
The Parliament of the Commonwealth of Australia

Review of the Reserve Bank of Australia Annual Report 2011 (Second Report)

House of Representatives
Standing Committee on Economics

October 2012
Canberra

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ISBN 978-0-642-79794-0 (Printed Version)

ISBN 978-0-642-79795-7 (HTML Version)

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Chair's foreword

Australia's national economy continues to achieve sustainable growth with low inflation and low unemployment. This is despite global economic uncertainty particularly in the Eurozone. The RBA noted that the economic and financial problems in the euro area remain the most significant downside risk to the forecasts for global economic growth.

The fundamentals of the Australian economy remain strong. Public debt is low and underlying inflation is at the midpoint of the inflation target range. While resource investment is expected to decline gradually, the RBA noted that the effect of this on GDP growth is expected to be roughly offset by faster growth in resource exports and, in time, a gradual recovery in non-resource investment.

The outlook for Australia remains substantially the same as it has throughout the current calendar year. Real GDP growth is expected to slow over the second half of 2012, as growth in domestic demand in the first half of the year moderates. A surge in growth in the first half of 2012 has lifted the forecasted GDP growth over 2012 to 3½ per cent. This is expected to moderate a little in 2012, when the economy is expected to grow at around 3 per cent over 2013 and 2014.

Since the committee's previous public hearing in February 2012, global conditions have varied, with a general tendency towards weaker growth. The problems of the European economy remain unresolved, so growth throughout the Eurozone has been constrained, while the economy of the United States has grown at a modest pace. Growth in China also eased to a more sustainable rate.

In relation to Note Printing Australia and Securrency International the committee has at six consecutive public hearings examined the RBA about the Bank's knowledge of and response to allegations of corrupt activity. On 8 October 2012 the committee's examination of these matters continued for almost seven hours. It

is expected that once the criminal proceedings are finalised the RBA will be able to release relevant documents which are currently subject to court orders. This will then provide further opportunity for scrutiny by this committee.

Finally, on behalf of the committee I would like to thank the Governor of the Reserve Bank, Mr Glenn Stevens, and other representatives of the RBA for appearing at the hearings on 24 August 2012 and 8 October 2012.

Julie Owens MP
Chair



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Membership of the Committee

| | |
|-----------------------|---|
| Chair | Ms Julie Owens MP |
| Deputy Chair | Mr Steven Ciobo MP |
| Members | Mr Scott Buchholz MP Mr Stephen Jones MP Dr Andrew Leigh MP Ms Kelly O'Dwyer MP Mr Craig Thomson MP |
| Supplementary Members | Mr Adam Bandt MP Hon Tony Smith MP |

Committee Secretariat

| | |
|-------------------------|---|
| Secretary | Mr Stephen Boyd |
| Research Officer | Dr Phillip Hilton |
| Administrative Officers | Ms Natasha Petrović Ms Carissa Skinner |



Terms of reference

The House of Representatives Standing Committee on Economics is empowered to inquire into, and report on, the annual reports of government departments and authorities tabled in the House that stand referred to the committee for any inquiry the committee may wish to make. The reports stand referred in accordance with the schedule tabled by the Speaker to record the areas of responsibility of the committee.



List of abbreviations

| | |
|-----|-----------------------------|
| CPI | Consumer Price Index |
| GDP | Gross Domestic Product |
| IMF | International Monetary Fund |
| RBA | Reserve Bank of Australia |

Introduction

Background

- 1.1 The House of Representatives Standing Committee on Economics (the committee) is responsible for scrutinising the Reserve Bank of Australia (RBA) and for ensuring its transparency and accountability to the Parliament, the community, and the financial sector.
- 1.2 The appearance by the Governor of the RBA at biannual public hearings of the committee is an important element of the RBA's accountability framework. The details of this framework are set out in the *Statement on the Conduct of Monetary Policy*, agreed between the Treasurer, the Hon Wayne Swan, MP, and the RBA Governor, Mr Glenn Stevens. The statement formalises the biannual appearance before the committee. The statement, which is reproduced at Appendix B, states:

The Governor has also indicated that he plans to continue the practice of making himself available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics.

The Treasurer expresses support for the continuation of these arrangements, through which the transparency and accountability of the Reserve Bank's conduct of monetary policy are in line with international best practice. These arrangements enhance the public's confidence in the independence and integrity of the monetary policy process.¹
- 1.3 A second procedural mechanism for achieving this accountability is set out in the Standing Orders of the House of Representatives, which provide for the referral of annual reports within a committee's area of portfolio responsibility for any inquiry the committee may wish to make.

¹ Reserve Bank of Australia, *Statement on the Conduct of Monetary Policy*, 30 September 2010.

Accordingly, the committee may inquire into aspects of the annual report of the RBA.

Scope and conduct of the review

- 1.4 The fifth public hearing of the committee with the RBA during the 43rd Parliament was held in Canberra on 24 August 2012. The committee conducted a further public hearing on 8 October 2012. At this hearing, the committee examined the RBA over issues relating to Note Printing Australia and Securrency International.
- 1.5 The audio proceedings of the hearing were webcast over the internet, through the Parliament's website, allowing interested parties to listen to the proceedings as they occurred. The transcript of the hearing is available on the committee's website.²
- 1.6 Before the hearing, the committee received a private briefing from Mr Alan Oster, Group Chief Economist, National Australia Bank. This briefing provided valuable background information for the committee and perspectives on issues for discussion at the public hearing. The committee appreciates Mr Oster's cooperation and assistance.
- 1.7 Public hearings with the RBA continue to bring issues of monetary policy into the public arena, and have assisted in providing a public face to parliamentary committees and the RBA. The committee welcomes the Governor's frank and open comments at the hearings. In addition, the hearings are an important means whereby financial markets can be better informed on the current thinking of the RBA.
- 1.8 The report focuses on matters raised at the public hearing, and also draws on issues raised in the RBA's *Statement on Monetary Policy*. The *Statement on Monetary Policy* may be viewed through the RBA's website.³

² See: <<http://www.aph.gov.au/economics>>

³ See: <<http://www.rba.gov.au>>

Monetary policy and other issues

Overview

- 2.1 Since the committee's previous public hearing in February 2012, global conditions have varied, with a general tendency towards weaker growth. The problems of the European economy remain unresolved, so growth throughout the Eurozone has been constrained, while the economy of the United States has grown at a modest pace. Growth in China also eased to a more sustainable rate.¹
- 2.2 The IMF forecasts world GDP to grow at a rate of about 3½ per cent in 2012, before increasing slightly next year. The Governor advised that this forecast seemed reasonable at this stage, 'though the risks still seem weighted to the downside'.²
- 2.3 There have also been episodes of anxiety within global financial markets. There was a general increase in aversion to risk, which saw bond yields on some European government debt rise, while yields for German, US and UK sovereign debt declined to record lows. Australia received a portion of the capital flight to safety and market yields on Australian sovereign debt declined to their lowest levels since Federation.³
- 2.4 The Governor summed up the global situation by saying that:
- It is worth noting that we have still not seen thus far the sort of collapse in production and trade across a wide range of countries that was observed in 2008. The global slowing we have seen has so far at least been of the more ordinary variety. That is not to make

¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 1.

² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 1.

³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 1.

light of these developments; only to keep them in some sort of perspective.⁴

2.5 The Governor advised that Australia continued to experience reasonable overall growth, relatively low unemployment and low inflation. The governor explained that the Reserve Bank board had reduced the cash rate in May and June 2012, by a total of 75 basis points. As a result, borrowing rates are now a little below their medium-term average. Australian growth rates remain close to trend and the rate of inflation is consistent with the bank's target.⁵

2.6 The Governor stated:

Looking ahead, the peak of the resource investment boom as a share of GDP, the highest such peak in at least a century, will occur within the next year or two. After that the rate of resource investment is likely to decline while the export shipments of the resources themselves will pick up. By then we might expect that some other sectors that have been weak of late, like residential and non-residential construction, might be starting to pick up. Overall growth is forecast still to be close to trend, albeit with a different composition from that seen in the past year or two, and inflation consistent with the target.⁶

2.7 When questioned by the committee about how current Australian conditions compared to the past, the Governor summed up the nation's present situation as follows:

...we have an unemployment rate of a bit over five per cent; core inflation is two per cent; our government is AAA rated...our banks are strong; and we have been given, by the global economy, a huge gift, really, by the terms of trade rise...that is a very respectable position.⁷

Forecasts

2.8 Following the re-emergence of anxieties about both the sustainability of government budgets and the stability of the banking sector in the Eurozone, global growth slowed in 2012. This slow-down was especially marked in the Eurozone in the June quarter.⁸

⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 2.

⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 2.

⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 5.

⁸ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

- 2.9 Following this development in the June quarter, forecasters have revised down their forecasts for global growth. The IMF's most recent forecast (in April) cut global growth by 0.1-0.2 per cent. The IMF now forecasts global growth of 3.5 per cent in 2012 and 3.9 per cent in 2013.⁹
- 2.10 Australia's key trading partners are forecast to grow a full percentage point above the global rate in 2012 and 2013. Falling global growth has led to falling global demand, with a consequent fall in commodity prices.¹⁰
- 2.11 The Chinese economy has continued to grow at a marginally slower, but more sustainable, rate than previously. Overall export growth has slowed, in particular exports to Europe, but exports to the United States and emerging markets outside of Asia continue to grow. Domestic demand within China continues to grow. There has been a moderation in investment levels in trade-exposed industries, accompanied by an increase in investment in industries that cater for domestic needs alone.¹¹
- 2.12 In Japan domestic demand has grown, with motor vehicle sales staying at a high level and construction growth increasing. The latter is an effect of reconstruction spending. In India, GDP growth slowed to 5½ per cent over the year to the March quarter, which is well below the average of the past decade, with investment continuing to shrink and household consumption growth easing. This was brought about by relatively tight monetary policy aimed at reducing inflation. Rupee depreciation added to cost pressures and prices for food are expected to rise, following a disappointing monsoon.¹²
- 2.13 The outlook for Australia has barely changed since the *May Statement*. Real GDP growth is expected to slow over the second half of 2012, as growth in domestic demand in the first half of the year moderates. The forecast for growth in the second half of 2012 is similar to that in the *May Statement*, a surge in growth in the first half of 2012 has lifted the forecasted GDP growth over 2012 to 3½ per cent. This is expected to moderate a little in 2012, when the economy is expected to grow at around 3 per cent over 2013 and 2014.¹³
- 2.14 The outlook for inflation is expected to remain around its average over the inflation-targeting period. Inflation in the prices of tradable items is expected to rise as a long-term effect from the earlier appreciation of the exchange rate wanes. Together with the increase in the price level arising from the introduction of the carbon price in July, this is expected to push

⁹ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

¹⁰ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

¹¹ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, pp. 6-8.

¹² Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, pp. 8-9.

