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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/123

3:00 p.m., August 6, 1984

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	T. Ramtoolah, Temporary
	H. G. Schneider
	G. E. L. Nguyen, Temporary
	M. Teijeiro
	D. C. Templeman, Temporary
	N. U. Haque, Temporary
	T. Yamashita
	I. R. Panday, Temporary
R. K. Joyce	
	H. A. Arias, Temporary
	G. Grosche
	N. Coumbis
R. N. Malhotra	
	J. E. Suraisry
	T. de Vries
	A. J. Tregilgas, Temporary
	A. Yasseri, Temporary
	S. M. Hassan, Temporary
	J. E. Rodríguez, Temporary
J. Tvedt	A. Lindø
	J. Bulloch, Temporary
	Wang E.

J. W. Lang, Jr., Acting Secretary
S. J. Fennell, Assistant

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Also Present

European Department: P. B. de Fontenay, Deputy Director; M. A. Evans, J. J. Hauvonen, P. L. Hedfors, W. L. Hemphill, H.-J. Huss, A. Knöbl, S. Mitra. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director. Fiscal Affairs Department: L. Müten. Legal Department: J. K. Oh. Advisors to Executive Directors: D. I. S. Shaw, A. Vasudevan. Assistants to Executive Directors: D. Hammann, L. Ionescu, A. K. Juusela, H. Kobayashi, E. Olsen.

1. SWEDEN - 1984 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/84/122, 8/6/84) their consideration of the staff report for the 1984 Article IV consultation with Sweden (SM/84/167, 7/13/84). They also had before them a report on recent economic developments in Sweden (SM/84/179, 7/23/84).

The Deputy Director of the European Department remarked that the authorities had originally aimed to reduce inflation to 4 percent in 1984, but had revised their target to 6.5 percent. It was possible that the new target would be met, particularly as year-on-year inflation had declined to 7.5 percent in July. The effects of the recent wage settlements would not be felt fully for some time, and productivity gains continued to reduce wage costs.

The government training program represented only a small part of Sweden's work schemes, the Deputy Director went on, but it was the authorities' intention to develop those training programs further, while phasing out the other work schemes. The authorities recognized the need to improve training in order to relieve the shortage of skilled workers, which was less a shortcoming of the training system, than a reflection of very low wage differentials between skilled and nonskilled workers. There was therefore little incentive for workers to go through additional training. In the past, unions had been reluctant to accept greater wage differentials, and, in fact, differentials had narrowed over the past decade. During the recent round of wage negotiations, although employers had insisted on decentralizing wage negotiations in the hope of obtaining larger wage differentials, unions had pressed for the maintenance of those differentials.

The wage earners' funds had only recently been established, and had had no discernible effect on investment, the Deputy Director commented. However, it was difficult to determine whether those funds had had an impact on investment decisions, because the economy was going through a strong investment recovery.

The prospects for wage restraint in 1985 depended partly on negotiations still taking place between the Government and labor unions, the Deputy Director remarked. The Government's objective of limiting average wage increases in 1985 to 5 percent was ambitious, and some slippage was not improbable.

The discrepancies between figures on public expenditure in Table 1 of SM/84/167 and Table 17 of SM/84/179 had been due to the inclusion of net lending in the former table, the Deputy Director stated.

With respect to monetary and debt management policies, there had been a sharp increase in the share of the budget deficit financed by the nonbank public, the Deputy Director indicated. Some of the new borrowing instruments were extremely liquid, such as the short-term treasury bills

of six months' maturity, but the authorities had decided to lengthen the maturities and to rely more heavily on such instruments as treasury notes and new savings schemes. Nevertheless, the stock of short-term instruments remained large and represented a problem for the management of monetary policy. Those instruments were not included in the definition of M-3, but they must be taken into account in the framing of monetary policy. Sweden was in an unusual position in that respect. Enterprises were so flush with liquidity that they invested all their cash in those short-term instruments, and enterprises as a whole were not borrowing on a net basis from the banking system. The Government must, therefore, make sure that interest rates were high enough so that new holders could be found if the original holders of short-term bills wished to cash them.

With respect to the present strength of the economy, on the basis of the first-quarter national accounts for 1984 and the most recent business surveys, the staff considered that the economy was buoyant, the Deputy Director said. It was true that capacity utilization rates were not as high as they had been during some of the previous economic peaks. However, the staff was concerned about the speed at which the economy was moving toward greater rates of capacity utilization and about the fact that the recovery was largely concentrated in the export sector, where a number of firms were already working at full capacity. The recovery was thus unbalanced, and pressures were emerging in the labor market. Large wage settlements, in those sectors where full capacity had almost been reached, would spread quickly to other sectors because unions insisted on eliminating differentials.

At the heart of the disagreement between the staff and the authorities was the question of the size of the 1982 devaluation, the Deputy Director stated. The Swedish authorities considered that the devaluation had not been too large. The staff, immediately after the devaluation, had concluded that it had been too large from an international point of view. The staff had now come to the conclusion that the devaluation had been too large from a domestic point of view as well, by putting too much pressure on the export sector and contributing to inflationary expectations.

There were certain circumstances in which the staff would favor Sweden's repaying debt while maintaining a current account surplus, the Deputy Director of the European Department commented. However, at present, the current account surplus was associated with inflationary pressures, a situation in which the staff would not favor its use to repay debt. If the government deficit were reduced dramatically, and there were a reduction in domestic demand and inflationary pressure, it would be legitimate to use the current account surplus to repay the external debt. Sweden was not in a situation in which the repayment of debt was urgent in the short term. If external debt were maintained at its present level over a number of years, it would diminish as a percentage of GDP.

Mr. de Vries commented that the Fund could learn a great deal by analyzing the proportion of government expenditure in GDP in different European countries. That factor, which was a most central issue of policymaking, tended to receive too little attention in staff papers.

The Deputy Director of the European Department remarked that the size of the public sector was roughly the same in Sweden and the Netherlands, but the latter had high unemployment and weak investment. The OECD had recently studied the effects of the size of the public sector on the performance of the economy, and had come to the conclusion that it was impossible to find a relationship between those variables in the sample of industrial countries. However, the size of the public sector and the tax burden were clearly constraints on economic management, a point that had been made by a number of Directors at the present meeting. In Sweden, for example, for the deficit to be reduced, measures were necessary on the expenditure side, as the tax burden was already high and raising taxes would produce unfavorable consequences in terms of incentives to work and save.

Mr. Lindå noted that he had little to add to the staff paper and his earlier statement on future budget policy. The Government had indicated the need for further fiscal action in 1985, but the substance and extent of the measures would not be decided upon before the meeting with the social partners at the end of the summer.

Regarding monetary policy, Mr. Lindå emphasized that the domestic contribution to money creation during the 12 months up to June 1984 had been as low as 5 percent. Furthermore, the authorities' determination to take further measures when necessary was demonstrated by the recent action by the Sveriges Riksbank to adjust interest rates. Moreover, liquid assets of the commercial banks were falling, in contrast to the earlier trend, and the outstanding amount of bank advances remained at a level only slightly--at present 2 percent--above that of 1983.

With respect to exchange rate policy, the views of his authorities had been covered on page 11 of SM/84/167, Mr. Lindå went on. He could only add that the krona had appreciated slightly, the currency index at present being about 1.5 percent below the new benchmark for the effective value of the krona.

He had nothing new to report on the discussions between the Government and the labor market partners, Mr. Lindå said. With respect to labor market policy, the authorities' aim had been to concentrate on education and other active measures, rather than to provide support in the form of unemployment benefits. Sweden had been somewhat of a forerunner in implementing such an active labor market policy, and the authorities had gone a long way toward meeting demands for more skilled workers. To provide incentives for workers to move geographically, the authorities had recently increased relocation allowances substantially. As it was often difficult for couples to obtain jobs in the same area, a special wage subsidy would be provided temporarily to a firm that employed an accompanying

spouse. As for vocational mobility, special funds were directed toward technical professions and other professions with severe shortages. A special training course on the use of computers for individuals with low educational attainments was being arranged.

