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# Principles & Practical Recommendations for Strengthening the Governance and Accountability of the Reserve Bank of Australia[1]

## Overview

Over the past several decades, the Reserve Bank of Australia (RBA) has generally had an excellent track record in fostering macroeconomic stability and contributing to the general welfare of the nation. Nonetheless, the current juncture provides an opportune time to review that track record and to consider potential enhancements to the RBA's monetary policy framework. This note begins by identifying a set of four broad principles for the effective design of monetary policy frameworks and then proceeds to consider some specific adjustments to the RBA's governance, statutory independence, and monetary policy framework. Such adjustments could significantly enhance the RBA's accountability and transparency as well as its effectiveness in carrying out its crucial mission.

## General Principles

### *1. Monetary policymaking is inherently complex and requires difficult real-time judgments.*

Central banks bore no responsibility for macroeconomic stability under the classic gold standard; at that time, their principal role was to serve as "banker to the banks" and to hold the accounts of the national government. That role remained broadly similar in the 1950s and 1960s, when monetary policy was mainly determined by the international monetary system established at Bretton Woods.[2]

Following the collapse of the Bretton Woods system, each central bank effectively became responsible for fostering the stability of its own currency in a context of economic growth. During the 1970s, inflation rates surged upwards in Australia as in many other advanced economies, and the subsequent disinflationary process turned out to be challenging and protracted. In the wake of that experience, analysts reached a broad international consensus about the benefits of anchoring inflation expectations by establishing and maintaining a specific

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[2] The key exception was the Federal Reserve, because the U.S. dollar served as the anchor of the international monetary system established at Bretton Woods.

numerical inflation objective. Indeed, that consensus provided the foundations for the RBA's adoption of flexible inflation targeting during the early 1990s.

At that time, the intellectual underpinnings for monetary policy analysis rested heavily on a specific approach that economists commonly refer to as *rational expectations*.[3] In particular, the structure and dynamic evolution of the economy is assumed to be known to all economic decision-makers, including public officials as well as ordinary consumers and businesses. This assumption facilitates very elegant and tractable macroeconomic and monetary policy analysis. Moreover, while such an assumption might seem utterly unrealistic, many empirical analysts found that it was broadly consistent with the macroeconomic data in the "Great Moderation" era that prevailed in many advanced economies from the late 1980s until the onset of the global financial crisis in 2008.

Over the past fifteen years, however, the consensus of economists has shifted quite dramatically to formulating analytical approaches that incorporate *bounded rationality*.[4] Under this approach, the structure and dynamic evolution of the economy are too complex to be fully understood by consumers or businesses, and hence they form expectations and make decisions using simplified rules-of-thumb that may be characterized as myopic, inertial, or extrapolative depending on the circumstances. Numerous empirical studies have demonstrated the merits of this approach in interpreting various patterns in the economic and financial data.

Those recent analytical developments are highly relevant in considering the effective design of monetary policy governance. Under the assumption of rational expectations, determining the appropriate stance of monetary policy is roughly similar to a technical problem in engineering. Of course, even in a framework where the private sector is constrained by bounded rationality, one might conceive of policymakers having full knowledge of the economy, but such an notion seems untenable in practice.

The reality is that central bank officials face difficult challenges in determining the appropriate stance of monetary policy. A macroeconomic model fitted to previous data can be very useful, but good judgment is needed in interpreting the incoming data, assessing the contours of the economic outlook, and identifying emerging risks to that outlook. Moreover, when tradeoffs arise between the dual objectives of full employment and price stability, careful judgment is needed in deciding how to balance those objectives.

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[3] This approach was a key element of the Nobel Prize-winning work of Lucas (1972,1976) and of Kydland and Prescott (1977,1982) and was subsequently incorporated into practically all of the models used at central banks over subsequent decades; for notable examples, see Goodfriend and King (1997), Rotemberg and Woodford (1997), Clarida, Gali, and Gertler (1999), Smets and Wouters (2003), and Christiano, Eichenbaum, and Evans (2005).

[4] Prominent examples include McKay, Nakamura, and Steinsson (2015), Angeletos and Lian (2018), Gabaix (2020), and Woodford and Xie (2022).

