



THE UNIVERSITY OF
MELBOURNE

Melbourne Economic Forum

Review of Reserve Bank of Australia

29 May 2023

*“An Australian Symphony Needs the
Full Orchestra”*

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Melbourne

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Overview of Review

- Review makes recommendations on structure and process.
- Not obvious how recommendations would have improved economic performance 2013-23.
- This presentation focusses mainly on inadequate discussion in the Review of economic performance.



The Dog Decade 2013-23

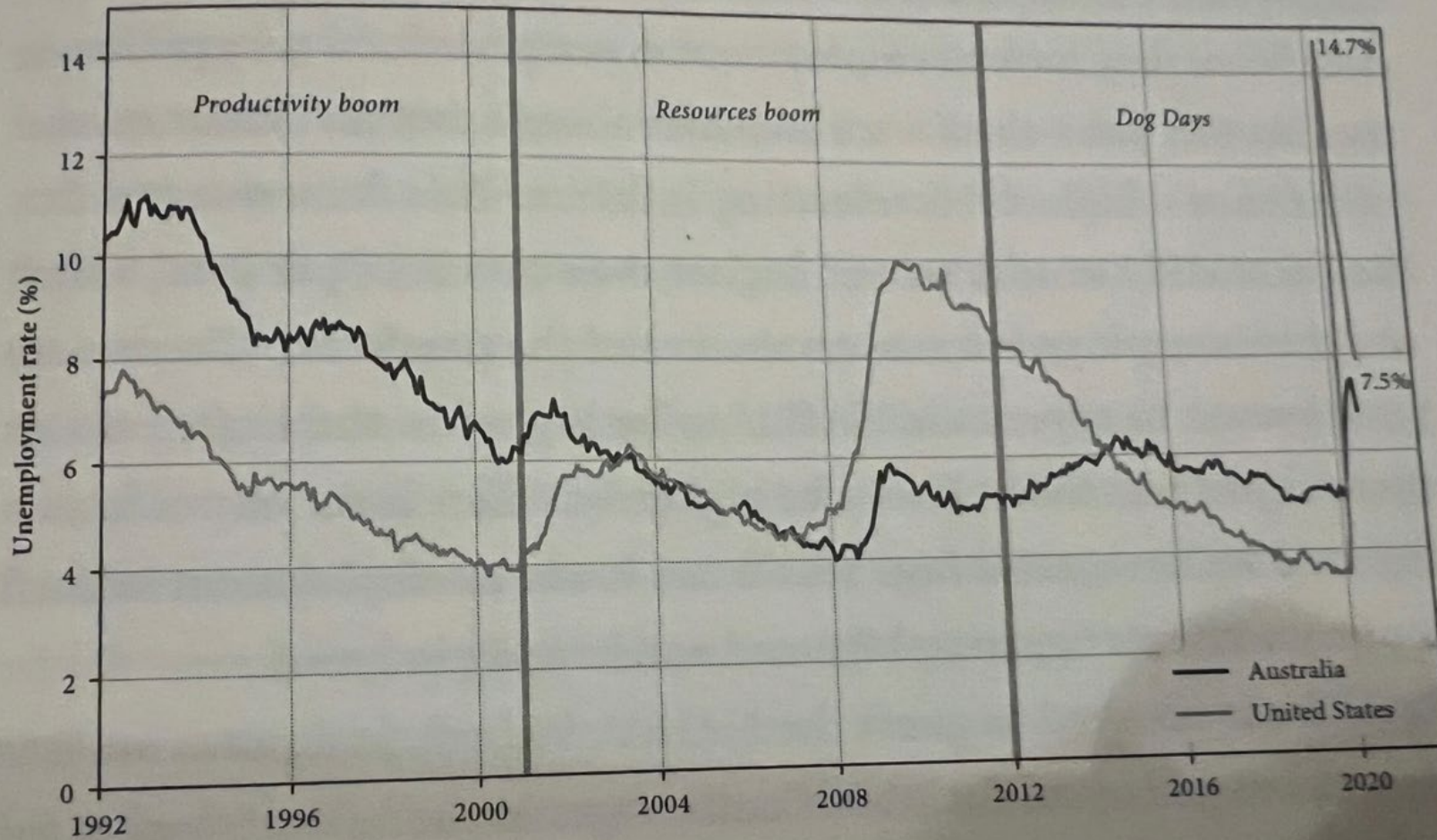
- Per capita income growth at low end of OECD outcomes.
- Real wages down over a full decade.
- Stagnant unemployment and rising underemployment when unemployment fell in other OECD countries.
- No comparable underperformance in Australian history.
- Contrasts with productivity growth which was at high end of OECD outcomes in 1992-2002.
- And mid-range productivity growth and high income growth during China Resources Boom 2002-13.