¹³ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 5.

underlying inflation into the top half of the inflation target range over the year to mid 2013, easing to the middle of the target range thereafter. CPI inflation is expected to rise to 3 per cent over the coming year (as a result of previous volatility in fruit and vegetable prices and the carbon price) before also returning to the middle of the target range over the remainder of the forecast period.¹⁴

Table 1 RBA Output growth and inflation forecasts

| | | June 2012 | Dec 2012 | June 2013 | Dec 2013 | June 2014 | Dec 2014 |
|-----------------------------|--|---------------|-------------|---------------|-------------|---------------|-------------|
| GDP growth | | 3¼ | 3½ | 2½–3½ | 2½–3½ | 2½–3½ | 2½–3½ |
| Non-farm GDP growth | | 3¼ | 3½ | 2½–3½ | 2½–3½ | 2½–3½ | 2½–3½ |
| CPI inflation | | 1.2 | 2¼ | 2½–3½ | 2–3 | 2–3 | 2–3 |
| Underlying inflation | | 2 | 2½ | 2–3 | 2–3 | 2–3 | 2–3 |
| Year-average | | | | | | | |
| | | 2011/ 2012 | 2012 | 2012/ 2013 | 2013 | 2013/ 2014 | 2014 |
| GDP growth | | 3¼ | 3¼ | 3–3½ | 2¾–3¼ | 2½–3½ | 2½–3½ |

Technical assumptions include A\$ at US\$1.06, TWI at 79 and Brent crude oil price at US\$108 per barrel.

Source Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012.

2.15 Australia faces an important risk from developments with the exchange rate, which has been high for some time. There is a possibility that the persistently high exchange rate may exert a more contractionary influence on the economy than historical relationships would suggest.¹⁵

2.16 The bank acknowledged the limitations of forecasting. In his opening address, the Governor admitted that:

At a time of significant global uncertainty and of important structural changes in the Australian economy the degree of confidence we can attach to particular forecast is unavoidably reduced.¹⁶

2.17 The committee sought the Governor's advice on the precision of the bank's forecasts. The governor responded by stating that 'we cannot have

¹⁴ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 3.

¹⁵ Reserve Bank of Australia, *Statement on Monetary Policy*, August 2012, p. 4.

¹⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

great confidence in anybody's individual forecasts', but we should, instead, approach forecasts as 'prudent estimates'.¹⁷

- 2.18 The committee explored the resilience of the Australian economy and the likely impact of possible shocks. The Governor stated:

We are still fairly well equipped to handle some of the things that could go wrong – some of the things to do with, say, the need for foreign funding of the banks. I think our reliance on that is now lower than it was four years ago when, under what you would have to say was an extreme stress scenario globally, we coped. Because of the way the banks have changed their funding structure since then, we are probably in a better condition than we were.¹⁸

- 2.19 The Governor noted that the household sector was managing its debts very well. The Governor explained that scenarios to test the resilience of the banking system are routinely carried out by APRA. Such scenarios might involve a recession, a major downturn in house prices or rise in unemployment. The Governor insisted, however, that there was no reason why we should not remain quietly confident that the Australian economy would be able to manage such stresses and reassured the committee that the system here 'remains well and truly solvent'.¹⁹

Inflation targeting and monetary policy

- 2.20 The committee sought the bank's advice on the possibility that the current intervention of the European Central Bank (ECB) to counter the ongoing financial/monetary crisis in Europe might set off inflationary pressures. The Governor responded to this by saying:

That is a very important question because, in anything approaching normal times, for the central bank to be contemplating large-scale purchases of government debt in the market and so on, and putting the amount of liquidity into the system that they already have – let alone what they do in the future – every textbook I ever read said that in the long run and even in the not-so-long run that would be inflationary....the thing is that we are not in anything like normal times...it has to be extraordinary times for them to think about this and, even within the system, it is probably not without its controversy. I think

¹⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 5.

¹⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, pp. 5-6.

¹⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 6.

analytically the thing there is a potential downside scenario that would be deflationary. I think that is the idea, and that must be headed off, if at all possible, because that is very damaging. So what they are doing is certainly inflationary compared with that real deflationary possibility, and if they get it right they will keep inflation just positive but not high.²⁰

- 2.21 The RBA advised that governments could not solve the European economic problems by themselves; neither could the ECB do so alone. Together, however, they could. The RBA noted that the Europeans were making progress and that the support of the ECB was probably critical to the success of the whole process. The size of the intervention is significant with the ECB (as well as the central banks of Japan, the UK and the US) increasing its balance sheet by up to 20 or 30 per cent. Under normal conditions, this would be inflationary, but the bulk of the money in these swelling balance sheets was not doing anything but was sitting idle, and, hence, was not contributing any inflationary pressure on prices. So the intervention was 'not really doing very much to the global economy, other than forestalling a serious crisis'.²¹

Banking sector

- 2.22 The committee noted that the BIS Shrapnel annual report for 2012 found that Australian banks were the most profitable in the developed world for the second consecutive year and wondered to what extent Australians might need a greater degree of banking competition. The committee was interested in finding out if this profitability was merely a function of other banks in other parts of the world doing poorly, rather than Australian banks gaining unwarranted profits. The Governor stated:

As far as I know, it would still be the case that the return on equity to bank shareholders is good, but there are various other parts of the listed sector where it would be similar. So, on that test, I am not sure it would be obvious that profits are excessive...²²

- 2.23 The Governor warned that people appeared to have a preference for exploring this issue through 'the prism of mortgage finance' alone.²³ While this is an important issue, there are other considerations that need to be taken into view as well, such as the interest of depositors. The Governor noted that for many years depositors received limited returns by today's

²⁰ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 6.

²¹ Dr Lowe, Assistant Governor (Economic), RBA, *Transcript*, 24 August 2012, p. 7.

²² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

²³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

standards, while at the moment there is considerable competition between banks to secure deposits. In the Governor's words, 'the depositors, with a bit of shopping around, enjoy quite considerable competition for their money. That is not something to be ignored or sneezed at.'²⁴

- 2.24 The Governor summed up his position by stating that to gauge the true nature of competition in the banking sector we need to look at both the provision of mortgages and business finance and at the receipt of deposits. This holistic perspective is best.²⁵
- 2.25 The committee sought the Governor's advice on the nation's contingent liabilities in relation to the bank guarantee deposits, their value and the charge the banks pay for that service.²⁶ The Governor advised that there were a number of guarantees in place: a guarantee for wholesale funding (which attracts a charge), a guarantee under the Financial Claims Scheme of ordinary deposits up to \$250,000 (which attracts no charge) and possibly a price guarantee, as well. The Governor was not able to say whether any of those are still outstanding. The Governor estimated (from memory) that the total amount of the guaranteed wholesale obligations peaked at around \$173 billion and is about \$90 billion now. The RBA noted that the total value of the deposits which have been underpinned by the financial claims scheme is now around \$620 billion. This is down from \$780 billion because the cap on the Financial Claims Scheme came down from one million to \$250,000 and there are still outstanding around \$32 billion of state government debt, which has been guaranteed. To date the government has collected nearly \$4 billion in revenue in guarantee fees.²⁷
- 2.26 The committee asked the bank about the relationship of these sums to national GDP. The RBA noted that if all the various liabilities were added up, you would get a number that is close to \$980 billion, which is the equivalent of about 75 per cent of GDP.²⁸
- 2.27 The committee asked if there has ever been a period in Australia's history when contingent liability was at 70 per cent of GDP. The Governor

²⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

²⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

²⁶ This refers to the Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme) which commenced in November 2008. The Scheme enabled authorised deposit-taking institutions to access funding during the global financial crisis. They ensured that Australian institutions were not placed at a disadvantage compared to overseas competitors that had access to government guarantees on bank debt. Once the crisis had passed and similar schemes overseas started to close, the Australian Government closed the Guarantee Scheme to new liabilities from 31 March 2010. Large deposits and wholesale liabilities guaranteed under the Scheme at that time remained under guarantee, for a fee, for the relevant term.

²⁷ Dr Lowe, Assistant Governor (Economic), RBA, *Transcript*, 24 August 2012, p. 16.

²⁸ Dr Lowe, Assistant Governor (Economic), RBA, *Transcript*, 24 August 2012, p. 16.

advised that public debt liabilities of public debt were in excess of 100 per cent of GDP, during wartime. The Governor went on to explain that the critical factor at issue is the similarity between the guarantee scheme and an insurance scheme: it is the expected amount of pay outs, not the gross volume of guarantees, which is important. Furthermore, the Financial Claims Scheme works so that if an institution is wound up, its assets would repay the depositors first, or they actually repay the scheme first because the scheme is paid out to the depositor. If there were not enough assets to cover obligations, then a levy can be put on the rest of the industry. Thus, there is a funding mechanism there to assist the government to pay. Finally, it is unlikely that any government could stand by and allow financial institutions to fail at the expense of their depositors. In the Governor's words: '...even if you did not have an explicit guarantee, you cannot just assume that there would never be any possibility of the taxpayers being on the hook in a big enough crisis.'²⁹

- 2.28 The committee sought the Governor's advice on progress with an International Monetary Fund (IMF) review of the Australian banking system.³⁰ The Governor responded by stating that the bank has met with them, various processes were undertaken and that 'I do not think there are serious concerns arising from that work'. One of the staple questions raised by such a review is the foreign funding for the banks coupled with the housing story. The review process is not yet complete, so the Governor was not able to elaborate in any great detail, but he did reassure the committee that 'I do not anticipate there being serious concerns arising from that when it is finalised'.³¹

Exchange rate

- 2.29 The committee referred to the current debate in the press about the merits of intervention in the exchange rate and sought the Governor's views on whether or not Australia should pursue a similar policy to that of the Swiss. The Governor advised that overseas demand for Australian sovereign debt has been strong; foreigners now hold nearly 80 per cent of the stock of Australian government debt. By global standards, the volume of that debt is not large, but it is rated AAA standard and offers a yield which is quite attractive to the alternative on offer in much of Europe,

²⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 17.

