Review of the Reserve Bank Act

Release Document

March 2018

http://www.treasury.govt.nz/publications/reviews-consultation/rbnz-act-1989

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.

[3] 18(d) - the information requested is or will soon be publicly available.

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).

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Summary of Stakeholder Engagement on Phase 1 of the Review of the Reserve Bank Act

Date:	22 February 2018	**Report No:**	T2018/291
		File Number:	MC-1-7-5

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note the summary of stakeholders' views on Phase 1 of the Review of the Reserve Bank Act	27 February 2018

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Ralph Hall	Senior Analyst	[1][2] (wk)	N/A (mob)	✓
Renee Philip	Manager	[1][2] (wk)	[1][2] (mob)	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Summary of Stakeholder Engagement on Phase 1 of the Review of the Reserve Bank Act

Purpose of Report

1. This report provides you with a summary of the views emerging from stakeholder engagement on Phase 1 of the Review of the Reserve Bank of New Zealand Act 1989 (the Review). The summary is largely based on stakeholder meetings hosted by the Treasury that were held under “Chatham House Rules”. The summary is therefore done thematically in this report, with no views attributed to any individual or institution.

2. Four written submissions were received on Phase 1: Ganesh Nana, Michael Reddell, Geof Mortlock, and Federated Farmers of New Zealand. These submissions are incorporated into this summary.

3. The report is intended to help you in making policy decisions on Phase 1 of the Review. Stakeholders’ views on the list of issues for Phase 2 of the Review will be provided in a separate report at the time that policy recommendations are being made.

Stakeholders’ Views on Adding Employment as a Monetary Policy Objective

4. A list of the people whose views are summarised in this report is in the Appendix. This includes a mix of bank, academic and think tank economists, along with people from sector representative organisations such as the Council of Trade Unions.

5. There was broad agreement amongst stakeholders that inflation is not an end in itself. Instead it is an intermediate target for supporting macroeconomic stability, and ultimately wellbeing and higher living standards. A number of stakeholders said that this should be better communicated and potentially reflected in the Act as part of the purpose of the Reserve Bank.

6. The major areas of discussion and some disagreement were:

   a. whether there was anything wrong with the current Act and the Policy Targets Agreement (PTA), and

   b. how best to frame an employment objective if it is to be added.

Problem definition

7. A number of stakeholders argued that there has been no clear problem definition to justify that something was wrong with the Bank’s existing objectives. There was a request for Treasury and the Reserve Bank to build an analytical evidence base to underpin the proposal to include an employment objective. These stakeholders argued that if there was not an evidence base justifying the change, then that lack of evidence should be made clear to the Government.

8. Others argued that adding an employment objective to the Act would be a useful way to recognise the broader impact monetary policy has on the real economy and that it could, if the objective was framed correctly, help convey the role monetary policy can (and cannot) play in supporting the economy. Some stakeholders went further and suggested that inflation has been given too much weight, and that adding an employment objective was an important first step in having greater balance in decision-making.

How best to incorporate an economic objective – dual mandate or secondary objective?

9. Many argued that if an employment objective was added to the Act it should be a secondary objective to price stability. There was a strong push that the Reserve Bank's current settings were broadly working and a feeling of "if it's not broken, don't fix it". A number of stakeholders argued that the consensus view of economists and academics was that monetary policy had little or no influence over employment outcomes in the long run. For these stakeholders, including employment as anything other than a secondary objective would not properly reflect the limits to the Reserve Bank's ability to influence employment levels.

10. Many of these stakeholders were concerned that a dual mandate would raise businesses' and people's inflation expectations, which in turn could take New Zealand back to a period of higher inflation. Some of these stakeholders raised the point that even with just a focus on price stability, the Reserve Bank only had limited power in the modern age of globalisation to control inflation. The longevity of any dual mandate was also questioned, as it was considered that a different Government could change it back.

11. A minority of stakeholders argued that monetary policy did have wider effects on the real economy – noting that the Volcker recession in the United States in the 1980s was a clear case of an aggressive monetary policy tightening having real effects. Others also noted that monetary policy directly affects the exchange rate, which if too high, can undermine New Zealand's export capacity and weigh on employment. These stakeholders wanted to see a tangible change in the Reserve Bank's focus, which a dual mandate would help deliver.

