RBA Pay is About Independence

The Australian Treasurer, Wayne Swan, recently criticized the Reserve Bank of Australia (RBA) for the pay rise it gave to Glenn Stevens—the governor of the RBA. To his credit, Mr Swan pointed to a lack of transparency in the pay-setting process, and a purported one-year time delay in informing the Commonwealth. Those are real issues and they should be taken seriously.

But Mr Swan seems to have forgotten the importance of central bank independence—especially for Australia, which is a small open economy. A key part of the legacy of Paul Keating and Peter Costello as treasurers is the transformation of the RBA from a government-manipulated puppet run by a series of yes-men, into a genuinely independent institution that sets monetary policy for the good of Australia and its citizens, rather than the government's short-term approval ratings.

We can't have it both ways. Either financial markets believe the RBA is independent or they don't. Currently they do. And every Australian with a home loan, a credit card, or a bank account benefits greatly. When markets believe governments will dictate monetary policy they know that it will cause huge inflation. "'Twas always thus, and always thus will be." 17% mortgage rates in the 1980s were a direct result of such interference. If we want to go back there we can—by questioning the independence of the RBA.

I don't know what the governor of the RBA "deserves" to be paid, or how it should be related to the pay of other public servants at home or around the world. But I do know that a government interfering in the governance of institutions that need to be independent causes big problems. Judges have certain salary guarantees—and in some countries have lifetime tenure—precisely for this reason.

Of course, in the judicial context we are more worried about a government reducing judges pay to a very low level to coerce favorable decisions. Here, the issue isn't that—and though Mr Swan is being overtly populist and political—he isn't being nefarious and coercive. I personally doubt that the pay rise to Mr Stevens—or lack thereof—will change any decision he makes. But markets can get very jittery very quickly. Even a seemingly small probability of a regime change can lead to a spiral of doubt: basically a bank-run on the RBA's reputation. One need only look at the recent financial crisis (e.g. Bear Sterns, Lehman Brothers, AIG, and even for a couple of shocking days Goldman-Sachs and Morgan Stanley) to see how quickly a seemingly small event can become a self-fulfilling prophecy.

Mr Swan, you are playing a dangerous game. A good reputation is a precious asset—hard to acquire and easy to lose. Thanks to Messers Keating, Costelo, and the governors of the RBA since the 1980s, the RBA enjoys one. It leads to lower mortgage and credit card rates. It provides funding for our banks. If you destroy that reputation for independence over a couple of hundred thousand dollars going to a dedicated public servant you will definitely not be dubbed "the world's greatest treasurer." You might be called the opposite.

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