# THE ROAD TO THE EURO

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## A White Paper on the Swedish EMU Accession


Economic Research

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# Contents

# Summary

This “white paper” describes the negotiation procedures and economic policy considerations that will shape Sweden’s preparations to join the EMU currency union. Our purpose is to point out where the possible impediments to the negotiations lie, and how they will affect the timetable. It is not to analyse the advantages and disadvantages of EMU, or to deduce in detail the equilibrium exchange rate of the krona or forecast interest rate developments during the accession process. We will return to these issues in our regular publications.

- Under the Maastricht Treaty, Sweden is formally obligated to join the currency union when the country fulfils the convergence criteria. In the long run, it will be increasingly difficult for Sweden to remain outside. We view membership *de facto* as a matter of time.
- The only “official” **timetable** specified to date is the one that Prime Minister Göran Persson proposed in January this year: A referendum in 2003, leading to Swedish accession to the currency union on January 1, 2005.
- There are two obstacles to this schedule: Sweden’s preparatory **fixed exchange rate period in ERM2** will be too short, and the amendment of certain passages in the Swedish **Constitution concerning the role of the Riksbank** will occur too late.
- There is some negotiating room, of course. The EU Council of Ministers will assess whether Sweden meets the conditions for accession to the currency union. In other words, the **final assessment will be made by politicians**, who have the opportunity to stretch the convergence criteria and soften up their interpretation.
- According to the Swedish prime minister, the **transition to a fixed exchange rate in ERM2** will begin only in early 2004. However, it will be difficult for the EU to accept such a short ERM period. If Sweden’s ERM accession instead takes place during the summer of 2003, this will increase its chances of joining the currency union in 2005.
- **The constitutional issue** should be possible to resolve, provided that Parliament has approved an amendment by the time Sweden applies for membership; it must then approve it a second time after an intervening election. On this point, too, the prime minister’s timetable must be speeded up.
- If both ERM accession and the constitutional issue are handled in this way, Sweden can join the currency union on **January 1, 2005** and introduce euro banknotes and coins one year later. We give this scenario a **45 percent probability**.
- If, on the other hand, the referendum is postponed until the autumn of 2003, and / or ERM accession does not occur until early 2004, **Persson’s timetable will not work**. In that case, accession to the currency union will probably occur one year later, on **January 1, 2006**. We believe there is an overall probability of **75 per cent** that Sweden will be a member by 2006
- If the EU demands a second parliamentary decision to change the Constitution, Sweden cannot join the currency union until **2007**. In that case, the prime minister’s timetable will be delayed by two years. The probability that Sweden will be a currency union member by 2007 is **90 per cent**.
- In our judgement, the probability that Sweden will stand outside the currency union even after 2007 is only 10 per cent.

# 1. EMU's three stages

The Maastricht Treaty entered into force in 1993. It established plans for a single European currency and central bank. The Economic and Monetary Union (EMU) has been implemented in three stages:

1 **The first stage** started as early as July 1990, when movements of capital were set free and the basis for a single capital market was created.

2 **The second stage** began in 1994, among other things with the convergence programme aiming towards low inflation and sound state finances, and with the establishment of the European Monetary Institute (EMI), predecessor of the European Central Bank (ECB). Sweden, too, is participating in the second stage.

3 **The third stage, the currency union** itself, started on January 1, 1999, when the exchange rates between the euro and national currencies were "irrevocably" fixed and the ECB replaced the EMI. Euro banknotes and coins were introduced on January 1, 2002.

On May 3, 1998, the EU countries' heads of state or government decided that eleven countries met the necessary conditions to introduce the single currency. This decision was made against the backdrop of the EMI's and the European Commission's examination of the **"convergence criteria"**. The eleven thus formed the currency union on January 1, 1999. On January 1, 2001, Greece also joined. Today there are thus only three EU countries outside the currency union: the United Kingdom and Denmark, which have **opt-outs** from the Maastricht Treaty, and Sweden – which has no opt-out but did not wish to participate from the start for domestic political reasons. Another twelve countries are negotiating to become EU members, with the intention of eventually also joining the currency union once they have met the convergence criteria. The EU has said that these countries will not be granted opt-outs.

The currency union includes a single monetary policy and central bank. The same key interest rate applies to all member countries. However, there is no common budget policy, which may cause tensions. If an individual country pursues a very expansive fiscal policy with large budget deficits, the result may be high inflation, which could spread and force an interest rate hike that also has an impact on other countries in the currency union. This tightens the requirements for a sound budget policy in each country, so that no individual country will get a free ride at the expense of the others.

To maintain budget discipline, the 1997 Amsterdam summit adopted a **Stability and Growth Pact**. In this pact, member countries agree among other things to respect a medium-term budget target that is "close to balance or in surplus". Deficits may not exceed 3 per cent of GDP. If a country is in danger of failing to meet this budget target, it will receive a warning and be urged to take steps to lower its deficit. If the deficit still remains too large, some kind of fine is possible.

The currency union therefore requires a certain, though limited degree of fiscal policy collaboration. However, EMU includes no rules or ordinances on the harmonisation of tax rates or taxation policy.

### The convergence criteria

Article 121(1) of the EC Treaty states that the following criteria must be examined before the Council decides whether a country may become a member of the currency union:

- **Price stability:** the inflation rate may not exceed by more than 1.5 percentage points the inflation in the (at most) three EU countries that have the lowest inflation during the year before the examination.
- **Long-term interest rates:** may not exceed by more than 2 percentage points the average of the (at most) three above-mentioned countries during the year before the examination.
- **Government deficit:** may not exceed 3 per cent of GDP, unless it has declined "substantially and continously" and reached a level close to 3 per cent, or the excess over the limit is "only exceptional and temporary" and the ratio is still close to 3 per cent.
- **Government debt:** may not exceed 60 per cent of GDP, unless it is "sufficiently diminishing" and is approaching 60 per cent "at a satisfactory pace".
- **The exchange rate**: must have been stable for the past two years. Stability is defined as having kept the exchange rate within the "normal fluctuation margins provided for by the exchange-rate mechanism" ERM for at least two years, without devaluing.

Beyond these economic criteria, there are also **legal criteria** for joining the currency union. A country's national legislation, including the statutes of its central bank (for example, the right to issue banknotes and coins) must be compatible with the statutes of the ECB system and Article 108-109 of the EC Treaty.

# 2. Sweden's relationship to EMU

When Sweden negotiated on EU membership in 1994, it never requested any opt-out like those granted to the UK or Denmark. Instead, Sweden made a unilateral declaration that the decision on its transition to the third stage of EMU would be made by the Swedish Parliament. This does not, however, signify that Sweden is entitled to remain outside the currency union in the long term – even though the other member countries will not force a reluctant member into this union.

In our judgement, **for treaty reasons, Sweden is obligated to join the currency union in the long term. In that sense, accession is a matter of time.** Formally, in fact, Sweden is already a member of EMU (since it has no opt-out clause), even though the country has not yet entered the third stage of the union. The very concept of "becoming a member of EMU" is therefore somewhat misleading, although it is common. In this publication, when we speak somewhat loosely of future Swedish "EMU membership", we are actually referring to joining the third stage of EMU.

In November 1996, the Swedish government presented its report on the economic prerequisites for Sweden's EMU membership – **the Calmfors Commission** report. Its conclusion was that Sweden should wait before joining the currency union, among other things since the country's structural unemployment at the time was too high and the credibility of Swedish monetary policy had not yet been fully established. When the labour market has become more flexible, state finances are stronger and the inflation target is credible, however, Sweden should apply for EMU membership.

