



Australian Government

The Treasury

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Mr John Hawkins
Committee Secretary
Senate Economics Committee
Parliament House

CANBERRA ACT 2600


Dear Mr Hawkins

**SUBMISSION - RESERVE BANK AMENDMENT (ENHANCED INDEPENDENCE) BILL
2008**

Please find attached Treasury's submission into the inquiry on the Reserve Bank Amendment (Enhanced Independence) Bill 2008.

If you have any questions please do not hesitate to contact Rose Verspaandonk on 6263 3913.

Yours sincerely



Tony McDonald
General Manager
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**SUBMISSION TO THE SENATE ECONOMICS COMMITTEE INQUIRY
INTO THE RESERVE BANK AMENDMENT (ENHANCED
INDEPENDENCE) BILL 2008**

by the Australian Treasury

Introduction

Since the early 1990s, inflation targeting has formed the basis of Australia's monetary policy framework. This framework was formalised in a Statement on the Conduct of Monetary Policy in 1996.

The independence of the Reserve Bank in conducting monetary policy contributes to Australia's macroeconomic stability through facilitating low inflation outcomes. Since the Reserve Bank was granted operational independence to pursue its inflation target, the average annual inflation rate has been within the target range of 2 to 3 per cent on average over the cycle.

The Government affirmed its support for the principle of the operational independence of the Reserve Bank, in the Joint Statement on the Conduct of Monetary Policy issued by the Treasurer and the Reserve Bank Governor on 6 December 2007 (attached). The Statement identifies the effective conduct of monetary policy as crucial to Australia's economic performance and prospects.

The Statement notes the importance of the independence of the Reserve Bank in conducting its monetary policy responsibilities, and that the Government will respect the Reserve Bank's independence as stated. The Statement also recognises the importance of inflation targeting as providing the basis for the Reserve Bank's monetary policy framework, recognises the success that inflation targeting has achieved to date, and endorses the continuation of the Reserve Bank's inflation target.

To further enhance the independence of the Reserve Bank, the Statement announces that the positions of the Governor and Deputy Governor of the Reserve Bank of Australia (RBA) will be raised to the same level of statutory independence as the Commissioner of Taxation and the Australian Statistician. The Reserve Bank Amendment (Enhanced Independence) Bill 2008 (the Bill) gives effect to this decision.

The Statement also announces that the Secretary to the Treasury and the Governor will maintain a register of eminent candidates of the highest integrity from which the Treasurer will make new appointments to the Reserve Bank Board.

The Statement also notes a series of initiatives taken by the Reserve Bank to improve its transparency. The Reserve Bank Board now publishes a statement after each Board decision irrespective of whether the cash rate changes, whereas previously a statement was released only when the cash rate changed. The Reserve Bank Board now publishes its decision statement at 2:30pm of the day of the Board meeting, rather than at 9:30 on the morning following the Board meeting. In addition, the Reserve Bank Board now publishes the minutes of its Board meetings, two weeks after the Board meeting is held.

These initiatives all build on the established principle of the Reserve Bank's independence.

Purpose of the Bill

The purpose of the Bill is to give effect to the Government's announcement to raise the statutory independence of the Reserve Bank Governor and Deputy Governor to be that of the Commissioner of Taxation and the Australian Statistician.

Specifically, the Bill will amend the *Reserve Bank Act 1959* (the Act) so that:

- the Governor-General will have the authority to appoint, suspend or terminate the Governor or Deputy-Governor of the RBA, subject to the conditions specified in Item 3, subsection 8 of the Reserve Bank Amendment (Enhanced Independence) Bill 2008;
- the appointment of the Governor or Deputy-Governor can be terminated, at the request of both Houses of the Parliament; however, both Houses of the Parliament must resolve that the Governor or Deputy-Governor has failed in their duties, based solely on the above specified conditions; and
- should the Governor or Deputy-Governor of the RBA resign from office, they are to provide a written letter of resignation to the Governor-General.

Issues

Continuing operation of 'good behaviour' provisions

It has been suggested¹ that the Bill would nullify the operation of section 24(1)(c) of the Act, which provides that the Governor and Deputy Governor hold office subject to good behaviour. This is incorrect. Section 24(1)(c) will remain unchanged as a mechanism for the termination of an appointment where lack of good behaviour is appropriately established (provided the ground for termination is not one covered by section 25 of the Act, in which case the procedures outlined in the Bill would be followed).

This is consistent with the intention of the amendment, which is to enhance the independence of the Board of the RBA, by removing the authority of the Treasurer to appoint, suspend and terminate the positions of the Governor and Deputy-Governor of the RBA, and placing this authority in the hands of the Governor-General. The advice of the Australian Government Solicitor is that to terminate an appointment under the 'good behaviour' provisions in section 24(1)(c), it would be necessary for legal proceedings to be brought in an appropriate court by a person having sufficient standing alleging that the Governor or Deputy Governor had failed to fulfil the condition of his or her office as to 'good behaviour' and seeking a declaration as to when that occurred. This authority does not rest with the Treasurer, and has therefore not been transferred to the Governor General. This authority will continue to be able to be exercised by the courts.

¹ Diane Spooner, *Bills Digest — Reserve Bank (Enhanced Independence) Bill 2008*, Parliamentary Library, 29 April 2008, pp. 11-12.



STATEMENT ON THE CONDUCT OF MONETARY POLICY

The Treasurer and the Governor of the Reserve Bank of Australia

6 December 2007

This statement records the common understanding of the Governor, as Chairman of the Reserve Bank Board, and the Government on key aspects of Australia's monetary policy framework.

Since the early 1990s, inflation targeting has formed the basis of Australia's monetary policy framework. Since 1996, this framework has been formalised in a Statement on the Conduct of Monetary Policy.

Monetary policy is a key element of macroeconomic policy and its effective conduct is critical to Australia's economic performance and prospects. For this reason, it is appropriate and timely for the Governor, and the Treasurer on behalf of the new Government, to outline their mutual understanding of the operation of monetary policy in Australia.

This statement should continue to foster a better understanding, both in Australia and overseas, of the nature of the relationship between the Reserve Bank and the Government, the objectives of monetary policy, the mechanisms for ensuring transparency and accountability in the way policy is conducted, and the independence of the Reserve Bank.

Relationship between the Reserve Bank and the Government

The *Reserve Bank Act 1959* (the Act) gives the Reserve Bank Board the power to determine the Reserve Bank's monetary policy and take the necessary action to implement policy changes. The Act nominates the Governor as Chairman of the Reserve Bank Board.

The Government recognises the independence of the Reserve Bank and its responsibility for monetary policy matters and will respect the Reserve Bank's independence as provided by statute.

The Government will implement two new initiatives to further enhance the Reserve Bank's independence.

The positions of the Governor and Deputy Governor will have their level of statutory independence raised to be equal to that of the Commissioner of Taxation and the Australian Statistician. As such, their appointments will be made by the Governor-General in Council, and could be terminated only with the approval of each House of the Parliament in the same session of Parliament.

The Secretary to the Treasury and the Governor will maintain a register of eminent candidates of the highest integrity from which the Treasurer will make new appointments to the Reserve Bank Board. This procedure removes the potential for political considerations in the appointment process and ensures only the best qualified candidates are appointed to the Reserve Bank Board.

Section 11 of the Act prescribes procedures for the resolution of policy differences between the Reserve Bank Board and the Government. The procedures, in effect, allow the Government to determine policy in the event of a material difference; but the procedures are politically demanding and their nature reinforces the Reserve Bank's independence in the conduct of monetary policy. Safeguards like this ensure that monetary policy is subject to the checks and balances inherent and necessary in a democratic system.

In addressing the Reserve Bank's responsibility for monetary policy, the Act provides that the Reserve Bank Board shall, from time to time, inform the Government of the Reserve Bank's policy. Such arrangements are a common and valuable feature of institutional systems in other countries with independent central banks and recognise the importance of macroeconomic policy co-ordination.

Consistent with its responsibilities for economic policy as a whole the Government reserves the right to comment on monetary policy from time to time.

Objectives of Monetary Policy

The goals of monetary policy are set out in the Act, which requires the Reserve Bank Board to conduct monetary policy in a way that, in the Reserve Bank Board's opinion, will best contribute to:

- a. the stability of the currency of Australia;
- b. the maintenance of full employment in Australia; and
- c. the economic prosperity and welfare of the people of Australia.

The first two objectives lead to the third, and ultimate, objective of monetary policy and indeed of economic policy as a whole. These objectives allow the Reserve Bank Board to focus on price (currency) stability while taking account of the implications of monetary policy for activity and, therefore, employment in the short term. Price stability is a crucial precondition for sustained growth in economic activity and employment.

Both the Reserve Bank and the Government agree on the importance of low inflation and low inflation expectations. These assist businesses in making sound investment decisions, underpin the creation of jobs, protect the savings of Australians and preserve the value of the currency.

In pursuing the goal of medium-term price stability, both the Reserve Bank and the Government agree on the objective of keeping consumer price inflation between 2 and 3 per cent, on average, over the cycle. This formulation allows for the natural short-run variation in inflation over the cycle while preserving a clearly identifiable performance benchmark over time.

Since the adoption of inflation targeting in the early 1990s inflation has averaged around the midpoint of the inflation target band. The Governor takes this opportunity to express his continuing commitment to the inflation objective, consistent with his duties under the Act. For its part the Government indicates that it endorses the inflation objective and emphasises the role that disciplined fiscal policy must play in achieving such an outcome.

Transparency and Accountability

Monetary policy needs to be conducted in an open and forward-looking way. A forward-looking focus is essential as policy adjustments affect activity and inflation with a lag and because of the crucial role of inflation expectations in shaping actual inflation outcomes. In addition, with a clearly defined inflation objective, it is important that the Reserve Bank continues to report on how it sees developments in the economy, currently and in prospect, affecting expected inflation outcomes. These considerations point to the need for effective transparency and accountability arrangements.

The Reserve Bank takes a number of steps to ensure the conduct of monetary policy is transparent. Changes in monetary policy and related reasons are clearly announced and explained. The Reserve Bank's public commentary on the economic outlook and issues bearing on monetary policy settings, through public addresses, its quarterly statements on monetary policy and monthly bulletins, have been crucial in promoting increased understanding of the conduct of monetary policy. The Reserve Bank will continue to promote public understanding in this way.

The Governor has also indicated that he plans to continue the practice of making himself available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics, Finance and Public Administration.

The Governor has announced that the Reserve Bank Board will release a statement explaining the reasons behind its decision on monetary policy following each meeting, irrespective of whether there is a change in the cash rate target. This statement will be made on the afternoon of the day of each Board meeting (rather than the morning of the following day), with the minutes of the Board meeting being released publicly as soon as possible after the meeting.

The Governor has also indicated that the Reserve Bank will continue to extend the scope of the economic forecasts in its quarterly statement on monetary policy to enhance public understanding of the conduct of monetary policy.

The Treasurer expresses support for these arrangements, which bring the transparency and accountability of the Reserve Bank's conduct of monetary policy into line with international best practice, further enhancing the public's confidence in the independence and integrity of the monetary policy process.