

Central banking in the British ‘dominions’, 1930-2000¹

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Introduction

During the 1990s the Reserve Bank of New Zealand (RBNZ) was widely considered to be the world’s most innovative central bank. It was a pioneer in four respects:

- (1) The 1989 Reserve Bank Act introduced a new form of central bank independence. The Bank was to enjoy operational but not goal autonomy. Price stability was to be the sole goal of monetary policy. From time to time the Governor and the Minister of Finance were to negotiate a Policy Targets Agreement. The Governor was to be held personally accountable for achieving the mutually agreed targets.
- (2) New Zealand was the first country to adopt an inflation target. The Minister of Finance announced an informal inflation target in April 1988. The targeting regime (0-2 per cent inflation by the end of 1992) was formalised in March 1990 with the signing of the first PTA.
- (3) In the 1990s the RBNZ developed a novel approach to the prudential oversight of banks. Rather than actively supervising banks, it required them to disclose a wide range of prudential information to the public. Bank directors risked large penalties, up to imprisonment, for misleading the public.

¹ N.B. This is a précis of a more detailed paper. Please don’t quote without author’s permission. I am obliged to Gary Hawke, Francine McKenzie, Paul Robertson, and seminar participants at the University of Gothenburg for comments on an earlier draft. I am also grateful to the Reserve Bank of New Zealand for access to their library.

- (4) The RBNZ made substantial internal economies during the early 1990s, demonstrating that an effective central bank need not be an expensive one.

New Zealand's many followers in the area of monetary policy² in the 1990s included the Bank of Canada (BoC), the Bank of England (BoE), the Reserve Bank of Australia (RBA), and the South African Reserve Bank (SARB). Canada introduced inflation targeting in 1991; Britain followed suit in 1992 after sterling's withdrawal from the ERM. Australia moved towards a looser form of inflation targeting in the mid-1990s, as did South Africa. Within a few years, inflation targeting had become one of the world's most popular monetary policy frameworks.

As monetary policy agencies, the New Zealand, Australian and Canadian central banks are now the equals of the Bank of England. Given their comparative youth, it is reasonable to conclude that they have been good learners.³ This paper focuses on the process of 'catch up' in central banking, using Britain and the dominions as case studies. Changes in the economic, political, and intellectual environments are central to our story.

The spread of new ideas in central banking

Frequent contact between central bankers – not least within the Commonwealth – hastened the spread of new ideas. The Bank of England was keen to advise other Empire countries on central banking. In 1928 Montagu Norman started a regular newsletter – the Empire Letter – for the benefit of central and state banks in the Empire. He invited Empire central bankers to a conference in London in 1937. The Bank of England occasionally supplied personnel to the new central banks. W.H. Clegg, the BoE's Chief Accountant, was appointed Governor of the SARB in 1920, while Leslie Lefeaux, an Assistant to the Governors, became the first Governor of the RBNZ in 1934

² For reasons of space this paper will not dwell on banking supervision or central bank management.

³ The Commonwealth Bank of Australia opened for business in 1912, and acquired some central banking functions in the interwar period. These central banking functions were spun off into the Reserve Bank of Australia in 1960. The South African Reserve Bank was set up in 1921. The Reserve Bank of New Zealand was founded in 1934 and the Bank of Canada in 1935.

International monetary cooperation deepened and broadened after the Second World War. Central bankers played an important role in managing the Sterling Area's system of exchange controls. This involved frequent consultation between the Bank of England, the dominion central banks, and their respective governments. Although the Sterling Area was moribund by the 1960s, the Bank of England continued to host formal dinners for the 'old Sterling Area' Governors into the 1990s. Dominion central bankers were seconded to positions at the International Monetary Fund and World Bank as representatives of their countries.

The Bank for International Settlements was an additional forum in the late twentieth century. Cooperation was also evident at the regional level. The Commonwealth Bank of Australia established a group called SEANZA in 1957. This put on training courses for central bankers in the Asia Pacific region, and provided a meeting place for central bank governors. The Bank of England also offered courses for Commonwealth central bankers.