At an extra party congress in March 2000, the ruling Social Democrats decided – partly on the basis of arguments from the Calmfors Commission report – that Sweden should join the currency union when **certain criteria are met**, and that the issue should be decided in a referendum. The criteria that were established were:

1 There must be room for a policy that can counteract economic downturns. The **cyclical phases** in the euro zone and Sweden must be reasonably in sync.

2 Swedish **pay increases** must occur at a pace similar to those of the other EU countries. As preparation for any crises, the need for and the design of **"buffer funds"** or other systems should be studied.

Another criterion that Göran Persson established is that the introduction of euro **banknotes and coins** in the twelve EMU countries on January 1, 2002 should occur smoothly.

As part of its preparatory work, the government has also appointed a **new EMU commission** headed by a former deputy finance minister, Bengt K Å Johansson. It will analyse how Sweden will manage its stabilisation policy during a transition to the euro. The commission will examine the effects of EMU membership on budget policy, as well as the need for buffer funds – one of the conditions specified by the congress of the Swedish Trade Union Confederation (LO) if LO is to support Swedish accession to the currency union.

At this writing, the commission has still not submitted its final report, but we assume that it will not recommend any large-scale system of new buffer funds. Instead, we believe that it will advocate a voluntary system of readjustment insurance, managed by Swedish employee and employer organisa-

### The prime minister's EMU timetable

The timetable that Göran Persson presented in January looks as follows:

| | |
|---|---|
| March 2003 | EMU referendum |
| April/May 2003 | Government bill on EMU membership |
| December 2003 | Parliamentary decision |
| February 2004 | Swedish ERM2 accession, membership application |
| May 2004 | Convergence reports from Commission and ECB |
| June 2004 | EU decision on Swedish accession |
| January 1, 2005 | Swedish EMU membership |
| December 2005 | Proposal on constitutional amendment |
| January 1, 2006 | Euro banknotes and coins introduced in Sweden |
| February 28, 2006 | Euro the only legal tender in Sweden |
| Spring 2006 | First decision on constitutional amendment |
| After 2006 election | Second decision on constitutional amendment |

In the following sections, we will discuss this timetable in detail and how it may be adjusted. Some alternative timetables – depending on various assumptions about the outcome of negotiations – will be presented at the very end.

tions. From all indications, the commission will also propose that fiscal policymakers instead be given greater latitude to respond to economic cycles by raising the long-term surplus target (currently 2 per cent of GDP over an economic cycle) to some extent.

# 3. A Swedish EMU referendum

Formally speaking, a Swedish EMU referendum is only advisory. Yet since all parliamentary parties have said that they will respect the outcome of the EMU vote, **in this case the referendum will be decision-making**. It would be devastating to their credibility and to the legitimacy of the decision if one or more parties tried to back away from their pledges regarding a decision-making referendum.

The question, then, is when a referendum can be held. Göran Persson has admittedly stated that public opinion will not determine the date. But he has also said that there is no reason to hold a referendum in order to confirm the existing situation – that is, to remain outside EMU. Our own perception is that **public opinion will determine the choice of date**. A referendum will be announced as soon as a majority of Parliament makes the assessment that the probability of a Yes vote is high. In our judgement, a 55-45 support level for EMU membership over six months is sufficient. However, one sub-condition for the Social Democrats is that they must have LO on their side. The demand for buffer funds must therefore be handled in one way or another that will persuade LO to support the party line.

## How will the referendum be organised?

No Swedish referendum will take place before the September 2002 parliamentary election. After the election, the government – and we are assuming that the Social Democrats will stay in power – will evaluate the **criteria** that were established at the extra party congress. This will also include a follow-up of the Calmfors Commission's recommendations.

We see no difficult obstacles in this. Professor Lars Calmfors, who chaired the Commission, said not long ago that he thinks that Sweden's adaptations of its monetary policy, the labour market etc have been so successful that the advantages of membership now outweigh the disadvantages. The prime minister recently declared that he views the requirement of synchronisation in economic cycles as having been met. Given our own economic forecasts, we see no problems with the requirement that the Swedish **economic cycle** must be in phase with that of the euro zone. The degree of synchronisation between economic cycles increased during the 1990s, which is hardly surprising, since Sweden no longer pursues economic policies that deviate from those of the EMU core countries.

However, there is a slight risk when it comes to **wage formation**. In recent years, Swedish wages and salaries have climbed more than the average for the EMU countries. The Swedish Metal Workers' Union has also threatened to terminate its collective agreements and call for new negotiations this autumn – that is, precisely during the sensitive period when the criteria that were established will be evaluated. However, we believe that the Metal Workers will abstain from terminating these agreements.

One unclear factor is LO's demand for **buffer funds**. Bengt KÅ Johansson's commission will not propose any funds that will satisfy LO's earlier demands.

### The United Kingdom, Denmark and Sweden

Both the UK and Denmark have opt-out clauses from the Maastricht Treaty that enable them to remain outside the currency union and still adhere to the Treaty. Yet it appears reasonable that in the long run, both – like Sweden – will join EMU.

As for the UK, Prime Minister Tony Blair has declared that the criteria that were established for British membership should be evaluated within two years after the last parliamentary election, that is, by the spring of 2003. We believe that the prime minister himself would like to see a British referendum during late spring next year. However, the trend of public opinion is more difficult to predict than in Sweden. Although a British decision would probably have a greater impact on Swedish public opinion than a Swedish decision would have in the UK, we believe that **a Swedish referendum will precede a British one**. One reason is tactical; from all indications, it will be easier to achieve a Yes vote in Sweden than in the UK. This indicates that Persson and Blair have a common interest in letting the Swedish referendum precede the British one.

Denmark has already voted No to EMU – in fact, twice – yet the krone is pegged to the euro in the EU's Exchange Rate Mechanism (ERM). If Sweden or the UK should vote Yes, however, there is a high probability that Denmark will announce a new referendum and follow its neighbours into the currency union.

### What will the parliamentary election mean?

The outcome of the parliamentary election in September this year may have some importance to the timetable. At the present time, the Social Democrats enjoy a clear public opinion lead. In our analysis, we have assumed a continued SDP government. If the election should result in a non-socialist majority, the process leading to a referendum will hardly move faster. On the contrary, it may take a somewhat longer time, for two reasons.

- Firstly, so far the Centre Party has been sceptical of EMU, so a new non-socialist coalition government must first resolve any internal disagreements. The non-socialist parties have so far made no joint statement on the issue. In the latest public opinion surveys, however, a larger number of Centre voters are saying Yes to EMU than No (in the other non-socialist parties a clear majority favours EMU).
- Secondly, it is not entirely clear how the SDP and LO would handle the EMU issue if the Social Democrats end up in opposition. In that case it might be tempting to raise the stakes in the demands for a buffer fund system.

However, it is not certain that the negotiations to prepare a referendum need be much more prolonged than if the SDP stayed in power. In purely practical terms the prime minister, regardless of political colour, will summon the heads of the other parties for talks. It is likely that at least the Moderates, Liberals and Social Democrats will want a referendum in the spring of 2003 even if a non-socialist government were in power – provided that public opinion surveys show stable support for EMU.

Given a Social Democratic government and favourable public opinion, a referendum may thus occur in the spring of 2003. Given a non-socialist government, it may take somewhat longer, if the buffer funds lead to a battle. But even in this case, it is fully possible to organise a referendum no later than the autumn of 2003.

Nevertheless, we believe that the government will meet the unions part of the way, perhaps with support for some form of readjustment insurance.

