

Senate Economics Legislation Committee submission on Treasury Laws Amendment (Reserve Bank Reforms) Bill 2023 [Provisions]

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REMOVING THE GOVERNMENT'S POLICY OVERRIDE POWER

The RBA review has recommended (Recommendation 1.1):

The RBA should continue to have operational independence for monetary policy. The Government should remove the power of the Treasurer to overrule the RBA's decisions.¹

The government has adopted this recommendation and we believe this is an error because the mechanism the government currently has to overrule the RBA serves an important function.

The power to control monetary policy in Australia is an extremely important and powerful function. Well calibrated monetary policy can help smooth fluctuations in the business cycle, as well as assist in stabilizing the economy in periods of economic crisis.

High interest rates have the potential to push the economy into recession. Low interest rates, at a time when the economy is growing too rapidly, has the potential to push the Australian economy into an inflationary bubble.

¹ de Brouwer et al. (2023) *An RBA fir for the future: Review of the Reserve Bank of Australia*, Final Report, https://rbareview.gov.au/sites/rbareview.gov.au/files/2023-06/rbareview-report-at_0.pdf

History behind override mechanism

The history behind why this mechanism was put in place is an important example of why it continues to be necessary. In 1930, the newly elected Scullin Labor Government faced one of the largest economic crises that Australia has ever faced, the Great Depression. With the economy in free fall, the then Treasurer, Edward Theodore, believed that the solution was for the government to borrow large sums of money to fund public works to soak up the rapidly rising pool of unemployed.

The government wanted to borrow this money from Australia's then central bank the Commonwealth Bank.² The then Governor of the central bank, Sir Robert Gibson, and the Commonwealth Bank Board refused to lend the government the necessary funds. The Treasurer protested but the Governor and the board stood firm.

There was no mechanism in place for the government to force the central bank to do what the government wanted and ultimately the government was forced to back down. The official unemployment in Australia peaked in 1932 at 32%. It is difficult to understate how devastating the Great Depression was. By removing this mechanism, it creates the possibility that such a situation could occur again.

No democratic oversight

The RBA review argued that this mechanism undermined the RBA's independence. It said:

If an elected government controls monetary policy there are risks that it may try to push the economy to run above its capacity, resulting in higher inflation but with no lasting impact on employment.³

Even if such a situation were to occur, then the elected government would be responsible to the people, many of which may have been adversely affected by this policy. They would have to explain to the people why they overrode the RBA and then submit themselves to the judgement of the electorate at a general election.

We also need to also consider the alternative. If this mechanism was removed and the RBA Board refused to work in tandem with the government on economic policies to stabilize the economy, with serious adverse results, then the RBA board would face no

² The central bank functions were later removed from the Commonwealth Bank and placed in the newly created Reserve Bank of Australia in 1959. The Commonwealth Bank was later privatized in the 1980s.

³ de Brouwer et al. (2023) *An RBA fir for the future: Review of the Reserve Bank of Australia*, Final Report, https://rbareview.gov.au/sites/rbareview.gov.au/files/2023-06/rbareview-report-at_0.pdf

such judgement. Those impacted by the RBA board's decision would not have the ultimate say on the merits of that decision.

This is as much a democratic question as it is an economic one. Who should prevail if there is a serious disagreement between an elected government and an unelected board. Almost without exception, our Australian system believes that the elected government should prevail because it is ultimately responsible to the people.

Government appointment of the board

It could be argued that the government has ultimate control of the RBA board because it makes all the appointments to the board. While it is possible for the government to change the members of the board, this would be a slow and time-consuming process.

History has shown that during an economic crisis it is vital that fiscal and monetary policy act quickly and in tandem to get the best results for stabilizing the Australian economy. The mechanism as it is currently constructed allows for a speedy and transparent resolution to any impasse. The removal of it would make any resolution slow and difficult, as well as far less transparent.

Removing override mechanism does not diminish the RBA's independence

Removing the override mechanism has been justified as a way of ensuring the RBA's independence. The RBA review said:

To further enhance the RBA's monetary policy independence the Review recommends the repeal of s 11 (2)-(7) of the RBA Act, which sets out a procedure for the Government to override decisions of the Reserve Bank Board.⁴

The government ability to be able to override the RBA Board does not diminish the RBA's independence, it simply ensures that disputes between the government and the RBA board are transparent.

Under the current provisions, if the government and the RBA Board are in dispute about policy, the government can override the RBA. But if it does so it must provide to both Houses of Parliament, a copy of the order determining the government's policy, a

⁴ de Brouwer et al. (2023) *An RBA fir for the future: Review of the Reserve Bank of Australia*, Final Report, https://rbareview.gov.au/sites/rbareview.gov.au/files/2023-06/rbareview-report-at_0.pdf

statement about how the difference of opinion arose, and a statement from the RBA Board about how they think the difference arose.

This makes any dispute between the government and RBA Board very transparent. It also means the government must take effective responsibility for any policy that the government forces on the RBA Board. Which means the electorate knows who is to blame (or praise) for the consequences of that policy.

Importantly this process allows the RBA Board to make independent decisions and provide arguments for them. But at the same time, it is the elected government that has final say on policy.

If the override mechanism is removed, then consider how any dispute might be resolved in the future. Such a situation might play out in three possible ways.

- (1) The government could stack the RBA board with political allies to ensure that the RBA Board makes decisions the government approves of. This means members of the Board might not be those best suited to making good policy decisions. It also means the Board is no longer independent but is instead there to rubber stamp government decisions.
- (2) The government could pressure the RBA Board behind the scenes to resolve the dispute in the government's favor. This could include threats about Board appointments. If this pressure was successful then rather than the dispute process being transparent and the government ultimately being forced to take responsibility for the policy, it would appear to be a decision of the RBA Board. This would also mean the Board was not independent.
- (3) Ultimately if the government was unable to sway the RBA Board's mind, it could seek to have parliament change the Reserve Bank Act to force the RBA to pursue the government's preferred policy. Such legislative changes might be taking place during an economic crisis and risk being rushed. This could permanently damage the independence of the RBA.

Removing the override mechanism means that any future dispute is likely to lead to a less independent RBA Board. Under the current system the RBA Board is able to pursue policy independent of government interference. If the two do come into dispute, the RBA Board can still argue for what it thinks is the correct course to follow, in an open and transparent way.

RECOMMENDATIONS

We recommend that Section 11 of the Reserve Bank Act not be amended to remove the government's policy override power.