Reviews of Monetary Policy in New Zealand and Norway[*]

Lars E.O. Svensson

Princeton University

March 2004

On two separate occasions, I have been asked to review the monetary policy of a country, namely that of New Zealand and Norway. The purpose of the reviews was to provide a critical evaluation and to make recommendations for improvements. I also hoped the reviews would stimulate and improve the discussion of best-practice inflation targeting. The reviews covered the objectives, the institutional organization, the decision-making process, the implementation, the actual policy decisions, the communication, and the accountability of monetary policy.

Many – but not all – of the reviews' recommendations have been implemented, and I hope they have made a positive contribution. I personally found the experience very rewarding, and I particularly appreciate the enthusiastic cooperation of the two central banks, the Reserve Bank of New Zealand and Norges Bank.

In May 2000, I was asked by the Minister of Finance to undertake an independent review of the operation of monetary policy in New Zealand. The Reserve Bank cooperated fully in the review. The result of the review was briefly summarized at a press conference in Wellington in February 2001 as follows:

"Monetary policy in New Zealand is currently entirely consistent with the best international practice of flexible inflation targeting. The Reserve Bank compares well with best-practice central banks, like the Bank of England and the Bank of Sweden. But this has not always been the case. The period from mid 1997 to March 1999, when the Bank used a Monetary Conditions Index (MCI) to implement monetary policy, represents a significant departure from best-practice inflation targeting."

"With regard to governance and accountability structures, I have found some weaknesses. These weaknesses have not caused any problems because of the qualities of the current Governor, Dr Brash, but they could in different circumstances. Therefore I recommend some substantial changes."

I made several recommendations, including some modification of the inflation target, improvements in the accountability of the bank, and some technical improvements of the Bank's modelling and forecasting tools. Many of these recommendations have been acted upon, but not the most far-going recommendation, to introduce a formal internal monetary policy decision-making committee in place of the existing single decision-maker model.

---

[*] Prepared for the newsletter of the Study Center Gerzensee, Gerzensee, Switzerland.

In 2002, I was asked by the Centre for Monetary Economics (CME) at the Norwegian School of Management BI to chair a committee, Norges Bank Watch 2002, to review monetary policy in Norway. The committee included Kjetil Houg of Alfred Berg and Haakon Solheim and Erling Steigum of the Norwegian School of Management BI. Norges Bank cooperated fully in the review.

The result of the review was presented at a press conference in September 2002 and summarized as follows:

"Monetary policy in Norway is equal to the best international practice of flexible inflation targeting. But the legal framework for monetary policy is among the weakest in the world."

The committee made several recommendations for changes in the Central Bank Law, to give Norges Bank a mandate for price stability, formal operational independence, and clear accountability for achieving the mandate. The committee also made several recommendations to improve the institutional framework within the existing law. Several of the latter recommendations have been followed, and a modest revision of the Law has been made. The committee also had a number of recommendations for improvements of the monetary-policy framework, mostly of a technical nature, and for research priorities at Norges Bank. Almost all of these have been acted upon by Norges Bank.

Svensson, Lars E.O. (2001), "Independent Review of the Operation of Monetary Policy in New Zealand: Report to the Minister of Finance," February 2001, www.princeton.edu/~svensson.

Svensson, Lars E.O., Kjetil Houg, Haakon Solheim and Erling Steigum (2002), "An Independent Review of Monetary Policy and Institutions in Norway," *Norges Bank Watch 2002*, Centre for Monetary Economics, Norwegian School of Management BI, September 2002, www.princeton.edu/~svensson.