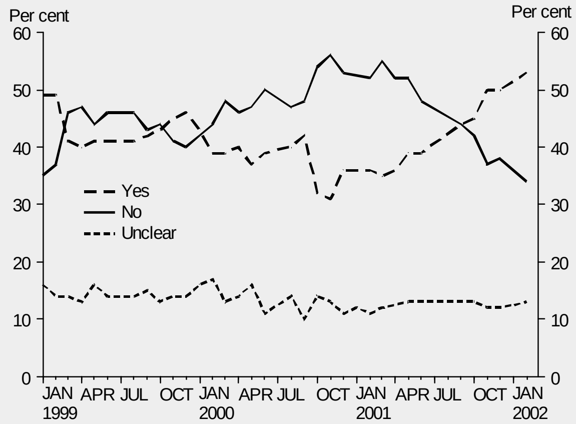
Despite certain risks, we thus believe that this autumn, the government will conclude that the criteria have been fulfilled. This will make it possible to proceed with **preparations for a referendum**. An informational and educational campaign about EMU will have to be implemented. The actual date of the referendum will be discussed in **talks between political party leaders**, which will also deal with campaign financing and how the alternative responses on the ballot should be formulated.

- It should be observed here that Sweden is already part of the second stage of EMU. Asking "Shall Sweden join EMU?" is therefore not legally correct. One possible formulation can instead be "Should Sweden replace the Swedish krona with the euro?"
- As for the date of the referendum, there will be different views. Some people want a long campaign period, while others – perhaps wise from the experience of Denmark, where public opinion had time to shift against EMU during the campaign – want a shorter period.
- If public opinion is favourable to EMU, the talks will take place relatively soon after the 2002 election. Since so many party chairmen have already declared themselves in favour of a referendum during the spring of 2003, they should also reach a consensus on the arrangements rather quickly.

After that, the government can write a bill concerning a **special law on an EMU referendum**. It must then be adopted by Parliament. This process will take about 1½ months. Once the date of the referendum has been set, the informational campaigns will need to start as soon as possible, if the Swedish people are to vote on EMU as early as the spring of 2003.

Since numerous pieces of the puzzle obviously need to fall into place, we believe that the **referendum will be scheduled for April 2003**, rather than March. There is also a minor risk that the referendum will be

### EMU public opinion




Source: Demoskop

After the Danish referendum, the No side made dramatic gains. During 2001, public opinion gradually swung back to a Yes plurality. The introduction of euro banknotes and coins subsequently bolstered the pro-EMU side further.

postponed until the autumn of 2003 if more than one of the issues we mentioned should take a long time and thereby leave little time for the informational campaign. Since both the Left Party and LO want long campaign periods, this might cause the prime minister to choose a later referendum date, so as not to make the date itself a bone of contention. However, in the final analysis, the public opinion situation will be decisive.

## The trend of public opinion

Swedish public opinion on the EMU issue has fluctuated sharply in recent years. When EMU began its third stage in January 1999, the pro-EMU side was ahead – during a period of "europhoria" – but during 2000, when Denmark voted No, public opinion quickly swung back to a No majority. For the past few months, the pro-EMU side has again been leading, and since the beginning of 2002 a clear majority of Swedes have said in several public opinion surveys that they would vote Yes to EMU.

There are several reasons why the pro-EMU side is now leading again. The Swedish krona has been weak over a long period. The introduction of euro banknotes and coins at the beginning of 2002 went smoothly, and the Swedish EU presidency last spring put EU issues in sharper focus. The prime minister has clearly declared his support for accession to the currency union.

Of great importance is the weak krona, combined with the current physical existence of the single currency in all euro countries. This is having a significant psychological effect. In our view, this shift in public opinion will result in a **lasting Yes plurality among the voters** – a lead that will be confirmed by recurrent public opinion surveys. We therefore believe that public opinion supports a timetable featuring a referendum in April 2003.

But there are, of course, factors that may cause public opinion to swing back.

- One such factor might be the **value of the krona** – as the krona strengthens in the run-up to Swedish EMU accession, this may paradoxically cause the No side to gain ground again.
- Another risk would be if the EU **enlargement process** and EU budget issues create conflicts. New quarrels and sandbox arguments between EU leaders (like the recent debate on where to locate the head offices of EU agencies) may throw unfavourable light on the entire European project, as Sweden's EU dues meanwhile increase in conjunction with the enlargement. Also, the debate preceeding the next Inter-governmental Conference is about to start. If strongly **federalist rhetoric** should dominate the debate, this may strengthen the No side.
- The most obvious risk that might shift Swedish public opinion towards an anti-EMU plurality is if economic growth in the euro zone were to develop clearly worse than in Sweden. If the Swedish economy should recover rapidly while the **recession in Germany** deepens, the euro will naturally appear less attractive.
- If Germany in the future, however unlikely, receives a sharp reprimand – or in the worst case is ordered to pay a fine as provided by the **Stability Pact** due to excessive budget deficits – this may have a negative impact in Sweden. The No side would see this as evidence that a nation that joins the currency union not only loses power over its monetary policy, but is also stripped of its influence on fiscal policy. This would probably strengthen opposition to EMU based on fears of surrendering national independence.

In other words, the arguments in Sweden's public discourse will be both economic and political. In the run-up to the latest EMU referendum in Denmark, the Danish government made the mistake of focusing entirely on economic arguments, while the public largely embraced the No side's political arguments against EMU accession. However, the question of the need for a supranational fiscal policy has already come up in the Swedish debate, and this may indicate that the Swedish government will deal with the issue differently to the Danes. Another difference, compared to the Danish situation in 2000, is of course that euro banknotes and coins are now making the EMU project appear more concrete.

# 4. The parliamentary decision and membership application

If the Swedish referendum leads to a Yes vote, the next step will be a **government bill on the transition to the euro**. This will be followed by a parliamentary decision, in which **Parliament will authorise the government to submit an application** for membership of the currency union to the EU.

According to the draft timetable that the prime minister presented in January, Parliament will not vote on a membership application until December 2003, that is, more than six months after the referendum. It is difficult to understand why. On the contrary, we believe that this procedure can move relatively fast – in a month or so. Provided that the April referendum results in a Yes vote, it should be possible for Parliament to vote on the issue before its summer recess begins in **mid-June 2003**.

A separate government bill could also be submitted on the constitutional amendments that the ECB and the European Commission have urged Sweden to carry out (on the role of the Riksbank: see also Section 8 below). Constitutional amendments require two parliamentary decisions, with an intervening election. In our opinion, a first pending decision should be made even before a Swedish application is submitted, while the second parliamentary vote will have to wait until after the 2006 election.

### If Sweden votes No

If the referendum results in a No vote, the EMU process will grind to a halt. Sweden should then initiate a discussion with the rest of the EU about how long a country without opt-outs from the Maastricht Treaty can stay outside the currency union. This will also put a number of economic policy issues on the agenda: If the people have said No due to their desire for a different economic policy, what implications will this have on inflation targets, budget policy etc? These questions lie outside the limits of this white paper; let us merely state here that for our own part, we are convinced that today's Swedish macroeconomic policy – with inflation targets, budget surplus targets and a floating exchange rate – will remain unchanged in that case.

# 5. Joining ERM2

To enable Sweden to become a member of the currency union, its exchange rate must first have been stable. According to the convergence criteria, this stability must have lasted for two years. In concrete terms, this means that during a preparatory period, Sweden must be part of the **ERM2 exchange rate** system, pegging the krona to the euro in a fixed exchange rate arrangement. The system is formally known as ERM2, to denote that the ERM was overhauled after the foreign exchange crises of the early 1990s. For the sake of simplicity, however, we will henceforth call it ERM (the Exchange Rate Mechanism).

