



# SPEECH

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## ■ The relationship between the Swedish Riksbank and the Riksdag

### *Independence and opportunities for evaluation and accountability*

Let me begin by thanking you for the invitation to today's conference. Of course it is both an honour and an inspiration to have the opportunity to discuss in such knowledgeable company the Riksbank's relationship to the Riksdag (the Swedish parliament) and what this means for monetary policy.

In recent decades many central banks have become increasingly independent in relation to the political system. This also applies to the Riksbank. At the same time, these institutions, which have often been fairly closed and secretive, have become more open and clear with regard to their objectives, motives and means. Many central banks now conduct monetary policy with more or less explicit price stability targets and the Riksbank was one of the first to introduce this type of quantified target for inflation at the beginning of the 1990s. Both our price stability objective and our independence have been written in the law since 1999. This contributes to strengthening the credibility of monetary policy.

The fact that increased independence has gone hand in hand with greater openness and clarity – what is usually called transparency in central bank language – is not particularly strange. For an independent authority to gain general acceptance and legitimacy, there must be good opportunities for evaluation and accountability. A necessary condition for this is openness and clarity!

But there are also other important reasons why most central banks, and not least the Riksbank, have moved towards greater transparency. One reason is that the effectiveness of monetary policy depends on how well we succeed in communicating our intentions to the financial markets and the general public. By being open and clear, the possibility to influence interest rate-setting in the way we desire increases, both in the short term and the slightly longer term. This gives better conditions for achieving the price stability objective which the Swedish people, via the Riksdag, have allocated to us.

■ The Riksbank's ambition is of course to live up to, in the best manner possible, the requirements of openness and clarity made of us, both in our role as public authority and in our dealings with the financial markets and the general public. But the fact that the world around us is constantly changing leads to new demands. In practice, it means that we must be constantly developing and improving our ways of working. One expression of this is, for example, that we have begun to publish our own forecasts for the development of the policy rate. And it is probably difficult for a central bank to be clearer than this with regard to its monetary policy intentions – we actually say what we consider to be a well-balanced monetary policy in the coming period.

So allow me to briefly pause here and explain clearly my own intentions with regard to the next half-hour. The theme of my speech here today is how the Riksbank's independent position, together with a high degree of transparency and efficient communication, contributes to long-term target fulfilment and credibility for monetary policy. Key words in this context are evaluation and accountability. It is these different pieces of the puzzle that I now wish to discuss in more detail.

### **The Riksbank's position – from bank crisis in the 17th century to independent central bank**

The fact that we are in this room today is actually rather appropriate. I can tell you an interesting fact here – that the Riksbank and the Riksdag had a fairly intimate relationship, in geographical terms, for over 70 years, from the early 20th century up until 1976. The Riksbank was then located in the building across the street, where the Riksdag now has its assembly hall. Riksbank officials thus sat almost side by side with the people's elected representatives. Now I do not believe one should draw any far-reaching conclusions on the degree of independence for monetary policy on the basis of geographical location – other factors decide this. But for those who have any doubts, I can point out that the Riksbank is now at a more "suitable" walking distance from the Riksdag, a few blocks away.

The Riksbank is formally an authority under the Riksdag. It is stated in the Instrument of Government, Chapter 9, paragraph 13 that "the Riksbank is the central bank of the Realm and an authority under the Riksdag. The Riksbank is responsible for monetary policy. No authority may determine the decisions made by the Riksbank on issues relating to monetary policy." We have a statutory task to maintain price stability and thus a statutory, independent position.

The fact that the central bank is directly accountable to a country's parliament and not to its government can to some extent be interpreted as an ambition to provide additional weight to its independent position. And the fact that there has been a need to do so over the years is witnessed by several episodes from the Riksbank's own 339-year history. I would therefore now like to take you back in time for a few minutes.

### ***Ideas regarding the Riksbank's position many years ago...***

The Riksbank, or "the Bank" as it was then known, was given a position back when it was founded in 1668 directly under the four estates – what roughly

■ constituted that time's equivalent of the Riksdag. The reason was probably the way in which the precursor to the Bank, Stockholm Banco, had rather dramatically gone bankrupt. As in most bank crises, then as now, Stockholm Banco had lent too much money to people with low creditworthiness and with too little collateral. For various reasons there had been deficiencies in management and control.

