



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 13.2.2007
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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, 2006-2009

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL 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. The 2005 reform of the Pact acknowledged its 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 policies¹, which is part of the Stability and Growth 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.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the convergence programme of Sweden, submitted on 7 December 2006, and has adopted a recommendation for a Council opinion on it (see box for the main points covered by the assessment).

In order to set the scene against which the budgetary strategy in the updated convergence programme is assessed, the following paragraphs summarise:

- (1) the economic and budgetary performance over the last ten years;
- (2) the most recent assessment of the country's position under the preventive arm of the Stability and Growth Pact (summary of the Council opinion on the previous update of the convergence programme); and
- (3) the Commission's assessment of the November 2006 national reform programme.

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

2.1. Recent economic and budgetary performance

In the last ten years Swedish economic performance has been strong overall. Real GDP growth has been higher than in the euro area. This growth performance has been characterised by strong productivity developments and growth contributions from net exports. The current account has shown a continuously growing surplus position. Unemployment rates are lower than in the euro area and have fallen, although they are still considered high by domestic standards. Labour market participation rates are relatively high. Inflation is low, reflecting a credible inflation-targeting monetary regime. As elsewhere, real and nominal interest rates have fallen. The public finance position, guided by the national rules-based framework, has been sound, showing average budget surpluses broadly in line with the national 2% surplus objective over the cycle. The general government gross debt ratio has been progressively reduced and is well below the 60% threshold.

2.2. The assessment in the Council opinion on the previous programme

On 24 January 2006, the Council adopted its opinion on the previous update of the convergence programme, covering the period 2005-2009. The Council was of the opinion that the budgetary position was sound and the budgetary strategy provided an example of fiscal policies conducted in compliance with the Stability and Growth Pact.

Sweden uses the transition period (expiring in spring 2007) for implementing the Eurostat decision of 2 March 2004 on the sectoral classification of funded pension schemes. Compliance with Eurostat's decision will lower the surplus position by around 1% of GDP each year and will raise the government debt ratio by 0.5 percentage point.

2.3. The Commission assessment of the November 2006 national reform programme

The implementation report of the national reform programme of Sweden, as revised by the new government and provided in the context of the renewed Lisbon strategy for growth and jobs, was submitted on 28 November 2006. Sweden's national reform programme identifies as key challenges/priorities: the need for high levels of labour market participation and hours worked as well as the promotion of a knowledge-based economy with environmentally-efficient production processes.

The Commission's assessment of this programme (adopted as part of its December 2006 Annual Progress Report²) is that Sweden is making very good progress in the implementation of its National Reform Programme. The stability-oriented macroeconomic framework is appropriate and performs well. A strong effort is being made to strengthen incentives to work. Additional measures are needed to enhance competition in services.

Against the background of progress made, Sweden was encouraged to focus also on the areas of: regulatory measures to increase competition, the impact assessment system, better regulation, labour supply and hours worked, the employment rate of immigrants and young people, and reintegration of people on sickness-related schemes.

² Communication from the Commission to the Spring European Council, "Implementing the renewed Lisbon strategy for growth and jobs - A year of delivery" - COM(2006) 816, 12.12.2006.

Box: Main points covered by the assessment

As required by Article 5(1) (for stability programmes) and Article 9(1) (for convergence programmes) of Council Regulation (EC) No 1466/97, the assessment covers the following points:

- whether the economic assumptions on which the programme is based are plausible;
- the medium-term budgetary objective (MTO) presented by the Member State and whether the adjustment path towards it is appropriate;
- whether measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle;
- when assessing the adjustment path towards the MTO, whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times, and, for euro-area and ERM II Member States, whether the Member State pursues an annual improvement of the cyclically-adjusted balance, net of one-off and other temporary measures, of 0.5% of GDP as a benchmark to meet its MTO;
- when defining the adjustment path to the MTO (for Member States that have not yet reached it) or allowing a temporary deviation from the MTO (for Member States that have), the implementation of major structural reforms which have direct long-term cost-saving effects (including by raising potential growth) and therefore a verifiable impact on the long-term sustainability of public finances (subject to the condition that an appropriate safety margin with respect to the 3% of GDP reference value is preserved and that the budgetary position is expected to return to the MTO within the programme period), with special attention for pension reforms introducing a multi-pillar system that includes a mandatory, fully-funded pillar;
- whether the economic policies of the Member State are consistent with the broad economic policy guidelines.

The plausibility of the programme's macroeconomic assumptions is assessed by reference to the Commission services' autumn 2006 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. The assessment of consistency with the broad economic policy guidelines is made against the broad economic policy guidelines in the area of public finances as included in the integrated guidelines for the period 2005-2008.