In principle, Sweden can join the ERM even today, but since this would be interpreted as a government pre-emption of the outcome of the EMU referendum, no ERM accession will occur until after the referendum. According to the prime minister's timetable, the Swedish krona will join the ERM only in February 2004 – ten months after the referendum has taken place (in March 2003, according to his schedule). This delay may have two conceivable causes:

- Firstly, he hopes to have the flexibility – in case of unfavourable public opinion figures – to **postpone the referendum** until the autumn of 2003, but still be able to stick to the rest of his timetable.
- Secondly, **Sweden wants as short an ERM period as possible**, since the fixed exchange rate phase implies putting stabilisation policy in a new situation where it must achieve both low inflation and a fixed exchange rate. The EMU countries, however, want to ensure that the Swedish krona has been stable for a longer period before joining EMU.

## Negotiations on the exchange rate

Accession to the ERM is subject to a special procedure, apart from regular EU decisions. According to Swedish law, the **government makes the decisions on the exchange rate system** (that is, on the transition from a floating to a fixed exchange rate), while the **Riksbank handles the practical issues** and decides the central rate and the width of the fluctuation bands. In reality, however, the Riksbank does not decide this on its own; Sweden's negotiating position will be decided in consultation between the government and the Riksbank. In addition, the actual decision will evolve after negotiations with the EU, which obviously also has opinions about both the exchange rate and the width of the fluctuation bands.

When the time comes for Sweden to peg the krona to the euro, negotiations will occur in the **Economic and Financial Committee** (EFC), as provided by the 1997 Amsterdam resolution establishing the ERM2. The EFC is the EU agency that prepares the meetings of the finance ministers in the Council. The European Commission provides economic documentation. At the present time, Sweden is represented by Sven Hegelund, under-secretary of state in the Finance Ministry; and Lars Heikensten, deputy governor of the Riksbank.

According to the Amsterdam resolution, decisions on ERM accession and central rates shall be made unanimously by the euro zone finance ministers, the ECB and ministers and central bank heads from non-euro zone countries that participate in the ERM (only Denmark today) after negotiations in the EFC. Representatives of the non-euro zone countries that

## A digression: Challenges to stabilisation policy during the ERM phase

The period when Sweden is part of ERM, as a preparation for joining the currency union, will raise a number of difficult stabilisation policy issues. Today Sweden has a floating exchange rate; the krona fluctuates against other currencies. The Riksbank's objective is price stability, which in concrete terms means keeping inflation at 2 per cent. In other words, the exchange rate is no objective in itself; on the other hand, a weak krona can obviously become a problem if it causes import prices to climb so much that the inflation target is threatened.

This will change when Sweden switches to a fixed exchange rate. **The Riksbank's task will then be to keep the krona firmly at the established central rate against the euro** (with a little room for fluctuations – see below).

**Meanwhile Sweden must meet the convergence criterion concerning low inflation** (no more than 1.5 per cent above the three EU countries with the lowest inflation). It is unclear what the relationship will be between this target and the Riksbank's current inflation target, but it is reasonable to assume that the convergence criterion will be fulfilled if inflation is kept at the 2 per cent that is today's target. It is therefore possible to argue that even during the period of Swedish participation in the ERM, the Riksbank will retain its current inflation target, both since it is well known and established and since this will ensure that the convergence criterion concerning inflation will be met.

Yet this is not uncomplicated. In this situation, Sweden would be operating with two monetary policy objectives: a fixed krona exchange rate against the euro plus price stability. This is not desirable, since it is normally difficult to use the same policy instrument – in the Riksbank's case, interest rates – to achieve two objectives.

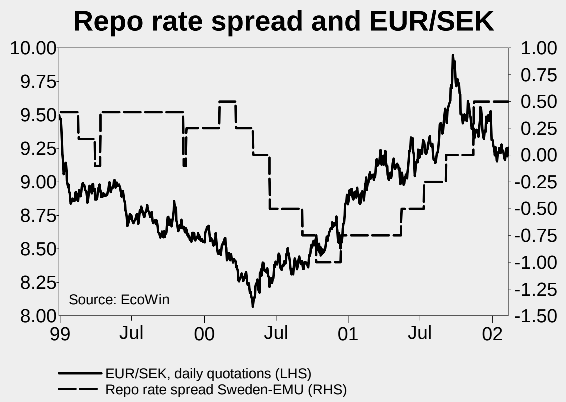
How to resolve this has not been discussed in Sweden so far. Two alternatives are hypothetically conceivable:

- *Either* that the Riksbank completely prioritises the exchange rate objective and hands over inflation fighting to Sweden's fiscal policymakers. If interest rate adjustments to keep the exchange rate stable come into conflict with the inflation target, monetary policy must thus be offset by fiscal policy. This policy mix is not altogether easy to manage, especially since fiscal policy must also contribute to the task of stabilising the real economy over an economic cycle.

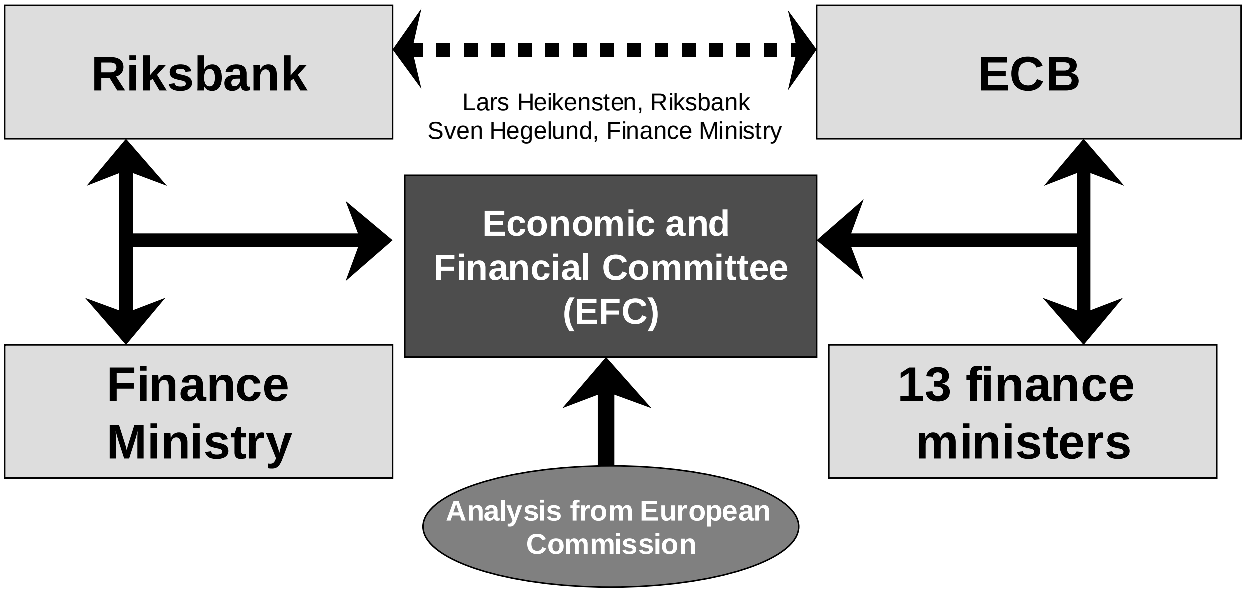
- *Or* that during the ERM period, the Riksbank shoulders the dual task of keeping the exchange rate stable and at the same time meeting the inflation criterion. But here, too, goal conflicts may arise. If, for some reason, inflation should accelerate in a way that threatens the inflation target, the repo rate must be raised to cool off the economy – even if the krona shows no signs of weakness at that exact time. And if foreign currency outflows should threaten the krona for some reason, the interest rate must likewise be raised – even if inflation is low at that time. This is because both objectives must be met if Sweden is to fulfil the convergence criteria.

