COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 11.1.2006
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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, 2005-2008

(presented by the Commission)

EXPLANATORY MEMORANDUM

Background

The Stability and Growth Pact, which entered into force on 1 July 1998, is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. In 2005, the Pact was amended for the first time. The reform acknowledged the Pact's usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Pact, stipulates that Member States have to submit, to the Council and the Commission, stability or convergence programmes and annual updates thereof (Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes). The first convergence programme of Sweden was submitted in December 1998. In accordance with the Regulation, the Council delivered an opinion on it on 8 February 1999 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. In accordance with the same procedure, updated stability and convergence programmes are assessed by the Commission and examined by the Committee mentioned above, while the Council may examine them.

In these programmes, Member States need to specify their medium-term objective for the budgetary position and set out the policy measures to achieve and maintain it, including the accompanying economic assumptions. Following the reform of the Pact, the medium-term objective should be differentiated for individual Member States in the light of the economic and budgetary heterogeneity in the Union, including as regards the fiscal risk to sustainability. Other elements of the reform are that a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in economic good times should be achieved, while "major structural reforms" with a verifiable impact on long-term sustainability should be taken into account for a temporary deviation from the medium-term objective or the adjustment path towards it.

Taking into account the Commission services' autumn 2005 forecast, the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances and the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008, the Commission has examined the recently submitted update of the convergence programme of Sweden and, based on its assessment below, has adopted a recommendation for a Council opinion on it.

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[1] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). 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] Opinion of the Economic and Financial Committee on the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005.

Assessment

(1) The sixth updated Swedish convergence programme was sent to the Commission on 24 November 2005 and covers the period 2005 to 2008. The programme is based on the Budget Bill for 2006 adopted by Parliament on 16 December 2005. The programme broadly follows the model structure for stability and convergence programmes specified in the new code of conduct. The programme has gaps in the compulsory and optional data prescribed by the new code of conduct (especially compensation of employees is missing). The Swedish programme does not explicitly define the medium-term objective (MTO) for the budgetary position as required by the code of conduct.

(2) Over the last decade, annual real GDP growth in Sweden has been slightly below 3% on average. This growth performance has been characterised by strong productivity developments and positive net export contributions. However, over the last few years employment growth has been weak and employment rates reduced while unemployment has increased. Inflation developments have stayed at the lower range of the Riksbank's target of 2% plus or minus one percentage point. Real GDP growth in the update is forecast to be 2.4% in 2005, then to pick up to 3.1% in 2006, 2.8% in 2007 and 2.3% in 2008. Employment growth is expected to recover in the coming years. Overall, the macroeconomic scenario underlying the update seems plausible and is broadly in line with the Commission services' evaluation including the autumn 2005 forecast. Calculations using the commonly agreed method on the basis of the update figures indicate that potential GDP growth rates remain relatively high but on a slightly declining trend in the medium term. There is a small amount of free resources in the economy in 2005 but already in 2006 the output gap is closing. Inflationary pressures are expected to remain subdued and gradually approach the Riksbank 2% target over the programme horizon. The programme's projections for inflation appear realistic.

(3) The krona has been relatively stable vis-à-vis the euro in 2002-2004 but has depreciated recently despite Sweden's stable macroeconomic environment, solid growth outlook and current account surpluses, probably reflecting the relatively low repo rates. The yield differential between long-term government bonds in Sweden and the euro area, standing at around 50 basis points in the start of 2004, has declined to almost zero.

(4) On 18 January 2005, in its opinion the Council endorsed the budgetary strategy presented in the 2004 update of the convergence programme of Sweden. Regarding the 2005 budgetary implementation, the 2004 update targeted a 0.6% of GDP general government surplus for 2005 while the current update forecast a 1.6% surplus despite a downward revision of 2005 growth. Overall, revenues have come in better than expected, partially explained by some one-off corporate taxes, but also expenditures have developed in a contained way.

(5) The budgetary framework in Sweden is geared at maintaining sound public finances in the context of full employment and sustainable growth. To this end it 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. This update foresees a general government surplus

of 1.6% in 2005, 0.9% in 2006, 1.2% in 2007 and 1.7% in the final year, 2008. Both expenditure and revenue ratios are on a gradually declining trend over the projection period. However, while the reduction in the revenue ratio is front-loaded, the reduction in the expenditure ratio is back-loaded. While the pension system and the local government sub-sector are expected to show stable surpluses, the central government deficit is driving the changes in the general government position. Sweden currently uses the transition period until spring 2007 for the implementation of the March 2004 Eurostat decision on the classification of second-pillar funded pension schemes. The effect on the general government balance of the implementation of this decision would be a downward adjustment of around 1% of GDP each year. Overall, compared with the previous programme, the new update broadly confirms the planned adjustment against a slightly more favourable macroeconomic scenario.

