COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23.1.2008
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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, 2007-2010

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact 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 policies[1], which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme 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. As regards updated stability and convergence programmes, the regulation foresees that these are assessed by the Commission and examined by the Committee and if necessary and following the same procedure as set out above, the updated programmes may be examined by the Council.

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 27 November 2007, and is recommending 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 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);

(2) the March 2007 update of the country-specific broad economic policy guidelines in the area of budgetary policies;

(3) the Commission's assessment of the October 2007 implementation report of the national reform programme.

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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). The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

2.1. The assessment in the Council opinion on the previous update

In its opinion of 27 February 2007, the Council summarised its assessment of the previous update of the convergence programme, covering the period 2006-2009, as follows. "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 contain the risk of pro-cyclicality by ensuring 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".

2.2. March 2007 update of the country-specific broad economic policy guidelines in the area of budgetary policies

On 27 March 2007, the Council adopted a recommendation on the 2007 update of the broad guidelines for the economic policies of the Member States and the Community and on the implementation of Member States' employment policies[2]. Sweden was not recommended to take particular action in the area of budgetary policies.

2.3. The Commission assessment of the October 2007 implementation report of the national reform programme

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Sweden's national reform programme[3]. It can be summarised as follows.

Sweden's national reform programme identified as key challenges 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 2006 Implementation Report, presented as an updated national reform programme by the new government, broadly confirmed these overall objectives but put increased focus on further measures to increase labour supply and conditions for job creation.

The Commission's assessment was that Sweden has made very good progress in implementing its national reform programme over the 2005-2007 period. Against the background of the strengths and weaknesses identified and the evidence on progress made, the Commission recommended that Sweden should focus on increasing competition, notably in services, and on the implementation and impact evaluation of recent reforms to increase work incentives.

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2 OJ L 92, 3.4.2007, p. 23.

3 Communication from the Commission to the European Council, "Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)", COM(2007) 803, 11.12.2007.

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 2007 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

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 sustainability[4];
- the degree of consistency with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs, and its October 2007 implementation report. 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 conduct[5], which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

4 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.

5 "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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On the updated convergence programme of Sweden, 2007-2010

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[6], 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 [12 February 2008] the Council examined the updated convergence programme of Sweden, which covers the period 2007 to 2010.

(2) The Swedish economy has performed well in recent years. In 2007, the economy has entered into a more mature phase that is reflected by a solid domestic demand boosted by buoyant investment and private consumption growth. Against this background, Swedish public finances have also been strong with consistent and sizable general government surpluses. The healthy public finances have been supported by a stability-oriented macroeconomic framework, healthy economic growth and a national rules-based budgetary framework. While economic activity is forecast to decelerate gradually in coming years, both economic fundamentals and the fiscal situation are expected to remain favourable. Against this background it is important that the room for manoeuvre provided by strong public finances is not used to permanently increase public consumption expenditure. Notably if local governments were to increase expenditure in the current good times this could lead to permanently higher public expenditure in the future, which would interfere with the plans for a moderate reduction of the expenditure-to-GDP ratio over time and the government's strategy of lowering taxes aimed at enhancing incentives to work.

6 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://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

(3) The programme contains three different scenarios for the macroeconomic and budgetary projections: a "base" scenario, a "low growth" scenario and a "high growth" scenario. The "base" scenario is considered the reference scenario for assessing budgetary projections because, assessed against currently available information[7], it appears to be based on plausible growth assumptions. It envisages that real GDP growth will slow down from 3.2% in 2007 to 2.6% on average over the rest of the programme period. The programme's projections for inflation, which foresee an increase above the 2% Riksbank target, also appear realistic. Higher wage growth combined with weaker productivity growth than in recent years is predicted to raise unit labour costs, which could add to inflationary pressures.

