

Speech

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The first year with the new Executive Board

Swedish Economics Association

Legislation effective from the beginning of last year has made the Riksbank formally independent for the first time since its foundation 332 years ago. The Bank has admittedly acted independently in practice for quite some time but that had to do with the prevailing political consensus on the advantages of this, not with any statutory arrangements.

I am now in my seventh year as Riksbank Governor and have had experience of cooperation in this period with four finance ministers. None of them attempted to influence the conduct of interest rate policy. It would be stretching things a bit to say that every finance minister has actively supported our interest rate hikes in every situation but, as I said, none of them has tried to achieve a different interest rate policy.

The Riksbank's predecessor, Palmstruch's Bank or Stockholm Banco, established in 1656, was a private enterprise with a royal warrant to conduct banking operations. Its directors, moreover, were appointed by the monarch. Having issued too many notes on the basis of uncertain collateral, however, the bank collapsed.

On 17 September 1668 the bank was re-established directly under the Estates of the Realm in order to preclude royal interference in its affairs. In those days kings were rather inclined to plunge their countries into war and wars were expensive. So even in the 17th century it was realised that a central bank could be used to finance projects that were deemed to be worthy but costly.

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In practice, however, placing the central bank of the day under the control of the Estates of the Realm did not rule out interference. The commissioners who were appointed to run the bank were never in a position to function as independently as had been intended. The Estates constantly meddled in the bank's business and there were repeated instances of the monarch attempting to requisition funds.

Moreover, when a parliamentary system was introduced in Sweden in the early 20th century and the power to govern issued instead from the Riksdag, there was an end to the separation of powers that had been aimed for in the 17th century by subordinating the bank to the Estates of the Realm.

To some extent, however, this was more a matter of separating powers. Today, independence is not a question of power-sharing across institutions but a delegation of authority and responsibility.

In our current legislation, monetary policy decisions have been delegated by the Riksdag (Sweden's parliament). In other words, the Riksbank is not in a position to manage monetary policy completely independently of the democratically elected institution. This is an important difference. The Riksdag has stipulated that the Riksbank shall be accountable for price stability. The delegation of an explicit objective to the central bank lessens the scope for abrupt changes in — or political pressure on — monetary policy and thereby enhances the policy's credibility.

The delegation of monetary policy in the new legislation can be said to stand on three legs:

- *Firstly*, the Riksdag has defined and prescribed monetary policy's objective as being to maintain price stability and promote a safe and efficient payment system.
- *Secondly*, the Riksbank has been instructed to work for these objectives independently.
- *Thirdly*, the Riksbank is accountable to the Riksdag for its actions.

There is nothing exceptional about this type of delegation from the political system in a democratic society. The judiciary is commonly cited as a comparable example. The law courts go about their business in an independent manner, guided by the laws that politicians have enacted. If the elected representatives of the people are displeased with the judgements of the courts, they pass new laws. They do not interfere with the handling of particular cases in the courts. The comparison should not be taken too far, of course; law courts handle a series of cases that concern particular individuals and firms, whereas monetary policy affects everyone in society.

The independent status of the Riksbank is broadly equivalent to that of the law courts. The Riksbank's objective is laid down by the Riksdag but it is the Riksbank's new Executive Board that regularly and independently sets the repo rate. The Riksdag can always change monetary policy's objective if it is dissatisfied with the consequences that the policy for fulfilling the earlier objective entails.

It is against this background that I prefer to talk of the new legislation rendering the Riksbank independent but accountable. This is a better description of the current arrangements for monetary policy.

New executive

Besides conferring greater formal independence and enshrining the policy objective in law, the new legislation has given the Riksbank a new executive from the start of last year. The new Executive Board, made up of six full-time members, makes its decisions collectively. The members are appointed by the General Council, which also has controlling functions. Under the new arrangements, Executive Board members are appointed in rotation (one each year) for six-year terms.

A major task for the Executive Board is, of course, to decide the formation of monetary policy. But its functions amount to much more than setting the repo rate, though it is often this which attracts most attention from the media and people in general. Other matters include what the law refers to as promoting 'a safe and efficient payment system', the optimal management of exchange reserves, ensuring an efficient supply of notes and coins, and naturally seeing to it that the Riksbank is properly managed in general.

Our Executive Board accordingly has a far-reaching responsibility and collegiality. In the Bank of England, for example, the Monetary Policy Committee concentrates entirely on deciding interest rate policy, while other matters are in the hands of other groups.

So what consequences may the collegiality have for the decisions? This has been discussed in the academic literature but only with reference to the effects on monetary policy, while other matters have not been considered.

Arguments that are usually put forward in academic work in favour of collective decision-making in monetary policy include a good balance of decision-makers and adequate competence in the decision-making body. But I still find it difficult to recognise our situation in many of the academic descriptions, which tend to see the members as representing different preferences and hidden motives.

As far as the Riksbank is concerned, in my opinion there can be little doubt that all the Board members subscribe to the same objective. Price stability is our statutory objective and the Board members have jointly agreed that it amounts to a 2 per cent rate of inflation, measured by the consumer price index, with a tolerance of deviations up to ± 1 percentage point. Moreover, the members are individually responsible for the fulfilment of this target. So their preferences should be the same.

It seems to me, moreover, that there is a consensus on the Board about monetary policy's intellectual framework. Policy is to be formed in the light of assessments of inflation one to two years ahead. If the Riksbank's inflation forecast shows a rate above the target at this horizon, then the interest rate shall normally be raised, and vice versa. At the same time, the Board has made it clear that at times there may be grounds for deviations from the target. One reason would be if bringing inflation

quickly back to the target after a shock would be excessively costly for the real economy. Another is if CPI inflation is affected by transitory factors that leave no permanent mark on the path of inflation; examples of such factors are interest expenditure that directly affects the CPI and effects of changes in indirect taxes and subsidies.

But monetary policy is in no sense an exact science. So although there is a consensus on the basic approach, opinions may differ to some extent about the ongoing formulation of monetary policy. This is evident from the work of the Executive Board to date. It also seems to be something the legislators aimed for in that they have made six persons accountable for the decisions.

How has the Board functioned?

Our Executive Board has chosen to meet once a fortnight. Monetary policy is discussed at roughly eight to ten designated meetings a year. The procedures for assessments and decisions are broadly the same as before, with the major difference, of course, that it is now a matter of six persons arriving at decisions independently. The transparency of policy, which includes the publication of minutes that reproduce the discussions at Board meetings, means that what used to be internal deliberations are now common property. Anyone can see how the arguments have been weighed in the discussion and thereby judge how policy has been conducted.

To date, the different shades of opinion on the Executive Board have been confined to monetary policy. No member has yet entered a reservation against any majority decision in the other spheres of responsibility.

The reservations by Board members have concerned both the foundation for policy decisions — the inflation assessment — and the actual repo rate decision. There were two occasions last year when a member entered a reservation against the inflation assessment; the Inflation Report then represented the majority's forecast. On four occasions, various members entered reservations against the majority's repo rate decision. There have not yet been any instances of opinions about the formation of monetary policy being based on diametrically opposed views; it has been more a question of different shades of opinion. There has been no meeting at which one member advocated raising the interest rate at the same time as another wanted to leave it unchanged and a third argued for a cut. That has actually happened, however, in the Bank of England's Monetary Policy Committee.

The reservations to date have arisen from disagreements about inflation prospects, about the tendencies in various components and about the timing of an interest rate adjustment. Thus, they have concerned different assessments in current monetary policy, which is only natural for something so complex as this and often by no means self-evident. After all, a difference of 25 basis points is not the difference between black and white. The effects of such small interest rate differences on the real economy or inflation should not be exaggerated.

When it comes to the basic policy approach in terms of the objective, its clarifications and the intellectual framework, I find that we are in agreement. So the Executive Board does not entirely conform to the academic picture of

individual members with different preferences for the path of inflation and hidden intentions of fulfilling goals of their own choice.

That is a situation which, in theory, could arise in the future but the current Board members have shown no inclination to practice for that sort of decision making.

How has this gone down?

So how has our work been received by the outside world? The extent to which our discussions, including any differences of opinion, have been made public has no doubt come as a surprise to some.

In the run up to the new Executive Board, some observers speculated about the possibility of the Board meetings taking the form of well-rehearsed events with no genuine discussion. I believe that so far we have made it pretty clear that things are not like that. The policy discussions are held at Board meetings and their outcome is by no means given in advance.

That is also what makes this form for decision making so exhilarating. Neither I nor my colleagues can be entirely sure just what the final decision will be. The discussions are accordingly minuted and held in the presence of General Council representatives. This is how we have interpreted the legislators' intentions with the new arrangements.

The new independence demands more in the way of transparency about policy and the Riksbank's ideas about monetary policy and other matters. The publication of inflation reports and stability reports predates the new Executive Board. To them we have now added the minutes of Board meetings and a somewhat different role for speeches. There is now a greater overall insight into what we are doing, though the picture we present is not always as uniform as before.

With the new transparency it can be said that people are now admitted to the decision-making process at an earlier stage. Communication with the earlier model did not occur until after the decisions had been made, formally or informally. With the new system, people are informed about what each decision-maker is thinking as regards the decision that is in the process of being reached.

