspective, ensuring that central bank policy decisions are more closely coordinated with the government represents an emergency measure of sorts.

Once conditions normalize, we may return to a world in which monetary policy decisions are made by a body like the Policy Board under a framework of monetary policy independence. Unfortunately, the underlying causes of the current policy challenges in developed economies including Japan appear unlikely to go away anytime soon, and while there have been some trial-and-error efforts regarding the decision-making framework for central banks in the west, the debate seems to be still in its formative stages.

Policy Board appointments

The current political environment is increasingly hostile to the appointment of individuals to the BOJ Policy Board. Inasmuch as the Bank of Japan Act declares a nine-member Board (including the governor and deputy governors) to be the optimal configuration, the two existing vacancies need to be filled as soon as possible. But inasmuch as the appointment process raises a variety of issues, achieving greater awareness of these issues among concerned parties and encouraging them to join the debate may be just as important as considering new candidates for the Board. These lines of debates could contribute to the constructive discussion of a nomination of new governor of the BOJ next year.

(Note from author): This article was originally written in Japanese in mid-April and included in monthly report of "Capital Markets Affairs" by RP Tech (Tokyo). With the kind permission of RP Tech, it was translated into English and updated for lakyara.

Author's Profile

Tetsuya Inoue

General Manager and Chief Researcher
Financial Technology and Market Research Department

E-mail : kyara@nri.co.jp

Inquiries to : Financial Technology and Market Research Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

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