

## Sweden and the Euro\*

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*The recent opinion shift in Sweden in favor of entering the Monetary Union need not be stable. The Eurosystem seems to need the Riksbank and the Bank of England in order to reform its monetary-policy strategy.*

The Euro notes and coins were apparently successfully introduced on January 1, 2002, an impressive logistic operation. From a monetary-policy point of view, this introduction does not imply any substantial change. The Euro has already existed as a common currency in the Monetary Union since January 1, 1999, although without the physical form of notes and coins. With irrevocably and credibly fixed exchange rates, the member countries already have a common monetary policy, with a common short interest rate set by the Eurosystem's Governing Council. From a monetary-policy point of view, the effects of the introduction of the Euro are mainly psychological; the common currency becomes physical and concrete for anyone to see.

The introduction of Euro notes and coins could still bring substantial economic effects, with reduced cross-member transaction costs, dramatically increased proportions of prices and transactions denominated in Euro, increased ease of cross-member price comparisons, increased financial integration, and increased competition on markets for goods and services.

The introduction of Euro notes and coins also makes the situation of the European Union members who have not joined the Monetary Union more conspicuous. In Sweden, public opinion has recently changed in favor of entering the Monetary Union, after having been substantially against it for several years. Several reasons for this have been suggested. One is the depreciation and volatility of the *external* value of the krona, the exchange rate (the *internal* value of the krona, the reciprocal of the general price level, has been more stable than ever). Although the krona's external value has depreciated quite a bit since mid 2000, the average depreciation from

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January 1999 to January 2002 is not that large, however. In early January 1999, the krona's so-called TCW index (an effective nominal exchange-rate index computed with so-called Trade Competitiveness Weights) was around 130. In early 2002, it was around 135 (an increase in the index corresponds to a depreciation). The volatility has been substantial, though. In June 2000, the krona reached its strongest level during the period, 120; in September 2001, it reached its weakest level, 145. Interestingly, the krona has on average appreciated somewhat against the Euro, from around 9.5 krona/Euro in early 1999 to around 9.2 in early 2002. I do not find krona movements a convincing explanation for the opinion change. Another reason cited is a more favorable attitude to the Monetary Union by the Swedish Government and signs of some leadership on the issue by the Prime Minister (who has previously been accused of a somewhat hands-off attitude). Furthermore, the introduction of Euro notes and coins may certainly add to the impression of increased permanence of the Monetary Union and perhaps give Swedes an increased sense of undesired isolation from the rest of Europe. I find it difficult to see any very strong reasons for the opinion change, though. In particular, there is little reason to believe that the change will be stable.

The *economic* case for Sweden's entry in the Monetary Union may be finely balanced. The economic advantages of entering include reduced cross-border transaction costs, improved competition in markets for goods and services (including financial services), and resulting increased volumes of trade and direct investment and increased financial integration. The economic disadvantages include the loss of an independent monetary policy, especially since Sweden's trade pattern and industrial structure deviate from the European average. This makes the likelihood larger that shocks hitting Sweden differ from the average shocks hitting Europe, in which case an independent monetary policy comes handy. My own view is that the economic pros and cons essentially cancel out, but that the *political* case for Sweden's entry is strong. The monetary union is an essential part of a policy towards increased economic and political integration in Europe that will, among other things, make future wars in Europe exceedingly remote. I find this a most worthwhile project in itself. Furthermore, it should be in Sweden's own political interest to both support and influence that project by participating fully. Staying outside will unavoidably further reduce and marginalize Sweden's political influence in Europe.

The economic benefit for Sweden of entering would be larger, if it were the case that Sweden on its own would suffer bad monetary policy. Then the loss of an independent monetary policy would be less. Unfortunately for advocates of Sweden's entry, the opposite is the case. Against a history of very poor monetary policy in the 1970's and 1980's, the Riksbank has during the 1990s become one of the three central banks in the world that arguably represent best

international practice when it comes to the combined monetary-policy strategy, institutional setup, and competence of the bank (the other two are arguably Bank of England and the Reserve Bank of New Zealand, see Svensson [2]).

Unfortunately, the Eurosystem has, seemingly with open eyes, chosen a monetary-policy strategy that is substantially inferior to the inflation targeting of the Riksbank. Although the legislated framework is similar for the Riksbank and the Eurosystem (since the Swedish framework is consistent with the Maastricht Treaty), the Riksbank's decision-making body, the Executive Board, is, with six members, small and efficient with, in particular, almost every member highly experienced and qualified, whereas the Eurosystem's decision-making body, the Governing Council, is too large to be efficient, with 18 members, most of whom have no experience of independent monetary policy. Furthermore, the clear and logic role of the published inflation forecast and the transparent to-the-point *Inflation Reports* stand in stark contrast to the confusing two pillars and the muddled, voluminous and largely irrelevant reporting in the ECB's *Monthly Reports*. Clearly, from the view of the likely quality of the monetary-policy decisions, Sweden would not gain from an entry into the Monetary Union.

On the other hand, the discrepancy between the monetary-policy framework in the Monetary Union and that in Sweden and the United Kingdom provides a strong *Monetary Union* case for entry of both Sweden and the United Kingdom. With the addition of the Riksbank's and the Bank of England's competence in the Eurosystem, a critical mass for reform of its monetary policy strategy might be created. So far the Eurosystem seems unable to reform itself; the ECB has instead become further entrenched and fallen back on a book-length defense of its indefensible strategy (Issing, Gaspar, Angeloni and Tristani [1]). When it comes to monetary policy, the Monetary Union needs Sweden and the UK, not the other way around.

## References

- [1] Issing, Otmar, Vitor Gaspar, Ignazio Angeloni and Oreste Tristani (2001), *Monetary Policy in the Euro Area*, Cambridge University Press, Cambridge, UK.
- [2] Svensson, Lars E.O. (2001), "Independent Review of the Operation of Monetary Policy in New Zealand: Report to the Minister of Finance." Available at [www.princeton.edu/~svensson](http://www.princeton.edu/~svensson).