COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 11.1.2005
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Recommendation for a

COUNCIL OPINION

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

On the updated convergence programme of Sweden, 2004-2007

(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 coordination of economic policies[1] stipulates that non-participating Member States, that is, those which have not adopted the single currency, had 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 assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). On the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme. According to the Regulation, Member States need to submit annual updates of their convergence programmes, which may also be examined by the Council in accordance with these same procedures.

The first convergence programme of Sweden, covering the period 1998-2001, was submitted on 23 December 1998 and assessed by the Council on 8 February 1999. Updates were presented every following year. Sweden submitted the most recent update of its convergence programme on 18 November 2004. The Commission services have carried out a technical evaluation of this update, taking into account the results of the Commission services Autumn 2004 economic forecasts, and having regard to the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances, the recommendations in the broad economic policy guidelines for the period 2003-2005 and the principles laid down in the Communication from the Commission to the Council and the European Parliament of 27 November 2002 on strengthening the coordination of budgetary policies[3], endorsed by the Council. This evaluation is as follows:

- The sixth updated Swedish convergence programme was sent to the Commission on 18 November and covers the period 2004 to 2007. The programme is based on the Budget Bill for 2005 adopted by Parliament on 16 December 2004. The programme complies partly with the data requirements of the "code of conduct on the content and format of stability and convergence programmes"[4] with some data not fully in line with ESA95 standards.

- The 2004 update projects GDP growth of 3.5% in 2004, 3.0% in 2005, 2.5% in 2006 and 2.3% in 2007. Despite high growth in 2004, employment growth was negative but is expected to recover in the coming years. Overall, on the basis of currently available information, the macroeconomic scenario underlying the update seems plausible and is broadly in line with the Commission services' evaluation including the autumn 2004

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

2 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.

3 COM(2002) 668 final, 27.11.2002.

4 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, document EFC/ECFIN/404/01 - REV 1 of 27.6.2001 endorsed by the ECOFIN Council of 10.7.2001.

forecast. Moreover, for the later years the growth assumptions appear cautious and below estimated potential growth rates.

– Inflation in Sweden has fallen gradually since the beginning of 2003, partly as a result of earlier energy price increases falling outside the base reference period, and is currently clearly below the Riksbank 2% target level. The krona has been relatively stable vis-à-vis the euro in 2003 and 2004 but has appreciated recently, reflecting Sweden's stable macroeconomic environment and solid growth outlook, large current account surpluses, and market expectations of relatively higher policy rates in the course of 2005. Over the past year, developments in Swedish bond yields have been in line with trends in major bond markets. The positive yield differential between long-term government bonds in Sweden and the euro area fluctuated around 50 basis points over recent years but declined in the course of 2004.

– The budgetary framework in Sweden includes a general government surplus objective of 2% of GDP on average over the cycle, multi-annual nominal ceilings for central government expenditures and a balanced budget requirement for local governments. The update foresees a general government surplus of 0.7% in 2004, 0.6% in 2005, 0.4% in 2006 and 0.9% in the final year, 2007. Both expenditure and revenue ratios are on a gradually declining trend over the projection period. Adjusting for the estimated impact of the cycle using the common methodology, the cyclically-adjusted budget balance is in surplus throughout the projection period. Compared to previous updates, budget targets for 2005 and 2006 have been revised downwards despite growth assumptions now being significantly higher. This can partly be explained by lower projected tax revenues in line with recent outturns. Tax reductions introduced in the 2004 Spring Bill and the 2005 budget also contribute to the projected slight weakening in 2005 and 2006. While the pension system and the local government sub-sector are expected to show stable surpluses, the central government deficit is increasing in 2005 and 2006, thus driving the deterioration in the general government position in these years. In 2007 lower government expenditure is foreseen.

