COMMISSION OF THE EUROPEAN COMMUNITIES

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RESTRICTED

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, 2001-2004

(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.

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].

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. The first annual update, covering the period 1999-2002, was submitted on 12 November 1999 and examined by the Council on 31 January 2000[3]. The second annual update, covering the period 2000-2003, was submitted on 10 November 2000 and examined by the Council on 19 January 2001[4].

Sweden submitted the third and most recent updated convergence programme, covering the period 2001-04, on 9 November 2001. The Commission services have carried out a technical evaluation of this updated programme, which warrants the following assessment:

> The Swedish economy has developed less favourably than foreseen in the 2000 update. Output growth has slowed and is set to be substantially lower in 2001, compared with 2000. Inflation has increased substantially since the spring 2001, partly due to temporary factors, but is expected to fall in 2002. The labour market has, on the other hand, developed favourably, although it is expected to be less buoyant in 2002. The 2001 update forecasts GDP growth of 1.7% in 2001, 2.4% in 2002 and 2.6% in 2003. This scenario is more positive than the Commission's autumn forecast for 2001 and, in particular, for 2002. This can largely be explained by the fact that the Swedish government's forecast was finalised on 7 September, i.e. before the 11 September events. The Commission has taken the view that this would result in lower GDP growth with lower external and domestic demand in 2002, compared with the government's forecast.
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> Public finances in Sweden are 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 fiscal rule of a 2% of GDP surplus over the cycle. In the 2001 update, a large surplus of 4.6% of GDP in 2001 is expected and surpluses of more than 2% of GDP are expected between 2002 and 2004. Moreover, the debt ratio, that fell below the reference value of 60% of GDP in 2000,

[1] OJ L209, 2.8.1997
[2] OJ C68, 11.3.1999
[3] OJ C60, 2.3.2000
[4] OJ C 73, 6.3.2001

is expected to continue to fall substantially over the programme period. While the Commission's view is for lower surpluses, it can be concluded that Sweden continues to fully respect the Stability and Growth Pact's target for public finances of a fiscal position 'close to balance or in surplus'.

The sound strategy of the previous programme is being continued, in that both expenditure and tax ratios are being reduced. For 2002, the third tranche of tax cuts, corresponding to 1.1% of GDP, was proposed in the 2001 Budget Bill. This is in line with both the previous Council Opinion[5] and the Broad Economic Policy Guidelines. Expenditure ceilings remain a key ingredient in ensuring expenditure control and lends confidence to the good outlook for the public finances. These ceilings have been instrumental in strengthening the credibility of sound public finances in recent years. However, given the downside risks to growth in 2002, some corrective measures may be necessary in order not to breach the expenditure ceilings.

Cyclically-adjusted, the public finances are expected to show strong surpluses over the programme period, reaching its low of 1.5% of GDP in 2002 and improve thereafter, according to the Commission's calculations. While somewhat below Sweden's 2% of GDP fiscal rule in 2002 and 2003, the average cyclically-adjusted surplus in the period 2001-2004 is estimated at a respectable 2.3% of GDP.

After several years of low inflation, a sharp rise occurred in the spring 2001 and it has remained relatively high since then. Still, in Maastricht terms Swedish HICP inflation continues to be among the lowest in the European Union. A cause for concern is that inflation expectations have risen above the 2% target recently. The depreciation of the Swedish Krona observed in 2001 is also a risk factor for the inflation outlook despite the very recent appreciation observed, coinciding with rising share prices. Inflationary pressures are, nevertheless, expected to be lower in 2002 and beyond, underpinned by a decline in the positive output gap and continued wage moderation. The fiscal stance being expansionary in 2002 and broadly neutral thereafter is therefore considered appropriate, given the stance of the slowdown in economic activity at present and the favourable position of Swedish public finances.

In order to obtain respectable and sustainable economic growth, structural measures are being undertaken with a view to enhancing the supply side of the economy. In this context, the programme strategy is also consistent with the Broad Economic Policy Guidelines, particularly in efforts to lower the, still, high tax burden. These initiatives should be continued with determination.

Preparing for ageing populations is an integral part of Sweden's budgetary strategy and a main reason for having a 2% of GDP surplus target for the public finances over the cycle. This, together with the reformed pension system and measures aimed at increasing labour force participation, suggest that Sweden is in a good position to meet the budgetary consequences of ageing populations as measured in terms of continued compliance with the Stability and Growth Pact over the very long-run. However, ensuring sustainable public finances poses some challenges, and the projections are sensitive to the targeted budget surpluses being realised in coming years. Moreover, the projections contained in the programme are based on a continued high tax ratio between 2005 and 2050. While it is up to each Member

[5] OJ, C 73, (2001/C 73/01), 6.3.2001

State to determine its tax ratio, the projected level is high relative to those observed in other industrialised countries. In addition, the international mobility of production factors (and consequently tax bases) may increase in light of globalisation, rendering it difficult for Sweden to maintain high tax revenues and at the same time remain competitive.