The assessment also examines:

- the evolution of the debt ratio and the outlook for the long-term sustainability of the public finances, which should be given "sufficient attention in the surveillance of budgetary positions" according to the Council report of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact". A Commission Communication of 12 October 2006 sets out the approach to the assessment of long-term sustainability³;
- the degree of integration with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs. In its cover note of 7 June 2005 to the European Council on the broad economic policy guidelines for the period 2005-2008, the ECOFIN Council stated that the national reform programmes should be consistent with the stability and convergence programmes;
- compliance with the code of conduct⁴, which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

³ Communication from the Commission to the Council and the European Parliament, "The long-term sustainability of public finances in the EU" - COM(2006) 574, 12.10.2006 - and European Commission, Directorate-General for Economic and Financial Affairs (2006), "The long-term sustainability of public finances in the European Union", European Economy No 4/2006.

⁴ "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.

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**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, 2006-2009

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 policies⁵, 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 [27 February 2007] the Council examined the updated convergence programme of Sweden, which covers the period 2006 to 2009.
- (2) The macroeconomic scenario underlying the programme envisages that real GDP growth will slow from 4.0% in 2006 to 3.0% on average over the rest of the programme period, although it will remain at close to potential. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions, with growth in 2006 having possibly been even higher. The programme's projections for inflation also appear realistic.
- (3) For 2006, the general government surplus is estimated at 2.8% of GDP in the Commission services' autumn 2006 forecast, against a projected outturn of 0.9% in the previous update of the convergence programme; the difference mainly reflects a base effect from the much higher-than-expected surplus in 2005. On the basis of available cash data it appears that, due both to lower primary expenditure and higher tax revenues, the 2006 surplus is likely to have been higher than the Commission services' forecast.

⁵ 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

- (4) The updated programme confirms that a budget surplus of 2% of GDP on average over the cycle remains the key guiding fiscal rule, supported by multi-annual expenditure ceilings. In the spring 2007 Fiscal Policy Bill, the Government will re-evaluate the present target for the general government surplus to take into account Eurostat's decision on the classification of funded second-pillar pension schemes⁶. After the expiry of the transition period for implementing this decision (spring 2007), the surplus will be lower by approximately 1% of GDP each year and the gross-debt-to-GDP ratio will be revised upward by about 0.5% of GDP. The budgetary strategy presented in the update foresees a decline in the surplus in 2007 (from 3.0% of GDP in 2006 to 2.4%) and thereafter projects a progressive recovery (to 3.1% in 2009); the primary surplus follows a similar path. Both expenditure- and revenue-to-GDP ratios are on a gradually declining trend throughout the programme period. The strategy is somewhat backloaded, with significant tax cuts in 2007 being only partially financed. Compared with the previous update, the projected path for the surplus (an initial decline followed by gradual recovery) is similar, but with higher net lending positions throughout the programme period.
- (5) The structural surplus (i.e. the cyclically-adjusted surplus net of one-off and other temporary measures), calculated according to the commonly-agreed methodology, is projected to remain above 2% of GDP throughout the programme period. As in the previous update of the convergence programme, the medium-term objective (MTO) for the budgetary position presented in the programme corresponds to the above-mentioned objective of a budgetary surplus of 2% of GDP on average over the business cycle (i.e. in structural terms), which the programme plans to maintain throughout the programme period. As the MTO is significantly more demanding than the minimum benchmark (estimated at a deficit of around 1% of GDP), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO is also significantly more demanding than implied by the debt ratio and average potential output growth in the long term.
- (6) The risks to the budgetary projections in the programme appear broadly balanced from 2007. The macroeconomic outlook and the tax revenue projections seem to reflect plausible assumptions, in spite of some uncertainty on the future performance of capital gains taxes. The expenditure targets are supported by a good track record owing to the above-mentioned expenditure ceilings.
- (7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the MTO throughout the programme period, as envisaged in the programme. In addition, it provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations during the programme period. There is a risk, however, that the fiscal policy stance implied by the programme may turn out to be pro-cyclical in 2007, during which good times are expected to continue. This would not be in line with the Stability and Growth Pact.
- (8) Government gross debt is estimated to have fallen to 46.5% of GDP in 2006, well below the 60% of GDP Treaty reference value. The programme projects the debt ratio will continue following a downward path, falling by 13.5 percentage points over the programme period.

⁶ See Eurostat News Releases No 30/2004 of 2 March 2004 and No 117/2004 of 23 September 2004.

