

CHALLENGING THE INTELLECTUAL CLIMATE OF
THE TIMES: WHY THE RESERVE BANK OF AUSTRALIA
IS TOO INDEPENDENT?

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"Experience and not theory has demonstrated that...monetary policy is not an effective instrument for achieving directly either full employment or economic growth. As a result there is today a worldwide consensus, not only among most academic economists but also among monetary practitioners, that the long-run objective of monetary policy must be price stability..."

(Milton Friedman, 1986:13)

There is...another view which emphasises the independence of policy objectives and policy instruments - that inflation objectives should not be pursued independently of their implication for growth and vice versa...While monetary policy does have a comparative advantage in achieving price stability, it cannot deliver sustainably lower inflation on its own - that will depend also upon the fiscal, wage and other components of the government's overall program."

(Reserve Bank Governor Bernie Fraser, RBA Bulletin, December 1991)

INTRODUCTION: The Exceptionalism of Australia's Central Banking Culture

If Milton Friedman is correct in asserting that there is today a worldwide consensus that the objective of monetary policy must be price stability, and if, as a cursory examination would suggest, the objectives of central banks, and the pattern of institutional relations between political and monetary authorities appear to reflect this consensus, then Australia's central banking arrangements are manifestly exceptional.

The charter of the Reserve Bank of Australia embraces a multiplicity of objectives, including, 'the stability of the currency; the maintenance of full employment; and the economic prosperity and welfare of the people of Australia'. The defence by the Bank - and in particular by the present Governor - of this charter is a vigorous one and constitutes not just an affirmation of the appropriateness of the Bank's existing objectives, but an equally vigorous repudiation of the suggestion that the Bank's charter should be amended by the substitution of a single quantified price stability objective for the present set.

The issue goes not just to objectives but to the vexed question of central bank independence. The text-book argument is that, left to their own devices, central bankers will assiduously direct their energies to ensuring the soundness of the currency, that goal autonomy for central banks and central bankers will result in a focus on the price stability objective. Conversely, under institutional arrangements where central banks and bankers are subordinate to the preferences of political authorities monetary policy, it is argued, risks being compromised by the short-term expedients of the electoral cycle.

Central bankers can be expected to exhibit a preference for institutional arrangements that provide the necessary insulation from political authorities, and the autonomy to pursue that which, it is assumed, central bankers care most about - the pursuit of price stability.

The Australian case is an exception. Those who argue for changes to the charter do so on the grounds that the Bank lacks independence -

that the present institutional arrangements are politically porous. Those who oppose such changes argue not only that the Bank currently enjoys sufficient independence to pursue its mandate, but that changes to the charter, and in particular the suggestion that the Bank's mandate should be confined to a single price stability objective, risk compromising, not enhancing, the independence of the Bank.

This paper explores the exceptional nature of Australia's central banking arrangements and in so doing attempts to answer the following question:

Why do Australia's central bankers, quite contrary to what happens in virtually every other country, argue against a single inflationary target and, instead, prefer the Reserve Bank's existing charter stating a broad range of objectives?

The extent of these exceptional, and quite anomalous preferences, is made all the more manifest in the context of the prevailing climate of academic (principally economist) opinion. But before we turn to these views, we need to locate this issue within the context of the current Australian debate over the merits of greater central bank independence, and, by so doing, identify the political and economic antecedents of the Reserve Bank's current charter.

A Keynesian anachronism?: The origins of the Charter

The antecedents of the present Reserve Bank Act can be traced back to the Commonwealth Bank Act of 1945, with the statutory responsibilities (the charter) of the Commonwealth bank carried over to the Reserve Bank under the Reserve Bank Act 1959.

The 1945 legislation quite consciously sought to provide the Commonwealth with a measure of sovereignty in the conduct of monetary policy, and it is clear from the account of former Bank Governor Dr H.C. Coombs that in drafting the legislation, its authors were concerned to avoid the situation that confronted the Commonwealth during the Great Depression when, it is suggested, Australia's central bankers took less notice of the views of the Commonwealth Government than of the central banking establishment in London.

The development of the Bank's charter was very much informed by a Keynesian world-view, but one not universally shared by the Commonwealth Government's advisors at the time. Coombs recalls that,

"... from the Keynesian stronghold of the Ministry of Post War Reconstruction, I and my colleagues were urging that the bank legislation should record the commitment of the objective of full employment. Treasury and the (Commonwealth) Bank argued that the concern of the bank was essentially financial and that its primary objectives should be the stability of the currency in both its domestic and international contexts." (Coombs, 1981:111, see also Linklater, 1992)

At the time of the drafting of the 1945 legislation Coombs argued successfully for the establishment of a Bank Board, concerned that the Bank should have access to a variety of views - not limited to those of the banking fraternity (1981:112):

"Banking is a limited field of experience and bankers are notoriously narrow in their outlook and inclined to rule of thumb methods" (1981:112).¹

The matter of the make-up of the Board of the Reserve Bank is an issue to which we return below, and it is noteworthy in that regard that Coombs' argued in his 1933 doctoral dissertation, that while neither the banks nor the Government should be represented on the Board, ex-bankers would be a natural source for Reserve Bank Board members; and that new Board appointments should be made by the Governor-General on the recommendation of the Board, subject to a veto on the part of the Government (Linklater, 1992:41).

There is one final aspect of the 1945 banking legislation that requires noting, and that is the provision of a transparent disputes resolution procedure to be used in the event of a conflict over the conduct of monetary policy between the Bank Board and the government of the day. Concerned to avoid any politicisation of the Bank, Chifley sought advice on ways in which this potential problem might be overcome:

"I was anxious, while acknowledging that responsibility for general financial policy must rest ultimately with the

Government, to protect the Bank from arbitrary or narrowly political interference and to strengthen its capacity to influence that policy. I saw parliament as the potential source of that protection. Thus I argued that not merely should any directive be derived from a formal decision of Cabinet, but that if one were in fact communicated to the Bank, Parliament should be informed so that the Bank's views would become known and the issues debated..." (Coombs, 1981:111; see also Linklater, 1992: 29-33).

It is to these issues, principally the bank's charter, the make-up of its Board, and the utility of the present disputes resolution procedures, that the current policy debate is directed.

THE CONTEMPORARY AUSTRALIAN POLICY DEBATE

The central feature of the reform agenda is the call for changes to the Bank's present charter to identify the pursuit of price stability as its principal, or in some cases, exclusive objective (Jonson, 1990; Cole, 1990, Stone, 1992). The search for what Cole describes as a 'champion with teeth' with which to fight inflation (1990:5), was arguably an understandable response to a decade in which Australia's performance was worse than many other nations. However, the early 1990s have seen a dramatic diminution in Australian inflation, with no corresponding decline in calls for changes.

The suggestion that the make-up of the Board be changed has been a constant feature of the calls for change to the present institutional arrangements. Cole suggests that the Board should be made somewhat smaller, that three full-time directors should be appointed, (who, while not participating directly in the management of the Bank, would have access to the resources of, and be housed within it), and that the Secretary of the Treasury not be a Board member (Cole, 1990:8).²

In 1979 John Hewson similarly raised the issue of the Secretary of the Treasury's participation on the Board of the Bank (Linklater, 1992:40).³

More recently Dr Hewson and his Coalition colleagues have advanced the cause of reform by way of the Liberal and National Parties "Fightback!" proposals on Taxation and Expenditure Reform. In a prescription that clearly owes much to the model adopted by New

eland in 1989, and one predicated on the assertion that monetary policy "has been manipulated for short-term political ends" (LNP, 1991b: 129), the Coalition propose changes that include a charter mandating the Bank to pursue price stability, and a requirement, not dissimilar to that required of the Governor of the US Federal Reserve, that the Reserve Bank Governor give regular testimony before Parliamentary Committees. (LNP, 1991a: 37-38, 1991b: 129-130) ⁴

Not surprisingly, the manifest differences in the views being variously expressed by Australia's central bankers and the LNP Coalition have resulted in some vigorous and willing exchanges of views. Opinion and commentary in the serious press has been similarly divided.⁵

The advocates of reform have a considerable body of academic literature on which to draw in making their case. The intellectual climate of the times is one that serves to further illuminate the anomalous preferences of Australia's central banking elite.