The rising level of interaction between central bankers, and between central bankers and government representatives, owed much to the falling real cost of air travel, and to the adoption of academic economics as a *lingua franca*. By the 1980s there was a thriving international conference circuit for central bank governors and economists. Don Brash of the RBNZ was one of the stars of this circuit in the 1990s. The fact that so many countries adopted parts of the New Zealand model suggests that Brash's international audience extended to policy-makers.

Origins of the dominion central banks

In *Central banking in the British dominions* (1940), A.F.W. Plumptre – a Canadian economist – traced the origins of the dominion central banks. They were set up in response to a mixture of national, international, and imperial pressures. Supporters in the dominions were seeking financial and economic stability, and an increase in national autonomy. External sponsors, including the Bank of England, wished to promote international monetary cooperation and stability, as well as to create bulwarks against the potentially troublesome activities of dominion governments. In the 1930s the Bank of England towered over the dominion central banks in both experience and refinement.

It was something of a muddle. According to Plumptre (1940: 201), 'neither nationalism nor imperialism spoke with the still small voice of logic. Instead they

spoke with many tongues, often babbling and contradictory.’ More generally, there was no coherent theory of central banking in the 1920s and 1930s. When Sir Otto Niemeyer, a leading Bank of England official, expressed contempt for ‘colonial savages’ in the dominions, he overlooked the crudity of monetary policy in Britain, the USA, and Germany.

In the 1930s the Bank of England towered over the dominion central banks in both experience and refinement. Plumptre devoted a whole chapter to ‘English’ influence over the dominion central banks. But he accurately foresaw that the Bank of England’s authority would wane: ‘nationalism has time on its side; its influence is in the ascendant in the Dominions (Plumptre 1940: 201).’ Thus the dominions would become more rather than less independent of London. In so far as the Bank of England tried to steer central banking in the Commonwealth after 1945, its focus was on colonies (and ex-colonies) such as Malaya and Ghana.

Plumptre felt that the establishment of the dominion central banks had ‘in some cases and some respects [been] premature’, not least because of the underdevelopment of dominion capital markets, and the consequential lack of scope for open market operations, the traditional operational tool of the BoE. He hoped that the new central banks could play a role in developing such markets. But much would depend on the attitude of governments:

Whether or not central banking [in the dominions] will ... extend along more or less accepted lines or whether it will extend into increasingly direct forms of intervention in financial affairs, will depend upon the course of political developments in the various countries (Plumptre 1940: 426).

Contrary to Plumptre’s hopes, the 1940s did indeed see a shift towards ‘direct forms of intervention’ that would not be reversed until the late twentieth century.

The era of direct controls

Although the Bank of England possessed vastly more experience than the dominion central banks in the conduct of market operations, it could claim no particular expertise in the design and implementation of administrative controls. Thus the policy changes of the 1940s were of a levelling nature. They tended to degrade the technological leadership of the Bank of England.

The extent of the swing to direct controls varied from country to country. Britain and the sterling dominions were somewhat more inclined to resort to direct financial controls than were Canada or the United States.

Administrative controls were employed in conjunction with OMOs in Britain and Canada, whereas in Australia and New Zealand they were in effect used as substitutes for market operations. But the overall thrust of change was unmistakable.

After 1945 fiscal policy was more prominent than monetary policy. 'Keynesian' thinking portrayed monetary policy as a weak tool. In particular, it was assumed that variations in interest rates could not be relied on to achieve short-run macroeconomic stability.

Nonetheless, governments were inclined in this era to assert a tighter grip over central banks.⁴ They plainly did not want central banks to have the capacity to obstruct or veto economic policy, as the Commonwealth Bank of Australia had done in 1931.

Postwar governments were anxious to maintain an environment of low interest rates. Government debt had risen strongly during the war, and it was cheaper to service when interest rates were modest. Low interest encouraged investment, employment, and economic development, and benefited powerful or meritorious groups such as exporters, farmers, and home purchasers. Economic development was a major policy goal in many countries.

Interest rates were kept down by a combination of regulation and accommodating monetary policy. Since low interest rates stimulated expenditure, and threatened to fuel inflation and balance of payments problems, administrative controls were imposed on bank lending and access to foreign exchange.

In short, in the Keynesian era central banks were required to facilitate cheap government borrowing, to promote economic development, and to manage the controls over the banking system and external transactions.