³⁰ *The Financial Sector Assessment Program (FSAP) analyses a country's financial sector. Established in 1999, the FSAP assessments are conducted in advanced economies by the IMF. In the emerging and developing economies, the World Bank is involved as well. For further details of the FSAP, see <http://www.imf.org/external/np/exr/facts/fsap.htm>.*

³¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 12.

which is now zero or negative. Furthermore, the flow of overseas investment into Australia is now greater than it once was because 'generally rates of return overall in this country are attractive'.³²

- 2.30 The Governor advised that the Swiss case is very different to ours. Switzerland is in Europe and they have a very open economy, so a very large share of their GDP is in the traded sector. They are experiencing consumer price deflation and their interest rates are at nothing. The Swiss National Bank's reserves are now approximately the equivalent of 70 per cent of Switzerland's annual GDP; Australia's reserves are \$45-odd billion, a tiny fraction of Australia's GDP.
- 2.31 The Governor warned that the risks involved in currency intervention are not inconsiderable. While such a policy may be plausible, in extremis, 'it is a big call and it is not a call that we have felt should be made to this point in time.'³³
- 2.32 The committee sought the Governor's views on whether the value of the Australian dollar is distorted. The Governor insisted that the current value of the dollar is not necessarily a distorted one and that the underlying rationale for the present condition was that global markets found in Australia an attractive place to invest: 'I think there is more tendency now for some official flows seeking high-quality assets.'³⁴
- 2.33 The Governor went on to note that in his opinion, the Australian dollar was:
- '...trading a bit above where I would have thought it would be... I would say it is probably a little on the high side, but in terms of the statistical relationships you can fit you cannot actually say that error is all that significant. It is just my instinct that suggests that it is a bit on the high side.'³⁵
- 2.34 The Governor also advised that one's perspective of the value of the dollar depended in large part on our understanding of the wider economic context, the situation with global relative prices. In the Governor's view:
- If you really think the whole thing is going to go away imminently – the mining boom is going to completely crash, the relative price shift is not there, the whole thing is not going to persist – then the Aussie dollar in that scenario presumably would need to be much lower than it is. It probably will go there if that scenario unfolds – that would be my guess. But in the interim, if

³² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 10.

³³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 10.

³⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 11.

³⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 11.

that was your view, you would probably be worried that it is too high.³⁶

Investment boom

2.35 The committee was interested in the bank's views on the valuation of the capital expenditure pipeline and forecasting for capital expenditure (CAPEX) in general. The Governor stated that there were no recent developments that might cause the RBA to revise its expected profile. The RBA noted that CAPEX will peak at a bit over nine per cent of GDP, which is equivalent to about \$145 billion per annum over the next two or so years. The Bank warned that we need to distinguish between different types of projects and how we come up with these sorts of numbers. There are two types: those which big resource companies have made a very strong commitment to and those without a firm commitment.³⁷

2.36 The committee asked the Governor to comment on the recent statement by the Treasurer, to the effect that this is the first time that Australia has had a AAA credit rating from all three major credit agencies. The Governor advised that he did not know – he had not checked the number of agencies involved in the past and insisted that:

I do not want to comment on things that the Treasurer said...for most of its history, apart from a period from somewhere in the mid-nineties through to about 10 years ago – I cannot remember when the upgrade happened – Australia has been known as a AAA country, and so it should have been.³⁸

2.37 The committee also asked the Governor to clarify matters regarding inflation. The committee was puzzled by the apparent disparity between the bank's public statements and public expectations, noting that while the statement on monetary policy notes about a two per cent on tradeable prices underlying inflation to its lowest level in the late 1990s, the public debate is about the rising costs of living and the rapid increases in prices. The Governor responded:

I have not seen evidence of late to suggest that there is a dislodging of inflation expectations. On everything we can measure they look like they are fine... There is always prominence given in the media to the things that have gone up...People are

³⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 12.

³⁷ Dr Christopher Kent, Assistant Governor of the RBA (Economic) *Transcript*, 24 August 2012, pp. 18-19.

³⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 19.

invited to focus on the news that is bad. That is the nature of things. We can lament that, but I am not sure we have much hope of that changing. But I do not think that at this point we have a significant problem with inflation expectations being excessive, as best I can judge.³⁹

Productivity

2.38 The committee referred to a recent RBA publication that claimed that there are signs that productivity growth has picked up over the past year.⁴⁰ The committee asked the Governor to what extent he thought that this is within-sector productivity growth and what were his views on the productivity pick-up?⁴¹

2.39 The Governor advised caution, on the grounds that it is premature to become preoccupied with this, because productivity is notoriously difficult to measure. Furthermore, in order to comment with any confidence one would have to have low-frequency data. Thus we cannot be really sure at this stage if we have had a slowdown in productivity yet. This will be obvious several years after it has actually begun.⁴²

2.40 The Governor stated:

Personally I think it is to be expected that we will see higher productivity growth performance in this period, because I think that is really what structural change is. It is almost the definition of it. So I think it is happening...So my judgment would be that I believe it is likely to be happening.⁴³

Labour market

2.41 In relation to unemployment, the committee questioned the Governor about variation by region. The Governor advised that the bank tracks the dispersion of the rate of unemployment. There are quite a large number of regions where you can get this. On the basis of the figures available at the

³⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 19.

⁴⁰ This appears to be a reference to an article by Patrick D'Arcy and Linus Gustafsson 'Australia's Productivity Performance and Real Incomes' that was published in the RBA's *Bulletin*, June Quarter 2012. This is available at <http://www.rba.gov.au/publications/bulletin/2012/jun/3.html>

⁴¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 19.

⁴² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, pp. 19-20.

⁴³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 20.

hearing, about half the regions have unemployment at five per cent or less; 90 per cent of them have unemployment less than seven per cent as measured. There are very few regions, if any, with double digits. This confirms that the situation is indeed a patchwork.⁴⁴

- 2.42 In addition, the committee wanted to know if the decline in the terms of trade would reduce the extent of the patchwork nature of the economy. The Governor replied that:

Yes, I think it is fair to say that, to the extent that the impetus for growth shifts away a bit from where it has been to be more broadly focused, that is probably right: you might get some reduction in the so-called patchwork. In saying that, I think it is important to say as well that it is always a patchwork. It is not and never has been a seamless garment. There is always a patchwork nature. 'Patchwork' is a new word we have coined and it is a reasonable description, but it has always been there.⁴⁵

The payments system

- 2.43 The committee noted that the Payments System Board had recently made some comments in a release with respect to multifunctional cards and multi-network debit cards and that the Board appeared to have concerns about whether or not EFTPOS is able to take advantage of R&D that four-party schemes have undertaken with respect to contactless payment systems.⁴⁶ The committee asked the Governor for his advice in particular what his general view was concerning the IP that is being developed by the four-party schemes and whether or not EFTPOS should be able to piggyback on developments in contactless payments systems.
- 2.44 The Governor responded that he did not have a strong view about the IP issue and that the Board's starting point is an acknowledgement that the ability of a card to function in more than one way is a good thing. Ideally, the Board would prefer the industry to co-operate together to find a way

⁴⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

⁴⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 9.

⁴⁶ *Transcript*, 24 August 2012, pp. 20-21. This refers to a media release of 17 August 2012 by the Payments Board entitled *Payments System Issues: Multi-Network Debit Cards*. These cards are issued by banks and other institutions for ATM usage and with debit functionality from more than one payments network. The release acknowledged concerns with rules that require the provision of commercially sensitive data about one network to a competitor network, the imposition of fees by one network on another network's transactions and disputes over the placement of network brands on cards and the emergence of a emerging issues between the various networks concerning contactless debit cards. The release is available in full at: <http://www.rba.gov.au/media-releases/2012/mr-12-20.html>.

so that this could happen. The Governor was disinclined to support regulatory intervention.⁴⁷

- 2.45 According to the Governor, the key issue with contactless cards is the ability for some of the schemes to reduce the ability of the merchant to help steer the consumer by networks. The board's position has been that, while the four-party schemes have got fine products, a legitimate business model and so on, we must ensure that both the consumer and the merchant are suitably empowered with choice as well. This is a potential issue with contactless cards because they are pre-programmed to go through one network.⁴⁸
- 2.46 The Governor characterised the state of discussion about these issues as follows: much of the debates come down to the piece of plastic *per se*. Who owns it? Whose logo can be placed upon it? Every party seems to claim that they own it: the schemes, EFTPOS and the issuing bank alike.⁴⁹
- 2.47 In the Governor's view, the optimal outcome would be for consumers to have a card which could function through more than one network, where no particular provider is in any way unfairly advantaged by the location of their logo for example. The Governor insisted that those who invest in developing such facilities have a right to earn a return on their investment. Equally, people who have a valid contribution to make of their own should not be put in a position of being artificially excluded from the card.

Conclusion

- 2.48 Australia's economic performance remains exceptionally strong, by global standards. Together with economic powers like the United States, Japan and the United Kingdom, Australia is an attractive destination for highly global mobile capital in uncertain times. The strength of our economy is now such that the international credit ratings agencies are unanimous in awarding Australia the much-coveted AAA standard.
- 2.49 The fundamentals of the Australian economy are strong. Public debt and unemployment are low, underlying inflation is at the midpoint of the inflation target range, and we have a significant pipeline of business investment remains to flow, particularly in the resources sector.
- 2.50 Over the medium-term monetary policy is expected to meet the goals of its long-standing inflation target, with inflation remaining within the 2 to 3 per cent band for most of the forecasting period.

⁴⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 21.

⁴⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 21.

⁴⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 21.

Note Printing Australia and Securrency

Public hearing – 24 August 2012

- 2.51 The Governor reported on Note Printing Australia (NPA) and Securrency International. The Governor stated that it was desirable for him to offer a coherent and complete narrative of developments.⁵⁰ The Governor explained that in 2006, following developments at the Australian Wheat Board, the Board had asked questions about the policies for the use of overseas agents by the two companies.
- 2.52 These questions prompted NPA to begin a process of developing stronger policies. RBA management sought an update on progress with this in early 2007. To brief the bank, the NPA board requested a paper from their management on dealings with sales agents. After considering that paper, the NPA board resolved to audit past practices and compliance. That audit identified concerns and recommended that the NPA should discontinue the use of agents and investigate the role of management and staff in dealing with agents to ensure compliance with Australian law. On receiving this report, the NPA board took the decision to cease using agents. Acting through a subcommittee of the board, they also commissioned Freehills to assess questions of standards and compliance.⁵¹
- 2.53 At the same time, the RBA Board asked Securrency for its policies on agents. Consequently, the company adopted additional and stronger policies and procedures. Following the audit at NPA in 2007, the Securrency board requested a similar audit which led to the termination of one of the agents which it shared with NPA. That audit found that Securrency had a 'good and robust process' in place in relation to overseas agent contracts and payments. A follow-up audit was conducted in 2008. This audit made the same finding.⁵²
- 2.54 Because of the findings of this audit, neither the Securrency board nor the Bank discontinued the use of agents, as had occurred at NPA. However, the Reserve Bank was taken by surprise by the allegations published in mid 2009. It is now clear, however, from a KPMG report conducted for the Securrency board later in 2009, that information regarding agents was withheld from the audit teams and the Securrency board in 2007 and 2008.⁵³
- 2.55 At the same time that the audit of NPA was under way a member of NPA's management expressed his concerns over the company's conduct to

⁵⁰ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁵¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁵² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

an RBA assistant governor who sat on NPA's board. The NPA manager was asked by the then Deputy Governor to make a written statement, which in turn was provided to Freehills. This document was held in strict confidence at the request of its author.⁵⁴

2.56 In the bank's view, it was imperative to investigate the issues identified by the audit and to ascertain the facts regarding the NPA manager's concerns. The board believed that neither the bank nor the NPA board should make such an assessment. This decision ensured a proper, independent and rigorous process, and that was the intention.⁵⁵

2.57 The Freehills report was highly critical of NPA's practices but it concluded that there was no evidence of a breach of Australian law. Consequently, there were no grounds for approaching the police. When the Australian Federal Police were called in 2009 by the Chairman of Securrency regarding the allegations made about that organisation, the 2007 NPA matters were all disclosed to the AFP. The Freehills report and audit reports were provided to the AFP when requested.⁵⁶

2.58 In relation to the statement made by an NPA manager, the Governor stated:

It has been claimed by some that the written statement by the NPA manager contained clear evidence of corrupt behaviour. In 2007, two senior legal practitioners from a leading law firm who received this material directly from the author as part of their review, and who interviewed the author and others, did not view it that way in coming to their conclusion that there was no evidence of a breach of the law.⁵⁷

2.59 The Governor was emphatic that though it is possible that a different conclusion might be drawn in future, it should be clear by now that there was no attempt to cover anything up by anyone in the Reserve Bank.

