

How the Bank Got Its Groove Back

Stephen Bell, Australia's Money Mandarins: The Reserve Bank and the Politics of Money, Cambridge University Press, 2004

Reviewed by William Coleman

This is the story of how the Reserve Bank of Australia won its independence.

The tale is told with a trove of interviews of the principal protagonists — Bob Johnston, Bernie Fraser, John Phillips, Paul Keating. Ian Macfarlane is also interviewed, the only interview, in my reckoning, that he has ever granted. The words used by Macfarlane, and the other central bankers, have a candour and immediacy that constitute a rarity to be prized by central bank watchers in Australia, and abroad. Stephen Bell is to be congratulated.

Our story begins in the early 80s, when there was movement in the air. The Campbell Inquiry had reported; a new governor, Bob Johnston was installed. The Bank, however, was slumbering in contented submission to the Federal Government. And this was just how the new Treasurer Paul Keating wanted it to stay.

When Keating came into office [in 1983] he clearly assumed the old rules of the game applied. The Treasurer made monetary policy on the advice of the Reserve Bank and the Treasury I am sure he came into office firmly of that view (Ian Macfarlane)

As the Bank was also firmly of that view there was, initially, no lack of mutual confidence. Trust was lost because of Keating's wrath at the lack of 'instant action' in response to his behests. The critical incident came in March 1988, with the resolution to tighten monetary policy. As Macfarlane relates:

What happened was we had decided that we should lift interest rates, we sent it to the Board, we went along to the debrief with Keating and said we should do it, and Keating agreed immediately, so there was no conflict... [But] Bob Johnston had misinterpreted the meeting, and didn't realise he had the Treasurer's agreement. He then went overseas for a few weeks and nothing happened. (Macfarlane, p. 51)

Keating was, as Johnston puts it, 'extremely disappointed'. It became, in Keating's mind, proof positive of something wrong in the central bank.

They were slow putting the rates up I wanted the rates up, and the Bank was slow to put them up. In the period after the 1987 stock market crash, when the property market took off, I wanted them up, and it took a long time to get them up' (Keating, p. 50)

Was it not the time for a reliable pair of hands at the wheel? In September of 1989 the 'strong-minded' John Phillips was passed over, and Bernie Fraser - Keating's earlier appointment as Treasury Secretary, and 'close friend' - was appointed Governor. But Keating still seemed distrustful. In June of 1990 Phillips advanced in a public forum the eminently sane view that monetary policy should be directed primarily to fighting inflation. Keating, writes Bell, 'was furious', and according to one journalist promised to cut Phillips 'off at the knees'. (Bell, p. 62).

In was time to tell everyone who was boss. On 7 Dec 1990, speaking to the Canberra press gallery, Keating declared 'I have Treasury in my pocket, the Reserve Bank in my pocket, wages policy in my pocket, the financial community both here and overseas in my pocket'. Fraser laments, in interview,

It was unfortunate, and he regretted it. I chastised him ... he regretted it, and he never repeated it. He came close a couple of times to more or less backing away, but being the person he was he couldn't bring himself to make a full apology. (Fraser, p.117)

Keating's expostulation was one small step in his own self-destruction. But the consequences for the Bank were more immediately telling. In Bell's words (p.117) 'Keating's comments helped torpedo the Bank's credibility'. In the face of these humiliations, and presumably at some risk to himself, Macfarlane — not yet Governor — publicly asserted the dignity of the Bank. Yet, as Macfarlane (p.95) recalls, 'The IMF did not trust us'.

Paradoxically, it was at this time of its lowest fortunes that the Bank was experiencing something that would undercut Keating's trumpeting: Fraser was being 'captured'. As Macfarlane explains, Fraser 'had to go through a transformation as well, which he did slowly, at his own pace ... There was no way you could bully him or anything like that. And gradually once we got him on board at his pace, he had the capacity to bring the government of board with him which was, it turns out, terribly important' (Macfarlane, p.121).

Significantly, it was about this time, say 1991/2 that the inane policy of using the Current Account Deficit as a goal for the cash rate ceased. Things at the Bank now 'felt independent', says Macfarlane (p. 121). '... for us it sounded as though we were very independent because we were giving our views to Bernie, and Bernie was either accepting ... or accepting after a bit of discussion But I don't know how many conversations Bernie had with Paul. I mean maybe Bernie only agreed with us once he'd already cleared it'.

For all these uncertainties, it seems true that in his final years Fraser was captaining his own vessel. Keating in interview with Bell states that in the run-up to the 1996 election he wished to have cash rate reduced more sharply than it had so far been.

The option for me, near a difficult election, was to have an open brawl with the Bank and Bernie Fraser. Further away from an election, I would have dealt with the Bank's unreasonable intransigence in much sterner and more decisive terms'. (Keating, p. 127)

That 'difficult election' concluded Keating's role in this story. And Fraser, the Bank, and Australia, was preserved from 'stern and decisive' action.

1996 also ushered in the Statement. Bell's narrative here becomes sketchy as to which interest conceived the Statement. But, certainly, it well met the Bank's own earnest wish, after ten years of mortifications, to have its independence formally recognised, and signalled to the world. And it allowed this independence to be signalled without the revolution and alarms posed by some new Reserve Bank Act, that John Hewson had proposed. At the same time the Statement allowed the incoming government to display its own virtue, and at the same time bury, yet again, the spectre of Hewsonism. In the words of the freshly appointed governor Ian Macfarlane, the Bank had 'independence from then on, there's no doubt about that' (p. 130)

So: in this tale we have a villain, a victim, a hero, and an agreeably ambiguous figure. And the ending is a happy one: the Bank and monetary policy is now in the hands of professionals, instead of wilful, irascible, and idiosyncratic amateurs. A sunny confidence prevails.

I want to here issue a warning against self-satisfaction. If Paul Keating is the apparently clinching argument in favour of Bank independence, then a longer historical memory provides counsel against Bank 'independence' as it is now constituted. A longer historical memory will recall Sir Robert Gibson was the supreme power in a perfectly independent Commonwealth Bank during the Great Depression. Gibson, in the delicate irony of L. F. Giblin (1951), 'had a clear and confident but somewhat imperfect vision of Central banking problems'. Facing a collapse of export prices, in nominal and real terms, he was fiercely opposed to depreciating the currency. He was scandalised by the thought of stimulating the

money supply, even though M1 had fallen 20 percent between 1928/9 and 1929/30. And he did all he could to stop either, and that was a great deal.

The general principle I am reaching for is that any ‘monarchical’ system of governance produces extreme outcomes. When it is good it is very good, and when it is bad it is, truly, horrid.

A cabinet system does better. With respect to Bank’s constitution, the cabinet is the Bank’s Board. Bell properly spends considerable time upon it. His pages reinforce the general impression that the Board is an empty shell. It is difficult for the outsider to be confident about this, as the Board is shrouded in a mysterious silence. But I fear that this silence is the silence of the dead. There is nothing — or generally nothing — there. Contrast the chatter of the British press about the activities and make-up of the Bank of England’s Monetary Policy Committee with corresponding silence in Australia.

Granted, the *ex officio* presence Secretary of the Treasury must be an intellectual presence independent of that of the Governor and Deputy Governor. And the convention of making an academic appointment makes for another presence. But, as Sir William Cole notes, ‘Most of these directors, do not depend for good or ill, on the performance of the Reserve Bank, but on their other activities’. (p. 173)

The weighting of the Board with company suits matters little now, given the Bank’s excellent stewardship. But, dear reader, race forward in your imagination, to some future age, where a Gibson or a Keating is installed as Governor, and with all the independence the Bank now enjoys. It can happen.

One calming response to the fearsome vision is the likelihood of ‘capture’. Any Governor, speaks the reassuring voice, will find it in their advantage to take the advice of the experienced heads that surround him. I find this reassurance a little hopeful; we cannot rely upon Governors being sufficient good judgement to be to be captured. If Fraser was indeed captured, it was to his credit that he was captured.

A better proofing against an incompetent Governor is a Board that knows its subject, and invests its reputation in its conduct. How to produce this? One suggestion is more economic expertise, as in the bank of England. Macfarlane is acerbic. ‘The Bank of England model has a board which basically consists of professors of economics, so that it is not at all surprising that a professor of economics is very much in favour of the model’. But ‘economists’ do not need to be professors; there can be financial journalists, and business economists.¹ And they need not be from the private sector. An *ex officio* appointment could be made from the Productivity Commission, APRA, or the ACCC.²

One more recommendation: the Board should have a power to pass a motion of no-confidence in the Governor. The governor-general ‘on the advice of the government’ would then appoint a replacement.

There is of course, the possibility of an incompetent Board dismissing a competent governor. Just as there is the possibility that a jury of 12 may, on occasion produce, an inferior verdict to a jury of 1. The key point is that a jury of 12 is less likely to give a bad decision than a jury of 1.

In matters of constitution design power spreading — ‘democracy’ — is not only just, it is prudent.

Reference

L.F. Giblin (1951), *The Growth of a Central Bank*, Melbourne University Press.

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¹ The Bank of England’s Monetary Policy Committee includes a former financial journalist, and two business economists.

² The academic appointment should also be *ex officio* — with the option of the appointee resigning the appointment on the completion of one term.