Central bankers responded to the new intellectual and political climate with varying degrees of enthusiasm. Nugget Coombs, the Governor of the Australian central bank between 1949 and 1968, was perhaps the most 'Keynesian' of central bankers. Coombs accepted that the government should have the final say in monetary policy. As Governor, he worked to 'establish the "Keynesian" conceptual framework

⁴ Keynes himself was in favour of considerable autonomy for central banks (Bibow 2004: 554).

as the language of communication between myself and my colleagues, between the Bank and the Government/Treasury complex, and between the Bank and its commercial bank clients.’ (Coombs 1981: 147-8)

But even relatively Keynesian central bankers did not accept that monetary policy was as toothless as many economists, politicians, and Treasury officials held it to be. Central bankers called for moderation in the application of direct controls, and for a more flexible approach to interest rate policy. In evidence to the Radcliffe Committee on the British monetary system, the Bank of England was less inclined than the authors of the final report were to dismiss the significance of the quantity of money.

Central banks were very much under the thumb of government in countries such as Australia and New Zealand. At the other end of the spectrum, however, were the United States, and later West Germany. After a decade of subordination to the US Treasury, the Federal Reserve System reasserted its autonomy in March 1951. Instead of continuing to hold interest rates down in order to satisfy the Treasury, the Fed started to adjust them in response to developments in the economic situation. Martin Mayer describes this episode, and the resulting accord between the Fed and the Treasury, as the ‘pedigree’ for central bank independence elsewhere, including – after a forty year time lag - New Zealand. By the 1960s, the American and German approaches were looking increasingly attractive to central bankers in other countries.

The collapse of the old consensus

Pierre Siklos describes the half-century between the 1940s and 1990s as a period of ‘experimentation’ in central banking. The regulatory frameworks that came to prominence in the 1940s had been largely *ad hoc*. Although there was a trend away from regulations in the 1970s and 1980s, there was no consensus over what to put in their place. Some felt that monetarism offered a coherent set of principles, but the popularity of monetary targeting was brief. Not until the development of inflation targeting, and the revival of interest in central bank independence, was there a new (provisional) orthodoxy. This new approach was pioneered in New Zealand in the late 1980s.

Why New Zealand – a country that was a backwater in the early 1980s? After 1984, New Zealand embarked on a decade of hectic change in economic policy. Reform of the central bank was but one aspect of this wider transformation. The

impetus for reform arose from the failure of the Muldoon government's heavily interventionist approach to economic management. (By contrast, in Britain, Australia, and Canada there was less of a sense of crisis than in New Zealand.) That New Zealand was a very small country with a highly centralized political system – unlike Australia or Canada – also helped the reformers. They could move quickly and ride roughshod over criticism.

Internationally, the 1970s saw the collapse of the Bretton Woods system, the rise of inflation, and the end of full employment in many countries. Governments and central banks were troubled by these developments. The existing policy framework lost credibility, partly because of inherent defects, and partly because macroeconomic policy was too loose, not least in Britain and the former dominions. Efforts to keep interest rates below market levels boosted the demand for credit. High government borrowing provided the financial system with additional liquid assets, facilitating an increase in loans. In so far as the banking system was prevented from fully satisfying demand, fringe institutions increased their market share.

Against this background, there was renewed interest in monetarism and in central bank independence. Monetarists called for the adoption of monetary targets as the antidote to inflation. Advocates of central bank independence pointed out that governments could not resist the temptation to seek transitory reductions in unemployment by loosening monetary policy, even though the only lasting effect was to increase inflation. Governments did this regardless of manifesto promises to control inflation ('time inconsistency'). The ideal remedy was legislation to restore the autonomy of central banks, and the appointment of Governors of a 'conservative' disposition.

Announcing Germany's first monetary target in December 1974, the Bundesbank set an influential example. Many central bankers were inclined to accept monetary targeting as a useful tool in the struggle to control inflation. As practitioners rather than theorists, however, they were not easily convinced that there was a close relationship between the monetary and credit aggregates and the price level. Gordon Richardson, Governor of the BoE between 1973 and 1983, endorsed 'practical monetarism' or tighter monetary policy, but tried to resist the more dogmatic approach of the Thatcher government.

