

## ARTICLE – The coronavirus is highlighting the need for flexibility in the new Sveriges Riksbank Act

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At the end of November 2019, the Riksbank Committee submitted its final report to the Government with a number of proposals for amendments to the Sveriges Riksbank Act.<sup>1</sup> However, the inquiry and the report were written before the outbreak of the coronavirus pandemic. During the crisis ensuing from the pandemic, the Riksbank has used a number of different tools to support the Swedish economy. The aim has been to bolster the economy and avoid a crisis in financial markets exacerbating the economic downturn and causing a deeper decline and a longer period of below-target inflation. The development illustrates the relevance of several of the objections to the legislative proposal submitted by the Riksbank in its consultation response to the report.<sup>2</sup>

The assessment of the Executive Board is that, if the Committee's proposal had become law, the Riksbank would have had more limited room for manoeuvre during the COVID crisis than is currently the case. The monetary policy toolbox would have been smaller and it would have taken longer to take the necessary decisions. It would have led to costs for the Swedish economy, partly because more companies would have gone bankrupt and more employees would have lost their jobs. There is therefore reason to review the legislative proposal, not least in light of the experiences from the past year. The starting-point should be that a new Sveriges Riksbank Act must create the conditions for powerful and effective monetary policy in the environment it now operates in.

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### The Riksbank needs to be able to use its tools in a flexible way

According to the Riksbank Committee's final report, the new Sveriges Riksbank Act shall have a structure in which the Riksbank is given specific objectives, tasks and

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<sup>1</sup> En ny riksbankslag (A new Sveriges Riksbank Act), SOU 2019:46.

<sup>2</sup> See the consultation responses of the Executive Board and the General Council to the report A new Sveriges Riksbank Act (SOU 2019:46), DNR 2019-01285, Sveriges Riksbank. See also the two separate statements of opinion on the inquiry by the Riksbank Committee experts Anders Vredin and Christina Wejshammar. In addition to comments on the proposals and their implications for monetary policy, the consultation responses also contain comments on the Committee's proposals that affect the Riksbank's other tasks, organisation and scrutiny.

powers in different areas. What constitutes monetary policy shall be defined by a number of monetary policy powers allocated to the Riksbank. These powers consist of different tools (or instruments, using the vocabulary of the Committee) and possible limitations in the use of these tools. Similarly, the Riksbank shall have a number of tasks in its work on financial stability and powers to use certain tools. However, the powers in the various areas overlap each other and, according to the proposal, the Riksbank shall decide in each individual case whether the main purpose of using a specific tool is a monetary policy one or whether it is linked to financial stability. To draw the boundary between the areas, the Riksbank shall apply detailed criteria and, depending on the main purpose, the processes leading up to decisions shall differ.

The Riksbank has needed to use a number of different tools during the COVID crisis (see also Chapter 2). Just like during the global financial crisis, however, it is difficult to clearly distinguish which measures have primarily been a question of monetary policy and which have been primarily aimed at promoting financial stability. Monetary policy and financial stability are interconnected, something which becomes particularly clear in times of crisis. Major disruptions in financial markets have consequences for economic activity in general, which also affect the ability to achieve the price stability objective. Furthermore, monetary policy measures have an effect via the financial system and can affect the degree of financial stability.

The boundaries, criteria and assessments that the Committee wishes to introduce and which shall govern when and how various tools may be used are difficult to apply in practice. According to the Committee, a measure implemented because of “limited turmoil” in the market where banks obtain their funding will be classified as monetary policy. If instead there is “substantial turmoil”, it is considered to be a financial stability measure. This is a division which in practice will become very difficult to attain, as it will depend on a subjective assessment of what is “limited” or “substantial” turmoil. This division is not meaningful either, as “substantial turmoil” in financial markets will always affect inflation and economic developments in general as well. Moreover, during a crisis, turmoil can go very rapidly from being “limited” to “substantial” and in time also back to being more “limited”.

Overall, the experiences of the last decade or so have made it clear that monetary policy is considerably more than just setting the level of an interest rate for short-term transactions between the Riksbank and banks. Other dimensions in the Riksbank’s operational framework are also a part of monetary policy. Furthermore, the Riksbank needs to be able to use more tools than just the repo rate (see the description of the Riksbank’s measures in Chapter 2). The Sveriges Riksbank Act needs to provide considerable flexibility in how these tools can be used and avoid establishing a specific order of priority among them. Depending on the situation, necessary monetary policy measures may include purchases of various financial assets and lending to banks that increases the Riksbank’s liabilities. The sequence in which the measures need to be employed can vary. Technical and detailed limitations linking different items on the Riksbank’s balance sheet to different purposes, as the Committee proposes, restricts the ability to conduct monetary policy in an effective manner. It must be possible to adapt the Riksbank’s balance sheet to monetary policy needs at that particular time.

As experience has shown, problems in financial markets risk leading to major negative consequences for output, employment and inflation. The need to stabilise these markets, however, is not just a question of deciding in a given situation what type of turmoil exists, how substantial the turmoil is and thus what measures shall be employed. The seeds of turmoil can always be found in these markets and it is therefore also important to reduce in advance the risks of problems and crises arising. If it is already clear from the outset that the central bank has the tools and mandate to use them in a flexible way, this may have a stabilising effect in itself and thereby reduce the risk of crises arising at all.

## Independence in monetary policy needs to be maintained, as does the requirement for collaboration where necessary

That the Committee considers there to be a need for a clear boundary between monetary policy measures and financial stability measures largely stems from the argument that the Riksbank has a stronger independent status in the area of monetary policy.<sup>3</sup> Clarifying the Riksbank's tasks and powers is therefore, according to the starting-point of the Committee, important for democratic anchoring and to elucidate the Riksbank's possibilities to collaborate with other authorities. Regarding the measures that, in the Riksbank's view, fall within the framework of supporting the financial system, the requirements for collaboration with other authorities and the government are greater than for measures that are considered to fall within monetary policy.

The high degree of independence that central banks like the Riksbank should have stems from previous negative experiences, when economic policy as a whole did not come to grips with high and fluctuating inflation, which also had negative effects on economic developments in general. One way of gaining credibility for the ambition to control inflation is to ensure that monetary policy can be conducted "at arm's length" from economic policy in general. Under EU legislation, the ECB and national central banks have a high degree of independence in the area of monetary policy. In concrete terms, this means that the Riksbank is subject to the prohibition on instructions that is enshrined in EU law, according to which other authorities may not give instructions to the Executive Board of the Riksbank when it performs monetary policy tasks.<sup>4</sup> The Act does not specify exactly what these tasks are, however.

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<sup>3</sup> The Riksbank having a high degree of independence was also a starting-point of the review, according to the Riksbank Committee's terms of reference.

<sup>4</sup> As a national central bank within the EU, the Riksbank shall be institutionally independent in the area of monetary policy under the Treaty on the Functioning of the European Union (TFEU). This implies that the Executive Board of the Riksbank shall neither seek nor take instructions when performing tasks allocated to it under the Treaty and the Statute of the European System of Central Banks (ESCB). In addition to this, the Riksbank's autonomous status is also built on a functional independence, according to which the bank, given a specific monetary policy objective, shall decide independently how the objective shall be achieved, a financial independence to be able to perform the tasks without being governed by appropriations, and a personal independence for the Riksbank's management. Furthermore, the Riksbank is a separate legal entity divorced from the state, which means that the Riksbank can have its own assets and liabilities and conclude agreements.

The Court of Justice of the European Union (CJEU) has recently passed judgement on what is included in the concept of monetary policy in two cases relating to the issue of the ECB's asset-buying programmes. The CJEU noted that the ECB's ability to affect price development largely depends on how monetary policy decisions are transmitted via financial markets and affect the various sectors of the economy. If the transmission of monetary policy deteriorates due to disruptions in the financial system, it may affect the efficacy of the ECB's measures. The conclusion of the CJEU was therefore that the bond-buying programmes were within the framework of the ECB's monetary policy mandate.

One problem with the Committee's proposal for a boundary is that it is not compatible with the approach taken in EU law. Financial stability is crucial for the transmission of the Riksbank's monetary policy. A detailed division will therefore create problems for those who are to interpret the act in such a key issue as setting limits for the Riksbank's independence.

The Committee has also proposed that a principle of proportionality be incorporated into the Riksbank's decision-making. According to the principle, which is based on EU law and the Swedish Administrative Procedure Act, a measure may be taken if the intended result is in reasonable proportion to the costs and risks of the measure to the finances of the Riksbank and the state. Employing such a principle reduces the risk of the Riksbank over-interpreting its independence and makes it clear that decisions have to be transparent and well motivated for those scrutinising the Riksbank. The requirement that decisions shall abide by this principle is sufficient to avoid giving the Riksbank too much freedom to act under the protection of its monetary policy independence.<sup>5</sup>

The principle of proportionality also has a bearing on the requirements for the Riksbank to collaborate with other authorities. The importance of such collaboration is another reason behind the Committee's proposal for boundaries between the Riksbank's various tasks and tools. However, the Riksbank has a strong interest in collaborating with other authorities to be able to assess whether the measures it is considering are appropriate and effective. This assessment will also be an important component of proportionality testing. The proposal for boundaries is therefore not needed for the Riksbank to be able to collaborate with the government and authorities that also have a responsibility for financial stability without contravening the prohibition on instructions.<sup>6</sup>

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<sup>5</sup> As the Executive Board writes in its consultation response, however, the principle of proportionality should be formulated in the same way as it is in EU law.

<sup>6</sup> However, it should be clear that the Riksbank, when taking decisions in issues that have been the subject of collaboration, does so independently. Under administrative law, this means that decisions are taken **after** consultation, not **in** consultation. The same system should apply in the reversed case, where other authorities make decisions after consultation with the Riksbank.

## The monetary policy toolbox needs to have appropriate content

The Executive Board essentially supports the Committee's proposal on the objective of monetary policy continuing to be price stability, and on how the details of the objective shall be formalised. But the last ten years have shown that monetary policy, to be able to achieve the objective, needs to have access to a toolbox with contents that are appropriate under different conditions and in situations that can be difficult to specify in advance. It is therefore unfortunate that the Committee's proposal contains limitations that both affect the definition of monetary policy, which would be narrowed compared with what it is today, and the Riksbank's powers, i.e. how the tools and the balance sheet may be employed. Examples of such limitations include:

- According to one proposal, the Riksbank may only purchase securities other than government securities if there are "exceptional reasons". These reasons are not defined in closer detail, however, which can create problems when the boundary between different measures is to be drawn, and when the need for collaboration with other authorities is established. It is also unclear whether, and if so, how the requirement for exceptional circumstances differs with the assessment according to the principle of proportionality as proposed by the Committee.
- According to the Committee, it shall only be possible to strengthen the foreign exchange reserves with reference to financial stability. This implies a limitation of monetary policy, as it must also be possible to strengthen the foreign exchange reserves when foreign currency has been lent for monetary policy purposes.
- According to the Committee's assessment, the Riksbank may not make lending to banks conditional on them increasing their lending to companies. However, such conditional lending is an important tool that is also widely used in several countries to mitigate the effects of the COVID crisis.
- The Committee proposes that the Riksbank be granted a statutory power to offer loans and enter repurchasing agreements to counteract serious shocks to the financial system, referred to by the Committee as general liquidity support. That the Riksbank continues to be able to offer such support is good, but the legal conditions for this tools become unclear if the tool is to be confirmed by law in the way proposed by the Committee. Both loans and repurchasing agreements are also in the monetary policy toolbox, in Sweden as well as in other countries. What the Committee proposes, however, is a new concept, general liquidity support, divorced from monetary policy, which is unparalleled in the EU and many other countries.<sup>7</sup>
- The payment system, particularly the Riksbank's system for electronic payments (RIX), is a necessary instrument for monetary policy to have an impact

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<sup>7</sup> If the Riksbank needed to use an instrument called general liquidity support, without this being part of monetary policy, it would have to be approved on the EU level to ensure that it does not contravene EU government support regulations and the prohibition of monetary financing. This is a consequence of the proposed division into different toolboxes for monetary policy and financial stability policy.

on all parts of the financial system. According to EU legislation, the task of promoting a smoothly functioning payment system falls within the framework of the Riksbank's independence. The Committee has proposed an amendment to the Swedish Instrument of Government so that it corresponds to EU legislation, but with the limitation that the independence will only apply if the task is within the framework of the cooperation within the European System of Central Banks. ESCB. The proposal means therefore in practice that the Riksbank will not retain independence in issues in this area that lie outside of the ESCB cooperation, despite there being a strong link between payment system and the implementation of monetary policy.

## A modern Sveriges Riksbank Act needs to give monetary policy the scope to manage new challenges

A result of the ambition to regulate the various tasks and powers of the Riksbank in detail is that the legislative proposal has become very extensive. In addition, the interpretations of some concepts are unclear, as is how certain assessments are to be undertaken. Circumstances will also change as a result of rapid technical development, the emergence of new financial players, new financial markets and new forms of payment, which will require recurrent revisions of the Act. To avoid too many revisions of this kind, the Act should be more focused on principles and enable the Riksbank to act promptly with all its monetary policy toolbox, as well as intervene with new tools and in new ways should the need arise. It is impossible to predict exactly how the policy will need to be designed. How the Riksbank exercises its independence can nevertheless be tested by performing regular reviews. The scope for the Riksdag to monitor the Riksbank and require accountability, both for monetary policy and for the Riksbank's other operations, is already considerable. Scrutiny and evaluation can always be improved and strengthened, however. The Riksbank largely supports the Committee's proposal for changes in this area, which would mean, for instance, that several different bodies have a mandate to scrutinise the Riksbank's operations. It is important that the evaluation and scrutiny are effective and that the ban on instructions is not transgressed.

Since the financial crisis of 2008–2009, there has been a discussion on what can be considered to be a new normal for monetary policy. Expectations of a return to the conditions and the policy that prevailed prior to the global financial crisis have been unfulfilled time and again. Recently, there has also been an increasingly intensive discussion about the tools available when the next recession or crisis occurs – especially bearing in mind the very low level of interest rates to begin with. The monetary policy measures described as unconventional have now been in place in various forms for many years and may very well be needed for much longer than previously thought. Validating in law detailed rules for what is to be regarded as monetary policy, in contrast to financial stability policy, and limitations in how the Riksbank's balance sheet may be used, are not the right way to build up resilience in the Swedish economy.

A better strategy would be to modernise and deal with the ambiguities in the current Sveriges Riksbank Act by means of less extensive amendments. These amendments

should be aimed at strengthening the structures for the existing collaboration among authorities in the financial area, instead of seeking to micro-regulate the Riksbank. The Riksbank should continue to have the scope to take on various challenges in a powerful and effective way to ensure that monetary policy can contribute to healthy economic development.