



Submission to the Inquiry into the Treasury Laws Amendment (Reserve Bank Reforms) Bill 2023

Senate Economics Legislation Committee

February 2024

The Reserve Bank of Australia (the Bank) welcomes the opportunity to comment on the review of its governing legislation in light of the recommendations of the Review of the Reserve Bank of Australia (the Review). The *Reserve Bank Act 1959* has served Australia well for many decades. However, the environment within which the Bank operates has evolved and it is appropriate to refresh the Bank's governing legislation. Doing so will ensure that the Bank's responsibilities and structure are suitable for the decades ahead.

The Bank has collaborated with the Australian Treasury as the Treasury Laws Amendment (Reserve Bank Reforms) Bill 2023 (the Bill) has been drafted. The Bank is confident that the Bill appropriately reflects the recommendations of the Review and will equip the Bank to navigate future challenges. The Bill clarifies the Bank's objectives and powers, in particular in relation to monetary policy, and provides for stronger governance of the Bank's operations. For these reasons, the Bank supports the Bill being passed into legislation.

This submission expands on the reasons why the Bank supports the passage of the Bill. It sets out the Bank's views in relation to five aspects of the Bill: the functions of the Monetary Policy Board; explicit recognition of the Bank's role in contributing to financial stability; membership of the Monetary Policy Board over the coming few years; interaction between the Monetary Policy Board and the Governance Board; and the Chair of the Governance Board.

1. Monetary Policy Board

The Bill proposes a new Monetary Policy Board to continue the primary function of the Reserve Bank Board. The Bank supports this proposal, recognising the benefits of the Monetary Policy Board having a clear focus on its core functions – to determine monetary policy and the Bank's policies for contributing to financial stability in Australia.

The Bank considers that the provisions in the Bill to establish the functions, structure and operation of the proposed Monetary Policy Board give appropriate effect to the recommendations of the Review in this area. In particular, the Bill clarifies the scope of the Board's objectives and the interaction between them. It also removes a source of ambiguity in the current Reserve Bank Act about the extent of the Board's responsibilities for governing the Bank.

The changes proposed in the Bill would complement a number of other recommendations of the Review, which affect the operation of the Reserve Bank Board but do not require legislative change. The Bank is in the process of implementing changes to give effect to these recommendations.

Functions of the Monetary Policy Board – section 9B

The Bill proposes that the objectives of the Monetary Policy Board differ from those of the Reserve Bank Board in two ways: promoting ‘the economic prosperity and welfare of the people of Australia’ would be an overarching, not independent, objective of monetary policy;¹ and it establishes that this overarching objective is best met by the Board setting monetary policy to achieve both price stability and full employment. The Bank supports both changes.

The current Reserve Bank Act’s provisions on the functions of the Reserve Bank Board regarding monetary policy have provided the Bank with helpful flexibility. However, this flexibility has created some ambiguity and confusion about the scope of the Reserve Bank Board’s objectives and whether they extend beyond price stability and full employment. The wording proposed in the Bill would address this by making it clear that the Monetary Policy Board can best contribute to the economic prosperity and welfare of Australians by setting monetary policy to achieve price stability and full employment, not by pursuing broader objectives. This will provide a clearer basis for the public to hold the Board accountable for meeting its objectives. It will help mitigate the risk of unrealistic public expectations of what monetary policy can achieve.

It may be possible to achieve these aims without legislative change. In particular, the Reserve Bank Board and the Treasurer could agree on a new *Statement on the Conduct of Monetary Policy* that makes clear that section 10(2)(c) of the current Reserve Bank Act (in relation to contributing to ‘the economic prosperity and welfare of the people of Australia’) is not interpreted as an independent objective of monetary policy. However, enshrining this in legislation is a stronger and more enduring way to clarify the objectives of monetary policy. Doing so will, in turn, facilitate better decision-making and more effective accountability.

The Bank also supports the adoption of an explicit ‘dual mandate’ for monetary policy, under which the Board sets policy to achieve both price stability and full employment.

The way that objectives for monetary policymakers have been specified differ somewhat across central banks, with no one approach being clearly viewed as ‘best practice’. Most central banks have either a single objective relating to price stability or a hierarchy of objectives in which full employment is a relevant objective to the extent that achieving it does not impede the likelihood of achieving price stability. However, some central banks, including the US Federal Reserve, have a long history of operating effectively with a dual mandate similar to that set out in the Bill.

The Bank is satisfied that the mandate specified in the Bill is a suitable framework within which to conduct monetary policy in Australia. In particular, the Bank notes the following:

- Full employment can be a suitable objective for monetary policy when it is defined as the maximum level of employment consistent with price stability (referred to as ‘sustainable full employment’ in the *Statement on the Conduct of Monetary Policy*).