(6) Based on Commission services' calculations on the basis of the programme, according to the commonly agreed methodology, the estimated CAB net of one-offs is around 1% of GDP in 2006, reduced from around 1¾% in 2005. Thus, the fiscal expansion planned for 2006 takes place against a closing output gap and improving cyclical conditions. The CAB then gradually improves towards 1½-2% in 2007-2008.

(7) The programme presents the national surplus objective of 2% on average over the cycle as the guiding medium-term reference in the update strategy. It is also the cornerstone in the Swedish national budgetary rule-based framework. Therefore, 2% of GDP can be regarded as the programme's MTO.

(8) As the MTO implied in the programme is more demanding than the minimum benchmark (estimated at a deficit of about 0.5% of GDP), its achievement should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. As regards appropriateness, the programme's MTO is significantly more demanding than implied by the debt ratio and the average potential output growth. However, its achievement remains central for ensuring long-term sustainability.

(9) On balance, the risks to the budgetary projections in the programme appear to be on the positive side. This is because recent national accounts data point to 2005 growth having been higher than forecast in the programme. Moreover, recent cash data indicate that tax revenues have been substantially stronger towards the end of 2005 than those included in the update budget figures. Hence, the budgetary outcome could be better than projected in the programme.

(10) In view of this risk assessment, the budgetary stance outlined in the programme seems broadly sufficient to ensure that the programme's MTO will be reached by the end of the programme period. Nevertheless, the expansionary budget for 2006 makes the budget position diverge from the MTO by roughly 1% of GDP in 2006 and 2007, putting at risk the achievement of the MTO within the programme period. Moreover, there is a concern that the strong expansionary fiscal stance in 2006 (with the CAB deteriorating by almost 1 percentage point) may not be fully appropriate in the sense that this period may qualify as "good times". However, as stated above the programme's MTO is significantly more demanding than required by the Stability and Growth Pact. In particular, over the whole programme period there is a sufficient safety margin against breaching the 3% of GDP threshold for the deficit with normal cyclical fluctuations. This assessment would also seem be robust to the reclassification in 2007 of the second-pillar funded pension schemes outside the general government

accounts, as required by Eurostat. Overall, the budgetary position is sound and the budgetary strategy provides an example of fiscal policies run in compliance with the pact.

(11) The gross debt ratio is projected to continue to decline and reach 46% of GDP in 2008. 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 negative implying that the general government sector has a net asset position. This is projected to improve from some -6% of GDP in 2004 to close to -9% in 2008. These projections seem plausible.

(12) With regard to the sustainability of public finances, Sweden appears to be at low risk on grounds of the projected budgetary costs of ageing populations. The level of gross debt is currently comfortably below the 60% reference value and is projected to remain below the reference value throughout most of the programme period. The Swedish strategy of putting sustainability concerns at the heart of fiscal policy making, including the pension system reform, which contains pension expenditure and involves accumulation of assets, contributes positively to the outlook for the public finances. The currently favourable budgetary position contributes to limit the projected budgetary impact of ageing populations while the planned consolidation towards the 2% MTO at the end of the programme period contributes to improve sustainability.

(13) The envisaged measures are broadly consistent with the broad economic policy guidelines in the area of public finances, included in the integrated guidelines for the period 2005-2008. While a sufficiently strong medium-term budgetary position is planned to be maintained, the departure from the MTO in 2006-2007 may risk being pro-cyclical and also puts at risk the achievement of the MTO at the end of the programme period.

(14) Sweden’s National Reform Programme (NRP), submitted on 21 October 2005 within the context of the renewed Lisbon strategy for growth and jobs, put great emphasis on sustainable development and emphasises that the achievement and maintenance of high labour market participation and hours worked are important challenges, and will have a significant impact on public finances in the long term. The NRP incorporates the 2006 budget on which also the programme update is based and in this sense the two documents are consistent.

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, 2005-2008

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[3], 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 [24 January 2006] the Council examined the updated convergence programme of Sweden, which covers the period 2005 to 2008. The programme broadly follows the model structure for stability and convergence programmes specified in the new code of conduct. The programme has gaps in the compulsory and optional data prescribed by the new code of conduct (especially compensation of employees is missing). The Swedish programme does not explicitly define the medium-term objective (MTO) for the budgetary position as required by the code of conduct.