The Intellectual Climate of the Times

The prevailing intellectual climate would, at first glance, appear to support Friedman's assertion of a 'worldwide consensus' to the effect that the long-run goal of monetary policy should be price stability. There is a theoretical case, there is some empirical evidence supporting the Downsian assumptions about the behaviour of politicians and the influence of electoral cycles of economic performance, and thirdly there is some evidence that the normative prescription works in practice - that superior inflation performance is a function of central bank independence. There is at least the appearance that Australia's present central banking arrangements, and the defence of them by the Reserve Bank's incumbents, constitutes a distinctly anomalous, if not exceptional state of affairs.

Advocates of reform of those central banking arrangements draw support from three related seams of academic work in economics and political science:

- * from the economic 'credibility' literature which purports to demonstrate the superiority of a rules based policy regime over policy discretion, and which, in turn offers a strong normative prescription in favour of institutional arrangements which seek to

enhance policy credibility by a separation of monetary and political authority;

- *from the 'political business cycle' or 'new political economy' literature which seeks to identify a relationship between electoral and business cycles; and,

- * from the comparative public policy literature which seeks to examine, across nations, the relationship between specific institutional forms, and macro-economic outcomes.

The economic 'credibility' literature is voluminous, (Kydland and Prescott, 1977; Barro and Gordon, 1983; Rogoff, 1985; and reviews in Argy, 1988; and Swinburne and Castello-Branco, 1991), and it is sufficient for the purposes of this present discussion to distil the essence, both of the central argument, and of the normative prescription which that argument sustains.

The notion of a 'time inconsistency' policy constraint is central, and simply posits that, under circumstances where monetary policy is subject to discretion, and not to some form of diachronic rule - that is to say where long-term commitments are precluded - it is in the interests of policy makers (politicians) to use monetary policy in such a way so as to create what is termed 'surprise inflation', which may, in the short-run reduce unemployment and increase government revenues (Barro and Gordon, 1983: 489). In other words policy makers attempt to use monetary policy settings to produce 'favourable' employment/inflation Phillips Curve trade-offs. Over time however adaptive expectations mean that price setters in the private sector anticipate 'surprises', with the result that these episodes cannot occur systematically, and the result is ever increasing inflation as the relationship between policy makers and price setters operates as a ratchet on the price level. The game-theoretic nature of the argument is demonstrated by the following example in which a central bank (the policy maker) sets monetary policy under conditions of policy discretion:

"The central bank announces for a given year a low money growth, low inflation target. Workers faced with this announcement have to decide what their wages policy should be for the year (say the

annual contract). They have two options but there are four potential outcomes. Workers can opt for a low wage policy consistent with the announced money growth and expected inflation or they can opt for a high wage policy inconsistent with the announced money growth plan and implicit inflation. In turn the monetary authorities can (a) stick with the original game plan (b) modify their game plan in the light of actual wage settlements" (Argy, 1988:169)

Fundamentally what is at issue in this example is the credibility of the monetary authorities. In this example, if those authorities lack credibility a high wage route will be chosen, with the result that, provided the wage increase is validated by the monetary policy stance, real wages and employment will be stabilised, but inflation will have risen (Argy, 1988). The solution is seen as, on the one hand, a policy regime predicated on rules and not on discretion, and on the other, a set of institutional arrangements which make it difficult for policy makers to resile from rules once established (Kydland and Prescott, 1977:487).

These institutional arrangements may involve the use of monetary targeting and rules, and the appointment of 'conservatives' to head central banks:

"It can be entirely rational for society to structure its central bank in such a way that the monetary authorities have an objective function very different from the social welfare function. Whenever a distortion causes the time-consistent rate of inflation to be too high, the society can be made better off by having the central bank place "too large" a weight on inflation rate stabilisation." (1985:1187)

The import of the economic credibility literature is clear. The rational expectations revolution means that there is no Phillips Curve that is exploitable in the long-run, and in the absence of a set of institutional arrangements which provide credibility to monetary policy settings over time, the result will be outcomes that are sub-optimal both for policy makers and the private sector. The case for institutional reform would appear to be a strong one.

This paper is less concerned with the merits of the economic arguments than it is with the socio-political determinants of central bank independence. It would however be an egregious omission not to note that the neo-classical assumptions on which the credibility literature is premised are not universally accepted, and to note the possibility that, whatever the weight of the neo-classical argument, the atypical nature of Australia's central banker preferences may be explained by an unwillingness to accept these assumptions.

Two inter-related assumptions in particular are apposite to the current Australian debate; the first that the rate of unemployment at any one point in time conforms to the 'natural rate' (more correctly non-accelerating inflation rate of unemployment or 'NAIRU') or Friedman-Phelps hypothesis; and the second that the effects of monetary policy are benign over the long-run - that in Barro and Gordon's terms, "the systematic parts of monetary policy are irrelevant for real economic activity" (1983:590).

The concept of 'hysteresis' in the labour market suggests that the 'natural rate' of unemployment may not be independent of the course of actual unemployment, (Indecs 7, 1992: 38; Chapman, 1990), and, as a consequence it may be inappropriate to conceive of the output and employment effects associated with contractionary monetary policy settings as being confined to the short-run. Whatever the reasons for the unwillingness of Australia's central bankers to accept uncritically the neo-classical credo - and this paper advances one possible explanation - the fluid state of the economic debate should not be over-looked.

The Political Business Cycle literature shares many of the assumptions that inform the economic credibility literature, and in particular that politicians will be influenced by the confluence of their own desires to retain office, and a preference on the part of the governed (who in the more simple variants of the model are possessed of myopic propensities) to enjoy more employment/economic output in the short-run (see Nordhaus, 1975, 1990; Hibbs, 1987, 1990; Alesina, 1989).

In the context of the present discussion the business cycle literature provides a useful empirical check on the theoretical claims made for

and by the economic credibility literature. If politicians are rational maximisers with access to the economic levers, then we would expect to see the electoral cycle made manifest in cycles of economic expansion and contraction. And if the cycles do indeed exist, then this is further support for the argument that institutional arrangements which insulate policy levers from short-term political manipulation may be necessary.

The evidence is mixed and the theoretical bases to the political business cycle literature not un-contested (see Alt and Chrystal 1983; Whynes, 1989; Elliot and Whiteley, 1990), but the normative thrust of the literature tends to support central banks enjoying a measure of institutional independence from political influence.

Nordhaus' seminal 1975 paper reports evidence of a political business cycle in the case of six of the nine countries included in his analysis (1975:118), and more recent contributions have identified an 'excessive variability' in policy making as a result of partisan manipulation (Alesina, 1989).

The resultant policy prescription includes, inter alia, a rules-based approach to the conduct of economic policy and, more specifically, in the case of monetary policy, an institutional design with which to effect a degree of 'inter-temporal' policy coordination' between governments in office at different times (Alesina, 1989:82).

But whereas the political business cycle and the economic credibility literature share a common preference for rules over policy discretion, in the case of the former there is the acknowledgement both that the implications of a diminution in the extent of democratic control over monetary policy is a matter on which economics as a discipline has little to offer, and that the rules to which an independent agency such as a central bank may work might appropriately be as much informed by social, as by economic objectives (Nordhaus, 1975:188; Alesina, 1989:83). The tenor of these concerns is captured in the following admonition:

"It may be objected...that delegating responsibility to an agency which is not politically responsive to legislature needs is even more dangerous than a few cycles. The danger is frequently

alleged regarding central banks which pay more attention to the 'soundness of the dollar' or the latest monetarist craze than to fundamental policy problems. The costs and benefits of independent policy determination are difficult to weigh" (1975:188).

If the economic credibility literature makes out a strong theoretical case for rules-based policies and institutional arrangements through which government and the private sector enjoy implicit contracts of credibility and certainty, and if the political business cycle literature in turn supports the notion that governments can and do exploit policy instruments for short-term, electorally expedient, and partisan ends, then what evidence is there that the prescription for institutional independence actually works? In order to answer this question we need to examine the relationship between institutional form and economic outcomes - specifically between central bank independence and inflation performance.

Leaving aside the vexed question as to what in fact constitutes central bank 'independence' - an issue which we canvass in some detail below - and accepting that the comparative literature is informed by quite diverse operationalisations of the term, there is some support in the literature for the view that central banks do in fact make a difference to inflation performance.

Alesina reports that for a sample of central banks from 17 industrialised nations over the period 1973-1986 the four most independent central banks were associated with four of the five lowest inflation rates (1989:81). Similar results are also reported, albeit with varying degrees of statistical support, by Grilli et al (1991), Cukierman et al (1991), Busch (1992), and by Way (1992). On balance the comparative evidence supports the view that there is a relationship between central bank independence and price stability.

We have then a prevailing intellectual climate that serves both to support the reformist challenge to the present Australian arrangements, and illustrate the anomalous nature of those arrangements.

In seeking to explain this state of affairs, we need to take a few steps back and examine more closely the notion of central bank independence. What is meant by the term 'independence', and what, in particular, do definitions of it have to say about the preferences of central bankers?

THE MEANING OF 'INDEPENDENCE'

Leverage on the issue of central bank independence can be exercised an institutional approach, which seeks to illuminate the nature and consequences of independence by reference to cross-national variations in the formal or legal characteristics of central banking arrangements, and by a behavioural approach which seeks to identify episodes in which the preferences of monetary and political (fiscal) authorities differ, and in which - for the test of independence to be satisfied - those of the former prevail (Woolley, 1985). Our focus is on the institutional approach.

Generally speaking institutional arrangements as between central banks and political authorities fall into one of three categorisations (Holtfrerich, 1988). Integration characterises cases where the monetary authority forms part of the government, subordination where the government has the right to instruct the central bank and thus to control its actions, and autonomy where central banks are empowered to act on their own, independently of instructions either by government or any other institution.

While in the final analysis it is clear that all governments possess at least some residual power to instruct the central bank (Swinburne and Castello-Branco, 1991:5), what tends to differ is the extent to which specific national institutional arrangements provide insulation from expedient forms of political intervention and manipulation. Most often cited as the exemplar of true independence in the German Bundesbank, which enjoys a measure of autonomy not dissimilar to that afforded the judiciary in Western liberal democracies (see Schmidt, 1989; Deutsche Bundesbank, 1989). In others, the measure of independence is somewhat more circumscribed (Swinburne and Castello-Branco, 1991).

Conceptually, an important distinction can be made between, on the one hand 'independence', and 'autonomy' on the other. There is clearly a difference between independence conceived of as a set of institutional arrangements which preclude government intervention in the conduct of monetary policy, and independence conceived of as the autonomy to set the objectives to which monetary policy may be directed. The essence of the distinction, on which we will build an analytic framework through which to better understand the nature of Australia's exceptional central banking arrangements, is captured in the following observation:

"[F]ormal subordination of a central bank to government control may restrict a central bank's room for manoeuvre much less than subordination to monetary policy rules...such rules tie the hands not only of central bankers but of governments at the same time. Therefore cases where the central bank is subordinated to the government and also subjected to monetary policy rules may have to be judged differently from rules where the bank is subordinated and monetary policy is left to discretion rather than rules" (Holtfrerich, 1988, emphasis added).

Independence is typically conceived as going to the institutional nature of relations between government and central banks, or political independence, and to the capacity of central banks effectively to control the instruments of monetary policy, or economic independence (Grill et al, 1991). Generally speaking the comparative literature accepts this bifurcation. The terminology attached to these discrete aspects of central bank independence differs, with Way, for example illuminating the difference by way of a distinction between control of the means, and of the ends, of monetary policy (1992:15). For Way this distinction supports a four-fold typology in which banks lacking control on either dimension are characterised as 'fully politicised', those enjoying control over means but not ends as possessing 'technical independence', while those controlling ends but not means are characterised as 'goal independent' (1992:15).

For the purposes of this discussion the focus will be on the political dimensions of independence. The extent of the Reserve Bank of Australia's technical independence is, in the context of the present Australian policy debate, not an issue. Our introductory observations on

that debate suggest that what is at issue is the extent to which the Reserve Bank may enjoy a sufficient measure of political independence - alternatively expressed as the independence to choose the goals of monetary policy.⁶

Assessing the extent of political or goal independence requires an examination of the formal or legal aspects of relations between central banks and political authorities. While the operationalisations of political independence are quite diverse, the disaggregated elements of the various measures tend to be drawn from a common menu - the provisions embodied in central banking legislation. This legislative menu includes such matters as:

- * who appoints the chair (Governor), and board of the central bank, how often and provisions relating to their dismissal
- * the presence of government officials on the board of the central bank
- * whether government enjoys a right to veto monetary policy formulation
- * the existence, and transparency, of disputes resolution procedures in the event of a conflict between central bank and government over monetary policy
- * the nature of the central bank charter, and in particular the presence or otherwise of a price stability objective ⁷

This last factor is particularly apposite to the distinction between independence and autonomy. If goal independence is a measure of central bank independence, we might expect central banks for which no objectives are enshrined in statute to be categorised as being among the most independent, followed perhaps by those for which multiple objectives are provided, with those for which single objectives are specified being categorised as among the least independent. The converse is the case.

Definitions of independence typically result in those banks that are mandated to pursue a price stability objective attracting a higher ranking on scores of independence.

Thus while Grilli *et al* acknowledge that independence to choose the goals of monetary policy may be defined without reference to the content of such goals;

"[i]n practice however the main virtue of having an independent central bank is that it can provide credibility. This is why we identify independence with autonomy to pursue the goal of low inflation. Any institutional feature that enhances the capacity to pursue this goal will, on our definition, increase central bank independence" (1991:367, emphasis added).

Similarly for Cukierman *et al*:

"Central banks in which the only or main objectives of policy (as specified in the charter) is price stability are identified as being more independent in this dimension than central banks with a number of objectives in addition to price stability" (1991:9).

Arguably what we have is a measure of the credibility of monetary policy - very much informed by the neo-classical economic literature we discussed above - being used as a proxy for central bank independence. There is accordingly an acceptance both of the neo-classical credo that inflation is a monetary phenomenon, and that monetary policy enjoys a comparative advantage in combating inflation, and an acceptance of the argument that there are no adverse consequences for output and employment, over the long-run, as a result of directing monetary policy exclusively to price stability objectives.

More importantly for the purposes of this discussion, there is an assumption that the preferences of central bankers are such as to be confirmed by central bank charters directed exclusively to price stability objectives. The suggestion that, in defining political or goal independence in this way, there may be some diminution of goal autonomy is not entertained because the preferences of central bankers are assumed to be homogeneous. That being the case, for the purposes of operationalising central bank independence, those preferences are treated effectively as being endogenous.

The normal expectation is, accordingly, that institutional independence together with goal autonomy will lead central banks and central bankers to place the primary emphasis on price stability.

However we know that this is not the case with Australia's central bankers, who defend a charter that goes to multiple objectives, and who resile from any suggestion that the charter should be directed exclusively to price stability objectives.

In order to illuminate the Australian case we need to re-cast the model of central bank independence by defining political independence, not as a function of the existence of, and adherence to, an exclusive price stability objective, but as going instead to the autonomy to pursue those goals that a central bank, in its wisdom, deems to be appropriate for the conduct of monetary policy. Existing definitions of central bank independence simply fail to illuminate the Australian case sufficiently.

If we can explain the Australian paradox, then we can perhaps more generally identify what it is in the nature of the institutional relations between central banks and political authorities that the existing definitions of central bank independence have failed to capture. What is it about the Australian arrangements that might explain their manifest exceptionalism?

THE AUSTRALIAN PARADOX

A possible answer to this question may be found in the social and political determinants of central bank independence. In a recent paper Goodman has argued, after Gourevitch (1986), that the origins of central bank independence, and of economic policy choices more generally, are to be found in the nature of the societal coalitions whose preferences serve to set the policy agenda at any one point in time (1991:331).

Under conditions of economic stability, and where the dominant societal coalition represents other interests - for example farmers, manufacturers and workers - it is argued that the individual and collective preferences of such groups will tend to favour greater monetary expansion (Goodman, 1991:333).

Independent central banks emerge, it is argued, where two conditions are satisfied - under conditions where the dominant societal coalitions are those in which financial interests dominate, because, it is argued, those financial interests tend to be more supportive of policies of monetary restriction, and where the incumbent government expects to be in office for only a short period of time and seeks to effectively institutionalise policy constraints on future governments (1991:332).

Accepting that the interests of monetary and political authorities will at times diverge, it is argued that central banks maintain their independence by building support among key societal actors, and that the financial community serves as the "first line of that support" (Goodman, 1991:335). These ties serve both to establish an enduring societal coalition capable of maintaining the institutional bases to central bank independence, and to sustain a conservative central banking ethos:

"Banks are highly averse to both unexpected inflation and market instability; their long-term interests depend upon the central bank's ability to control inflation and maintain stability in the financial system. Thus, central banks can be seen (and see themselves) as providers of a collective benefit which banks are themselves unable to supply" (Goodman, 1991:329)

That being the case we would expect to find that conservative ethos being promoted out of institutional arrangements in which the coalition of central bank and financial interests manifests itself in particular organisational forms. For central banks the point at which that elite articulation takes place is at the level of central bank boards. It is in the make-up of the representation on central bank boards that we can identify the source of central banker preferences, and it is the specific make-up of the Board of the Reserve Bank of Australia that explains the exceptional nature of Australia's central banking culture. That culture is other than the kind of bank culture that we find embodied in the Boards of central banks such as the German Bundesbank and the US Federal Reserve - Boards that draw together elite central banking interests, in large part because of the federal nature of central banking arrangements and representation at the national level.

By contrast the Board of the Reserve Bank of Australia represents exactly those interests with a greater investment in the real economy than typically expected of those whose interests are confined to the financial and banking sectors. And the Constitutional basis to the Australian Federation is such as to provide the Commonwealth with sole prerogatives in the area of central banking arrangements. There is no regional central banking infrastructure from which to draw the membership of the central bank board.

Moreover our observations on the origins of Australia's present central banking legislation identified that, as a matter of conscious policy choice, membership of the Board of what is now the Reserve Bank of Australia, was afforded to interests other than those of the financial and banking sectors. In Australia the preferences of central bankers are arguably determined by the nature of the interests that one finds on the Reserve Bank Board. As perhaps befitting a central bank whose charter goes to multiple objectives, those interests go to a diverse range of constituencies.

The present Bank Board includes individuals drawn from trade union, manufacturing, retailing and farming interests; and an academic economist. While the Act is, apart from the stated prohibition on representation drawn from those with active interests in the financial and banking sectors, silent on the question of the particular skills or interests that Board members might bring to the work of the Bank, it appears that particular forms of representation may be becoming institutionalised. Linklater notes, for example, that the Secretary to the Australian Council of Trade Unions (ACTU) was a member between 1973 and 1980, that the present Secretary of the ACTU was appointed a member of the Board in 1987 (1992:35), and that it has been the practice since 1969 for an academic economist to sit on the Board (1992:41).

The fact that recent Board appointments have gone to individuals with interests in the real economy (Mrs Janet Holmes a Court, and the chairperson of Coles Myer, Mr Solomon Lew, were appointed to the Board in August 1992 for five year terms) has not, in the context of the debate over the Bank's future role, gone unremarked (see Tim Dodd, The Australian Financial Review, 18 August 1992).

It is in the nature of these interests that we can perhaps discern an explanation for the exceptional nature of the preferences of Australia's central bankers. The answer to the question, 'Why do Australia's central bankers, quite contrary to what happens in virtually every other country, argue against a single inflationary target and, instead, prefer the existing Reserve Bank charter stating a broad range of macro objectives?' rests in the interests represented on and articulated by the Board of the Reserve Bank.