Indeed, the challenges of real-time monetary policymaking have been readily apparent in the wake of the COVID-19 pandemic. Like many other central banks, the RBA has been in "uncharted waters" in the face of global supply chain disruptions and other factors. Nevertheless, even as those particular developments fade away, economic and financial conditions are likely to continue evolving rapidly over coming years with the widespread dissemination of artificial intelligence, quantum computing, nanotechnologies, and robots. Consequently, the need for good judgment in monetary policymaking at the RBA will surely continue for the foreseeable future.

***2. Monetary policy decisions should be made by a diverse team of experts, all of whom have essentially the same degree of influence and accountability in making those decisions*.**

During the era when central banks' most visible role was serving as the *"banker to the banks"*, it may not be surprising that central bank governance largely echoed that of private institutions. In particular, the head of the central bank (the *"governor"*) served as its chief executive officer *(CEO)* and as chair of its board of directors. The board's fiduciary responsibilities were generally limited to setting executive compensation and overseeing financial audits, with practically no involvement in the central bank's strategic planning or policies. The other senior executive officers (deputy governors and advisers) were directly accountable to the governor, who effectively bore sole responsibility for the central bank's decisions.

Over the past few decades, however, the standard practices in corporate governance have shifted markedly. For example, the corporate governance council of the Australian Securities Exchange (ASX) has concluded that the board of a listed corporation should be responsible for setting its strategic objectives and for overseeing management's implementation of those objectives, and it specifically recommends that *"The chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the CEO."*[5]

In fact, those governance principles are now followed by all major commercial banks in Australia, Canada, and the United Kingdom and by practically all non-financial corporations in each of those jurisdictions.[6]

Similar practices have been adopted in the public sector, where some specific functions are delegated to independent agencies whose officials are appointed by the government but cannot be terminated except for malfeasance. In particular, an agency whose functions are mainly administrative and technical may be headed by a single commissioner who has primary

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[5] ASX Corporate Governance Council (2019).

[6] In contrast, U.S. corporate governance is not fully consistent with those principles: At six of the ten largest U.S. commercial banks (as measured by total assets), the CEO is currently serving in a dual role as board chair. More broadly, that dual role now characterizes about 40% of the S&P-500 (i.e., the 500 largest U.S. publicly-traded corporations), compared to more than 80% of the corporations in that index as of three decades ago; see Spencer Stuart (2022).

responsibility for its conduct.[7] For more complex regulatory matters, however, the independent agency is generally led by a board of directors who are responsible for determining its policies and procedures. Moreover, the senior executives of such agencies report to the full board, not just to the board chair. For example, the Australian Prudential Regulatory Authority (APRA) is led by an executive board comprising the chair, two deputy chairs, and two other full-time members, and the senior management team reports directly to the APRA executive board.[8]

Such governance arrangements also have parallels in the judicial system. An individual judge typically presides over routine civil and criminal cases, whereas appellate cases are generally heard by a panel of judges. The most complex and consequential legal cases are decided by a high court of highly distinguished jurists, and its chief justice serves as *"the first among equals."*

The practice of central banking has also evolved over the past few decades: In nearly every advanced economy, monetary policy is now delegated to a committee of experts rather than to a single decision-maker.[9] Indeed, the institution of a monetary policy committee (MPC) is particularly compelling in light of the complexities of monetary policymaking noted above.

Nonetheless, the effective governance of the MPC can be impaired by several pitfalls:

- *The MPC chair* is responsible for disseminating information to committee members and sets the agenda for MPC meetings. Thus, the effectiveness of the committee's deliberations may be diminished if the governor also serves in a dual role as MPC chair. Indeed, such considerations have been a key reason for separating the roles of CEO and board chair in corporate governance.

- *Internal MPC members* may tend to be deferential to the governor's views, especially if the governor is responsible for assessing their performance. By contrast, the independence of their views may be strengthened if these officials are ultimately accountable to the full committee.

- *External MPC members* may have only marginal influence on policy decisions, especially if they serve on a part-time basis and have limited access to information or staff expertise. Ideally, every MPC member should serve in a full-time capacity and should have comparable ability to call on staff expertise.

