

The Treasury

Reserve Bank Act Review Phase 2 Submission Information Release

October 2019

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MEMORANDUM

TO: Phase 2 of the Reserve Bank Act Review
New Zealand Treasury

FROM: Andrew Body
Principal
Andrew Body Limited

DATE: 14 August 2019

SUBJECT: Submission to the Independent Expert Advisory Panel for the second consultation round of Phase 2 of the Reserve Bank Act Review

Summary

1. The Reserve Bank of New Zealand (RBNZ) should have as its sole purpose the maximisation of net economic benefit to New Zealanders. Further objectives are not required.
2. Section 1A of the Act should be amended to read:
 - (1) *The purpose of this Act is to promote the prosperity and well-being of New Zealanders by contributing to a sustainable and productive economy.*
 - (2) *This section does not limit the functions or powers given to the Bank by any other enactment.*
3. A new section 7A should be added to the Act to read:
 - (1) *The Bank must use its powers and functions to take action when such action would result in a net economic benefit to New Zealanders.*
 - (2) *The Bank must publish a net economic benefit analysis prior to it taking action under 7A(1).*
 - (3) *The consistency of the Bank's use of its powers and functions with its purpose of creating net economic benefit is subject to judicial review.*
4. The critical issue within this scheme, of what monetary and prudential powers the RBNZ has under the scheme described above, would need to be revisited.
5. There is a sense about the RBNZ's behaviour that it does not want to, or is simply unable, to engage in all-sector efficiency or net economic benefit analysis because it takes the organisation out of a familiar institutional and "macro" analytical environment into an unfamiliar and more complex "meso" analytical environment.
6. Our statutory scheme corrects this problem.

Explanation

7. This submission addresses the question of what policy objectives the Reserve Bank of New Zealand (RBNZ) should have (the objectives' question).
8. The context for consideration of the objectives' question is very important:
 - a. RBNZ's macro and microeconomic impact on the New Zealand economy is far reaching - far beyond cost of capital and prudential supervision of the banking and insurance sectors
 - b. The RBNZ has a governance structure and level of independence that substantially limits its accountability - its regulatory hegemony in its field means it can simply ignore and fail to even acknowledge the negative consequences of its actions
 - c. Clarity and internal and temporal consistency of purpose is important to both its results and meeting the demands of its limited accountability – the purpose (including objectives) of the RBNZ is becoming unclear and internally and temporally inconsistent
 - d. As an organisation it does not bear the consequences of the mistakes it makes
 - e. There is a vast array of well-developed literature on the theory and practice of efficiency and its application to New Zealand, including New Zealand Treasury's cost benefit analysis
 - f. Regulation is now in the domain of political populism – the voters will decide on what regulation they like, so being too clever and stepping away from clarity, consistency and meaningfulness is not a politically sustainable position in regulatory policy development.
9. Consistent with the beginning of section 1A of the Reserve Bank of New Zealand Act 1989 (the Act) the RBNZ should be solely focussed on maximising the net economic benefit to New Zealanders of its actions. Any other focus will only maximise net economic benefit to New Zealanders by accident.
10. In cost benefit analysis terms this amounts to maximising the sum of:

Benefit of an action

Less cost of an action

Less cost of administration
11. Maximising net economic benefit to the New Zealanders is an allocative, productive and dynamic economic efficiency task. It also incorporates the concept of the administrative cost of intervention.
12. Maximising net economic benefit to New Zealanders does not require a statutory objective. It is clear, internally and temporally consistent and amongst other things requires consideration of the stability of the financial system. Importantly voters can “get it”.
13. Practically, expressing and operationalising RBNZ's purpose can only be undertaken with reference to the powers the RBNZ has. The critical issue within this scheme, of what monetary and prudential powers the RBNZ has under the scheme described above, would need to be revisited.

14. Therefore section 1A of the Act should be amended to simply read:

(3) The purpose of this Act is to promote the prosperity and well-being of New Zealanders by contributing to a sustainable and productive economy.

(4) This section does not limit the functions or powers given to the Bank by any other enactment.

15. A new section 7A should be added to the Act to simply read:

(4) The Bank must use its powers and functions to take action when such action would result in a net economic benefit to New Zealanders.

(5) The Bank must publish a net economic benefit analysis prior to it taking action under 7A(1).

(6) The consistency of the Bank's use of its powers and functions with its purpose of creating net economic benefit analysis is subject to judicial review.

16. RBNZ's powers and functions largely relate to the operation of monetary policy and banking and insurance prudential supervision. Trade-offs between the cost and benefit of additional financial stability are simply subsumed within the net economic benefit analysis and proposed provisions of the Act described above.

17. Moreover the concept of multiple subsidiary objectives as suggested in the June 2019 Consultation Document 2A creates a dangerous lack of clarity of purpose and encourages internal and temporal inconsistency. There should not be any subsidiary purposes or objectives in the Act.

18. For example maintaining public confidence as a subsidiary objective can only be achieved using the powers the RBNZ has and the exercise of these powers to maximise net economic benefit to New Zealand is the only positive way the RBNZ can influence public confidence. So why make it a separate objective?

RBNZ avoiding the full implications of its actions

19. The critical question that both the November 2018 and June 2019 Consultation Documents missed is how far should the RBNZ's net economic benefit analysis of its actions extend beyond the financial system? For example should the RBNZ be required to take into account the impact of its actions in its cost benefit analysis on all sectors of the New Zealand economy?

20. There is a strong sense from RBNZ's behaviour that it that it does not want or is simply unable to engage in all-sector efficiency analysis because it takes the organisation out of a familiar institutional and "macro" analytical environment into an unfamiliar and more complex "meso" analytical environment.

21. Instead it simply relies on its regulatory hegemony to avoid consideration of the all-sector economic implications of its action or inaction.

22. The RBNZ's current narrow consideration of efficiency is extremely expensive for the New Zealand economy and is at odds with the voters' trust and confidence in such an "independent" regulator.
23. Our proposed statutory scheme corrects this behaviour of the RBNZ.