The fixed exchange rate period thus requires **fresh thinking in stabilisation policy**. If fiscal policymakers are assigned greater responsibility for inflation, the situation will become more complicated for the Finance Ministry. If monetary policymakers retain responsibility for inflation, it is the Riksbank that faces a more difficult existence.

If the Riksbank should retain responsibility for inflation, according to the above analysis this would pose a risk that interest rates, all else being equal, may be somewhat higher during the fixed exchange rate period.




That risk is also apparent in the above chart, showing the repo rate spread between Sweden and the EMU area as well as the exchange rate between the krona and the euro in recent years. It indicates that precisely during the period when the Riksbank's repo rate was below that of the ECB, the krona weakened against the euro. Admittedly we believe that other factors besides the interest rate spread contributed strongly to the weakening of the krona – portfolio reallocations by the National Pension (AP) fund system, Ericsson's share prices etc. But the chart still serves as a reminder to those who believe that Swedish preparations for EMU will automatically mean lower interest rates.




do not participate in the ERM (today the UK) may participate but not vote. In practice, **the agreement is signed at the EFC upon authorisation by the finance ministers** – after the negotiators have consulted with their respective "home bases". In other words, the negotiations in the Economic and Financial Committee are decisive.

When the current twelve EMU countries joined the currency union, their central rates were immediately and irrevocably fixed, when the national currencies were abolished after the ERM period and replaced with the euro. This means that the choice of central rate in the ERM will be decisive to a country's competitiveness and import price impulses for a long time, even after EMU access. The central rate may be changed during the period in the ERM, but so far this has only happened in two cases (Ireland and Greece). According to the Treaty, such a change may not involve a devaluation of the currency.

It is therefore not surprising that earlier negotiations on central rates have sometimes assumed a harsh tone. The formal negotiations between Sweden and the EU are likely to be preceded by a number of informal contacts in order to ease the process. The purpose of the negotiations, of course, is to find an exchange rate that is sustainable in the long term. Equilibrium calculations, historical trends and the market exchange rate must be weighed together at the time of the negotiations.

If the negotiations go smoothly, a decision can be made quickly. We are assuming that the two negotiating sides have an interest in ensuring that the process moves rapidly, if not otherwise to avoid market nervousness. In that case, the negotiations can be completed in a few weeks. This would mean that the **krona could join the ERM system no earlier than around July 1, 2003**.

The customary fluctuation band in ERM2 is ±15 percent. However, Denmark – currently the only participating country – has established a fluctuation band of ±2.25 per cent under an agreement between the ECB and the Nationalbank, the same that applied before the currency crises of the early 1990s. On top of this, the Danish central bank customarily keeps the krone even more tightly linked to the central rate than this narrow band allows.

When the various convergence criteria were written into the EC Treaty, the standard fluctuation band was ±2.25 per cent. The European Commissioner for Economic and Monetary Affairs, Pedro Solbes Mira, has also declared that he regards this narrow fluctuation band as the natural one in Sweden's case. It is therefore probable that 2.25 per cent will be the starting point of the Commission's and the ECB's assessments of whether the Swedish krona meets the exchange rate criterion. More concretely: **If the band is set at ±2.25 per cent and the central rate is fixed at 8.60, the interval between which the krona is allowed to fluctuate will be 8.79-8.41.**

### What krona exchange rate?

The choice of central rate in the ERM is of great significance. Granted, a weak krona will support exports. But it will also create inflationary impulses. A strong krona involves a corresponding risk of slower growth. The exchange rate that is finally chosen will be negotiated via several different methods of assessment.

One is economic estimates of the krona's **equilibrium rate** against the euro, that is, the rate that is "correct" in various economic respects in the long term. The problem, however, is that there are several different – partly contradictory – methods for determining this "correct" exchange rate, and none of them appears especially self-evident. For example, we can try to calculate a krona exchange rate that would yield equilibrium in the current account, while keeping the domestic economy in some semblance of balance. Another method is to assume an exchange rate that is compatible with the long-term inflation rate in each respective country. A third method is simply to try to eliminate what is considered short-term currency fluctuations from the long-term trend, and base the exchange rate on the latter.

A number of years ago, the Riksbank's economists published an analysis stating that the krona's equilibrium exchange rate in terms of TCW (indexed against the currencies of all trading partners) at that time would be between 109 and 118, that is, clearly stronger than today. Since then, however, the krona has shown a weakening trend. The Riksbank's October 2001 Inflation Report presented a new calculation of a "trend rate based on relative GDP and terms of trade". This can be interpreted as a kind of equilibrium exchange rate, even though the bank did not use that exact concept. Last autumn this rate, according to the Inflation Report, was about TCW 122 – nearly a 10 per cent appreciation from today's level. Given the euro-dollar exchange rate that SEB anticipates in the near future, this calculation of the equilibrium exchange rate would yield a central rate of SEK 8.30-8.40 against the euro.

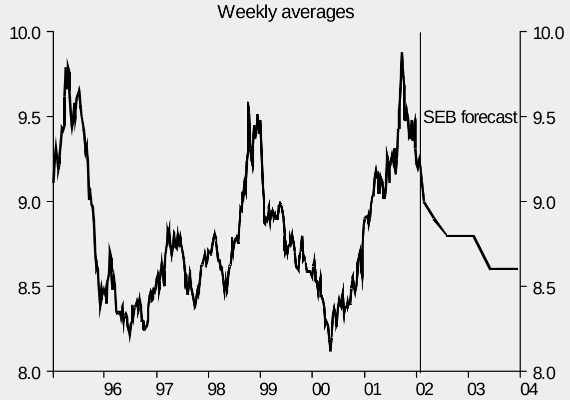
Other observers have made other estimates of where an equilibrium exchange rate may conceivably lie. The Confederation of Swedish Enterprise has argued that the equilibrium level of the krona is clearly weaker than according to the Riksbank's calculations. It estimates that a Swedish central rate against the euro should be around SEK 8.90.

In addition, various **politically coloured assessments** are factored in during negotiations. We thus assume that the Finance Ministry may conceivably want a somewhat weaker krona exchange rate than the Riksbank, in order to provide greater support to the Swedish export sector and employment. On the other hand, it is likely that the EU in turn would like to see a relatively strong krona.

Finally, the **current market exchange rate** is also important. During preparations for ERM membership, if the krona has shown orderly pre-accession movement to a level reasonably close to those being discussed in the EFC, and has stayed there for a while, there is a high probability that the market exchange rate will strongly influence the choice of central rate. This has been true for the countries that have previously joined the ERM. The run-up to the ERM is naturally a good time for both the Swedish side and the EU to try to influence the market exchange rate through various statements, and by publishing studies about the equilibrium exchange rate etc – thereby gently "nudging" the exchange rate towards the levels being negotiated. However, you should remember that the referendum may cause a certain "risk premium" which prohibits the market rate to move all the way to the perceived central rate long before the ERM entry.

**SEK vs euro**

Weekly averages




Sources: EcoWin, SEB

Today most market observers expect the krona to be pegged to the euro somewhere in the SEK 8.30-8.80 interval. Our own long-time opinion, based both on an estimate of where a reasonable long-term exchange rate lies and an assessment of how the political negotiations will turn out, is that the **central rate will be set at about 8.60.**

# 6. How much time in the ERM?

We assume that Sweden's negotiators in the EFC want to have a fixed exchange rate for as short a time as possible. The reason is that the ERM period may cause problems, since the fixed exchange rate must be defended at the same time as the inflation criterion must be met. However, the other EU countries are keen on the krona having been stable for a long period before accession to the currency union.

The starting point here is the convergence criteria that form the basis of the examination of Sweden's application for membership of the currency union.

These criteria (see the box in Section 1 above) stipulate that the exchange rate must have remained within the normal ERM fluctuation margins for at least two years without devaluation.

**The critical question is how "two years" should be defined**. Formally, what counts is the period until the Commission and the ECB examine, in their convergence reports, how well Sweden fulfils the convergence criteria. We have assumed above that Sweden will submit its membership application no earlier than the summer / autumn of 2003, after the EMU referendum and the parliamentary decision. It will thus be possible for the ECB and the Commission to evaluate Sweden's application during the winter and spring of 2004. At the time of the publication of the convergence reports during the spring of 2004, given a strict interpretation of the criterion, Sweden must have been an ERM member since the spring of 2002. If ERM accession should occur as late as February 2004 (according to Göran Persson's timetable), Sweden's period would thus be extremely short – only one or a few months.

There is some flexibility. It is the EU Council of Ministers that makes the decisions on accession to the currency union, and according to the EC Treaty the Council has some authority to modify the formal criteria. When EMU was established two countries, Italy and Finland, had been ERM members for less than two years (they were about half a year short at the time of their convergence evaluations in the spring of 1998). Also important to the evaluations by the Commission, the ECB and the finance ministers, of course, will be **how stable the krona was against the euro *before* the ERM peg**. The faster the process of adjustment to the central rate and the longer the krona was stable before ERM accession itself, the shorter the ERM membership period that will presumably be acceptable.

The problem here is that foreign exchange markets must reasonably assign a certain risk premium to the EMU referendum. Although, in our judgement, the krona will appreciate significantly during the coming year, the final adjustment to an intended central rate is not likely to occur until after the referendum, when the political risk premium has disappeared.

We doubt that EU leaders and finance ministers are inclined to accept a Swedish ERM accession only a month or so before the convergence criteria are evaluated. This seems like a rather major deviation from the two-year rule. One reason is that **a clear exception for Sweden runs the risk of setting a precedent**. It is fully possible that ten countries will be negotiating for EMU membership only a few years after Sweden. In that situation, both the Council, the ECB and the Commission probably want strict rules. To the extent any country can insist on special treatment, it is the UK, with an economy many times larger than Sweden's and with its own global currency. In the particular case of the UK, we believe that the EU can accept significant compromises – but this is hardly true of the krona.

**Here is the greatest risk that Göran Persson's timetable will not work**. It is also the point on which our own timetable deviates most clearly from the prime minister's. We draw the conclusion that **if Sweden is to join the currency union on January 1, 2005, the krona must become part of the ERM before the February 2004 date that Mr Persson has proposed.**

The earliest possible date for this is in **June 200**3, if a referendum approving Swedish membership of the currency union has occurred in April. In that case, Sweden would have had time to participate in the ERM for about 10 months by the time the convergence reports are drafted. If EMU accession should occur in January 2005, according to the prime minister's timetable, the ERM period will total about 18 months. This is also shorter than the Maastricht Treaty stipulates, but we believe there is a great likelihood that the EU countries would accept this arrangement, especially if the foreign exchange market has started to move the krona closer to the expected central rate by the spring of 2003.

# 7. Convergence reports and EU decision

Under the procedure specified in Article 122(2) of the EC Treaty, EU countries that are not yet participants in the currency union shall be examined at least once every second year, or at the request of the country in question, to evaluate whether they meet the convergence criteria. Once Sweden has applied for EMU membership and joined the ERM, the next step will thus be for the Swedish application to be processed by the EU. The decisive question will then be whether Sweden meets the criteria in the Maastricht Treaty (see the box in Section 1 above).

According to the procedure described in Articles 121-122 of the Treaty, the Commission and the ECB will report to the Council on how well the applicant country meets the convergence criteria. Then the **Council of Finance Ministers (Ecofin Council) will decide on the basis of the Commission's proposal** whether the country can join the third stage of EMU. This will be done after input from the European Parliament and deliberations in the European Council. Ecofin must make the final decision by a qualified majority.

The EU's decision on Sweden's EMU membership will thus be decided by the currency union's finance ministers, after the Commission and the ECB have passed judgement on how well Sweden fulfils the convergence criteria. Even if the finance ministers have the Commission's and the ECB's reports as documentation, in other words a **political decision determines the final outcome**. As indicated in our discussion of the exchange rate criterion, we also believe that under the Treaty there is some room for flexibility in interpreting the convergence criteria.

An application to join the currency union may be submitted either in conjunction with the convergence examination that occurs every second year (the next time will be in the spring of 2004) or if the Swedish government writes a letter to the Chairman of the Council requesting a special examination. Altogether, the entire procedure including a review of criteria and decision-making, is likely to take about 5-6 months.

In conjunction with the adoption of the Swedish convergence programme, on January 15, 2002 the European Commission stated that **all convergence criteria have currently been met, except for the exchange rate criterion and the legal criterion** concerning the role of the Riksbank. On January 22, the Ecofin Council approved the Swedish convergence programme, limiting itself to stating that the exchange rate criterion had not been met (the legal aspects were thus not raised this time).

As indicated above, we believe that if Sweden joins the ERM in the summer of 2003 – but not in February 2004 – this is sufficient to enable the Council to be somewhat flexible about the formalities and view the exchange rate criterion as having been met. What, then, is the situation with regard to the Constitution and the role of the Riksbank?

**Time frames for assessment and decision-making on EMU membership**

| | |
|---|---|
| 3-4 months | Preparation of convergence reports by the Commission and the ECB (according to the convergence criteria protocol, the statistical data used to determine convergence must be provided by the Commission and not the country in question). |
| 2 weeks - 1 month | Discussion and decision in the European Parliament concerning the convergence reports of the Commission and the ECB. |
| First possible meeting | Deliberations in the European Council (heads of state or government) on the convergence report. |
| First possible meeting | Decision on accession to the currency union by the Ecofin Council. An Ecofin meeting can be held in conjunction with the European Council meeting in order to speed up the process. |
| Altogether: | The whole process will take about 5-6 months. |

# 8. The Constitution

In Sweden the function and authority of the Riksbank are regulated, among other things, by one of the four documents comprising the national Constitution: the Instrument of Government, Chapter 9. The 1998 convergence reports of the EMI and the European Commission clearly state that some portions of this chapter must be amended, among other things with regard to responsibility for monetary policy and the monopoly on issuance of banknotes and coins.[1] If Sweden is to join the currency union, the tasks assigned today to the Riksbank must be moved to the ECB. **Swedish EMU membership thus presupposes amending the Constitution**.

In March 1998 the EMI and the Commission submitted reports that provided the basis for the European Council's decisions on what countries could be part of the currency union starting in 1999. In its assessment of Sweden, the EMI and the Commission noted that Sweden had not implemented these legal changes and was not participating in the ERM. Sweden thus did not meet all the convergence criteria and could not become a member of the currency union from the start.

The sections of the Instrument of Government that the EU singled out at that time have still not been changed. Since this involves amending the Constitu-

[1] The three sections in question are found in the Instrument of Government, Chapter 9, Article 11: The Government is responsible for general currency policy questions; Article 12: The Riksbank is the central bank of the Realm and an authority under the Riksdag. The Riksbank is responsible for monetary policy. No public authority may determine how the Riksbank shall decide in matters of monetary policy; and Article 13: The Riksbank alone shall have the right to issue coinage and banknotes.

tion and therefore requires **two parliamentary decisions with an intervening election**, it will be difficult for Sweden to formally meet the legal criterion – as the Commission and the ECB view it – in case of an EMU application in 2004. An initial pending decision to amend the Constitution may admittedly have been made by that date, but the constitutional amendment itself may not be approved until after the next parliament election in 2006 – which is *after* Sweden, according to the prime minister's timetable, has become a member of EMU.[2] According to Göran Persson's own timetable, the first decision about the amendment to the Constitution will actually be made as late as the spring of 2006, in other words long after the Council will have dealt with the Swedish application; indeed, more than a year after Sweden has joined the currency union.

So will the prime minister's timetable fail, due to the Constitution? The answer from the Cabinet Office is No. In an internal memorandum, the Directors-General for Legal Affairs of the Finance and Justice Ministries and the Prime Minister's Office have argued that no amendment to the Constitution is formally needed, but instead **EC law will take over**. However, they feel that an amendment is still desirable, and should be implemented after an EMU referendum. The chief legal counsel of the Riksbank, on the other hand, has argued that the Swedish Constitution should be amended to be compatible with EC law.

The European Commission and the ECB – which prepare the convergence reports – have been clear with regard to the legal criterion. However, just as in the case of the exchange rate criterion, this is a matter on which the final decision will be made by the EU's finance ministers, who also take politics into account. This question, too, will thus be resolved in a tug-of-war between legal and political considerations.

So far, Sweden has been good at gaining acceptance of various exceptions in EU contexts. But here, too, there are problems related to the EU's eastward enlargement. In only a few years, a number of countries from Eastern and Central Europe will be moving close to EMU membership. As a result, **the current EMU countries may not be keen on granting precedent-setting exceptions**. Perhaps we should also point out that it is certainly not the world's best negotiating tactic for Sweden, as now seems to be happening, to disagree totally with the ECB on the closely related issue of the size of the Riksbank's capital base.

Also worth recalling is that all of today's member countries met this legal criterion when they joined EMU. However, there were other legislative criteria that were not entirely fulfilled by all the applicant countries. At that time, however, it was a matter of small imperfections or of measures that these countries would have time to implement before they joined the currency union.

We therefore do not believe that the prime minister's timetable will work, as it looks now. Nonetheless, in our judgement the politicians in the Council will arrive at a **compromise**. One such compromise, we believe, is that **as soon as possible after a referendum, the Swedish Parliament will make the first of the two decisions needed to amend the Constitution**, so that there is a pending constitutional decision when Sweden submits its membership application. Then there will be a good chance that EU leaders and finance ministers will find a way to **let Sweden in, even though the final parliamentary decision to amend the Constitution has not yet been made.**

### Is there a risk that Sweden will not meet other convergence criteria?

We have pointed out Sweden's current problems in fulfilling the legal criterion and the exchange rate criterion in time to become an EMU member on January 1, 2005, in accordance with the prime minister's timetable.

However, one should not entirely neglect the risk that other convergence criteria may also end up in the danger zone. In the case of budget deficits and central government debt, we regard the risk as insignificant. Given our own GDP growth forecasts, we see no risk of large budget deficits. But concerning **inflation**, one should not entirely disregard the risk.

The inflation criterion is formulated in such a way that the inflation rate during the year preceding the convergence examination may not be more than 1.5 percentage points higher than the average inflation for the three EU members that have the lowest rate of price increases. Purely hypothetically, it is not at all impossible that three countries will show inflation clearly below 1 per cent. If Sweden in 2003 should again have inflation at today's level – around 3 per cent – it will thereby not meet the inflation requirement.

Our own forecast is that underlying inflation in Sweden during 2003 will amount to 2.1 per cent. According to our calculations, this suffices to meet the inflation criterion by an ample margin. However, the purpose of this box is to remind the reader that it is not a foregone conclusion that this will occur. For this reason, we should be prepared for the Riksbank to show extreme vigilance and resort to its interest rate weapon every time there is an indication that the convergence criterion on inflation is threatened.

[2] There is admittedly a chance of obtaining a dispensation from the rule that government bills on amending the Constitution must be submitted at least nine months before the election, but if an initial decision has been made, one third of the members of Parliament may request that the decision be approved in a decision-making referendum that must be held on election day – something that the government wants to avoid.

# 9. Accession to the currency union

The prime minister's timetable is based on **Swedish EMU accession on January 1, 2005** – assuming that the Council has approved Sweden's membership application in 2004. There is admittedly nothing that says Sweden must become a member precisely on January 1, but this is clearly the most practical date in terms of accounts, tax systems and tax returns etc. The beginning of the year is thus the date that all current members have chosen.

Any **difficulties in meeting the exchange rate criterion when the EU Council's decision is taken during the spring of 2004 would therefore force Sweden to wait for EMU membership until January 1, 2006,** instead of January 1, 2005 as Mr Persson has proposed. We thus do not think that it is practical to postpone Sweden's actual EMU accession by a few months or half a year; January 1 is the right date. This further underscores the importance of joining the ERM in time; a six-month delay in ERM accession may cause membership of the currency union to be delayed by a full year.

It is also worth recalling that Swedish companies and public agencies need time to **prepare their transition** to the euro. After all, joining EMU means that the euro will formally become Sweden's legal tender. It is true that krona banknotes and coins will remain during a transition period, just as today's euro countries kept their old currencies between 1999 and 2002. But these notes and coins will only be a temporary, national variant of the euro, irrevocably fixed to the single currency through the conversion rate established upon accession to the currency union. When Sweden joins the currency union, the euro will also become the valid currency for electronic foreign exchange dealing and trading in government bonds etc. Finally, power over monetary policy will be moved from the Riksbank to the ECB.

In other words, EMU membership will lead to an enormous change in accounting systems, bookkeeping, tax returns, social insurance systems, computer systems etc. in Swedish public administration as well as the business sector. In various contexts, public agencies and business organisations have therefore stated the need for enough time to prepare for EMU accession. The National Tax Board and the National Social Insurance Board need two years for the whole process, from the time they begin converting their systems until they are ready to handle euro banknotes and coins. Most large companies in the business and financial sectors say that they need one year.

A parliamentary decision and ERM accession in the summer of 2003 – which according to our analysis above should suffice for approval by the Council in the summer of 2004 – would thus allow the requisite time to prepare for EMU accession in January 2005 and, above all, for the final transition to euro banknotes and coins one year later.

# 10. Euro banknotes and coins

The countries that formed the currency union on January 1, 1999 had a three-year transitional period until January 1, 2002, when euro banknotes and coins were introduced. Major companies in the euro zone introduced the euro relatively quickly as the currency of their accounts and adapted their accounting and computer systems, invoicing etc to the euro. Small and medium-sized companies often waited until the last year or six months before converting to euros. As a rule, banks let their customers choose either local currency or euros for their accounts until the final six months, when local-currency accounts were converted into euros.

In light of the experiences of the current EMU countries, we can assume that in Sweden's case, the full introduction of the euro will take considerably less time than three years. The timetable with EMU accession in 2005 and euro **banknotes and coins in 2006** allows a transitional period of one year from the date the euro is introduced electronically, which would correspond to the situation in Greece. If the formal decision has been made about six months before accession to the currency union, Swedish companies, public agencies and the general public will have **18 months to switch over to the euro**, even if they wait until the Council has approved Swedish membership. If they begin with minor preparations as early as 2003, after the referendum, they should finish without problems by January 2006. Actually, in such a scenario we cannot preclude that the changeover occurs already in the autumn of 2005.

Once euro coins and notes have been introduced in Sweden, it should be possible to phase out the krona quickly. For the EMU countries that introduced euro banknotes and coins on January 1, 2002, the period of dual currencies has varied from one month (in the Netherlands) to two months (in most other countries). In Sweden's case, a period as long as two months would probably not be necessary, since Sweden can learn from how other countries dealt with the transition and by then will also be more accustomed to handling euro banknotes and coins. It therefore seems likely that Swedish kronor could cease to be legal tender after only two weeks or at most one month.

### Big Bang?

Sometimes we hear proposals to the effect that – since it will join the currency union when euro banknotes and coins already exist in the other countries – Sweden could switch directly to euro banknotes and coins, perhaps immediately after EMU accession, otherwise with only a brief delay. This question is raised especially if Swedish EMU membership is delayed until 2006 – perhaps due to delayed accession to the ERM. On paper, Sweden could then introduce euro banknotes and coins directly, at the same time as the country joins EMU – a kind of "**big bang"** scenario.

We do not believe that this is possible either in 2005 or 2006. As for 2005, it is obvious that the time for preparations between the decision and the changeover to notes and coins would be much too short. Neither companies nor public agencies would have time to convert.

The same thing applies to accession in 2006 as well.

The problem with a big bang is that companies and public agencies want to be completely sure that Sweden is really joining the currency union before they finally launch their often costly transition plans. If a formal decision cannot be made until late 2004 or 2005, since the exchange rate criterion must first be met, a preparatory period until January 1, 2006 would be short. Many companies and public agencies would find it difficult to prepare in time.

Hypothetically, the entry into the currency union could be postponed in order to make a big bang possible. However, that would mean a longer period outside the EMU which hardly can be seen as desirable. The most probable outcome is thus that some time will be required between accession to the currency union (with the euro being used as "electronic money"), on the one hand, and banknotes and coins on the other. If Sweden's EMU accession is delayed until 2006, the introduction of euro banknotes and coins will thus wait until the autumn of 2006 or until 2007.

# 11. Conclusion: Will the timetable work?

Our most important conclusion from what we have said about the various control stations for Swedish EMU accession is this: **In order to work, the prime minister's timetable must be modified**.

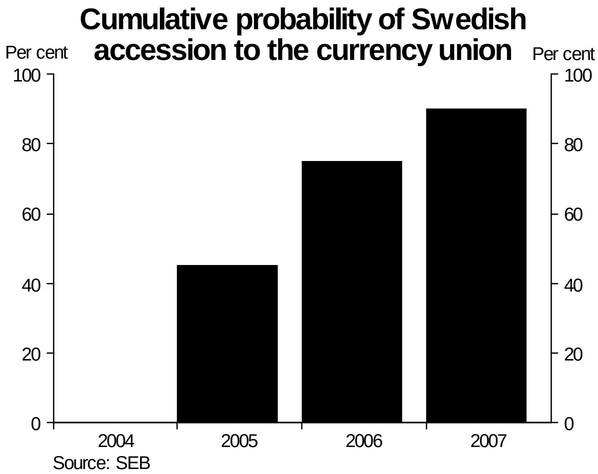
- As for the EMU referendum, there should not be any technical problems in holding it in April 2003, provided that the date is fixed early and informational campaigns can get started soon after the September 2002 parliamentary election – all of this obviously depends on the trend of public opinion.
- Nor should the government bill and the parliamentary decision on Swedish accession cause any problems.
- However, it is **doubtful that the heads of government and the finance ministers of the other EU countries would approve such a short ERM period** as the prime minister has proposed. Formally, the situation is crystal clear: ERM accession in February 2004 allows far too short a period. But the issue will ultimately be decided on political grounds, and some flexibility exists. In earlier assessments, Italy's 15 months and Finland's 16 months of ERM participation were considered acceptable. By virtue of its global currency, the UK can probably stretch the ERM criterion more than the little krona can. A problem for Sweden is that exceptions granted to Sweden may also lead to equivalent demands from several of the countries in Eastern and Central Europe that will be knocking on EMU's door.
- Swedish ERM accession in February 2004 – according to the prime minister's timetable – is therefore very likely to mean postponement of Swedish EMU membership until 2006.
- However, if ERM accession should take place as early as one month or so after the spring 2003 referendum, the rest of the prime minister's timetable might work.
- The prime minister's timetable implies that the legal criterion will not be met, according to the view of the Commission and the ECB to date. Since the final decision on Swedish EMU membership will be decided by the Council, however, political considerations will play a decisive role. Our main scenario is therefore that a pending constitutional amendment after the referendum might be accepted.

Something that may obviously upset the entire timetable is **negative public opinion about EMU**. The public opinion situation, or difficulties in completing all the preparations for a referendum during the spring of 2003, may cause a postponement of the referendum until the autumn. In that case, too, it would be difficult to adhere to the prime minister's timetable, since ERM accession would occur close to the EU's decision and since the preparatory time for Swedish public agencies and companies would be short.

Altogether, however, we believe that there is a rather good probability that Göran Persson's timetable will work *if* it is modified as regards ERM accession. This means that in our assessment, a modified timetable would look as follows:

| | |
|---|---|
| **September 2002** | **Parliamentary election** |
| **Autumn 2002** | **Talks among party leaders on referendum** |
| **April 2003** | **Referendum** |
| **June 2003** | **Parliamentary decision on application to currency union** |
| **July 2003** | **Swedish ERM accession** |
| **Autumn 2003** | **Government bill on amending Constitution** |
| **Autumn 2003** | **First decision on amending Constitution** |
| **Autumn 2003** | **Application to currency union** |
| **Spring 2004** | **EU examination of convergence** |
| **June 2004** | **EU decision on Swedish accession** |
| **January 1, 2005** | **Swedish accession to currency union** |
| **January 1, 2006 (possibly autumn 2005)** | **Euro banknotes and coins** |
| **January 31, 2006** | **Euro the only legal tender** |
| **September 2006** | **Parliamentary election** |
| **Autumn 2006** | **Second decision on amending Constitution** |

In our judgement, the probability that this timetable will work is **45 per cent**. We believe that the biggest risk of a delay – which in that case would be one year – is the issue of the length of the ERM period and whether the referendum takes place in the autumn of 2003 instead of the spring. The legal issue has a better chance of being resolved, in our opinion, but if this cannot happen, the delay will be a full two years compared to our main scenario. **We estimate the risk of a one-year delay at 30 per cent and a two-year delay at 15 per cent.** The probability that Sweden will be a member of the currency union by 2007 would thus be 90 per cent. In other words, we see the probability that Sweden would then still be outside EMU as a mere 10 per cent.



## Appendix: Alternative timetables

If the **referendum should be delayed** until autumn 2003:

| | |
|---|---|
| Autumn 2003 | EMU referendum |
| Autumn 2003 | Parliamentary decision |
| Winter 2003 | Sweden ERM accession |
| Autumn 04/spring 05 | EU examination of convergence |
| Winter 04/spring 05 | EU decision on Swedish accession |
| January 1, 2006 | Swedish EMU membership |
| January 1, 2007 | Euro banknotes and coins |
| January 31, 2007 | Euro the only legal tender |

If the timetable at first follows the prime minister's – a referendum in 2003 and ERM accession in February 2004 – but the EU refuses to accept Sweden into the currency union as early as 2005 after **too short an ERM period**, the rest of the prime minister's timetable would be delayed by one year:

| | |
|---|---|
| April 2003 | Referendum |
| February 2004 | ERM accession |
| Spring 2005 | EU decision on Swedish membership |
| January 1, 2006 | Swedish EMU membership |
| January 1, 2007 | Euro banknotes and coins |

If the EU concludes that Sweden must **amend the Constitution** before accession to the currency union, the schedule may be delayed in the following way:

| | |
|---|---|
| April 2003 | EMU referendum |
| February 2004 | Swedish ERM accession |
| Autumn 2004 | First vote on amending Constitution |
| September 2006 | Parliamentary election |
| Autumn 2006 | Second vote on amending Constitution |
| December 2006 | EU decision of Swedish membership |
| January 1, 2007 | Swedish EMU membership |
| January 1, 2008 | Euro banknotes and coins introduced in Sweden |
| January 31, 2008 | Euro the only legal tender in Sweden |