(4) For 2007, the general government surplus is estimated at 3.0% of GDP in the Commission services' autumn 2007 forecast, against a target of 1.2% of GDP set in the previous update of the convergence programme. The better-than-targeted balance is notably due to a base effect (reflecting a stronger outturn in 2006 than projected in the previous programme) and to a stronger than anticipated labour market in 2007, which had a more favourable impact on revenue and, to a lesser extent, expenditure than anticipated. In line with the implicit policy invitation in the Council opinion of 27 February 2007 on the previous update of the convergence programme[8], the structural balance is estimated to improve significantly in 2007, indicating that the fiscal stance has been counter-cyclical in 2007.

(5) The main goal of the medium-term budgetary strategy in the programme is to achieve a nominal budget surplus of 1% of GDP on average over the business cycle, supported by multi-annual expenditure ceilings for the central government and a balanced budget requirement for local governments. This surplus target corresponds to Sweden's medium-term objective (MTO) for the budgetary position of a 1% of GDP structural surplus (i.e. cyclically adjusted surplus net of one-off and temporary measures), which is foreseen to be respected with a good margin throughout the programme period. The MTO target has been revised downward from 2% in the previous update, in response to the implementation of the March 2004 Eurostat decision on the recording of second-pillar pension funds outside the government sector as from April 2007[9]. This revision is purely technical and the new target confirms the same level of fiscal ambition. The general government surplus is estimated to decline slightly in 2008 to 2.8%, from 3.0% of GDP in 2007. Thereafter the balance is projected to recover progressively to 3.6% in 2010. The weakening in 2008 reflects significant income tax cuts for low and middle income earners by means of a strengthened in-work tax credit, which are only partly financed through other revenue-increasing and expenditure-decreasing measures. For the rest of the programme period the projections are based on a no-policy change assumption, according to which both revenue and expenditure ratios are on a gradually declining trend. In view of better-than-expected outturns in 2006 and 2007, these surplus projections are much higher than in the previous update against a broadly similar macroeconomic background. The primary balance and the structural balance show a path that is broadly similar to that of the headline balance.

7 The assessment takes notably into account the Commission services' autumn forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

8 OJ C 72, 29.3.2007, p. 2.

9 See Eurostat News Release No 30/2004 of 2 March 2004 and No 117/2004 of 23 September 2004.

(6) The risks to the budgetary projections in the programme appear broadly balanced. While GDP growth is projected to decelerate gradually over the programme period, the composition of growth still remains favourable from the point of view of public finances, notably given the solid private consumption growth. Moreover, the budget projections are supported by a good track record, owing partly to the above-mentioned expenditure ceilings, while tax revenue projections appear plausible.

(7) In view of this risk assessment, the budgetary stance in the programme allows meeting the MTO by a good margin throughout the programme period, as envisaged in the programme. The somewhat weaker budgetary position in 2008 is linked to continued structural reforms aimed at encouraging labour force participation by reducing the tax wedge which thus increases the growth potential of the economy. If the economy continues to be in good times in 2008, which is not certain in the light of the most recent developments, there is a risk that the fiscal policy stance implied by the programme may turn out to be mildly pro-cyclical in 2008.However, the budgetary deterioration would be temporary as it is not expected to spill over into subsequent years.

(8) Sweden appears to be at low risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing 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 adopted in 1998. The budgetary position in 2007 as estimated in the programme with a high primary surplus contributes to the reduction of gross debt. Maintaining sound government finances with continued surpluses as planned in the programme would contribute to limiting risks to the sustainability of public finances.

(9) The convergence programme is fully consistent with the October 2007 implementation report of the national reform programme. In particular, both include fiscal measures aimed at increasing incentives to work and increasing labour supply. Focussing on the measures with a direct budgetary impact, income taxes are to be further reduced in 2008 and both the unemployment and the sickness insurance systems are to be reformed to better integrate people that currently stand outside the labour market. The updated convergence programme also describes in qualitative terms the overall impact of the National Reform Programme within the medium term fiscal strategy, in particular with regard to the increase in labour supply on the public finance position at large and the growth potential of the economy.

