The RBA Board needs renewal and greater independence

In recent months two major proposed changes to the RBA Board have been the subject of much debate. First, the removal of the long-standing ability of the Federal Government to overrule the RBA Board on any policy matter has shifted from being initially supported to largely friendless. Second, the creation of a new monetary policy Board to be filled with economics experts has become contested over perceptions of political partisanship. Both changes are substantial and necessary, but the media discussion on them has frequently missed the key points.

Government dominance over the RBA Board

Currently, the Federal Government has considerable power to override the RBA Board on any policy matter. A plain reading of section 11 of the Reserve Bank Act 1959, makes clear that the RBA Board has no meaningful ability to independently determine monetary policy if confronted with an interventionist Cabinet.

The Act states that in the event of a disagreement between the Treasurer and the RBA Board on a policy matter, the Treasurer makes a recommendation to the Attorney general, who then takes advice from the Federal Executive Council and makes a determination. The RBA Board is obligated to comply with the determination as long as it remains in effect. The Treasurer must inform Parliament of such an order and provide statements from both sides regarding the disagreement.

The media coverage of this issue has been framed as the power of the Treasurer to overrule the RBA Board on setting interest rates. This ignores the clear language of the Act, which uses “policy” and “matter”, terms vague enough to cover almost decision. The most obvious example of how this dominant position could be misused is by a government forcing the RBA to print money to fund large budget deficits as well as setting interest rates well below CPI, which could trigger hyperinflation. Argentina, Turkey, Venezuela and Zimbabwe are recent examples of governments implementing these policies to disastrous effect.

The crux of this debate is whether the RBA Board or the Australian Government is better placed to have ultimate control over monetary policy. Supporters of the status quo have argued that the RBA Board isn’t elected or accountable to the Australian public, and therefore it should be subject to the direction of the government of the day. This a naïve position, as it promotes the view that a government focused on winning the next election will make better monetary policy decisions than an independent board of experts.

We rightly recognise that governments shouldn’t overrule judicial decisions that might be politically unpopular, although a government can change legislation to impact similar future cases. The same respect and independence should be given to the RBA Board, which is best placed to make monetary policy decisions focussed on Australia’s long-term prosperity. Removing the ability of the Treasurer and Cabinet to override RBA decisions would simply mirror the approach taken in legal matters.

Also ignored in the debate is the ability of a government to stack the RBA Board with partisans. Most members are appointed on five-year terms, allowing a government that secures consecutive three-year terms to appoint essentially all members. Additionally, there is the fallback option of amending legislation to spill or remove existing board members, not unlike what is currently occurring. The government also has the Treasury Secretary as a voting member and participant, ensuring their views are consistently represented.

When considering the overall range of mechanisms a Federal Government has to influence the RBA Board, the emphasis on the Board being independent is widely accepted but structurally weak. The government of the day can compel the Board to engage in private discussions aimed at changing their position, overrule their decisions by executive decision, replace Board members in the ordinary course or spill the non-executive members via legislation. This all points to the status quo being substantially imbalanced. It allows the government of the day to pressure Board members to choose politically expedient actions over the long-term prosperity of Australia.

The need for renewal

The existing non-executive members of the RBA Board come from diverse backgrounds, with some being experienced economists and others being professional company directors. This diversity aligns well with the proposal to split the current RBA Board's duties into two new boards, one for monetary policy and another for governance. The practicalities of the split could mean that the new monetary policy board comprises five non-executive members who are either newly appointed or were appointed by the current Federal Government in 2023 with only one non-executive member appointed by the previous Federal Government. It is also worth noting that all three ex officio members have been appointed by the current Federal Government.

The debate about the proposed board split focuses on the potential to stack the new monetary policy Board, not the need for the new Board or the need for greater economic expertise on it. Recent errors by the RBA include setting interest rates too low and for too long, quantitative easing, the term funding facility and a series of communication mistakes. Mistakes this large and as easily foreseeable would result in significant turnover of board members if they occurred at an ASX listed corporation.

It has been noted that there has not been a Board vote against a recommendation by RBA staff for at least a decade. Given the number and severity of the recent errors, this points to a board that did not have sufficient economic expertise and diversity of economic thinking to challenge staff recommendations. Appointing new board members who recognise the strengths of Austrian and monetarist economic analysis, and who have financial markets and credit expertise would address obvious gaps and reduce the likelihood of similar errors.

As an olive branch option, the Federal Government could offer the opposition the opportunity to participate in the selection process. If two or more new non-executive members are to be added to the monetary policy board, one could be recommended by the Shadow Treasurer. This approach would demonstrate a healthy level of bipartisanship in implementing the greatly needed changes to the RBA's monetary policy decision making processes.

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Disclosure