

Press Release

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Stabilisation policy in the monetary union

Deputy Governor Kristina Persson held a speech today at a conference organised by the Swedish National Financial Management Authority (ESV), under the heading "The Riksbank's views on stabilisation policy following Swedish participation in Stage Three of EMU".

"If Sweden decides to participate in Stage Three of EMU, trade with other EMU countries will become easier, which should mean lower prices and a higher standard of welfare in Sweden in the longer term. It may entail a not insignificant advantage for the Swedish economy in the long run. The focus for the debate in Sweden so far has been the disadvantage of the loss of an own domestic monetary policy, i.e. the responsibility currently held by the Riksbank," said Mrs Persson.

"It is always more difficult to leave behind a regime that is considered to function well than one that is less successful. The Riksbank concludes in its statement regarding the report 'Stabilisation policy in the monetary union' that Sweden should try to retain as many of the considerable benefits of the current regime as possible if we join the Eurosystem. This includes maintaining a clear goal for stabilisation policy, having clear institutional terms and a high degree of transparency and clarity in the decision-making processes."

"There is a risk that the Swedish economy could suffer shocks even after participation in Stage Three. The ECB's inflation target (a maximum of 2 per cent inflation) could in the long term comprise a credible objective for inflation expectations in Sweden. But there is a risk that achieving this could take a long time and prove costly in the form of loss of production capacity and higher unemployment. In the long term, of course, EMU membership could lead to increased mobility in the labour market and increased flexibility in wage formation, particularly if the stabilisation policy proves unable to check large fluctuations in the economy. The difference from our current situation is that we now have exchange rate fluctuations to act as shock absorbers or, in the case of a fixed exchange rate, we could resort to devaluation as an emergency measure. Adoption of the euro would therefore increase the significance of structural reforms that improve the economy's ability to adapt and its long-term competitiveness. If such

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measures were sufficiently successful, the need for stabilisation policy would decline significantly,” said Kristina Persson.

“The Riksbank's opinion is that the government should consider the possibility of using a national inflation target for fiscal policy instead of a target that expresses the difference between potential and actual production. An inflation target is clearer, easier to understand and simpler to assess than a production gap target. Bearing in mind the difficulties associated with a stability-oriented fiscal policy, the Riksbank shares the Committee's conclusion that fiscal policy measures should only be taken in the event of relatively large disturbances. ‘Normal’ fluctuations in the economy should be handled as far as possible by the automatic stabilisers.”

“The Riksbank does not consider that the Committee has convincingly proved that the Swedish net lending target of a 2 per cent surplus in public finances must be raised. It is not possible to separate an assessment of the need for a surplus from an analysis of the optimal size for the central government debt. This requires, for instance, taking into account demographic developments. The net lending target should initially be set at such a level that the optimal size of the debt can be attained during a reasonable time period. With regard to the need for a surplus in public finances to meet the effects of demographic developments, reforms that increase the labour supply and economic growth are preferable to a high net lending target. These can be tax and expenditure reforms, the design of the insurance system, regulations concerning pensions and labour force immigration. The low level for potential growth risks making it more difficult in the long term to maintain good standards of living and welfare in Sweden. Personally, I consider these issues to be much more important than the loss of the national monetary policy,” said Kristina Persson.

“What happens to the Riksbank if we participate in Stage Three of EMU? The fact is that the central banks of Europe have shrunk in size only marginally or not at all since the ECB was established. The explanation for this is that a large part of the central bank tasks are carried out through a network of national central banks, for instance, the implementation of monetary policy, the establishment of a system for large interbank payments, oversight of financial stability, issuing of banknotes and coins and the management of foreign currency reserves. All this is done in co-operation, but through a decentralised system for implementation. And when the governors of the national central banks travel to Frankfurt they take with them reports and analyses of the situation in their own country, in Europe and the world,” concluded Mrs Persson.