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1. Policy Instruments

MONETARY POLICY

The Sveriges Riksbank, Sweden's central bank, is legally independent of the government, and is directly responsible to the parliament. Most members of the Board of Directors (except its chairman, who is a government appointee) are nominated by—and are members of—the parliament, which provides general guidance to the Riksbank's operations. In the actual conduct of policy, a large measure of cooperation exists between the Riksbank and the government. Yet, the former has been known to have on occasion acted independently, even without prior consultation with the government.

The discount rate is the most significant of the monetary instruments employed by the Riksbank. Left almost untouched until 1955, the discount rate has been changed regularly (about once a year, on the average) since the beginning of that year. As in most other countries, these changes had little direct impact on the amount of commercial-bank borrowing from the Riksbank. Although not restricted to emergency situations, this borrowing was nevertheless quite limited and was used primarily as a device for smoothing out short-term fluctuations rather than as a long-term source of funds. In recent years the average amount of this borrowing has increased, but changes in the discount rate still do not play a major role in determining the size of borrowing. During a few recent periods (mid-1961 to early 1962; early 1964 to mid-1966), penalty rates were imposed on borrowings beyond given quotas—a measure which apparently did have a large impact on the amount of borrowing. In general, however, changes in the discount rate were important primarily as a major signal of changes in over-all policy. Rates of interest, both on bank deposits and on commercial-

bank lending, tended to change with the discount rate, although the association was not rigid or automatic, and on a few occasions the order of change was reversed: the discount rate followed market rates rather than the other way around.

In addition to discount policy, the Riksbank uses a variety of other monetary instruments. Open-market operations are undertaken on occasion, but not continuously. The government, which regularly sells large amounts of its securities in the market, in fact carries out most of the open-market operations by its debt policy. However, the National Debt Office, which carries out these operations, works in close coordination with the Riksbank. Minimum-liquidity ratios are also regulated by the Riksbank. Actual formal changes in the ratios have been rare, and most of the time the minimum requirements have been of little relevance. But at the time of its introduction in 1952, the system of minimum ratios was used as a restrictive measure. Later, on a few occasions, the system was again used for this purpose, but more by agreement with the banks and by persuasion than by the strict legal enforcement of the schedule of liquidity ratios. Another and probably more important instrument was the direct regulation by the Riksbank of the amount of commercial-bank lending. A few times this took the form of "moral suasion." From mid-1955 to mid-1957, however, banks were actually instructed to reduce their credit by specific amounts (gradually, the reduction reached 5 per cent of the amount outstanding in mid-1955). The use of these various instruments, though by no means unimportant, was sporadic and often cannot be quantified. As a rule, they were applied in conjunction with changes in the discount rate, though not necessarily at precisely the same time. Movements of the discount rate may thus be taken to indicate the thrust of other policy instruments as well.

BUDGETARY POLICY

Sweden, unlike many other countries, does not aim at a regular balance in the government's budget. It is assumed that a rough balance in the budget should be attained over a number of years, but that for each year, or for even longer periods, the budget may yield a deficit or surplus. In other words, the budgetary balance—as well as specific components of the budget—is regarded as an important instrument in the conduct of short-term policy. The declared task of this policy is to counteract cycles in domestic economic activity.

In order to facilitate the fulfillment of this task, several devices have been introduced to make budgetary performance more flexible than in most other countries. Thus, the amount of expenditures authorized in the budget is only a ceiling, and the government may use its discretion in deciding whether or not to spend it fully. The government has an inventory of public work projects, which may be activated or terminated on a few months' notice when the need arises. Another important device is the "investment fund," a semibudgetary instrument that allows considerable tax concessions to firms that refrain from investment in boom times, depositing their allocations to the fund in a blocked account, while spending for investment in slack times. It is relevant to note that the time schedule for the operation of this device—that is, the decision on when is the proper time to save and when to spend—is determined by the government's Labor Market Board; the use of this tool is thus directly associated with the employment situation.

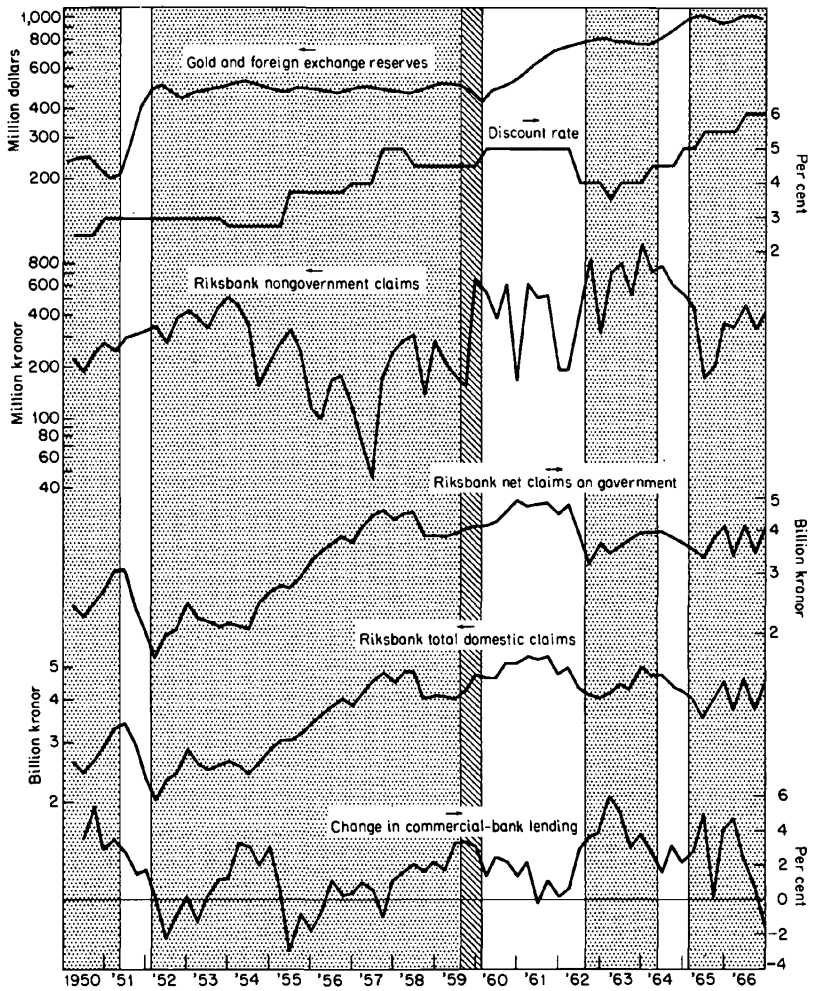
As has been noted, the government borrows on a large scale in the market. It also borrows from the Riksbank, which faces no legal limitations on the amount or form of its lending to the government.

2. Statistical Analysis

The postwar record of Sweden is marked by an almost complete absence of balance-of-payments deficits of long duration or significant size. The only exception is the period between the third quarter of 1959 and the first quarter of 1960; but even this brief deficit was not very substantial in proportion to the country's trade, or even to its customarily quite small external reserves. Except for this episode, a graph of the level of the country's external reserves (as in Chart 10-1) has the form of long plateaus, interrupted by a few brief and quite steep upward steps. The first—and steepest—rise occurs from mid-1951 to early 1952, when reserves (which had been almost stable since 1947) more than doubled. The second upward movement took place between early 1960 and mid-1962, when reserves again nearly doubled; the last episode, a brief one, occurred between mid-1964 and early 1965.

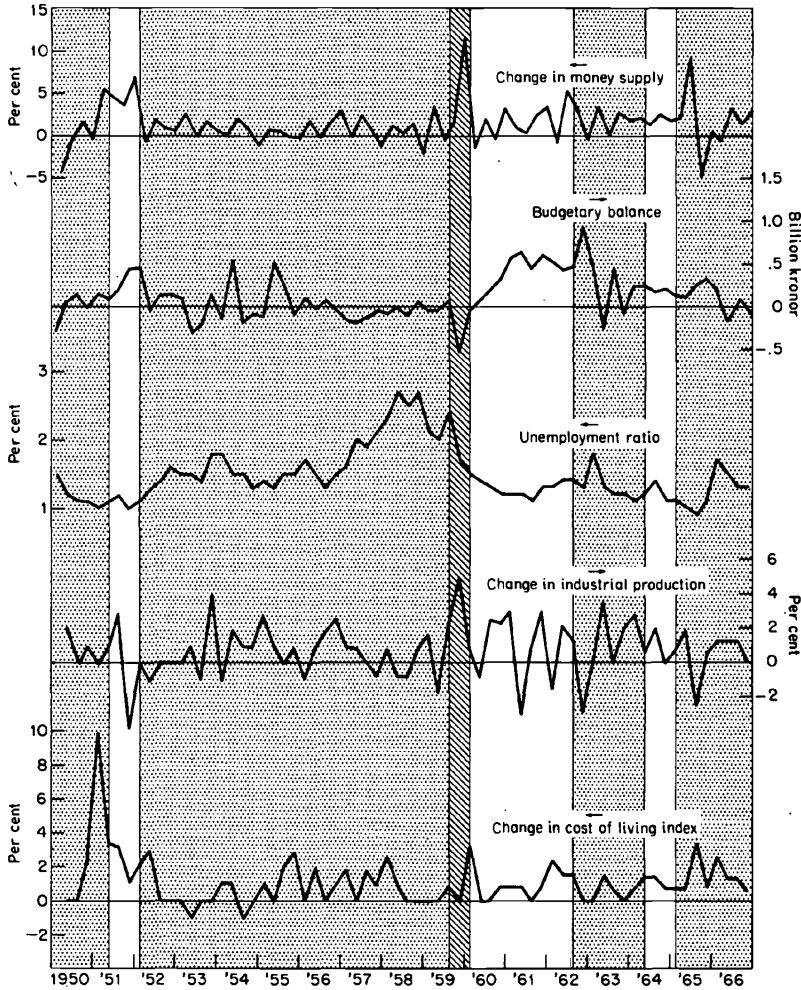
A statistical analysis of the pattern of policy responses to balance-of-payments developments in Sweden must therefore be very limited in the number of observations covered. The summary presented in Table

CHART 10-1
 SWEDEN: TIME SERIES OF SELECTED VARIABLES



10-1 is confined to the three periods of surplus just noted, the single deficit episode of 1959-60, and several longer periods of stability. Starting with the discount rate (column 2), it seems clear that its movements do not conform to an assumption which would make them dependent on the balance-of-payments position. The discount rate is found to be stable in the first surplus period; almost stable in the sec-

CHART 10-1 (Concluded)



NOTE: Diagonal-line areas represent period of downward imbalances; gray areas represent stability; white areas represent upward imbalances.

ond—except for a lowering of the rate in mid-1962, toward the end of this relatively long period; and rising during the third. A response to the balance-of-payments position, however, would require the lowering of the rate during these periods. In the deficit period of III 1959-I 1960 the discount rate was raised, as balance-of-payments adjustment would require.

TABLE 10-1
SWEDEN: MOVEMENTS OF POLICY VARIABLES DURING SUBPERIODS OF IMBALANCES

Subperiod	External Reserves	Discount Rate	Riksbank Claims on Commercial Banks	Riksbank Net Claims on Government	Commercial-Bank Lending to Public (quarterly rate of increase, per cent)	Money Supply (quarterly rate of increase, per cent)	Budgetary Balance (quarterly average, in millions of kronor)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
I 1950 - II 1951	stable	raised	rise slightly	rise	3.7	2.2	+17
II 1951 - I 1952	rise sharply	* stable	* rise slightly	- fall	(-) 1.1	(+) 3.3	(-) +426
I 1952 - III 1959	stable	raised	fluctuate	rise	.8	.8	+10
III 1959 - I 1960	fall	+ raised	- rise sharply	* stable	(-) 2.3	(-) 5.1	(-) -180
I 1960 - III 1962	rise	* mostly stable	* fluctuate	- fall	(-) 1.6	(*) 2.0	(-) +425
III 1962 - II 1964	stable	fluctuates	fluctuate	rise	3.7	1.7	+293
II 1964 - I 1965	rise	- raised	* fall slightly	* stable	(-) 2.7	(*) 2.1	(+) +166
I 1965 - IV 1966	stable	raised	fluctuate	fluctuate	2.2	1.6	+96

NOTE: For explanation of symbols, see Table 8-3.

Similar conclusions hold for all the other monetary variables—the Riksbank's nongovernment claims (column 3); the Bank's net claim on the government (column 4); the Bank's total domestic claims (not represented in Table 10-1, but very similar to the Bank's claim on the government, which is the chief component of the Bank's total domestic claims); the rate of expansion of commercial-bank credit (column 5); and the rate of expansion of money supply (column 6). In the examination of all these variables, the same pattern is repeated: when balance-of-payments movements (predominantly upward) take place, the variables either show no response (remaining stable) or move in the direction opposite to that which balance-of-payments adjustment would require.

Examination of the budgetary balance (column 7) leads to a similar conclusion with regard to this major fiscal variable. By and large, it moves in the direction opposite to that which the target of balanced external transactions would call for and in no single instance is a movement in the adjusting direction found. It is therefore safe to conclude that the budgetary instrument was not used in Sweden as a means of maintaining stability in the balance of payments.

It thus appears that none of the monetary and fiscal instruments examined were used for balance-of-payments adjustment. Tables 10-2, 10-3, and 10-4 are intended to investigate the possible relation of three major variables—the discount rate, the credit supply and the budgetary balance, respectively—to major economic targets. This may indicate whether the lack of use of these instruments for balance-of-payments adjustment might have been due to the assignment of the instruments to other targets, whose claims conflicted with those of the balance of payments. The only conclusion which emerges at all firmly from observation of these tables is that the budgetary balance changed regularly in a manner consistent with the target of high employment (column 4 in Table 10-4). This conforms, of course, with the announced target of budgetary policy, which is supposed to follow an anticyclical pattern where the "cycle" refers mainly to the employment situation. The two monetary variables (the discount rate and the rate of expansion of money supply) give some indication—as may be seen from column (5) in Tables 10-2 and 10-3, respectively—that they were intended to be used to maintain price stability. But the evidence is not very firm: the pattern is not entirely consistent, and the variations in price movements between periods of "high" and of "low" price increases are not very large—usually the differences are only in the order of 1 to 1.5

TABLE 10-2
SWEDEN: THE DISCOUNT RATE AND POSITION OF TARGET VARIABLES

Subperiod	Discount Rate (1)	External Reserves (2)	Industrial Production (rate of increase) (3)	Level of Unemployment (4)	Rise of Cost-of- Living Index (com- pared with trend) (5)
I 1950 - I 1955	stable	rise, stable	normal	fluctuates	slow (since 1952)
I 1955 - III 1957	raised	* stable	* normal	- rises	+ fast
III 1957 - I 1962	stable	fluctuate, rising trend	normal	falls	normal
I 1962 - I 1963	lowered	+ rise, stable	+ low	+ rises	* normal
I 1963 - II 1966	raised	- rise	+ high	slightly + low	+ fast

NOTE: For explanation of symbols, see Table 8-3.

TABLE 10-3
 SWEDEN: CREDIT SUPPLY AND POSITION OF TARGET VARIABLES

Subperiod	Credit Supply (rate of expansion)	External Reserves	Industrial Production (rate of increase)	Level of Unemployment	Rise of Cost-of-Living Index (compared with trend)
	(1)	(2)	(3)	(4)	(5)
II 1950 - IV 1951	high	* mostly stable	+ low	- low	- fast
IV 1951 - IV 1953	low (negative)	* stable	- low	- rises	- slow
IV 1953 - IV 1954	high	* stable	* normal	- falls	+ slow
IV 1954 - IV 1957	low (negative)	* stable	* normal	- rises	+ fast
IV 1957 - I 1961	high	* fluctuate	- high	+ high	* normal
I 1961 - I 1962	low	- rise	- low	+ falls	+ fast
I 1962 - II 1966	high	* mostly stable	* normal	- low	- fast

NOTE: For explanation of symbols, see Table 8-3.

TABLE 10-4
SWEDEN: THE BUDGETARY BALANCE AND POSITION OF TARGET VARIABLES

Subperiod	Budgetary Balance (1)	External Reserves (2)	Industrial Production (rate of increase) (3)	Level of Unemployment (4)	Rise of Cost- of-Living Index (compared with trend) (5)
I 1950 - I 1953	surplus	- rise	- low	+ low	+ fast
I 1953 - IV 1956	nil	* stable	- high	+ moderate	+ slow
IV 1956 - I 1960	deficit	* stable	+ normal	+ high	- fast
I 1960 - I 1963	large surplus	- rise	* normal	+ low	- slow
I 1963 - I 1966	moderate surplus	- rise	+ high	+ low	- fast
I 1966 - IV 1966	small deficit	* stable	* normal	+ moderate	- fast

NOTE: For explanation of symbols, see Table 8-3.

per cent per annum. It also seems that monetary policy was not tied to price developments until the mid-1950's; during these earlier years the discount rate was practically stable, while credit supply—which did fluctuate substantially—does not seem to have responded to the needs of price stability. It is possible, though, that the pattern of changes in credit supply during these earlier years was motivated by price developments, but with a quite considerable time lag.

3. Summary and Interpretation

Sweden entered the 1950's with an unusually low level of external reserves in relation to its volume of international trade. From 1950 to the end of the period surveyed, the absolute level of reserves increased about fourfold in a few relatively short episodes interrupting long periods of stable reserves. Yet this increase only more or less kept pace with the rising volume of the country's trade. Such an increase of reserves could well have been regarded as desirable, rather than as a disturbance which should be counteracted. Yet, the stability of the absolute size of reserves during most of the period was also apparently not considered a source of anxiety and a disturbance calling for adjustment through restrictive policies. Thus balance-of-payments developments appear not to have played a role in determining broad policy patterns in Sweden. Major policy instruments were reserved for the achievement and maintenance of other primary targets. Budgetary policy, which appears to be more flexible than in most other countries, was regarded as the major instrument to employ in counteracting cyclical fluctuations in the domestic economy, and, in particular, cycles in the labor market. Monetary policy does not appear to have followed the same consistent pattern. It seems likely that, part of the time, monetary instruments were used in the same way as fiscal policy, that is, for counter-cyclical adjustment. At other times—either by coordinated design or, not implausibly, due to a high degree of independence of the central bank—monetary policy must have been intended to prevent substantial price increases.

Only a single episode of an actual absolute fall of reserves of some significance may be distinguished: it took place during late 1959 and early 1960. During this time, the target of high employment appears to have been given preference in budgetary policy over the target of

balance-of-payments stability. Unemployment at that time was still high, although declining, and the budget recorded an unusually large deficit. Indications are less clear-cut for the monetary instruments. The discount rate, the major instrument and the directional signal of monetary policy, was raised, as balance-of-payments equilibrium would require. In addition, "recommended" liquidity ratios of commercial banks were raised. But commercial bank borrowing from the central bank increased markedly, despite the higher discount rate—as is quite usual under similar circumstances in other countries; and both commercial-bank credit and money supply increased at a fast rate. The evidence of this episode is thus inconclusive in the monetary sphere. Needless to say, this review cannot suggest what the country's policy patterns, in both the monetary and the budgetary areas, would have been, had the country realized periods of substantial balance-of-payments deficits rather than a succession of periods of stability and of surplus. It is thus relevant to point out that the apparent disregard of the needs of balance-of-payments adjustment is confined to a period in which balance-of-payments deficits were, by and large, absent.

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