CONCLUSION

In seeking to unravel the Australian paradox we have highlighted what is possibly an important new and hitherto unremarked dimension of the central bank independence issue, namely the pivotal importance of factoring into analyses of central banking institutions and behaviour the nature of the interests represented on the boards of central banks. This is an area deserving of future attention by comparative scholars.

In terms of the current Australian policy debate we should note, in passing, that the comparative evidence offers little support for the kind of changes proposed to the Reserve Bank's charter and Board. To the extent that central bank independence matters for inflation performance, it is in areas where the Reserve Bank already possesses the requisite measure of technical independence.

If, in the light of this knowledge, the demands for changes to the charter and Board continue undiminished, we might perhaps look elsewhere for the underlying rationale behind the calls for change. It is perhaps in the nature of the societal coalitions vying for control of the public policy agenda that we may identify those imperatives. We should note also that the politics of central banking illuminate the fact that, on matters of both policy process and substance, economics itself is a divided science.

In its own way the Reserve Bank is a peculiarly 'corporatist' creature, and as such has an investment in the procedural as much as the substantive aspects of public policy formation and implementation. In the final analysis the fight for the Reserve Bank's charter may be better viewed as a contest between two policy paradigms - an engaged

corporatism on the one hand, and the libertarian proponents of the minimalist state on the other.

Footnotes:

¹The matter of the make-up the Bank Board is fundamental to the argument developed in this paper, and, as such, is canvassed in some detail below. At this juncture it is sufficient to note that the somewhat controversial prohibition on members of the banking fraternity sitting on the Reserve Bank Board remains in the Act. (Section 17, Reserve Bank of Australia Act 1957)

²But having advanced these proposals Cole suggests that legislation to make the Bank more independent is neither necessary, nor desirable, - "the Act gives the Bank independence now..."(1990:8). One could reasonably infer from this that what constitutes changes to the Bank's independence is a matter on which a plurality of views exist. The distinction between goal independence and technical independence is matter to which we return below.

³The make-up of the Board, and more specifically the merits or otherwise of Treasury representation on the Board, was also canvassed in the 1983 Reid Review of Commonwealth Administration, and by the 1981 Campbell Committee on Australia's financial system (see the discussion in Linklater, 1992:40-41).

⁴And the Coalition make it abundantly clear that the changes proposed go to much more than the conduct of monetary policy in isolation:

"Excessive reliance on monetary policy and interest rates of the kind we have seen in recent years can be avoided only if the Government does its part to change other policies to reduce or eliminate cost disadvantages and free-up markets. We therefore envisage two-way discipline as a result of the enhanced independence of the Reserve Bank. The Government would clearly specify the role and responsibilities of the Reserve Bank and the Bank would be held accountable for its performance. Equally, the Government would be under constant pressure to push ahead with labour market and structural reforms" (1991b: 130)

⁵See for example David Clark in the Australian Financial Review, 5 October 1992; Michael West in the Australian Financial Review, 13 October 1992; Max Walsh in the Sydney Morning Herald, 8 October 1992; the Editorial in The Weekend Australian, 10-11 October 1992; and comments by New Zealand property investor Sir Robert Jones reported in The Weekend Australian, 17-18 October 1992

⁶Our focus should not however disguise one important consequence of the distinction, and that is, to the extent that central bank independence, as variously measured, does indeed have an influence on inflation

performance, that influence is reported to be a function of 'economic' or 'technical' independence, and not of 'political' or 'goal' independence (see for example, Grilli et al, 1991)

⁷Not surprisingly the diverse operationalisations drawn from this menu result in, what are at times, markedly divergent rankings on indices of independence accruing to the one central bank. This is certainly the case with the Reserve Bank of Australia which is variously described as being among the most, and the least independent of the central banks (see Alesina, 1989:81; Grilli et al, 1991: 370; Cukierman et al, 1991:15 - 23; Way, 1992:18).

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