Monetarism was a short-lived panacea in the dominions. The Bank of Canada began to announce monetary targets in 1975, in an attempt to support the

government's anti-inflation strategy, which was based on a prices and incomes policy. In 1976 the British Prime Minister, James Callaghan, repudiated the Phillips curve. As a condition for the grant of an IMF rescue package, the British government introduced targets for the growth of the money supply and domestic credit expansion in December 1976. The Australian authorities also started to publish monetary projections – a euphemism for targets – in 1976. The RBA was uncomfortable with this decision. It acknowledged the need to fight inflation, but was unsure how monetary targeting would work, not least in a country with a fixed exchange rate.

The South African monetary policy framework was reformed in the 1980s in the light of the recommendations of the De Kock Commission (1977-85). Interest rate controls were relaxed somewhat, and more emphasis was placed on open market operations. Exchange controls on non-residents were lifted in 1983. The exchange rate was floated. South Africa, rather anachronistically, adopted monetary targets or guidelines in 1986. However, financial liberalization was thrown into reverse later in the decade as the economic situation deteriorated. Exchange controls were tightened, and not relaxed until after the transition to democracy.

Monetary targeting was a blunt instrument. In an era of financial innovation, the information provided by the monetary aggregates was often ambiguous. The Bank of Canada was having second thoughts by 1978. Canada dropped monetary targeting in 1982, partly because of the incompatibility between this approach and an exchange rate policy that amounted to shadowing the US dollar. After an initial burst of enthusiasm, the Thatcher government's commitment to monetarism waned between 1983 and 1987.

New Zealand watched the monetarist experiments in Britain and elsewhere from the sidelines. Monetary targeting did not appeal to Prime Minister Muldoon, whose main goal was to insulate employment and living standards from the impact of the oil crises and weak overseas demand for pastoral exports. Muldoon eventually imposed a freeze on prices and wages between 1982 and 1984, and reintroduced strict interest rate controls. While the RBNZ deplored Muldoon's tactics, it also noted the shortcomings of monetary targeting. The Bank's position was that interest rates should be allowed to rise to levels that would restrain spending and render attractive the holding of government debt. (It did not rule out the use of monetary targets at some stage.)

Following the abandonment of monetarism, there was another interlude of *ad hoc* monetary policy, but this time with the emphasis on market-related instruments. Britain gravitated towards a policy of shadowing the deutschemark. The Australians introduced a 'checklist'. Thus they ruminated on a number of indicators: the monetary aggregates, interest rates, the exchange rate (which was floated in 1983), the external accounts, and the current state and outlook for the economy, including asset price changes, inflation, and inflationary expectations. Australian monetary policy was in any case demoted to a secondary role after 1983, as the Labor government sought to control inflation by means of a wage 'accord' with the unions. Bob Johnston, the RBA Governor between 1982 and 1989, recalls that monetary policy was in the 'wilderness' during this period. Inflation had fallen from the high levels of the 1970s, but monetary policy-makers did not follow any consistent doctrine.

The New Zealand model

Following Muldoon's defeat in 1984, the incoming Labour government deregulated interest rates and devalued the kiwi dollar. The freeze was lifted. Exchange controls and the reserve asset ratio system were abolished. In March 1985 the kiwi dollar was floated. Monetary policy was now based on the 'full funding' – a British concept – of the government's borrowing requirement. Government bonds were offered through a tendering process, with yields set by supply and demand. The central bank assessed monetary conditions by monitoring an Australian-style checklist. Inflation fell from 16.3 per cent in the year to September 1985 to 3.9 per cent in the year to March 1989.

Despite progress in the global battle against inflation in the 1980s, many central bankers were uncomfortable with *ad hoc* methods. Moreover, in countries such as New Zealand, Australia, and Britain there were no institutional safeguards against a return to inflationary (or time inconsistent) policies under different political leaders.

Could or should governments try to commit their successors to maintaining low inflation or even price stability by strengthening central bank autonomy? In the 1980s there was no consensus in this area. Margaret Thatcher, one of the most determined foes of inflation, insisted that monetary policy remain under political (her) control. When, in 1987, her Chancellor, Nigel Lawson, devised a scheme for an independent Bank of England, with a mandate to protect the stability of the currency, he was handbagged for his temerity. The BoE was not granted 'independence' until

1997, and in the meantime New Zealand pioneered the redesign of monetary institutions.