(10) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required data and most optional data[10].

[10] In particular, data for general government expenditure by function; break down of stock-flow adjustment; and potential GDP growth contributions, which have the effect of making the assessment objectively more difficult, are not provided.

The overall conclusion is that the medium-term budgetary position is sound with high general government surpluses and Sweden is at low risk with regard to the sustainability of public finances. While the planned fiscal stance in 2008 might be mildly pro-cyclical in good times, the weakening of the structural budgetary position is linked to continued structural reforms aimed at encouraging labour force participation and thus increasing growth potential and is not envisaged to spill over into subsequent years.

Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	**CP Nov 2007**	**4.2**	**3.2**	**3.2**	**2.5**	**2.2**
	COM Nov 2007	4.2	3.4	3.1	2.4	n.a.
	CP Dec 2006	*4.0*	*3.3*	*3.1*	*2.7*	*n.a.*
HICP inflation (%)	**CP Nov 2007**	**1.4**	**1.7**	**2.7**	**2.5**	**2.1**
	COM Nov 2007	1.5	1.6	2.0	2.0	n.a.
	CP Dec 2006	*1.9*	*2.2*	*1.5*	*1.9*	*n.a.*
Output gap[1] (% of potential GDP)	**CP Nov 2007**	**0.6**	**0.3**	**0.6**	**0.5**	**0.3**
	COM Nov 2007[2]	0.5	0.6	0.8	0.5	n.a.
	CP Dec 2006	*0.0*	*0.3*	*0.3*	*0.3*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**CP Nov 2007**	**6.5**	**7.1**	**7.2**	**7.4**	**7.7**
	COM Nov 2007	6.3	7.0	6.9	7.2	n.a.
	CP Dec 2006	*6.1*	*7.5*	*7.4*	*7.5*	*n.a.*
General government balance (% of GDP)	**CP Nov 2007**	**2.5**	**3.0**	**2.8**	**3.1**	**3.6**
	COM Nov 2007	2.5	3.0	2.8	3.0	n.a.
	CP Dec 2006	*1.8*	*1.2*	*1.5*	*2.0*	*n.a.*
Primary balance (% of GDP)	**CP Nov 2007**	**4.2**	**4.6**	**4.4**	**4.5**	**4.8**
	COM Nov 2007	4.2	4.7	4.3	4.5	n.a.
	CP Dec 2006	*3.5*	*3.0*	*3.1*	*3.5*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**CP Nov 2007**	**2.2**	**2.8**	**2.4**	**2.8**	**3.4**
	COM Nov 2007	2.1	2.7	2.3	2.8	n.a.
	CP Dec 2006	*1.8*	*1.0*	*1.3*	*1.9*	*n.a.*
Structural balance[3] (% of GDP)	**CP Nov 2007**	**1.7**	**2.4**	**2.1**	**2.8**	**3.4**
	COM Nov 2007	2.1	2.7	2.3	2.6	n.a.
	CP Dec 2006	*1.8*	*1.0*	*1.3*	*1.9*	*n.a.*
Government gross debt (% of GDP)	**CP Nov 2007**	**47.0**	**39.7**	**34.8**	**29.8**	**24.5**
	COM Nov 2007	47.0	41.1	35.7	30.5	n.a.
	CP Dec 2006	*47.0*	*42.0*	*37.9*	*33.5*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 3.3%, 3.4%, 2.9% and 2.7% respectively in the period 2006-2009.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.5% of GDP in 2006, 0.4% in 2007 and 0.3% in 2008; all deficit-reducing according to the most recent programme and 0.2% of GDP in 2009; deficit-reducing in the Commission services' autumn forecast. The Commission services do not take into account the effect identified in the programme for 2006 and 2007 in its assessment as they are not considered as one-offs or other temporary measures.

Source:

Convergence programme (CP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations.