Submission

By

THE NEW ZEALAND INITIATIVE

to the Finance and Expenditure Committee

on the

Reserve Bank of New Zealand (Monetary Policy) Amendment Bill

7 September 2018

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1. SUMMARY

This submission on the Reserve Bank of New Zealand (Monetary Policy) Amendment Bill is made by The New Zealand Initiative, a Wellington-based private sector public policy think tank.

Our review of the case for the proposed changes in this Bill finds has failed to find any official documents that identify flawed decisions under current arrangements, let alone flaws that could be attributed to these arrangements.

We recommend that they should not proceed until a concrete case has been made that there are problems that require fixing by the proposed means.

In the event that the government does proceed to make changes, we concur with the recommendations in the submissions of Business New Zealand and Federated Farmers to the effect that any changes to the existing section 8 of the Reserve Bank Act 1989 (defining its primary function) should ensure that the pursuit of price stability remains its main focus.

2. INTRODUCTION

This submission on the Reserve Bank of New Zealand (Monetary Policy) Amendment Bill is made by The New Zealand Initiative, a Wellington-based private sector public policy think tank.

The Initiative's mission is to help create a better New Zealand for all New Zealanders. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy.

In preparing this submission we have looked at:

- The Independent Expert Advisory Panel Report, March 2018
- The Reserve Bank of New Zealand (Monetary Policy) Amendment Bill
- The Treasury's departmental disclosure statement on the Bill
- The Treasury's 7 March 2018 Regulatory Impact Statement
- The Treasury's 27 June 2018 Regulatory Impact Statement
- Treasury Report T2018/321 23 February 2018,"Advice on Phase 1 of the Reserve Bank Act Review"

We are aware of, but have not looked through, the other papers on Treasury's website here.

3. CHANGES TO SECTION 8 PRIMARY FUNCTION OF THE BANK

The official documents we have reviewed in preparing this submission have not made any case that monetary policy implementation under the existing Act has failed to take due account of employment and output issues.

As a result, the decision to amend section 8 of the Act to blur its primary function appears to be entirely political.

We do not consider that is a good enough reason. Multiple objectives with no clarity about the trade-offs undermine accountability.[1] Lack of clarity about the policy objective risks putting an unnecessary premium into interest rates. That would increase the cost of capital to the government and to borrowers in New Zealand more generally.

Another concern is that the proposed term to be included in section 8 – "supporting maximum sustainable employment" is undefined. It will be in practice whatever someone decides is opportune in the circumstances. That further reduces accountability.

Of course, the pursuit of price stability to date has always taken into account the state of real economic activity, since this is relevant to assessing what action is needed. In addition, the Policy Targets Agreement process has allowed the government of the day to indicate what weight it wishes to be put on other considerations.

Given the scope for flexibility under current arrangements, we recommend that there should be no changes to section 8 until a clear case has been made that there are problems that require fixing by the proposed means.

4. PROPOSED MONETARY POLICY COMMITTEE

Accountability for the implementation of monetary policy under the Act lies squarely on the shoulders of the Governor. That assignment could not be clearer.

The official documents we have reviewed have not identified any deficient monetary policy decisions, let alone any attributable to that structure. Rather they have relied on an undocumented assertion that decision-making by committee is better on average.

Yet if that is so, a fully accountable Governor, overseen by the Reserve Bank board, could be expected to adopt a committee consultative structure. Indeed, it seems from the official papers we have reviewed that existing Governors have followed a consultative process and are prepared to modify it along the way.

There seems to be a confusion between clear accountability for the decision and the consultative structure for reaching that decision. Under a majority vote rule taken by a committee it is not clear who is accountable for the decision reached.

The expertise in monetary policy of the external members of the committee will matter. Crank thinking that cheap Reserve Bank credit is a panacea for most ills has made its mark on New Zealand's political history. Lay people may be more prone to hoping that more largess today will not mean more stringency tomorrow. Publication of lay dissenting views that strike professional money managers and others as irresponsible would raise doubts about New Zealand's financial management.

We are aware that the proposed changes have ample precedents among the structures for central banks elsewhere. As such we do not see them as being serious mistakes. Our main point is that it will be important to provide a structure that ensures that competent people with relevant expertise are on the committee.

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[1] As the expert panel's paper notes, when there is stagflation, as in the second half of the 1970s in New Zealand, the trade-off is stark. The clearer the commitment to price stability, the lower should be the premium in interest rates for inflation risk.

5. THE RESERVE BANK BOARD'S ROLE

We have not formed a view as to whether it should be the Board or the Minister who appoints and dismisses the members of the monetary policy committee.

The Initiative has recommended an expanded decision-making role for the Reserve Bank Board. But this is in another context – the Banks's role as a regulator.[2]

6. CONCLUSION AND RECOMMENDATIONS

The proposed changes to the objective for monetary policy implementation and to the decision-making structure are not a response to identified real problems. They appear to reduce both the clarity of the objective of monetary policy implementation and accountability for that implementation.

We recommend that they should not proceed until a concrete case has been made that there are problems that require fixing by the proposed means.

In the event that the government does proceed with changes to section 8 of the Reserve Bank Act 1989, we concur with the recommendations in the submissions of Business New Zealand and Federated Farmers to the effect that any changes to the existing section 8 of the Reserve Bank Act 1989 (defining its primary function) should ensure that the pursuit of price stability remains its main focus.

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[2] See Roger Partridge and Amy Thomasson, *Who Guards the Guards? Regulatory Governance in New Zealand*, The New Zealand Initiative, 13 April 2018.