The Muldoon experience had been traumatic for the New Zealand Treasury and the RBNZ. Muldoon had routinely ignored official economic advice. Roger Douglas, the new Minister of Finance in 1984, was determined to ‘Muldoon-proof’ monetary policy. As he explained in the 1988 budget speech, it was necessary ‘to make certain that no future politician can interfere with the Bank’s primary objective of ensuring price stability, or manipulate its operations for their own purposes, without facing the full force of public scrutiny (Douglas 1988: 11)’. Thus the central banking reforms in New Zealand were a reaction to ‘Muldoonery’.

Central bank autonomy and the feasibility of price stability had been discussed internally at the RBNZ, but it was Douglas who took the initiative. In 1986 he asked the Governor, Spencer Russell, to consider whether the central bank should be granted more autonomy. The eventual legislation – the 1989 Reserve Bank Act – was strongly influenced by parallel developments in the wider New Zealand public sector. The principles underlying public sector reform were austerely contractarian. Each organization was given transparent and measurable objectives. Individuals were to have clear responsibilities, and to be held accountable for their performance.

Advice on the redesign of New Zealand’s central banking framework was sought from academic experts such as Charles Goodhart (LSE), formerly of the Bank of England, and Allan Meltzer (Carnegie Mellon). The government consulted other leading central banks including the Federal Reserve, the Bank of England, the Bank of Canada, and the Bundesbank, but the final product was a distinctively New Zealand effort.

Under the 1989 Act, which came into force in February 1990, the central bank has operational, but not goal autonomy. The Act declares price stability to be the sole objective of monetary policy. When a new Governor is appointed (or reappointed) by the Crown, he or she must negotiate a Policy Targets Agreement (PTA) with the Minister of Finance.⁵ The PTA gives precision to the Bank’s goal, and establishes a benchmark against which the Governor’s performance can be judged. Once the PTA is in force, the Minister must not interfere in operational matters, although provision does exist for the government to issue a public override. If the inflation target is

⁵ The PTA could also be renegotiated by mutual agreement.

breached, the Governor risks being chastised or dismissed. The new regime stresses transparency – a relatively new concept in central banking. According to one prominent monetary economist, these arrangements came close to replicating an optimal central bank contract.

In April 1988, and rather to the surprise of RBNZ and Treasury officials, Douglas announced that he intended to reduce the annual inflation rate to between 0 and 1 per cent by the 1990 general election. He hoped that this announcement would dampen inflationary expectations. But not until the first PTA was enacted in March 1990 was the ‘inflation target’ formalized (0 to 2 per cent per annum by December 1992) and made the basis for assessing the Governor’s performance. Price stability was achieved ahead of schedule in 1991. Minor adjustments were made to the target range during the 1990s.

The upper limit was breached in 1995-96, but in general the regime was extremely successful. Although tight monetary policy contributed to rising unemployment in the early 1990s, the economy made an impressive recovery after 1991. Despite the Act’s insistence on the single goal of price stability, the central bank has also tried to moderate fluctuations in output.

New Zealand’s monetary policy framework attracted widespread international interest in the 1990s. Don Brash, the Governor of the RBNZ between 1988 and 2002, and his staff were enthusiastic publicists for the model at conferences around the world. However, the new framework owed at least as much to Roger Douglas, the ‘conservative (though nominally Labour!) politician’ as it did to the ‘conservative central banker’.

Learning from New Zealand

Inflation targeting caught on rapidly. According to one study, at least 54 countries were using this approach by 1998. The 1990s saw the enactment in many countries of legislation to increase central bank independence. But not all aspects of the New Zealand model were welcomed overseas.

There was widespread reluctance to make price stability the *sole* objective of monetary policy. Many observers, including Lars Svensson, the Swedish academic commissioned by the New Zealand government to review the first decade of the new framework, also felt that the Act put too much stress on one individual – the central bank Governor.

Canada was the second country to introduce an inflation target. John Crow, who became Governor in 1987, believed that price stability was the most appropriate goal for a central bank, and repeatedly said so in public. The government was open to the discussion of Crow's proposal, and the Bank sought advice from New Zealand. Crow recalls that:

The Bank did not send anyone to New Zealand to check matters over, but at one point in our process Gordon Thiessen [a senior BoC official] did go over some key points by telephone with the New Zealand Reserve Bank's senior deputy governor – taking care, as central bankers must, to be as vague as possible about why we wanted to know what we wanted to know. (Crow 2002: 171)

Crow and the Finance Minister announced a series of agreed targets in February 1991. Their ultimate goal was to reduce annual inflation to 2 per cent (plus or minus 1 per cent) by December 1995.

A campaign was mounted to revise the Bank of Canada Act in the early 1990s. Supporters of reform spoke in terms of raising transparency, thwarting political interference, and establishing price stability as the only goal of monetary policy. This was similar to the New Zealand programme. Their opponents pointed out that reform was superfluous, since the Bank of Canada already had inflation under control. In the event, the government did not proceed to legislation.

Mervyn King (1994: 115) notes that Britain was one of several countries 'following the earlier lead of New Zealand and Canada' over inflation targeting. Britain introduced a target of 1 to 4 per cent for annual underlying inflation in October 1992. This target was designed to provide an alternative anchor for monetary policy after sterling's departure from the European exchange rate mechanism.

King – then the Bank of England's Chief Economist – told Don Brash that the British approach to inflation targeting was modelled on the New Zealand example. Links between the RBNZ and the Bank of England were strong.⁶ However, instead of being announced jointly by the BoE and the government, the British inflation target was proclaimed unilaterally by Norman Lamont, the Chancellor of the Exchequer.

⁶ Arthur Grimes, the chief manager of the Economic Department of the RBNZ in the early 1990s, had studied for a PhD at the LSE in the 1980s under Mervyn King's supervision.

If nothing else, Nigel Lawson had started a debate on Bank of England independence. The New Zealand and German models of central bank independence were praised in the unofficial Roll Report on BoE independence and accountability published in 1993. The UK Treasury and Civil Service Committee (1993) also reported favourably on the central banking framework in New Zealand, after examining a written submission from the RBNZ.

The government allowed the BoE somewhat more leeway to set interest rate policy in the mid-1990s. But formal autonomy was delayed until after the election of Tony Blair's government in 1997. Blair and his Chancellor, Gordon Brown, were anxious to demonstrate that financial market participants had nothing to fear from a Labour government. They made the BoE responsible for setting interest rates and for achieving the government's inflation target. In 1998 a new Bank of England Act consolidated these reforms.

There can be no question that the British have learned much from New Zealand, but there remain significant differences between the two regimes. The British inflation target is handed down annually in the Chancellor's budget speech, whereas in New Zealand it is a matter for negotiation between the Finance Minister and the RBNZ Governor. Secondly, at the Bank of England monetary policy is decided by a committee and not by the Governor alone.

The RBA's initial response to the changes in New Zealand was cautious. During the early 1990s, the new monetary policy framework in New Zealand was a bone of contention between the Australian Labor government and the Liberal opposition. The central bank did not wish to get drawn into this rumpus. In any case there was no consensus within the RBA. Bernie Fraser, the Governor between 1989 and 1996, was uncomfortable with the dogma that monetary policy should have a single objective. As well as striving for low inflation, he believed that the RBA should continue to aim for a high level of employment. He regarded New Zealand's approach to inflation targeting as far too rigid. In 1993, however, Fraser admitted that there might be merit in a loose form of target: 'if the rate of inflation in underlying terms could be held to an average of 2 to 3 per cent over a period of years, [then] that would be a good outcome.' (Fraser 1993: 2)

The RBA and the RBNZ were in frequent contact. Fraser was invited to discuss his views at a meeting of the RBNZ board in 1994, but there was no meeting of minds. Even so, Fraser's '2 to 3 per cent' evolved into a 'target'. This target was

enshrined in the 1996 Statement of Conduct on Monetary Policy between the RBA and the new Liberal-led coalition government. The RBA's dual mandate was retained, but the achievement of high employment was subordinated to price stability. The Australian inflation target became somewhat firmer in the late 1990s, but not as firm as its New Zealand counterpart. Perhaps Australia's flexible approach to inflation targeting became the international norm in the late 1990s.

Australian central banking legislation was untouched, despite the efforts of the Liberals to promote reform in the early 1990s. Nonetheless, the RBA was permitted to assert greater autonomy from government. Paul Keating, the Treasurer between 1983 and 1991, claimed to have the RBA in his pocket, but in practice he was inclined to defer to his central bankers, especially to his 'mate' Bernie Fraser. Maybe it was convenient to pass the buck for unpopular monetary policy decisions, such as increases in interest rates, to the central bank. The Howard coalition continued to respect the central bank's *de facto* autonomy after 1996.

The independence of South Africa's central bank was protected under the 1996 constitution. The government was influenced by overseas advice. New Zealand offered a prominent example of an independent central bank. After visits to South Africa by RBNZ officials in 1994, Don Brash went over in 1995 to offer moral support. He concluded that Chris Stals, the Governor, saw 'himself as fighting a rather lonely battle for monetary policy rectitude, and was keen to demonstrate that other central bankers [had] views very like his own.'⁷ South Africa adopted inflation targeting in 2000, citing the examples of 'New Zealand, Canada, the United Kingdom' and other countries. The government sets the inflation target, but leaves the key policy tool, the repo rate, in the hands of the SARB's Monetary Policy Committee.

Inflation had fallen substantially in New Zealand, Canada, Britain, and Australia before the introduction of inflation targets. If not a precondition for reducing inflation, it would appear that inflation targeting helps to 'lock in' such gains. British and Australian experience also suggests that it is possible to subdue inflation without an independent central bank. But these caveats do not detract from the novelty of the New Zealand model.

⁷ RBNZ Archives, Box A0421, Governor's overseas trip report, 4 April 1995.

Conclusion

The gap in sophistication and experience between the Bank of England and the dominion central banks closed during the second half of the twentieth century. This process occurred in two stages. First, in the 1940s many central banks – both old and new – converged around a new monetary policy framework. This framework was based on the application of direct controls, and the subordination of central banks to politicians and government officials. By the 1960s central bankers were becoming uncomfortable with aspects of this approach, including the rigidity of interest rates, the absence of firm monetary control, and the trend towards disintermediation.

Macroeconomic instability further undermined the credibility of the postwar settlement after 1970. Some countries now experimented with monetarism, but the results were unconvincing. Central bankers, economists, government officials, and some politicians then turned their minds to the relationship between the central bank and the state, and the appropriate goals of monetary policy. As luck would have it, New Zealand was the scene of the next major breakthrough in central bank design. After the collapse of the Muldoon government, the political situation was conducive to radical innovation in central banking, as in other areas of economic policy. (By contrast, Margaret Thatcher vetoed Nigel Lawson's proposal for an independent central bank.) Germany and the United States offered alternative examples of central bank autonomy, but the approach developed in New Zealand – price stability as the single goal of monetary policy, inflation targeting, a formal contract between the Governor and the Minister of Finance, and transparency – was clearly innovative.

The second stage of the catch-up process occurred in the late 1980s and 1990s. New Zealand was now the exemplar. Impressed to varying degrees by the New Zealand model, the British, Canadians, Australians and South Africans all modified their central banking frameworks. Inflation targeting was the most popular component of the New Zealand package. The British and the South Africans brought in new legislation to enhance the autonomy of their central banks. However, legislation was not forthcoming in Canada or Australia. The Bank of Canada was already relatively autonomous, while the Reserve Bank of Australia was encouraged to assert greater *de facto* autonomy.

Both rounds of convergence – in the 1940s and the 1990s – were rapid. Their timing was driven as much by the economic and political environment as by intellectual developments in monetary economics and central banking.

Plumptre anticipated that the 1940s might bring more government intervention in the monetary sphere. Macroeconomic policy between the 1940s and 1960s did have some considerable achievements: the dreaded return of depression did not materialize after 1945. Nevertheless – for better or worse – the development of central banking in the former British dominions was held back for many years. Central banks in the southern dominions were not really permitted by their governments to act as central banks until the late twentieth century.

When the RBNZ was at length unshackled its influence was substantial. As Siklos (2002: 308) puts it:

It is always premature to declare that policy makers have found the Holy Grail in the current design of monetary policy ...Nevertheless, it should be noted that the inflation targeting regime will soon surpass in longevity all the other monetary policy regimes over the last half century or so of economic history.

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