COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Article 9 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated convergence programme of Sweden, 2002-2004

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No. 1466/97, on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[1], stipulated that countries not participating in the single currency were to submit convergence programmes to the Council and the Commission by 1 March 1999. In accordance with Article 9 of this Regulation, the Council had to examine each convergence programme based on the assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty, the Economic and Financial Committee. The Commission adopted a recommendation on each programme. On the basis of this recommendation and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme. According to the Regulation, the updated convergence programmes, to be presented annually, may also be examined by the Council in accordance with these same procedures.

Sweden's convergence programme covering the period 1998-2001 was submitted on 23 December 1998 and assessed by the Council on 8 February 1999[2].

The first annual update, covering the period 1999-2002, was submitted on 12 November 1999 and examined by the Council on 31 January 2000[3]. The second annual update, covering the period 2000-2003, was submitted on 10 November 2000 and examined by the Council on 19 January 2001[4]. The third annual update, covering the period 2001-2004, was submitted on 9 November 2001 and examined by the Council on 22 January 2002[5].

Sweden submitted the fourth and most recent updated convergence programme, covering the period 2002-04, on 29 November 2002. The Commission services have carried out a technical evaluation of this updated programme, namely taking into account the Communication from the Commission to the Council of 27 November on strengthening the coordination of budgetary policies[6]. This evaluation warrants the following assessment:

> The 2002 updated Swedish convergence programme covers the period 2002 to 2004 and is based on the Budget Bill for 2003. The Budget was adopted by parliament in December 2002. According to the 2002 update, the focus of economic policy continues to be full employment and increased prosperity through high, sustainable growth. Stable prices and sound public finances are a precondition for achieving this. The updated programme provides detailed information, including the analysis of the long-term sustainability of public finances, which is broadly in line with code of conduct. The expenditure ceiling, which forms the basis for the medium-term budgetary plans is normally set three years ahead. However, a ceiling was not set for 2005, as prolonged negotiations with respect to forming a government following the general elections in September 2002 delayed such a decision. The lack of detailed information for 2005 in the programme is not in line with the code of conduct. However, the government has declared that new expenditure ceilings for 2005 *and* 2006 will be presented in the 2003 Spring Fiscal Policy Bill, and subsequently included in the Budget Bill for 2004.

[1] OJ L209, 2.8.1997
[2] OJ C68, 11.3.1999
[3] OJ C60, 2.3.2000
[4] OJ C 73, 6.3.2001
[5] OJ C 33, 6.2.2002
[6] COM (2002) 668 final, 27.11.2002.

The Swedish economy has developed less favourably than foreseen in the 2001 update. GDP growth slowed substantially in 2001, to 0.8%. Stronger growth is expected in both 2002 and 2003, though lower than foreseen in the previous update. Inflation has fallen since the spring 2002, partly due to favourable base effects, and is expected to remain close to 2% over the programme period. The labour market has stayed relatively stable, with low employment growth and largely unchanged unemployment. The 2002 update forecasts GDP growth of 2.1% in 2002, 2.5% in 2003-04, and an assumption of 2.3% in 2005. This scenario is more positive than the Commission's autumn forecast. This can largely be explained by the fact that the Swedish government expect a stronger pick-up in private consumption and project a stronger external recovery than the Commission. This would result in higher GDP growth, compared with the Commission's forecast.

Public finances in Sweden are in good shape, owing to a successful fiscal consolidation programme initiated in the mid-1990s, and a strengthened budgetary framework with an ambitious medium-term fiscal rule of a 2% of GDP surplus over the cycle. In the 2002 update, a surplus of 1.7% of GDP in 2002 is projected, followed by slightly lower surpluses in 2003 and 2004. For 2005, an assumption of a surplus of 2% of GDP is made. Moreover, the debt ratio – below 60% of GDP since 2000 - is projected to continue on a downward trend and reach 48% of GDP in 2005. The Commission's view is for lower surpluses and slower debt reduction, resulting from a less buoyant growth outlook. Therefore, efforts to maintain tight expenditure control and achieving a surplus in accordance with the 2% of GDP surplus target in 2003 are important in the light of the 2002 Broad Economic Policy Guidelines.

According to the Commission's calculations, continued surpluses in the cyclically-adjusted balance in each year over the period underpin that the public finances should remain sound. Taking account of some transitory factors e.g. the change in tax revenues resulting from, in part, the large fluctuations in stock market prices does not alter this view. Therefore, the underlying budgetary position is expected to remain in surplus over the programme period. However, the underlying budgetary surplus is expected to be below Sweden's 2% of GDP fiscal rule in the years to 2004, according to the Commission's analysis. This results from the fact that the considerable fiscal stimulus in 2001 and 2002 is only partially reversed in the following years. Nevertheless, even if growth turned out worse than expected, this would be unlikely to put compliance with the Stability and Growth Pact at risk. It can therefore be concluded that Sweden continues to fully respect the Stability and Growth Pact's requirement of a fiscal position 'close to balance or in surplus' over the programme period.

As in the previous updates strong public finances are considered an important pre-requisite for a stability-oriented macro-economic framework. In 2002, the third tranche of tax cuts, corresponding to 1.1% of GDP, was implemented. This was in line with both the previous Council Opinion[7] and the BEPGs. The expenditure ceilings have been instrumental in strengthening the credibility of sound public finances in recent years. These ceilings remain a key ingredient in achieving expenditure control and the Swedish government's firm commitment to continue to adhere to this is welcome. However, given that there are clear downside risks to the economic outlook presented in the programme and that the budgetary margins within

[7] OJ, C 33, (2002/C 33/04), 6.2.2002.

these ceilings are very narrow, some restraining measures may be necessary in order not to breach the expenditure ceilings, in line with the Budget Law.

The attention given in the 2002 update to the sustainability of public finances is welcome. On the basis of current policies, public finances appear to be on a sustainable footing to meet the budgetary costs of ageing populations, benefiting from the sustained running of budget surpluses and the ambitious reform of the pension system implemented during the 1990s. A prudent approach is needed when considering long-run budgetary developments, and the budgetary strategy to prepare for ageing populations should not rely on savings in non-age related expenditure items which may not emerge in the absence of policy measures. The budgetary objective of running budget surpluses of 2% of GDP up to 2015 with a view to running down public debt at a fast pace seems warranted. This may however prove difficult for such a sustained period. It is noted that the tax ratio in Sweden is high compared to other industrialised countries. A challenge will be to complete the tax reform while safeguarding the achievements of the past decade of placing public finances on a sustainable path.

CPI inflation in Sweden fell back towards 2% in the spring of 2002 after having risen sharply one year earlier, influenced by these favourable base effects. The Riksbank's assessment is that looser monetary conditions, as reflected in the recent cuts in the repo-rate in November and December this year (totalling 50 bp and thereby annulling the two increases of 25 bp each made in the spring 2002), should not result in inflation rising much beyond the inflation target. However, re-negotiations of wage agreements foreseen in the beginning of 2003 in some sectors might put some upward pressure on wages. Swedish HICP inflation has been on a declining path since March 2002. It was slightly higher than the EU average in October (Swedish 12-month average inflation rate at 2.2% compared with 2% in the EU). Sweden continues to fulfil the convergence criterion for price stability.

Long-term interest rates in Sweden over the past year have been in line with the trend in the international bond and equity markets. Bond yields fell globally during the summer and fall, in response to the gloomier growth outlook and the better inflation outlook, as well as in response to equity market weakness. Sweden continues to fulfil the long-term interest rate convergence criterion. The 2002 update states that Sweden does still not intend to bring the Swedish krona into ERM2. It has recently exhibited some volatility against the euro. Hence, as was the case at the time of the 2001 assessment of convergence, Sweden does not fulfill the exchange rate criterion. The Council has stated in its previous Opinion[8] that "Sweden needs to demonstrate its ability to stay in line with an appropriate parity between the krona and the euro over a sufficient period of time without severe tensions. To this end, the Council expects Sweden to decide to join the ERM2 in due course." Furthermore, current legislation is not in compliance with the statute of the ESCB, as concluded in the Commission's Convergence Report 2002[9].

In order to obtain respectable and sustainable economic growth, structural measures are being undertaken with a view to enhancing the supply side of the economy. In this context, the programme strategy is broadly consistent with the Broad Economic

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[8] OJ, C 33, (2002/C 33/04), 6.2.2002
[9] COM(2002) 243, 22.5.2002.

Policy Guidelines. Completing the tax reform and efforts to reach the key policy objectives regarding employment, social security recipients and days of sick-leave should be given priority within the framework of sound public finances.

