

Speech

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Sweden and the Preparations for the EMU

Let me begin by thanking you for inviting me to speak to you about the European Monetary Union (EMU). Interest in EMU questions is increasing more and more and I am now spending a lot of time outside the Riksbank informing people about the preparations for the EMU. We most often meet representatives from the financial sector, so it is especially a pleasure to come here to ABF and have the opportunity to speak in front of a new public. It is also my conviction that more and more people, not just those in the financial sector, need to familiarise themselves with what the EMU is and how the EMU will affect Europe.

What I am going to talk about principally here tonight is how the timetable for the EMU is looking, what changes we know today are going to occur and what practical preparations the Riksbank is making before the EMU. I also want to mention a few of the consequences of the EMU for the financial sector in Sweden and something about how we as individuals will be influenced by this process. I will begin with some of the more important economic features and then go into the EMU's practical aspects.

Monetary Union or Not?

The monetary union will soon be a reality. Consequently, to discuss whether or not the plan is reasonable has become less relevant. What we should ask ourselves instead is whether or not we want to take part?

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Sweden Should Participate from the Beginning

As to the Riksbank's view on whether Sweden should participate in the monetary union, the Governing Board has come to the conclusion that we should take part from the beginning in 1999. We believe that the economic and political advantages of taking part in the union have been underestimated in the debate. At the same time the political stabilisation costs have been exaggerated.

Let me explain in more detail. One of the most common arguments against monetary union is that some think that we should retain the possibility of devaluing in order to eliminate asymmetrical shocks, shocks in the economy that affect Sweden only. Inherent in such shocks is the risk of a substantial increase in unemployment and to avoid that, we must be able to adjust the exchange rate in the face of economic shocks. This argument is usually called the insurance argument. In a monetary union, we do not have this "insurance" of being able to adjust exchange rates in the event of external economic shocks. In the EMU, Sweden will not be able to devalue its way out of economic problems.

It is here that our view on economic policy differs from those that say no to the union. The Riksbank believes that we cannot continue to use monetary policy to solve problems that we have created ourselves and that often in practice are the result of poor economic policy and long-standing structural problems. The problems highlighted by the government-appointed EMU Committee—for example, increased unemployment—deserve very serious consideration, but they cannot be solved first-hand by monetary policy. Employment problems have to be solved through measures aimed at wage formation and the way the labour market functions, that is to say, through structural changes. Staying out of the EMU, we believe, will not facilitate these reforms.

That Sweden would experience more external shocks than other countries in Europe also appears less probable. The Swedish economy does not differ to any appreciable extent from the economies in the EU's core countries. Moreover the changes to financial and monetary policy that have been made in recent years will most likely reduce sensitivity to economic shocks.

In the Riksbank's commentary submitted to the EMU Committee, we have also pointed out the negative effects on the Swedish financial system of staying out or joining at a later stage, which the Committee did not appreciably touch upon. I will come back to this question later on.

The Political Consequences

The economic effects of the EMU are naturally important to discuss, but difficult to foresee in the present situation. What are easier to see are the political effects of joining or remaining outside. Here we share the Committee's view. To stay outside the union would involve significant political costs. As non-participants, we would be outside the inner circle of countries that will lead Europe into the future. Our chance to influence important decisions would presumably also be reduced in areas of concern other than pure monetary policy. Should Sweden stay outside the monetary union for good, there would be a risk that we would be marginalised as

an “out.” We should also be aware that those countries that join the EMU from the start will have a greater influence on how the new European Central Bank, ECB, will develop during its first few formative years.

In the Swedish debate, the EU often is portrayed as bureaucratic and sometimes as almost ridiculous, with reports on such matters as the prohibition of snuff or the size of strawberries. I do think, however, that we should not forget that the purpose of the European Union and the monetary union is improved co-operation, with the goals of increased integration, growth, employment, peace and prosperity—goals that I believe we can all support. What kind of a Europe do we want to see develop and how can we participate in this process? Of course, we can also choose to stand to the side and look on while the other countries continue this co-operation. But we should be aware that it is a choice we are making.

