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Separate statement of opinion from Anders Vredin

Sveriges Riksbank

Opinions in summary

The proposed new Sveriges Riksbank Act entails major changes compared with the current act. The new act is extremely comprehensive and detailed. This makes it complex and creates uncertainties over how it is to be applied. In some respects, it also restricts the Riksbank's monetary policy independence compared with the current act. Recent decades' experiences show that flexibility is needed if a central bank is to be able to manage crises rapidly. Instead of creating a comprehensive and detailed law, it would have been better to focus on strengthening the possibilities for controlling and following up the Riksbank's activities.

Many of the proposals are rooted in a desire to clarify the Riksbank's mandate and strengthen the Riksdag's ability to evaluate the bank, in line with the commission of inquiry's terms of reference. However, the arrangement that the inquiry has selected to achieve this – which specifies the Riksbank's powers and targets for its various activities in detail in different chapters – also means that the new act will be immensely comprehensive. The large amount of assessments that the committee also makes in the text of the inquiry, concerning how the Riksbank should act in various situations, also contributes towards creating a highly complex regulatory framework.

One purpose of the text of the new act has been to clarify where the boundary lies between decisions that other public sector agents may not attempt to affect – above all within monetary policy – and decisions where demands can be placed on the Riksbank to consult with other actors. Quite rightly, the current act could be seen as being far too unclear in this respect, with many possibilities for various interpretations of the law, and thereby of the Riksbank's mandate, as a result. However, the proposed new act entails many new uncertainties and problems in interpretation. This could make it difficult for the Riksbank to act quickly and decisively enough in a financial crisis.

Over the last decade, central banks around the world have been forced to test several new and different methods to dampen the effects of shocks to the financial markets and to manage an extended period of low inflation, with policy rates close to their lower bounds. Nobody has been able to predict exactly which tools were necessary or under which conditions. An act that micromanages the central bank would have been an obstacle to the efficient management of these shocks. Another central lesson from this period is that it is difficult to identify the borders between central banks' main tasks – price stability and a stable and efficient financial system – particularly (but not only) during a financial crisis. Considering too that the financial markets are in a state of rapid transformation, this argues against an act with very detailed provisions.

For example, looking abroad, we see that other countries have neither defined the monetary policy toolbox as narrowly as this inquiry proposes nor created separate toolboxes for monetary policy and financial stability. Moreover, neither is the drawing of boundaries between these areas of activity justifiable using economic theory as a basis.[1] However, my criticism of the technical approach taken by this legislation does not mean that I see any intrinsic value in formulating the act exactly as it appears in any other country or in basing the act on any specific economic theory. My criticism is due more to the very large changes the combination of legislative proposals now being tabled will entail in comparison to current law and to the lack of support existing for the proposals in other countries'

[1] See, for example, M. Hellwig, "Financial Stability and Monetary Policy" (Preprints of the Max Planck Institute for Research on Collective Goods, Bonn 2015/10) and F. Gourio, A.K. Kashyap and J. Sim, "The Tradeoffs in Leaning Against the Wind" (NBER Working Paper 23658, August 2017).

legislation[2] or in economic theory. Indeed, experiences from the last decade, in Sweden and other countries, instead suggest we need an act that allows flexibility, rather than one with detailed provisions that separate measures for financial stability and monetary policy.

Ultimately, a central bank's operations mostly revolve around determining, one way or another, how the bank's balance sheet is to be used. It is not appropriate to define, in advance, which of these decisions concern monetary policy and which concern the functioning of the financial system. This is partly due to the mutual interdependence that always prevails between monetary policy and financial stability and partly because the appropriate mix of measures needed to achieve monetary policy objectives and an efficient financial system will vary over time, depending on which shocks have occurred.

This criticism should not be interpreted as an argument for the Riksbank to have a completely open and unlimited mandate. Like central banks in other countries, the Riksbank has a high degree of independence compared with other public authorities. This independence needs to be balanced by a high degree of transparency and careful reviews. However, this democratic control could be strengthened in different ways and the inquiry also makes several proposals for this. These include strengthening the formal regulatory framework for information to the general public and the Riksdag; granting increased resources for reviews to the Riksdag Committee on Finance; giving further inspection assignments to the Swedish National Audit Office; introducing an explicit paragraph with proportionality requirements for the Riksbank's measures; clarifying the General Council of the Riksbank's controlling function; and passing control of the inflation target to the Riksdag. This means that the Riksbank's principals in the Riksdag have strong possibilities to exercise control, which should make it quite possible to design a new act that formulates clear processes for accountability, rather than indulging in micromanagement.

Below, I give a few more concrete examples of problems with the proposed new act and present an alternative arrangement.

1. Problems with the inquiry's technical approach

Chapter 13, on overall standpoints, establishes that the act must specify the Riksbank's tasks in a comprehensive manner, making distinctions between provisions for monetary policy and provisions for financial stability, for example. However, from an economic point of view, it could be claimed that the central banks' responsibility for monetary policy, financial stability and the payment system are interconnected (this is a matter of liquidity supply; my reasoning is developed in section 2.1 below). For example, price stability is an important component of a safe and efficient payment mechanism and the degree of financial stability affects the impact of monetary policy.

The ambition of creating a clear distinction between monetary policy and measures for financial stability is not fully reflected in the final proposed sections of the act, which instead make clear that there is a significant overlap between the different toolboxes. This limits the negative effects of the chosen arrangement to some extent. However, it also leads to uncertainties over how the act is to be interpreted. The most important problems with the final proposed act are the idea that it must be possible to distinguish "general liquidity support" from monetary policy, the prohibition on monetary policy taking particular account of financial imbalances, and the prevention of the issue of debt instruments in foreign currency by the Riksbank. In addition, it is unfortunate that the committee makes a number of assessments in the text of the inquiry that could result in restrictions to the Riksbank's tools over and above those specified in the actual legislative proposal.

[2] The closest example that can be found is the Bank of England, which has also served as inspiration for the inquiry. However, in practice, the delimitation between monetary policy and other measures for the functioning of the financial system will not be as sharp in the Bank of England's case, as the central bank there has been merged with the financial supervisory authority.

1.1. "General liquidity support" – a specifically Swedish and imprecise construction

The term "general liquidity support" (chapter 22 of the inquiry) is a new concept that is proposed for inclusion in the act's chapter on financial stability but that is not included in the monetary policy toolbox. As far as I know, this term is not included in other countries' legislation or in economic theory, at least not with any precise definition that distinguishes it from monetary policy in the manner now being proposed. Several of the measures adopted by the Riksbank in the crisis of 2008–9 could be defined as general liquidity support but they could also be defined as parts of monetary policy. These included loans to banks at longer maturities and other terms (collateral, interest rates) differing from the usual. Loans to banks are also included in normal monetary policy, so the question is when the terms for a loan (maturity, collateral, interest rates) cause it to transition from being part of monetary policy to being general liquidity support. This delimitation is significant, as the Riksbank, under the legislative proposal, must consult Finansinspektionen and the Swedish National Debt Office on general liquidity support, a requirement that does not apply to monetary policy. In addition, the prohibition on instruction (capital 11, section 26 of the act) applies to matters of monetary policy but not to general liquidity support. By introducing the term general liquidity support and putting it in the toolbox for financial stability, the legislator thereby creates the risk of limiting the Riksbank's independence in monetary policy.

The inquiry's opinion is that the intent of the measure can be used to determine which category it belongs to, which is to say whether the main aim can be justified by monetary policy (price stability, balanced development of output and employment) or by financial stability. But as the Riksbank, according to the proposal, can only provide general liquidity support to counteract a *serious* shock to the financial system, it is difficult to see how the measure would not also be motivated by monetary policy – considering the risks to price stability or the stability of the real economy entailed by serious shocks to the financial system. However, chapter 25 establishes that it is "necessary" for the Riksbank to clarify the main aim of the measures adopted. In contrast, I consider that it may often be impossible to determine whether the main aim is justified by monetary policy or by safeguarding the functioning of the financial system. For example, it is difficult to say whether the recent measures adopted by the ECB and Federal Reserve have one or the other main aim.

1.2. Monetary policy should also take financial stability into account

One change compared with the current act is that monetary policy must consider the real economy. Without neglecting the price stability objective, the Riksbank is to contribute to a balanced development of output and employment. This is compatible with established practice and with the legislative history of the current act. Like other central banks, the Riksbank already takes such consideration in its monetary policy. This is not controversial and it is positive that the Riksbank's mandate makes this clear. However, considering our experiences over the last decade of financial crises and the changes to monetary policy these have led to, it is surprising that the inquiry proposes a reform which emphasises consideration of the real economy without simultaneously expecting the monetary policy toolbox to be able to contribute to financial stability too.

During the crisis of 2008–9, monetary policy measures were used to counteract shocks to the financial system and the significance of monetary policy to financial stability has been discussed ever since, both in Sweden and in other countries. Some arguments have suggested that monetary policy has taken too much account of financial imbalances, others that it has taken too little. Considering this, the wording of the new mandate for monetary policy is surprising, which it also is in light of the responsibility central banks undoubtedly have for the payment system and the financial system. The new legislative proposal places increased emphasis on the role played by monetary policy for the business cycle, but the financial stability aspects do not receive as much attention.

At the same time, the inquiry sends contradictory messages regarding how much account monetary policy must take of the financial system. For example, chapter 18 makes the assessment that “the Riksbank may issue credit for monetary policy purposes to counteract shocks on the financial markets”. Chapter 38, on the consequences of the inquiry’s proposals, instead emphasises that monetary policy may not take account of financial imbalances, apart from their effects on monetary policy objectives (price stability, output and employment). This latter contradicts a point in the summary chapter, which says that the Riksbank must take account of how government security purchases (which can be part of monetary policy) affect the functioning of the financial markets.

1.3. The Riksbank should be able to issue debt instruments in foreign currency

According to the proposed new act, the Riksbank may issue and sell its own debt instruments in Swedish kronor, but not in foreign currency. The Riksbank's interpretation of the current act is that it does not imply any such restriction. In their provisions, central banks in the EU usually have no restrictions regarding borrowing through the issue of market-listed debt instruments. Normally, the central bank can certainly manage its role within payments, monetary policy and financial stability policy by issuing central bank money in the domestic currency. However, situations may arise in which the bank is justified in issuing debt instruments in foreign currency, for instance if it wanted, for contingency purposes, to increase the size of its foreign exchange reserves without, at the same time, affecting its net demand for or net supply of domestic and foreign currencies and thereby the exchange rate. Such an increase of the foreign exchange reserves, funded with equally large loans, could be justified by monetary policy reasons (to be able to conduct future foreign exchange interventions) or to promote financial stability (to be able to grant the banks loans in foreign currency). It is important to have this possibility so that the central bank is always able to contribute efficiently to economic and financial stability.

Giving the Riksbank the right, within certain boundaries, to borrow in foreign currency via the Swedish National Debt Office reduces the need for it to issue its own debt instruments. Even so, the new act implies a restriction of the Riksbank's independence in this area.

1.4. Monetary policy should not be restricted by the committee’s assessments

The committee is of the opinion (section 18.11.1 of the inquiry) that credits under the framework of monetary policy must not entail any restriction on the companies receiving these credits as regards the types of funding the companies themselves are allowed to offer their customers. This would form a restriction in comparison with what the Bank of England and ECB, for example, may do. This could also restrict monetary policy in Sweden, as is made clear by previous statements from the Riksbank (see, for example, an article in the Monetary Policy Report for February 2015) describing how lending to companies via banks could be one way of making monetary policy more expansionary when necessary.

The inquiry also states that the Riksbank – to comply with the prohibition, under EU law, of monetary financing – should avoid either purchasing an excessively large share of any individual loan of Swedish government securities or holding an excessively large share of the total amount of outstanding government securities. The inquiry refers here to case-law within the EU. The EU has a self-imposed restriction (which it could therefore amend) against purchasing more than 33% of any individual bond loan, while the judgement to which the inquiry refers (the Weiss judgement) concluded that it is reasonable to demand that actors other than the central bank purchase at least half of the national debt. This is to prevent the central bank's measures from undermining the central government’s budget discipline. According to the Court of Justice of the European Union, the ECB’s self-imposed restriction was one of many factors that could have affected the court’s overall assessment. The committee, however, gives the incorrect impression that the ECB’s own restriction is a necessary condition for purchases of government securities to be compatible with the prohibition of monetary financing.

Assessments of this kind in the inquiry may entail restrictions on freedom of action for monetary policy in the period ahead, or at least less clarity concerning room for manoeuvre, especially because, under the new act, credits to banks and purchases of government securities could be subject to instructions, depending on whether the instruments are also included in the toolbox for financial stability.

2. An alternative approach

Taking the functions the Riksbank and other central banks fulfil in the financial system as a starting point, I consider that there is a close relationship between monetary policy tasks and acting for a safe and efficient financial system. This argues in favour of legislation with less-detailed rules for how different instruments may be used to attain different goals. However, more flexible legislation like this demands clearer possibilities for evaluation and accountability than the current act, in line with the proposals the inquiry also makes.

2.1. How the Riksbank's functions can be viewed

Efficient payment systems are a condition for the positive development of the economy. Purchases and sales of goods and services would involve major costs if there did not exist a means of payment with a stable value and a reliable infrastructure. In modern society, payments also often include some form of credit. The overall task of the Riksbank and other central banks is to ensure that economic development is not impeded by poorly functioning systems for payments and credits.

The Riksbank fulfils its task in various ways. One is by issuing cash in the form of banknotes and coins, but this form of payment has become less and less significant in recent years. Almost all payments now take place through bank account transfers between seller and buyer. However, like other central banks, the Riksbank plays an important role for ensuring that this system of ‘bank money’ works. The Riksbank acts as the banks’ bank in various ways: the Riksbank provides a system in which the banks can transfer money between themselves and provides them with credit during the day within this system; the banks can make deposits or borrow money from the Riksbank for a certain time, at interest rates and other general terms as determined by the Riksbank; and an individual bank can receive credits on special terms in an emergency situation. All of this can be summarised by saying that the Riksbank has responsibility for the supply of liquidity, which is to say ensuring there is access to liquid funds (means of payment) that can be used to execute general transactions in the economic system. When there is a lack of liquid funds, the cost of liquidity increases and there is a general rise in interest rates. If instead there is a surplus of liquid funds, this can indicate that the value of money is decreasing, which is to say that there is inflation. The central bank thus stabilises interest rates and the value of money by supplying liquidity.

The Riksbank’s responsibility for the liquidity supply, and its role as a bank, is reflected by its balance sheet, with its assets and liabilities. The issuing of banknotes and coins is counted as a liability. On the asset side, a reserve of highly liquid assets in foreign currency is needed, partly because the Riksbank may need to give the banks liquidity support in foreign currency, and partly because the Riksbank may have to purchase or sell foreign currency against kronor to affect the krona's value against foreign currencies. However, the Riksbank may also have to affect the level of interest rates and liquidity in the economy by purchasing or selling assets in kronor. In recent years, the Riksbank has increased its holdings of Swedish government bonds, which has increased access to ‘central bank money’ in the banking system. Other central banks have also purchased other types of security. The administration of the Riksbank's assets and liabilities affects the Riksbank's economic result, and this is something that the Riksbank needs to take into consideration when deciding on different measures.