Based on this assessment, the Commission has adopted the attached recommendation for a Council opinion on the convergence programme update of Sweden and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Article 9 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated convergence programme of Sweden, 2002-2004

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[10], and in particular Article 9 (3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On [21 January 2003] the Council examined Sweden's updated convergence programme, which covers the period 2002 - 2004. This update provides detailed information, including the analysis of the long-term sustainability of public finances, which is broadly in line with code of conduct. The lack of detailed information for 2005 in the programme is not in line with the code of conduct. However, the Council recognises that the government's Budget Bill for 2003 did not include budgetary plans for 2005 as a result of prolonged negotiations with respect to forming a government in autumn 2002.

The Council considers that the updated programme is consistent with the previous Council Opinion[11] and the Broad Economic Policy Guidelines.

The Council notes with satisfaction that the updated Programme envisages continued government surpluses throughout the period to 2004 as Sweden maintains its medium term objective of a budget surplus of 2% of GDP on average over the business cycle. The strategy of maintaining sound public finances is supported by a commitment to continue to adhere to the ceilings for central government expenditure, which has been instrumental in strengthening the credibility of sound public finances in recent years, and a balanced budget constraint for local governments. This has been accompanied by tax cuts, of which the third step out of four was implemented in 2002. The Council further notes with satisfaction that the debt ratio remains below the reference value of 60% of GDP, and is projected to continue on a downward trend over the remainder of the programme period.

[10] OJ L209, 2.8.1997
[11] OJ C 33, 6.2.2002.

The macroeconomic scenario presented in the programme, with GDP growth of 2.1% in 2002 and 2.5% in 2003 appears somewhat optimistic and the Council considers that there are downside risks to growth. Indeed, the Commission's autumn forecast is for growth of 1.6% in 2002 and 2.2% in 2003, suggesting a more subdued economic recovery, as there are signs of some fragility both externally and domestically. Economic growth can therefore be expected to return only gradually to the potential growth rate.

The Council considers that Sweden continues to fully respect the Stability and Growth Pact's requirement of a fiscal position 'close to balance or in surplus' over the programme period. Indeed, continued surpluses in the cyclically adjusted budgetary position in each year over the period underpin that the public finances should remain sound. However, the Council notes that, on the basis of the Commission's analysis, the underlying budgetary position is expected to remain in surplus but below Sweden's 2% of GDP fiscal rule in the years to 2004. This results from the fact that the considerable fiscal stimulus in 2001 and 2002 is only partially reversed in the following years . Moreover, some restraining measures may be necessary in order to ensure adherence to the expenditure ceilings.

The Council considers that on the basis of current policies, public finances appear to be on a sustainable footing to meet the budgetary costs of ageing populations, benefiting from the sustained running of budget surpluses and the ambitious reform of the pension system implemented during the 1990s. The Council considers that a prudent approach is needed when considering long-run budgetary developments, and that the budgetary strategy to prepare for ageing populations should not rely on savings in non-age related expenditure items which may not emerge in the absence of policy measures. The Council welcomes the budgetary objective of running budget surpluses of 2% of GDP up to 2015 with a view to running down public debt at a fast pace. This may however prove difficult for such a sustained period. A challenge will be to complete the tax reform while safeguarding the achievements of the past decade of placing public finances on a sustainable path.

Inflation in Sweden fell back towards the inflation target of 2% in the spring of 2002. The Council notes that Sweden continues to fulfil the convergence criterion on price stability and is expected to continue do so in the years to 2004. Long-term interest rates in Sweden over the past year have been in line with the trend in the international bond and equity markets. Sweden continues to fulfil the long-term interest rate convergence criterion. Regarding the exchange rate, the krona has not participated in the ERM2 and it has exhibited some volatility since the submission of the previous update. Hence, Sweden does still not fulfil the exchange rate convergence criterion. The Council considers, as stated in its previous Opinion[12], that "Sweden needs to demonstrate its ability to stay in line with an appropriate parity between the krona and the euro over a sufficient period of time without severe tensions. To this end, the Council expects Sweden to decide to join the ERM2 in due course."

In order to obtain high and sustainable economic growth, the strategy of previous programmes is continued and structural measures in this regard have been implemented and proposed, in line with the Broad Economic Policy Guidelines. To this end, the Council considers that completing the tax reform and efforts to reach the key policy objectives regarding employment, social security recipients and days of sick-leave should be given high importance within the framework of sound public finances.

[12] OJ, C 33, (2002/C 33/04), 6.2.2002