Submission to the

Finance and Expenditure Select Committee

of the House of Representatives

Reserve Bank of New Zealand Bill

New Zealand Business Roundtable

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Executive Summary

* The Reserve Bank Bill represents a significant step towards improving New Zealand's chances of entrenching a much lower rate of inflation for the future than it has been able to achieve in recent decades.

* Contrary to some suggestions that it weakens the democratic power of a government to determine monetary policy objectives, the Bill explicitly spells out the subservient role of the Reserve Bank in this respect and greatly increases its accountability to the Minister of Finance, parliament and the public at large for its performance in pursuing the government's monetary policy objectives.

* Section 8 which specifies that it will have, in the absence of political instructions to the contrary, the prime monetary policy objective of price stability is a highly desirable ingredient in the process of improving the Reserve Bank's accountability to politicians for its performance. Past experience in New Zealand has amply demonstrated that imprecise and conflicting objectives for government agencies greatly diminish such agencies' accountability to the government, and the general public, for their actions.

* Making price stability, rather than some other objective, the core focus of monetary policy fully accords with the weight of both expert and official international thinking on such issues.

* The sections in the Bill covering the role of the Reserve Bank in relation to the exchange rate weaken the Bill in the above respects. It is recommended that the Bill be amended so as to increase the Bank's accountability for the effect on monetary policy outcomes of any Bank transactions in foreign exchange and the government's accountability, under section 11, for the implications for inflation of any exchange rate instructions it gives to the Bank.

* It is recommended that the Select Committee also study carefully the possible costs and benefits of the proposed mechanisms for prudential regulation; the issue of ensuring that the Bank is placed under the direction of a high calibre board; and the accountability of the Bank and the government for the non-monetary policy functions set out in the Bill.

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1. Introduction

1.1 This submission is made on behalf of the New Zealand Business Roundtable, an organisation of chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies which reflect overall New Zealand interests. A list of the current membership is included in an annex to this submission.

1.2 The Reserve Bank Bill, ("the Bill"), proposes significant changes in the relationship between the Reserve Bank of New Zealand ("the Bank") and the government. According to the Bill's explanatory notes, the Bank's "primary function will be to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices."

1.3 Some critics of the Bill have interpreted it as an attempt to limit the constitutional power of the government to determine monetary policy objectives. The thrust of this submission is that, to the contrary, the Bill represents a major step towards ensuring that the government, alone, has responsibility for determining *economic objectives* for monetary policy and that the Bank is held much more accountable than in the past for achieving monetary policy *targets or outcomes* which are consistent with those objectives.

1.4 While, as argued below, section 8 of the Bill quite properly establishes price stability as the standard objective for monetary policy, it very clearly provides explicit mechanisms in section 11 by which the Bank is required to achieve monetary policy outcomes which are consistent with whatever economic objectives the government may specify through the Governor-General by Order-in-Council. The Bank's subservience to such policy directives is put beyond doubt in section 11.

1.5 Furthermore the Bank is held accountable, to a remarkable degree, for its performance in setting monetary policy targets that are in accord with such directives and achieving them. Under section 14 it must *publicly* report on its performance every six months and it has a board, dominated by non-executive directors appointed by the Minister of Finance, which is required, under section 51, to keep the Reserve Bank Governor's performance in this and other respects under constant review and to advise the Minister of Finance, in writing, of inadequacies in the Governor's performance The board may recommend the Governor's dismissal on such grounds. The Bill explicitly specifies, in section 47, that the Governor may be removed, by the Governor-General, on the recommendation of the Minister of Finance, for an inadequate performance in these and other respects.

1.6 The following sections of this submission elaborate on these points. Section 2 discusses the principles inherent in the price stability objective. Section 3 discusses the practicability of such an objective in the face of continually changing relative prices in a dynamic world environment. Section 4 considers mechanisms and the costs

of attempting to achieve a realistic price stability objective. Section 5 highlights some ways of minimising the costs of disinflation. Finally, section 6 raises some questions concerning aspects of the Bill which lie outside the issues discussed in the previous sections.