Stockholms Banco was an imitation of foreign commercial banks and the idea was originally that it would be a private company. But instead it became a state-owned institution that was managed by officials appointed by the Government. The fact that it went bankrupt created scepticism regarding this type of operation, but there was nevertheless general agreement that a bank was needed. With the bank crisis fresh in their memories, the Government handed over to the estates of the realm at the 1668 parliament the task of deciding how banking operations could be maintained and strengthened. At the request of the four estates, the Government provided "an assurance.... on certain terms and advantages to the Bank's best". This meant that all legislative and regulatory power regarding the bank, as well as its management, was handed over to the estates.

The Riksbank's relationship to the political system has changed quite substantially over the course of the years. Different parts of the political system, the King, the Riksdag and the Government have all at various times wanted to gain control over the central bank. One telling example is the period around the mid-18th century. The so-called "Hat party" came to power in 1738-1739 and began to conduct a very expansionary economic policy. The Bank then became – in its capacity as the bank to the general government and the cash-office for the public authorities – a tool for business subsidies and, not least, the funding of a war which was a total failure. The expansionary credit policy, combined with monetary financing of large general government deficits in turn put foreign exchange and monetary policy under considerable strain. The result was hardly surprisingly inflation and a depreciation of Sweden's currency.

Today the time when Sweden's central bank could be forced to finance war efforts in far-away countries seems very distant. Of course, the financial system was also entirely different a couple of hundred years ago. But the fundamental principles for the credibility of monetary policy and that it should not be possible to use the central bank for "short-term" purposes, remain largely the same.

### *...and experiences closer to our time.*

There are also examples of the importance of a clear framework for economic policy even in modern times. At the beginning of the 1990s Sweden underwent the deepest economic crisis since the Depression of the 1930s. This also came to be a rather dramatic conclusion to almost 20 years of stabilisation policy problems.

The economic policy conducted in the 1970s and 1980s was for various reasons overly expansionary and not compatible with the monetary policy objective of the time – to maintain a fixed exchange rate. Price and wage developments repeatedly came on a collision course with the fixed exchange rate target and Sweden suffered cost crises. As a temporary solution the krona was devalued when the situation became acute – a strategy they adopted on no less than five

occasions in just seven years. But the depreciation of the krona did not solve the fundamental problem. Swedish prices and wages continued rising much too fast. The credibility of the exchange rate target had been gradually undermined and finally it was lost completely. In November 1992 the Riksbank was forced, under great drama – with high interest rates and in principle the entire foreign exchange reserve sold on forward contracts – to let the krona float. The anchor that was supposed to secure expectations of low and stable inflation had been let go.

The seriousness of the situation probably contributed to a broad support for powerful measures needed to bring the Swedish economy onto a better track. The framework for economic policy was in principle redefined from scratch. We were also given a clearer allocation of roles between monetary policy and fiscal policy.

Fiscal policy had previously often been overly expansionary and contributed to excessively high inflation. Now it was subjected to requirements for long-term stability and durability in public finances. A floating krona meant that the main task of monetary policy was to directly act to ensure that inflation remained at a low and stable rate. And the change in regime that was later implemented – with an explicit inflation target for monetary policy and a clear regulatory framework for fiscal policy – has gratifyingly made economic policy more long-term and stable.

It is difficult with hindsight to say anything other than that inflation targeting with an independent Riksbank has been a success. But I would like to point out that the reforms in the fiscal policy area have also been very important. The relatively good central government finances over the past ten years have undoubtedly been a source of strength for the Swedish economy. If we had instead had large budget deficits, a large national debt and unclear regulations in the fiscal policy field it would probably have been difficult to win credibility for monetary policy.

In this context it may be worth mentioning that the Riksbank actually had some experience earlier of conducting monetary policy with an inflation target. We were the first central bank in the world to introduce a price stability target for monetary policy after abandoning the gold standard at the beginning of the 1930s. The Riksdag supported the Riksbank's monetary policy programme and evaluated the policy conducted in a modern manner on several occasions during the 1930s. The price stability target contributed to anchoring inflation expectations, which probably helped Sweden manage the 1930s crisis better than, for instance, the United States. But after this we had many decades with a fixed exchange rate and the episodes I have just described.

### ***The Riksbank's inflation target and legal position***

In January 1993 the Riksbank made its target of low and stable inflation more concrete. The annual rate of change in the consumer price index, CPI, should be 2 per cent, with a tolerance for deviations of  $\pm 1$  percentage point. The target would formally apply with effect from 1995. This created a new norm for monetary policy. Sweden then became one of the first countries in the world to conduct monetary policy with a floating exchange rate and an explicit inflation target.

■ The decision to word the monetary policy target in terms of a particular figure was made for several reasons. Perhaps the most important reason was to create an anchor that everyone would recognise and on which they could base their expectations. A clear target would also make it easier to evaluate the Riksbank's operations and to hold it accountable. As I said, this is particularly important as the Riksbank has such a high degree of independence.

In 1999 the target of low and stable inflation was written into the Sveriges Riksbank Act. In connection with this, the Riksbank was also given greater independence, for instance, in that decisions on the repo rate would be taken by an Executive Board consisting of six members. Interest rate decisions were previously made by the Governing Board, whose successor, the General Council, now has the main task of appointing the members of the Executive Board. The six members of the Executive Board are also forbidden by law to seek or take instructions when making monetary policy decisions. The legislation is largely in line with the applicable legislation in other parts of the EU.

These changes have contributed to further strengthening our credibility. The fact that the political system in a democracy chooses to delegate such an important task as monetary policy to an authority with such a high degree of independence as the Riksbank is not in principle completely uncontroversial. But as I implied earlier, there are good reasons why one, with a clear majority has chosen to do so. I will like to take the opportunity to develop this point.

### **Why has monetary policy been delegated?**

One could say that the Riksbank is at the end of a delegation chain. The Swedish people have elected a parliament which has in turn legislated on the Riksbank's objective and appointed the General Council of the Riksbank. The General Council in turn appoints the six members of the Executive Board, who take the monetary policy decisions.

The fact that some tasks in society, such as monetary policy, are delegated in this way may be appropriate for several reasons. This applies perhaps mainly when there is a risk that political decisions might be taken with too short a time horizon. This problem is dealt with in monetary policy by the Riksbank having a high degree of independence and a clear statutory task. Our independent position is thus an important – perhaps even an essential – condition for being able to maintain low and stable inflation in the long term. It is a necessary condition for credible monetary policy.

A further example connected with the same argument concerns the delegation of the management of the state finances to the Swedish National Debt Office – the state's own internal bank. That "allocation of responsibility" is also important for monetary policy. I spoke earlier about occasions long ago when the central bank was forced to use its banknote printing presses to finance government deficits that for various reasons had got out of hand. This type of behaviour is of course incompatible with price stability. It is therefore important for the credibility of monetary policy that there are rules for how state borrowing should be handled and that monetary financing is forbidden. According to the law, the Riksbank shall not "...extend credit to or purchase debt instruments directly from the state, another public body or an institution of the European Union."<sup>1</sup> In Sweden it is

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<sup>1</sup> Sveriges Riksbank Act (1983:1385), Chapter 8, Article 1.

■ another authority, the Swedish National Debt Office, that finances the national debt and grants state guarantees and loans.

Another reason why the political system has delegated monetary policy to an organisation with expertise in this field, is that it in many ways concerns technically complicated operations. This has also been done in the case of many other authorities, which are responsible for technical issues that are important to society. And this is in itself natural. Most of us probably think, for example, that the decisions regarding the length of the runway at an airport should be taken by experts at the Swedish Civil Aviation Authority and that the approval of new drugs should be managed by the Medical Products Agency, rather than by political voting.

But as I mentioned earlier, the delegation of an important social issue such as monetary policy also requires evaluation and accountability – necessary conditions for public support and legitimacy. This, and the need for openness in this context, is something I will now discuss in a little more detail.

## The need for openness and clarity

### *Independence makes demands of evaluation and accountability*

Some of the demands made of us on the basis of our role as authority are fairly self-evident. We must, for instance, to the best of our ability try to meet the price stability target we have been allocated. In addition, we must also be able to explain to the general public in a suitable manner the motives behind our decisions. The Riksbank's independence and the requirement for legitimacy also mean that it must be possible, not least from the point of view of democracy, to evaluate our work – how we have done – and to hold us accountable. How does this work?

In formal terms, the General Council may only sever a member of the Executive Board from his or her appointment if "...he no longer meets the requirements which are made on him to be able to carry out his duties or if he has been guilty of serious misconduct." <sup>2</sup> The legislation strengthens the Riksbank's independence and credibility for monetary policy. For example, it should not be possible for those in power to be able to groundlessly dismiss a member of the Executive Board for the purpose of appointing their "own" decision-makers.

As the question of accountability is stated in law, it is not actually the Riksbank's task to take a stand on how this should be achieved. However, what we can do – and also strive for – is to create the best possible conditions for accountability. We do this by being as open and clear as we can. This makes it easier for outsiders to critically examine how monetary policy is conducted and how well we live up to our principles.

There are also certain formal requirements for providing information to our principal. Our tasks include, for instance, presenting a written report on monetary policy to the Riksdag Committee on Finance at least twice a year. In connection with this, the Committee also holds a hearing with the Riksbank Governor.

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<sup>2</sup> The Instrument of Government, Chapter 9, Article 13.

■ I would like to add that it should also be possible to examine the areas of our work that are not directly concerned with monetary policy. Openness is something that permeates Swedish public administration and is one of the keystones of our principle of free public access to official documents. It means that the authorities' activities should as far as possible be carried out in an open form. This also applies to the Riksbank, of course.

But there are other types of more "informal" accountability that are facilitated by our openness, credibility and independent position. The information from the Riksbank also makes easier the often fairly lively debate on monetary policy conducted in the media. Through our independent position and our openness, we create very good conditions for a debate without any great risk that our credibility will be chipped away. The possibilities for accountability even in this more informal way are thus fairly large.

The Riksbank's responsibility as an authority also makes other demands on our actions. This applies, for instance, to the forms for how we make our interest rate decisions and how we communicate our monetary policy intentions – what is usually called "signalling" in central bank language. Our interest rate decisions must be taken in what I would like to call a "correct procedure" and it is important that our principal – ultimately the general public – has insight into the decision-making process. This is why, for instance, the minutes taken at the monetary policy meetings are normally published two weeks after the meetings. In addition, the Chairman and Vice Chairman of the General Council have the right, according to the Sveriges Riksbank Act, to attend the meetings of the Executive Board, which they normally make use of.<sup>3</sup> The purpose of this is in principle that they are monitoring that things are done correctly, on behalf of the Riksdag and the general public. We decided only a couple of weeks ago to make some changes in these areas. I shall return to this shortly. But let me first state another aspect as to why openness and clarity are so important to us.

### ***Target fulfilment – Openness and clarity contribute to efficiency***

There are not merely democratic reasons as to why central banks have become more open and clear. Many central banks have seen greater transparency as a means of more easily attaining their objectives and of making monetary policy more efficient. Openness and clarity can even here enable us to better meet the requirements made by our principal.

Firstly, openness and clarity regarding monetary policy make it easier for economic agents to be convinced that the interest rate decisions made are really intended to attain low and stable inflation. This contributes to greater credibility and to anchoring expectations around the target. And this was an important reason why the Riksbank began to publish its forecasts and other material on which decisions were based early on in the new inflation-targeting regime. Building up confidence in the price stability target as quickly as we actually did would probably have been very difficult if we had not been as open as we were with regard to our work and our decisions.

Secondly, openness and clarity are nowadays an important part of monetary policy in itself. According to economic theory, there is a correlation between interest rates with different times to maturity. And expectations of short-term

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<sup>3</sup> Sveriges Riksbank Act (1983:1385), Chapter 3, Article 3.

■ interest rates, which the central bank governs, are important to the long-term interest rates. By influencing expectations of short-term interest rates, a central bank can therefore also indirectly affect interest rates with longer maturities. Greater influence over interest-setting for all maturities – the yield curve – means that the impact of monetary policy is more effective. This is often called conducting monetary policy by “management-of-expectations”. And the best way to do this is to provide good information.

A third reason for working to achieve greater openness and clarity “outwards” is that it can help us to work more efficiently within the Riksbank’s walls. And this is an argument I do not think should be underestimated. Openness quite simply increases the incentives for us to do a good job as it makes it easier for others to evaluate how well monetary policy functions.

### **Changes for more efficient communication**

Ever since the inflation target was introduced, openness and clarity have been guiding principles for us. We have gradually implemented changes to become more transparent and more efficient in our communication. In February we presented for the first time our own forecast of the development of the policy rate over the coming years, something that our colleagues in Norway and New Zealand have also done. And as I mentioned earlier – a central bank can hardly be much more open and clear with regard to its monetary policy intentions. This increases the opportunities for evaluation and accountability. It has also become easier for us to explain our decisions and forecasts and to outline alternative scenarios for the interest rate. We are better able to live up to the requirements made in our interaction with the general public and the financial markets.