Views on exact wording to use in employment objective

12. There was broad agreement that the Bank should not be given a numerical employment target, given uncertainty over estimates of full employment and for fear of damaging the Bank's credibility when the policy trade-off (between inflation and employment) meant that both targets couldn't be hit simultaneously. Some stakeholders went further, suggesting that the Act should be kept very broad to enable maximum flexibility in the future. Some went further still, arguing that the Act should be left unchanged and any secondary employment objectives should feature in the PTA only.

13. Most stakeholders agreed that monetary policy was only one driver of employment outcomes (given the important role of structural factors and other government policies), so it was important not to over-promise on what monetary policy could achieve. The majority of stakeholders agreed that any employment objective should not be aimed at boosting the level of employment per se, but should be framed around the concept of minimising fluctuations around a "sustainable" trend. If the objective did not reference "sustainable employment", there is a danger that monetary policy may be encouraged to boost employment above this level, which would generate inflationary pressure and risk price stability.

14. Several stakeholders also had a preference for using the term "full employment", or "the non-accelerating inflation rate of unemployment (NAIRU)" rather than "maximising employment", as these are better-defined economic concepts. A few stakeholders also queried whether the employment objective should be expressed in terms of "minimising unemployment" rather than supporting employment.

15. One stakeholder recommended that the Bank should be required to regularly report on on its estimates of the long-run sustainable rate of unemployment. This stakeholder considered that it would help focus the Reserve Bank, and create better accountability and transparency.

16. Issues were also raised about the status of the PTA and whether it would still be fit for purpose under the second main change in Phase 1: formalising a committee structure for monetary policy decision-making.

Stakeholders' Views on Formalising a Monetary Policy Committee

17. The majority of stakeholders were comfortable with or supported the idea of formalising a Monetary Policy Committee (MPC) as the decision-making body for monetary policy, rather than sole responsibility sitting with the Governor of the Reserve Bank. This was because the diversity of views in a committee can lead to better decision-making, and because there is an opportunity for trade-offs to be more transparent.

18. There was broad agreement on some of the details of the committee structure, while other areas were more contested.

Size and make-up of MPC

19. Most stakeholders recommended a committee of 5 or 7 members with a majority of internal members (with a minority of stakeholders arguing that there should only be internals). The main reasons given for not favouring a majority of externals were the following concerns:

    a externals would likely not have the same level of technical expertise as held by full-time, internal Reserve Bank staff,

    b internals could be overruled and the Reserve Bank would then need to implement a decision they didn't agree with,

    c non-conflicted and qualified externals would be difficult to find, and

    d the committee could be more easily politicised if the Minister of Finance had a big role in the appointment of externals and externals were in the majority.

20. A minority of stakeholders favoured externals being a majority on the MPC. Some of the arguments in support of this approach were:

    a if the internals are unable to convince at least one external of the merits of their view then that is reasonable grounds to question the strength of the internals' argument,

    b that a majority of internals could "neuter" the external members by block voting making the whole point of externals redundant, and

    c it could be difficult to get new externals onto the committee if it was seen as being run by the Reserve Bank and not being a substantive position.

Role and resources available to externals

21. Questions were raised about whether the externals would be full-time or part-time, and the sorts of resources that would be available to them. The majority of stakeholders agreed that externals should be part-time, and most recommended that externals should be non-conflicted, independent experts and should not represent sector interests (such as business or unions). Several stakeholders noted that the pool of potential candidates with specific monetary policy expertise that were free from conflict was likely to be small, so the criteria for selection should be broadened to include individuals who had sound judgement and broader expertise in governance roles or business backgrounds.

22. There was some debate over how external MPC members should be resourced, but without a clear consensus. Several stakeholders noted that external MPC members should be sufficiently resourced so that they are in a position to ask difficult questions and challenge. One stakeholder suggested that resourcing for externals could be achieved by a specific process where the MPC can collectively commission work from Bank staff, or external MPC members could be given a separate budget to commission research from outside the Bank.

Treasury representation on the MPC

23. Having a Treasury representative on the MPC was not discussed extensively. The small number of stakeholders that did express an opinion argued that a Treasury representative should not have a vote on the MPC, but were more relaxed about having a Treasury representative as an observer.

