

Third Submission

By

**THE
NEW ZEALAND
INITIATIVE**

to Treasury and the Reserve Bank of New Zealand

on

**The third consultation round of Phase 2 of the Reserve
Bank Act Review**

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Introduction and summary

- 1.1 This submission in response to the third round of consultation on Phase 2 of the review (the review) of the Reserve Bank of New Zealand Act (the Act) is made by The New Zealand Initiative (the Initiative), a Wellington-based think tank supported primarily by chief executives of major New Zealand businesses. In combination, our members provide employment to more than 150,000 people.
- 1.2 The Initiative undertakes research that contributes to the development of sound public policies which help create a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society.
- 1.3 The Initiative's second submission of 16 August, 2019 on the second round of consultation focused on four issues raised in consultation documents 2A and 2B: 1) the Reserve Bank of New Zealand's (RBNZ) high-level financial objective; 2) its governance; 3) prudential regulation tools and powers and 4) enforcement.
- 1.4 That submission strongly opposed dropping the objective of achieving an efficient financial system. Contrary to our submission, the material released for the third round of public consultation indicates that Cabinet has provisionally determined the RBNZ's high-level objective will be "financial stability."
- 1.5 The Initiative considers this decision to be a major error. Without a high level efficiency requirement, an utterly moribund, entirely government-owned financial system would arguably best meet a "financial stability" objective. An utterly moribund, desultory, high cost private sector hog-tied by regulatory red-tape might achieve financial stability. Efficiency is fundamental and must be reinstated in the RBNZ's primary objective.

Reasons for making efficiency the over-riding objective

- 1.6 The prime objective for financial policy should be to ensure New Zealanders have the benefits of an efficient financial system. The reasons were set out in the Initiative's August 2019 submission:
 - Efficiency is a wellbeing objective. Financial stability only contributes to wellbeing to the extent that it enhances efficiency;
 - The Government's "Wellbeing Budget 2019" put wellbeing at the centre of what it intends to achieve. But to downgrade efficiency is to downgrade wellbeing;
 - This will also downgrade both Treasury's Living Standards Framework and its Social Cost-Benefit Primer. In each case the focus is on assessing benefits to those affected relative to costs – i.e. wellbeing;
 - An efficient financial system processes transactions quickly and at least cost. Competitive dynamic innovation will expand the range of products, reduce unit costs and increase risk management options. A moribund "stability over all" system will not;
 - An efficient system would let non-competitive institutions fail, but not at the expense of systemic instability. A "financial stability" objective could easily put too much weight on protecting inefficient individual institutions.

Recommendation

- 1.7 Officials should invite the incoming Government to reconsider this in principle decision.