Five wage earners' funds had recently been established, Mr. Lindø indicated. Each fund was expected to receive revenues of SKr 380 million. The first purchases of shares on the stock exchange had taken place, including stocks in large, well-known Swedish companies. Funds had to have high earnings in order to reach the target of delivering 3 percent of the assets annually to wage earners, while maintaining the real wealth of the fund. It was still too early to judge the implications of those funds for the level of investment.

A government commission was studying regulations and the organization of insurance in Sweden, Mr. Lindø concluded. The commission had produced a report in 1983 recommending more liberal rules for new insurance companies, both Swedish and foreign. A bill based on the report would be put before Parliament later in the year, and new rules could possibly be in effect from January 1, 1985.

The Acting Chairman made the following summing up:

> Executive Directors noted that the Swedish authorities' economic strategy, which aimed at a revival of the industrial sector by means of an improvement in international competitiveness, had achieved large gains in export market shares and a marked reduction in the external current account deficit in 1983. Further progress was projected for 1984. The devaluations of 1981 and 1982, together with wage restraint and the recovery in foreign demand, had resulted in a significant improvement in the competitiveness and profitability of Swedish industry and had led to a strong upturn in investment. These developments had helped to keep the rate of unemployment relatively low. Directors, however, shared the concern of the staff about the pace and sustainability of the current upswing in view of the emergence of capacity constraints and the resurgence of wage demands and inflationary pressures.
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> Directors supported the Swedish authorities' objective of a sharp reduction in the rate of inflation for 1984 and 1985, but many observed that wage developments in 1984 would cause inflation to exceed the official target for the year. They welcomed the understanding reached among the labor market participants to limit the rise in earnings to 5 percent on average in 1985 and expressed the hope that ways could be found to make such a limit effective.

At the same time, Directors agreed with the staff's caution against excessive reliance on incomes policy to contain inflationary pressures. A firmer stance of financial policies was judged necessary to provide adequate support for wage restraint in 1985. In view of the shortage of skilled workers, Directors encouraged greater labor mobility and wage differentiation. Decentralized wage negotiations were regarded as a favorable development in this respect.

Directors commended the improvement in budgetary performance in fiscal year 1983/84 and welcomed the tighter fiscal stance planned for 1984 and 1985. However, they judged that a further significant reduction in the fiscal deficit was required in order to release resources for a continued recovery of investment and to ease the task of monetary management. Given the high level of taxation, this effort would need to center on expenditures. Expenditure cuts would also provide more opportunity to pursue reforms that would further reduce the effect of the high burden of taxes on work incentives and capital formation. In this connection, it was observed that a reduction in government expenditures would also reduce the relative size of the government sector.

Directors welcomed the recent increase in interest rates as well as the significant deceleration in domestic credit expansion experienced in the year ended June 1984, but they also observed that the economy was still highly liquid and that private sector capital flows had been substantial over the period. Despite the increase in interest rates, differentials relative to interest rates abroad had not been fully restored and further action might be required if capital outflows persisted. Directors encouraged the ongoing work aiming at further reductions in financial regulations and controls, including the easing of restrictions on entry of foreign banks.

Directors commended the Swedish authorities for the sharp reduction in subsidies to ailing industries in 1983/84 and welcomed their stated determination to hold such expenditures down. They believed that it remained appropriate for Sweden to pursue an asymmetric exchange rate policy supported by firm counterinflationary financial policies. Sweden's competitive position remained strong, and the underlying current account position was likely to improve further. In these circumstances, most Directors urged the authorites to let upward pressures on the exchange rate be reflected in an appreciation of the Swedish krona and not to prevent the emergence of such pressures by a relaxation of monetary policy. In their judgment, this would also assist the authorities in achieving their ambitious inflation target for 1985.

Directors welcomed Sweden's continued commitment to a free trading system and the attention given to the possibility of liberalizing trade in certain services, and they commended its record on development assistance.

It is expected that the next Article IV consultation with Sweden will be held on the standard 12-month cycle.

APPROVED: May 21, 1985

JOSEPH W. LANG, JR.
Acting Secretary