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31 October 2022

RBA Review submission – Australian Citizens Party

RBA Review c/o The Treasury

Langton Crescent
PARKES ACT 2600
AUSTRALIA

Dear panel,

Please accept this submission to your inquiry, regarding:

- Monetary policy frameworks
- Interaction of monetary, fiscal and macroprudential policy

Yours sincerely,

Elisa Barwick	Robert Barwick	Craig Isherwood
Executive Member	Research Director	National Secretary

A bank for the nation

1. Introduction

The Australian Citizens Party is an independent political party which for over 30 years has campaigned for a national bank, modelled on the pre-1959 Commonwealth Bank of Australia. We have prepared draft legislation for various aspects of our recommendations noted below.

Restore a national bank

The privatisation of the Commonwealth Bank in 1996 removed Australia's final remaining public bank from the financial landscape, leaving private banks without a public competitor. Given the degeneration of the banking sector, confirmed by the shocking revelations in the 2017-19 Financial Services Royal Commission, the Australian Citizens Party recommends the return of public banking in Australia. This could be achieved by expanding the role of the Reserve Bank to restore the former Commonwealth Bank's public investment and central banking functions, or by the creation of a new national bank. When the Commonwealth Bank operated as a public bank—which was not driven by the motive of private shareholder profit—it provided competitive pressure that compelled the private banks to offer services beneficial to the public. Quite apart from the regulatory role the Bank played, this competition function itself provided a regulatory influence.

The critical functions to be restored by a national bank include, but are not limited to:

- Creation of national credit for infrastructure and other critical government services, providing long-term investment outside of the budget;
- To act as a driver of development and employment, rather than responding to market or monetary concerns;
- Provide a regulatory role to keep private banks in line;
- Develop a broader toolkit to tackle inflation and ensure financial stability, with measures such as credit regulation, as deployed in the past;
- Protection of diverse payments systems, including access to cash;
- Restore financial sovereignty to Australia, following the direction of the elected government rather than pressure from the International Monetary Fund and Bank for International Settlements.

The fork in the road: Denationalising the Commonwealth Bank

In 1959, in what may be seen as a turning point leading to the demise of the government-owned and -run Commonwealth Bank, in its crucial function as a national bank, the Menzies government split off the Reserve Bank of Australia from the Commonwealth Bank, establishing the RBA as the central bank.

The Commonwealth Bank's powers to administer monetary and banking policy, in addition to administering exchange controls, had only been formalised in 1945 under the *Commonwealth Bank Act* and the *Banking Act*. Its central banking activities had evolved gradually, "in response to the pressures of the Depression in the early 1930s and later by formal, albeit temporary, expansion of its powers under wartime regulations. These included exchange control and a wide range of controls over the banking system (including authority to determine advance policy and interest rates, and to require private banks to lodge funds with it in special accounts)."[1]

[1] "A brief history", www.rba.gov.au/about-rba/history

In an effort to halt this evolutionary progression that was increasing the authority of a government agency over monetary policy, the governing *Commonwealth Bank Act 1945* was superseded by the *Reserve Bank Act 1959* which hived off the Commonwealth Bank's central banking function and left the "Commonwealth Banking Corporation" with the institution's commercial banking activity. This laid the foundation for 1) a "neoliberal" approach to independent central banking, removed from the control of elected politicians, leading to a lack of appropriate banking regulation; and 2) the privatisation of the newly commercial Commonwealth Bank (1991-1996), thereby removing the critical utility of public banking from the financial sector. As private banks close their branches and shutter ATMs in the regions and the cities alike, the consequences of this decision are being felt across the nation.

2. Ideology shifts priorities

The RBA's mandate

Despite revisions to the Act, the *Reserve Bank Act 1959* still puts the bank at the service of the Australian people by mandating that it protect the nation's economic prosperity:

"It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank … are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:

"a. the stability of the currency of Australia;

"b. the maintenance of full employment in Australia; and

"c. the economic prosperity and welfare of the people of Australia."

But since that Act became law the imposition of neoliberal policies, sweeping the globe, gradually eroded this policy mandate.

For instance, the 1959 mandate did not specify inflation as a target, *per se*. Yet today, inflation is arguably the top, some may say singular, priority of the RBA's monetary policy. It is accorded great importance as a "policy regime" in and of itself.[2]

This also occurred by evolution. In April 1999, then-Assistant Governor of the RBA Glenn Stevens (later Governor in 2006-16) documented the early stages of the new regime in an address to the Economic Society of Australia in Sydney.[3]

Signs of a shift to using inflation as a primary marker for central bank intervention in Australia began appearing in 1989. In March 1993, RBA Governor Bernie Fraser (in office 1989-96) discussed holding inflation within an "average" range of 2-3 per cent, in a speech to a group of Sydney economists. Thereafter this "implicit" objective "was progressively made more explicit", said Stevens.

The regime was never formalised and the "*Reserve Bank Act* was not rewritten", Stevens stated. "There was no formal agreement by which the Government instructed the Bank … and little formal review process. In

[2] "Six Years of Inflation Targeting", published May 1999, Reserve Bank of Australia Bulletin.