1 This is established as an overarching objective of the Bank.

- The mandate specified in the Bill would not be a significant departure from the approach under which the Reserve Bank Board has operated for many years. That approach has always placed some weight on maintaining full employment, indicating that the differences between flexible inflation targeting and a dual mandate approach are modest in practice.
- Price stability and full employment are complementary objectives over the longer term and are often complementary in the short term, as Governor Bullock discussed in October 2023.²
- The proposed mandate would place an onus on the Monetary Policy Board to determine the optimal weight to put on each of these objectives, recognising this can appropriately vary with economic conditions. This provides suitable flexibility for monetary policy decision-making to respond to changing economic circumstances (including the nature and potential persistence of shocks that hit the economy). The Reserve Bank Board has committed in the *Statement on the Conduct of Monetary Policy* to be always clear about how it is balancing its two objectives and why. The Bank believes this approach will contribute to good economic outcomes and a high degree of accountability, and expects this would continue under the Monetary Policy Board.

Financial System Stability – section 9(1)(b) and Part VI

The Bill gives the Monetary Policy Board responsibility for determining the Bank's policy (other than its payments system policy) for contributing to the stability of the Australian financial system. More generally, Part VI of the Bill explicitly recognises that the Bank's functions include contributing to the stability of Australia's financial system.

The Bank welcomes making its longstanding role in relation to financial stability explicit in the Bill. Doing so will provide a firmer foundation for its work in this area and will support the Bank's collaborative work with the other agencies of the Council of Financial Regulators.

Membership of the Monetary Policy Board

Over the decades since the establishment of the Reserve Bank Board, members have demonstrated intelligence, integrity and skill, making valuable contributions to monetary policy. As former Governor Lowe stated in April 2023, the Bank's judgement is that Board members have provided strong, independent and constructive challenge to the Governor and Bank staff.³

The Bank acknowledges that when narrowing the responsibilities of the proposed successor to the Reserve Bank Board to just monetary policy and financial stability, as set out in the Bill, it is appropriate to reconsider the skills required for future appointments to the Monetary Policy Board. The more focused functions of the Monetary Policy Board, compared with the responsibilities of the Reserve Bank Board, are consistent with having a greater proportion of external board members possessing specific expertise in monetary policy and closely related fields.

Given this, the Bank supports a shift in the balance of skills represented on the Monetary Policy Board over time. Having said that, we believe that it is essential that any near-term reconsideration of the composition of the Board recognises the value of continuity of membership and recent monetary

2 See Bullock, M (2023), 'Monetary Policy in Australia: Complementarities and Trade-offs', speech at the Commonwealth Bank Global Markets Conference, Sydney, 24 October. Available at <https://www.rba.gov.au/speeches/2023/sp-gov-2023-10-24.html>

3 Lowe (2023), Transcript of Question & Answer Session, Reserve Bank Review press conference, 20 April, Sydney. Available at <https://www.rba.gov.au/speeches/2023/sp-gov-2023-04-20-q-and-a-transcript.html>

policy experience. This is particularly important at the current juncture, where the Board is navigating a challenging policy environment and significant changes in processes for determining monetary policy. For these reasons, the Bank believes that having a high degree of continuity of membership will be important during 2024 and 2025.

2. Governance Board

The Governor has always been responsible for managing the Bank under the Reserve Bank Act, and since the commencement of the *Public Governance, Performance and Accountability Act 2013* has been the accountable authority under that Act. The Governor is therefore responsible for governing all aspects of the Bank. This approach has worked well over many decades, but it places a very considerable set of responsibilities on the Governor. It is also inconsistent with contemporary standards of corporate governance of complex entities, including other central banks.

The Bank is already taking an important step to uplift its internal accountability and governance arrangements, by establishing a position of Chief Operating Officer. The person filling this role will provide significant expertise in operational matters and additional focus on internal resourcing, decision-making and accountability. The Bank believes that establishing a Governance Board, as proposed in the Bill, will complement the creation of the Chief Operating Officer position. Specifically, the Governance Board will bring skills and oversight to reinforce the additional focus on operational excellence that will be provided by the Chief Operating Officer.

At the same time, experience at other central banks has shown that challenges can arise from having a governance board in a policymaking institution. The following section sets out two arrangements in the Bill that are important to minimise those challenges and facilitate productive collaboration between the Bank's boards.

