



Full employment, not price stability, should be the economic goal

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PIE invited commentaries on an issue topical to this year's budget, and to inform election debates.

Emeritus Professor Tim Hazledine offers this contribution to argue that the blight of unemployment should be the focus of monetary policy, not inflation.

Foreign Minister Winston Peters reprimanded Reserve Bank governor Dr Anna Breman in January 2026 for joining 13 other central bank chiefs in signing a letter supporting their United States counterpart, Federal Reserve chair Jerome Powell. Powell is facing trumped-up criminal charges because he resisted President Trump's call for lower interest rates.

Peters said Dr Breman should "stay in her lane" and not meddle in US domestic politics. But given that our governor, like her international colleagues, enjoys statutory independence in her monetary policy choices – independence from interfering politicians – it seems quite natural that this independence should extend to being able to independently support independence, as in the case of the beleaguered Powell in America.

I'd like to see Peters ask some different questions – questions all of us indeed have an interest in as we approach the 2026 election.

For example, why do all the central bankers happily accept that their primary goal, in New Zealand's case, their only goal should be to control inflation? Why do they believe that increasing or decreasing interest rates should be the only policy tool used to achieve this? And why should they operate independently of, in particular, the fiscal (tax and spending) policies that are the responsibility of the elected Minister of Finance?

How did all this come to pass?

It goes back 50 years, to the terrible decade of the 1970s, when the Western world's first post-war "supply shock" – the Organization of the Petroleum Exporting Countries (OPEC) oil price increases – triggered a spiral of prices and wages that pushed annual rates of inflation beyond 15%.

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At this time, our Reserve Bank Act (1973) still specified "full employment" as the first goal of monetary policy (followed by "price stability") and allowed for a mix of policies in active consultation with government to achieve this remit.

But this way of operating simply could not continue. There had to be a single-minded attack on inflation, with mass unemployment used explicitly to scare unions and firms into moderating their wage and price increases.

Triumphant, the inflation-focused "monetarists" expelled the unemployment-oriented "Keynesians" from the citadels of power and then codified their victory into the Reserve Bank Act (1989), which gave us the system that central bankers and governments, unthinkingly, still support today.

But monetarism has hardened into dogma, heedless of changing times in New Zealand and the world. In particular, the importance of international trade has increased dramatically.

The ratio of trade (exports plus imports) to GDP has more than doubled since 1970: from around 25% to 60%. Especially in a very open economy like ours, trade in goods and services provides a powerful competitive constraint on domestic pricing -- much more direct than interest rates. And, for better or worse, the power of the trade unions in wage setting has almost collapsed.

By now, the real-world data have gone a long way towards refuting monetarist dogma. In New Zealand, our near-disastrous "Rogernomics" experiment of the late 1980s had pushed unemployment above 10% in 1991, but for the next 17 years the rate trended down, to below 4% in 2007, before we were victims of the Global Financial Crisis, like everybody else.

At every step, nervous monetarists warned that further decreases in unemployment would "risk" inciting inflation, but it simply never happened. Indeed, the goods and services produced by the newly employed workers would have had a deflationary effect on prices, by increasing what economists call "aggregate supply".

On the other side of the coin, the turmoil of the Covid years around 2020-21 allowed unscrupulous corporations to push up profit margins and prices. But international pricing competition was unravelling that negative supply shock naturally, when a previous Reserve Bank management panicked and doubled interest rates, thereby helping to perpetuate the recession of 5-plus per cent unemployment we suffer today.

It's high time we got our priorities sorted. Inflation is a nuisance; unemployment is a tragedy.