



Committee on Finance  
Riksdagen  
100 12 STOCKHOLM

SVERIGES RIKSBANK  
SE-103 37 Stockholm  
(Brunkebergstorg 11)

Tel +46 8 787 00 00  
Fax +46 8 21 05 31  
registratorn@riksbank.se  
www.riksbank.se

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**The General Council's consultation response to the report "An Evaluation of Swedish Monetary Policy between 1995 and 2005" (2006/07:RF11) (060-1070-06/07)** 23 February 2007

*Summary: The General Council of the Riksbank welcomes the very positive assessment of the Riksbank and its monetary policy, as well as the more critical views and suggestions for improvements in certain areas. The General Council wishes to emphasise in its oversight role the importance of the Riksbank's monetary policy work being carried out efficiently and with a high level of competence. The General Council notes that the reform which gave the Riksbank an independent position in 1999 has worked well and wishes to point out that the General Council would welcome the principles for the allocation of the Riksbank's profits being regulated by law.*

*The General Council agrees with the evaluators' recommendation that Government ministers, etc. should exercise some caution in the public debate on monetary policy, but does not agree with the recommendation that persons nominated to the Executive Board of the Riksbank should appear at hearings in Parliament before they are appointed.*

*The General Council proposes two changes in the law: that the mandate period for a member of the Executive Board should be five or six years and that the qualification period<sup>1</sup> for new members of the Executive Board should be changed from twelve months to nine months. The General Council does not consider that the number of members of the Executive Board should be changed, but agrees that it would be more efficient if the governance and management of the Riksbank as an organisation were entrusted to the Governor and one or two Deputy Governors.*

## 1 Introduction

The Riksbank has been invited to present its views on the report "An Evaluation of Swedish Monetary Policy between 1995 and 2005" (2006/07 RFR1). The Riksbank is presenting two separate responses, one from the General Council of the Riksbank and

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<sup>1</sup> The period after the end of their employment when they may not take on a new assignment or position where their knowledge could harm the Riksbank if utilised, but they can receive a full salary without performing official duties.

one from the Executive Board of the Riksbank. This response concerns the questions that fall within the General Council's sphere of activity. The Executive Board will at the same time issue a consultation response regarding the issues that belong to its sphere of activity. The General Council's comments cover certain introductory general views and comments on the recommendations numbered 8 and 9 in the final chapter, and also some of the questions raised by the authors of the report in earlier chapters.

## 2 General views

The General Council wishes to point out from the outset that it has been very valuable that an independent analysis of monetary policy during the period 1995-2005 could be carried out by two highly-qualified foreign economists.

The Riksbank's independent position makes it particularly important that the Riksbank's operations are evaluated as a basis for the Riksdag's and the general public's assessment of how the Bank has carried out its tasks. This applies in particular to monetary policy, which is an essential part of economic policy. The examination and assessment of monetary policy that was carried out thus plays an important role in strengthening confidence in the regime the Riksdag has chosen, with an independent Riksbank that carries out this part of economic policy.

In this context the General Council welcomes the very positive assessments in the report of the Riksbank and its monetary policy. The General Council notes that the authors begin the summary of their evaluation with the words "Our evaluation of monetary policy in Sweden indicates that the Riksbank compares favourably with the best central banks in the world and that monetary performance has greatly improved from what occurred prior to the adoption of inflation targeting under an independent central bank".

Further, the General Council considers that the report should provide a good basis for the continued discussion of how monetary policy can be developed. This is given that the evaluators observe that inflation in recent years "has persistently undershot the Riksbank's target; this has been associated with a loss in output and higher unemployment" and that "the Riksbank also has been somewhat less effective in clearly communicating its strategy for the conduct of monetary policy".

It is the General Council's responsibility to follow up activities in the Riksbank. The General Council can be regarded as a bridge between the independent Executive Board and the Riksdag, and thereby contributes to the Riksbank's position in society.

The Sveriges Riksbank Act gives the General Council a number of specific tasks. These include appointing the Governor and the members of the Executive Board, establishing the Riksbank's Rules of Procedure and making proposals to the Riksdag regarding the allocation of the Riksbank's profits.

The General Council also has a controlling function. This function has not been specified in the preliminary work or by the Riksdag's Committee on Finance. The General Council has therefore sought to regulate the scope of its activities itself, taking into account the fact that the Executive Board must take independent responsibility for monetary policy, without taking instructions from outside.

Both the Executive Board's independence and the ban on giving instructions mean that there are limits to the extent to which the General Council can influence the Riksbank's monetary policy and general operations. This does not mean that the General Council is prevented from, for instance, following the Executive Board's monetary policy work and its monetary policy decision-making process. Within the scope of the controlling function the Chairman and Vice Chairman of the General Council regularly participate in the Executive Board's meetings and can thereby use their right to ask questions and to make comments for the purpose of carrying out the General Council's tasks as described earlier. The General Council also has the possibility to request that a member of the Executive Board present a report at the General Council meetings, and the General Council's auditors examine the Bank's activities within the scope of the General Council's sphere of responsibility. The members of the Executive Board normally attend the General Council meetings.

The General Council wishes to emphasise the importance of the Riksbank's monetary policy work being conducted efficiently and with a high level of competence and also observes with satisfaction that the evaluation shows that the preparations for the monetary policy decisions meet high requirements. The evaluators summarise their assessment by saying that the Riksbank's organisation is characterised by a high level of competence. In addition, it is noted that the Bank's employees include highly qualified economists who use the best economic and statistical methods available. The evaluators also find that the Executive Board uses the economists' analyses in a professional and efficient manner. The General Council notes in this context that the number of employees with postgraduate qualifications has more than doubled, from 20 persons in 2000 to 45 persons in 2006, which is a relatively high figure in an international comparison.

The General Council wants to provide general support, within the scope of its role, for what the Executive Board of the Riksbank states in its comments on the evaluation.

The General Council has noted the criticism expressed in the report with regard to the inflation forecasts, which are central foundations for the Executive Board's monetary policy decisions. The work on improving understanding of the real economy and in particular developments in productivity has already begun within the Riksbank and in consultation with Statistics Sweden. The General Council intends, within its own role, to devote additional attention to the Executive Board's work on following up the areas identified in the report as requiring improvement.

The General Council wishes to add that forecasts are uncertain and that it is not always possible to predict developments in the economy with a high level of accuracy. It is, of course, important that the forecasting work is conducted using the best possible methods, that lessons are learned from forecasting errors and that deviations between forecasts and outcomes are reduced as far as possible. It is interesting to note in this context that inflation has been significantly lower since the new monetary policy with an inflation target was introduced, that the fluctuations in inflation have declined substantially and that inflation expectations have stabilised around the inflation target. This indicates both that inflation can be predicted with less uncertainty than before and that monetary policy has had the intended purpose of stabilising price stability.

■ The General Council notes that during the period covered by the report, the reform giving the Riksbank an independent position was implemented, and that this reform has functioned well. The independence is considered to cover functional, institutional, personal and financial independence. Functional independence means that the central bank's primary objective is price stability. Institutional independence means that the decision-making body is independent of political bodies such as the Riksdag (parliament) and the Government. Personal independence means that the members of the Executive Board should be independent from different interests and able to make decisions independently without influence from other parties. This independence is safeguarded by the members having long periods in office and by the fact that they can only be forced to leave their positions under strictly limited circumstances. Financial independence means that the central bank can carry out its tasks without being dependent on subsidies from the Government.

The General Council would like to remind the Committee of its communication to the Riksdag with a proposal for the allocation of the Riksbank's profits for the financial year 2004. The General Council stated in this communication that it would welcome the principles for the allocation of the Riksbank's profits being regulated by law. In this context it can also be pointed out that both the European Commission and the ECB consider that Swedish legislation contravenes the EC Treaty and the Statute of the ESCB on this point. The Government has appointed a special investigator, who will put forward proposals on this in spring 2007.

### 3 The report's recommendations

The General Council comments in this section on the recommendations numbered 8 and 9 in the concluding chapter.

*Recommendation 8: A main venue for public debates on monetary policy is in the parliament.*

The General Council agrees that the Riksdag is an important venue for public debates on monetary policy. The Riksbank is accountable to the Riksdag and the natural venue for a discussion of whether the Riksbank is carrying out the tasks delegated to it by the Riksdag.

However, the evaluators go further and even state the following: "An improved debate on monetary policy by the public and particular the parliament makes it less necessary for government officials to express their own views on monetary policy. While government officials have the right to speak on any issue they choose, the experience in many countries suggests that monetary policy and economic performance is enhanced when the government refrains from commenting on the stance of monetary policy."

In the opinion of the General Council, the decision to give the Riksbank independence in monetary policy issues entails a greater need for an all-round monetary policy debate, as the Riksbank holds a special position and is not followed up in the same way as other public agencies. At the same time, the scope for such a debate has expanded, as confidence in the Riksbank's ability to independently conduct monetary policy has strengthened considerably. Monetary policy must be examined and tolerate scrutiny. The evaluation made of Swedish monetary policy between 1995 and 2005 is

■ a good example of one such scrutiny, which can serve as a good basis for further developing monetary policy.

However, the General Council wishes at the same time to point out, as do the evaluators, that members of the Government and others with political assignments and functions, which are important to economic policy, should exercise caution in the public debate on monetary policy. They should consider the effect their statements might have on the credibility of monetary policy. If the general public were to gain the impression that the decisions in the independent central bank could be influenced in one way or another, this could undermine confidence in the Riksbank's ability to carry out its tasks.

*Recommendation 9: Individuals who are nominated to the Executive Board of the Riksbank should be asked to appear in parliamentary hearings before they are appointed.*

The General Council does not agree with the evaluators' suggestion.

One of the General Council's most important tasks is to appoint the members of the Riksbank's Executive Board. The choice of Executive Board members is important, bearing in mind that these members together exercise considerable influence over the economy, an influence that they exercise independently in relation to political instances (including the Riksdag and its Committee on Finance, the Government and the politically-appointed General Council). Given this, and the strong protection a member of the Executive Board has against being dismissed from his or her post, it is essential that this General Council task is carried out properly.

The General Council is the body that can most easily determine what competence is needed in the Executive Board and which competence needs to be reinforced when a vacancy arises. The General Council is also the body that controls the Executive Board members' exercising of their duties and it thus has the background required to assess whether a further mandate period should be granted to a member whose mandate period is expiring. It would hardly be possible for the Riksdag Committee on Finance to gain similarly well-founded impressions through a hearing in parliament of a candidate's suitability for appointment to the Executive Board or for re-election for a further period.

#### 4 Other questions

The General Council has also found reason to comment on certain questions raised by the evaluators not in the form of recommendations.

*(1) The evaluators propose that the Executive Board members' period of appointment should be gradually returned to the original timetable, according to which one member's mandate expires each year.*

The General Council observes that the original aim in 1999 was that one Executive Board member should be appointed each year on a rolling six-year schedule. It was predicted even then that this schedule could be disrupted, for instance, due to members leaving the Board before their term expired. To achieve a slightly better spread of the distribution of mandate period, the General Council proposes that a member could be appointed for a period of five or six years.

As the evaluators observe, the originally-intended rolling six-year schedule has been disrupted by members leaving before their term has expired. If the current Executive Board members stay until the end of their mandate periods, one new member will be appointed from 1 May 2007, two members from 1 January 2009, and three members, including the Governor of the Riksbank, will be appointed from 1 January 2012. According to the evaluators, this could lead to a majority in the General Council at particular times having considerable influence over the composition of the Executive Board.

However, the method for correcting this proposed by the evaluators is not possible in accordance with EU regulations. The evaluators consider that the rolling schedule should be reintroduced by appointing the Executive Board members for shorter periods and that if members leave before their term expires in future, a successor should be appointed for the remainder of the mandate period. However, EU regulations stipulate that all members of a national central bank's decision-making body should be guaranteed an appointment of at least five years.

The General Council proposes instead that the law should be changed so that the mandate period for an Executive Board should be five or six years and that the General Council can within this framework afterwards arrange a better spread of the mandate periods. To enable such a spread the mandate periods should vary between the Executive Board members. With reference to EU regulations these periods must be at least five years. However, they should not be too long. The General Council's deliberations have resulted in the conclusion that the current mandate period of six years should form the upper limit.

*(2) The evaluators propose that one or at most two deputy governors should assist the Governor in managing the Bank and that the other Executive Board members should not have any other responsibility than to take part in the monetary policy work at the Bank, for instance, discussions of interest rates and interest rate decisions and the communication of these discussions to the general public.*

The General Council agrees that it would be more efficient if questions of governance and management of the Riksbank as an organisation were entrusted to the Governor and one or two deputy governors. It ought to be possible for the Executive Board to deal with this question internally, without requiring changes in legislation.

The report takes up the question of how the Executive Board members' tasks and responsibilities should be determined and allocated. Whether the collective decision-making model with six Executive Board members functions with regard to management and administration, etc. of the Bank is a question for discussion. The General Council's Audit Unit has also pointed out some problems with the current management model.

