

Speech

Governor Urban Bäckström

FRIDAY, 3RD OCTOBER 1997

Sweden's relations with the EMU

Conference on the changing role of central banks

Bank of Lithuania

Let me start by thanking you for the invitation to talk about Sweden's approach to the EMU. I will begin by explaining the political situation. Further, I will talk about the macroeconomic situation and how Sweden fulfils the convergence criteria, and also the fulfilment of another prerequisite for EMU membership, the independence of the central bank. The ongoing preparations by the Riksbank will be discussed as well, and finally what will happen in the Swedish financial sector if Sweden remains outside the EMU from the start.

The coming years will be a very interesting time. Europe is in the process of starting the most far-reaching project ever made in the economic field. It is always difficult to foresee how things will work when there is no earlier experience to draw on. It is often noted that EMU is a macroeconomic project, with fulfilment of economic conditions. But the EMU has other dimensions that must also be considered when the project is discussed. One is political; EMU is an instrument for fulfilling the European integration process in general. It is a logical step in the completion of what was started with the ideas behind the single internal market. Another dimension is that EMU will change Europe's financial infrastructure. A common currency will increase market transparency and facilitate comparisons.

SVERIGES RIKSBANK

Telephone
+46 8 787 00 00

Telefax
+46 8 21 05 31

E-mail
registratorn@riksbank.se

There is a high probability that Stage Three of EMU will come into being on the 1st of January 1999. The Ecofin meeting in Luxembourg in September between ministers and central bank governors displayed even more determination than before to start the monetary union on time. One of the most important results of the meeting was the decision about when to announce the fixing of the bilateral exchange rates between the national currencies in the euro area. This will be done in May next year, in connection with the selection of countries that will adopt the euro. It has not yet been decided, however, how the conversion rates will be chosen.

There are just about 310 working days left to the 1st of January 1999 and the preparatory work in the European Monetary Institute (EMI) in Frankfurt is proceeding at an undiminished rate so that everything will be in place for the start. A lot of work areas are nearing completion; in a number of cases all that remains is to test the systems. It seems clear that there will be enough time in which to complete the preparations. The EMI has recently published reports that describe in more detail how the ESCB monetary policy instruments and procedures and the ECB's payment system, TARGET, will function in practice.

When the countries that will constitute the euro area have been chosen, the European Central Bank (ECB) and the European System of Central Banks (ESCB) will be established. The National Central Banks (NCBs) of participating countries will have an active operational role in the implementation of the single monetary policy. Central banks in countries outside the euro area will, nevertheless, be a part of the ESCB. Consequently, all central banks will be involved in the co-ordination of certain tasks. In particular, monetary policy in EU countries that are not participating in the euro area will be co-ordinated with that of the ECB, with a view to fostering stability and facilitating participation at a later date.

The political situation- would Sweden like to join?

There are many indications that Sweden will not be joining the euro area from the start on 1st of January, 1999. What is the reason for this? We seem close to fulfilling the formal conditions and, unlike the UK and Denmark, we do not have a formal derogation.

In order to explain, I have to go back some years. The Swedish attitude to European co-operation has been somewhat mixed. The reason lies mainly in foreign policy. A radical change in this approach occurred around 1990, with the fall of the Berlin Wall in 1989 and the surfacing of serious problems in the Swedish economy. The attitude among politicians to EU membership became more positive, which led to negotiations in 1993.

During the negotiations for EU membership, however, the possibility of remaining outside the EMU from the start was brought up. It was explained during the negotiations that "Sweden wants to participate in the emerging Economic and Monetary Union" but it was also added that "a prior Swedish position relating to the transition from the second to the third stage will be taken in the light of future events and in accordance with the provisions of the Treaty". And the time has come now to take that position. The Swedish parliament will make the final decision, probably in December this year.

The governing party, the Social Democrats, has already expressed its opinion on membership from the start of EMU. Its recommendation is to wait. One of the main reasons is the low level of support for EMU participation among Swedish citizens, although lately this support has tended to grow. The sceptical attitude of Swedes to EMU at this stage has to do with the restructuring of Sweden's economy, which many people connect with membership of the European Union.

The macroeconomic situation - do we qualify?

The Swedish economy has undergone some fundamental changes in recent years. In the early 90s the economic situation was precarious. Output fell continuously for three years, by a total of around 6 per cent, and unemployment shot up to almost 9 percent. The Government finances were also in bad shape, causing the budget deficit to grow to more than 12 per cent of GDP. This was accompanied by a serious crisis in the banking sector.

The situation is now quite different and we are experiencing a steady improvement in the conditions for Sweden's economy. Low inflation and low interest rates are accompanied by a trend towards a balanced government budget and even a surplus over the medium term. We are very close to fulfilling most of the convergence criteria. But like many of our European colleagues, we have some way to go to fulfil the public debt criterion. Currently the government debt ratio is around 77 per cent but it does show a falling trend. The consolidation of public finances and the firm establishment of price stability as the monetary policy objective are fundamental cornerstones that will apply regardless of EMU. Staying outside the euro area will, therefore, not imply a different policy stance but rather a continued commitment to stability.

Another condition that has to be met regardless of whether an EU country qualifies for the monetary union or not, is the independence of the central bank. In Sweden, five of the political parties in Parliament (the "Riksdag") reached an agreement this summer to make the Riksbank formally independent of direct political influence on monetary decisions. Furthermore, the objective of price stability will be given the force of law. The Riksbank is to have a new Executive Board and its role will be to conduct monetary policy independently. Under normal circumstances neither the Governor of the Riksbank nor the other five members of the Executive Board can be dismissed during their six-year term in office. The Governing Board, which at present decides monetary policy, will in future have a controlling function.

Central bank independence is a crucial element in maintaining the credibility of the price stability objective. This goes for countries both inside and outside EMU.

Swedish preparations for EMU

For some years now, the Riksbank has been engaged in practical preparations for monetary union. The purpose has been to be prepared for participation in 1999 if Parliament were to decide upon Swedish membership of the euro area from its start. An important part of this work has been to inform and consult with the Swedish financial sector on changeover aspects.

In order to arrange that, we have set up a consultative group for the financial sector. One result of this collaboration is a report published last January containing consequences for the financial sector if Sweden were to adopt the euro in 1999.

A new report is now being drafted and will be published in January next year. This report takes into consideration the prospect that Sweden will not participate from the start. It can already be concluded that the financial sector will be involved in far-reaching changes even if Sweden does stay outside. For competitive reasons, banks will, for example, be forced to offer various kinds of euro services, especially to corporate customers. To some extent private customers will probably also be interested in euro services. This situation will be more costly than participation from the start, since it will require parallel systems for handling both kronor and euro.

For their part, the securities market organisations consider that competition will necessitate a switch to trading certain securities in euro; for these securities that means that trading in kronor will cease.

Even if Sweden does not participate in the euro area from the start, the Riksbank will be able to use the ECB's payment system, TARGET. The conditions for outside countries have still to be finalised. The TARGET system is intended primarily for monetary transactions but will also process large-value commercial payments. Our national payments system, RIX, will have to be adapted so that it can handle kronor and euro in parallel.

Along with the Riksbank, the Swedish Ministry of Finance has its own organisation for analysing the practical introduction of the euro. This includes questions affecting citizens in general, legislation, the business sector and the public sector. In September, a report was published focusing on a scenario for Sweden remaining outside the euro area. What would be the consequences in particular for the business and the public sector?

One of the conclusions from the report is that the climate for the European business sector will change radically when the monetary union becomes a reality. This will have strategic and practical implications for the Swedish business sector, whether or not Sweden stays outside the euro area from the start. Companies will have to review their strategies so as to be in a position to meet the new competitive situation. The new situation will also call for practical changes in their payment and accounting systems.

The establishment of EMU will be of a direct importance that extends outside the borders of the euro area. International competition will effectively favour the use of euro, at least in relation to the smaller European currencies.

Some companies, especially those with a European market, intend to use the euro even if Sweden stays outside. The business sector has therefore expressed a need to be able to have external accounts and share capital in euro whether or not Sweden stays outside. At present it is not permitted to have these entities in any other currency than kronor. A government enquiry is checking these matters and will present its findings this autumn.

Another aspect is the public sector's possible willingness to accept that companies would like to use the euro in their contacts with certain authorities, for tax returns etc. This is a question both when membership is envisaged (i.e. before euro banknotes are introduced) and if Sweden stays outside. Many public authorities in Europe have lately shown a strong inclination to meet these needs. The Swedish authorities' approach in this matter is under consideration.

Conclusion

It is not yet clear how long Sweden will stay outside the euro area. If nearly all EU countries (including the UK) become members in or soon after 1999, it will be very important for Sweden to maintain a high degree of preparedness so that we are ready if the political situation should change. The Swedish central bank will therefore continue to take an active part in the European preparations. Continued EMU work is ultimately also part and parcel of our EU membership. It will generally be important to seek to have a flexible approach to technical solutions in adaptations so they can be suitable for different scenarios. Otherwise it will be difficult to get everything ready for the day of entry.

Membership or not, Sweden will be obliged to keep a firm grip on its economy. From an outside position, our determination to keep inflation low and maintain budget surpluses must be demonstrated with particular clarity.

The Swedish financial and business sectors will be the first to be affected at the start of Stage Three, whether or not Sweden joins from the beginning. This will amount to a major change in the competitive situation. Those who now realise this, and have already started or plan to make their preparations at this stage, will have a major advantage in the coming years when EMU will begin to affect us all.