Interaction between the Governance Board and the policy boards - section 10D(3) and other provisions

The Bank considers that section 10D(3) of the Bill is important to provide clarity about the allocation of responsibilities between the Governance Board and the Bank's two policy boards (the Monetary Policy Board and the Payments System Board). Providing this clarity will increase the likelihood of good decision-making and productive collaboration in areas of overlapping responsibilities.

Given the proposed Governance Board will be responsible for overseeing the Bank's resourcing, risk management and finances, some overlap with the responsibilities of the Bank's two policy boards is inevitable and beneficial. At the same time, this creates a risk that the objectives of the Governance Board and one of the Bank's two policy boards come into tension. Any tension is most likely to occur when questions arise about whether to use the Bank's balance sheet to achieve monetary policy or financial stability objectives (for example, engaging in direct asset purchases or providing liquidity to banks to affect financial conditions).

The Bank recognises that the scope for challenge is helpful for good governance and it welcomes this. At the same time, it recognises the importance of clarity around the scope of responsibilities for each board, the appropriate lines of delineation and mechanisms to resolve disputes that cannot be settled through reference to the limits of each board's powers. Having each of these elements will maximise the chance that any challenge by one board of another results in better decision-making, not conflict.

The Bank considers that the Bill contains a number of elements that will assist the Governance Board and the Bank's two policy boards to work collaboratively with each other.

Sections 9B and 10D of the Bill make clear the responsibilities of each of the Monetary Policy Board and the Governance Board, as well as the limits of the Governance Board's powers on matters relevant to monetary policy – including use of the Bank's balance sheet for this purpose. Section 9B(2) establishes that the Monetary Policy Board 'has the power to do all things necessary or convenient' to perform its monetary policy functions. Section 10D(1)(a) and (3) establish that while one function of the Governance Board is to manage the Bank's balance sheet, it must do so without limiting the Monetary Policy Board's ability to achieve its objectives for monetary policy.

The Bank believes that providing the Monetary Policy Board with ultimate authority for decisions that use the Bank's balance sheet for monetary policy purposes creates an appropriate framework within which to take such decisions. The Monetary Policy Board is best equipped to consider the risk-reward trade-off of these decisions from a public interest perspective, given that its mandate and objectives compel it to consider how its decisions contribute to economic outcomes for the Australian people. This is an important perspective to bring to such decisions because losses to the Bank can be more than offset by gains for the country – for instance if an expansion of the Bank's balance sheet is successful in stimulating the economy.⁴ Having a clear delineation of responsibilities will also enable faster and more effective decision-making by reducing the potential for disputes about which board has the authority or duty to take decisions in this area.

At the same time, the Bill establishes clear mechanisms for encouraging the policy boards and the Governance Board to work collaboratively. Sections 9B(3) and 10B(3) compel the policy boards to have regard to the duties of the Governance Board under the Public Governance, Performance and Accountability Act. Section 10D(4) requires the Governance Board to consult with a policy board before it makes a decision that may materially affect the policy functions or powers of that board.

The Bill also retains and extends a longstanding provision in the Reserve Bank Act that gives the Governor the authority to resolve disputes that may arise between the Bank's boards. The Bank views this provision as a backstop in the event the current Bill has not allocated responsibility for decision-making sufficiently clearly.

Chair of the Governance Board – Section 25NC

The Bill provides flexibility on who will be appointed as Chair of the Governance Board. It does this by only requiring 'at least one' of the positions of Chair and Deputy Chair to be filled by an external member. The Treasurer has publicly stated his intention to appoint the Governor as the Chair for at least the initial years of the Governance Board's existence. The Bank supports this approach as an effective mechanism to foster collaboration between the three boards, particularly during coming years as members of these boards settle into their roles. It is a helpful supplement to the provisions in sections 9B and 10D that aim to clarify each board's respective authorities and responsibilities.

4 Specifically, if the expansion of the Bank's balance sheet results in faster growth economic growth, it is likely to cause the value of assets held by the Bank to decline but the incomes of households, businesses and the Government (that is, taxation revenue) to rise. If so, the financial position of the Government as a whole would improve, despite the Bank's capital being eroded, which would be in the public interest.

Appointing the Governor as Chair will – as the Review acknowledged – further contribute to the likelihood of productive collaboration between the three boards. It should facilitate information flows that will also reduce the potential for conflict between a policy board and the Governance Board when matters arise in which more than one of those boards appropriately has an interest. Any such conflict could impinge on the relevant policy board’s ability to take timely decisions in the best interest of the country, undermine collaboration across the Bank and have unwelcome adverse reputational effects for the Bank. The scope for such conflict may be heightened during the initial years after the Governance Board is formed, as it establishes its operating rhythm.

Reserve Bank of Australia
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