Submission to the review of the Reserve Bank of Australia

Senator Nick McKim, Economic Justice and Treasury spokesperson

Submitted on behalf of the Australian Greens

Introduction

Australia and the world are facing two enormous crises: growing economic inequality and the breakdown of the planet's climate and ecological systems. The response to these crises must be bold. We need to jettison the economic policies that have created these crises and adopt a transformational approach that gives everyone the opportunity of a good life on an inhabitable planet.

Against this backdrop, this review of the RBA is timely. During the neoliberal era, and while current monetary policy arrangements have been in place, monetary policy has become disconnected from democratic processes. This has been achieved by framing monetary policy as a predominantly technocratic pursuit that should be above the messy business of politics.

But monetary policy is not and never has been a neutral mathematical exercise. Current monetary policy arrangements are steeped in the dominant neoliberal ideology that was advanced and implemented in order to serve specific interests above the public good.

What ultimately matters for the RBA is the fulfilment of its statutory duties. During the period that current monetary policy arrangements have been in place—arrangements consistent with neoliberal ideology—the RBA has consistently underperformed when measured against these duties.

- The currency has not always been stable: For example, in the seven years prior to the GFC, inflation was stable and the average comfortably within the target range, yet the exchange rate nearly doubled as the resources sector boomed.
- Full employment has not been maintained: Twice in fifty years there has merely been the "opportunity to achieve and sustain full employment".[1] The first opportunity was quashed by the GFC. The second opportunity is being quashed right now.

[1] Dr Steven Kennedy PSM, Secretary to the Australian Treasury, Opening statement to the Economics Legislation Committee, 16 February 2022

- Economic prosperity and welfare has not been assured: Wages share of national income is at a record low while corporate profits are at record highs. Wealth inequality has grown, as has income inequality after taking into account housing costs.[2]

This illustrates that measuring the RBA's performance only against the "clearly identifiable performance benchmark"[3] that is the inflation target is not adequate and, more importantly, that prioritising inflation targeting above all else has not resulted in the RBA fulfilling its duties.

And while the Issues Paper rightly states "there are limits to what monetary policy can achieve",[4] the idealisation of independent central banking has meant that public debate about monetary policy is constrained and self-censoring, and there is rarely any holistic consideration of how monetary policy and other economic policies are being coordinated in order to achieve the RBA's duties.

This review of the RBA must be prepared to confront the limitations of independent central banking as currently perceived. Independence must not equal freedom from accountability. The aim of this review should be to establish a framework that ensures monetary policy is conducted in accord with other economic policy and in a way that is accountable to our democratic institutions. This will best ensure that "the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia".

Housing costs through the roof

The greatest cost-of-living crisis in Australia is the housing crisis. Australian house prices are some of the highest in the world. House prices have grown twice as fast as wages this century. Whether renting or paying off a mortgage, Australians are spending too much money keeping a roof over their heads. This is assisting the economic prosperity and welfare of *some* of the people of Australia. But it is not assisting the economic prosperity and welfare of *all* of the people of Australia, and it is one of the primary drivers of inequality.

House prices have gotten so out of control as a result of: tax policies biased to landowners, most notably tax concessions that give property investors a public subsidy to outbid would-be homeowners; and the retreat of governments of all stripes and at all levels as a provider of housing.

But house prices also have gotten out of control as a result of the structural decline in interest rates and a monetary policy regime that is agnostic about the flow of credit. The financialisation of housing is one of the defining features of the period that current monetary policy arrangements have been in place. Banks went all-in on increasingly speculative property lending after monetary and prudential regulation was loosened or removed. Thirty years ago, Australian banks lent twice as much to business as they did for housing. Now they lend twice as much for housing as they do for businesses.[5]

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[2] Brendan Coates, The Great Australian Nightmare, 14 September 2022
[3] Review of the Reserve Bank of Australia: Issues Paper, 15 September 2022
[4] ibid
[5] Productivity Commission, Competition in the Australian Financial System: Final Report, 3 August 2018

This should be prominent in the RBA's assessment of house prices, yet in September this year, Governor Lowe stated:

> …the fact that Australians have to pay higher prices for housing isn't anything to do with the Reserve Bank over the long period of time. It's the choices that we've made as a society that have given us high housing prices.
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> …
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> The choices we've made about taxation; the choices we've made about zoning and urban design; the fact that most of us have chosen to live in fantastic cities on the coast; the fact that, when we choose to live in these fantastic cities on the coast, we want a block of land, we don't want to live in high density; and we've chosen, as a society, to underinvest in transport.[6]

The denial of the role of credit in this analysis is astonishing.[7] The exclusion of banking from an analysis of structural land price inflation is consistent with neoliberal theory that conceals the role that credit creation has in shaping our economy and society, and that sees private banks purely as intermediaries. In turn, this theory supports the idea that central banks need not concern themselves with where private banks are directing credit, even if it results in counter productive social effects such as excessive housing costs.

Land price inflation, facilitated by monetary and prudential policy, is fuelling inequality, with landowners being enriched at a faster rate than non-home owners, to the point where people are earning more from land price inflation than are from working.[8] This is inconsistent with the bank's primary duty "to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia."[9]

Moreover, the RBA now considers landowner's ability to access home equity as a supplement to wages in supporting aggregate demand[10], creating a further bias in favour of landowners. This was on display during the RBA's economic response to the pandemic as it sought to increase the 'wealth effect'. Through interest rate policy and its forward guidance, the RBA deliberately encouraged people to borrow record amounts of money and push house prices to new record highs. Famously, Governor Lowe said:

> The Board is committed to maintaining highly supportive monetary conditions to support a return to full employment in Australia and inflation consistent with the target. It will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. For this to occur, the labour market will need to be tight enough to generate wages growth that is materially higher than it is currently. This is unlikely to be until 2024 at the earliest.[11]

Although partially caveated, as all central banks statements are, the message was clear: go and borrow lots of money to buy a house.

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[6] Philip Lowe, House of Representatives Standing Committee on Economics, Review of the Reserve Bank of Australia Annual Report, 16 September 2022

[7] It is also worth noting that land price inflation immediately prior to recent increases in interest rates—which was the strongest rate of land price inflation in living memory—was actually strongest in regional areas.

[8] Josh Ryan-Collins & Cameron Murray, When homes earn more than jobs: the rentierization of the Australian housing market, 29 July 2020

[9] The Reserve Bank Act 1959, Section 10(2)

[10] For example: Philip Lowe, AFR Business Summit: The Recovery, Investment and Monetary Policy, 10 March 2021

[11] Statement by Philip Lowe, Governor: Monetary Policy Decision, 4 May 2021

Finally, the RBA's blind spot on the relationship between monetary policy and the cost of housing was also demonstrated when Governor Lowe, in response being asked what the impact of recent interest rates increase was on renters, and again in September this year, stated:

> It is not particularly large. There will be some flow-through to some renters because some landlords will put their rents up because of higher interest rates but it is not a first-order effect.[12]

In the period corresponding to the current run of consecutive interest rate increases, rents have grown at the highest rate on record.[13] Such indifference to people's lived experience of being a tenant and the cost of housing can not be simply attributed to any one individual—although the individual is of concern—but to a structural bias that permeates the RBA and that must be addressed by this review.

Profits up and wages down

Another of the defining features of the period that current monetary policy arrangements have been in place has been a shift in the distribution of the national income between profits and wages. The most recent national accounts show that, as a share of total factor income, profits are now at the highest point on record and wages are the lowest point on record.[14]

Again, this enrichment of the owners of capital and reduction in distribution to workers, assists the economic prosperity and welfare of some, but not all, and fuels inequality. And, again, monetary policy is not entirely to blame, but neither is it entirely innocent.

Neoliberal policies that have empowered corporations and disempowered workers to push down wages are fundamental to this trend. Fallacies about individual autonomy have been used to justify restrictions on workers' ability to act collectively when negotiating wages and conditions, and to justify the proliferation of casual and other forms of insecure work.

The RBA appears not to have grasped the impact of these policies. From 2012 to 2017, a period in which nominal wages growth declined, the RBA consistently overestimated future wages. From 2014 to 2021, the RBA also consistently undershot its target inflation rate.

Whatever figure the RBA told themselves the NAIRU was, the nation was clearly not in a state of full employment during this period. Hundreds of thousands of people were unnecessarily unemployed during this time through a combination of inadequate fiscal and monetary policy.[15]

More recently, in response to rising inflation, the RBA has adopted a clear and deliberate strategy to suppress wages consistent with neoliberal ideology, taking a 1970s lens to a 2020s problem. This is despite promising in May 2021 that interest rates wouldn't increase until wages growth was "materially higher than it is currently".[16] Such wage growth did not occur, yet the RBA has increased interest rates for six consecutive months.

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[12] Philip Lowe, House of Representatives Standing Committee on Economics, Review of the Reserve Bank of Australia Annual Report, 16 September 2022
[13] Domain, September 2022 Rental Report
[14] ABS, Australian National Accounts: National Income, Expenditure and Product, Reference period: June 2022
[15] Ross Garnaut, Reset: Restoring Australia after the Pandemic Recession, 2021
[16] Statement by Philip Lowe, Governor: Monetary Policy Decision, 4 May 2021

Supply-side shocks have driven recent high inflation, with pandemic and war having global impacts, and climate change having both global and domestic impacts. Corporate profiteering has also been a global and domestic driver as companies with market power have used the cover of supply shocks to increase margins. What has clearly not been a driver of inflation is wages, evidenced by the fact that real wages have fallen back to where they were a decade ago.

Yet the RBA has consistently jawboned down wages. It has justified this approach with 'evidence' of wage pressure from its methodologically dubious business liaison program, as though businesses complaining of wage pressures constitutes impartial evidence. Meanwhile, the RBA has only once warned corporations against price gouging, while never actually addressing the question of what impact market power over suppliers, workers, and customers is having on inflation.

The reality is, monetary policy alone is not suited to the job at hand. Cost-push inflation calls for a different policy response to demand-pull inflation, including taxation and regulation. Yet the RBA has taken an unsophisticated approach. Governor Lowe has said "high inflation is a scourge."[17] Well, so is losing your job, especially in the middle of a cost-of-living crisis.

The RBA should have been upfront about the limits of monetary policy in tackling this current bout of high inflation. That it hasn't been, and that it has embraced monetary austerity as a legitimate response, again indicates a structural bias consistent with neoliberal ideology. Price stability is valued above all else, the effect of which is that full employment is not achieved, wages are suppressed, and the owners of capital get even further ahead.

The breakdown of the planet's climate and ecology

The breakdown of the planet's climate and ecological systems threatens Australia's economy and society, and the world's economy and society. We face ecological and civilisational collapse unless we keep global warming below 1.5 degrees. Australia has an international, economic and ecological imperative to recognise the climate emergency and to act.

The RBA is to be commended for their advocacy for better incorporation of climate risk into economic policy. In particular, during the reign of the Morrison Government, the RBA consistently took a position outside the comfort zone of the executive. This demonstrates that the RBA can speak about economic policy beyond monetary policy, for social good, and in advance of government policy when it is willing to.

However, the breakdown of the climate will also require changes to monetary policy that collides with neoliberal ideology. As noted in the Issues Paper, climate change will continue to cause supply-side shocks. The RBA cannot respond to such shocks with the monetarist playbook. The RBA needs to be able to identify the episodic inflation impact of climate change related disruptions to supply, and explain why trying to squash such inflation with interest rates alone is not the best policy response.

