

Jarle Bergo: A professional monetary policymaker steps down

Arne Jon Isachsen, professor at the Norwegian School of Management BI, interviews the outgoing Deputy Governor of Norges Bank¹

Jarle Bergo's second and last term as Deputy Governor of Norges Bank will be completed on 1 April 2008, close to 40 years after he assumed his first post at this august institution. As a fresh graduate of the University of Oslo – with excellent grades – he was assigned to the post of economist in the Monetary Policy Department in 1969. A year and a half at the Norwegian Institute of International Affairs, a few years at the International Monetary Fund (IMF) in Washington D.C. and a few years at the EFTA Secretariat in Geneva were the only periods Jarle Bergo spent away from his work at the Bank. In April, he returns to the IMF as deputy director of the Nordic-Baltic Office. Has he specialised as deputy? No. During his previous period at the IMF, he was executive director of the office. But the posts are rotated. Today, it is a Swede's turn to take the helm.

We met him at his spacious, airy and stylish office atop Norges Bank's impressive building in the city centre of Oslo, an edifice history will show that we were right to have built. His office is half-full of cartons. He is already busy packing. There is also an almost empty fruit basket and a few bottles of sparkling water. And instant coffee.

"It's a strange time to look back" the retiring Deputy Governor reminisces, "purely in monetary policy terms.

During his long career at Norges Bank, Jarle Bergo was also head of the editorial committee for *Penger og Kreditt* (Economic Bulletin) for close to ten years. As he is now stepping down as Deputy Governor after close to 40 years of service at the Bank, the editorial committee has asked Arne Jon Isachsen to interview him in a more personal style than the speeches regularly published in the Economic Bulletin. A bibliography of work by or about Jarle Bergo published in books, periodical, reports and newspapers is also provided.

Arne Jon Isachsen is a professor at the Norwegian School of Management BI and head of the Centre for Monetary Economics at the school. As an active writer, he has followed Norwegian monetary policy throughout Bergo's career at Norges Bank. Isachsen was also an employee of Norges Bank for several years in the 1980s when the Bank was developing its research department.

In some respects, we are now back to normal" he continues. "From the collapse of the Bretton Woods System in the period December 1971– March 1973 and up to the 1990s, virtually all countries 'forgot' that the overriding task of monetary policy is to provide economic agents with a secure and stable nominal anchor. Monetary policy can never have permanent real economic effects," Bergo reminds us.

In the first years after the Second World War up to the end of the 1960s, the exchange rate served as an anchor. "People my age," says Bergo, "remember that the value of the US dollar against the Norwegian krone was fixed for a long period at NOK 7.14. The empirical observation that lower unemployment could apparently be 'bought' through higher inflation – as shown by the Phillips curve – became too tempting for politicians. With steadily rising inflation in the anchor currency country the US, the fixed exchange rate system functioned ever less effectively. Other countries that had pegged their currency to the US dollar were forced to accept US inflation rates," he points out.

But why did the Phillips curve fail to function? Why did this curve not hold? Bergo explains, "Imagine Robinson Crusoe and Friday on their desert island. They fish, gather coconuts and firewood. In this simple economy, if Robinson as governor of the central bank conducted a monetary policy where he started printing more banknotes, would this in itself have resulted in more fish, coconuts or firewood? No. Robinson may for a short period have been able to fool Friday into selling his stock of goods and pay with new money. Prices would have risen. But Friday would have learned."

The larger picture: You can fool some of the people all of the time, and all of the people some of the time, but not all of the people all of the time, as Abraham Lincoln once said. This is exactly why the Phillips curve does not hold, and why demand management in the 1970s and 1980s had such limited success.

"When the battle against inflation was finally taken seriously, both unemployment and inflation were high. Many countries, including our own, were struggling with stagflation." Bergo reminds us.

"Why," I wonder, "did Norway choose its own little currency basket in 1978, while we had participated in the European snake in the preceding 5–6 years, a system that involved fairly fixed exchange rates between European currencies." "There were two reasons," says Bergo. "The need for pound sterling, the Swedish krone and the US dollar to influence the krone's external value by including them in the basket. In addition, there was

¹ Translated by Helle Snellingen, senior translator Norges Bank.

probably a political element, which was that the more binding EMS arrangement was less suitable for Norway after voting against EEC membership in 1972.”

In the ten years up to our last devaluation under Gro Harlem Brundtland’s government in May 1986, Norway devalued its currency as many as ten times,” affirms the Deputy Governor. “The background was higher inflation in Norway than among our trading partners. Over those ten years, the price level in Norway increased by 120 per cent, or more than 8 per cent as an annual average,” Bergo informs us. “The cumulative devaluation of the krone came to a good 20 per cent,” he adds.

An utterly wild environment compared with what we have become accustomed to over the past 12–15 years. If the figures for inflation, which are published on the tenth of each month, were to show an inflation rate of 2.1 per cent over the past 12 months while the market expected 1.9 per cent, it would be big news. A difference of 0.2 percentage point, and no one would have batted an eye a few decades earlier. What has actually happened?

“Monetary policy has again been given a nominal and credible anchor,” the soon-to-be former deputy governor explains patiently. “New Zealand was the first country to introduce an inflation target as early as in 1990. Canada, the UK and Sweden were next. In Norway it took somewhat longer, but when Norges Bank Governor Kjell Storvik stopped exchange market intervention to support the krone in August 1998 and did not find it appropriate to raise the key rate above 8 per cent, it entailed a relaxation of the requirement of day-to-day management geared towards a stable exchange rate when the effects were clearly procyclical,” says Bergo.

With a new central bank governor a few months later, increasing weight was given to low inflation as a means of achieving a stable exchange rate. In March 2001, Norway followed suite with the introduction of an inflation target for our monetary policy. Since that time, Norges Bank has taken quantum leaps and is now among the foremost in practicing inflation targeting. Bergo illustrates this by a concrete example.

“An inflation target requires a perception of the rate of inflation ahead. In the early days of inflation targeting, our inflation forecasts were based on the assumption of a constant interest rate,” he says. “But with liquid markets for different instruments with different maturities, it is easy to calculate market interest rate expectations. Better to use these rates than the assumption of a constant interest rate, Norges Bank thought. No sooner said than done. And we based the interest rate expectations underlying the projection of the price path on forward interest rates. But,” continues the Deputy Governor, “if the central bank did not share with market interest rate expectations, what should we do then?”

What then?



Photo: Sturlason

Jarle Bergo

Born 1945, Voss, Norway. Master’s Degree in Economics, University of Oslo, 1969

Work experience:

- 2002 Reappointed Deputy Governor for a further six-year term, Norges Bank
- 1996 Appointed Deputy Governor for a six-year term, Norges Bank
- 1993–1995 Executive Director elected by the Nordic and Baltic countries, IMF, Washington D.C.
- 1979–1993 Director, Norges Bank
- 1977–1979 Senior Economist, Norges Bank
- 1975–1976 Economist, EFTA Secretariat, Geneva
- 1971–1972 Researcher/civilian service, Norwegian Institute of International
- 1969–1974 Economist, Norges Bank

Other:

- 2002–2003 Member of the Committee on Ethical Guidelines for the Government Petroleum Fund
- 2000–2001 Member of the Board, Oslo Stock Exchange
- 1999–2000 Member of the Committee on Employment and Growth (‘Holden Committee’)
- 1996 Chairman of the Expert Group on Globalisation and Competitiveness
- 1991–1993 Manager, Government Bank Insurance Fund
- 1990–1993 Short-term assignments as consultant to IMF (Eastern Europe and former Soviet Union)

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“Vi trenger IMF”, (We need the IMF) *Dagens Næringsliv*, 31 July 2002

“Risk and efficiency in the payment system”, lecture at the banks’ payment system conference 11 November 1999, *Penger og Kreditt*, no. 1 (2000), pp. 13–21

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“I Norge – for tiden? Konsekvenser av økt internasjonalisering for en liten åpen økonomi” (In Norway – at present? Consequences of increased internationalisation for a small, open economy). Report of an expert group appointed by the Ministry of Finance, the Ministry of Industry and Energy and the Ministry of Foreign Affairs on 15 March 1996; submitted on 1 July 1996. Head of Commission: Jarle Bergo. *NOU: 1996:17*. Oslo: Public Administration, 1996

Sammenslåing av Kredittilsynet og Norges Bank (A merger of the Financial Supervisory Authority and Norges Bank). Report of a working group established by the Ministry of Finance and Customs on 21 February 1992; submitted to the Ministry of Finance and Customs on 30 March 1992. Jarle Bergo, Arne Øien, Erlend Kvaal, Erling Selvig. Oslo: Ministry of Finance, 1992

Utredning om tilgangen på risikovillig kapital i næringslivet: rapport II (Report on the supply of risk capital to the business sector: report II). Report of a working group appointed by the Ministry of Finance and the Ministry of Industry, headed by Jarle Bergo. Oslo: Ministry of Finance, 1989

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“Vi var uheldige med tidspunktet for liberaliseringen av kredittmarkedet” (We were unlucky with the timing of the liberalisation of credit market). Director Jarle Bergo, Norges Bank. Interviewed by Bent Vale. *Sosialøkonomen*, no. 7 (1988), pp. 13–15

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Et forsøk på å estimere parametrene i en dynamisk modell når observasjonene er en kombinasjon av tidsrekke- og tverrsnittsdata (Attempt to estimate parameters in a dynamic model when the observations are a combination of times-series and cross-section data). Oslo: UiO/USØ, 1969

“We projected our own interest rate path” exclaims Berge, with a hint of pride.

This interest rate path is used to estimate endogenous variables, such as inflation and other variables. This is bold because if the market is right and the central bank wrong, wouldn’t that be a bitter pill to swallow? No. Openness or transparency comes before prestige. Norges Bank finds it more efficacious to explain as well as possible to the market how the bank thinks and assesses conditions.

“As an advocate of such changes, the institution Norges Bank Watch has worked well,” says Berge. Every year, the Centre for Monetary Economics at the Norwegian School of Management BI appoints a committee of two to four experts – from the academic community or the market, often with one or two foreigners – that scrutinises the central bank’s activities. Does the central bank carry out the tasks assigned to

it by the government? Have the interest rate decisions been wise? Has the rationale behind them been communicated effectively? Where do potential improvements in Norwegian monetary policy lie? Openness about the interest rate path is a good example of how the report of Norges Bank Watch has improved Norges Bank’s communication with the market.

A short sigh is heard. “Why,” wonders Berge, “do the media so gladly take a negative angle on things? After the latest NBW report, which was published in February, the newspapers were very crass even though the report was very satisfied with the central bank, and the central bank with the report.

No news is good news, as the saying goes. In our media world, it may at times seem as if good news is no news. But if something negative can be said, the media willingly fires away.

Jarle Berge has sat on many important committees.

“What is the point of such committees?” I ask. “The purpose is to receive advice about things that were to be done anyway,” says the Deputy Governor, who as outgoing Deputy Governor can take the liberty of using a somewhat freer style than if he were about to come into this noble office.

As secretary to the Interest Rate Commission in the mid-1980s, Bergo played a key role in the gradual liberalisation of credit and exchange rate policy. “Quantitative regulation did not have a future,” says Bergo. “But it was difficult to change things rapidly in a society with strong interest groups,” he continues. “Democracy requires time. Decisions that involve considerable changes must gain acceptance over time. Those who stand to lose with a new system, must not be allowed to block the necessary changes.”

“Perhaps more thought should have been given through the 1970s and 1980s to how a new monetary policy and exchange rate regime should have been designed rather than resisting changes that were nevertheless inevitable?” says Bergo, almost speaking to himself.

The Interest Rate Commission’s work continued intensively over a year and a half. “Were you released from other tasks then?” I ask. No, Jarle Bergo was not. He also had to perform his functions as Director of the Research Department in Norges Bank. “Have you worked too much in your life?” I wonder, “at the expense of other, more important things?” The Deputy Governor pauses to think. Did I hit a sore spot? Or will the answer be “Je ne regrette rien”, as Edith Piaf, or the “Sparrow” as she was called, sang at the end of her career? “No,” the outgoing Deputy Governor eventually replies, “as a general statement, I wouldn’t say that the job has taken too much of my time. “But,” he adds, “in some periods that may have been the case.” A tinge of regret perhaps?

When the authorities established a commission in the 1990s to examine the supply of risk capital in the Kingdom of Norway, Bergo advanced from secretary to chairman. No, the commission concluded, extensive measures to increase the supply of venture capital are not necessary. “As a consolation to those who were of a different opinion, the state-owned fund Norsk Venture was established. This calmed the atmosphere” says the unflappable Bergo.

Through Bergo’s time, Norges Bank has increasingly focused on what the key functions of a central bank should be. “Strange to think that not too many years ago the Bank provided loans to the fishing industry,” Bergo tells us. Business loans do not belong on the balance sheet of a central bank. It was also the Bank’s task to examine the accounts of companies that received support from the Regional Development Fund. This function has also been completely removed from the central bank’s remit, even though providing crisis loans to the fishing industry was at the time a task that had been

assigned to the central bank by the Storting (Norwegian parliament).

What about the Petroleum Fund,” I interject, “is it really a central bank’s task to manage the capital of the Norwegian people?” “The Executive Board of Norges Bank is of the view that the Bank has performed this function in a sound manner,” replies Bergo. But I insist, “is it really a key function of the central bank to manage the Government Pension Fund – Global? It was fine to do so in the start phase. The expertise in managing foreign exchange reserves was very useful, as well as the quality stamp that the address Bankplassen 2 provides. Whether the management of the Government Pension Fund – Global will forever remain the responsibility of the head of the country’s monetary policy is far from obvious?” Still my words. Bergo listens. Grumbles a little. He doesn’t directly disagree, the grumbling in my ears tells me.

The interviewer is now warmed up. “How can you defend the interest rate hike in July 2002,” I ask, “in a period when all other countries cut rates? And the result was a surge in the value of the krone that wiped out 30 000 manufacturing jobs over the next few years?”

“Our finest hour,” Bergo answers, but with the calm and substance worthy of Churchill. Norges Bank at its best. “Not only did we raise the interest rate, as you said, we were prepared to raise it even further. But the exchange rate did the work before us. The appreciation of the krone provided a sufficient tightening effect. Why did we do it? Under the monetary policy regime of that time, the central bank’s task was entirely clear. We had made our response pattern known in advance. In order to avoid an inflationary spiral, the interest rate would have to be increased in response to excessively high pay increases. In the wage settlement in spring 2002, pay increases were much too high.”

A long, assertive and coherent stream of words from an otherwise cautious central banker.

The nominal anchor was cast. And at once everyone understood the new division of responsibility in economic policy. Norges Bank has the responsibility for inflation. The fiscal policy authorities for the real exchange rate. And the social partners for employment.

The fragile point in this division of responsibilities is the risk that asset managers in international financial markets drive the krone exchange rate completely off course. On this score, we have both been competent and lucky. Norges Bank’s communication with the market must take some of the credit for a more stable exchange rate than comparable countries can boast.

“There is virtually no doubt that the current division of responsibility functions well,” Bergo maintains.

The real growth in wages that most of us have experienced over the past four-five years is exceptionally high. And that is what counts – the purchasing power of the money we earn. In addition, the labour market has

been more flexible than most people had expected. The problem of rising benefit recipients lowers the score somewhat, however.

But everything hasn't always been rosy. The Norwegian banking crisis early in the 1990s was so severe that it is also well-known abroad. The Norwegian government did the only right thing. When undercapitalised banks' owners were no longer willing to put money on the table, the state had to provide the capital. And the private owners' were zeroed out. With a coy Mona Lisa smile Bergo remembers how he as manager for the Government Bank Insurance Fund signed the check for NOK 5 billion to pay for the government's purchase of new shares issued by Christiania Bank.

Lastly, "How is it possible," I say, "year in and year out, to be so concerned with, if not so enthusiastic about, marginal changes in Norges Bank's key policy rate? A quarter up, a quarter down, or unchanged – can you think of anything less exciting to spend your life on?"

"That's not the only thing we do," says Bergo. "The two other core responsibilities – financial stability and investment management – also require considerable time and energy. I also have the pleasure of participating in many exciting events abroad, the most edifying being the annual meetings arranged by the Federal Reserve Bank of Kansas in Jackson Hole, Wyoming, which I attend every other year. This is where the top people in my field meet. The foremost experts in central banking come together the sharpest academics.

When Jarle Bergo soon takes over as the second-in-charge of the Nordic-Baltic Office at the IMF's headquarters in Washington D.C., the road to Jackson Hole will be shorter.

Have a nice trip to America.