[3] *Ibid.*

fact, there was no involvement of, or endorsement by, the Government of the day until much later." Whereas other countries which preceded Australia in this direction articulated the policy explicitly.[4]

Stevens said the new regime brought credibility to Australia, by which he meant that we obtained credibility with international financial markets as a stable destination for investment. This was restated by then-RBA Deputy Governor Guy Debelle in a speech at a 12 April 2018 RBA conference in Sydney, in a review of "Twenty-five years of Inflation Targeting in Australia". He affirmed there was "greater confidence" from financial markets, instilled by the new regime, as well as from the public and policymakers.[5]

But in the process of prioritising inflation, the RBA has not lived up to its explicit mandate to ensure the "maintenance of full employment" and "economic prosperity and welfare of the people".

The Campbell Inquiry

The blueprint for a complete overhaul of the RBA monetary policy framework came in September 1981 with release of the Campbell Committee Financial System Inquiry's final report. The Campbell Report targeted for destruction every financial regulation that served to direct investment into long-term productive processes; eliminated any government control over bank lending; opened the floodgates on privatisation, including the sell-off of the Commonwealth Bank; removed government control of capital flows, interest rates and the currency; and admitted foreign banks into Australia.

Some of these mechanisms targeted by Campbell, as mentioned, had been ushered in during the war, and the Chifley Labor government had tried to make them permanent. As we will see, there had been also a big reaction to the continuation of large wartime deficits, which had to be reined in.

In a submission to a 2011 inquiry on banking competition, political economist Dr Evan Jones wrote: "The Campbell report bequeathed us abolition of specialist (including government-owned) institutions, market-based banking regulation (generally confined to hands-off prudential regulation), and market-based monetary policy (generally confined to manipulation of the cash rate). The abolition of specialist institutions has been a significant mistake … The over-dependence on prudential regulation has produced failings—lack of control over credit excesses (indeed contributing to it by the discounting of capital requirements on residential mortgage lending); lack of control over bank tendencies to illiquidity; lack of control over off-balance sheet manoeuvrings—but the attraction to the system (not least because of Basel-based global legitimation) remains undiminished. The ludicrous overdependence on the single short-term cash rate instrument has produced manifest failings—a fundamental enhancing of boom and bust…."[6]

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[4] New Zealand led the world in this approach, said Stevens: "New Zealand had pioneered the inflation-targeting regime from early 1990, as part of a fundamental change to their whole approach to economic management". Canada followed, then came the United Kingdom, Sweden and Finland. The *Reserve Bank of New Zealand Act 1989* went so far as to state a singular mandate for the RBNZ: "The primary function of the Bank is to formulate and implement monetary policy directed to the economic objective of *achieving and maintaining stability in the general level of prices*." (Emphasis added.)

[5] "Twenty-five years of Inflation Targeting in Australia", Guy Debelle, RBA Conference 2018, Sydney, 12 April 2018.

[6] "Competition within the Australian banking sector", Senate Economics References Committee, Final Report, 6 May 2011, Chapter 3, Past reviews and calls for a new review.

The chief architect of the Campbell Committee was John Hewson, economic adviser to Treasurer John Howard, and a devotee of Prof. Milton Friedman of the University of Chicago. Friedman was a co-founder, with Austrian School economist Friedrich von Hayek, of the international neoliberal think tank called the Mont Pelerin Society (MPS). In his book *The End of Certainty*, political commentator Paul Kelly described Hewson and Howard as "radical liberals" who held up Hayek and Friedman as "the high priests of their doctrine".

Freidman first came to Australia in 1975 at the invitation of Maurice Newman, who would later become chair of Australian MPS think tank the Centre for Independent Studies (CIS) and chair of the Australian Stock Exchange. The Bretton Woods financial order had been dismantled after the US dollar was floated in 1971, and finance was rapidly decoupled from the real economy, with speculation taking on a life of its own. Prime Minister Gough Whitlam was still in office, but the political climate was rapidly changing around him. Friedman pushed for an independent central bank that would target inflation as its primary objective, with decreasing regard for maintaining low unemployment or fostering economic growth. Treasury and the RBA were increasingly recruited to Friedman's free market and monetarist beliefs. In a tribute to Friedman after his death on 16 November 2006, Newman revealed that Friedman "became the rallying point for free thinkers all over Australia".[7]

Friedman visited Australia again in 1981, when the CIS organised a sell-out public forum. He was recruited by Hewson as an "outside adviser" to the Campbell Committee, along with several foreign banks. Friedman had an audience with Prime Minister Malcolm Fraser but was given the cold shoulder. Hope would soon emerge however, reported Newman, "through the Hawke Government and a supportive John Howard-led opposition".[8] This was the beginning of the "bipartisan economic consensus" whereby both major parties accepted neoliberal doctrine regarding the primacy of markets in the economy as incontrovertible. Fraser had binned most of the Campbell recommendations, but PM Bob Hawke and his Treasurer Paul Keating implemented the lot, rebadged under the Martin Inquiry's review of Campbell's Report. The Campbell Committee reforms, along with the abandonment of deficit budgets typified by Whitlam's Treasurer Jim Cairns, were hailed as a "triumph" of Friedman's policies.

Professor Peter Swan of the University of NSW School of Banking and Finance, in a 2007 tribute to Friedman following his death the previous November, documented the gradual shift following the Campbell Inquiry from "targeting both full employment and inflation with the one instrument of monetary policy", with very little emphasis on inflation, to "*only concentrat[ing] on inflation* while downplaying the requirement to maintain full employment". (Emphasis added.) This concurs with the assessment of Stevens and Debelle, cited above.