The breakdown of the climate will also require that money be directed to fund the transition to a low emission economy. Left to its own devices, the market is unlikely to do this at the speed

[17] Philip Lowe, Inflation and the Monetary Policy Framework, 8 September 2022

required. The RBA must be willing to break with the orthodoxy that discourages central banks from directing the flow of credit.

Conclusion

Class has been redefined in Australia. For most of the post-World War II era, if you worked hard, studied hard, and spent your money wisely, you could set yourself up for a good life. But this guarantee no longer exists. The egalitarian social contract upon which we once prided ourselves has been torn up.

We have gone from being a nation of the fair go, to being one where financial success is most likely to be determined by the extent to which you or your family own land.

Wages and incomes are not keeping up with the cost of living. Yet workers are being told they will need to cop further cuts to real wages, or even lose their job, in order to quash inflation that they did not cause. Meanwhile, profits are at record highs.

On top of this, the breakdown of the Earth's climate and ecology requires unprecedented global efforts to sustain life as we know it on this planet.

The response to the inequality crisis and the climate crisis must include a significant change in the conduct of monetary policy. The Greens propose the following changes to best ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia.

The existing three objectives must be retained, and a fourth added regarding "the maintenance of a stable ecology and climate".

The existing objectives, as well as the primary duty in Section 10, have provided sufficient guidance for the RBA to ensure monetary policy gives everyone the opportunity of a good life. The inequality crisis is evidence of a failure of economic policy, including current monetary policy, to achieve these objectives. It is not evidence of the inadequacies of these objectives.

However, a new objective that addresses climate and ecosystem breakdown is needed. As stated by the Bank of International Settlements, climate change poses an "unprecedented challenge to the governance of global socioeconomic and financial systems."[18] The all encompassing nature of its impact requires it be explicitly considered at the apex of economic policy making, including monetary policy. That it is a global problem in no way makes it less relevant to the RBA operations in the same way that the global impacts on the stability of the currency do not lessen the relevance of this objective.

The composition of the board must be relevant to the achievement of the RBA's objectives, and should include representation from trade unions, and limit representation from business.

The RBA is far more likely to meet its objectives if the members of the board reflect a diversity of interests and expertise. The current board is tilted towards the priorities of business, but has no

[18] Bank of International Settlements, The green swan: Central banking and financial stability in the age of climate change, 20 January 2020

one representing workers. The Act must be amended to require, along with the current appoint of the Governor, Deputy Governor and Treasury Secretary:

- One member appointed by trade unions.
- Five independent members, appointed by the Treasurer, and who together provide a diversity of expertise relevant to achievement of the RBA's objectives. These five members must include no more than one person who is an executive or on the board of a large Australian company.
- The appointment of no fewer than four women in total to the Board.

The minutes of meetings must also record the votes of board members, and must allow for board members to publish additional or dissenting comments.

The Treasurer must provide written instructions to the Treasury Secretary prior to each meeting of the board, and these instructions and the reasoning that sits behind them must be made public.

The instructions must set out the positions that the Treasury Secretary is to take on decisions of board with the aim of better integrating fiscal and monetary policy. The board must also respond to the positions of the Treasury Secretary in the minutes of its meetings.

Despite the prevailing orthodoxy, the independence of the RBA is not unambiguous. The bank has statutory authority to set monetary policy. But "subject to the observance of certain procedures" the government has always had "an ultimate power to determine the policy of the bank".[19]

In reality, the RBA's independence is a matter of practice as much as anything. This extends to the government not usually commenting in detail on monetary policy, and the RBA not usually commenting in detail on fiscal policy. While this creates the appearance of harmonious economic policy, it obfuscates attempts to critique economic policy in a holistic fashion and in the pursuit of the RBA's objectives.