Dog Days Unemployment

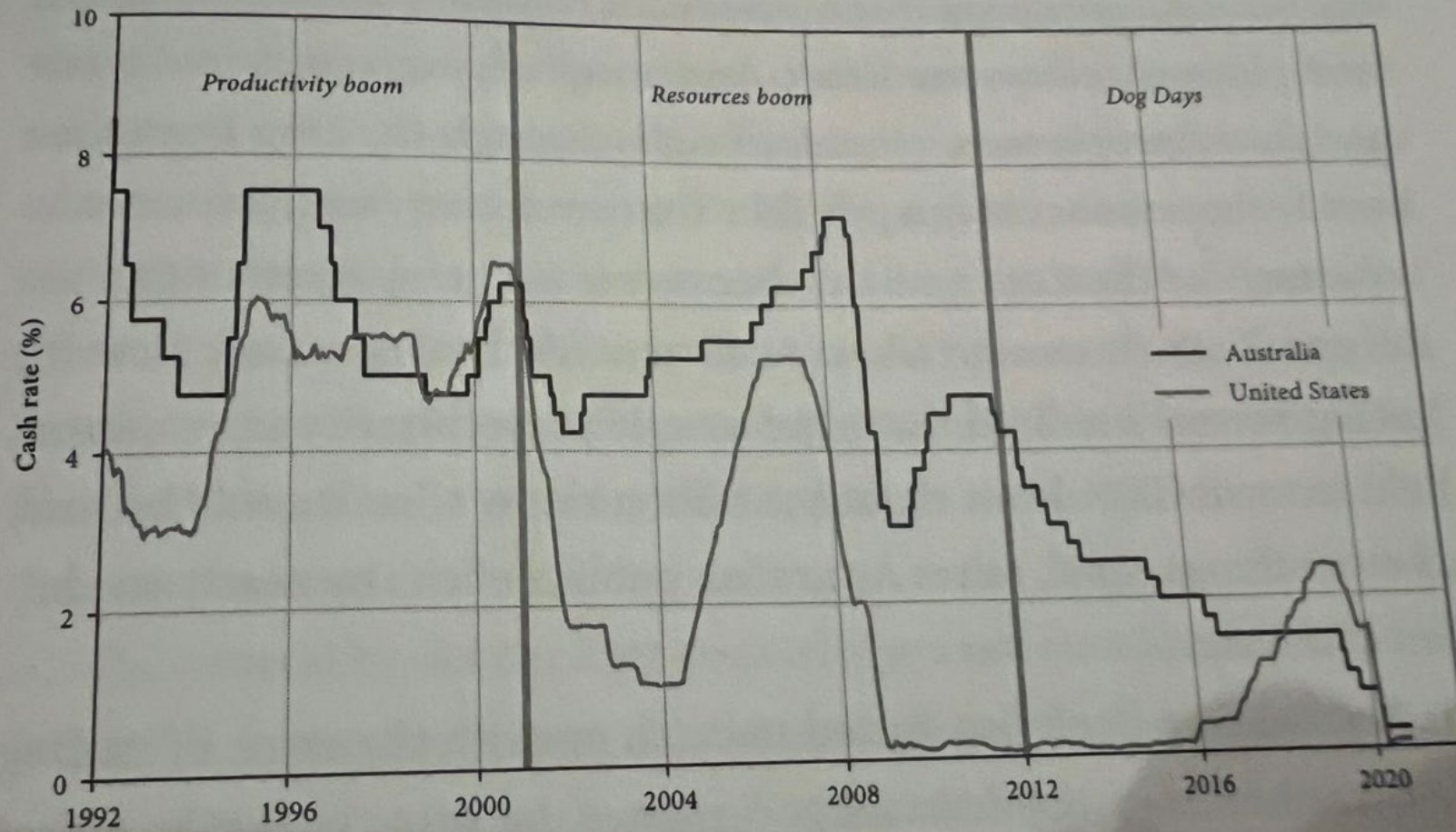
- Underperformance predated COVID.
- RBA Review does not assess underperformance on unemployment over the past decade.
- The Review notes the Gross-Leigh claim that there was excess unemployment of 270,000 in the period 2016-19.
- Gross-Leigh accepts RBA model with artificially high NAIRU, so we think that the excess was even larger.
- The Review makes no reference to excess unemployment 2013-16.