I would find it difficult to believe that in the long run Sweden would remain outside a functioning EMU. The countries of Europe must continue to integrate. The question is therefore not *if* but *when* Sweden should join. That was also the conclusion of the EMU Committee. When the question is formulated in this way it takes some of the heat out of the debate.

Let me now turn to more practical aspects of this project.

The Timetable

In all EU agencies and in member countries, preparatory work is in full swing. In May 1995 the Commission presented a green book on the practical arrangements for the changeover to the single currency. In Madrid the same year the European Council approved a changeover scenario, which laid out a fixed schedule for the major decisions. There it was agreed that the EMU would begin in January 1999. As early as possible in 1998 (most likely February-April) the Council of Ministers will decide what countries will participate in the union. The decision will be based on which countries have fulfilled the convergence criteria on the basis of statistics for 1997. On the first of January 1999 the exchange rates will be fixed and the ECB will take over monetary policy.

The euro will be introduced as the union’s currency and all monetary policy operations will be conducted in euros. From then until January 1, 2002, at the latest, both euros and kronor will exist as parallel currencies. Legally, however, they will be one currency. It is not any stranger than the Swedish currency being expressed both as öre and kronor. But we will not have euros in our wallets during this time. By January 1, 2002 at the latest, the euro will exist as bank-notes and coins. When the euronotes and cent are put into circulation, a large exchange of notes and coins will begin and continue for six months. By July 1, 2002 at the latest, kronor will lose their status as a legal tender, but the Riksbank will, of course, exchange kronors for euros even after that date.

Who Will Join?

EU countries are now making an effort to meet the economic criteria required to join the monetary union. Simultaneously, intensive political work is being undertaken to clear away possible remaining obstacles. After the latest meeting of

the heads of states and governments in Dublin in December 1996 there are political agreements on, among other things, the stability and growth pact, the agreement which will ensure that stability and convergence prevail between member countries' economies, even after the union is established, and on the relations between the new currency, the euro, and the EU currencies outside the EMU. This agreement is called ERM2.

However a number of important matters are still outstanding. One such question concerns the route into the EMU for those countries that do not join on the first wave. There are also many technical details that must be adjusted, but the big pieces of the puzzle are in place.

As I have mentioned, the countries are working hard to fulfil the convergence criteria. One year ago the prospects were fairly dismal. Only a very few countries met the criteria for joining. During 1996 big changes have taken place. Both the Commission and the EMI presented forecasts last fall showing that the majority of countries very probably are going to meet the convergence criteria. But I want to point out that it is important not to focus only on individual pronouncements and isolated figures. Forecasters throughout Europe are most likely going to be extremely busy during all of 1997 presenting progress reports on different countries' prospects for participation. What I can say now is that we are not going to know before the spring of 1998 when heads of states and governments sit down and analyse the numbers that they will have at that time on the economic situation of candidate countries. It will then be decided which countries will form the monetary union. Speculating now is therefore not useful. However, it appears more and more likely that there will be more members than we earlier thought.

The convergence criteria do not imply a new direction for Swedish economic policy. Three criteria fall directly within the Riksbank's area, namely, the inflation criterion, the criterion for long-term interest rates and the exchange rate criterion. At the moment, Sweden has the lowest inflation rate in Europe and we expect that Sweden will meet the criterion for inflation in 1997. We will probably also meet the interest-rate criterion. There has been a lot of discussion about the exchange rate criterion. Some think that a country must participate in the exchange rate mechanism (ERM) for at least two years before qualifying for EMU, while others argue that it is the currency's stability in reality that is essential. We would concur with the latter point of view.

With respect to the remaining criteria, the forecast is for the budget deficit to stay near 3 per cent for 1997. The Government has stated that it is prepared to take measures if the deficit develops in an unfavourable direction. However, we will not likely succeed in lowering the ratio between government debt and GNP, which today is about 80 per cent, to the 60 per cent mark as early as 1997. The Maastricht treaty, however, leaves room for a flexible interpretation of this point. For example, it is acceptable for a country to have a debt ratio of over 60 per cent, if it can show a fast and stable enough rate of reduction. All in all it appears that we are actually going to meet the convergence criteria. Of course this makes beginning preparations all the more interesting also for those who earlier were hesitant.

What preparations are we making at the Riksbank then? Well, first and foremost we are participating, along with the central banks in other European countries, in work of the EMI to prepare for the single monetary policy. We are taking part in a

number of working parties that are looking into everything from statistics to monetary and exchange-rate policy and every month the Governor of the Riksbank goes to Frankfurt to participate in the meetings of the council of the EMI. Some ninety projects in which we actively participate are currently ongoing.

In addition we have begun work on the internal changeover at our own bank. We, like all the other banks, must make certain changes, for example, in the EDP systems. Moreover, work is continuing to keep the financial sector informed here at home in Sweden.

The Preparations in Sweden

It is the parliament that will decide on Sweden's membership in the EMU. The Riksbank's contribution is to see that Sweden actually is in a position to join, if the majority in the Riksdag so wishes. That is why preparations are needed even now.

Along with the Riksbank, the Finance Department has its own organisation for the practical introduction of the euro. A fundamental principal is that voluntariness shall prevail. Accordingly, it is up to each organisation to decide itself which adjustments it wants to do. All the parties involved must also solve for themselves the problem they are confronted with as a consequence of the EMU.

The Finance Department is co-ordinating the entire Swedish changeover. To date they have looked at citizens' questions, legislation, business sector and the public sector.

The Riksbank has taken upon itself the task of informing and consulting with the financial sector on questions about the changeover. To accomplish this we have formed a consultative group and five sub-groups to work on the practical preparations together with the financial sector.

One result so far is the report "Euron i den svenska finansiella sektorn - en lägesrapport" (The Euro in the Swedish Financial Sector - a Status Report), which was published at the beginning of February. The report was prepared together with representatives from the financial sector and thus reflects both our view on matters concerning the changeover and the views of another 12 organisations by way of appended commentaries. It is the first report in which a review and a compilation have been done on the EMU preparations in the Swedish financial system.

In this report we drew the conclusion that the preparatory work in the Swedish financial sector has come a long way. Schedules and appropriate solutions have been presented in most areas. It is the Riksbank's assessment therefore that the financial sector will cope well with the changeover to the euro on January 1, 1999. It is also our opinion that joining the EMU later could in certain cases facilitate preparations and in other cases would make them more difficult. The worst alternative would be a long period of uncertainty about our participation, what we usually call a "soft no." In that event double and costly systems would become a reality in several areas. We have also noticed concern within the financial sector about increased costs, competitive disadvantages and risks of different forms of discrimination associated with staying out of the EMU. These concerns were pointed out in our status report and in our commentary on the EU committee report.

Our work with the preparations will proceed during the spring. We have recently sent our status report to some fifty organisations we had not previously worked with to give other interests in society the chance to express their views on the changeover to the EMU. In addition, we have also requested commentaries on the work that we have under way. The responses will be taken into consideration during the spring when we plan to continue the work with a new report.

What Is Going to Change?

What will we notice about the EMU? What changes are going to have the biggest impact on the financial system? What will we as citizens notice? I intend to give a brief review of some of the changes we know are going to happen in a number of important areas.

1. *The Monetary and Exchange Rate Policy*

A single currency implies a single monetary policy. In the EMU, this will be decided by the ECB. The role of the Riksbank and the other national central banks will be to execute this monetary policy. For Swedish banks and other financial institutions, there will probably be no big difference. It is likely that the Riksbank will continue to be their counterparty. The main differences from today will be that the markets for intra day and overnight money will be much larger and that the counterparties will be located all over Europe.

How monetary policy will be conducted has not been decided yet in every detail. Only when the ECB has been created in 1998 will the final decisions be taken. Consequently, it will be the countries joining from the start that will be able to influence what policy will be conducted and how the activities of the new bank will be organised. Already today, there are tendencies for the countries expected to belong to the "core" to have more influence over the process than the rest.

2. *Payment System*

To be able to conduct a single monetary policy one needs a single payment system. Otherwise it will not be possible to handle the payments associated with monetary policy. TARGET is the name of the system which is now being formed and which will connect all the national systems into a common one.

A payment from one bank in, say Gothenburg to another bank in Milano, will normally be executed in a few seconds. Today it often takes a day or more. The main purpose of TARGET is to enable the ECB to conduct monetary policy, but the new system also means the construction of a new "expressway" for commercial payments. To what extent banks and companies will use the system will probably depend on the price. What the costs of using the system will be we do not know yet, but the costs are to be fully covered.

All the national central banks of the EU will be able to join TARGET, regardless of whether they are members of the EMU or not. Discussions concerning the construction of the system clearly show that there is a significant risk that countries outside the euro area will have more limited possibilities to use TARGET, e.g. due to restrictions on intra-day credits in euros, which are essential for the ability to meet variations in the flow of payments. Among other things, it has been discussed that the so called out banks will have to close the system earlier. The Riksbank has acted forcefully against this looming discrimination, but the decision in this matter, as in some others, has been postponed and will now be taken by the countries joining the EMU from the start. TARGET will be tested this summer and will be ready for use January 1, 1999.

3. *Laws*

Everyone must be able to trust that the euro has a sound legal basis. Economic values in for example contracts, bank accounts and pension agreements must be guaranteed between 1999 and 2002, when both the euro and national currencies are in circulation.

Companies and private individuals must be certain that contracts concluded in kronor will be valid also when we have the euro, i.e. in the continuity of contracts. This and many other things are regulated by the so called Euro Regulations. These laws will be directly applicable in all the EMU Member States and will consequently be valid in Sweden if we become members. We will probably also have to change our national laws.

One such national, legal matter concerns the role of the Riksbank. According to the Maastricht Treaty, the Riksbank will have to be made more independent legally. Among other things, it means that the status of the Governor has to be clarified. It must only be possible to dismiss him or her for exceptional reasons, such as grave misconduct. Furthermore, the Riksbank may not receive directions, except by law, from any other party, such as the Government. On the Governing Board of the Riksbank, there are by tradition Members of the parliament. This is in conflict with the traditions prevailing in Central Europe, where an arrangement such as ours regarded as a risk for political interference with monetary policy.

4. *Notes and Coins*

As mentioned, notes and coins will be introduced first in the beginning of 2002. Thus, for some time the commercial sector will have to function with some kind of double price information. The exchange of notes and coins will take place according to a time table decided nationally and the Riksbank hopes that we will manage to do the changeover in a much shorter time than the six months available. The public will be informed well in advance how this is going to be done. Information about security details and appearance will also be given in due course. What we know already today is that we will have seven notes and eight coins. Thus, we will have more denominations than we have today. The coins will have a

national side, where we decide the motif ourselves. Also the notes may display a national symbol.

What Happens in Other Areas?

Securities - Those countries joining the EMU may, and should, make their new issues of government securities in euros. If a country wishes to convert its outstanding debt into euros, that will be allowed too. We can also make it possible for e.g. the Stock Exchange, the OM and the VPC to change over to euros already in 1999. This is what many institutions and players want to do. Participants in the Swedish securities market, banks, financial institutions, VPC, the Stock Exchange, OM etc. unanimously support a "big bang" solution, i.e. a fast and common changeover from kronor to euros already at the turn of the year 1998/1999.

When we get a single monetary policy and the exchange rate risk is eliminated, interest rate differentials between government securities of different countries will only reflect the credit risk. The Swedish market for government securities will be more or less integrated into a euro government securities market. If the debt situation is reasonably similar, government securities of different countries will be traded in a similar way.

We ordinary citizens will be able to choose whether we want to use the euro from the start on January 1, 1999 or if we want to wait until the changeover is completed in 2002. Nobody would be forced to use the euro in this period. However, such use will be encouraged.

The banks have during 1996 been developing strategies and routines for the changeover to the euro. It has been agreed that the banks, the "postgirot", the "bankgirot" and the "privatgirot" will handle both kronor and euros during the transitional period. The cashiers will redenominate a payment in the currency the institution is using in its systems no matter what currency we used as customers. At the banks two kinds of forms will be available, one for kronor and one for euros. New checks and forms for deposits and withdrawals will be produced for this purpose. On our statements of account it will be stated that the currency has been redenominated at the rate xxx. Also the systems of automatic tellers (Bankomat and Minuten) will have to be changed.

The banks will also have to be prepared for private individuals wanting to make their payments in euros as giro transfers already from January 1, 1999. Furthermore, some big companies may want to pay their salaries in euros already before the currency exists as notes and coins. How large the demand for euroservices will be and how quickly companies and individuals will change from kronor to euros is difficult to say.

Finally, there are reasons to believe that the EMU will change the financial map radically. Globalisation, concentration and integration are not new to the financial markets of the world, but it is reasonable to think that the process will be accelerated by the EMU.

Summary and Conclusions

Most of the facts today testify in favour of the economic and monetary union starting as planned on January 1, 1999. For Sweden the question is whether we should join from the start, wait a while or try to stay out for good. My hope is that we can soon have a more lively debate on this very important decision. The discussion should not focus only on the issue of monetary policy independence. It is not just a question of the economy, even if we believe that the economic arguments speak in favour of membership. It is also a question of the fact that the EMU is a vital part of the development of European co-operation in which Sweden is now participating.

– Sweden’s Economy Requires Change

Sometimes one gets the impression from the discussion that staying outside provides Sweden with an easy way to go. Outside this European co-operation we would escape all the adjustment requirements that are being posed. This is not so. Now we must under all circumstances continue our efforts to put government finances on a sound basis and create a long-term confidence in the stability of the Swedish economy. That would hardly be easier outside the EMU. If we are a small neighbour of a large currency we will be closely watched and we will have to behave.

– The World Will Not Be the Same

Saying no to the EMU is not the same as maintaining the status quo. With the creation of a monetary union just outside our borders, the world will not stay the same. Both private individuals and companies are going to be affected by the introduction of the euro regardless of whether we join or not. In our work keeping the financial sector informed about the EMU, we see that their preparations have gone a long way. We also see a strong desire on the part of parties involved that Sweden join as quickly as possible in order not to lag behind. Swedish financial institutions and companies want to have the chance to compete under the same conditions as other European companies and they do not want to risk losing business opportunities.

– A Common Changeover or a Divided Society?

What we risk with being an “out”, which I do not think has been discussed earlier, is the risk of a divided Sweden. The financial players along with the big companies are declaring that they technically speaking “will join the EMU” regardless of whether or not Sweden does. From a competitive point of view, they cannot risk

staying out of a big and influential euro area. At the same time, the public sector and consumer organisations are stating that they want to wait as long as possible. Evidently these statements are coming from, among others, the Finance Department's report on the practical preparations in Sweden.

The question that we should ask ourselves is what kind of society we get if this scenario becomes reality. What does it mean if companies declare themselves for the euro while we citizens continue to live in a world of kronor? Such a development might signify greater losses than moving monetary policy to the ECB. Presumably it would be better if the whole society changed together and at the same time. In any case it is an aspect of the EMU worth discussing.

– Continuing Preparations

Regardless of the political discussion, the practical preparations must continue. Within the EMI they are continuing to solve those problems on which no positions have yet been taken. We are going to continue to participate in this work. Here at home the Government will continue to keep the public informed about its plans and we will continue our work with the financial sector. In the fall we plan to write a new report on the preparations for the EMU. After the Riksdag takes a position on Swedish participation, we are also going to have the opportunity to give clearer and more unambiguous information on what preparations will be needed. We stand facing a dynamic process both in the world around us and here at home.