

# Submission to the Senate Economics Committee on the Reserve Bank Reform Bill (2023)



12 February 2024



## Who we are

ACOSS is the peak body of the community services and welfare sector, and the national voice for the needs of people affected by poverty and inequality.

Our vision is for a fair, inclusive and sustainable Australia, where all individuals and communities can participate in and benefit from social and economic life.

## What we do

ACOSS leads and supports initiatives within the community services and welfare sector, and acts as an independent non-party political voice.

By drawing on the direct experiences of people affected by poverty and inequality and the expertise of its diverse member base, ACOSS develops and promotes socially and economically responsible public policy and action by government, community and business.

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# ACOSS submission on the Reserve Bank Reform Bill (2023)

## Summary

ACOSS has followed the RBA reform process closely, beginning with our [submission to the RBA Review](#). Our main concern is to restore genuine full employment, where people seeking paid work or more working hours can secure them without searching for too long. In a full employment economy, millions of people would be able to secure the paid working hours they need, wages and other incomes could grow strongly again, the quality of jobs would improve, and income inequality would be reduced.

Australia has not experienced full employment for the last 50 years. We came close during the economic recovery from the COVID recession from 2021 to 2023 but hopes of restoring it are receding following the sharpest rise in official interest rates for the last 30 years.

ACOSS has consistently argued that the loss of this opportunity to restore full employment is too high a price to pay to curb inflation, and that there are better ways to tackle the causes of the latest upsurge in inflation than over-reliance on interest rate hikes.

We warmly welcome the government's commitment to full employment and its efforts to promote it, from the Jobs and Skills summit through to the Reserve Bank Review and [Employment White Paper](#).

The *Reserve Bank Reform Bill*, together with the [Statement on the Conduct of Monetary Policy](#) recently agreed between the Treasurer and the Bank, together present an opportunity to re-engineer monetary policy to give greater priority to full employment. This also requires concerted action from government – beyond the scope of this submission – to support the Bank's efforts to contain inflation, strengthen labour force participation and end the exclusion from paid employment of over 600,000 people who rely on unemployment payments long-term.

It would be unwise to unduly restrict the ability of the government and Reserve Bank to develop and adjust monetary policy as economic conditions change. Instead, our proposed changes to the Bill aim to get the high-level priorities right and ensure the most appropriate people are around the table when the Bank makes decisions on interest rates.

We draw on key recommendations of the [Reserve Bank Review](#) which are not adequately reflected in the Bill – that full employment and price stability should be given equal priority in monetary policy and that progress towards each of these goals should be tracked and publicly reported. We also propose an amendment to embed a commitment to diversity on the RBA Board in the legislation.<sup>1</sup>

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<sup>1</sup> See our [issues paper for the Jobs and Skills Summit](#) and [submission to the Reserve Bank Review](#) for more detailed discussion of the above issues.

Full employment should be given equal priority to price stability in monetary policy.

The Reserve Bank Review recommended that:

*'The RBA Monetary Policy Board and the Government should agree in the Statement on the Conduct of Monetary Policy that equal consideration should be given to price stability and full employment in setting monetary policy.'* (Reserve Bank Review 2022, *A Reserve Bank fit for the future*)

This important commitment is missing from the present Bill and the *Statement on the Conduct of Monetary Policy*.

The *Statement on the Conduct of Monetary Policy* states that:

*'The Reserve Bank Board and the Government agree that an appropriate goal is consumer price inflation between 2 and 3 per cent. The appropriate timeframe for this depends on economic circumstances and should, where necessary, balance the price stability and full employment objectives of monetary policy.'*

*The Government's objective is sustained and inclusive full employment where everyone who wants a job can find one without searching for too long. The Reserve Bank Board and Government agree that the Reserve Bank Board's role within this is to focus on achieving sustained full employment, which is the current maximum level of employment that is consistent with low and stable inflation.'* (Treasurer and Reserve Bank Governor 2023, *Statement on the Conduct of Monetary Policy*)

While we welcome the explicit recognition of full employment in this statement – for the first time since the first such statement was drafted 30 years ago - there is an imbalance here between an explicit, quantified inflation target agreed between the government and the Bank, and an unspecified full employment target that is to be set, in effect, by the Bank itself.

This imbalance affects the Bank's regular monetary policy decisions. For example, in its latest Monetary Policy decision the Bank stated that:

*'Returning inflation to target within a reasonable timeframe remains the Board's highest priority. This is consistent with the RBA's mandate for price stability and full employment.'* (Reserve Bank of Australia 2024, *Monetary policy decision, February 2024*)

## Recommendation

### Give equal consideration to price stability and full employment

**R1: In setting monetary policy, the Monetary Policy Board should give equal consideration to price stability and full employment, and regularly explain how it is balancing these objectives.**

## Targets should be set for full employment as well as inflation, and the Bank should be required to report on progress towards them

In public policy, what is not measured generally has a low priority. While it would be inappropriate to set targets for full employment by legislation (and the current inflation target is set out instead in the *Statement on the Conduct of Monetary Policy*), the legislation could require the government and Bank to set targets for both full employment and inflation and publish regular material tracking progress towards those targets. This is needed to ensure that monetary policy decisions which affect the lives of millions of people are justified and communicated in a transparent way.