One of the targets of the so-called inflation concern was large government deficits. This is also recounted by Swan, with the example of the Whitlam government's 1974-75 budget, in which government expenditure was raised by 33 per cent. The "Cairns Budget", brought down by Treasurer Jim Cairns, amounted to "irresponsible" behaviour, said Swan, and "was blamed for inflation that appeared out of control". [9]

Cairns declared: "The deficit was aimed directly at the economy to increase production, to get the economy going and to employ resources wherever there are resources available for employment."

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[7] "Milton Friedman: A Tribute", 12 March 2007, Centre for Independent Studies.

[8] *Ibid.*

[9] The fear regarding government deficits is not inflation, nor the debt incurred, but the resulting economic strength and resurgence of national sovereignty. See, for instance, "History shows future generations don't need to suffer from government debt", by Warwick Smith, 17 April 2020, michaelwest.com.au

The sacking of Cairns (over a political scandal) saw the budget reined in drastically. The first budget of new Treasurer Bill Hayden was "one of the most responsible budgets" (1975-76) and inflation began to decrease, said Swan. This was achieved, at least in part, due to the "climate of opinion in favour of 'fighting inflation first' brought about by Friedman's visit".

The Martin Inquiry

The job started by the Campbell Inquiry continued through subsequent reviews.

The Australian Financial System Review Group (1983-84) was commissioned by the new government of Bob Hawke. It was a brief review of the Campbell Committee's recommendations, led by MLC insurance group chairman Vic Martin, which did not seek submissions or hold hearings. It merely rubber-stamped the stalled Campbell reforms, concluding that "Market-oriented policy … is seen as having considerable advantages for monetary policy purposes…. [T]he Group does not consider controls over bank interest rates as appropriate for either monetary policy or prudential purposes."[10] It did, however, advocate for an increase of competition in the banking sector.

The Wallis Inquiry

The Wallis Inquiry (1996-97), launched by John Howard shortly after he took office and headed by former AMP Chair Stan Wallis, propelled the market approach further. Its philosophical underpinning was the now-discredited "efficient markets theory", an ideological premise that the market would solve all ills. The Inquiry recommended regulatory intervention be kept to a minimum, with a preference for the industry to self-regulate through voluntary codes of conduct. This will be discussed further below.

Statements on the Conduct of Monetary Policy

At issue with the newly evolving inflation targeting regime, said Debelle in his 2018 speech, was in fact "the operational interpretation of the goals of monetary policy set out in the Reserve Bank of Australia's founding legislation in 1959" (cited above). Since exchange rates were fixed at the time this law was written, the reference to "stability of the currency … interpreted as preserving the purchasing power of the currency", he continued, should today be interpreted as applying to "maintenance of low and stable inflation".

The RBA argues that low inflation and financial stability is essential to maintain full employment; but given that this priority mandate *is not enshrined in law*, it must be reviewed by elected chambers of government and gauged against actual economic performance. This must include the state of the "real" (materially productive) economy and of small business, which are impacted by lack of access to bank finance; and accurate measures of the cost of living, including affordability of housing. One such impact is seen with today's rising mortgage interest rates.

In a paper prepared for a Bank of England conference in 1995,[11] Stevens and Debelle noted that already in the past couple of years the unofficial 2-3 per cent inflation target "had an increasingly central role in the Reserve Bank's policy statements and other public utterances". Indeed, that BoE conference was convened on the "nascent area of inflation targeting", and Debelle noted (2018) that Australia nearly wasn't invited because

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[10] "Competition within the Australian banking sector", Footnote 6.

[11] "Monetary Policy Goals for Inflation in Australia", Glenn Stevens and Guy Debelle, presented at Bank of England conference, 1995.

"there were doubts about whether we even really had an inflation-targeting framework", in comparison to the stricter New Zealand and Canadian models. At that time, he added, financial markets still exhibited a "lack of faith in the new framework" in Australia.

In 1996 came the first formal endorsement of the inflation target, though still not in legislated form. The first Statement on the Conduct of Monetary Policy was issued jointly by the new Howard government and the new RBA Governor, Ian Macfarlane. The Conduct of Monetary Policy Statement is renewed at the start of each term of an RBA governor and endorsed by each new government.

These joint statements from the government and Reserve Bank[12] have declared that "these objectives allow the board to focus on price (currency) stability" while merely "taking account" of employment and economic activity. "Both the Bank and the Government agree", say the statements, "on the importance of low inflation and low inflation expectations" as underpinning the other policy goals such as employment.

As Debelle made patently clear (2018), "Today, inflation targeting is now the default framework for monetary policy." The extent to which any other considerations come into the RBA's vision is clearly very limited. Debelle's only concession is that "The dual mandate [i.e. the inclusion of full employment"] is embodied in the *flexible expression* of the [inflation] target." (Emphasis added.)[13]

One of the concerns of the Australian Citizens Party is that the RBA Review may finally deliver the legislative mandate for a singular focus on inflation.

3. Who has control—governments or the Bank?

Senators press the paradox

While the RBA has created money in various forms, including via quantitative easing (QE) programs, to support the economy during times of crisis, due to bank lending practices most of this has been injected directly into the housing bubble, making it impossible for many Australians to own their own home. A number of Senators pressed the RBA at Senate Estimates hearings in 2021-22 as to why it, in conjunction with the government, could not instead inject funds into the real economy.

In March 2021 Senators Gerard Rennick (LNP) and Nick McKim (Greens) quizzed RBA Deputy Governor Debelle on this subject. When asked if the RBA could use credit guidance to steer allocation of central bank money as in the post-war era, Debelle said he was "not sure". Just over a month later, at the 6 May Shann Memorial Lecture, Debelle had a clear response, however, insisting on the "strong separation between monetary and fiscal policy" which ensures the RBA does not "directly finance governments".[14] Before the Commonwealth Bank was emasculated and turned into a central bank, *that was its primary job*—acting in concert with government to create credit for nation-building. The broader question raised by the Senators is

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[12] Statement on the Conduct of Monetary Policy, rba.gov.au

[13] This is despite the example of New Zealand, which as noted led the way to a sole mandate. The RBNZ mandate in the *Reserve Bank of New Zealand Act 1989* stated: "The primary function of the Bank is to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices." The outcome of the recent RNBZ review, resulting in the *RBNZ Act 2021,* linked the RBNZ mandate to two economic objectives—price stability and supporting maximum sustainable employment, in addition to financial stability and central bank objectives.

[14] "Monetary Policy During COVID", Guy Debelle, 6 May 2021.

whether the government should be in control of monetary policy. This was summarily dismissed by Debelle, in favour of central bank independence.[15]

Rennick and McKim were joined by One Nation Senator Malcolm Roberts for a subsequent dialogue with Debelle in June 2021. Raising the RBA mandate to protect "the economic prosperity and welfare of the Australian people", Rennick insisted that by lowering interest rates and fuelling the housing bubble the RBA is clearly hurting Australians, because when "house prices go up, people have to borrow more money to actually pay for the house".

Rennick asked if governments should have control over monetary policy. Debelle admitted there is an advantage to a "coordinated approach to policy" but insisted central banks require independence, with one reason being that elected governments often show an unwillingness to raise rates, especially at election time.

Senator Roberts pursued the QE question, noting that the RBA balance sheet more than doubled from March 2020 to May 2021—from $180 billion to $450 billion. He asked Debelle if all that money just facilitates "yet more overheating of the home loan market". Debelle dodged again with the deflection, "We don't direct where it goes". Roberts followed up, referring to the ability to earmark funding banks must dedicate to small business lending, for instance: "Surely a composition of the economic activity goes to the security and resilience of the economy. Can you direct it?" Debelle reiterated that the RBA cannot direct the credit, while insisting it does incentivise lending to business. (Combined with prudential regulations that encourage mortgage lending and unprecedented government incentives for homebuyers, it is woefully inadequate.)

Senator McKim raised the exacerbation of wealth inequality admitted by Debelle in his Shann lecture. Referring back to the RBA charter, McKim cornered Debelle on the impact of ultra-easy monetary policy on "the economic prosperity and welfare of the people of Australia". "Yes, lower interest rates do lead to higher house prices. That is true", answered Debelle, but repeated again that "Higher interest rates lead to higher unemployment. That has a first-order impact on inequality as well. That's the balancing act…."[16]

In Senate Estimates on 16 February 2022, Senator McKim drew attention to existing RBA powers to "direct the class of loans that banks can make", contained in the *Banking Act 1959*. Answering the question on notice, the RBA admitted it does indeed have this power—a remnant of the old Commonwealth Bank.

McKim asked Dr Debelle whether the RBA has considered using the powers granted it by Section 36 of the *Banking Act 1959*, which states that:

(1) Where the Reserve Bank is satisfied that it is necessary or expedient to do so in the public interest, the Reserve Bank may determine the policy in relation to advances [loans] to be followed by ADIs; and,

(2) Without limiting the generality of subsection (1), the Reserve Bank may give directions as to the classes of purposes for which advances may or may not be made by ADIs.[17]

McKim suggested the power would "allow the RBA to direct a bank to limit the number of housing loans it makes with any particular basket of money that it might get, for example from the RBA's money printing". McKim also asked whether it might, to the same end, be used to "establish a different cash rate for lending for housing, as opposed to lending for business".

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[15] Senate Estimates, Economics Legislation Committee, 24 March 2021

[16] Senate Estimates, Economics Legislation Committee, 2 June 2021

[17] *Banking Act 1959* – Section 36, Advance policy.

Answering on notice, the RBA bluntly responded: “This power dates from the era prior to the deregulation of the financial system in the early 1980s, when there were wide-ranging controls on the financial system.” Government guidance of bank lending ended in June 1982 and “monetary policy now operates by influencing interest rates”, the RBA said.

Evidently lacking an internal understanding of clause 36, the RBA went searching for explanatory memoranda that might provide a clue. In the absence of any guidance on “the scope of, or intended use of, the RBA's powers under section 36”, the RBA cited a revealing section of the explanatory memorandum for the equivalent clause in the predecessor of the 1959 Act, the *Banking Act 1945*. That explanatory memorandum reads:

‘Regulation 7 of the National Security (War-time Banking Control) Regulations *provides that “in making advances a trading bank shall comply with the policy laid down by the Commonwealth Bank from time to time.” This power has proved helpful under war-time conditions, and will be useful as a continuing power to ensure that at all times the credit resources of the nation are put to the best use, and that the making of advances by banks* ***does not lead to an unbalanced expansion of credit in any particular field****. This clause will enable the Commonwealth Bank to determine the policy in relation to advances which is to be followed by all banks, without giving it control over individual advances.’* (Emphasis added.)

Whilst this memorandum indeed referred to the war-time era, prior to deregulation, nonetheless *the powers remains in effect* in section 36 of the current *Banking Act 1959*, allowing the RBA to determine bank policy in relation to advances. The *Banking Act 1959* has not—*yet*—been sufficiently rewritten to entirely reflect the neoliberal phase-change ushered in starting with the Campbell Inquiry.

On the possibility of adopting targeted interest rates for different economic sectors, the RBA stated that it “cannot set a different cash rate for housing and other purposes”. It is also clear from the RBA's responses to McKim's questions that it was by mutual agreement that the government and RBA settled on the current policy to ditch interest rate controls and sideline the power to provide guidance on bank loans. The removal of controls “was a joint decision of the RBA and the government”, responded the RBA. “This decision was supported by the Campbell Committee, which also recommended that the power to impose direct interest controls should be removed from section 50 of the *Banking Act 1959*.”[18]

However, as with the previous power, this one also remains in the current *Banking Act*. It seems Australia has had an approach of doing things by convention, rather than engraining changes in law, as we have seen was the case with giving priority to inflation over employment in the RBA’s objectives. This was insignificant while the neoliberal economic consensus was strong, but that consensus is now weakening. It is critical such powers are not neutered by the outcome of the current RBA review; instead they should be revived to allow the government to direct an economic recovery.

Again, in April 2022, the government’s scope to direct policy was raised, this time with new RBA Deputy Governor Michele Bullock. Senator Rennick asked what the RBA would do “if the government directed [it] to create money through a quantitative easing program to build infrastructure such as dams, power stations and roads”? After a lengthy back and forth, Ms Bullock stated that building infrastructure is “a matter for the government”.

Rennick stated: “We're not disputing whether or not we should build infrastructure. It's how it gets funded. If we borrow $1 billion offshore to build a dam, the first billion dollars we create in wealth goes back offshore. If

[18] *Banking Act 1959* - Section 50, Control of interest rates

we fund it here, domestically, the first billion dollars we create we keep here. We shouldn't be paying other countries billions of dollars a year to use their printing press when we've got our own here. That's my point."

Significantly, Ms Bullock's ultimate answer was: "If the government directed us to do that, that is a conversation that would have to be had."[19]

Parliament responsible for monetary policy

In his first estimates interrogatory with Debelle on 24 March 2021, McKim had foreshadowed the intention of this power: "In the post-war era, central banks were much more prescriptive about where any newly created money was directed. In particular, they used credit guidance to steer central bank money to productive purposes. Is there any impediment to the RBA doing that?" Over one year later, we finally arrived at the answer. If the political and ideological blockages are cleared, legally there is no impediment.

Extending as it does from the *Banking Act 1945*, the power contained in the *Banking Act 1959* is the legacy of Labor Treasurer and Prime Minister Ben Chifley. Chifley served on the Royal Commission into Monetary and Banking Systems which commenced in 1935 under the Joe Lyons government. The inquiry had resulted from contentious debates about who had the ultimate authority in the financial system—the elected government, or the central bank? This came to a head in 1930 during the Great Depression when Treasurer Ted Theodore instructed the Commonwealth Bank to issue £18 million for public works to deal with the crisis, but the central bank's chair Sir Robert Gibson refused, declaring, "I bloody well won't."

The final report of the Royal Commission, released in 1937, confirmed that the elected government is the ultimate authority in the financial system. "The Federal Parliament is ultimately responsible for monetary policy, and the Government of the day is the executive of the Parliament." In a dispute between the government and the Commonwealth Bank board, the government's view must prevail, it confirmed. These findings established the principle of democratic control over the banking system, at odds with the neoliberal tenets of financial deregulation that have taken control since the 1980s.

Regarding control over bank lending, the final report stated that "In order to promote a wise distribution of credit, the Commonwealth Bank … can advise trading banks as to the directions in which it is desirable in the national interest that advances should be made."

As treasurer in the Curtin government (1941-45), Chifley ensured that the Royal Commission's best recommendations were adopted. Not only did the Curtin-Chifley government effectively use the Commonwealth Bank to fund the war mobilisation, it also legislated to make permanent its wartime controls over finance and the economy. This is reflected in the language of the *Banking Acts 1945* and *1959* and the explanatory memo regarding advances cited by the RBA in response to McKim's questioning.

A number of amendments made over the course of the late 1940s and 1950s did not touch this advances power. In part this may have been due to the far greater preoccupation of the banks and politicians in fighting Labor's 1947 bank nationalisation law and their effort to split off the central bank from the Commonwealth Trading Bank.

Whitlam government wanted to control banking

Even in the late 1970s these powers were still entertained by government. Recounting the Whitlam government's effort to borrow money to "buy back the farm" which resulted in the Khemlani loans scandal,

[19] Senate Estimates, Economics Legislation Committee, 6 April 2022

Treasurer Jim Cairns said he knew government had the option to borrow from the RBA in the same way the Curtin-Chifley government had borrowed from the Commonwealth Bank during WWII. In his 1976 book, *Oil In Troubled Waters*, Cairns stated: "The Australian government in 1974 and 1975 could have used Treasury Bills to borrow from the Reserve Bank … and this, as far as possible, I was determined to bring about. … I had hoped to extend considerably the government's ability to attract public financial support both in the establishment of the National Investment Fund and in the use of the central bank—the people's bank—to finance great national projects." Cairns expressed his regret that "the necessary political climate of support did not eventuate nor were we able to create it. … Nothing Rex Connor or I tried to do or say seemed to persuade anyone."

Dispute resolution

The split between government and monetary policy has created an artificial divide which prevents efficient deployment of the tools available to direct the nation. This must be resolved by bringing the RBA back under government control; in other words, by restoring its function as a national bank that acts on behalf of the people.

The Statements on Conduct of Monetary Policy stress the independence of the RBA, but there is also reference to the procedure provided for by the Act in the case of a disagreement between the RBA and the government. Section 11 of the *Reserve Bank Act 1959* "allow[s] the Government to determine policy in the event of a material difference", state the monetary policy conduct statements from 1996 to 2010 (the language disappears thereafter). However, "the procedures are politically demanding and their nature reinforces the Bank's independence in the conduct of monetary policy", they conclude. While that may be true in practice, those demanding procedures are not set in stone, and the pathway for governments to take charge is there for the taking.

4. The RBA 'tool box'

More than interest rates

As we have seen, monetary policy has devolved into a one-stringed bow. A number of questions are raised, among them:

First, concern for inflation does not extend to the housing market or other inflationary asset bubbles, therefore it may be presumed that the greater objective of the independent RBA is to facilitate the profits of the banks at the expense of national economic development. Consideration must also be given to how inflation is calculated, such as what is included in the "basket" which determines the Consumer Price Index.[20]

Secondly, if we are to accept that inflation is the number one target of central bank policy, another question follows. Targeting inflation is one thing, but how it is done is quite another. There are more tools available

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[20] In a 15 March 2019 *Sydney Morning Herald* opinion column, entitled "We're at a global debt precipice and our central banks are failing us", former Liberal Party leader John Hewson said he was "disturbed" that the RBA excluded asset prices (mainly real estate) from its working definition of inflation, which determines where it should set interest rates. Because the inflation measure never included the skyrocketing house prices of the past two decades, it officially stayed low, and the RBA could cut rates and keep them at record lows. "Imagine how it may have responded differently, indeed should have responded differently, with the explosion of house prices, and household debt in recent years", he said.

than just interest rates and adjuncts of interest rate policy such as asset purchases, yield curve control or forward guidance.

Professor of Finance at the University of Melbourne, Kevin Davis, reminded readers of the *Australian Financial Review* on 11 September that the RBA's single "blunt weapon", interest rates, was not always the only tool in the box with which to achieve its monetary policy goals.

Davis's article, "'Bad old days' of credit regulation might be better than rate rises", documents how the monetary policy of decades past worked by primarily targeting "real investment in plant and equipment (rather than household consumption) by changing asset values", causing new investment to be "scaled back or deferred".

"It was not the usual case to expect a major channel of monetary policy to be conducted through the reduction in free cash flows and spending ability of households with outstanding mortgages", he wrote. But today it seems to be accepted that choking economic growth "by crunching the budgets of households with mortgages" is the only way to crush inflation.

Alternative options, says Davis, include taking actions to reduce bank lending, "thus focusing more directly on investment type expenditures financed in this way". This could be done by using "direct controls on the quantity of bank lending, although many would see this as a return to the 'bad old days'. … Another option would be to use changes in bank capital requirements, either by changing risk weights or required capital ratios, to inhibit new lending." This is a practice used in China to good effect **(Appendix 1, "What's in China's monetary tool kit?")**.

Sydney Morning Herald Economics Editor Ross Gittins in a 19 September article, "Reserve Bank of Australia's rate hikes raise risk of recession", observed that the current wave of inflation has "revealed the limitations and crudity of the main instrument we've used to manage the macro economy for the past 40 years: monetary policy—the manipulation of interest rates by the central bank.

"We've been reminded that monetary policy can't fix problems on the supply (production) side of the economy. Nor can it fix problems arising from the underlying structure of how the economy works."

Even on the demand side, he said, it is ineffective, having little impact on government spending or business investment. "Its control over interest rates gives it direct influence only on the spending of households. And, for the most part, that means spending that has to be done on borrowed money: buying a home."

Dr Evan Jones documents the economic and monetary controls deployed after World War II, administered by the Commonwealth Bank, from advances to industry policy, regulatory measures to constrain banking and controls over capital issues. Full employment was accepted as critical to rebuild the economy, even at the expense of some inflation.[21]

Tools ineffective against inflation

In recent months it has become evident that manipulation of interest rates is not effective against inflation. Speaking in front of the British Treasury Select Committee on 16 May 2022, Bank of England Governor Andrew Bailey admitted that 80 per cent of inflation was caused by external forces, i.e. from outside of the

[21] "Macroeconomic And Structural Policies: Economic Policy In Post-World War II Australia", Dr Evan Jones, *Journal of Australian Political Economy*, 2021.

British economy, and therefore rate rises would not be effective, adding that he felt "helpless" to act against the crisis.[22]

Nonetheless the IMF is pressing nations not to flinch in pursuit of their mandates. According to a report in the *Australian Financial Review* on 12 October, the IMF representative for Australia and New Zealand, Harald Finger, said it was "not the right time" to debate changing targets and that central banks must "stay the course".[23]

Furthermore, as we have recently witnessed with collapsing bond markets in the United Kingdom, it is becoming a challenge to fight inflation when central banks resort to new quantitative easing measures or bond purchase programs to rescue collapsing pension funds, for instance. Central bank tool kits need to be revised.

Another case in point is the RBA's COVID-19 Bond Purchase Program (2020-22), which, while touted as a success, contributed to real inflation by funnelling money into banks which put the majority of their lending into the housing bubble. Bonds were purchased by the RBA in the secondary market at very low rates and therefore a high purchase value. At the end of the program they were sold at high rates and low resale value, incurring losses for the RBA (and pushing its balance sheet into negative equity) but resulting in a tidy profit for the banks, which could go on to channel more finance into housing.[24]

Likewise the banks achieved heightened profits from the RBA's Term Funding Facility. Reported *Crikey* in August 2021: "The RBA's commitment to both financial stability and easy credit drew, initially, first home buyers, and then investors, into the housing market, sparking a surge in the residential mortgage lending market that is lower-risk and easy returns for banks."[25]

Bank Competition

As we have seen above, the Martin inquiry did, at least, stress the benefits of increased competition in the banking sector. This has not been successful due to the deregulated model adopted. The Productivity Commission's 29 June 2018 report on competition in Australia's financial system observed that, "Australia's banking sector is an established oligopoly … The four major banks as a group hold substantial market power … This is substantially supported by regulatory settings, which contribute to the major banks' structural advantages."[26]

Dr Evan Jones, who has extensively documented the damage done to effective monetary policy by the Campbell Committee Report, notes that the committee had "failed to examine the historic reasons for the significant regulatory structure" in banking, before dismantling it. In a 2018 paper, "Financial deregulation exposes banking's antisocial character", he observed that after World War II, "Lending criteria were strict and tightly controlled", but that the Campbell Committee had replaced the regulatory framework with light-touch

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[22] Treasury Committee, Monday 16 May 2022, parliamentlive.tv

[23] "Don't mess with the RBA's 2-3pc inflation target: IMF", *AFR*, 12 Oct. 2022.

[24] "Review of the Bond Purchase Program", speech by Michele Bullock, RBA Deputy Governor, Sydney, 21 Sept. 2022.

[25] "Commonwealth's bonanza derived from taxpayers—not so much excellent management", *Crikey*, 12 August 2021; see also "Money for nothing, debts for free: the RBA, the banks and a negative interest rates warning", 15 July 2021, michaelwest.com.au.

[26] "Competition in the Australian Financial System", Productivity Commission Inquiry Report, 29 June 2019.

prudential regulation. The promised banking benefits brought by competition didn't materialise, wrote Jones, except when it came to banks undercutting each other to dish out mortgages, leading to the "uncontrolled expansion" of the housing bubble.

The Australian Citizens Party recommends the RBA be expanded into the centrepiece of a national banking system. As a government central bank it could also support a public savings bank, taking deposits as the original Commonwealth Bank did, at post offices around Australia. The post office currently boasts a larger retail presence across the country than all bank branches combined. The Citizens Party is currently gathering support from councils, unions, state and federal members of parliament and the general public for its legislation to create a public Post Office "People's Bank".[27] As with the previous version, councils and governments could be invited to bank with the national bank, providing a pool of deposits that could underpin long-term, government-directed investments into national infrastructure and other crucial investment such as the public health system.

5. The lawlessness of financial deregulation

Wallis Inquiry regulatory spin-offs

With the new "self-regulating" financial system recommended by the Wallis Inquiry, a green light was given for decades of financial predation. The once effective regulation conducted by the Commonwealth Bank and associated bodies, has been non-existent under new agencies the Australian Prudential Regulation Authority (APRA) and Australian Securities and Investments Commission (ASIC) established in July 1998 at Wallis's recommendation. This was deliberately so, according to the "efficient markets" hypothesis which prescribed non-interventionism. The regulatory model comprised self-regulation and a hybrid model, known as "co-regulation", a collaboration between regulators and the institutions they regulate.

The number of subsequent inquiries into the financial system and the regulators, including the 2018 Financial Services Royal Commission, show the detrimental impact the neoliberal assumptions underlying the new regulatory model have had on the lives of countless Australian consumers.

RBA independence

RBA independence, conducted in line with post-war international policy directions, has been a failed experiment. This status should be reassessed by the RBA Review.

As one of the fathers of Reserve Bank "independence", former Liberal Party leader John Hewson has revealed, he is embarrassed at the consequences it has had for the Australian economy. In the aforementioned 15 March opinion column in the *Sydney Morning Herald*, Hewson insisted the RBA must be held accountable for its actions.[28]

"As a long-term advocate for independent central banks, and for inflation targeting as their *modus operandi*, my advocacy for an independent Reserve Bank here in Australia dating back to an academic paper in 1980, I am embarrassed and dismayed as to where we have ended up", Hewson wrote. "Being entirely objective, you'd have to conclude that the RBA has been asleep at the wheel. Unfortunately, the RBA has been put on a

[27] "Create a public post office bank!", citizensparty.org.au

[28] Footnote 19.

pedestal with our politicians unwilling to criticise—but even though the bank is independent, it should still be held accountable, like any other arm of government."

Related issues

Other issues that require review include the New Payments Platform, which makes the RBA the middleman in all electronic settlements and has enshrined reliance on the SWIFT interbank payments network. The merging of payments infrastructure may expose Australia to payment interruptions or financial shocks.

Likewise, the establishment of a Central Bank Digital Currency may reduce competition in the banking landscape. In 2020 the RBA said it would be costly "to support two different types of central bank currency" (cash and CBDC), which raises "an argument for removing cash".[29] The RBA's assurance in its White Paper, therefore, that its CBDC pilot "does not reflect any intention to discontinue access to physical cash" is not taken at face value by many Australians.

6. Conclusion

In conclusion, the gradual erosion of the RBA mandate has led to a dramatic reduction of bank regulation, exposing citizens to financial dangers; and has rendered monetary policy ineffective in the face of today's economic challenges, exposing the entire nation to financial hazards. The government must put itself in a position to direct banking policy once again.

[29] "Retail Central Bank Digital Currency: Design Considerations, Rationales and Implications", RBA, 17 September 2020

Appendix 1

What's in China's monetary tool kit?[30]

According to figures issued 9 September by China's National Bureau of Statistics, reported by Global Times, the rate of growth of both producer and consumer prices is slowing in China. Chinese economists believe the aim of limiting annual CPI growth to 3 per cent should be achievable, crediting China's adherence "to a prudent monetary policy, based on its own economic conditions".

While China is still suffering the economic impacts of COVID-19 restrictions, its number one protection against inflation has long hinged on pre-empting it: prevent it happening by ensuring the majority of credit goes into the productive sector and increases actual production through construction of new infrastructure and implementation of new technologies and work practices. This ensures sufficient supply and boosts average productivity per worker, raising income. At the same time it uses credit controls to restrict the flow of money into speculation, including sectors such as housing that are susceptible to build-up of asset bubbles.

Australia can do this too, but it amounts to what China calls "deleveraging"—taking the heat out of financial bubbles—and financial fallout is guaranteed to come with the territory. China has experienced significant financial fallout due to the effort to deleverage housing, corporate debt and shadow banking bubbles.

So how is it done?

First, on monetary policy. A 2018 CNBC article complained that because the Chinese "central bank uses multiple tools to control interest rates and the amount of money in the Chinese economy … interpreting what China wants to achieve can sometimes be a confusing affair." Also, Chinese policy makers "frequently add new tools or retire older ones as they modernise their country's system", adding to the "difficulty of reading the central bank's signals". All the better to manage the economy, though.[31]

China's central bank, the People's Bank of China, manages the amount of money in the economy using several mechanisms, all of which impact interest rates and money flows:

1. Open market operations including repurchase agreements (short term lending using bonds as security) and reverse repurchase agreements, to alter liquidity;
2. Adjusting the reserve requirement ratio (the proportion of deposits banks must hold against their lending). If that ratio is lowered, the bank can lend more and borrowing costs fall. Recently it has deployed targeted cuts to reserve ratio requirements to certain sectors (e.g. agriculture) to provide increased liquidity, but tightened for non-productive sectors;
3. Adjustment of benchmark interest rates;
4. Purchase of loans from banks at a discount, to provide added liquidity ("rediscount" loans);
5. Standing lending facility for lending to commercial banks with longer-term options than open market operations (1-3 months). Assets with high credit ratings are put up as collateral;
6. Medium-term lending facility of three months to one year, similar to above, but with a wider range of collateral accepted;

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[30] See also "The PBC's Objectives and Operational Framework", by Bradley Jones and Joel Bowman, December 2019 paper, rba.gov.au. As the authors write: "The PBC attaches high priority to price stability, but this serves as just one among many objectives for monetary policy in China."

[31] "China's monetary policy is complex and shifting. Here's what you need to know", CNBC, 5 Aug. 2018.

7. Pledged supplementary lending, a recent addition, whereby the central bank provides funds to China's policy banks to lend for specific projects in agriculture, business or local infrastructure.

Then there are additional tools China uses for "deleveraging" bubbles and channelling investment into the real economy:

- Tight financial regulation in general, including Glass-Steagall-style bank separation that prevents deposit-taking banks from speculating;
- Targeted state bank credit issuance, into the real economy;
- Crackdown on risky and off-balance-sheet lending and on complex speculative financial products and tight regulation of derivatives trading and exposure to counterparty risk, including increased capital reserve requirements for derivatives positions and increased regulation of "shadow bank" lending;
- Crackdown on commodities speculation by metals producers and banks, making banks unwind existing books of commodity-linked futures trades, and implementing price-control measures for commodities through the exchanges;
- Restrictions or bans on overseas non-productive investment, and incentivisation of Belt and Road/productive investment;
- For the big four commercial banks the ratio of outstanding property loans to total loans is capped at 40 per cent; outstanding mortgages as a proportion of total loans is capped at 32.5 per cent. This is similar, with some variation, for smaller banks. Subsequently, less than 30 per cent of outstanding loans issued by China's financial institutions are property loans (PBC data),[32] compared to Australia's banks which devote some 63 per cent of lending to mortgages.

[32] "China central bank says to cap property loans by banks", Reuters, 31 Dec. 2020.