We Must not Politicise the RBA

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In recent weeks the Australian Treasurer has signalled his intent to endorse a new Statement on the Conduct of Monetary Policy. Typically, amendments to The Statement have occurred with a change in Government or a change in Governor of the Reserve Bank of Australia (RBA). It is critically important that this departure from the norm does not threaten the independence of the RBA. Its independence has been an important part of the success of the Australian economy since the recession Australia didn't have to have in the early 1990s. Perception of reduced independence would undermine central bank credibility and exacerbate an already challenging policy environment.

The Statement on the Conduct of Monetary Policy documents the agreed understanding of the monetary policy strategy between the Commonwealth Government and the RBA. The Statement serves to clarify the objectives to which the RBA will be held accountable and to formally acknowledge the RBA's independence. A central component of this statement is the agreement that the goal of consumer price inflation between 2 and 3 per cent, on average, over time, is consistent with the stability of the currency of Australia, as mandated by the Reserve Bank Act of 1959.

The timing of current discussions raises important questions about why and how The Statement on the Conduct of Monetary Policy should be reviewed. If re-evaluating its content is a step towards genuine reform, this would be most welcome. There are good arguments for a formal review of the RBA's policy and communication strategy and perhaps even a review of the RBA's governance structure.

But if the review reflects political considerations, an immediate casualty will be the independence of the RBA. Of particular concern is the political motive for publicly chastising the Reserve Bank. One likely reason is to provide cover for the Government to run fiscal deficits in future years, should Australia face a significant downturn. When delivering deficits in future budgets, the Treasurer may want to claim that it was the fault of the RBA. By the RBA not doing its job, the Government could claim it was forced to provide fiscal stimulus. It would be far better to have an amended statement reflect more precise requirements on the conduct of policy.

These specific circumstances naturally raise questions of a general nature: if there are changes in the economic outlook or changes in our understanding of what constitutes good economic management that is so urgent as to warrant revision of The Statement, why don't changes to The Statement deserve public discussion and scrutiny? The language of The Statement has changed in substantive ways with past changes in Government and Governors, most notably with Governor Lowe. While these changes have been sensible, they need not always be so. Looming large is the unanswered question of whether these amendments reflect preferences of the Governor or those of the Government to which the RBA is accountable.

Any changes to the RBA's policy strategy should occur within an articulated and transparent framework of review, not within the closed doors of Government. In the case of politically motivated changes, anything short of this sets a dangerous precedent which will compromise central bank independence. If the Government can change The Statement at unstated times for unstated reasons, or because of prevailing economic conditions, the public will not perceive monetary policy to be insulated from political interference. Failure to strengthen institutional arrangements within a transparent review process will create uncertainty about the future policy objectives of the RBA and impair the credibility of monetary policy. From this perspective, periodic reviews, such as those conducted by the Bank of Canada every five years, are preferable.

The Australian Treasurer is right to ask whether changes in the RBA's monetary policy framework would improve accountability and transparency. But to succeed in achieving the important goal of genuine reform, there should be a wide-ranging formal review of the RBA. The review should have clear objectives, such as ensuring the long-term welfare of Australians and meet the requirements of public transparency. The review should not be motivated by, or be responding to, current economic difficulties.

While the current monetary policy framework has served the Australian people well in recent decades, we should at least ask whether it remains a suitable framework to contend with contemporary and future challenges. There is a compelling case for a formal review of the role of the RBA with a focus on the transparency, accountability and independence of RBA decisions.

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