- (9) The long-term budgetary impact of ageing in Sweden is lower than the EU average, with pension expenditure projected to remain relatively stable as a share of GDP over the long term, influenced by the considerable expenditure-reducing impact of the reform of the pension system. The initial budgetary position with a high primary surplus contributes to the reduction of gross debt and the accumulation of assets. Maintaining sound government finances with continued surpluses as planned would contribute to limiting risks to the sustainability of public finances. Overall, Sweden appears to be at low risk with regard to the sustainability of public finances.
- (10) The convergence programme contains a qualitative assessment of the overall impact of the November 2006 implementation report of the national reform programme within the medium-term fiscal strategy. In addition, it provides systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme and its budgetary projections seem to take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the convergence programme seem consistent with those foreseen in the national reform programme. In particular, both programmes envisage the implementation of measures to increase the labour supply.
- (11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.
- (12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data⁷.

The overall conclusion is that the medium-term budgetary position is sound and the budgetary strategy provides a good example of fiscal policies conducted in compliance with the Stability and Growth Pact. However, it will be important to ensure that a deterioration of the structural budgetary position in 2007, which is linked to structural reforms aimed at encouraging greater participation in the labour market, will not spill over to subsequent years.

⁷ Missing required data include inter alia certain deflators, the tax burden and the growth of relevant foreign markets.

Comparison of key macroeconomic and budgetary projections¹

		2005	2006	2007	2008	2009
Real GDP (% change)	CP Dec 2006	2.7	4.0	3.3	3.1	2.7
	COM Nov 2006	2.7	4.0	3.3	3.1	n.a.
	CP Dec 2005	2.4	3.1	2.8	2.3	n.a.
HICP inflation ² (%)	CP Dec 2006	1.3	1.9	2.2	1.5	1.9
	COM Nov 2006	0.8	1.5	1.6	1.8	n.a.
	CP Dec 2005	1.5	1.5	2.0	2.0	n.a.
Output gap (% of potential GDP)	CP Dec 2006³	-0.7	0.0	0.3	0.3	0.3
	COM Nov 2006 ⁷	-0.5	0.2	0.5	0.6	n.a.
	CP Dec 2005 ³	-0.4	-0.1	0.1	-0.1	n.a.
General government balance (% of GDP)	CP Dec 2006	3.0	3.0	2.4	2.7	3.1
	COM Nov 2006	3.0	2.8	2.4	2.5	n.a.
	CP Dec 2005	1.6	0.9	1.2	1.7	n.a.
Primary balance (% of GDP)	CP Dec 2006	4.6	4.5	4.1	4.2	4.6
	COM Nov 2006	4.6	4.5	4.1	4.3	n.a.
	CP Dec 2005	3.2	2.5	3.0	3.6	n.a.
Cyclically-adjusted balance (% of GDP)	CP Dec 2006³	3.4	3.0	2.2	2.5	3.0
	COM Nov 2006	3.3	2.7	2.1	2.1	n.a.
	CP Dec 2005 ³	1.8	0.9	1.1	1.7	n.a.
Structural balance ⁴ (% of GDP)	CP Dec 2006⁵	3.0	3.0	2.2	2.5	3.0
	COM Nov 2006 ⁶	2.9	2.7	2.1	2.1	n.a.
	CP Dec 2005	1.8	0.9	1.1	1.7	n.a.
Government gross debt (% of GDP)	CP Dec 2006	50.3	46.5	41.5	37.4	33.0
	COM Nov 2006	50.4	46.7	42.6	38.7	n.a.
	CP Dec 2005	50.9	49.4	47.8	46.0	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 according to the updated programme would be 2.0% of GDP in 2005, 2.0% in 2006, 1.3% in 2007, 1.6% in 2008 and 2.0% in 2009, while government gross debt would be 50.9% of GDP in 2005, 47.0% in 2006, 42.0% in 2007, 37.9% in 2008 and 33.5% in 2009.

² The CP inflation figures are estimated on a December-December basis, whereas the Commission figures are annual averages. This explains the difference between the Commission and HICP figures for 2005 and 2006. The programme also assumes that the HICP will follow UND1X (national consumer price index excluding changes in indirect taxes, subsidies and mortgage interest expenditure) in 2008 and 2009. However, HICP is expected to be 0.5 pp. higher than UND1X inflation in 2007, thereby accentuating the programme's projected drop in HICP inflation in 2008.

³ Commission services calculations on the basis of the information in the programme.

⁴ Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.

⁵ One-off and other temporary measures taken from the programme (0.4% of GDP in 2005; deficit-reducing).

⁶ One-off and other temporary measures taken from the Commission services' autumn 2006 forecast (0.4% of GDP in 2005; deficit-reducing).

⁷ Based on estimated potential growth of 2.6%, 3.2%, 3.1% and 3.0% respectively in the period 2005-2008.

Source:

Convergence programme (CP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations.