

Jan F Qvigstad: On making good decisions

Speech by Mr Jan F Qvigstad, Deputy Governor of the Norges Bank (Central Bank of Norway), at the Norwegian Academy of Science and Letters, Oslo, 9 November 2010.

The text below may differ from the actual presentation. This speech does not contain assessments of the economic situation or current interest rate setting.

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1. Introduction

When Hans Rasmus Astrup was appointed minister in Johan Sverdrup's government in 1885, he sold his business in Stockholm and moved back to Norway. As I mentioned in my lecture here two years ago¹, Astrup was at the time perhaps Norway's wealthiest man. On his return to Norway, he needed a place to live, bought a plot of land here in Drammensveien and decided to build the house we are sitting in now.

The question might be raised whether it was a good decision to build such a large and ostentatious house. But Astrup was not just looking for a home for his family. The house was also intended to provide a venue for interdisciplinary and political discussions.²

We all make many decisions every single day, some more important than others. And we all presumably want these decisions to be good ones. But how can we ensure that a decision is good? This is a weighty and far-reaching question. If I am to make meaningful contribution, I will need to limit my focus.

Norges Bank makes many decisions. The monetary policy decisions every six weeks are awaited with particular interest. Based on my experience from interest rate decision-making, I will focus on how the quality of a decision can be assessed. Even though I am speaking from my own perspective, I hope I am able to touch on more general issues that are of wider relevance.

2. Independence provides a sound framework for interest rate decisions

Most countries have now delegated the task of ensuring price stability to the central bank. This is also the case in Norway. The government has set an inflation target for monetary policy and delegated the operational conduct of monetary policy to Norges Bank.³

This framework can be regarded as an institutional solution to the problem of avoiding major mistakes. An independent central bank is better able to give priority to long-term interests over short-term gains.

¹ The lecture "On keeping promises", commentaries by Endre Stavang and Henrik Syse and Francis Sejersted's summary of the debate are published in Norges Bank Occasional Paper No.39 (2009).

² Kim Gunnar Helsvig (2007): *Elitisme på norsk. Det Norske Videnskaps-Akademi 1945–2007* [Elitism in Norway. The Norwegian Academy of Science and Letters 1945–2007], Novus forlag, Oslo, pp. 18–19.

³ See *inter alia* Report No. 29 (2000–2001) to the Storting, Guidelines for economic policy, Ministry of Finance, and the Regulation on Monetary Policy of 29 March 2001.

That it is tempting, but dangerous, for a government to focus on short-term gains was a lesson Greek politicians learned this spring. Government spending exceeded revenues over a long period. Accounts and official statistics were fudged. Politicians may have hoped to secure a quick admission for Greece into the euro area, with the advantages this would bring. They may have also believed that high government spending and low taxes might help their re-election prospects. Instead, they now have to steer the country through harsh reforms and substantial cuts.⁴

The Norwegian economist Finn Kydland received the Nobel Prize for economics in 2004 for having shown that on the whole, monetary policy decisions are better if policymakers delegate interest rate setting to an independent central bank under a clear mandate.⁵ As a central bank we must adhere to the mandate we have been given and be able to set the key rate based on a professional assessment.⁶ This is a system that lays a solid foundation for making good decisions.

3. We make decisions under uncertainty

Independence alone does not guarantee good decisions. Even if an independent central bank is better positioned to avoid having short-term expediency and changing preferences dictate interest rate policy, its decisions must be made under considerable uncertainty.

We have imperfect knowledge about the state of the economy, nor are we absolutely certain of how economic relationships function. Alan Greenspan, the former Chairman of the US Federal Reserve, described this in the following words:

“Uncertainty is not just an important feature of the monetary policy landscape; it is the defining characteristic of that landscape”⁷

Sometimes, the nature of the uncertainty allows one to draw inferences regarding the probabilities of different outcomes. It is possible, in other words, to judge the risks one is facing, at least to a certain degree. In that case, decisions can be made on the basis of a calculated risk, which is an approach underlying theories of equity investment,⁸ for example.