– The risks to the budgetary projections in the programme appear broadly balanced. On the one hand the budgetary projections seem plausible and Sweden has a very good track record in not exceeding set expenditure ceilings. In addition, the financial situation at local government level seems to be improving. On the other hand, tax revenues have been quite volatile over the last few years. In addition, the budgetary margin against the central government expenditure ceilings is very narrow not only for 2004 but, according to the 2005 budget, also for 2005 and 2006. Furthermore, elections scheduled for 2006 might influence the budget for that year. In view of this risk assessment, the budgetary stance in the programmes seems sufficient to maintain a medium-term budgetary position of "close to balance or in surplus" as required by the Stability and Growth Pact throughout the programme period. It also provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations. However, cyclically-adjusted budget positions as well as average surpluses over the programme period remain below the domestic objective of a surplus of 2% of GDP.

– The gross debt ratio - below 60% of GDP since 2000 - is projected to continue to decline and reach 49% of GDP in 2007. Debt is mainly issued by the central government sector - which runs budget deficits - and the surplus in the pension system is mainly invested in non-government assets, thus slowing the reduction in the gross debt ratio. The debt ratio net of financial assets is projected to improve from some -2% of GDP in 2004 to below -4% in 2007. These projections seem reasonable.

– The programme reviews the government's wider structural reform programme which focuses on improving the functioning of the labour market, increasing employment and reducing the number of working days lost to sick leave. A broad range of measures have been implemented but the results have so far been mixed. A further step has been taken to complete the tax reform and to ease labour taxation further in the framework of the 'green tax swap' strategy, though this has been partially offset by increases in local government tax rates in both 2003 and 2004. Completion of 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 continue to have priority within the framework of sound public finances.

– Sweden appears to be in a relatively favourable position with regard to long-term sustainability of the public finances, of which the projected budgetary cost of an ageing population is an important element. A sustainability gap of around 2% of GDP arises if the country wants to ensure full sustainability over time. This is based on the projected increase in the old-age dependency ratio and existing trends in healthcare-related expenditures, labour force participation and employment. Without further reforms modifying these trends, aiming at a budgetary surplus over the next 10 years of 2% of GDP, in line with the government's budgetary target, will become a key factor in addressing sustainability over the longer term.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007
Real GDP (% change)	**CP Nov 2004**	**3.5**	**3.0**	**2.5**	**2.3**
	COM	3.7	3.1	2.9	n.a.
	CP Nov 2003	2.0	2.6	2.5	n.a.
HICP inflation (%)	**CP Nov 2004**[2]	**1.3**	**1.5**	n.a.	n.a.
	COM	1.1	1.5	1.9	n.a.
	CP Nov 2003[2]	1.7	n.a.	n.a.	n.a.
General government balance (% of GDP)	**CP Nov 2004**	**0.7**	**0.6**	**0.4**	**0.9**
	COM	0.6	0.6	0.8	n.a.
	CP Nov 2003[3]	0.6	1.4	1.9	n.a.
Primary balance (% of GDP)	**CP Nov 2004**[1]	**2.8**	**2.8**	**2.7**	**3.3**
	COM	2.7	2.8	3.0	n.a.
	CP Nov 2003	0.9	1.7	2.1	n.a.
Cyclically-adjusted balance (% of GDP)	**CP Nov 2004**[4]	**0.8**	**0.5**	**0.5**	**1.2**
	COM	**0.7**	**0.4**	**0.6**	n.a.
	CP Nov 2003[4]	**1.3**	**1.8**	**2.0**	n.a.
Government gross debt (% of GDP)	**CP Nov 2004**	**51.7**	**50.5**	**50.0**	**49.0**
	COM	51.6	50.6	49.7	n.a.
	CP Nov 2003	51.5	50.0	48.3	n.a.

[1] In the update, the Swedish authorities provide primary balances excluding net interest and not the conventional gross interest. However, in the table, primary balances are given excluding gross interest using data from the update.
[2] % change Dec-Dec
[3] For comparability,net lending reported for the 2002 and 2003 updates refers to figures calculated taking into account the full periodisation of taxes (while this accounting change was not formally introduced until 2004).
[4] Commission services calculations on the basis of information in the programme.
Sources:
Updated Swedish Convergence Programme, November 2003 and November 2004 (CP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations

On the basis of this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the updated convergence programme of Sweden and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

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

On the updated convergence programme of Sweden, 2004-2007

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 coordination 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:

(1) On [18 January] 2005 the Council examined the updated convergence programme of Sweden, which covers the period 2004 to 2007. The programme partly complies with the data requirements of the revised "code of conduct on the content and format of stability and convergence programmes". In particular, some data are not fully in line with ESA95 standards. Accordingly, Sweden is invited to achieve full compliance with data requirements.

(2) The macroeconomic scenario underlying the programme envisages real GDP growth moderating from a strong 3.5% in 2004 to 3.0% in 2005 and an average 2.4% in 2006-07. On the basis of currently available information, this scenario seems to reflect plausible growth assumptions. The programme's projections for inflation appear realistic.

(3) The budgetary framework includes a general government surplus objective of 2% of GDP on average over the cycle, multi-annual nominal ceilings for central government expenditures and a balanced budget balance requirement for local governments. The

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

update foresees general government surpluses of 0.7% in 2004, 0.6% in 2005, 0.4% in 2006 and 0.9% in the final year, 2007. Both expenditure and revenue ratios are on a gradually declining trend over the projection period. Adjusting for the estimated impact of the cycle using the common methodology, the cyclically-adjusted budget balance is in surplus throughout the projection period. However, cyclically-adjusted budget positions as well as average surpluses over the programme period remain below the domestic objective of a surplus of 2% of GDP. While the pension system and the local government sub-sector are expected to show surpluses, the central government deficit is increasing in 2005 and 2006, thus driving the deterioration in the general government position in these years. In 2007 lower government expenditure is foreseen.

(4) The risks to the budgetary projections in the programme appear broadly balanced. On the one hand, the budgetary projections seem plausible and Sweden has a very good track record in not exceeding set expenditure ceilings. In addition, the financial situation at local government level seems to be improving. On the other hand, taxes have shown to be quite volatile over the last few years. In addition, the budgetary margin against the central government expenditure ceilings is very narrow not only for 2004 but, according to the 2005 budget, is expected to be so also for 2005 and 2006. Furthermore, elections scheduled for 2006 might influence the budget for that year.

(5) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the achievement of surpluses over the 2004 to 2007 period in line with the Stability and Growth Pact's medium-term objective of a position of close to balance or surplus. It also provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period.

(6) The debt ratio is estimated to have reached 51.7% of GDP in 2004, well below the 60% of GDP Treaty reference value. The programme projects the debt ratio to decline to 49.0% of GDP by 2007.

(7) Sweden appears to be in a relatively favourable position with regard to the long-term sustainability of the public finances, despite important projected budgetary costs of an ageing population. A sustainability gap of around 2% of GDP arises if the country wants to ensure full sustainability over time. This is based on the projected increase in the old-age dependency ratio and existing trends in healthcare-related expenditures, labour force participation and employment. Without further reforms modifying these trends, aiming at a budgetary surplus over the next 10 years of 2% of GDP, in line with the government's budgetary target, becomes a key factor to address sustainability over the longer term.

Key projections from the updated convergence programme of Sweden

	2003	2004	2005	2006	2007
Real GDP growth (%)	1.6	3.5	3.0	2.5	2.3
HICP inflation (%)	1.8	1.3	1.5	n.a	n.a
General government balance (% of GDP)	0.5	0.7	0.6	0.4	0.9
Primary balance (% of GDP)	2.7	2.8	2.8	2.7	3.3
Cyclically-adjusted balance (% of GDP)[1]	1.4	0.8	0.5	0.5	1.2
Government gross debt (% of GDP)	52.0	51.7	50.5	50.0	49.0

[1]Commission services calculations applying the commonly agreed methodology to the information in the programme