COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.1.2004
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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, 2003-2006

(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] and updates were presented every following year.

Sweden submitted the fifth and most recent updated convergence programme, covering the period 2003-06, on 1 December 2003. The Commission services have carried out a technical evaluation of this updated programme, taking into account the information provided in accordance with the Code of Conduct[3], the Autumn forecasts as well as subsequent evaluations, the commonly agreed methodology for the estimation of cyclically-adjusted balances, the recommendations in the Broad Economic Policy Guidelines and the principles laid down in the Communication of the Commission to the Council of 27 November 2002 on strengthening the co-ordination of budgetary policies[4]. This evaluation warrants the following assessment:

> The 2003 updated Swedish convergence programme covers the period 2003 to 2006 and is based on the Budget Bill for 2004. The Budget was adopted by parliament in December 2003. The updated programme provides detailed information and an elaborated description of structural issues, including the cyclical position of the economy together with its impact on public finances. In addition, the long-term sustainability of public finances is covered in some detail. This is broadly in line with Code of Conduct. According to the 2003 update, the focus of economic policy continues to be full employment and increased prosperity through high, sustainable growth. The stability-oriented macro-economic policy framework of stable prices and sound public finances remains in place.
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> As in the rest of the EU, the Swedish economy has developed less favourably than foreseen in the 2002 update. The 2003 update projects GDP growth of 1.4% in 2003, 2.0% in 2004, 2.6% in 2005 and 2.5% in 2006. The labour market has deteriorated in 2003, with negative employment growth and a rise in the unemployment rate, and it is not expected to recover until 2005. This scenario is broadly in line with the

1 OJ L 209, 2.8.1997. All the documents referred to in this text can be found at the following web site http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

2 OJ C 68, 11.3.1999.

3 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

4 COM(2002) 668 final, 27.11.2002.

Commission's evaluation including the Autumn forecast, though the Commission's forecast foresees somewhat weaker labour market developments.

Public finances in Sweden remain 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 surplus target 2% of GDP on average over the cycle. In the 2003 update, a surplus of 0.4% of GDP in 2003 is targeted, followed by gradually higher surpluses in the years to 2006. Moreover, the gross debt ratio – below 60% of GDP since 2000 - is projected to continue to decline and reach 48.3% of GDP in 2006 and the low net debt ratio is expected to turn into a net claim in 2006. The Commission's view is in line with these projections.

The considerable fiscal stimulus in 2002 - which was possible given the existing sound fiscal position - and the prolonged period of relatively subdued economic growth weighs on the government finances. Nevertheless, the cyclically-adjusted fiscal position is expected to remain sound and to strengthen gradually, although remaining lower than the 2% of GDP target in each year to 2005, according to both the Commission's analysis and the estimates in the 2003 update.

The main instruments for maintaining sound government finances continue to be i) the expenditure ceilings for central government and ii) the balanced budget constraint for local governments. The budgetary margin included under the ceiling for 2004 is very narrow, suggesting that close monitoring remains important and corrective measures might be called for in case of worse-than-expected developments. For 2005 and 2006, the budgetary margins are appropriately larger. According to calculations in the update, the 2% of GDP surplus target will be met on average over the period 2000-2006. However, this hinges inter alia on the achievement of the expenditure ceiling in 2004 and expenditure plans in 2005 and 2006 for central government, suggesting that there is little room, if any, for further deterioration in this respect. The 2003 update projects that the balanced budget requirement is met for the local government sector during the period 2004-06. In order for local governments to comply with the balanced budget constraint, several local governments raised tax rates in 2003. Some additional rises are foreseen in 2004. Despite this, some of the larger local governments appear to face great difficulties in achieving balance, resulting in proposed rises in both taxes and charges. If local governments are to achieve a balanced budget, they may be forced to raise taxes further. This could, all else equal, reverse the achievement in recent years of reducing the overall tax burden, which in turn could have adverse effects on economic growth.

The 2003 update includes a detailed section on the likely impact of ageing population on public finances. Age-related expenditures are expected to increase by 6.7% of GDP between 2007 and 2050. On the basis of current policies, Sweden appears to be in a relatively good position to meet the budgetary costs associated with ageing populations. Long term projections show that gross debt will stay below 60% of GDP at all times and that the adjusted gross debt will fall close to zero. This is largely due to the reformed pension system and the medium term strategy to come back to a structural surplus of 2% of GDP. However, the increase of health care expenditure, including expenditure related to ill health, foreseen in the projections needs to be addressed as the update notes that further measures are necessary in order to achieve the target of half the number of sick days. Moreover, according to the Commission's analysis the medium term target has to be reached; failure to do so can determine some budgetary unbalances in the very long term. In addition, as noted in the Broad Economic Policy Guidelines, “additional efforts appear necessary to improve further the incentives to work, notably as Sweden still has the highest overall tax burden in the EU and relatively generous benefit schemes in an international perspective”.

Inflation in Sweden has come down recently, after having been relatively high due to temporary factors in the beginning of 2003. New wage agreements for the most part of the labour market are expected to be reached in the beginning of 2004. So far, it appears likely that wage increases will remain moderate, in party linked to poor labour market developments.

Over the past year, developments in Swedish bond yields have been in line with trends in international bond markets. The 2003 update states that entering ERM II is not under consideration. Compared to developments in previous years, the krona has been relatively stable in 2002 and 2003.

In order to obtain sustainable economic growth, structural measures are being undertaken with a view to enhancing the supply side of the economy. However, some planned measures could have an adverse impact on labour supply. In this context, the programme strategy is broadly consistent with the Broad Economic Policy Guidelines. Completing the tax reform and efforts to reach the key policy objectives of raising employment, reducing the number of 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, 2003-2006

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[5], 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 20 January 2004 the Council examined Sweden's updated convergence programme, which covers the period 2003 - 2006. The updated programme broadly complies with the data requirements of the revised "code of conduct" on the content and format of stability and convergence programmes.

The budgetary strategy underlying the update is based on a continuation of the medium term objective of a budget surplus of 2% of GDP on average over the cycle, aimed at preparing for the expected budgetary impact of the ageing of the population and the sustainability of public finances in the long-term. The planned return to a general government surplus of 2% of GDP beyond 2006 relies in particular on a decline in the expenditure-to-GDP ratio from 2004 onwards which is expected to rise in 2003, but also on a decline in the revenue-to-GDP ratio from 2005 onwards which is expected to rise in 2003 and remain unchanged in 2004.

The update projects real GDP growth to accelerate from an estimated 1.4% in 2003 to 2.0% in 2004. In 2005 and 2006, growth is estimated to be 2.6% and 2.5%, respectively. Employment growth is expected to pick up from 0.1% in 2004 to 0.7% in 2005 and 2006. CPI inflation is forecast to gradually increase from 1.3% in 2004 to slightly above 2% by 2006. On the basis of currently available information, the macroeconomic scenario underlying the update seems realistic and is in line with the Commission evaluation including the autumn forecast.

[5] OJ L 209, 2.8.1997.

The update targets a general government surplus of 0.6% of GDP in 2004, compared with an expected surplus of 0.4% in 2003. In cyclically-adjusted terms, based on Commission calculations according to the commonly agreed methodology, there is an improvement from 0.5% to 1% of GDP. For 2005 and 2006, the projections are for headline surpluses of 1.4% and 1.9% of GDP, respectively. In cyclically-adjusted terms, the corresponding surpluses would amount to 1.8% and 2.3% of GDP, respectively. The debt ratio is projected to decline gradually, from 51.7% in 2003 to 48.3% in 2006.

The budgetary stance in the programme should provide a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations. Under plausible macroeconomic and budgetary assumptions, the medium-term objective of a budgetary position of close to balance or in surplus should be maintained throughout the programme period.

However, on the basis of the Commission's analysis and the estimates in the 2003 update, the cyclically adjusted budgetary position is expected to be in surplus but below Sweden's 2% of GDP surplus target in the years to 2005. This results from the fact that the considerable fiscal stimulus in 2002 is only partially reversed in the following years. Strict expenditure control therefore remains important in this respect, not least by ensuring continued adherence to the expenditure ceiling in 2004 and the expenditure plans in 2005 and 2006.

On the basis of current policies, Sweden should be able to meet the projected budgetary costs of an ageing population. However, the increase of health care expenditure, including expenditure related to ill health, foreseen in the projections needs to be addressed as the update notes that further measures are necessary in order to achieve the target of half the number of sick days. Moreover, according to the Commission's analysis the medium term target has to be reached; failure to do so can determine some budgetary unbalances in the very long term.

The economic policies as reflected in the updated programme are broadly consistent with the recommendations in the Broad Economic Policy Guidelines. However, some planned measures could have an adverse impact on labour supply. Completing the tax reform, and efforts to reach the key policy objectives of raising employment, reducing the number of social security recipients and days of sick-leave should be given priority within the framework of sound public finances.