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[7] For example, the Australian Taxation Office (ATO) is headed by the Commissioner of Taxation. Its executive committee comprises the commissioner, two deputy commissioners, and the chiefs of three ATO departments (finance, operations, and service delivery).

[8] The APRA executive board directly oversees the chief risk officer, chief internal auditor, chief operating officer, general manager, and the executive directors of five departments.

[9] Most recently, Israel and New Zealand established a monetary policy committee in 2019. The only exception is the Bank of Canada, whose governor has sole decision-making authority by statute.

The process of selecting MPC members can ensure that the committee is comprised of a diverse team of experts. That diversity should encompass demographic characteristics (gender, race/ethnicity, geographical location) as well as educational background and professional expertise. It is noteworthy that the current heads of some central banks have an economics Ph.D. (Australia, Canada, Sweden, and Switzerland), but several other central banks are led by officials with law degrees (the Bank of Japan, the European Central Bank, and the U.S. Federal Reserve), while the governor of the Bank of England has a Ph.D. in history.

Decision-making procedures are also crucial for fostering individual accountability and mitigating the risk of groupthink. In the past, the phrase *"decision-making by consensus"* had largely positive connotations, but modern organizational management has recognized that such practices tend to discourage innovative thinking and marginalize anyone with a different viewpoint *("outside the consensus")*. Consequently, all MPC decisions should be subject to a vote, and each member should be accountable for their own individual views.

***3. Monetary policymaking should be non-partisan, consistent with the central bank's statutory independence.***

In analyzing the inflationary episodes of the 1970s, one key "lesson learned" was that monetary policy decisions need to be insulated from political interference.[10] Indeed, that lesson led to the strengthening of the central bank's statutory independence in many jurisdictions, most notably, regulations ensuring that central bank officials cannot be terminated except for malfeasance. Nonetheless, the extent of the central bank's independence from short-term political pressures also hinges on a number of other factors:

*Terms of office*. The central bank could be perceived as excessively partisan if a high proportion of its top officials have been appointed by a single government administration within a relatively short timeframe.[11] To avoid such situations, MPC members should generally have terms of office that extend beyond the duration of the election cycle, and those terms should be staggered to ensure that the MPC's composition evolves gradually over time.

*Non-renewability of appointments*. Central bank officials whose appointment is renewable could be perceived as susceptible to political pressures, especially during the period preceding

[10] See Cukierman et al. (1992), Alesina and Summers (1993), and Levin and Taylor (2013).
[11] For example, the chair and both vice chairs of the U.S. Federal Reserve Board are appointed to 4-year terms that are practically synchronized to the U.S. presidential election cycle. The other five board members are commonly perceived as having a marginal role in the policymaking process, and hence their turnover has generally been quite rapid in recent decades. Consequently, as of year-end 2022, six of the seven Fed board members (including the chair and both vice chairs) had been appointed by President Biden, who was inaugurated in January 2020.

the reappointment decision.[12] To avoid such perceptions, the best practice is for every MPC member to be appointed to a single non-renewable term.[13]

*Selection of MPC members*. The appointment of each MPC member could be perceived as excessively political or arbitrary if that selection is made at the discretion of a single government official. To mitigate that risk, the selection process should be systematic and transparent with appropriate checks and balances.[14] Such arrangements will help ensure that the MPC comprises a diverse team of experts.

*Ex officio members*. In some jurisdictions, MPC meetings are attended by a senior government official (such as a representative of the finance ministry), which might sometimes contribute to perceptions of undue government influence on monetary policy decisions. Consequently, the best practice is for MPC meeting attendance to be limited to central bank officials and for the MPC to be highly transparent in explaining its policy decisions, including the release of detailed minutes for every MPC meeting.

*Potential override of policy decisions*. To insulate monetary policy from political interference, it seems unwise to give government officials authority to overrule the MPC's decisions except in cases of malfeasance; indeed, even a veiled threat along such lines could substantially undermine the central bank's statutory independence. Therefore, the MPC's authority for setting monetary policy should only be overruled through the legislative process.

***4. Transparency strengthens the central bank's accountability and fosters public confidence in the legitimacy of its decisions.***

Some regulatory agencies' actions are only relevant for a limited set of private institutions. In contrast, the central bank's monetary policy decisions have direct effects on practically everyone: the cost of goods and services paid by consumers, the job opportunities and wages of workers, and the rate of return on the savings of retirees. Consequently, it is not sufficient for the central bank to communicate in technical terms to a limited audience of financial market participants; rather, a wide spectrum of communication tools is needed to clearly explain monetary policy decisions to ordinary families and businesses.

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[12] During 2017, newly-elected U.S. President Donald Trump considered reappointing Janet Yellen to a second term as Fed Chair but decided instead to appoint Jerome Powell so that he could *"have his own person in the job"*; see Rucker et al. (2018).

[13] At the European Central Bank (ECB), each executive board member (including the president and vice president) is appointed to a single non-renewable term of 8 years. Similarly, at the Bank of Canada, every governor since 1987 has served for a single term of 7 years (with the exception of Mark Carney, who departed after 5 years to become governor at the Bank of England).

[14] The members of the ECB executive board are appointed by a qualified majority vote of the European Council. The members of the U.S. Federal Reserve Board (including the chair and both vice chairs) are nominated by the President and confirmed by a majority vote of the U.S. Senate. By contrast, the appointment of central bank officials is more discretionary and opaque in many other jurisdictions.

Effective monetary policy communications should start by explaining the baseline outlook for the economy, in light of all available information about recent and prospective economic and financial developments. In particular, MPC members should convey their assessments of the appropriate path of monetary policy and the associated outcomes for economic growth, employment, and inflation.

However, the MPC cannot simply focus on characterizing the contours of the baseline outlook. In its policy deliberations and communications, the MPC needs to engage in scenario analysis and contingency planning. In particular, policymakers need to identify material risks and consider policy actions that could mitigate such risks or that would likely be taken if such a scenario materializes. This approach is parallel to the stress tests now conducted by bank regulators in many jurisdictions. In effect, the MPC should be engaged in *stress testing for monetary policy*.[15]

Some officials might worry about whether greater transparency about risks and contingency plans could be counterproductive. Nonetheless, valuable lessons can be garnered from other fields. For example, in a complex medical situation, the team of physicians consults carefully with the patient and the patient's family about the prognosis, uncertainties, and contingency plans, and many decades of experience has confirmed that such consultations are conducive to improved health outcomes. Likewise, when a hurricane or typhoon begins developing offshore, weather forecasters provide early warnings and regular updates about the potential range of trajectories, and that information facilitates public preparedness and prevent panic. Central banks can do likewise in communicating their assessments of the economic outlook and the appropriate path of monetary policy.

Moreover, MPC members should *not* be constrained to "speak with one voice" in their public communications. As noted above, monetary policymaking involves complex judgments on which informed experts can reasonably disagree, and that context is a key rationale for delegating this task to a diverse team of experts. To avoid cacaphony, the MPC can follow the standard practice in the judicial system, where a panel of judges conveys each decision by issuing the ruling of the majority together with concurring opinions and dissenting views. Such an approach will foster public confidence in the monetary policymaking process.

[15] See Levin (2014).

**Strengthening the RBA's Governance**

The preceding principles provide a compelling case for strengthening the RBA's governance. Monetary policy decisions should be made by an board of full-time members who have roughly similar influence and accountability, and such decisions should be reached by a majority vote of the board. More specifically, the Reserve Bank Board (henceforth referred to as "the Board") could have seven members as follows:

-- ***Three executive members***. Each executive member would be appointed to a single non-renewable term of nine years, starting with three years as deputy governor, followed by three years as governor, and concluding with three years as Board chair. These appointments would be staggered evenly so that a new executive member would be appointed every three years.[16] The chair would be responsible for setting the agenda for Board meetings and disseminating information to Board members. The governor would serve as the RBA's chief executive officer. The deputy governor would assist the governor in the management of the RBA but would have individual accountability for casting votes on Board policy decisions.

-- ***Four non-executive members.*** Each non-executive member would be appointed to a single non-renewable term of six years. These appointments would be staggered evenly so that a new non-executive member would be appointed at 18-month intervals.[17] Each non-executive member would have individual accountability for casting votes on Board decisions.

By separating the roles of governor and Board chair, this arrangement would implement the best practice in public governance (as instituted at the APRA) and corporate governance (as followed by all listed companies in Australia).

It is noteworthy that the Bank of England followed an analogous arrangement throughout its first two centuries, as described in the classic text of Bagehot (1873): *"At the Bank of England there is no fixed executive. The governor and deputy governor, who form that executive, change every two years."*[18] Those appointments almost invariably followed a rotating system in which one of the Bank's part-time directors was appointed for a 2-year term as deputy governor followed by a

[16] At the adoption of this new governance structure, the staggered arrangement could be implemented by appointing one individual to a 3-year term as MPC chair, a second individual to a 6-year term (starting with an initial 3 years as governor, followed by a period of 3 years as MPC chair), and a third individual to a full 9-year term (starting as deputy governor during the first 3 years). From that point onwards, each subsequent appointment would be to a full 9-year term. In contingencies involving the vacancy of an unfilled term of office, an individual would be appointed to fill the remaining portion of the 9-year term with the same sequence of responsibilities as the original appointee.
[17] The staggered arrangement could be launched by an initial set of appointments of four non-executive members with terms of 1½ years , 3 years, 4½ years, and 6 years, respectively. In contingencies involving a subsequent vacancy, an individual would be appointed to fill the remaining portion of the 6-year term, with renewability only in instances where the remaining unfilled term would be less than 2 years.
[18] Bagehot (1873), p.105.

2-year term as governor.[19] All former governors served on the Bank's executive committee, which was responsible for overseeing the decisions of the individual serving as governor.[20]

While those arrangements generally worked well, other aspects of the Bank of England's governance were deficient and eventually proved untenable. In particular, its governing board was large (comprising 24 directors) and self-perpetuating, with each new director chosen by the board itself and hence characterized by a narrowly-defined profile. The succession to deputy governor and then governor was based solely on seniority rather than demonstrated competence. Apart from those two positions, all other directors served on a part-time basis, which was particularly problematic during periods of economic turmoil when those directors might be distracted with managing their own businesses and investments.[21] Bagehot (1873) concluded that *"the policy of the Bank has frequently been deplorable, and at such times the defects of its governance have aggravated if not caused its calamities."* [22]

Consequently, the Bank of England's governance began changing markedly in the 1920s, as Norman Montagu became firmly entrenched as governor and continued in that role until 1944.[23] Montagu characterized himself as the *"currency dictator of Europe"*, while his contemporary John Maynard Keynes described him as *"always absolutely charming, always absolutely wrong."*[24] The Bank of England was subsequently nationalized in 1946 and became an independent agency in 1998 when its MPC was established. Since 2013, its governor has served a threefold role as CEO of the Bank, chair of the MPC, and chair of the financial policy committee (which acts to mitigate risks to the UK financial system). [25] By contrast, the roles of CEO and board chair are filled by two different people at all UK commercial banks and nearly all UK publicly-listed companies.[26]

Indeed, separating the roles of governor and Board chair is likely to be crucial for ensuring that monetary policy decisions are made by a diverse team of experts. In a context where every member's views carry equal weight in the Board's decisions, talented and public-spirited individuals will be far more amenable to taking office in a full-time capacity and to serving out their full terms of office.

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[19] From 1694 to 1920, the Bank of England had a total of 110 governors, and only one of them had a tenure exceeding 2 years. (The sole exception was Walter Cunliffe, who served from 1913 to 1918.) Over that same period, the Bank of England had 121 deputy governors, of whom 97 were subsequently appointed as governor.
[20] Bagehot (1873), pp.101-103.
[21] Bagehot (1873), p.114.
[22] Bagehot (1873), p.107.
[23] See Ahamed (2009) and Swinson (2020).
[24] See Bean (2018) and Swinson (2020).
[25] Since 1962, each governor at the Bank of England has served two consecutive 5-year terms, with the exception of Mark Carney, who served from 2013 to 2020.
[26] As of year-end 2022, only two listed UK companies had a dual CEO/board chair (Hikma Pharmaceuticals PLC and Renishaw PLC); for further details, see UK Spencer Stuart (2022).

The converse situation is well illustrated by the U.S. Federal Reserve's Board of Governors, where the chair serves as the sole executive officer while the other six board members have no executive authority. All seven seats have staggered terms of 14 years, and an individual who is appointed to fill a vacant seat can subsequently be appointed to a full 14-year term. Over the past two decades, there has been very high turnover of board members, whose typical tenure has been only two to four years; in fact, as of late 2022, Chair Powell and Vice Chair Brainard were the only two board members whose tenure was substantially longer than four years.[27]

Moreover, the chair of the U.S. Federal Reserve Board also chairs the Federal Reserve's monetary policymaking body, the Federal Open Market Committee (FOMC), which includes the presidents of the twelve regional Federal Reserve Banks as well as the seven Federal Reserve Board members. However, not a single member of the Federal Reserve Board has dissented from any FOMC decision since 2005. Dissents by Federal Reserve Bank presidents have also become rare: At the 16 FOMC meetings held during 2021 and 2022, there were only two dissents among the total of 174 votes cast at those meetings.[28]

## Strengthening the RBA's Statutory Independence

Some specific aspects of the RBA Act should be modified to strengthen the RBA's statutory independence and avoid any potential perceptions of partisan influence in the determination of monetary policy:

-- The Board's policy framework should be non-partisan and should be evaluated at regular 5-year intervals that do not hinge on the results of federal elections. Such evaluations should incorporate public consultations and should reflect rigorous analysis and empirical evidence (as discussed further below). The tradition of issuing joint statements with the Treasury should be discontinued.

-- The appointment of each Board member should incorporate appropriate checks and balances so that such decisions are not made solely at the discretion of a single government official.

-- Attendance at Board meetings should be limited to RBA officials and staff. No government official should attend such meetings, even in an *ex officio* role. Such a change should be associated with measures to ensure the transparency of the Board's monetary policy decisions, as discussed further below.

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[27] The exceptions have been Donald Kohn (2002-2010; vice chair 2006-2010), Elizabeth Duke (2008-2013), Daniel Tarullo (2009-2017), Jerome Powell (2012-present; chair since 2017), and Lael Brainard (2014-present; vice chair since 2021). See *https://www.federalreserve.gov/aboutthefed/bios/board/boardmembership.htm*.

[28] For further details, see *https://www.stlouisfed.org/fomcspeak/history-fomc-dissents*.

-- The Board's monetary policy decisions should not be subject to any potential override by government officials. RBA officials are already subject to removal for malfeasance or gross misconduct. Apart from such circumstances, monetary policy decisions could only be overturned by statutory changes following the usual legislative process.

## Strengthening the RBA's Monetary Policy Framework

Statutes are generally designed to remain in place for decades, as distinct from budgetary appropriations that may be adjusted at an annual or biannual frequency. Consequently, the wording of a particular statute needs to be specific enough to clarify the intent of the legislative body while providing sufficient flexibility for the cabinet office or independent agency to carry out its practical implementation on an ongoing basis.

Given the evolving complexities of monetary policy, its conduct cannot be prescribed effectively by a static legal framework. However, an overly broad mandate may endow monetary policymakers with an excessive degree of discretion that could erode its public legitimacy and accountability. Conversely, annual consultations with elected officials could undermine the RBA's statutory independence.

In light of these considerations, it seems sensible for the RBA Act to specify the overarching goals of monetary policy and to establish a periodic process for clarifying the strategy of the Reserve Bank Board in implementing those goals.

1. ***The RBA Act should be adjusted to clarify the overarching goals of monetary policy.***

Section 10(2) of the RBA Act of 1959 sets forth two specific objectives: (a) the stability of the currency; and (b) the maintenance of full employment. More broadly, this statute indicates that monetary policy actions shall be *"directed to the greatest advantage of the people of Australia"* and then reiterates that such actions should best contribute to (c) *"the economic prosperity and welfare of the people of Australia."*

***Price Stability***. The phrasing of section 10(2)(a) originated during the Bretton Woods system, whereby the *external stability* of the Australian dollar (its value against the U.S. dollar and other major currencies) served as the nominal anchor for Australia's economy. Following the collapse of Bretton Woods, however, this mandate was reinterpreted in terms of the *internal stability* of the currency, as measured by changes in the consumer price index. Thus, in a context of making other adjustments to the RBA Act, it would be appropriate to modify this clause to refer specifically to *"the stability of consumer prices in Australia."*

***Full Employment***. Some central banks have a *hierarchical* mandate focused on price stability, with employment or economic activity noted as secondary objectives. However, a *dual mandate*

– specifying full employment and price stability as joint objectives -- is more consistent with the findings of economic research over the past several decades, which has concluded that monetary policy actions have substantial effects on the job market and real output (not just prices and other nominal indicators). The goal of full employment is also included in the statutory mandates of several other central banks (including New Zealand, Norway, and the United States). Thus, it is appropriate to maintain this objective in the RBA Act.

***Other Objectives***. As discussed above, monetary policymaking requires complex real-time judgments, especially in the face of difficult tradeoffs between the goals of full employment and price stability. Thus, it seems ill-advised to incorporate any other major objectives into the monetary policymaking process. To avoid such pitfalls, clause (c) should be removed from section 10(2) of the RBA Act. With that adjustment, the Act will more clearly set forth the RBA's dual mandate of promoting full employment and price stability.[29]

In particular, international experience has highlighted the limitations and pitfalls of using monetary policy as a tool for mitigating risks to the financial system. Indeed, such monetary policy actions may exacerbate shortfalls in employment and price stability while having little or no effect on systemic risk.

Thus, rather than overburdening the formulation of monetary policy, it would be appropriate to formally establish the RBA as a "watchdog" with explicit responsibility for identifying emerging risks to the economy and the financial system. The RBA would publish its risk assessments in its regular reports to help ensure that such risks would be carefully considered and addressed by other government offices and independent agencies.

***2. The RBA Act should require the Reserve Bank Board to clarify its medium-term framework based on public consultations conducted at 5-year intervals.***

Monetary policy transparency strengthens the effectiveness of policy actions and fosters the central bank's legitimacy and public accountability. Thus, the RBA's medium-term framework should provide a quantitative description of its objectives, strategy, and operating procedures.

The RBA's existing strategy of flexible inflation targeting has generally worked well over the past several decades. The Reserve Bank Board could consider alternative approaches such as targeting the average inflation rate, the price level, or the level or growth rate of nominal GDP. However, any significant shift in its policy strategy should occur following public consultations based on rigorous analysis and empirical evidence.

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[29] The phrase *"the economic prosperity and welfare of the people of Australia"* could be inserted into the opening clause of section 10(2) as a substitute for the phrase *"to the advantage of the people of Australia."*

Each framework renewal would appropriately involve consultations with Treasury officials, public hearings of parliamentary committees, and open meetings with diverse members of the public. At the conclusion of this process, the Reserve Bank Board would conduct a vote to determine whether to adopt the new medium-term framework or retain its existing framework, and its decision would be published in a report describing the rationale for its decision as well as any dissenting views. That framework would then guide the Board's deliberations and decisions over the subsequent 5-year period.

***3. The RBA's monetary policy communications should enhance its transparency and public accountability.***

As discussed above, fostering diversity and individual accountability is crucial for sustaining the effectiveness and legitimacy of the central bank. Therefore, after each policy meeting, the Reserve Bank Board should issue a press release that includes the vote tally for its decision, the rationale for that decision, and a brief synopsis of any dissenting views.

The minutes of each meeting should be released as soon as practicable, providing a more detailed summary of the issues discussed at the meeting and the range of views on each issue. The RBA should subsequently release a verbatim transcript of the meeting, perhaps using the same 5-year time interval that the U.S. FOMC uses in releasing its meeting transcripts.

In its quarterly reports, the Board should indicate the central tendency and range of members' views about the baseline outlook for the economy, including their assessments of the appropriate path of monetary policy as well as their projections for employment, inflation, and other key macroeconomic indicators. These reports should include quantitative assessments of full employment.

Finally, the RBA's quarterly reports should include scenario analysis and contingency planning. In particular, policymakers should identify specific sources of risk and consider the extent to which such risks could be mitigated by monetary policy or measures taken by other government offices and agencies.

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