There are also other examples of measures taken to increase our openness. Here I am thinking about the publication of minutes from the monetary policy meetings, our monetary policy reports, the many speeches held by Executive Board members every year and the hearings of the Governor by the Riksdag Committee on Finance.

### ***Clarity, not just openness – quality, not just quantity***

But efficient communication is not merely about quantity, it also concerns quality. Publishing a lot of information and doing so very often does not necessarily make the message clearer and the communication more efficient. It is not enough to merely be open. One might say that it is a question of giving the right information at the right time and about expressing oneself clearly. This is an important aspect that ties in with a survey of central banks recently made by JP Morgan. There the Riksbank was ranked as the most open central bank. But the main message of the study was that a central bank, once it had passed a particular degree of openness, perhaps did not become much more predictable by providing even more information. And I believe there is some truth in this. At least if the central bank is already very open, the quality of the communication may be more important than the quantity. And we are consciously working all the time to become even better with regard to clarity and efficiency in our communication. As recently as a couple of weeks ago, we Executive Board members decided to take a few further steps in this direction.



■ To begin with, the public minutes of the monetary policy meetings will now state which of the Board members has said what in the general discussion. This means that we have both a correct decision-making procedure and everyone will be able to follow the reasoning of the individual Executive Board members with regard to each interest rate decision. Stating the names in the minutes will make us even more open and clear. It will provide better opportunities for evaluation and accountability.

The second change is that we will now hold press conferences in connection with all of the monetary policy meetings, and not, as before, only when we have adjusted the interest rate. The motives for keeping the interest rate unchanged are just as important as the motives for adjusting it. Together with publishing our own interest rate forecasts, press conferences after each monetary policy meeting will provide better and more regular information on the considerations we make.

Finally, we Executive Board members will normally avoid implying prior to a meeting what interest decision might be made there, what is known as signalling. And by this I mean signalling above the interest rate forecast, press releases and minutes of meetings that have earlier been published. The actual need for signalling has declined, not least with the publication of our own interest rate path. Our assessment is that it is enough to communicate our intentions clearly in connection with the seven monetary policy meetings held every year. Moreover, we publish our own interest rate forecasts in connection with three of these meetings, when a Monetary Policy Report is published. On the other four occasions we will report a qualitative assessment of how the most recently published interest rate forecast relates to the new information received.

I would like to point out that the individual members of the Executive Board will continue to express their own opinions in public. But this will above all be a question of afterwards clarifying and explaining personal deliberations made in connection with the monetary policy meetings. Differences of opinion within the Executive Board will also be clear from the minutes, possibly even more so than before.

These changes will in my opinion help us to better live up to the requirements for making decisions in the correct manner as required of us as a public authority. The purpose is also to attain more efficient communication with the financial markets and the general public.

## Conclusion

When the inflation target was introduced, after the Riksbank had been forced to abandon the fixed exchange rate at the beginning of the 1990s, under great drama, many people probably doubted that the policy would succeed. But confidence in the Riksbank's ability to maintain low and stable inflation in the long-term gradually increased.

And there are several factors that have been decisive so that we could achieve the credibility of monetary policy that we currently enjoy. The change of regime implemented after the severe economic crisis at the beginning of the 1990s – with an explicit inflation target for monetary policy and clear regulations for fiscal policy – has given economic policy as a whole a more long-term character and greater stability. Closely linked to this is our independent position as written into the law in 1999 and the shaping of our role as public authority. And I am fairly

- certain that this is to a great extent due to the fact that we have purposefully worked to attain greater openness and clarity. This provides prerequisites for evaluation, accountability and thus creates legitimacy. All of these factors have contributed to winning confidence in our monetary policy.

But the process does not stop here. It is not possible to "rest on one's laurels" when one works with monetary policy. No, we must keep on adapting to new requirements; we must develop and refine our methods. One expression of this is that we have recently made several changes to become clearer and more efficient in our communication. The fact that we always have these ambitions is something that the general public and our principal, the Riksdag, as well as agents in the financial markets can demand of us.

Thank you!