In this context it should be pointed out that the Riksbank's organisation has changed in recent years in order to deal with the type of problem highlighted by the evaluators. During 2005, new forms for management and governance of the Bank were introduced, with the purpose of clarifying the allocation of responsibilities between Executive Board members and heads of department and of attaining a more coherent management of the bank. However, as the evaluators point out, some problems still remain.

■ Given this, the Executive Board of the Riksbank has begun work on an overhaul of the current governance and management forms at the Riksbank. This work is aimed at finding solutions that will make the governance and management of the Bank's administration, etc. even more efficient within the framework allowed by the current Sveriges Riksbank Act, with six Executive Board members who all essentially share the overall responsibility for the Bank.

*(3) The evaluators also consider that a reduction in the number of Executive Board members should be considered.*

The General Council would like to point out that the question of the size of the Executive Board was raised in a proposal from the General Council to the Riksdag in 2000. The General Council then considered that there were reasons in favour of reviewing the size of the Executive Board. Reference was then made to the fact that the new management form with an Executive Board had become well-rooted in society and that the organisation of the Riksbank had been reduced. The Riksdag rejected the proposal, after the Committee on Finance opposed it. The General Council does not consider there are reasons for bringing up this question once again.

The evaluators take up the question of the size of the Executive Board from a particular point of view. According to the evaluators, there is reason to reduce the Executive Board to five or perhaps even four members if it proves difficult to recruit competent persons. However, the General Council does not consider there is any problem in recruiting competent persons to the Executive Board.

The question of the number of members should be regarded in a broader perspective than that applied by the evaluators. It should be discussed on the basis that the Riksbank's decision-making processes and decision-making body should be designed to offer the greatest possible efficiency and quality when carrying out monetary policy and the other questions the Executive Board deals with. These questions are of such importance that they justify the Executive Board having its current size.

*(4) The evaluators consider that the statutory qualification period for a departing Executive Board member should also apply to political assignments.*

The General Council opposes this suggestion.

According to the Sveriges Riksbank Act, Executive Board members who leave the Board have a qualification period of one year. During this period the member may not take up a seat on the board of a financial company. Nor may he or she hold a position or assignment that would have made this person unsuitable as a member of the Executive Board. However, the General Council can give their permission for the member to take up such a position.

When the provision regarding a qualification period was introduced in 1999, it was stated in the bill that the need to preserve the confidence of the general public meant that some sort of qualification period should be introduced. It was pointed out that the members of the Executive Board receive knowledge of issues of extreme importance to certain operations and that it could be perceived as generally objectionable if a member of the Executive Board could immediately transfer to a management position in another company.

■ However, the qualification period does not apply to political positions or assignments (member of the Riksdag, cabinet minister, employment in the Government Offices, political party offices). It was not considered necessary in the bill that a qualification period should be set for a transfer to a political position or assignment; these were thought to be of a nature that exempted them from the qualification period.

The evaluators consider that this exemption from the qualification period for political assignments risks affecting the Executive Board's independent status towards the Government, that is, the party that has the strongest motivation to try to influence monetary policy decisions. The General Council considers that it is important for all of those affected in any way to safeguard the independence and ensure that it is observed.

However, the General Council does not consider that the exemption for political positions or assignments should be removed. The ban on giving instructions that is expressed in the Instrument of Government and the ban on seeking or receiving instructions in the Sveriges Riksbank Act are aimed at the risks to which the evaluators draw attention. Furthermore, the interest that the democratic political system should be able to recruit representatives speaks against removing this exemption, for instance with regard to positions such as cabinet minister.

On the other hand, the General Council does consider that the qualification period should be changed from twelve months to nine months. The General Council has granted a shorter qualification period than twelve months on a couple of occasions. On these occasions, the General Council has carefully examined how long the qualification period should be to avoid risks that the departing Executive Board member could make use of the special information he or she has obtained through their work at the Riksbank in a new employment. The General Council's experiences of these occasions are that it would be sufficient, in normal cases, to have a qualification period of nine months. If this new system is introduced, it should be applied to new appointments, to avoiding breaching the terms that applied when the current Executive Board members were appointed.

On behalf of the General Council:

Johan Gernandt

Maria Svalfors

Taking part in the decision: Johan Gernandt (Chairman), Leif Pagrotsky (Vice Chairman), Sinikka Bohlin, Peter Egardt, Susanne Eberstein, Bo Bernhardsson, Elizabeth Nyström, Anders Flanking, Karin Pilsäter, Kjell Nordström and Ebba Lindsö.

Johan Gernandt och Leif Pagrotsky submitted the draft consultation response.