Chart 3.6 Unemployment in Australia and the United States



Data source: Australian Bureau of Statistics, US Bureau of Labor Statistics

Chart 3.7 Policy interest rates: Federal funds versus Reserve Bank cash rate



Data source: Reserve Bank of Australia, US Federal Reserve



Looking Again at the NAIRU

Lucy Ellis Freebairn Lecture:

“...you can guess you are below it if wage growth is accelerating”.

- Modelling doesn't account for weakening bargaining power and rising underemployment



RESET lectures 2020 surmised NAIRU 3.5% when unemployment 7.4%

- We know that sustained growth without recession lowers the NAIRU.
- There has been a massive increase in temporary immigration, reduced regulation of relative wages and a weakening enforcement of labour laws.
- There has now many months of unemployment around 3.5% without inflationary labour market pressures, suggesting NAIRU no higher than that.
- But it is possible that wage regulation will raise the NAIRU again.



Fall in Neutral Real Interest Rate

- Large and continuing fall in investment share of global GDP.
- Large and continuing rise in global savings propensities.
- Neutral real cash rate may not be positive.
- Massive implications for monetary policy.



Review underplays balance between fiscal and monetary policy

- With floating exchange rate, Mundell-Fleming model gives some guidance as to outcomes.
- Fiscal expansion increases demand and tends to raise interest rates and so to appreciate the exchange rate and reduce competitiveness.
- Monetary expansion increases demand and lowers interest rates and so tends to depreciate the exchange rate and improve competitiveness.
- Exchange rate outcomes matter so balance between fiscal and monetary policy matters.



Swan Diagram still matters with floating exchange rate

- Correct balance between fiscal and monetary settings required for optimal combination of demand and competitiveness.
- That optimal combination is required for full employment, low inflation and the right amount of public and external debt.
- Bringing about that optimal combination requires co-ordination of fiscal and monetary settings, for reasons given on previous slide.



Good Economy Requires Full Orchestra With Conductor not Monetary Maestro

Good Economy Requires Full Orchestra With Conductor not Monetary Maestro.

- Close co-ordination of fiscal and monetary policy.
- But also policies about labour market, competition, trade, energy and others.
- And the Productivity Commission can be harnessed to give assistance.
- Conductor can be one of several places in government, but must be somewhere.



Review takes extreme position on RBA Independence

- If absolute, RBA must be conductor of the orchestra.
- RBA has neither capacity nor democratic legitimacy to play this role.
- During the Dog Days, RBA partially assumed conductor role with calls for higher wages and a larger fiscal deficit; post-COVID for productivity improvements.
- The RBA was in no position to bring about any of this.
- RBA Independence of past several decades, within 1959 rules, may be optimal.



The report advises the repeal of the Government's right to over-rule the RBA

- No explicit use of right since then, but
- That would ignore the Australian lessons of 1930, when the Commonwealth Bank held out against the Scullin government, with disastrous consequences.
- Such a move would have no place in a democratic Australia.