There is no reason that the government should not express its opinion on monetary policy, particularly given that the Treasury Secretary is on the board. This extends to acknowledging and being willing to use the existing powers to overrule the RBA in the event that an agreement about monetary policy cannot be reached.

Requiring the government to take a public position on monetary policy, having that case put to the board, and then having the board respond would put in place a transparent mechanism that makes clear where and how any difference of opinion exists, and where and how monetary policy and other economic policy might not be being coordinated.

The entire board and the Treasurer must appear together before a public hearing of a parliamentary committee at least twice a year.

Requiring the board of the RBA and the Treasurer to be in the one place, at the one time, and on a regular basis would allow for fundamental questions regarding economic policy to be asked without there being any evasion on the grounds of 'that's not our responsibility'. It would afford the

[19] Hansard, House of Representatives, Reserve Bank Bill 1959, Second Reading, Mr Harold Holt, Treasurer, Thursday, 26 February 1959

parliament the opportunity to scrutinise both the operation and interaction of monetary policy and fiscal policy in pursuit of the RBA's objectives; and would increase accountability on both the RBA and the executive.

Prudential regulation must be shifted from APRA to the RBA.

APRA's remaining consumer and market regulation functions should be merged into ASIC and the ACCC.

Australia is relatively unusual in not having prudential regulation as a function of the central bank. This separation of monetary policy from prudential policy is yet another way in which any holistic examination of economic policy is obscured, and one that has made accountability for housing affordability particularly elusive.

For example, in March 2021, as house prices began to rise rapidly, both the RBA and APRA wiped their hands of responsibility. Governor Lowe stated that the "RBA does not target housing prices, nor would it make sense to do so."[20] APRA Chair, Wayne Byres, said "It's not our job to solve house prices; it's not our job to solve affordability."[21] Having the nation's two macroeconomic banking regulators play pass-the-buck while the biggest asset class is inflating at the fastest rate on record gets us no closer to ensuring the economic prosperity and welfare of the population.

The RBA and the government must be jointly responsible for inflation policy.

Monetary policy is a blunt instrument and, as has demonstrated recently, one that is particularly ill-suited to tackling supply-side inflation. The RBA cannot and should not take sole responsibility for price stability, and neither should it pursue price stability at the expense of fulfilling its legislated duties. The RBA and the government should jointly deploy economic policy tailored to respond to specific inflationary pressures depending on their nature. This should include, but not be limited to, tax policy, financial regulation, price regulation and supply chain support. For example, given the role of corporate profits and market power in driving the current bout of inflation, strengthening competition laws and a tax on corporate super profits should be introduced to stop price gouging and to fund cost-of-living relief.

The RBA and the government must develop a credit policy.

This policy should: encourage the flow of credit to productive ends, particularly the transition to a low emission economy; and discourage the flow of credit to speculative ends, particularly highly leveraged property investment. This policy would be given effect through prudential regulation and the RBA's use of its own balance sheet.

Who controls the volume and direction of credit has always been a fundamental economic policy question, although it has largely been absent from public debate in recent decades. The inequality crisis and the climate emergency calls for the RBA and the government to play a more active role in directing the flow of credit.

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[20] Philip Lowe, AFR Business Summit: The Recovery, Investment and Monetary Policy, 10 March 2021
[21] House of Representatives Economics Committee, Australian Prudential Regulation Authority Annual Report 2019, 29 March 2021

It is worth noting that the RBA already has the power to direct the flow of privately issued credit. The advance powers under Section 36 of the Banking Act 1959 give the RBA the capacity to instruct banks to follow policy regarding the loans they make. That senior RBA officials were unaware of these powers when questioned at Senate estimates,[22] and that the Issues Paper has stated “monetary policy makers have no way of adjusting how their policy changes impact individual households and businesses”, is another demonstration of how complete the neoliberal indoctrination has been.

[22] Senate Economics Legislation Committee, Treasury Portfolio: Reserve Bank of Australia, 16 February 2022