The *Reserve Bank Review* recommended that:

*'The RBA Monetary Policy Board will communicate its use of the framework's flexibility including expectations that the RBA will, in its regular communications:*

- explain how long inflation is expected to be materially away from the midpoint of the target and why, how long labour market conditions are expected to deviate from full employment and why, and how it is balancing its two objectives;*
- explain the key factors affecting its decision making, such as financial stability risks which should be a consideration in monetary policy decisions to the extent that they may influence the price stability and full employment objectives.'* (Reserve Bank Review 2022, *A Reserve Bank fit for the future*)

The *Statement on the Conduct of Monetary Policy* includes provisions consistent with this recommendation, but ideally transparency of decision-making would be elevated to a legislative requirement:

*'The Reserve Bank Board commits to regularly communicating its assessment of how conditions in the labour market stand relative to sustained full employment, drawing on a range of indicators and recognising that full employment is not directly measurable and changes over time.*

*The Reserve Bank Board commits to clearly communicating how it is balancing its inflation and full employment objectives. More generally, when inflation is expected to be significantly away from the midpoint of its target of between 2 and 3 per cent or labour market conditions are expected to deviate significantly from those consistent with full employment, the Board commits to communicating how long it expects it will be before it again meets each of its objectives and why.'* (Treasurer and Reserve Bank Governor 2023, *Statement on the Conduct of Monetary Policy*)

There is much economic debate over the meaning of full employment and how it can best be measured. We have a view on this, but it is not a matter that can be resolved by legislation.<sup>2</sup> It would be counter-productive to specify full employment or inflation targets in

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<sup>2</sup> The government's Employment White Paper identified two definitions of full employment – the level of labour underutilisation at which people can secure employment without searching too long, and the level at which inflation begins to grow unsustainably (the so-called NAIRU). Most official discussions of the Reserve Bank's role in achieving full employment

legislation, as the government of the day and the Bank need a degree of flexibility to adapt them to changing economic circumstances.

It is sufficient for the legislation to specify that targets for full employment and inflation are adopted by government and the Reserve Bank.<sup>3</sup>

## Recommendation

### Set targets for full employment as well as inflation, and report on progress

#### R2:

- (1) The Government and the Reserve Bank should periodically set targets for full employment as well as price stability, following a transparent consultation process including experts and organisations representing unions, business, and civil society (including people directly affected by unemployment).**
- (2) The Monetary Policy Board should publish regular reports of progress made and expected future progress towards these targets, including the main factors affecting progress and its decision making.**

### The legislation should require a diversity of expertise and perspectives on the Monetary Policy Board

The best policy decisions are made when a diversity of expert views is included in decision-making. For some time, the Reserve Bank board's external members have been drawn from a narrow pool of expertise, predominantly business executives and academic economists.

While technical expertise is important in monetary policy decision-making, the Board must also make judgement calls over which goals it prioritises (for example inflation or unemployment) and how people across the community will respond to economic conditions,

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(including the Reserve Bank Review) refer to the NAIRU measure, which is notoriously difficult to quantify. When the authorities 'target' the NAIRU, they implicitly privilege action to curb inflation over action to reduce unemployment since by this definition full employment is a 'residual' or secondary goal rather than a target in its own right. In theory the two measures are identical and there is no inherent conflict between inflation targeting and full employment, but in practice when higher unemployment is used as a tool to combat inflation there is a risk of a major economic downturn, after which high unemployment will persist for years.

<sup>3</sup> In its 1993 Employment White Paper, the Keating government set a target to reduce unemployment from 12% to 5% or less by 2000. ACOSS has suggested that full employment is likely to be reached when unemployment is 2-3%, under-employment is 4-5%, and there is at least one job vacancy per person unemployed. The government's Economic Inclusion Advisory Committee recommends that: *'The Government commit to an appropriate full employment target for labour utilisation, based on recent labour market outcomes, at a rate of unemployment close to 3.5 per cent. Moreover, there still being uncertainty about what the rate of unemployment can be reduced to without causing excessive wage inflation, the possibility that the target rate should be lower needs to motivate macroeconomic policy. Expressed in terms of labour underutilisation incorporating both unemployment and underemployment, this corresponds to a target for the ABS (hours-based) rate of labour underutilisation of 5 per cent to 5.5 per cent.'* (Economic Inclusion Advisory Committee 2023, [2023-24 Report for the Australian Government](#)).

including the bank's interest rate settings. While Board members do not 'represent' sectors of the community, governments should ensure that a range of community perspectives is brought to the table.

The *Statement on the Conduct of Monetary Policy* sets out the following process for selecting external members of the Board:

*'A panel comprising the Secretary to the Treasury, the Reserve Bank Governor and an independent third party will compile the shortlist through a process that is transparent and focused on ensuring the Reserve Bank Board has the right balance of skills and experience to best discharge its functions.'*

*To support this, the Government commits to maintaining and publishing a skills matrix for the Reserve Bank Board on the advice of the Secretary, Governor and Reserve Bank Board.'* (Treasurer and Reserve Bank Governor 2023, *Statement on the Conduct of Monetary Policy*)

There is no specific reference to the need for diversity on the Board in this statement, or in the present Bill (regarding external members of the proposed Monetary Policy Board).<sup>4</sup>

## Recommendation

### Ensure a diversity of knowledge and expertise on the Monetary Policy Board

**R3: The Monetary Policy Board's external members should be selected in a manner that ensures diversity of backgrounds and perspectives as well as relevant economic expertise, including:**

- gender diversity,
- a diversity of experience and perspectives including from business, employees and people unable to secure paid work.

## Acknowledgements

In preparing its submission to the Reserve Bank Review (on which this submission relies), ACOSS consulted with members of its Income Support and Employment Policy Network and received helpful advice from Professor John Quiggin at the University of Queensland.

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<sup>4</sup> The Reserve Bank Review made recommendations on diversity among RBA staff (see below) but not its Monetary Policy Board: 'RBA should further encourage diverse viewpoints and constructive challenge, including by ... setting diversity targets and tracking progress against them.' (Reserve Bank Review 2022, *A Reserve Bank fit for the future*).