2.60 The Governor explained that there are a number of court orders in place that place restrictions on the documents that the bank is permitted to disclose. The non-publication orders have been made as a result of applications by the individuals facing criminal charges. These applications are designed to protect their right to a fair trial before an impartial jury. In addition, non-publication orders have been sought and obtained by the Department of Foreign Affairs and Trade and the Australian Federal Police. Among the material subject to such orders is the statement of the

⁵⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 3.

⁵⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵⁶ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵⁷ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

NPA manager. The Governor received legal advice in relation to whether he could table the statement. That advice was that he could not.⁵⁸

- 2.61 The Governor insisted that the Bank is committed to transparency with this committee and with the community. The Bank indicated that it was available at any time to appear before the committee.⁵⁹
- 2.62 The committee sought advice from the Governor regarding reports by the Australian Broadcasting Commission (ABC). The Governor teased out the essential question, which was ‘when did I first learn about the allegations about Securrency?’ The Governor stated:

...when the papers published it. That was true. That has actually been misconstrued by many people as denying knowing anything about the events of NPA in 2007, but that is not what I was saying at all. I think we have been quite open with the committee about the 2007 matters.⁶⁰

- 2.63 The committee was also interested in pursuing issues arising from the sequence of disclosures and the priorities and reasons relating to the disclosure of specific documents during successive hearings of the committee. The Governor summed up his position as follows:

What I am saying today, given that there is so much controversy over these documents, is to this point what the Reserve Bank has done on these matters is cooperate with the police and keep our mouth shut because there are people on trial accused of crimes. It is, I think, therefore not appropriate for me to weigh in on these things and I know you all agree with that. So we have not thrown about documents and comments and so on. But if there is a feeling that the committee wishes to have these materials that we have, if I can possibly supply them I will because I think that is the situation we are at...⁶¹

Public hearing – 8 October 2012

- 2.64 The Governor acknowledged the legal sensitivity of discussing matters that have led to criminal prosecutions currently before the courts, stating that: ‘It is very important that the bank does not say or do anything which would improperly impinge on any of those processes, particularly not in a public form.’⁶²

⁵⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁵⁹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 4.

⁶⁰ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 15.

⁶¹ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 24 August 2012, p. 15.

⁶² Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 1.

2.65 The Governor discussed the detailed history of the two companies, the sequence of events that followed the Reserve Bank board asking about the use of overseas sales agents in April 2006 and an account of how the bank, NPA and Securrency reacted to the succession of allegations.⁶³

2.66 In order to clarify developments since April 2006, the committee posed a series of questions relating to specific events and the decisions made in response to these. These questions related to the pace of decisions, the provision of information to various parties, internal processes within the bank and mechanisms for transparency and accountability. For example, the committee sought an explanation as to why the board had requested that Freehills, rather than the Federal Police, inquire into the issues. The Governor responded:

I would view the decision that the NPA board made to commission Freehills as, in the circumstance of the time, a reasonable decision...I would think it quite a normal thing to do for any commercial organisation, even one that is publicly owned but operating in a commercial space, having heard concerns, to seek to have serious people. There was a measure of independence in the subcommittee, because we had a person of unimpeachable integrity, an independent member of the RBA's audit committee – not on our payroll, not on NPA's payroll and no great admirer, one would have to say, of NPA's record in the audit space – to chair that. There were very independent, serious people on that committee. They engaged two senior practitioners with experience in the area from one of the country's leading firms. I think that would be quite a reasonable response in the eyes of most people who are experienced in these matters. I think that was a reasonable thing for them to do and to find out: 'Do we have evidence? What is it we have?' Then, of course, had they concluded something like, 'There is evidence of a breach of the law,' or, 'We think there are very strong suspicions that there may have been,' then I think there would have been a process where the NPA board would have felt, inevitably, 'We must now take this issue to the police,' but that was not the conclusion...I did not feel at the time, nor actually looking back, that part of the process itself was deficient.⁶⁴

2.67 The committee also asked why the bank used agents at all. The Governor explained that the use of agents was a common business model.⁶⁵ The bank elaborated his explanation by explaining that the use of agents was

⁶³ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, pp. 1-5.

⁶⁴ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 17.

⁶⁵ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 16.

understood as a legitimate practice at the time the company (NPA) had begun to enter new markets in the western Pacific.⁶⁶

2.68 The committee asked the Governor if he believed that he had been derelict in his duties. The Governor responded:

Let's get right to it. No, I do not. I think my responsibilities as the chief executive of the organisation is always to satisfy myself that issues that come up are being dealt with properly by the relevant people. At each point in this very, very long process, which has taken me the best part of half an hour to read, I felt that the people who reported to me or were my colleagues were actioning appropriately the information that came to their attention and escalating the steps as needed. In fact, in some respects, they certainly did more than the minimum they might be expected to do, really.

2.69 The committee put the same question to the recently retired deputy governor, he responded in a similar vein, noting that on a number of occasions where he had intervened directly into NPA matters to escalate matters and that he was satisfied that the NPA board could not have done any more than they actually did.⁶⁷

2.70 The committee wished to know if the Governor had any regrets or could identify any lesson learnt from the issues under investigation. The Governor stated:

If pressed on this, I would have to say that there should have been more scepticism and more questioning of the managements of both companies earlier than there was. I think it is hard to avoid that conclusion. It is with that viewpoint I would say that this is why, in thinking about the future, we want Note Printing Australia to have a much more narrowly defined role and a closer link to the degree of risk tolerance that the Reserve Bank has. We really in the medium term have no business being an owner of Securrency. That is a successful company, but it no longer needs us. We have already said that we will be looking to exit that shareholding.⁶⁸

Conclusion

2.71 The committee, at six consecutive public hearings, has examined the Reserve Bank of Australia about the Bank's knowledge of and response to allegations of corrupt activity at Note Printing Australia and Securrency

⁶⁶ Mr Frank Campbell, Assistant Governor (Corporate Services), *Transcript*, 8 October 2012, p. 16.

⁶⁷ Mr Ric Battellino, former Deputy Governor of the RBA, *Transcript*, 8 October 2012, p. 18.

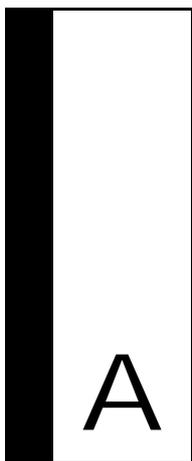
⁶⁸ Mr Glenn Stevens, Governor of the RBA, *Transcript*, 8 October 2012, p. 22.

International.⁶⁹ On 8 October 2012 the committee's examination of these matters continued for almost seven hours. In addition, a retired Deputy Governor was called to appear. This public examination was in the context of ongoing criminal proceedings relating to the alleged activity at Note Printing Australia and Securrency. The committee, therefore, in conducting the public hearing was conscious of the need to apply the sub judice convention and ensure that matters were not discussed which could interfere with those legal proceedings.

- 2.72 The committee notes that while the criminal proceedings are in progress, the Bank is subject to certain court orders preventing it from releasing information. Notwithstanding this limitation the committee's scrutiny provided an opportunity to examine the effectiveness of the Bank's corporate governance. In particular, while the Governor argues that he was not derelict in his duties he acknowledged that, in hindsight 'there should have been more scepticism and more questioning of the managements of both companies earlier than there was.'
- 2.73 The committee, at future hearings, will continue to scrutinise the RBA over these issues. At the same time, it is expected that once the criminal proceedings are finalised the RBA will be able to release relevant documents which are currently subject to court orders. This will then provide further opportunity for detailed scrutiny by this committee.

Julie Owens MP
Chair
31 October 2012

⁶⁹ The relevant public hearings are 26 November 2010, 11 February 2011, 26 August 2011, 24 February 2012, 24 August 2012 and 8 October 2012.



Appendix A — Hearings, briefing, and witnesses

Public hearings

Friday, 24 August 2012 – Canberra

Reserve Bank of Australia

Mr Glenn Stevens, Governor

Dr Philip Lowe, Deputy Governor

Dr Christopher Kent, Assistant Governor (Economic)

Monday, 8 October 2012 – Canberra

Mr Glenn Stevens, Governor

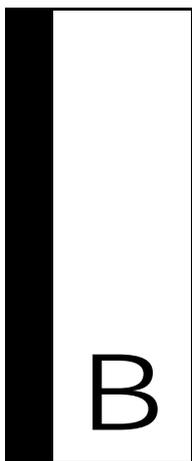
Mr Ric Battellino, Former Deputy Governor

Mr Frank Campbell, Assistant Governor (Corporate Services)

Private briefing

Wednesday, 22 August 2012 – Canberra

Mr Alan Oster, Group Chief Economist, National Australia Bank.



Appendix B — *Fourth statement on the conduct of monetary policy*

The Treasurer and the Governor of the Reserve Bank

30 September 2010

This statement records the common understanding of the Governor, as Chairman of the Reserve Bank Board, and the Government on key aspects of Australia's monetary and central banking policy framework.

Since the early 1990s, inflation targeting has formed the basis of Australia's monetary policy framework. Since 1996, this framework has been formalised in a Statement on the Conduct of Monetary Policy. The inflation targeting framework has served Australia well and is reaffirmed in the current statement.

This statement should continue to foster a better understanding, both in Australia and overseas, of the nature of the relationship between the Reserve Bank and the Government, the objectives of monetary policy, the mechanisms for ensuring transparency and accountability in the way policy is conducted, and the independence of the Reserve Bank.

This statement also records our common understanding of the Reserve Bank's longstanding responsibility for financial system stability.

Relationship between the Reserve Bank and the Government

The *Reserve Bank Act 1959* (the Act) gives the Reserve Bank Board the power to determine the Reserve Bank's monetary policy and take the necessary action to implement policy changes. The Act nominates the Governor as Chairman of the Reserve Bank Board.