2. Why Price Stability is a Desirable Objective

2.1 New Zealand's low growth/high inflation track record in recent decades relative to other OECD countries is common knowledge. Inflation weakens the efficiency of the resource allocation mechanisms of a market economy. It undermines the price system by aggravating uncertainty about the degree to which price movements for individual commodities represent relative or general price movements, and by raising the costs of long-term contracts which require prices to be determined in advance of particular transactions. Periodic bouts of inflation and action to unwind them impose greater volatility on some classes of business (e.g. exporting, property) than others, making investment in them more risky. Furthermore, as discussed below, inflation undermines the efficiency of the income tax system since no one has been able to find a satisfactory way of indexing the tax system for inflation.

2.2 Apart from these efficiency costs, inflation is typically also associated with socially-divisive wealth transfers. While the government is usually a major beneficiary of inflation, the so-called inflation tax has an erratic incidence which does not meet the standard criteria of equity or economic efficiency. For example, it can transfer wealth from savers (at fixed rates of interest) to borrowers and it can interact with the tax system to favour some economic activities (e.g. those in which income largely accrues as capital gains) over other economic activities.

2.3 Because of the practical problems involved in valuing unrealised assets for tax purposes, and in choosing an appropriate price index for indexing tax rates, it is not possible to adjust the tax system so as to remove the distorting effects of inflation on economic activity. *More importantly, the distortions introduced to the economy by the interaction between inflation and the tax system tend to be greater the higher the rate of inflation.* For example, the higher the rate of inflation the greater the degree to which historical depreciation for tax purposes will understate economic depreciation, the greater the degree to which changes in the value of inventories understate the economic cost of sales and the greater the degree to which interest income will represent capital repayment rather than economic income. The latter interaction will tend to force interest rates to rise by more than the rise in inflation - in other words, the interaction between the personal tax system and interest rates will tend to magnify the effects of inflation on interest rates.

2.4 New Zealand's inflation experience during the last twenty years is entirely consistent with the general characteristics noted in sections 2.1 to 2.3. Inflation has undermined wage and price stability by entrenching the concept of a costly annual "wage round" in which wages are expected to be substantially increased regardless of productivity growth. The difficulty of taxing inflation-augmented capital gains from some activities (such as farming), combined with the practical difficulties in determining economic rates of depreciation for the associated expenditures, has led to tax-driven expenditures and increases in asset prices. Major wealth transfers from investors in low interest (e.g. 3 percent per annum) savings accounts to borrowers and to the government have occurred. Retirement income savings have been eroded. Politically, the fact of high inflation was used to justify the comprehensive 1982-84 wage and price freeze. Regular devaluations of the New Zealand dollar were needed to maintain a measure of international competitiveness. Through these

mechanisms economic performance was impaired and income was redistributed in capricious and unfair ways.

2.5 **Such considerations invite the conclusion that price stability, that is a zero rate of inflation, is a desirable public policy goal** provided that the costs of achieving, and maintaining, such an objective do not exceed the benefits. Although very few governments in the OECD area have announced inflation goals, the desirability of a goal of zero inflation is understood to have gained considerable support in OECD country discussions. Arguments for settling for inflation rates in the 0-2 percent range could include recognition of the possibility that price indexes do not adequately measure the benefits from product-quality improvements, and so may overstate price inflation, and that a small amount of inflation could facilitate desirable relative price adjustments if some prices and wages can only be reduced absolutely with difficulty. Neither argument is particularly compelling - history reveals long periods of non-inflationary growth in many countries.

2.6 This leads to the question of the transitional costs associated with eliminating entrenched inflation expectations. As Canada, the United Kingdom, the United States and now New Zealand have found in the 1980s, the *costs of disinflation* can be high in terms of unemployment and economic activity. (During their disinflation in the early 1980s, quarterly real GDP fell for six quarters in Canada, seven quarters in the United States and nine quarters in the United Kingdom.) These costs appear to arise because inflation expectations readily become entrenched so that employers and employees in their price and wage setting behaviour, and investors in bonds, act on the basis that the government is not serious when it announces, after a prolonged period of inflation, that "this time" it is serious about reducing inflation. The consequence is often a period of high real interest rates (on an after-the-event basis), high unemployment, a high rate of business failures, marked political tensions and potential economic policy instability. The factors causing such outcomes are discussed further in section 5.

2.7 In conclusion, the arguments in this section show that inflationary policies typically cause a significant wealth transfer to the present from the future in two ways – they impose on the future the ongoing economic and social costs of persistent inflation as well as the costs associated with the need, at some stage in the future, to reduce the inflation rate. Proponents of inflationary policies generally understate the degree to which their proposals are inflationary and therefore seldom even acknowledge the latter cost.

3. How Stable Should the Price Level Be?

3.1 In evaluating the Bill it is important to distinguish between objectives which lie outside the Bank's control and targets which lie within the Bank's control. What the Bill does require the Bank to do is to pursue monetary policy *targets* which have been agreed to in advance with the Minister of Finance. These targets can readily accommodate the existence of powerful forces on the price level which are outside the Bank's immediate control and which prevent the attainment of the price stability *objective* in any one year. The Bill does not require the Bank to achieve objectives which are outside its control.

3.2 It is important to note that avoiding the serious costs of inflation discussed in section 2 does not require the Bank to achieve a zero rate of inflation year in and year out. Indeed, such an outcome is probably unattainable given the disturbances which can occur, for example from changes in indirect tax rates and in the world prices of major

commodities. What the goal of price stability would require is an acceptance that in some years price indexes would rise slightly and in some years they would fall.

3.3 The essential point is that the costs of inflation will be largely avoided if the degree of year-to-year general price level volatility is sufficiently small and trendless to generate a reasonably high level of confidence amongst decision makers that there will be no trend movement in the price level over the duration of their contractual arrangements. In such an economy, interest rates would incorporate no expectation of a rising trend in prices. One test of this level of confidence, therefore, will be the level and structure of interest rates.

3.4 New Zealanders have lived with relatively high rates of inflation (from an international and from an historical perspective) for so long now that we might have become vulnerable to claims from the proponents of inflationary policies that low or zero rates of inflation either are unattainable or, if attainable, are inimical to a healthy economy. For example, a zero rate of inflation implies that if some prices are rising other prices must be falling and many economists have become accustomed to thinking that prices are insufficiently flexible downwards to avoid major economic dislocation in the event of a drop in asset and/or commodity prices.

3.5 However, history proves otherwise. Mild deflation, not inflation was the order of the day in the United Kingdom and in New Zealand in the *50-year* period from 1860[1] - a period of remarkable economic progress for both countries - and the consumer price index in New Zealand in 1939 (after the deflation associated with the Great Depression) was no higher than in 1926[2]. Perhaps even more graphically, the same two sources indicate that interest rates on New Zealand public borrowings of 3-6% were common in the last half of the last century and that the average interest rate on new mortgages varied in the 3.85% to 6.47% range from 1920 to 1967. The days of 3% Post Office savings accounts may seem a quaint aberration to many of us now – but it is the last 20 years which is the aberration from this larger historical perspective.

3.6 Other arguments for inflationary policies based on the belief that low rates of inflation depress economic growth because they require permanently tight monetary policies and/or high rates of unemployment and/or high real exchange rates are also unsound, both in theory and in practice. Low inflation does not imply low growth, at least beyond any disinflationary period. To the contrary, high and variable rates of inflation weaken the growth potential of the economy through their adverse effects on resource allocation and on political and economic stability. Maintaining any given rate of inflation does not require as tight a monetary policy as one required to reduce a given rate of inflation. Historical experience demonstrates that New Zealand has achieved low inflation, high growth and low unemployment in the past and it is not hard to find other examples of low inflation, high growth, low unemployment countries such as Japan and Switzerland.

3.7 There seems to be no convincing reason why New Zealand should adopt a defeatist attitude towards inflation – particularly when it is so close to achieving the goal of price stability.

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1 See the graph by Jas McIlraith published between pages 182 and 183 in *An Economic History of New Zealand to 1939*, M. F. Lloyd Pritchard, Collins, 1970.

2 *New Zealand Official Yearbook*, 1970, page 702.

4. Achieving Price Stability

4.1 Robert Clower, Professor of Economics at UCLA and then president of the prestigious American Economics Association, wrote in 1984[3] as follows:

> "What about inflation? There can be no doubt that this has been the single most important source of economic inefficiency in Pacific Basin countries in the last two decades. Neither can there be any doubt that the problem of inflation is a consequence of ill-advised government policy rather than the working of natural economic forces. So the solution to the problem lies not in any restructuring of the economy but rather in the design of measures that will effectively restrain government from playing an active role in the determination of the general level of prices."
>
> "It is now generally acknowledged (though by no means universally - the economics profession will always have its lunatic fringe) that the only way to avoid sustained increases in the general price level is to avoid any but moderate and predictable increases in the monetary base."

4.2 The consensus in the economics profession is, therefore, that monetary policy is an essential instrument in the fight against inflation. Abstracting from technical complexities, the essential injunction to policy makers is : "Don't print money". The question which next arises is whether or not there should be other objectives for monetary policy.

4.3 In the same article (pages 3-5), Professor Clower was strongly critical of the Reserve Bank of New Zealand Act of 1964 for setting objectives for monetary policy which were so diffuse as to make them virtually meaningless, with the result that the true objectives of monetary policy from one day to the next could not be ascertained from the Act. In considering a better Act, Clower wrote that:

> "The importance of credibility and predictability in monetary policy can hardly be overemphasised. Though the Government must, of course, be able collectively to alter direction when conditions demand (e.g. in time of war or other national emergency), the normal procedure should be to assign meaningful policy objectives to the Reserve Bank and leave it to responsible Reserve Bank officials to carry them out."

4.4 In considering what these objectives should be, Clower made the obvious point that saddling the Bank with trying to achieve objectives, such as economic growth or full employment, which are related "only loosely or in unknown ways to instruments over which they have direct control" will cause its actions to "necessarily be confused, contradictory and subject to constant change". He endorsed the goals proposed for the Bank by the Treasury in its 1984 briefing paper *Economic Management* namely, price stability, efficient financial intermediation and the integrity of the financial system.

4.5 From this perspective, Part II, sections 8 and 11 of the Bill and Part V (concerned with prudential supervision of the payments system) are entirely in line with Clower's recommendations in that they focus the Bank precisely on price stability, efficiency and the integrity of the financial system while making provision, in

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3 "Financial Reform in New Zealand: A New Beginning?", a paper presented at the Pacific Basin Financial Reform Conference, Federal Reserve Bank of San Francisco, December 2-5 1984, page 13.

section 11, for other factors to predominate in exceptional circumstances (see 4.3 above).

4.6 While, as argued, the Bill does not remove monetary policy from political control, it introduces a lot more transparency into the political mechanism for directing the Bank to adopt inflationary objectives and it increases the accountability of the Bank for setting (intermediate) policy targets which are consistent with the politically-determined objective. To make the Bank more independent it would be necessary to constrain the ability of a government to use section 11 to override section 8 in the Bill.

4.7 Lawrence Summers of Harvard University is amongst those who argue that countries whose banks are highly independent of other government policy makers control inflation most effectively. The following table was presented to support his case[4]. (The scale runs from 0, totally beholden to politicians, to 4. Where the central bank is strong, citizens expect less inflation.)

Country	Degree of Central Bank Independence	Average Inflation Rate (1973-88)
Italy	1/2	16.1%
Spain	1	15.2%
New Zealand	1	12.7%
Britain	2	12.3%
Australia	1	10.5%
France	2	10.2%
Sweden	2	9.8%
Denmark	2	9.1%
Norway	2	8.8%
Canada	2	8.1%
United States	3	7.2%
Belgium	2	6.8%
Netherlands	2	5.8%
Japan	3	5.0%
West Germany	4	4.1%
Switzerland	4	4.0%

4.8 It might be noted that the record of the more successful central banks may not be due as much to their independence as to their explicit or implicit mandate to pursue a low inflation objective. As with the policy framework adopted by the government for state-owned commercial enterprises, the central issue would appear to be the establishment of a well-defined objective and means of holding the board and management responsible for its achievement.

4 Fortune, June 19 1989, page 89.

5 Mechanisms for Reducing the Cost of Achieving and Maintaining Price Stability

5.1 By reducing uncertainty and a range of economic distortions, the pursuit of stable financial policies by the government is of major benefit to business and the community in general. The advantages of greater stability in domestic costs and prices justify the efforts needed to break entrenched inflationary expectations. As indicated in section 2.4, the costs of disinflation are associated with insufficient credibility concerning the government's determination to adhere to its announced disinflationary policy intentions. The costs of disinflation can be reduced if devices can be found for enhancing the government's credibility in this respect. (Conversely, once a government has obtained a high level of credibility for resisting inflation, it will find it needs to devote fewer resources to defending its actions because decision makers will be less inclined to regard fluctuations in the money supply and/or the fiscal deficit or surplus as the harbinger of a return to inflationary policies.)

5.2 Governments have many devices for enhancing the credibility of their policy positions. Constitutional checks and balances, entrenched sections in Acts, the quality of political appointments to key positions, the independence and clarity of the incentives accorded to key institutions, the transparency and openness of key policy processes and the overall coherence of public policies will all enhance the credibility of a disinflation programme.

5.3 In the monetary policy context, the credibility of a disinflationary policy will be enhanced by policies to reduce the growth in government expenditure which generally drives a fiscal deficit and/or public debt problem. Large fiscal deficits, for example, typically lead to rapid increases in the proportion of tax revenues going to meet interest payments. Investors will observe this and are likely to start to factor into bond yields the possibility that the government will be tempted to resort to inflationary finance to avoid further increasing interest costs[5]. Similarly, a build-up in unemployment can also lead to fears of policy reversal, particularly if the government is registering both concern about the unemployment problem and a reluctance to tackle the sources of labour market rigidities directly.

5.4 On this analysis, the Bill goes a long way towards helping a government achieve credibility for its anti-inflationary objectives. **Preserving the prime focus on the price stability objective in section 8 of the Bill is clearly of major importance in reducing investor uncertainty about the true focus of the Bank's monetary policy activities.** In turn a commitment to this objective would increase the incentives facing the government to maintain fiscal discipline and to ensure other policies are compatible with the monetary stance.

5.5 The Bill is very timely in the light of the discussion in this section about policy credibility. The disinflationary process is now well-advanced but is currently facing a testing time with some renewed inflation risks and considerable political uncertainties which may be undermining the credibility of the disinflationary policy. On the other hand much hard-won progress has been made in demonstrating that New Zealand does not have to live with double-digit inflation. It seems reasonable to believe that it would be less costly to take measures now to increase

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5 Ewen McCann, University of Canterbury, surveys this literature in "US Theories of Monetary and Fiscal Policy", a paper prepared for the Fulbright seminars on "The Influence of American Economics on New Zealand Thinking and Policy", 15 September 1988.

the credibility of the 0-2 percent inflation target so that the job can be finished rather than to allow the attitude to develop that inflation cannot be reduced further. No greater difficulties for the conduct of monetary policy are posed by the objective of holding prices more or less stable than by holding some positive rate of inflation (say the present rate of 4 percent) roughly constant. Arguably the former task is easier since any other inflation goal is arbitrary and harder to defend.

6 Other Aspects of the Bill

A *The Exchange Rate Provisions*

6.1 There appears to be a potentially serious inconsistency between the foreign exchange part of the Bill, particularly sections 16 and 17, and the scheme adopted in section 11 for over-riding the price stability objective of section 8. The issue centres on the need to recognise explicitly the implications for the price stability objective of Bank transactions in foreign exchange and any exchange rate instructions given by the government.

6.2 In respect of government actions (actions by the Reserve Bank are dealt with below), a consistent approach would appear to require that any directions under sections 16 or 17 which could be in conflict with the price stability objective should be activated only through an explicit, section 11-type mechanism. The reason for such a requirement is that it is, in practice, not possible for action to be taken to influence the exchange rate without altering the monetary base. Reserve Bank transactions in foreign exchange through the banking system therefore typically affect monetary policy. Nothing is more likely to subvert the price stability objective than an instruction to the Bank to pursue an exchange rate objective. As a fundamental rule, monetary policy must either be devoted to achieving a particular domestic inflation target, while the exchange rate is left to find its own level, or it must be directed at achieving a particular exchange rate outcome – leaving the domestic inflation rate to move to a level consistent with that target. For example, a decision to peg the value of the New Zealand dollar to a trade-weighted basket requires monetary policy to be devoted to achieving the same trend rate of inflation as the trade-weighted average inflation rates of our trading partners.

6.3 The philosophy driving the Bill surely requires that any instruction from the Minister of Finance with exchange rate implications should be explicitly recognised as a departure from the provisions of section 8. It is submitted that the powers established under sections 16 and 17 should be subject to a transparent section 11-type mechanism, with a similar sunset provision to section 11 (2) and a similar review of policy targets to that prescribed in section 11 (5) (b) so that the risks of policy inconsistency are minimised.

B *Foreign Exchange Dealing by the Reserve Bank*

6.4 Section 15 permits the Bank to deal in foreign exchange on such terms and conditions as it sees fit. No indication is given as to why the Bank is allowed such discretion or how it is to be held accountable for the use of this discretion. While the bank should be able to conduct transactions in foreign exchange which are not motivated by a desire to influence the exchange rate, central banks around the world have shown a predilection for gambling, and sometimes losing, large amounts of taxpayers' money

in the pursuit of some exchange rate objective. While such activities are typically defended on the basis that financial markets do not always price foreign exchange efficiently (e.g. in terms of fundamental values), in reality central banks are unlikely to have any comparative advantage in gauging future movements in global commodity prices and in productivity growth in the local traded goods sector, both key determinants of relative currency values.

6.5 Such internationally highly-regarded academics as Martin Feldstein and Rudiger Dornbusch have considered the desirability of having central banks attempt to pursue exchange rate targets and have raised serious questions about the value of such activities. Central bank actions to reduce the nominal exchange rate and so transfer wealth from the non-traded goods sector to the traded goods sector are unlikely to be effective if the fundamental (real) factors affecting the relative price of traded and non-traded goods are unaffected. For example, if the government is determined to expand its claims on resources for public sector activities such as health or housing, then central bank action to depreciate the nominal exchange rate to try to protect the position of internationally-competing industries is unlikely to thwart the government. Similarly, if waterfront unions have the ability to use monopoly power to appropriate a certain portion of farm incomes, then a drop in the exchange rate will simply result in higher wage demands from those workers.

6.6 The following conclusion from a recent article by Martin Feldstein[6] summarises his viewpoint:

> "Better domestic economic policies in the fifteen years since the collapse of the Bretton Woods system would have prevented the extreme fluctuations of the dollar's exchange value during those years. The pursuit of good policies here [i.e. in the United States] and abroad in the future should reduce the likelihood of such substantial exchange rate swings in the years ahead. But elevating exchange rate stability to a separate goal of economic policy would have serious adverse consequences. Trying to achieve that goal would mean diverting monetary and fiscal policies from their proper roles and thereby risking excessive inflation and unemployment and inadequate capital formation. And succeeding in the effort to achieve dollar stability would mean harmful distortions in the balance of trade and in the international flow of capital."

6.7 In practice, central bank transactions in foreign exchange which are driven by the desire to inhibit a market-driven exchange rate movement can have adverse effects. Such actions obscure exchange market trends, lead to a lot of speculation about what the central bank will do next and can readily destabilise both the foreign exchange market (e.g. in New Zealand in June-July 1984) and other markets (for example, central bank intervention to prevent the US dollar from falling is suspected by some informed observers as having contributed to the October 1987 crash in share prices in the United States).

6.8 It is recommended that the Committee modify the Bill in respect of section 15 so as to provide that the Reserve Bank shall not deal in foreign exchange with a view to influencing the value of the New Zealand dollar unless explicitly instructed to do so by the government in terms of a revised section 11. This would amount to a reaffirmation of existing official policy which essentially envisages such dealing only in the event of "disorderly" market conditions.

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6 "The Case Against Trying to Stabilise the Dollar", *American Economic Review Papers and Proceedings*, December 28-30 1988, pp 36-40.

C *Lender of Last Resort and Prudential Surveillance*

6.9 The Bill gives the Bank extensive powers to demand information from registered banks and to protect the integrity of the payments system. The case for a lender of last resort function in times of extreme liquidity stress and for the use of reserve powers in the event of a generalised threat to the financial system is accepted. (This does not imply a role of protecting particular institutions.) However, the level of accountability for the use of these powers seems low and the costs they impose on the banks is potentially high. It is recommended that the Select Committee study the costs and benefits of these sections of the Bill closely.

6.10 At present the government is reviewing the policy framework for the supervision of New Zealand securities markets. Because of the inter-relationships of debt and equity markets, and inadequacies in the performance of securities market authorities in the supervisory function (both in New Zealand and abroad), consideration should be given to linking this function with the central bank prudential role, as in the United Kingdom.

D *Composition of the Reserve Bank Board*

6.11 We believe that it is essential that appointees to the Reserve Bank board be high calibre people who have a sophisticated understanding of capital markets (and so are less prone to gamble taxpayers' money in betting against market trends) and a keen appreciation of the costs of inflation, the dangers of imprudent lending behaviour, and the need for consistency and credibility in the execution of monetary policy. A difficulty in obtaining directors with the necessary expertise is created by the Securities Amendment Act 1988. The extraordinary reach of its provisions on inside information may severely constrain the scope for suitable appointments of New Zealand residents to be made. It is recommended that the Select Committee study this issue and the wider question of ways of ensuring that the Bank's management is supervised by a well-qualified board.

E *Improving the Reserve Bank's Accountability*

6.12 The Act confers many regulatory and monopoly powers on the Bank and permits it to provide banking and other services which could be provided by private sector organisations (e.g. the banking requirements of the public account and the management of the government's overseas reserves). The approach taken in the current Bill to these issues must be seen as subject to ongoing investigation and revision.

6.13 A general concern with the Bill is the rather low level of accountability both for ministerial instructions to the Bank and for the Bank itself in respect of many functions accorded to it. The accountability of ministers could be enhanced by a requirement that the Bank's board be obliged to publish an assessment, endorsed by a referee with an international reputation in the cost benefit analysis of regulatory issues, of which groups stand to gain and which to lose from any government directions, and the magnitudes of the relative gains and losses. The accountability of the Bank might also be improved by requiring it to publish cost/benefit assessments of a similar standard in respect of other activities with which is it specifically charged. Similarly the Bill is largely silent on the question of financial objectives for the Bank or equivalent disciplines for ensuring operating efficiency and the provision of services at least cost. The open-ended nature of the financial arrangements for non-monetary policy functions is an area where there

appears to be a lesser degree of accountability to Parliament than is required for other public sector agencies under the new financial management procedures. These would also be appropriate issues for further investigation.

MEMBERSHIP OF THE NEW ZEALAND BUSINESS ROUNDTABLE

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30 June 1989