But the financial crisis reminded us that keeping the overall risk picture in view may be difficult. When Queen Elizabeth visited the London School of Economics in autumn 2008 she asked why no one had foreseen the crisis. The British Academy Forum replied to the Queen in a letter six months later. Included in the letter was the following:

⁴ The euro area operates under rules intended in principle to facilitate long-term policy choices. The Maastricht criteria require participating states to keep fiscal deficits and public debt within defined limits. Recent history has shown that this framework must be reinforced through sanctions. Decision-makers need an incentive to comply with the rules in practice.

⁵ See Finn E. Kydland and Edward C. Prescott (1977): “Rules Rather than Discretion: The Inconsistency of Optimal Plans”, *Journal of Political Economy*, 85, no. 3, pp. 473–491.

⁶ See Arne Kloster and Kristin Solberg-Johansen (2006): “Forecasting in Norges Bank”, *Economic Bulletin*, 3/2006, Jarle Berge “Interest rate projections in theory and practice” (speech at the Foreign Exchange Seminar of Norwegian Economists on 26 January 2007) and Svein Gjedrem “Inflation targeting – some theory with main focus on practice” (speech at the Centre of Monetary Economics/Norwegian School of Management on 8 June 2004).

⁷ In Alan Greenspan’s opening remarks to the Jackson Hole symposium in 2003, available at: <http://www.bis.org/review/r030905a.pdf>.

⁸ See for example William F. Sharpe (1964): “Capital Asset Prices: A Theory of Market Equilibrium under Conditions of Risk”, *Journal of Finance*, vol. XIX, no. 3 and Harry M. Markowitz (1952): “Portfolio selection”, *Journal of Finance*, vol. XII, no. 1.

“One of our major banks, now mainly in public ownership, reputedly had 4000 risk managers. But the difficulty was seeing the risk to the system as a whole rather than to any specific financial instrument or loan (...) They frequently lost sight of the bigger picture.”⁹

In setting the key policy rate, too, we often face more fundamental uncertainty, where it is very difficult to calculate probabilities for possible scenarios.¹⁰ In decision situations like these, it may be appropriate to establish routines that can guard against especially severe consequences.

Many might believe that since Norges Bank’s key policy rate is set every six weeks, there might be scope for correction should it transpire that economic developments were not as expected. To a certain extent this is the case. But since it takes time for the effects of our decisions to come into evidence, our scope for correction is in reality rather narrow. Setting the key rate at an inappropriate level for a period of time, may have serious consequences for the Norwegian economy.

Without complete and reliable information at our disposal, it is easy to err. A number of studies have shown that in such situations humans often resort to more or less qualified guesses, gut feelings or rules of thumb.

Allow me to offer an example involving distance judgement. Ordinarily, the closer an object is, the more clearly we will see it. Thus, if they see an object clearly, most people will perceive it as nearby. But when the astronauts landed on the moon, they had great difficulty judging distances, nearly always underestimating them. The reason was that visibility was unusually clear and they were in a landscape without known references.¹¹

One approach to uncertainty is to do what others do in similar circumstances. The UK decided to abandon the gold standard in summer 1931. In practice this meant a devaluation of the pound sterling against the US dollar. A few days later, Norway and the other Nordic countries decided to follow suit. History has shown that the countries that devalued in 1931 weathered the depression better than those which did not.¹² Following the British lead was a decision that produced a good outcome.

In 1949 there was a new sterling devaluation, this time 30 per cent against the US dollar. As in 1931, the Norwegian government announced that the value of the krone would be lowered correspondingly¹³. But unlike at that time, the level of activity in Norway was now high, and

⁹ The letter from the British Academy to the Queen is available at:
<http://media.ft.com/cms/3e3b6ca8-7a08-11de-b86f-00144feabdc0.pdf>.

¹⁰ See Frank H. Knight (1921): *Risk, uncertainty, and profit*, Hart, Schaffner & Marx; Houghton Mifflin Co, Boston.

¹¹ See the article “Fotspor med historie” [Footsteps with history], *Aftenposten*, 8 July 1989 and Rod Pyle (2007): *Destination Moon: The Apollo Missions in the Astronauts’ Own Words*, Harper Paperbacks. For further discussion and additional examples, see Thomas Gilovich, Dale Griffin and Daniel Kahneman (2002): *Heuristics and biases. The psychology of intuitive judgment*, Cambridge University Press.

¹² See the discussion in Tore Jørgen Hanisch, Espen Søylen and Gunhild Ecklund (1999): *Norsk økonomisk politikk i det 20. århundre. Verdivalg i en åpen økonomi*, [Norwegian economic history in the 20th century. Ethical choices in an open economy] Høyskoleforlaget, Kristiansand.

¹³ The government had discussed how Norway should respond to a British devaluation. However, they had not reached a final conclusion and the government was split. The Minister of Trade and Industry at the time, Erik Brofoss, advocated following UK actions to the full, and was supported in this view by Gunnar Jahn, the director of Norges Bank. They feared a substantial loss of competitiveness if Norway was the only one among its trading partners not to follow the sterling devaluation. When the magnitude of the UK devaluation became known, Gunnar Jahn was attending the annual meeting of the IMF in Washington. He had received provisional authorisation from the government to inform the IMF that Norway would follow a moderate British devaluation. The expectation was a sterling devaluation of around 20 per cent. However, Erik Brofoss had informed Jahn that he favoured following the UK move regardless of how much they devalued. At an IMF dinner on the evening of 16 September Jahn received a business card with the date “18 September”, the number “30.5” and the words “Tell Bramsnæs” written on it (Bramsnæs was the director of Danmarks Nationalbank, who was also

demand pressures were elevated. The krone devaluation triggered high inflation.¹⁴ This time, the rule “do what the UK does” contributed to a less favourable outcome.¹⁵

4. Groups often make better decisions than individuals

So what steps can we take to ensure that important decisions are the best they can be, even if they have to be made under uncertainty?

In his novel *L*, Erlend Loe discusses advantages and drawbacks of different decision systems. The author-narrator has embarked on an expedition to a South Pacific island with six companions. On the island they experiment with different forms of social organisation. After the group tries despotism, anarchy, democracy, etc., Loe concludes that enlightened despotism has much to recommend it:

*“Of course it very much depends on who the ruler is and how enlightened he or she is, but at its best this is probably one of the more sensible forms of government.”*¹⁶

Martin, one of the other members of the expedition, also thinks that this system might work well. He stresses, however, that the form of despotism must be a truly enlightened one:

*“Not just moderately enlightened, but ultra-enlightened. The ruler needs to be highly educated, plus be well travelled and have lots and lots of varied interests (...) Just find an exceedingly likeable individual, someone you trust, someone who is warm-hearted and good-natured, and ask him or her to manage things as best they can.”*¹⁷

Most people would probably argue that despite certain benefits, enlightened despotism would not be very robust. As you may have noted, a number of assumptions underlie Martin’s conclusion, and these assumptions are not always satisfied. Delegating decision-making responsibility to a group may help to guard against situations where the individual’s weaknesses and vested interests come to dominate. It can also provide some insurance

attending the IMF meeting). The business card revealed the date and magnitude of the British devaluation. It was a busy night. Jahn sent a telegram to Brofoss where he recommended that Norway devalue the krone to the same extent as the UK. By then the Ministry of Trade and Industry had already been informed of the UK decision through official channels. Then, without first consulting with the other members of the government, Brofoss decided that the Norwegian krone should be devalued by 30.5 per cent. After being instructed by Brofoss, Gunnar Jahn informed the IMF of the decision on behalf of the Norwegian government in a letter dated 17 September. See Gunhild J. Ecklund (2008): “Creating a new role for an old central bank: The Bank of Norway 1945–1954”, Series of Dissertations 2/2008, BI Norwegian School of Management, pp. 141–143 and William Jansen (1975): “Devalueringen i 1949” [The devaluation of 1949], History thesis, NTNU, Trondheim.

¹⁴ For more on the background for these decisions, see Gunnar Jahn, Alf Eriksen and Preben Munthe (1966): *Norges Bank gjennom 150 år*, [Norges Bank through 150 years] Norges Banks seddeltrykkeri, Oslo and Nicolai Rygg (1950): *Norges Bank i mellomkrigstiden*, [Norges Bank in the interwar period] Gyldendal Norsk Forlag, Oslo.

¹⁵ In 1965 the former director of Statistics Norway Odd Aukrust assessed the successes and mistakes in Norwegian economic policy since the Second World War. Concerning the devaluation decision in 1949 he writes: “*This devaluation was probably the most important single economic decision made in this country since 1945, with a greater impact on prices and income distribution than any wage settlement. There can hardly be any doubt that in the 1950s, price changes would have been less abrupt in Norway if the devaluation had not taken place.*” See Odd Aukrust (1965): *Tjue års økonomisk politikk i Norge: suksesser og mistak*, [Twenty years of economic policy in Norway: successes and mistakes] Articles from Statistics Norway, no. 15.

¹⁶ Erlend Loe (1999): *L*, J. W Cappelens forlag, p. 376.

¹⁷ Loe (1999), pp. 397–398.

against serious missteps, which seems to be particularly important when decisions are made under uncertainty.

This notion is part of the justification for the jury system in our courts of law. The French philosopher Marquis de Condorcet's now well known jury theorem states that the higher the number of the group is, the higher the probability is that the group will make the correct decision by majority vote.¹⁸ Group decision making has been widely accepted, not only by the courts but also by business, public administration and elected governing bodies.

In his book *The Wisdom of Crowds*, James Surowiecki cites a number of examples where large groups outperform individuals or small groups of experts. Contestants on the television game show *Who Wants to Be a Millionaire?* have various so-called "lifelines", including telephoning a smart friend or asking the studio audience for help. It has transpired that the studio audience is the contestants' absolute best bet. The majority of the studio audience votes for the correct answer nine out of ten times, beating out smart friends, who provide the correct answer only 65 per cent of the time.¹⁹

This decision-making strategy, where each individual in a group gives an answer independently of the others, can function well for some types of decisions. But there may also be advantages to allowing the group to arrive at a decision through deliberation.

The economists Alan S. Blinder and John Morgan have shown in several experiments that students who work together to solve a problem obtain a better result than the average of the students who work alone.²⁰ In Blinder's words:

*"...the group seems to foster some sort of collective wisdom that makes the whole (a bit) greater than the sum of its parts."*²¹

These experiments indicate that there may be benefits to be gained from group interaction, which can provide increased access to varied knowledge, deconstruct opinions and test viewpoints. We can learn from each other.

I have learned a lot in this area from the organisational psychologist Ingeborg Baustad and her colleagues. Baustad argues that there may be a relationship between intragroup communication and task solving. Some tasks are so simple that unilateral communication is sufficient. For deliberative tasks the requirements are higher. Active bilateral communication is necessary, with a willingness to listen to the views of the others in the group. For more strategic decision-making, the level of communication must be raised a notch further. The hallmarks of such a high communication level are curiosity about the other person's views and the ability to broaden one's views or change one's mind as a result of discussion with others. This type of communication normally requires a high level of professional

¹⁸ This outcome assumes that each member of the group singly is more likely to arrive at the correct conclusion than the wrong one.

¹⁹ See James Surowiecki (2004): *The wisdom of crowds*. Little, Brown, London, pp. 3–4. This example was also cited in the speech "Uncertainty in macroeconomic policy making: art or science?", which Mervyn King, Governor of the Bank of England, gave on 22 March 2010, and is available at: <https://www.bankofengland.co.uk/publications/news/2010/034.htm>. That we both use this example may not be a coincidence. I received my copy of *The Wisdom of Crowds* from Dr. John Llewellyn. Llewellyn and King were fellow students at Cambridge.

²⁰ See Alan S. Blinder and John Morgan (2005): "Are two heads better than one: An experimental analysis of group versus individual decision making", *Journal of Money, Credit and Banking*, 37, no 5, pp. 789–811 and Alan S. Blinder og John Morgan (2007): "Leadership in groups: a monetary policy experiment", CEPS Working Paper No. 151.

²¹ Alan S. Blinder (2008): "On the design of monetary policy committees", Norges Bank Working Paper, 2008/6.

competence, mutual sympathy and trust and a large degree of openness. The potential reward is better decisions by the group.²²

As in most central banks, interest rate decisions in Norges Bank are entrusted to a committee. Committee deliberations are informed by advice given by the governor and deputy governor of Norges Bank. Norges Bank's Executive Board has seven members. The number of committee members at other central banks varies between three and 22.²³ A committee of many members can draw on an ample supply of varied backgrounds and opinions, but a larger number will then also have to have a say in the final decision. While research has yet to determine the optimal committee size, Anne Sibert, one of the experts in this field, has said that the committee should be "dinner size".²⁴

5. But groups are no guarantee for good decisions

Norges Bank's Executive Board can be described as a collegial committee. The committee seeks consensus through deliberations and its members stand behind the final decision.

The deliberative process does not necessarily lead to a better decision. When the group members share the same world view and thinking, groupthink can lead the members astray. There is typically little dissent in discussions where participants think alike. The group can therefore be convinced that their common standpoint must be right.²⁵

Nor is it unusual for independent thinking to be lost in a group setting. At an internal conference, the research department at Norges Bank was divided into three groups tasked with answering three sets of questions. Unbeknownst to the other participants, one member in each group had been instructed to argue for the wrong answer within one of the question sets. They did their job well. The groups did very poorly on the set of questions where the conference organiser's confederates argued for the wrong answer.²⁶

There is thus a danger that members of a group can be swayed by other members to make the wrong choice. But falling into the opposite trap – paying insufficient heed to others' advice – is not unusual either. This is a pitfall that many people, who have been in management for a while, will be acquainted with. Psychologists have known that such

²² See more about this in Erling S. Andersen, Ingeborg Baustad and Åge Sørsveen (1994): *Ledelse på norsk* [Norwegian management], Ad Notam Gyldendal, Oslo, pp. 117–126.

²³ Three in Switzerland and 22 in the European Central Bank.

²⁴ See more about this in for example Alan S. Blinder (2008) and Anne Sibert (2006): "Central Banking by Committee", *International Finance* 9:2, pp. 145–168. In September 2007 Norges Bank hosted a conference on monetary policy committees. The opening address was given by Alan S. Blinder, former vice chairman of the Federal Reserve Board, and is one of the economists who has focused most on group decision making. Anne Sibert also attended this conference.

²⁵ It has also been shown that when people are in groups of like-minded persons, and especially when they are socially isolated, they are prone to taking more extreme positions than they would on their own. The psychologist Irving L. Janis is particularly known for his research into groupthink. His analyses concerned US foreign policy, where groupthink might deserve much of the blame for competent persons making poor decisions. See Irving L. Janis (1972): *Victims of groupthink; a psychological study of foreign-policy decisions and fiascoes*, Houghton Mifflin Company, Boston.

²⁶ The psychologist Salomon Asch conducted a number of similar experiments in the 1950s. He found that "*the tendency to conformity in our society is so strong that reasonably intelligent and well meaning young people are willing to call black white.*" See Salomon E. Asch (1955): "Opinions and social pressure", *Scientific American*, vol. 193, no. 5, pp. 31–35.

exaggerated self-confidence is found in many occupations.²⁷ There is no reason to believe that we economists are so different from others in that regard.

Norges Bank's Executive Board consists of five external members with varied backgrounds, in addition to the governor and deputy governor of the Bank. The external members have influence over decisions on a par with the internal members. The Bank is in a peculiar situation in that the central bank governor is both administrative head of the Bank and chairman of the Executive Board. The external members are not full-time employees of Norges Bank, and their primary occupations are outside the central bank. In this respect, the Executive Board has an important control function. Its external members can act as a counterweight to any internal cultures of opinion that may arise at the Bank.²⁸

In some central banks, such as Sveriges Riksbank and the Bank of England, interest rate decisions are made by individualistic committees. Decisions are made by majority voting, with each member individually accountable for his or her vote. There are advantages and drawbacks to both individualistic and collegial committees. As I discussed in last year's speech, individual accountability can provide good incentives. There is no one to hide behind. At the same time such accountability entails more work and probably full-time employment at the Bank. In that case, the former outsiders may quickly assimilate the internal culture. The control function of the external members might be lost.

6. How do we arrive at a decision?

We also need to think carefully about how we should agree on a decision. There are two approaches: premise-based or conclusion-based.²⁹

The two approaches may have different outcomes. Allow me to offer a stylised example. Assume that a three-member committee is to reach an interest rate decision. They base their decision on two premises: inflation and pressures in the economy. The first member believes that inflation has risen more than expected, but finds that the pressures in the economy are broadly as expected. The interest rate should therefore be raised. The second member believes that inflation is broadly as expected, but the pressures in the economy are surprisingly high on the upside. This member, too, will conclude, that the interest rate should

²⁷ See overview and further references in Carl Andreas Claussen, Egil Matsen, Øistein Røisland and Ragnar Torvik (2009): "Overconfidence, monetary policy committees and chairman dominance", Norges Bank Working Paper 2009/17.

²⁸ The members of the Executive Board are appointed by the government. According to Proposition No. 81 (2002–2003) to the Odelsting, the appointment process shall ensure that the Executive Board reflects a broad range of backgrounds and expertise, with particular emphasis on economics and finance, as well as a thorough understanding of economic issues. The proposition states that the Executive Board shall be composed of persons of different backgrounds to ensure that it is capable of being critical of its own assessments. See Proposition No. 81 (2002–2003) to the Odelsting: Om lov om endringer i sentralbankloven og finansieringsvirksomhetsloven og om opphevelse av valutareguleringsloven og penge- og kredittreguleringsloven (Concerning an Act to amend the Norges Bank Act and the Financial Institutions Act and concerning the repeal of the Exchange Control Act and the Monetary and Credit Policy Act). Ministry of Finance. Board appointment guidelines and rules relating to limitations on members' ownership interests and functions are set out in the Norges Bank Act and the Regulation of 7 August 2000 relating to Norges Bank's Executive Board members' relationship to other credit institutions and undertakings. Executive Board members cannot *inter alia* be married to a member of parliament and external members cannot receive remuneration from or sit on the board or supervisory council of financial institutions, securities firms or collective investment undertakings. Nor are they permitted to buy or sell fixed income or foreign exchange products when they are in possession of information concerning conditions that may influence prices, unless the information is available to the public. In addition, the general impartiality provisions under Section 6 of the Public Administration Act apply.

²⁹ For a discussion of the relationship between conclusion-based and premise-based decisions, see Carl Andreas Claussen og Øistein Røisland (2010): "A quantitative discursive dilemma", *Social Choice and Welfare*, vol. 35, no. 1.

be adjusted upwards. The third member believes that developments have been as expected and concludes that the key rate should remain unchanged.

In a conclusion-based decision, the majority would vote to increase the key rate. Two out of three members came to this conclusion. But a premise-based conclusion would in this case have produced a different outcome. Two out of the three members believed that inflation and economic pressures were as expected. A premise-based decision would thus leave the key rate unchanged.

Many will favour the premise-based approach because it gives weight to the underlying basis for the decisions we make.³⁰ Research has also shown that it is better to discuss and vote on the grounds for any disagreements than to go directly to the conclusion.³¹ At Norges Bank we base our procedures on a premise-based decision-making process.

Economists working at Norges Bank have an important role in decision-making, particularly because decisions are premise-based.³² The Bank's economists thus constitute a stabilising element in the decision-making process that is robust to changes in central bank management and the Executive Board's external members.

For the Bank's economists to perform this role properly, it is essential that they are of a very high professional calibre. Here the Executive Board also performs a vital role, providing constant feedback on the quality of the research supporting policy decisions. The Board also discusses the Bank's personnel policy and measures to maintain and develop the skills of staff economists.

But Norges Bank has a monopoly on setting the key interest rate in Norway. One of the dangers of monopolies is a tendency towards complacency, which is why it is imperative to be in the critical spotlight. This keeps us, Board and staff economists alike, constantly on our toes and helps us to develop as professionals. This, in turn, results in better decisions.

Every year we must stand to account for the way in which we carry out our mandate. There is reporting to the government and hearings in the Storting. In addition, the Ministry of Finance commissions an independent review of monetary policy though what is known as "Norges Bank Watch".³³ At the same time we are open about what we do and why. There are external evaluations of work routines and professional standards.³⁴ There are no comparable institutions in Norway – there is only one central bank. The benchmark must be international best practice. The evaluations are generally performed by international central banking experts or economists at other central banks.

³⁰ See for example Bruce Chapman (2003): "Rational Choice and Categorical Reason", *University of Pennsylvania Law Review* 151(3), 1169–1210 and Philip Pettit (2001): "Deliberative Democracy and the Discursive Dilemma", *Philosophical Issues* (supplement to *Noûs*) 11, 268–99.

³¹ See the discussion in Carl Andreas Claussen and Øistein Røisland (2010): "The discursive dilemma in monetary policy", Norges Bank Working Paper 2010/5. It should be noted that premise-based decisions can be vulnerable to strategic behaviour. It is possible to vote on the premises in such a way as to reach a preferred outcome.

³² The material on which interest rate decisions is based is published on the Norges Bank website. For a more detailed discussion, see "On transparency" in Norges Bank Occasional Paper No. 41 (2010).

³³ Reports from Norges Bank Watch are available at: <http://www.bi.no/en/Research/Research-Centres/Centre-for-Monetary-Economics-CME/Norges-Bank-Watch/>

³⁴ See *inter alia* David Longworth and Asbjørn Rødseth (2003): "Report on the Decision-Making Process and the Strategy Document", Hans Genberg, Charles Wyplosz and Andrea Fracasso (2003): "How do central banks write? An Evaluation of Inflation Targeting Central Banks" and Ingimundur Fridriksson (forthcoming): "The Monetary Policy Report Process in Norges Bank".

7. Was the decision good?

Even if our delegating authority and critics have access to the background for our decisions and the way we arrive at them, one big question still remains: what should the criteria be for judging whether our decisions are good?

The objective of monetary policy is a natural place to begin our assessment. Have we or have we not achieved price stability? Even if we make our best efforts, there is no guarantee that we will succeed in reaching this objective. The key policy rate is not the only factor affecting the economy and that can disturb the outcome. Even so, we can give weight to accurate information, assess the most relevant alternatives and listen to input. Making a decision on this basis might excuse us from blame if the outcome should in retrospect turn out to be unfavourable.³⁵

Let us return to the decision in 1949 to follow the pound sterling. As I said, in retrospect the consequences of this decision appear to be less favourable. Nor, perhaps, was the decision-making process sufficiently thorough. Doubts have been raised as to whether alternative courses of action were adequately assessed.³⁶

But the authorities apparently felt that they had no choice other than a comparable devaluation of the krone.³⁷ Norway's competitiveness could have been weakened substantially if they had not followed the British move. In view of this, it can therefore be argued that their motives for doing what they did were good ones.

The 1949 decision also illustrates the problem of counterfactual analyses. Determining what might have happened if the authorities had acted otherwise is no easy task. Allow me to present a hypothetical example: The central bank thinks financial imbalances are building up, and the Executive Board sets the key rate higher than it otherwise would have done. While a financial crisis does not actually materialise, unemployment rises and economic growth slows. Inflation could fall below target. In this situation, it may be difficult to assess whether the Board made a good decision to raise the key rate.

Such assessments of motives and outcomes are also the subject of moral philosophy and its discussion of what constitutes a good decision. In setting the key rate, both intentionalist and deontological ethics will provide us with the same guidance as to what good decisions are. In both cases, the decision must be based on achieving the objective of monetary policy, and

³⁵ A fundamental principle of criminal law is that a person can only be judged if that person can be charged with a criminal offence and is proven guilty. There are two forms of guilt: One is guilty with intent, which typically means that the offender intended to produce the negative outcome. The other form of guilt is negligence, which somewhat simplified implies a failure to use reasonable care or prudence. In determining whether an offender has acted with negligence, his behaviour must be measured against ordinary reasonable and prudent behaviour in a comparable situation. A Supreme Court ruling from 1984 provides an illustration of negligence consideration. The Supreme Court was to decide whether a the driver of a car was negligent when in a very difficult intersection he crashed into a car that had the right of way on the other crossing road. The collision occurred in the midst of rush traffic, and the Court argued that crossing traffic should be expected at that time. However, a number of conditions made it difficult for the man to see the traffic before he was close to the intersection. It was dark, with rain and sleet and icy roads. On the other hand, the driver was very familiar with the site and he should have been aware of the all the risks at the intersection. As he did not adjust his driving so that he was able to stop, the Court found that the driver had acted negligently. See Norsk Retstidende (Norwegian journal of law) 1984–91.

³⁶ Preben Munthe, professor of economics, believes that the government was probably surprised by the magnitude of the sterling devaluation. He writes: "*When the authorities learned of the British decision, they probably felt they were under time pressure, which is why the situation was not nearly as thoroughly discussed as it actually could have been.*" See Jahn Eriksen and Munthe (1996), p. 371.

³⁷ Nor was this decision criticised by the business sector or the press, and in its publication "Økonomiske utsyn over året 1949", Statistics Norway wrote that "*the Norwegian external economy is so closely linked to that of the UK, that there was hardly any alternative to following the pound sterling*". See Jahn, Eriksen and Munthe (1966), p. 371. The decision to devalue the krone in 1949 is also discussed in Jansen (1975).

that alone. From a consequentialist standpoint, it matters little whether the intentions were good, if the consequences of the decision were not. Our decisions are good only if we reach the objective of price stability. As mentioned, our performance cannot be measured by whether inflation is always at target, partly because the economy is frequently exposed to abrupt and unexpected shocks. We will nearly always be slightly over or slightly under the target. But over time we can expect that these disturbances will even out, and in the long run we must also be evaluated on whether or not we achieve the objective of monetary policy. Have we, or have we not, achieved price stability these past ten years?

8. Conclusion

Making a good decision is of little use unless one also manages to have it implemented. Norges Bank enjoys a privileged position. When we make a decision, we can also implement it. Our independence gives us the freedom to decide what the key policy rate shall be.

In other areas of society, it is not always the case that those who are qualified to make good decisions also have the power to implement them. In the interest of democratic governance there may be good reasons why this is so, but the decision-making process will then require considerable attention.

We can concentrate on promoting an understanding of the decisions we make. We must be transparent about what we do, and explain premises, economic relationships and results. Our decisions must be well communicated and understood. If we are unsuccessful in this respect, our reputation may be impaired.

Independence, transparency and good decisions are intertwined. Independence is a precondition for keeping promises. Keeping promises was the topic of my lecture here two years ago.³⁸ We must also communicate and explain interest rate decisions to the public so that they have confidence that we are discharging our duties properly. Transparency is a precondition for accountability and that was the topic of my lecture here last year.³⁹ Today I have been speaking about how we can arrive at decisions that are good ones. Adequate institutional arrangements, high-quality professionals and appropriate routines are important elements for doing just that.

Hans Rasmus Astrup died in 1898, twelve years after this building was completed. Astrup's two daughters sold the house to the Norwegian Academy of Science and Letters a few years after their father's passing. They gave the Academy a gift of 106,000 kroner to go towards buying the house. The remaining funds were raised from donations.⁴⁰

Was the decision to build this stately residence a good one? Yes, given the outcome, it must be said to have been a very good decision indeed. Ever since Astrup's time, Drammensveien 78 has been a venue for interdisciplinary discussions. The benefits of learning across disciplines are well illustrated by the success of Olympiatoppen. Olympiatoppen serves as a venue for different sports. Where coaches and leaders have traditionally focused on international developments in their own disciplines, Olympiatoppen also gives them an opportunity to learn from one another's experiences, across disciplines. Many believe that this is part of the reason for Norway's numerous Olympic medals in recent decades.⁴¹

³⁸ See Norges Bank Occasional Paper No. 39 (2009).

³⁹ The lecture "On transparency", the commentaries by Inge Lorange Backer, Andreas Føllesdal and Bernt Aardal and Aanund Hylland's summary of the debate are published in Norges Bank Occasional Paper No. 41 (2010).

⁴⁰ See Helsvig (2007), pp. 19–20.

⁴¹ See the article "Særnorsk oppskrift for OL-gull" [Uniquely Norwegian recipe for Olympic gold], 10 February 2010, available at (in Norwegian).

For 150 years the Norwegian Academy of Science and Letters, by fostering contact across academic disciplines, has functioned as a kind of Olympiatoppen for science and scholarship. The Academy has always convened its members for discussions of topics that although may be rooted in a single field, are at the same time broader in scope and of common interest.⁴² This lays the foundation for making good decisions.

Thank you for your kind attention!

⁴² See Øyvind Østerud's introduction in the Norwegian Academy of Science and Letters annual report for 2009 at (in Norwegian).