The Government recognises the independence of the Reserve Bank and its responsibility for monetary policy matters and will continue to respect the Reserve Bank's independence as provided by statute.

New appointments to the Reserve Bank Board will be made by the Treasurer from a register of eminent candidates of the highest integrity maintained by the Secretary to the Treasury and the Governor. This procedure removes the potential for political considerations in the appointment process and ensures only the best qualified candidates are appointed to the Reserve Bank Board.

Section 11 of the Act prescribes procedures for the resolution of policy differences between the Reserve Bank Board and the Government. The procedures, in effect, allow the Government to determine policy in the event of a material difference; but the procedures are politically demanding and their nature reinforces the Reserve Bank's independence in the conduct of monetary policy. Safeguards like this ensure that monetary policy is subject to the checks and balances inherent and necessary in a democratic system.

In addressing the Reserve Bank's responsibility for monetary policy, the Act provides that the Reserve Bank Board shall, from time to time, inform the Government of the Reserve Bank's policy. Such arrangements are a common and valuable feature of institutional systems in other countries with independent central banks and recognise the importance of macroeconomic policy co-ordination.

Consistent with its responsibilities for economic policy as a whole, the Government reserves the right to comment on monetary policy from time to time.

Objectives of Monetary Policy

The goals of monetary policy are set out in the Act, which requires the Reserve Bank Board to conduct monetary policy in a way that, in the Reserve Bank Board's opinion, will best contribute to:

- a. the stability of the currency of Australia;
- b. the maintenance of full employment in Australia; and
- c. the economic prosperity and welfare of the people of Australia.

The first two objectives lead to the third, and ultimate, objective of monetary policy and indeed of economic policy as a whole. These objectives allow the Reserve Bank Board to focus on price (currency) stability while taking account of the implications of monetary policy for activity and, therefore, employment in the short term. Price stability is a crucial precondition for sustained growth in economic activity and employment.

Both the Reserve Bank and the Government agree on the importance of low inflation and low inflation expectations. These assist businesses in making sound investment decisions, underpin the creation of jobs, protect the savings of Australians and preserve the value of the currency.

In pursuing the goal of medium-term price stability, both the Reserve Bank and the Government agree on the objective of keeping consumer price inflation between 2 and 3 per cent, on average, over the cycle. This formulation allows for the natural short-run variation in inflation over the cycle while preserving a clearly identifiable performance benchmark over time.

Since the adoption of inflation targeting in the early 1990s, inflation has averaged around the midpoint of the inflation target band. The Governor takes this opportunity to express his continuing commitment to the inflation objective, consistent with his duties under the Act. For its part the Government indicates that it endorses the inflation objective and emphasises the role that disciplined fiscal policy must play in achieving such an outcome.

Transparency and Accountability

Monetary policy needs to be conducted in an open and forward-looking way. A forward-looking focus is essential as policy adjustments affect activity and inflation with a lag and because of the crucial role of inflation expectations in shaping actual inflation outcomes. In addition, with a clearly defined inflation objective, it is important that the Reserve Bank continues to report on how it sees developments in the economy, currently and in prospect, affecting expected inflation outcomes. These considerations point to the need for effective transparency and accountability arrangements.

The Reserve Bank takes a number of steps to ensure the conduct of monetary policy is transparent. The Governor issues a statement immediately after each meeting of the Board, announcing and explaining the Board's monetary policy decision, and minutes of each meeting are issued two weeks later providing background to the Board's deliberations. The Reserve Bank's public commentary on the economic outlook and issues bearing on monetary policy settings, through public addresses and its quarterly *Statement on Monetary Policy* and *Bulletin*, have been crucial in promoting increased understanding of the conduct of monetary policy. The Reserve Bank will continue to promote public understanding in this way.

The Governor has also indicated that he plans to continue the practice of making himself available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics.

The Treasurer expresses support for the continuation of these arrangements, through which the transparency and accountability of the Reserve Bank's conduct

of monetary policy are in line with international best practice. These arrangements enhance the public's confidence in the independence and integrity of the monetary policy process.

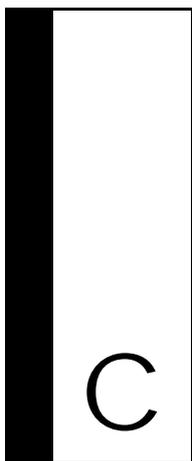
Financial Stability

The stability of the financial system is critical to a stable macroeconomic environment. Financial stability is a longstanding responsibility of the Reserve Bank and its Board, and was reconfirmed at the time of significant changes made to Australia's financial regulatory structure in July 1998. These changes included the transfer of responsibility for the supervision of banks to a new integrated regulator, the Australian Prudential Regulation Authority (APRA), and the establishment of the Payments System Board within the Reserve Bank.

The Reserve Bank Board oversees the Bank's work on financial system stability. Without compromising the price stability objective, the Reserve Bank seeks to use its powers where appropriate to promote the stability of the Australian financial system. It does this in several ways, including through its central position in the financial system and its role in managing and providing liquidity to the system, and through its chairmanship of the Council of Financial Regulators, comprising the Reserve Bank, APRA, the Australian Securities and Investments Commission and Treasury. In addition, the Payments System Board has explicit regulatory authority for payments system stability. In fulfilling these obligations, the Reserve Bank will continue to publish its analysis of financial stability matters through its half-yearly *Financial Stability Review* and will be available to report as appropriate to relevant Parliamentary committees.

The Reserve Bank's mandate to uphold financial stability does not equate to a guarantee of solvency for financial institutions, and the Bank does not see its balance sheet as being available to support insolvent institutions. However, the Reserve Bank's central position in the financial system, and its position as the ultimate provider of liquidity to the system, gives it a key role in financial crisis management. In fulfilling this role, the Reserve Bank will continue to co-ordinate closely with the Government and with the other Council agencies.

The Treasurer expresses support for these arrangements, which served Australia well during the recent international crisis period.



Appendix C — Glossary of terms

Australian Competition and Consumer Commission (ACCC). A Commonwealth statutory authority responsible for ensuring compliance with the *Trade Practices Act 1974* and the provisions of the Conduct Code and for administering the *Prices Surveillance Act 1983*. The Commission's consumer protection work complements that of State and Territory consumer affairs agencies.

Australian Payments Clearing Association Limited (APCA). A public company owned by banks, building societies and credit unions which has specific accountability for key parts of the Australian payments system, particularly payments clearing operations.

Australian Prudential Regulation Authority (APRA). APRA is the prudential regulator of the Australian financial services industry. It oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry.

Australian Securities and Investments Commission (ASIC). One of three Australian Government bodies (the others being the Australian Prudential Regulation Authority and the Reserve Bank of Australia) that regulates financial services. ASIC is the national regulator of Australia's companies. ASIC has responsibility for market protection and consumer integrity issues across the financial system.

accrual accounting. Revenues and expenses are recorded as they are earned or incurred, regardless of whether cash has been received or disbursed. For example, sales on credit would be recognised as revenue, even though the debt may not be settled for some time.

acquirer. An institution that provides a merchant with facilities to accept card payments, accounts to the merchant for the proceeds and clears and settles the resulting obligations with card issuers.

average weekly earnings. Average gross (before tax) earnings of employees.

average weekly ordinary time earnings (AWOTE). Weekly earnings attributed to award, standard or agreed hours of work.

average weekly total earnings. Weekly ordinary time earnings plus weekly overtime earnings.

balance on current account. The difference between receipts and payments as the result of transactions in goods, services, income and current transfers between Australia and the rest of the world. A current account deficit means that total payments exceed total receipts, while a current account surplus means the reverse.

bankruptcies. Bankruptcies and Administration Orders under Parts IV and XI of the Bankruptcy Act.

basis point. A basis point is 1/100th of 1 percent or 0.01 per cent. The term is used in money and securities markets to define differences in interest or yield.

BPAY. BPAY is a payments clearing organisation owned by a group of retail banks. Individuals who hold accounts with a BPAY participating financial institution can pay billing organisations which participate in BPAY, using account transfers initiated by phone or internet. The transfers may be from savings, cheque or credit card accounts.

business investment. Private gross fixed capital formation for machinery and equipment; non-dwelling construction; livestock; and intangible fixed assets.

card issuer. An institution that provides its customers with debit or credit cards.

cash rate (interbank overnight). Broadly defined, the term cash rate is used to denote the interest rate which financial institutions pay to borrow or charge to lend funds in the money market on an overnight basis. The Reserve Bank of Australia uses a narrower definition of the cash rate as an operational target for the implementation of monetary policy. The Reserve Bank of Australia's measure of the cash rate is the interest rate which banks pay or charge to borrow funds from or lend funds to other banks on an overnight unsecured basis. This measure is also known as the interbank overnight rate. The Reserve Bank of Australia calculates and publishes this cash rate each day on the basis of data collected directly from banks. This measure of the cash rate has been published by the Reserve Bank of Australia since June 1998.

cash rate target. As in most developed countries, the stance of monetary policy in Australia is expressed in terms of a target for an overnight interest rate. The rate used by the Reserve Bank of Australia is the [cash rate](#) (also known as the interbank overnight rate). When the Reserve Bank Board decides that a change in monetary policy should occur, it specifies a new target for the cash rate. A decision to ease policy is reflected in a new lower target for the cash rate, while a decision to tighten policy is reflected in a higher target.

charge card. A charge card is a card whose holder has been granted a non-revolving credit line enabling the holder to make purchases and possibly make cash advances. A charge card does not offer extended credit; the full amount of any debt incurred must be settled at the end of a specified period.

consumer price index. A measure of change in the price of a basket of goods and services from a base period. Changes in the Consumer Price Index are the most commonly used measure of inflation.

collateralised debt obligations. Collateralised debt obligations (CDOs) are securities that are exposed to the credit risk of a number of corporate borrowers. In the simplest form of a CDO, this credit risk exposure is generated in the same way as for any asset-backed security (ABS): the CDO is backed by outright holdings of corporate debt, such as corporate bonds and corporate loans. Increasingly, however, the exposure to corporate credit risk is synthesised through the use of credit derivatives. Unlike other forms of ABS, where the collateral pools usually consist of loans with broadly similar characteristics, CDO reference pools are typically quite heterogeneous, with exposures to a variety of borrower types and credit ratings and across a number of countries. A CDO will usually have exposures to between 50 and 200 bonds or large corporate loans, or up to 2,000 loans to small and medium-sized businesses.

The simplest forms of CDOs are known as 'cash' or 'vanilla' CDOs, and are similar to other forms of ABS. A special purpose vehicle buys loans and securities from financial institutions and other market participants, and funds these acquisitions by selling securities to investors. The manager of the CDO vehicle will usually deduct fees and expenses from the interest income received from the assets in the collateral pool, with the remainder used to make regular coupon payments to investors. The term to maturity of the loans and bonds in the collateral pool will determine the maturity of the CDO securities sold to investors.

credit card. A credit card is a card whose holder has been granted a revolving credit line. The card enables the holder to make purchases and/or cash advances up to a pre-arranged limit. The credit granted can be settled in full by the end of a specified period or in part, with the balance taken as extended credit. Interest may be charged on the transaction amounts from the

date of each transaction or only on the extended credit where the credit granted has not been settled in full.

debit card. A debit card is a card that enables the holder to access funds in a deposit account at an authorised deposit-taking institution.

derivative. A financial contract whose value is based on, or derived from, another financial instrument (such as a bond or share) or a market index (such as the Share Price Index). Examples of derivatives include futures, forwards, swaps and options.

employed persons. Persons aged 15 and over who, during a period of one week, worked for one hour or more for pay or worked for one hour or more without pay in a family business or on a family farm.

G-10. Group of Ten countries: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, and USA; plus Bank for International Settlements (BIS), European Commission, International Monetary Fund (IMF), and the Organisation for Economic Co-operation and Development (OECD). It was formed in conjunction with the establishment of the General Arrangements to Borrow, under which members agreed to make resources available to the IMF.

G-20. Group of Twenty Forum: Members are finance ministers or central bankers from - Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, UK and US; plus representatives of the IMF, European Union and World Bank. The G-20 aims to broaden the dialogue on key economic and financial policy issues among systemically significant economies, and promote co-operation to achieve stable and sustainable world economic growth.

G-22. Group of Twenty-two. The G-22's aim was to advance issues related to the global financial architecture. It operated through three Working Parties - on Transparency and Accountability, International Financial Crises, and Strengthening Financial Systems. The group made its recommendations in 1998, and its work has since been taken up in other forums.

G-7. Group of Seven countries: Canada, France, Germany, Italy, Japan, UK and USA. The G-7 Summit deals with issues covering macroeconomic management, international trade, international financial architecture, relations with developing countries, and other global issues.

G-8. Group of Eight countries: G-7 countries and Russia.

gross domestic product. The total market value of goods and services produced after deducting the cost of goods and services used up in the process of production but before deducting for depreciation.

gross domestic product—chain volume measure. Also known as *real GDP*, this is a measure used to indicate change in the actual quantity of goods and services produced. Economic growth is defined as a situation in which real GDP is rising.

gross domestic product at factor cost. Gross domestic product less the excess of indirect taxes over subsidies.

gross foreign debt. All non-equity financial claims by non-residents on residents of Australia. The major component of gross foreign debt is the amount of borrowings from non-residents by residents of Australia.

household debt ratio. The amount of household debt at the end of a quarter expressed as a proportion of annual household gross disposable income.

household gross disposable income. The amount of income that households have available for spending after deducting any taxes paid, interest payments and transfers overseas.

household net disposable income. Household gross disposable income less depreciation of household capital assets.

household saving ratio. The ratio of household income saved to household net disposable income.

housing loan interest rate. The variable rate quoted by banks for loans to owner-occupiers.

implicit price deflator for non-farm gross domestic product. A measure of price change that is derived (hence the term implicit) by dividing gross non-farm product at current prices by gross non-farm product at constant prices.

index of commodity prices. A Reserve Bank of Australia-compiled index (based 2001/02=100) which provides a measure of price movements in rural and non-rural (including base metals) commodities in Australian Dollars (AUD), Special Drawing Rights (SDR) and United States Dollars (USD).

inflation. A measure of the change (increase) in the general level of prices.

inflation target. A tool to guide monetary policy expressed as a preferred range or figure for the rate of increase in prices over a period. In Australia, the inflation target is between 2 and 3 per cent per annum on average over the course of the business cycle.

interchange fee. A fee paid between card issuers and acquirers when cardholders make transactions.

interest rate. The term used to describe the cost of borrowing money or the return to the owner of the funds which are invested or lent out. It is usually expressed as a percent per annum of the amount of money borrowed, lent or invested.

labour force. The employed plus the unemployed.

labour force participation rate. The number of persons in the labour force expressed as a percentage of the civilian population aged 15 years and over.

labour productivity. Gross domestic product (chain volume measure) per hour worked in the market sector.

long-term unemployed. Persons unemployed for a period of 52 weeks or more.

macroeconomy. The economy looked at as a whole or in terms of major components measured by aggregates such as gross domestic product, the balance of payments and related links, in the context of the national economy. This contrasts with microeconomics which focuses upon specific firms or industries.

market sector. Five industries are excluded from the market sector because their outputs are not marketed. These industries are: property and business services; government administration and defence; education; health and community services; and personal and other services.

monetary policy. The setting of an appropriate level of the cash rate target by the Reserve Bank of Australia to maintain the rate of inflation in Australia between 2 and 3 per cent per annum on average over the business cycle.

natural increase. Excess of live births over deaths.

net foreign debt. Gross foreign debt less non-equity assets such as foreign reserves held by the Reserve Bank and lending by residents of Australia to non-residents.

net overseas migration. Net permanent and long-term overseas migration plus an adjustment for the net effect of 'category jumping'.

non-farm gross domestic product. Gross domestic product less that part which derives from agricultural production and services to agriculture.

overseas visitors. Visitors from overseas who intend to stay in Australia for less than 12 months.

prime interest rate. The average rate charged by the banks to large businesses for term and overdraft facilities.

profits share. Gross operating surplus (the excess of gross output over costs incurred in producing that output) of all financial and non-financial corporate trading enterprises as a percentage of gross domestic product at factor cost.

real average weekly earnings. Average weekly earnings adjusted for inflation as measured by the Consumer Price Index.

real prime interest rate. The prime interest rate discounted for inflation as measured by the Consumer Price Index.

seasonally adjusted estimates. Estimates in which the element of variability due to seasonal influences has been removed. Seasonal influences are those which recur regularly once or more a year.

terms of trade. The relationship between the prices of exports and the prices of imports. The usual method of calculating the terms of trade is to divide the implicit price deflator for exports by the implicit price deflator for imports.

trade weighted index. A measure of the value of the Australian dollar against a basket of foreign currencies of major trading partners.

turnover. Includes retail sales; wholesale sales; takings from repairs, meals and hiring of goods; commissions from agency activity; and net takings from gaming machines. From July 2000, turnover includes the Goods and Services Tax.

unemployed persons. Persons aged 15 and over who, during a period of one week, were not employed but had actively looked for work in the previous four weeks and were available to start work.

unemployment rate. The number of unemployed persons expressed as a percentage of the labour force.

wage price index. A measure of change in the price of labour (i.e. wages, salaries and overtime) unaffected by changes in the quality or quantity of work performed.

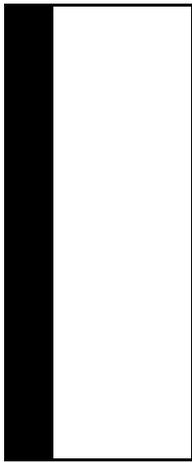
wages share. Wages, salaries and supplements (the total value of income from labour) as a percentage of gross domestic product at factor cost.

west texas intermediate. A type of crude oil used as a benchmark in oil pricing and the underlying commodity of New York Mercantile Exchange's oil futures contracts.

youth unemployment. Number of 15–19 year olds looking for full-time work.

youth unemployment rate. Number of 15–19 year olds looking for full-time work expressed as a percentage of the full-time labour force in the same age group.

Source: *Parliamentary Library and Reserve Bank of Australia*



Supplementary Comments – Mr Adam Bandt, MP, Deputy Leader, Australian Greens

1. The Reserve Bank of Australia (RBA) is a key pillar of the country's economy. It needs to operate free from the shadow that hangs over it because of the banknote printing bribery scandal.
2. The recent appearance of senior RBA officials before the committee to address the issues surrounding the bank and its subsidiaries, Security and Note Printing Australia, has left many questions unanswered.
3. Most significantly, there is still no satisfactory explanation as to why the police weren't called when the RBA was first presented with credible allegations of illegality, possible corruption and impropriety.
4. The hearings have confirmed that in the middle of 2007, a credible RBA whistleblower raised serious concerns - many of which have since proven to be well-founded - about public money being used to bribe foreign officials and politicians, in contravention of Australian law.
5. After receiving such a complaint, a senior official within such a central public institution should have informed the Australian Federal Police and/or the Australian Securities and Investment Commission.

6. Instead, the response of the RBA and its subsidiaries - to commission a commercial law firm to conduct an internal review - was manifestly inadequate. A commercial law firm does not have the power to question witnesses, seize documents or conduct investigations in the way that an investigatory body acting with the force of law can. Indeed, the hearings revealed that the law firm didn't even interview the agents subject to the whistleblower's allegations nor examine any of their financial records.
7. A director cannot contract their duties out to a third party. However, that was in effect what the RBA officials did. Their evidence was that as the lawyers' report did not disclose any crime had been committed nor recommend approaching the AFP, the RBA officials felt no obligation to do so. It is questionable whether a director of a private company today would be able to rely on such a defence.
8. In any event, in evidence and other statements the RBA overstates the lawyers' report's findings: at its highest, the report did not provide a clean bill of health. It found in one instance, for example, that simply because there were a number of equally compelling explanations for one of the allegations, no positive adverse finding could be made. The report wasn't positive evidence of the absence of wrongdoing, but rather a statement that no conclusive findings of illegality could be made. It should have been obvious on the face of the report that no relevant interviews had taken place and no financial documents examined, and thus the reliance to be placed on it by a director should have been very limited indeed.
9. The RBA also placed reliance on their internal audits. However, as was admitted in the hearings, these internal audits had less breadth and depth than an external audit and had fewer resources. Again, an external investigative agency such as the AFP would have had much greater powers and resources.
10. At the conclusion of his evidence to the Committee, the Governor acknowledged that in a similar situation in the future the police should be called in earlier. It has taken many years of questioning for the Governor to make this admission and the approach of the RBA to the Committee's past and current inquiries does not instil

great confidence that the RBA accepts that grave errors have been made.

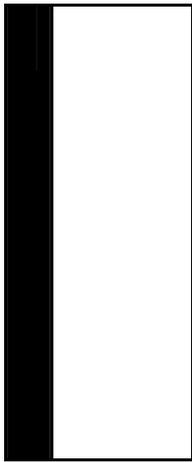
11. The Australian Greens remain concerned that the corporate governance of the Reserve Bank of Australia has been found wanting and we are not confident that the lessons have been learned. A cloud will remain over the Reserve Bank and its governance until a full inquiry is conducted.

12. Recommendation: That the government establish an inquiry into the Reserve Bank and its subsidiaries with regard to the bank note bribery scandal to make recommendations on strengthening corporate governance at the Reserve Bank.

Adam Bandt MP

Federal Member for Melbourne

Deputy Leader, Australian Greens



Supplementary Comments – Hon Tony Smith, MP, Liberal Member

Overview

What has come to be described in the media as the ‘Banknotes Bribery Scandal’ first emerged in the public sphere on 23 May 2009. On that day *The Melbourne Age* reported allegations of bribery by overseas business agents of Securrency International Pty Ltd, a company half-owned by the RBA that produces the substrate polymer material used in Australian banknotes.

This was the first in a long series of articles by *Age* journalists Richard Baker and Nick McKenzie alleging that the use of bribes to secure overseas business contracts was endemic to two RBA subsidiary companies.

Soon after the appearance of that first story, the name of another RBA subsidiary began to be mentioned by the media in relation to allegations of bribery. On 25 May 2009 *The Age* reported that Note Printing Australia, a wholly owned RBA subsidiary that prints Australia’s banknotes, had dismissed its foreign business agents after an internal company audit recommended that “stricter controls were required”.¹

These allegations of bribery mushroomed over the weeks and months that followed, with media reports linking Securrency and/or Note Printing Australia to arms dealers,² organised crime³ and business dealings with nations on the US State Department’s list of state

¹ Nick McKenzie & Richard Baker, “RBA firm sacked its foreign agents”, *The Age* (25 May 2009) p 1

² Richard Baker & Nick McKenzie, “RBA warned on arms broker”, *The Age* (10 Sept 2009) p 1

³ Richard Baker & Nick McKenzie, “Guns drugs and money”, *The Age* (28 Aug 2009) p 1

terrorism sponsors.⁴ Newspaper reports also included allegations that excessive commissions were used to bribe government officials overseas. Securrency and Note Printing Australia were ultimately implicated in the alleged bribery of foreign government officials in India, Malaysia, Nepal and Vietnam.

Once newspaper stories alleging bribery began to appear in May 2009, Securrency called in the Australian Federal Police. Law enforcement authorities in the UK and Malaysia subsequently opened their own investigations into the activities of Securrency and Note Printing Australia business agents.

In August-September 2011, it was announced that criminal charges would be laid against Securrency and Note Printing Australia over an alleged conspiracy to offer or pay a benefit to a foreign official not legitimately due. Both RBA subsidiaries were charged in relation to alleged bribery offences in Malaysia and Indonesia. Charges arising from allegations of bribery in Vietnam were laid against Securrency, and allegations of bribery in Nepal were laid against Note Printing Australia.⁵ Those legal matters are still pending. There are also other ongoing legal matters with a number of individuals from both firms.

And while this Parliament should have no business involving itself with ongoing legal matters, this Parliament has every business involving itself with the governance of the Reserve Bank. Parliament must always tread carefully in these circumstances but it must equally never forgo its oversight function. The fact legal matters are outstanding does not dictate that there should be no parliamentary oversight. It is only through rigorous parliamentary oversight that any deficiencies may be identified and rectified. It is only through rigorous parliamentary oversight that the rest of the world can be confident that the disinfecting qualities of sunlight are at work in Australia.

As this *Report* rightly notes:

The House of Representatives Standing Committee on Economics (the committee) is responsible for scrutinising the Reserve Bank of Australia (RBA) and for ensuring its transparency and accountability to the Parliament, the community, and the financial sector.⁶

⁴ Richard Baker & Nick McKenzie, "RBA company in Sudan link", *The Age* (29 May 2009) p 1; Nick McKenzie & Richard Baker, "RBA link to Saddam regime", *The Age* (6 June 2009) p 1

⁵ *Hansard* House Economics Committee Hearing (8 October 2012) p 5

⁶ House of Representatives Standing Committee on Economics, *Review of the Reserve Bank of*

And the *Report* is equally correct when it states:

The appearance by the Governor of the RBA at biannual public hearings of the committee is an important element of the RBA's accountability framework. The details of this framework are set out in the *Statement on the Conduct of Monetary Policy*, agreed between the Treasurer, the Hon Wayne Swan, MP, and the RBA Governor, Mr Glenn Stevens. The statement formalises the biannual appearance before the committee. The statement, which is reproduced at Appendix B, states:

The Governor has also indicated that he plans to continue the practice of making himself available to report on the conduct of monetary policy twice a year to the House of Representatives Standing Committee on Economics.

The Treasurer expresses support for the continuation of these arrangements, through which the transparency and accountability of the Reserve Bank's conduct of monetary policy are in line with international best practice. These arrangements enhance the public's confidence in the independence and integrity of the monetary policy process.

A second procedural mechanism for achieving this accountability is set out in the Standing Orders of the House of Representatives, which provide for the referral of annual reports within a committee's area of portfolio responsibility for any inquiry the committee may wish to make.

Accordingly, the committee may inquire into aspects of the annual report of the RBA.⁷

The Evolving Story

From the time the first story was published in mid-2009, senior bank officials have repeatedly asserted their ignorance of allegations about possible illegality at Securrency or Note Printing Australia.

That initial newspaper article on 23 May 2009 in *The Age* featured the following statement of assurance from Deputy Governor-at-the-time Ric Battellino:

Mr Battellino told *The Age* the RBA was aware that Securrency operated in countries with "bad reputations", but was "very conscious to ensure arrangements were in place to avoid corruption payments".⁸

In June 2010 the Governor of the Bank wrote a detailed letter to the Treasurer stating:

The audits of NPA and Securrency took place well before *The Age* first raised its allegations in May 2009. Neither Securrency nor the Reserve Bank was aware of the allegations until that time. The allegations were completely unexpected, given that the company had strong policies prohibiting the payment of bribes, including by the agents, and that the audit findings had provided re-assurance that the company's procedures supporting these policies were robust. Neither of the former employees who appear to be among the sources used by *The Age* had made their concerns known to the board of Securrency or to the Bank. Had they done so, given the seriousness of the issues, the

⁷ Ibid 1.2 – 1.3

⁸ Richard Baker & Nick McKenzie, "Revealed: the RBA's dodgy deals", *The Age* (23 May 2009) p 1

Bank, as in the NPA case, would have carried out investigations and made any necessary changes immediately.⁹

This correspondence was released under FOI in November 2011.

In August 2011, the *Age* published new assertions that:

The leadership of the Reserve Bank failed to alert police after the bank received damning evidence in 2007 that its subsidiary Note Printing Australia was implicated in the bribery of foreign officials.¹⁰

The bank also rejected those assertions in a statement that read:

The implication the *Age* seems to be drawing is that people in the company and the bank had information indicating illegality but did not act appropriately on that information. The apparent inference contained in the questions is unwarranted.¹¹

Evidence at Hearings

The Committee has posed questions to the Bank on these matters during the course of its semi-annual Hearings in November 2010, February 2011, August 2011, February 2012 and August 2012. In addition, the Committee held a dedicated Hearing into events at Securrency and Note Printing Australia on 8 October 2012.

Following the publication of new allegations in August 2011 involving Note Printing Australia specifically, and the Bank's response to those (see above), the then Deputy Governor Mr Battellino faced direct questioning at the 26 August 2011 Hearings.

It was here that Mr Battellino first alluded to the fact that a Note Printing Australia employee raised an alarm in 2007 about allegations of illegal activity by some of the company's foreign agents. Mr Battellino was asked:

It has been suggested in the *Age* newspaper, since the last meeting of this committee, that that report said that at least one agent had admitted to bribery, at least one agent had demanded 'under the table' secret commissions, at least one agent had demanded excessive payments and that payments were being made to third-party accounts. Is that an accurate summary of what was in that report?¹²

He responded:

I cannot recall. A range of issues were raised in there. Allegations had been made by one of the staff members that the agents had said certain things. The agents denied those.¹³

Mr Battellino retired 10 days prior to the next Hearing in February 2012 and therefore questions on Note Printing Australia and Securrency were directed to Governor Stevens.

⁹ Glenn Stevens, Letter to Treasurer Wayne Swan (2 June 2010) p 3

¹⁰ Richard Baker & Nick McKenzie, "RBA held evidence of bribery", *The Age* (11 August 2012) p 1

¹¹ "RBA Statement in response to questions from The Age", *The Age* (11 August 2011) p 9

¹² *Hansard* House Economics Committee Hearing (26 August 2011) p 14

¹³ *ibid*

When I inquired into the precise nature of that 2007 warning by a Note Printing Australia staff member, the Governor initially responded:

If you are asking whether the person in question wrote a letter or something to the bank, I do not think that he did, no.¹⁴

But in the dying seconds of the Hearing, Mr Stevens amended his previous assertion:

Mr TONY SMITH: Chair, according to Mr Buchholz's highly accurate clock on his iPad, we have a couple of minutes left. Is it possible to ask another question or two?

CHAIR: Just one.

Mr Stevens: Madam chair.

Mr TONY SMITH: Can we go back to a question on the topic I was asking about earlier, just for a clarification. I quoted statements to this committee from Mr Battellino back in August about allegations being made by one of the staff members that agents had said certain things and the agents denied those. Governor, I think your answer was that that was conveyed orally. I just want to confirm that.

Mr Stevens: I need to come back to that. I think I said that the bank was aware of that but that it was not in writing. Actually, that was not quite true. I have been reminded while we have been talking that, in fact, the deputy governor invited that person to put that in writing, which he did, and give it to the deputy governor. That written statement on the matter was available to the Freehills people that did the investigation in 2007. So, whereas I said I thought that we were aware of it but that it was not documentary, in fact it was invited to be put in documentary form, which it was.

Mr TONY SMITH: One final question, Chair?

CHAIR: No, we are done.¹⁵

At this point it became clear that not only did former Deputy Governor, Ric Battellino fail to provide pertinent information at the Committee Hearings in November 2010, February 2011 and August 2011, but he also responded to direct questioning during those Hearings in a manner that can fairly be described as less than open. In an opinion piece written for *The Age* I noted:

Despite direct questioning on these matters at committee hearings in November 2010, February 2011

and August 2011, neither the governor nor his former deputy saw fit to volunteer these two salient facts

— that a briefing paper containing allegations of impropriety by some NPA agents was written by an NPA staff member in mid-2007 at Battellino's request; and that Battellino met with the author of this memorandum around that same time.¹⁶

On 22 August 2012, *The Age* published the text of the alleged memorandum that it asserted was submitted in June 2007 to Mr Battellino by former Note Printing Australia company

¹⁴ *Hansard* House Economics Committee Hearing (24 February 2012) p 16

¹⁵ *Ibid* pp 23-24

¹⁶ Tony Smith, "Don't let these banknote questions fester", *The Age* (7 September 2012) p 15

secretary Brian Hood. Mr Hood's memorandum not only contained detailed allegations of bribery by Note Printing Australia business agents, but also noted explicitly that one of the suspect agents confessed to working on behalf of Securrency as well:

In October 2005, the agent denied, to [B*] and me, the existence of his agency agreement with Securrency. His agreement with NPA was, I note, an exclusive arrangement. Our concern centred on whether or not his role promoting polymer sales could lead to a conflict of interest, and/or a breach of confidentiality, should he interact directly with NPA's competitors. He subsequently, only days later, admitted that he had held for years an agency role with Securrency.¹⁷

The implications of this memorandum are extremely significant. Its revelation that a suspect Note Printing Australia foreign business agent was simultaneously representing Securrency should have raised a massive red flag about possible deficiencies in probity practices at the latter. It defies logic to assume that if this business agent may have engaged in bribery to secure overseas contracts for one company he would miraculously refrain from doing so on behalf of the other.

The Bank's lack of openness was pursued at the Committee's August 2012 Hearing when I asked Governor Stevens:

If we go back a year to August 2011, for instance, Mr Battellino was referring in response to some questions to the fact that the board of Note Printing Australia had taken certain actions. You do not think at that point through all the questioning over a couple of years it would have been sensible for him to say, 'As it happens, I actually had a meeting with the person who has made these allegations'?¹⁸

Mr Stevens responded:

I am not going to comment on whether he [Mr Battellino] should have given some piece of information that he was not asked about at the time.

I followed up by asking:

You do not think that in the interests of openness it would have been good for the committee to have been told that as it happens, he had met with the person who had serious concerns?¹⁹

To this the Governor replied:

I do not know. At least what we have tried to convey is the essence of what occurred. The fact that two particular people met on a given day as part of that process—there would have been lots of meetings between various people trying to put all this investigation together. I did not feel that particular event was of the importance that you seem to feel it is. I accept that, obviously, others feel it is more important. I am sorry that we did not make that clearer earlier.²⁰

¹⁷ <http://www.theage.com.au/national/the-june-2007-rba-memo-20120822-24llm.html?rand=1345598937818>

¹⁸ *Hansard* House Economics Committee Hearing (24 August 2012) p 14

¹⁹ *ibid*

²⁰ *ibid*

At this Hearing, I asked whether the Governor would be prepared to appear at a specially convened hearing to face questioning in detail on these important matters. Mr Stevens indicated he was. This special dedicated hearing took place on Monday 8 October 2012 and included the former Deputy Governor, Ric Battellino.

On this occasion, both Mr Battellino and Governor Stevens explained their failure to volunteer pertinent facts before this Committee by claiming this was done out of respect for Mr Hood's request for confidentiality because:

presumably he [Hood] was very concerned about anything getting back to the people in the company that he works in.²¹

But in light of the fact that Mr Hood left the employ of Note Printing Australia in September 2008, more than two years before these issues were first broached by this Committee, I find this explanation less than persuasive.

This 'confidentiality excuse' is also rendered threadbare by the following exchange during the 8 October 2012 Hearing regarding the discrepancy between the Bank's behaviour in August 2011 vis-à-vis February 2012:

Mr TONY SMITH: In August 2011, following a series of questions from Ms O'Dwyer and follow-up questions from Mr Bandt, you consciously felt that you could not volunteer this information because of confidentiality. Then, as I recounted before the break, the following February—that is in February this year—Mr Stevens was able to confirm the existence of the memo and the meeting. What changed between August and February?

Mr Battellino: I think that Mr Stevens was actually asked specific questions about the memo.

Mr TONY SMITH: Yes. That is true.

Mr Battellino: I was not asked specific questions. I was asked in general about the allegation that this person had made. As I say, those allegations were made mainly through the board paper and the audit and with this statement to me.

Mr TONY SMITH: If you had been asked, you would have answered? I thought that, if you had been asked, you would have said that you had to maintain the confidentiality.

Mr Battellino: It is an interesting question. What would I have done? I do not know. I would have had to answer to the committee. I really do not know. It did not come up.

Mr TONY SMITH: It was obviously in your mind at the time.²²

I believe this lack of openness hindered the oversight function of this Committee because members couldn't ask questions earlier on relevant facts never volunteered by the Governor or his former Deputy.

²¹ Op cit Hansard (8 October 2012) p 38

²² Op Cit Hansard (8 October 2012) p 27

It is also difficult to accept Mr Battellino's claim at the August 2011 Hearing that he could not recall the detail of the Note Printing Australia audit report:

Mr TONY SMITH: I will take you to August 2011—and I was not on the committee at that point. You were asked a series of questions by Ms O'Dwyer—who has joined us; I know she was held up this morning by some engagements—Mr Ciobo and Mr Bandt. This was in the days following some new revelations in the *Age* newspaper, and there have obviously been lots of stories since that first story in May 2009. After some questions from Ms O'Dwyer, Mr Bandt followed up and referred to one of those. He was talking about the audit report on Note Printing Australia, and he made a number of statements and asked whether it was an accurate summary of the report. Your answer, as *Hansard* records it—and I was not there—was, firstly, 'I cannot recall'. We can provide this for you, if need be, but your answer was, firstly: 'I cannot recall. A range of issues were raised in there. Allegations had been made by one of the staff members that the agents had said certain things. The agents denied those. One of the agents had sought to mislead one of the central banks overseas about the exact size of his agency fee. There were a number of issues like that.' On my reading of it, that was the first time you were asked about these issues. Your point was that you were trying to preserve the confidentiality. Was that in your mind at that time when you were asked those questions?

Mr Battellino: Yes, definitely. What you are referring to I cannot recall. A lot has happened at the Reserve Bank in the five or six years that all of this has gone on.

Mr TONY SMITH: You would recall what was in the audit report, surely?

Mr Battellino: In very broad terms. If you are asking me: do I recall six years after the event, or whenever, everything that is in that audit report? I had a very—

Mr TONY SMITH: I think, if you look back at the media coverage in the lead up that prompted the questions, I would have thought that, if you had not recalled, you would have reminded yourself.

Mr Battellino: The broad understanding I had at that point was that the audit report had made all these allegations about business practices, and raised some suspicions.

Mr TONY SMITH: Given we are an oversight committee, you did not feel, at any point—if we accept you are trying to preserve confidentiality—that, if you could not volunteer certain information, you did not want to add to the committee that there was certain matters—

Mr Stevens: Were we asked, Madam Chair, at some point: could we please have a blow-by-blow account of every piece of the process that happened in 2007? We were not being asked that. We have given that today. We have spent quite a lot of time in the last few weeks getting back across this. This was a very different setting.

Mr TONY SMITH: With respect, I will come back to you, Governor. I am asking Mr Battellino about his testimony.²³

Failure of Judgement by the Bank

There was also clearly a failure by the Bank fully to consider its distinct ethical responsibility earlier with respect to allegations of illegality at Note Printing Australia in particular. The Bank leadership has repeatedly stated that the law firm Freehills had been retained by the Board of Note Printing Australia to determine whether there had been a breach of law. But it a third party law firm – reputable and respected though it may be – does not have the authority and investigative power of the police. Therefore the Freehills

²³ *ibid*

referral does not waive the higher responsibility of the nation's central Bank to refer plausible allegations of serious criminal activity to the Federal Police. The Bank also could-have and should-have referred the information contained in the Hood Memorandum directly to law enforcement authorities in mid-2007. Whilst Securrency and Note Printing Australia had corporate responsibilities, the Bank also has higher duty as a key public institution.

Governor Stevens should have also requested a copy of the Hood memorandum at the time it was first submitted to Mr Battellino.²⁴ Mr Hood was the company secretary of Note Printing Australia, a position important enough to require his signature to be affixed to the company's annual financial statement submission to ASIC. And yet when this senior executive raised plausible allegations of illegality by some of the agents representing this wholly owned subsidiary of the Bank, with Mr Battellino, Governor Stevens was of the view that an oral briefing from Mr Battellino was a sufficient response to this potential violation of Australia's anti-bribery laws. This decision meant that Governor Stevens denied himself the opportunity to make a fully informed judgement about the contents, tone and seriousness of Mr Hood's 2007 memorandum.

Lessons and Conclusions

At the 8 October 2012 dedicated Hearing of this Committee on Note Printing Australia, I asked the Governor:

In hindsight, what regrets do you have or lessons have been learned generally?²⁵

Mr Stevens responded with the words:

Hindsight is a great thing. People do not live their life in hindsight; they live it a day at a time in real time. If pressed on this, I would have to say that there should have been more scepticism and more questioning of the managements of both companies earlier than there was. I think it is hard to avoid that conclusion.²⁶

At the 8 October 2012 Hearing the Governor himself conceded that he today would handle similar allegations of illegality much differently than he dealt with past events at Note Printing Australia and Securrency:

Ms O'DWYER: In light of the information that has been provided—you know, hindsight being a wonderful thing—if you were to look back and make a decision with the knowledge you have today, do you think you would have called in the Federal Police a lot earlier than you did?

²⁴ Op cit Hansard (8 October 2012) p 24

²⁵ Ibid p 22

²⁶ ibid

Mr Stevens: I have given some thought to that and I think it was technically properly a decision for the board of the company. I do not think this should be seen as either—as I said earlier—call Freehills or call the police, one or the other. You could have done both. As I said at the beginning, had the conclusion of the Freehills work been a different conclusion to the one it was then we would have had, I feel sure, the people associated with that process with the kind of experience and integrity that they do have saying, 'mmm, you've got to go to the police.' That was not the conclusion so that was not the outcome.

Were we to see that set of circumstances again, personally—older and more scarred and wiser now—I think it might be prudent to still do that whole process. But at the end, to be honest, no-one advised us at the time to say to the police: 'We've done this. This is our conclusion and we're not proposing further action but we're advising you just in case something comes up one day' or in case they have got any other suggestions to make. But if I review this in my own mind and contemplate whether we might ever see a parallel set of circumstances, I think that additional step would be prudent.

I am also concerned that the narrative presented to date by the governor and his former deputy lacks precision and clarity. And this has had the unfortunate effect of making the bank appear reticent and even secretive. In speech to Parliament on this matter I noted:

If these questions linger today they will fester tomorrow. Only if they are answered and addressed can we ensure that the good name of the Reserve Bank and its high level of credibility will be preserved.²⁷

The magnitude of these matters also causes me to consider more fundamental questions about the current regime for Parliamentary oversight of the Reserve Bank. Per the provisions of the *Statement on the Conduct of Monetary Policy*, the Reserve Bank appears twice-yearly before the House Standing Committee on Economics for a period of roughly three hours. And much of that time is rightly devoted to important discussions of monetary policy and global economic trends.

But a mere 180 minutes every six months are clearly inadequate to canvas matters of governance and probity that might arise, as in the cases of Note Printing Australia and Securrency. It is worthwhile to note the fact that the Australian Securities and Investment Commission appears quarterly in oversight Hearings before the Parliamentary Joint Committee on Corporations and Financial Services.

Accordingly, I believe consideration should be given to amending the *Statement on the Conduct of Monetary Policy* so as to provide for the Bank to appear before the House Standing Committee on Economics on four occasions per year.

Mr Tony Smith MP

²⁷ Tony Smith, *Hansard House of Representatives* (20 August 2012) p 9332