This description shows that the Riksbank's operations, in most cases, revolve around determining, one way or another, how the bank's balance sheet is to be used. The view of central banks' operations that the inquiry has chosen breaks this connection in that different areas of the Riksbank's operations are given different objectives and different, separate toolboxes. It is not appropriate to define like this, in advance, which decisions concern monetary policy and which concern the functioning of the financial system. The most appropriate mix of measures for achieving the monetary policy objectives and an efficient financial system will vary over time, depending on the actual shocks that have occurred.

A complicating factor is that in Sweden, as in many other countries, there are other authorities, in addition to the central bank, that have responsibility for the financial system. The central government sets the rules for the actions of the central banks and the other authorities, the various tasks they are to have, how they are to collaborate and so on. The inquiry's directive could be interpreted as suggesting the remit is a matter of clarifying both the Riksbank's responsibility as the banks' bank and how central government control (the democratic review) of the Riksbank is to be strengthened. The current act is unclear over both of these areas and the proposed new act includes several improvements. However, trade-offs have naturally been made here. It would have been possible to define the Riksbank's tasks and mandate to make these clearer in relation to those of other authorities and to strengthen the democratic review without unnecessarily impeding the Riksbank's ability to be the banks' bank.

2.2. *Flexible tools but sharpened democratic controls*

The financial crisis and subsequent period of low inflation and low interest rates clearly demonstrated the need for flexibility and new thinking to be able to manage the problems that arose. The central banks in many countries have been given new tasks in the area of financial stability whereas, in Sweden, other authorities have been given such tasks. This has also led to the need to clarify the Riksbank's responsibility for financial stability.

It is now being proposed that the Riksbank's responsibility be clarified so that the bank can "contribute to the stability and efficiency of the financial system". It is proposed that the tasks will include acting to identify vulnerabilities and risks. These are good changes.

On the other hand, a broader mandate for the Riksbank could also be perceived as problematic, particularly in the field of financial stability where other public authorities also have a responsibility and where there might be arguments for collaboration. This provides a justification for the inquiry to make clear, in the text of the new act, where the boundary lies between those decisions for which demands can be placed on the Riksbank to consult with other agents and those decisions – above all in monetary policy – that other public sector agents may not attempt to influence.

It is, however, possible to clarify the Riksbank's responsibility for financial stability and simultaneously strengthen democratic control without the separation of monetary policy and financial stability and without the degree of detail being proposed. One possible way would be to give the Riksbank the right to use all the tools it has been given to both manage its monetary policy tasks and to counteract risks to financial stability, which is to say without tying particular powers to different objectives, and to balance this flexibility with sharper mechanisms for evaluation and accountability. Allowing the Riksbank to use monetary policy instruments to achieve other objectives than monetary policy ones was proposed in an earlier inquiry (SOU 2013:6). This type of system would certainly not prevent the Riksbank and other authorities from having a close dialogue and exchange of information regarding measures, as was the case during the most recent financial crisis. The current act already includes a provision stipulating that the Riksbank is to consult

Finansinspektionen on more important issues connected to the stability of the payment system or on issues concerning Finansinspektionen's supervision activities.

The Riksdag already has good possibilities to inspect the Riksbank and require accountability for both monetary policy and the management of its balance sheet, as well as the consequences for public finances and so on. The General Council of the Riksbank appoints the bank's leaders on fixed-term mandates and has a controlling function, the Riksdag must approve the annual report, profit allocation and discharge from liability, the Riksdag Committee on Finance has the possibility to call the governors to special meetings and to commission independent evaluations and so on. The inquiry includes several proposals for more stringent mechanisms for evaluation and accountability: the formal regulatory framework for information to the general public and the Riksdag will be strengthened; the Riksdag Committee on Finance will receive increased resources for reviews; the Swedish National Audit Office will be given further inspection assignments; an explicit paragraph with proportionality requirements for the Riksbank’s measures will be introduced; the General Council of the Riksbank’s controlling function will be clarified; the Riksdag will control the inflation target; and so on. There are therefore good possibilities for accountability from the principals in the Riksdag. This should make it possible to formulate an act that is characterised by clear processes for accountability, instead of by micromanagement.