



Central banking: trending and cycling

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The Riksbank's journey from public savings bank to modern central bank epitomises the central bank as an adaptive, learning and improving organisation. Often crisis spurs adaptation, as it did in 2008. The Riksbank's evolution points to broad trends in central banking towards fiat money, public governance, centralised payments and a lender of last resort role. I submit that these trends will persist.

However, we have not reached "the end of history".¹ In important respects, central banking cycles, or at least fluctuates. Should central banks favour government bonds as assets?² What relative weights to assign to price stability and financial stability? How independent should the central bank be? Different times give different answers.

Going last, my remarks to some extent organise my fellow panellists' reflections into four trends and three cycles.³ Along the way, I argue that public, centralised large payment systems will survive advancing technology. I close with some thoughts on central bank independence and cooperation.

Trends

Let me start with four trends in central banking. The bar for reversing any of them looks high.

1. One trend is from metallic convertibility (as either goal or constraint) to fiat money. Historically, fiat money was at best a temporary war expedient and at worst a breach of trust. Today,

¹ Hegel's phrase was popularised by F Fukuyama, *The end of history and the last man*, Free Press, 1992, to interpret international relations after the breakup of the Soviet Union.

² There is also variation in the nature of the central bank's liabilities other than banknotes and coin, and more generally in its operating procedures.

³ S Ugolini calls them "unidirectional tendencies" and "cyclic patterns" in "What do we really know about the long-term evolution of central banking? Evidence from the past, insights for the present", *Norges Bank Working Paper 2011/15*, 21 November 2011.



- institutional credibility grounds price expectations, not gold. The Riksbank deserves credit for having “pioneered non-convertible paper money”.⁴
2. Also taking a long perspective, a second trend is from private to public governance of central banks. No one laments the 1947 nationalisation of the Bank of England.⁵ After its private, for-profit predecessor failed, the Riksbank started as a public institution in 1668.
 3. A third trend is towards the centralisation of the payment system at the national (or regional, as with the euro area) level. A state monopoly of the large payment system “became the international standard by the mid-twentieth century”.⁶ Only such infrastructure offers finality, so that a payment discharges the debt irrevocably. Today, Fedwire, TARGET2 and the BoJ wire dominate the turnover league.⁷ The Riksbank’s RIX system settles transactions amounting to Swedish GDP every week.⁸
 4. A fourth trend is for the central bank to lend in the last resort to relieve financial stress. Whether first done in the 18th or 19th century,⁹ once this practice begins, it tends to continue. In the Great Financial Crisis, central banks innovated in last-resort lending to non-banks. Internationally, the Riksbank, a pioneer in foreign currency last-resort lending,¹⁰ joined a broad effort in 2008 to relieve a global dollar shortage that shrank Swedish banks’ cross-currency funding.¹¹

These trends to a public, centralised payment system backed by last-resort lending leave me sceptical that new technology will displace central bank money. First, like the Riksbank’s ill fated predecessor, private moneys founder on self-serving over-issuance. Second, once market participants have enjoyed finality of payments, they will not abandon it. Third, cryptocurrency creators’ effort to separate money from a trusted institution burdens it with congestion. More use increases the size of the blockchain but decreases efficiency. By contrast, incumbent central bank money enjoys a virtuous circle from network externalities: the more use a money, the greater my incentive to use it. In sum, central bank money enjoys a scalable network: the more the merrier. Blockchain creates congestion: the more the sorrier.

⁴ See U Bindseil, “Pre-1800 central bank operations and the origins of central banking”, Mannheim University, 15 January 2018, p 65.

⁵ The BIS repurchased shares from private shareholders a generation ago.

⁶ Stockholm’s Banco mismatched maturities in the pursuit of profit. See S Ugolini, *The evolution of central banking: theory and history*, Palgrave Studies in Economic History, 2017.

⁷ See ECB, *TARGET Annual Report 2016*, May 2017, www.ecb.europa.eu/pub/pdf/other/ecb.targetar2016.en.pdf. Even the private CLS Bank, the busiest payment system, settles forex trades through central bank accounts and money.

⁸ See K af Jochnick, “How the Riksbank contributes to financial stability”, speech at Sveriges Riksbank, Stockholm, 29 January 2018.

⁹ It is debated whether this function appeared at the Bank of England in 1866 or earlier at the Bank of Hamburg in 1763. See M Flandreau and S Ugolini, “Where it all began: lending of last resort and Bank of England monitoring during the Overend-Gurney Panic of 1866”, in M Bordo and W Roberds (eds), *The origins, history, and future of the Federal Reserve: a return to Jekyll Island*, 2013, pp 113–61; Bindseil, op cit.

¹⁰ In the early 1990s, “the government was forced to go in and support the banking system. The Riksbank safeguarded the banks’ access to foreign currency by investing some of its foreign currency reserve in some of the larger banks”. See G Wetterberg, and A-L Mikiver, *Sveriges Riksbank – a 350-year journey*, Sveriges Riksbank, 2018, p 45.

¹¹ In 2008–09, it advanced as much as about \$30 billion dollars to Swedish banks, funded out of a Federal Reserve swap and its own foreign exchange reserves; see Sveriges Riksbank, *Annual Report 2009*, p 23. Sweden’s subsequent currency by currency application of the Basel Committee’s liquidity rules constrains banks’ need for such advances. The holding cost of own foreign exchange reserves (which Sweden’s strong credit rating makes relatively cheap to borrow) raises the question of whether the cost should be shared by the banks and the public sector. See S Ingves, “Managing structural risks in the Swedish banking sector”, speech at Affärsvärldens Bank & Finans Outlook, Stockholm, 20 March 2013.

To be sure, central banks will champion new technology, as they have with digital payments. But this would be an evolution of the present publicly run, centralised and digital system.

Cycles

Let us turn to cyclic, or at least changeable, aspects of central bank governance and functions. Consider three.

1. The holding of government debt as the preferred central bank domestic asset varies. Some fear excessive central bank credit to the government as the greatest risk, even if bonds are bought in the market, as is generally done today.¹² Others contend that a central bank holding anything but government debt allocates credit and therefore resources, as fiscal policy does. Norms change, however. At the outset, the Federal Reserve was set up to hold bank-related domestic assets, not government bonds. By contrast, the Riksbank has long held government debt. My bottom line is that the composition of central banks' assets should not be subject to dogma. It should respond to the policy needs that the institution faces at any particular point in time to achieve its mandate. The mandate is the anchor.
2. The weights assigned to monetary or price stability, on the one hand, and financial stability, on the other, also vary. The United States provides a good example. The original Federal Reserve Act sought an "elastic currency" to assure financial stability. In 1926–28, the head of the Federal Reserve Bank of New York argued to Congress against a Federal Reserve mandate for stable prices, given the imprecision of its control.¹³ The Fed's legislated dual mandate dates only to 1977. Somewhat related is whether the central bank has responsibility for banking supervision. The widespread impulse to change that responsibility after a financial crisis has led to cycling. Sweden stands out here: after the banking crisis of the early 1990s, the legislature strengthened supervision but did not move it into the central bank. As a profession, economists have still not constructed an integrated framework for monetary and financial stability. We follow with great interest the Riksdag's consideration of the Riksbank's role in financial stability and parallel discussions elsewhere.
3. Despite recent events, central bank independence varies, at least in the choice of means to agreed ends. If the first victim of war is truth, then the second is central bank independence. Variations in independence arise not only from legal but also behavioural sources, such as the timing of the appointment of the central bank head in the political cycle. Most but not all BIS members enjoy substantial independence to pursue agreed goals.

War apart, we can recognise two current challenges to central bank independence. First, adaptation of monetary policy to unprecedented conditions has left some central banks with huge domestic asset holdings, including government securities. For example, the Riksbank holds about a quarter of the outstanding Swedish government debt. With the best of will and communication, undoing this could prove delicate. Any government may find it easier to live with a large buyer of its debt than a substantial seller. But domestic assets must be reduced, privileging monetary control.

¹² What Bindseil, op cit, calls the Germanic aversion to central bank holding of government debt.

¹³ See R Hetzel, "The rules versus discretion debate over monetary policy in the 1920s", Federal Reserve Bank of Richmond, *Economic Review*, November/December 1985.



Second, financial stability mandates pose challenges to the model of agreed goals and independent means.¹⁴ Such mandates resist the clarity of an inflation target. What is more, financial stability is most often a shared responsibility. Sweden's Financial Supervisory Authority and National Debt Office both have financial stability tasks.¹⁵ To achieve financial stability, the central bank cannot be the only game in town.

I am confident that we will rise to these challenges. At the Riksbank's 400th anniversary, central bank independence will be a trend. To get there, we should embrace clear goals, articulate the means to reach them and engage with elected officials, as we do here at the Riksdag.

I close on what I hope will be a trend rather than a cycle: central bank cooperation. With global financial markets, central bankers value Basel discussion of policy spillovers and spillbacks. Understanding these enlightens self-interest in the pursuit of national mandates. Often, Basel discussions lead to joint action. Ben Bernanke recalled that "a number of cooperative efforts among central banks had their origin at ... [Basel] meetings, especially during the crisis".¹⁶ Extensive cooperation in banking supervision owes much to Governor Ingves' time, devotion and steely determination. BIS member central banks, both those here represented and others, hope that Sweden will continue to overachieve in central bank cooperation.

¹⁴ See P Tucker, *Unelected power: the quest for legitimacy in central banking and the regulatory state*, Princeton, 2018.

¹⁵ See K af Jochnick, *op cit*.

¹⁶ B Bernanke, "Federal Reserve policy in an international context", paper presented at the 16th Jacques Polak Annual Research Conference, International Monetary Fund, Washington DC, 5–6 November 2015, p 7.