Term-lengths and appointment process

24. Most stakeholders focused on the terms of appointment for externals, and recommended a length of appointment in the 3 to 5 year range (so that terms are at least as long as the lags of monetary policy) with a limit of one reappointment each. There was a consensus that these appointments should be staggered so that individual members left periodically rather than terms ending at the same time.

25. The majority of stakeholders supported maintaining the "double veto" system of appointment that is currently used for the Reserve Bank Governor. Most stakeholders argued that the Governor should have a role in appointments, with sign-off by the Board or Minister. This was out of concern that Ministerial appointments could undermine the independence of the Reserve Bank on monetary policy. A minority of stakeholders considered that the Minister should make appointments (with the Board only being consulted), as members of the MPC had significant statutory power and should either be elected themselves or appointed by those who are themselves elected.

Communications and accountability

26. There were mixed views on whether minutes of monetary policy decisions should be published. A number of market-oriented stakeholders supported the MPC publishing high-level minutes and the results of any vote that takes place soon after a decision has been made (one stakeholder suggested a 1 month lag before votes are made public). The primary motivation was to be more transparent to the public, including the key uncertainties, risks, and judgements that influenced the Bank's forecasts. Other stakeholders were more critical of minutes, arguing that they would not add much additional information and could risk generating noise among "market watchers", which would detract from the debate. No one supported publishing full transcripts of monetary policy meetings for fear of stymieing discussion.

27. There was also a range of views on whether MPC members should set out their different views publicly through speeches, academic papers, and other avenues. A number of stakeholders thought that this could be destabilising and would lead to an unhealthy focus by market watchers on the minutiae of individual MPC members' public comments. Other stakeholders disagreed and thought that public statements by members would be important in promoting transparency and accountability, and that it worked well in the United States and the United Kingdom.

28. There was broad agreement that the switch to a MPC model would mean the Governor was no longer solely accountable for monetary policy decisions, and that the group as a whole should be held to account. However, there were mixed views over what the new accountability model should look like. Some argued that an official body (such as a Macro Stability Council) should be responsible for holding the MPC to account for their

decisions, arguing that the Board's existing monitoring role would be insufficient. Others noted that the role of the Board would have to evolve in light of the changes, but would still be well-placed to perform its monitoring function.

Role of the Reserve Bank Board

29. Most stakeholders agreed that the role of the Board would need to be adjusted. The importance of accountability of the MPC was also discussed in this context. One stakeholder noted that the Board would have to develop a method for assessing whether the MPC had met its employment objective – just as it had when "avoiding unnecessary instability in the exchange rate" was added to the PTA. More substantive questions about the Board's role were considered to be best left to Phase 2 of the Review.

Recommended Action

We recommend that you:

a **note** the summary of stakeholders' views on Phase 1 of the Review set out in this report

b **agree** to this report being published online once Cabinet decisions on Phase 1 of the Review have been announced publicly, along with the written submissions received

Agree/disagree.

Renee Philip
Manager, Reserve Bank Act Review

Hon Grant Robertson
Minister of Finance

Appendix: List of Stakeholders Whose Views are Summarised in the Report

Stakeholders who attended meetings

1. Nick Tuffley (ASB)
2. Stephen Toplis (BNZ)
3. Con Williams (ANZ)
4. Christina Leung (NZIER)
5. Ganesh Nana (BERL)
6. Bob Buckle (Victoria University)
7. Michael Reddell
8. Kirk Hope (Business NZ)
9. John Pask (Business NZ)
10. Phil Love (Business NZ)
11. Richard Wagstaff (Council of Trade Unions)
12. Bill Rosenberg (Council of Trade Unions)
13. Arthur Grimes (Motu)
14. Viv Hall (Victoria University)
15. Bryce Wilkinson (NZ Initiative and Capital Economics)
16. Oliver Hartwich (NZ Initiative)
17. Christian Hawkesby (Harbour Asset Management)
18. Ulf Schoefisch (NZIER)
19. Nick Clark (Federated Farmers)
20. Mike Frith (NZ Super Fund)

Stakeholders who made written submissions

1. Ganesh Nana (BERL)
2. Michael Reddell
3. Geof Mortlock (Mortlock Consultants Limited)
4. Federated Farmers of New Zealand