(2) Annual real GDP growth in Sweden has been slightly below 3% on average over the last decade. This growth performance has been characterised by strong productivity developments and positive net export contributions. However, over the last few years employment growth has been weak and employment rates reduced while unemployment has increased. The macroeconomic scenario underlying the programme envisages that real GDP growth will rise from 2.4 % in 2005 to 3.1% in 2006 and average 2.5% over the following two years of the programme period. In the first two years of the programme period the growth outlook implies an improvement of cyclical conditions, which then are projected to stay broadly neutral. Assessed against

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3 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, 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

currently available information, this scenario appears to be plausible. The programme's projections for inflation appear realistic.

(3) On 18 January 2005, in its opinion the Council endorsed the budgetary strategy presented in the 2004 update of the convergence programme of Sweden. Regarding the 2005 budgetary implementation, the 2004 update targeted a 0.6% of GDP general government surplus for 2005 while the current update forecast a 1.6% surplus despite a downward revision of 2005 growth. Overall, revenues have come in better than expected, partially explained by some one-off corporate taxes, but also expenditures have developed in a contained way.

(4) The budgetary framework is geared at maintaining sound public finances in the context of full employment and sustainable growth. To this end it 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. This update foresees general government surpluses of 1.6% in 2005, 0.9% in 2006, 1.2% in 2007 and 1.7% in the final year, 2008. Both expenditure and revenue ratios are on a gradually declining trend over the projection period. The decline in the revenue ratio is front-loaded to 2006 due to tax cuts while the decline in the expenditure ratio is back–loaded, taking place against a forecast improvement in the labour market. Compared to the previous update, the current update broadly confirms a similar planned fiscal adjustment in the context of a more favourable macroeconomic scenario.

(5) The programme presents the national surplus objective of 2% on average over the cycle as the guiding medium-term reference in the update strategy. It is also the cornerstone in the Swedish national budgetary rule-based framework. Therefore, 2% of GDP can be regarded as the programme's MTO as it is in line with the principles for MTOs specified in the Stability and Growth Pact and the code of conduct. Over the programme period, the structural balance calculated according to the commonly agreed methodology is planned to improve from about 1% of GDP in 2006 to about 1½-2% of GDP in 2008.

(6) As the medium-term objective (MTO) implied in the programme is more demanding than the minimum benchmark (estimated at a deficit of about 0.5% of GDP), its achievement should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. As regards appropriateness, the programme's MTO is significantly more demanding than implied by the debt ratio and the average potential output growth. However, its achievement remains central for ensuring long-term sustainability.

(7) The budgetary outcome in 2005 could be better than projected in the programme. In particular, recent cash-based information on tax revenues and quarterly national accounts support this assessment.

(8) In view of this risk assessment, the budgetary stance outlined in the programme seems broadly sufficient to ensure that the programme's MTO will be reached by the end of the programme period. Nevertheless, the expansionary budget for 2006 makes the budget position diverge from the MTO by roughly 1% of GDP in 2006 and 2007, putting at risk the achievement of the MTO within the programme period. Moreover, there is a concern that the strong expansionary fiscal stance in 2006 (with the

cyclically-adjusted budget balance deteriorating by almost 1 percentage point) may not be fully appropriate in the sense that this period may qualify as "good times". However, as stated above the programme's MTO is significantly more demanding than required by the Stability and Growth Pact. In particular, over the whole programme period there is a sufficient safety margin against breaching the 3% of GDP threshold for the deficit with normal cyclical fluctuations. This assessment would also seem be robust to the reclassification in 2007 of the second-pillar funded pension schemes outside the general government accounts, as required by Eurostat. Overall, the budgetary position is sound and the budgetary strategy provides an example of fiscal policies run in compliance with the pact.

(9) The debt ratio is estimated to have reached about 51% of GDP in 2005, well below the 60% of GDP Treaty reference value. The programme projects the debt ratio to decline to 46% of GDP by 2008.

(10) With regard to the sustainability of public finances, Sweden appears to be at low risk on grounds of the projected budgetary costs of ageing populations. The level of gross debt is currently comfortably below the 60% reference value and is projected to remain below the reference value throughout most of the programme period. The Swedish strategy of putting sustainability concerns at the heart of fiscal policy making, including the pension system reform, which contains pension expenditure and involves accumulation of assets, contributes positively to the outlook for the public finances. The currently favourable budgetary position contributes to limit the projected budgetary impact of ageing populations while the planned consolidation towards the 2% MTO at the end of the programme period contributes to improve sustainability[4].

(11) The envisaged measures in the area of public finances are broadly consistent with the broad economic policy guidelines, included in the integrated guidelines for the period 2005-2008. While a sufficiently strong medium-term budgetary position is planned to be maintained, the departure from the MTO in 2006-2007 may risk being pro-cyclical and also puts at risk the achievement of the MTO at the end of the programme period.

(12) Sweden's National Reform Programme (NRP), submitted on 21 October 2005 within the context of the renewed Lisbon strategy for growth and jobs, put great emphasis on sustainable development and emphasises that the achievement and maintenance of high labour market participation and hours worked are important challenges, and will have a significant impact on public finances in the long term. The NRP incorporates the 2006 budget on which also the programme update is based and in this sense the two documents are consistent.

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4 Details on long-term sustainability are provided in the technical assessment of the programme by the Commission services, to be published at the website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

Comparison of key macroeconomic and budgetary projections[1]

		2004	2005	2006	2007	2008
Real GDP (% change)	**CP Nov 2005**	**3.6**	**2.4**	**3.1**	**2.8**	**2.3**
	COM Nov 2005	3.6	2.5	3.0	2.8	n.a.
	CP Nov 2004	*3.5*	*3.0*	*2.5*	*2.3*	*n.a.*
HICP inflation (%)	**CP Nov 2005**	**0.9**	**1.5**	**1.5**	**2.0**	**2.0**
	COM Nov 2005	1.0	0.7	1.4	1.8	n.a.
	CP Nov 2004	*1.3*	*1.5*	*n.a.*	*n.a.*	*n.a.*
Output gap (% of potential GDP)	**CP Nov 2005[2]**	**-0.3**	**-0.4**	**-0.1**	**0.1**	**-0.1**
	COM Nov 2005[6]	-0.3	-0.4	-0.1	0.0	n.a.
	CP Nov 2004[2]	*-0.1*	*0.1*	*-0.2*	*-0.4*	*n.a.*
General government balance (% of GDP)	**CP Nov 2005**	**1.6**	**1.6**	**0.9**	**1.2**	**1.7**
	COM Nov 2005	1.6	1.4	0.8	1.1	n.a.
	CP Nov 2004	*0.7*	*0.6*	*0.4*	*0.9*	*n.a.*
Primary balance (% of GDP)	**CP Nov 2005**	**3.2**	**3.2**	**2.5**	**3.0**	**3.6**
	COM Nov 2005	3.4	3.2	2.6	2.9	n.a.
	CP Nov 2004	*2.8*	*2.8*	*2.7*	*3.3*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**CP Nov 2005[2]**	**1.7**	**1.8**	**0.9**	**1.1**	**1.7**
	COM Nov 2005	1.8	1.6	0.9	1.1	n.a.
	CP Nov 2004[2]	*0.8*	*0.5*	*0.5*	*1.2*	*n.a.*
Structural balance[3] (% of GDP)	**CP Nov 2005[4]**	**1.1**	**1.6**	**0.9**	**1.1**	**1.7**
	COM Nov 2005[5]	1.2	1.4	0.9	1.1	n.a.
	CP Nov 2004	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**CP Nov 2005**	**51.1**	**50.9**	**49.4**	**47.8**	**46.0**
	COM Nov 2005	51.1	50.6	49.4	47.8	n.a.
	CP Nov 2004	*51.7*	*50.5*	*50.0*	*49.0*	*n.a.*

Notes:

[1] The budgetary projections exclude the impact of the Eurostat decision of 2 March 2004 on the classification of funded pension schemes, which needs to be implemented by the time of the spring 2007 notification. Including this impact, the general government balance would be 0.6% in 2005, -0.1% in 2006, 0.2% in 2007 and 0.7% in 2008, while government gross debt would be 51.4% in 2005, 49.9% in 2006, 48.3% in 2007 and 46.5% in 2008.

[2] Commission services calculations on the basis of the information in the programme.

[3] Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.

[4] The programme provides no explicit information on one-off and other temporary measures. However, the Swedish Ministry of Finance has provided an estimate of one-offs of 0.6% of GDP in 2004 and 0.2% of GDP in 2005.

[5] One-off and other temporary measures taken from the Commission services' autumn 2005 forecast (0.6% of GDP in 2004 and 0.2% of GDP in 2005; deficit-reducing).

[6] Based on estimated potential growth of 2.5%, 2.6%, 2.8% and 2.7% respectively in the period 2004-2007.

Source:

Convergence programme (CP); Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations.