



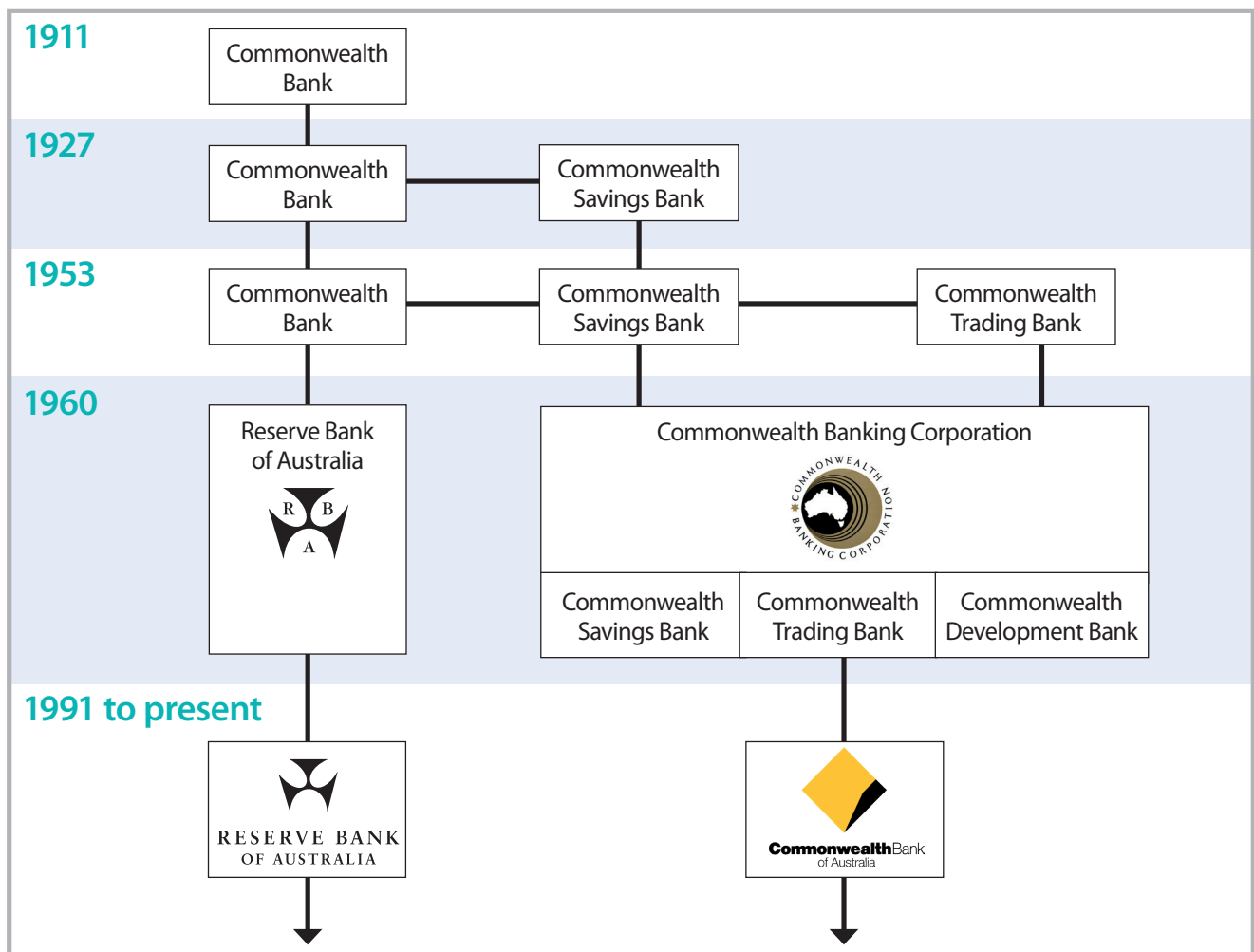
# Origins of the Reserve Bank of Australia

The Reserve Bank’s origins can be traced back to the creation of the Commonwealth Bank of Australia in 1911. The Commonwealth Bank was established as a government-owned savings and trading bank. Over subsequent decades it progressively acquired more of the responsibilities of a central bank. These central banking powers were formalised at the end of the Second World War through the *Commonwealth Bank Act 1945* and the *Banking Act 1945*.

Over time, the organisation’s central banking activities developed to the extent that warranted a separate

body. This was also important from a governance perspective so that the Commonwealth Bank was not both a regulator and a competitor of other commercial banks. The *Reserve Bank Act 1959* separated the commercial activities of the Commonwealth Bank from its central banking functions. The Commonwealth Bank would be renamed the Reserve Bank of Australia and would act as the nation’s central bank. The newly created Commonwealth Banking Corporation would operate as a trading bank. The Reserve Bank of Australia commenced operations on 14 January 1960.

## The Evolution of the Bank



## Timeline

- **1910:** Legislation is passed by the Australian Government to create a national system of paper currency in Australia.
- **1911:** The Commonwealth Bank of Australia is created as a government-owned trading and savings bank.
- **1913:** The Commonwealth Treasury begins printing the first purpose-designed Australian banknotes.
- **1914–18:** The Commonwealth Bank raises loans for the Australian Government to fund military spending in the First World War and manages resettlement, retraining and housing schemes for returned servicemen.
- **1920:** The responsibility for banknote issue is passed from the Commonwealth Treasury to the new Australian Notes Board. The Board was chaired by the Governor of the Commonwealth Bank and was administered by the Commonwealth Bank.
- **1924:** A Board of Directors is created for the Commonwealth Bank.
- **1924:** The Commonwealth Bank takes full responsibility for the issue of Australia's banknotes from the Treasury and the Australian Notes Board is abolished.
- **1927:** The Commonwealth Savings Bank gains separate legal status, but remains a part of the Commonwealth Bank.
- **1930:** Treasurer E G Theodore tables legislation to create a 'Central Reserve Bank' for Australia. The bill passes the House of Representatives but fails to pass the Senate.
- **1939–45:** The Commonwealth Bank raises loans to fund the war effort and closely advises the government on wartime economic policy.
- **1945:** The *Commonwealth Bank Act 1945* and *Banking Act 1945* are passed, giving a legislative basis to the central banking roles and functions that the Commonwealth Bank had assumed over previous decades.
- **1953:** The Commonwealth Trading Bank is given a separate legal status, leaving the remaining entity – the Commonwealth Bank – as the nation's central bank.
- **1959:** The *Reserve Bank Act 1959* is passed, which separates the Commonwealth Bank's central banking functions from its commercial banking activities. The Commonwealth Bank is renamed the Reserve Bank of Australia and is constituted separately from the newly created Commonwealth Banking Corporation.
- **1960:** The Reserve Bank of Australia commences operations as Australia's independent central bank. The Reserve Bank Board, chaired by the Governor of the Reserve Bank, has responsibility for conducting monetary and banking policy so as to best contribute to: stability of the currency; maintenance of full employment; and the economic prosperity and welfare of the people of Australia.
- **1991:** The Commonwealth Banking Corporation is privatised and becomes known as the Commonwealth Bank.
- **1998:** The Reserve Bank's banking supervision function is transferred to the newly created Australian Prudential Regulation Authority (APRA).
- **1998:** The Payments System Board is created with the Governor of the Reserve Bank as Chair. Its responsibility is to determine the Reserve Bank's payments system policy. It exercises this responsibility in a way that will best contribute to controlling risk in the financial system; promoting the efficiency of the payments system; and promoting competition in the market for

payment services, consistent with the overall stability of the financial system.

## A brief history of the Reserve Bank of Australia

### Before a national system of payments

One of the defining features of a central bank is its responsibility to issue the nation's currency and ensure that people are confident in it as a means of payment. Before European settlement, Indigenous trade operated with complex systems of exchange.

During the colonial period there was not a national currency in Australia. Early trade within and between the colonies of Australia was conducted with a number of methods such as:

- barter (directly exchanging one good or service for another)
- quasi-currencies (such as rum)
- foreign currencies that had been brought to the colony (such as Spanish dollars, Dutch guilders and ducats, Indian mohurs and rupees and Portuguese johannas)
- promissory notes (or IOUs).

As the colonial economy grew, private banks were created and began issuing their own banknotes. The eventual failure of many of these banks in the depression of the early 1890s caused a crisis of confidence in these private banknotes. This led to calls for a national currency, uniform banking laws and a central bank. These proposals came to fruition incrementally over the decades following Federation.

### 1901 to 1911: The introduction of a national currency

The Australian colonies were united in a federation in 1901. The Constitution of the new Commonwealth of Australia empowered the


Australian Parliament to make laws in relation to 'currency, coinage and legal tender', 'banking ... and the issue of paper money'. However, it was not until the *Australian Notes Act 1910* passed through parliament, that control over the issue of Australian banknotes was given to the Commonwealth Treasury. The first purpose-designed Australian banknotes to act as a national currency were produced by the Commonwealth Treasury in 1913. A 10 per cent tax on the use of private banknotes was introduced to discourage their use and make using the national currency more attractive to the public.

### 1911: Creation of the Commonwealth Bank

The legal predecessor of the Reserve Bank – the Commonwealth Bank of Australia – was established in 1911. The Commonwealth Bank was to serve as both a government-owned trading bank and a savings bank. It was the only bank to be supported by a Commonwealth Government guarantee. Despite earlier proposals, the Commonwealth Bank was not immediately given a significant central banking role. The responsibility of printing banknotes was assigned to the Treasury in 1910. Central banking responsibilities were conferred on the Commonwealth Bank by the government over time in response to major economic events. At the time of its creation, the Commonwealth Bank's only central banking function was to act as banker to the Commonwealth Government.

### 1911 to 1939: The First World War and expanding central bank responsibilities

The First World War saw the Commonwealth Bank raise public loans to fund the Australian Government's war effort. This was a historically significant scale of financial activity and the Commonwealth Bank's involvement in it consolidated its role as the banker to the government. The management of the government's



debts through local and international borrowing activities was an important development of the central banking responsibilities of the Bank.

The Bank was also involved in the repatriation of returned servicemen, funding and managing the construction and purchase of homes for servicemen at favourable rates in each state. Furthermore, it funded and coordinated retraining programs for returned servicemen – an early form of the central bank’s commitment to the objective of full employment.

Throughout the inter-war years, the functions of the Commonwealth Bank gradually broadened. In 1920, the responsibility for the issuing of banknotes was transferred from the Treasury to the Notes Board, which was chaired by the Bank. The Bank also began to oversee the administration of banknote issue. By 1924, the Bank had taken over responsibility for printing Australia’s banknotes. Through an amendment to the Commonwealth Bank Act in 1924, private banks were compelled to clear inter-bank balances by cheques drawn on the Commonwealth Bank. Consequently, they voluntarily deposited funds with the Commonwealth Bank. In response to growing economic instability in 1929, the Commonwealth Bank was given the power to requisition gold supplies from private banks.

The Commonwealth Savings Bank gained separate legal status in 1924, but remained a part of the Commonwealth Bank, with which it shared the same Board of Directors.

In 1930, Treasurer E G Theodore tabled legislation to create a ‘Central Reserve Bank’ for Australia. The bill passed the House of Representatives but failed to pass the Senate. In 1937, the Royal Commission into Monetary and Banking Systems recommended the continuation of a composite commercial-central Bank.


## 1939 to 1945: The demands of another war

The Second World War saw the Bank again contribute to the raising of loans to fund military activity. With low unemployment and high spending power on one hand, and reduced supply of consumer goods on the other, the risk of uncontrolled inflation grew. The raising of war loans from the public served to mitigate this risk. This was one of the earliest and most direct interventions the Bank had made in attempting to control inflation.

The Bank also played a prominent role in wartime economic planning, and it formally took on further central banking responsibilities, such as exchange controls, interest rate controls and the power to compel private banks to lodge funds with it in special accounts. Under this system, the Bank could require that 100 per cent of any increase in bank assets after September 1939 be lodged in its special accounts. Movement of funds into and out of these accounts was closely monitored and regulated by the Bank. However, these were only temporary wartime powers.

## 1945 to 1959: A legislative foundation

With the expiration of these powers at the end of the Second World War, new legislation was passed – the *Commonwealth Bank Act 1945* and the *Banking Act 1945*. It formalised the Bank’s powers in relation to the administration of monetary policy, interest rates, banking policy and exchange rate control. This was the first time the Bank had been formally given a legislated responsibility to pursue macroeconomic objectives. Commercial banks were required to lodge significant funds in ‘special accounts’ held by the Commonwealth Bank – the precursors to the deposit accounts that banks have at the Reserve Bank today – to record the value of their Exchange Settlement balances.



Further organisational delineation of the Bank's central banking functions took place when the Commonwealth Trading Bank was given a separate legal status in 1953. This left the remaining entity, the Commonwealth Bank, as the nation's central bank. The Commonwealth Bank, the Commonwealth Savings Bank and the Commonwealth Trading Bank shared the same Board of Directors.

## 1959: Separation of the Commonwealth Bank and Reserve Bank of Australia

By the late 1950s, the dual functions of the Commonwealth Bank as both a central bank and a trading and savings bank had become problematic. For some decades, the privately owned commercial banks in Australia had held the view that the Commonwealth Bank's involvement in these two areas simultaneously could give it an unfair advantage over other trading and savings banks operating in Australia. The previous structural reconfigurations did not fully address these criticisms. The government felt that, in order to maintain public confidence in the nation's central bank, these two functions should be formally separated.

The *Reserve Bank Act 1959* separated the Commonwealth Bank into two entities – the Reserve Bank of Australia and the Commonwealth Banking Corporation. The Reserve Bank would act as the nation's independent central bank, and the Commonwealth Banking Corporation would continue operating as a trading and savings bank. The Commonwealth Bank was renamed the Reserve Bank of Australia. The old board of the Commonwealth Bank was transferred to the Reserve Bank, and a new Commonwealth Banking Corporation (consisting of the Commonwealth Trading Bank, the Commonwealth Savings Bank and the Commonwealth Development Bank) was created as a new organisation with a new board.

When the Reserve Bank commenced operations on 14 January, 1960, its legislated objectives were to contribute to:

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

These remain the Reserve Bank's objectives today, and are often referred to as the Bank's 'charter'.

## 1960 to 1983: An independent central bank


The Reserve Bank moved into a purpose-designed building in Martin Place, Sydney, in early 1965. The decision to locate the Bank's headquarters in Sydney rather than Canberra was based on the desire to maintain the Reserve Bank's independence from the political sphere. The location also maintained continuity with the Reserve Bank's established presence in Martin Place – the heart of Sydney's banking precinct. Branch offices were also established in each state capital.

The Commonwealth Banking Corporation remained a publicly owned savings and commercial bank until its privatisation in 1991. From this time it has been known as the Commonwealth Bank.

## 1983 to the present: The Reserve Bank of Australia today

There have been several changes to the roles and functions of the Reserve Bank of Australia since the 1980s, though its overall objectives have remained the same. Direct controls over banking activities gave way to market-orientated methods of implementing monetary policy. The Bank adopted a policy of inflation targeting in the early 1990s (See [Explainer: Australia's Inflation Target](#)).

While the Bank remains accountable to parliament and the Australian people, its political independence



in conducting monetary policy is central to its mission and effectiveness as a modern central bank.

The floating of the Australian dollar in 1983 resulted in the abolition of the Reserve Bank's controls over the exchange rate, though it retains the ability to intervene in the event of significant market dislocation.

The function of the Reserve Bank as a prudential supervisor regulatory agency for the banking sector was transferred to the newly created Australian Prudential Regulation Authority (APRA) in 1998. The same year, the *Reserve Bank Act* was amended to create a new Payments System Board, which is chaired by the Governor of the Reserve Bank, with a mandate to promote the safety, efficiency and competitiveness of the Australian payments system. Its responsibility is to determine the Reserve Bank's payments system policy. It must exercise this responsibility in a way that will best contribute to controlling risk in the financial system; promoting the efficiency of the payments system; and promoting competition in the market for payment services, consistent with the overall stability of the financial system.

The Governor of the Reserve Bank chairs the Council of Financial Regulators (CFR), which has as members the Reserve Bank, APRA, the Australian Securities and Investments Commission (ASIC) and the Australian Treasury. The CFR members work together to contribute to the efficiency and effectiveness of regulation and to promote stability of the Australian financial system.