

Review of the Reserve Bank Act

Release Document

March 2018

Updated June 2018

**[https://treasury.govt.nz/publications/information-release/
phase-1-reviewing-reserve-bank-act](https://treasury.govt.nz/publications/information-release/phase-1-reviewing-reserve-bank-act)**

This document has been proactively released. Redactions made to the document have been made consistent with provisions of the Official Information Act 1982.

In the June 2018 update some previously withheld information was released.

Key to sections of the Official Information Act 1982 under which information has been withheld.

- [1] 9(2)(a) - to protect the privacy of natural persons, including dead people.
- [2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

SUBMISSION

TELEPHONE 0800 327 646 | WEBSITE WWW.FEDFARM.ORG.NZ



To: Reserve Bank Act Review
The Treasury
By email: rbnzactreview@treasury.govt.nz

Submission on: Reserve Bank Act Review (Phase 1)

From: Federated Farmers of New Zealand

Date: 19 February 2018

NICK CLARK
MANAGER GENERAL POLICY

Federated Farmers of New Zealand
PO Box 1992, Christchurch, New Zealand

P 03 357 9459
F 03 357 9451
✉ nclark@fedfarm.org.nz

www.fedfarm.org.nz

SUBMISSION TO THE TREASURY ON THE RESERVE BANK ACT REVIEW (PHASE 1)

1. INTRODUCTION

- 1.1 Federated Farmers welcomes the opportunity to submit to the Treasury on the Reserve Bank Act Review (Phase 1).
- 1.2 Federated Farmers has supported the Reserve Bank Act 1989 since its inception. We particularly support the enshrining in the Act of the Reserve Bank of New Zealand's (RBNZ's) operational independence with clear accountability and the Act's single monetary policy objective of price stability. We consider the Reserve Bank Act to be (along with the Public Finance Act 1989) a critical cornerstone of economic policy.
- 1.3 It is appropriate to review periodically whether institutions and arrangements are working effectively and if improvements can be made. In the case of monetary policy, it has been over a decade since the last review, the 2007 Finance & Expenditure Committee's *Inquiry into the Monetary Policy Framework*. It is therefore timely to have a review of the Reserve Bank Act but we also believe that it should not presuppose an outcome and "if it ain't broke don't fix it".
- 1.4 Federated Farmers believes that the framework provided by the Reserve Bank Act has meant that monetary policy has worked very effectively for the past 28 years and much more effectively than during the preceding 28 years. This despite a number of serious economic shocks, most recently the Global Financial Crisis and the Christchurch earthquakes.
- 1.5 A review is one thing but Federated Farmers is concerned that the cases for the review's proposed changes have not been adequately made and there are serious risks with them. We strongly prefer that no changes be made to the Act but in this submission we will offer some suggestions for how changes could be made that might reduce the risks associated with them.

2. RECOMMENDATIONS

- 2.1 Federated Farmers recommends that:
 - (a) Price stability should remain the single monetary policy objective in the Reserve Bank Act.
 - (b) If the Government wishes to provide the RBNZ with an employment objective then it should be:
 - Placed in the Policy Targets Agreement rather than the Reserve Bank Act.
 - Stated as a factor the RBNZ should have regard to when pursuing the objective of price stability.
 - Defined as the 'non-accelerating inflation rate of unemployment'.
 - (c) A formal Monetary Policy Committee should be an internal committee, but if external appointments are to be made they should be a minority of the committee members, they should not be political appointments,

and they should be sufficiently expert on economics and monetary policy.

- (d) Any changes to the RBNZ's role in the financial sector, especially if they involve more heavy handed regulation, should be very carefully considered to minimise the risks of unintended consequences.

3. MAXIMISING EMPLOYMENT ALONGSIDE PRICE STABILITY

3.1 Federated Farmers acknowledges that the Government has promised to add 'employment maximisation' to the RBNZ's current single monetary objective of price stability. We understand its concern about employment and the future of work, especially as the economy and the labour market changes. However, we do not believe that amending the Reserve Bank Act is a useful way to address the concern and we are concerned that it would open up considerable risks.

3.2 Federated Farmers believes the Reserve Bank Act 1989 has served New Zealand well. The 1989 Act was successful in reducing and stabilising inflation which was out of control in the 1970s and 1980s under the previous 1964 Act which had multiple and often conflicting monetary policy objectives and a lack of operational independence.

3.3 Inflation being kept under control is good for businesses, workers and consumers, but achieving and maintaining price stability has also been good for the economy, which has grown strongly over recent years. Employment growth has been strong and the rate of unemployment has fallen and is below the OECD average. It is true that productivity growth has been less impressive but monetary policy's ability to directly influence productivity growth is limited. Other aspects of government policy (e.g., the quantity and quality of regulation and investment in infrastructure, education and training, science, etc.) have more potential to improve productivity.

3.4 It is useful to recall that Lars Svensson had the following to say in 2001 in his review of New Zealand monetary policy and his words remain true today:
People typically ask too much of monetary policy—no less in New Zealand than elsewhere. In the long term, monetary policy can only control nominal variables such as inflation and the nominal exchange rate. It is beyond the capacity of any central bank to increase the average level or the growth rate of real variables such as GDP and employment, or to affect the average level of the real exchange rate. At best monetary policy can reduce the variability of these real variables somewhat. An attempt to increase the average level or growth rate of GDP or employment would trigger ever-rising inflation, at increasing cost to the economy in terms of less efficient resource allocation and arbitrary and inequitable redistributions of incomes and assets. For these reasons, an increasing number of countries have specified price stability as the primary goal for monetary policy.¹

3.4 In this vein, Federated Farmers cannot think of any advantages of amending the Act to add a maximising employment objective to that of price stability. It has been suggested that doing so might help in responding to an economic shock but the current operation of monetary policy allows sufficient flexibility

¹ *Independent Review of the Operation of Monetary Policy in New Zealand: Report to the Minister of Finance*, Lars E.O. Svensson, February 2001

to deal with shocks that might increase unemployment. The RBNZ's response to the GFC is a recent example.

- 3.5 We acknowledge concern about the ability of the OCR at its current low rate to be cut aggressively to stimulate the economy in the event of a shock. However, having employment maximisation as an objective would not change this and if anything would likely exacerbate the problem. In the event of a shock there are other options to stimulate the economy, such as use of fiscal policy.
- 3.6 There are serious risks from adding an employment maximisation objective alongside price stability. As well as encouraging overly loose monetary policy and higher inflation there is potential for contradiction and confusion about what is more important (especially if they have equal weighting) and heightened potential for political intervention and erosion of the Bank's operational independence. This is especially if there is disagreement between politicians and the RBNZ on what 'maximising employment' means in practice and what to do if inflation and unemployment are both on the rise, as was the case in the 1970s and 1980s under the 1964 Act with its multiple monetary policy objectives.
- 3.7 It is useful to consider international best practice. The 2001 Svensson Review found New Zealand's monetary policy framework to be 'entirely consistent with world's best practice'². According to a 2017 RBNZ paper all of central banks studied have forward-looking inflation targets and most of them have either an explicit or implicit single mandate (for controlling inflation)³. An important question is whether any countries have in recent years *added* employment as an objective?
- 3.8 If the Government wishes to include an employment objective for the RBNZ, there are three ways to make it less risky:
- (a) Place the objective in the Policy Targets Agreement (PTA) rather than the Reserve Bank Act. The PTA includes a number of factors the RBNZ needs to consider in the operation of monetary policy, including looking through the impacts of commodity price fluctuations, natural disasters etc., and avoiding unnecessary instability in output, interest rates and the exchange rate. The PTA is the best place to put an employment-related consideration.
 - (b) State the objective as a factor the RBNZ should "have regard to" when pursuing the objective of price stability. This is the appropriate hierarchy of objectives.
 - (c) Avoid the use of the term 'maximising employment'. It is unclear what this means in practice. Does it mean zero unemployment and if so would it ever justify a tightening of monetary policy to contain inflation? Should it take into consideration frictional unemployment or should it be a rate of unemployment before the economy starts to over-heat and push up the rate of inflation? Federated Farmers is of the latter view and as such we believe it would be appropriate to define it as the 'non-accelerating inflation rate of unemployment'.

² Independent Review of the Operation of Monetary Policy in New Zealand: Report to the Minister of Finance,

³ *An international comparison of inflation-targeting frameworks*, Reserve Bank Bulletin Vol. 80, No.8, August 2017.

4. COMMITTEE DECISION-MAKING MODEL FOR MONETARY POLICY DECISIONS

- 4.1 Federated Farmers is not averse to the creation of a formal committee to act as monetary policy decision-maker. A formal committee has the potential to increase knowledge and avoid capture by one person. However, our key caveats are that such a committee needs to preserve the Reserve Bank's operational independence and its accountability, and that there is sufficient evidence that it will actually result in better decision-making.
- 4.2 Possible disadvantages include risk of 'group-think' and if there are external members muddled accountability and the potential for political appointments. We would be particularly concerned about the possibility of non-experts with vested or sectional interests, which would compromise the RBNZ's operational independence and the quality of its decisions. The pool of truly suitable external candidates is likely to be small in a small country like New Zealand.
- 4.3 If there is to be a formal committee with external members, there should be five or seven members, with a majority of internal members and for it to be chaired by the Governor. In order to preserve the RBNZ's operational independence the committee should be appointed by the RBNZ and not by the Minister and there should not be a Treasury member on the committee (although it would be appropriate for a Treasury observer to be present). Internal members should be specific positions in the RBNZ (Governor and deputy governors) while any external members should be staggered appointments of up to five years to ensure continuity and the infusion of fresh thinking.
- 4.4 Regarding the communication of monetary policy decisions, Federated Farmers believes that the current approach, a media statement with the Governor fronting a media conference, works well. While not opposed to releasing minutes of committee decisions we would be concerned if their release resulted in a stifling of discussion and debate in the committee.
- 4.5 Overall, Federated Farmers submits that any formal Monetary Policy Committee should be an internal committee, but if external appointments are to be made they should be a minority of the committee members, they should not be political appointments, and they should be sufficiently expert on economics and monetary policy.

5. PHASE 2: RESERVE BANK'S ROLE IN THE FINANCIAL SECTOR

- 5.1 Federated Farmers has no specific comment on Stage 2 of the review, which we understand is to be focused mainly on its role in the financial sector. As a general comment though we believe the review should proceed with caution and ensure that if any changes involve more heavy handed regulation, they should be very carefully considered to minimise the risks of unintended consequences

6. ABOUT FEDERATED FARMERS

6.1 Federated Farmers is a member based organisation that represents farmers and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand's farmers.

6.2 The Federation aims to add value to its members' business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of the rural community; and
- Our members adopt responsible management and environmental practices.