Perhaps the new arrangement is not as clear as its predecessor but it is more open in the sense that the deliberations underlying monetary policy are more distinct. Here we accordingly have a conflict between transparency and clarity. Communication in the period with the new Executive Board seems to have worked relatively well. On the whole, monetary policy measures have been predictable. So transparency has not been detrimental for clarity, at least to date. I doubt whether it ever will be. The important thing for market players should be how the central bank is thinking about interest rate policy. With better knowledge in this respect, the course of monetary policy should be easier for them to foresee.

While the publication of minutes has been introduced so that people in Sweden can follow our reasoning and thereby hold us to account, it has also added a piece to the puzzle that has to be assembled by those who keep an eye on us and try to

interpret our policy. The minutes record the Board members' views of current policy as well as their deliberations about the conceivable future course.

Looking back over last autumn, the fact that some members entered reservations in August probably led the market into expectations of an increase. During the autumn, however, we came in for some criticism for talking about a restrictive adjustment long before the interest rate was actually raised. Expectations of this were already building up in September but the increase did not come until November. A majority of the Board, however, saw no alarming inflationary pressure and this, plus the fact that inflation expectations were anchored around the target, provided a respite in which to make it clear to one and all that a monetary tightening did not mark the end of the party. Instead, we intended it to create conditions in which the party could continue for longer without the participants becoming unduly inebriated. For those who perceived the need for an interest rate increase early on, it is possible that the interval between words and deed seemed unnecessarily long.

I willingly admit to being influenced by our experience from the autumn of 1994. Although I and many others considered that the interest rate increase on that occasion was necessary, it still came as a surprise. On this occasion I found it important to position the increase so that people in Sweden could see it was called for. This does not mean that either I or my colleagues would refrain from adjusting the repo rate promptly whenever necessary. It is just that there is much to be gained from people in Sweden feeling highly confident about the Riksbank's interest rate decisions, not least in the light of experience from the 1990s.
/kommentar kvar här i svenskan/

There have been occasions this spring when signals do not appear to have reached the market. At the February meeting the Executive Board raised the repo rate 0.5 percentage points because we saw risks of inflation one to two years ahead being above the target. But in that we raised the interest rate, we arrived in practice at a new assessment of inflation prospects that took the higher repo rate into account. In the press release announcing the repo rate increase, the Board noted that inflation one to two years ahead was now expected to be on the target.

In addition, Kerstin Hessius and I both pointed out in speeches that after the interest rate increase we perceived the risk spectrum for the path of inflation as being more balanced. Even so, there continued to be market expectations of an interest rate increase in connection with the monetary policy meeting; this, as you know, did not happen.

Both we at the Riksbank and market players have reason to consider what happened. The Riksbank has an interest in communicating its thoughts about inflation prospects in such a way that repo rate decisions do not come as a surprise. In this case we had discussed inflation prospects fairly explicitly on three occasions in a way that indicated a major probability of the repo rate being left unchanged when the time came to reach a decision. Yet expectations still focused on an increase.

Our repo rate decisions normally focus on prospects for inflation one to two years ahead. The Riksbank also has to consider its statutory objective of promoting 'a safe and efficient payment system' and if this were to be in jeopardy it could

require us to alter the repo rate. However, a safe and efficient payment system generally presupposes price stability, even though situations could arise where the relationship between them seems less simple. That might be the case if, for example, the supply of credit began to grow in a way that might lead to a new bank crisis of the kind we experienced in the early 1990s. But in such a situation we shall be very explicit about any intention of departing from the usual train of thought. The present expansion of credit seems to be too strong for macro-economic balance in the longer run but for the time being at least it does not threaten the payment system's stability.

Concluding remarks

To sum up, I can note that the debate about the Riksbank's independence has recently become more harmonious. Independence seems to have been accepted as such and the discussion is now concentrating more on factual matters in the field of the Riksbank. Personally I consider that the current legislation is working very well. It confers a formal independence that calls for far-reaching transparency.

The Riksbank has now reached the position of being one of the world's most open central banks. That makes it additionally gratifying that the status of the Riksbank is treated with greater equanimity than for some years ago. I well remember wondering how this could be achieved when I was first appointed Governor of the Riksbank at the beginning of 1994.

But openness makes new demands. It accentuates the need to make good assessments of future prospects, which any experienced economic forecaster knows is a difficult task. At the same time, however, that is what makes work at the Riksbank so stimulating — not just for me as Governor or for my colleagues on the Executive Board but also for all the skilled economists on our staff.

A higher degree of harmony around the Riksbank and its monetary policy should also mean that our statements and actions cease to make it to the front pages of newspapers. As long as they are part and parcel of the normally formulated monetary policy, they hardly belong to the news category that commands a lead position in the press, radio or television. We have not yet got that far but I believe the time will come when an interest rate adjustment of say 0.25 percentage points is not front-page news. When that happens, monetary policy and the independence of the Riksbank will not only have found their place in Swedish society but also be accepted in earnest by a broad public for the work that is done. I believe that day will come.