While it is noted that Sweden does still not intend to bring the krona into ERM2, the other convergence criteria for EMU participation are expected to continue to be fulfilled over the programme period. The Council has stated in its previous Opinion[6] that "Sweden needs to demonstrate its ability to stay in line with an appropriate parity between the krona and the euro over a sufficient period of time without severe tensions. To this end, the Council expects Sweden to decide to join the ERM2 in due course." The volatility observed in the exchange rate since the submission of the previous update has not added to the otherwise largely stable macro-economic framework in terms of the overall policy-mix. Furthermore, current legislation is not in compliance with the statute of the ESCB, as concluded in the Commission's Convergence Report 2000[7].

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.

[6] OJ, C 73, (2001/C 73/01), 6.3.2001

[7] COM(2000) 277, 3.5.2000.

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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, 2001-2004

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[8], 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 [22 January 2002] the Council examined Sweden's updated convergence programme, which covers the period 2001 - 2004. The Council notes with satisfaction that the updated Programme envisages continued government surpluses throughout the period to 2004 as Sweden maintain their medium term objective of a budget surplus of 2% of GDP on average over the business cycle. The strategy of lowering the expenditure ratio is supported by a commitment to adhere to the ceilings for central government expenditure, which have been instrumental in strengthening the credibility of sound public finances in recent years, and a balanced budget constraint for local governments. This is accompanied by a lowering of the tax ratio, now extended with additional tax cuts proposed for 2002. The Council considers this budgetary strategy appropriate and it is in line with the previous Council Opinion[9] and the Broad Economic Policy Guidelines. The Council further notes with satisfaction that the debt ratio fell below the reference value of 60% of GDP in 2000, and is expected to continue to fall substantially over the remainder of the programme period.

The macroeconomic scenario presented in the programme, with GDP growth of 1.7% in 2001 and 2.4% in 2002 appears optimistic and the Council considers that there are considerable downside risks to growth, especially in 2002, as the global outlook has worsened since the macro-economic scenario in the programme was finalised. For 2003 and 2004, the projections in the programme appear sensible.

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[8] OJ L209, 2.8.1997
[9] OJ C73, 6.3.2001

The Council notes with satisfaction that with the budgetary surpluses targeted in the updated programme, Sweden continues to fully respect the Stability and Growth Pact's requirement of a fiscal position 'close to balance or in surplus'. This remains valid in case that economic growth should be weaker and result in lower surpluses in the public finances than projected in the programme, as the Commission's autumn 2001 economic forecasts suggest. Furthermore, the Council welcomes the attention given in the programme to the sustainability of public finances. The Council notes that Sweden's strategy on this hinges on maintaining a surplus of 2% of GDP in the long-term. By lowering debt and interest payments this will make room to cover much of the costs related to ageing to be faced in later years. However, the Council encourages Sweden to also pursue other routes to restrict expenditure, as the international mobility of production factors (and consequently tax bases) may increase in light of globalisation, rendering it difficult for Sweden to maintain a tax ratio which is high relative to other industrialised countries and at the same time remain competitive.

The Council notes that Sweden at present fulfils the convergence criterion on price stability and is expected to continue do so in the years to 2004. After several years of low inflation, a sharp rise occurred in the spring 2001 and it has remained relatively high since. Inflationary pressures are, nevertheless, expected to be lower in 2002 and beyond, underpinned by the expected subdued economic activity and continued wage moderation.

Long-term interest rates in Sweden have remained at historically low levels, even though they have generally fallen less than in many other Member States during 2001, possibly linked to the weakening of the krona and increased uncertainty about global economic prospects. Sweden is expected to continue to fulfil the interest rate convergence criterion. Regarding the exchange rate, the krona has been volatile since the submission of the previous update and the Council re-iterates that Sweden needs to demonstrate its ability to stay in line with an appropriate parity between the krona and the euro over a sufficient period of time without severe tensions. To this end, the Council, as stated in its opinion on the updated 2000 convergence programme[10], "...expects Sweden to decide to join the ERM2 in due course", which would further enhance the stability-oriented macro-economic framework already achieved in large measure. Furthermore, current legislation is not in compliance with the statute of the ESCB, as concluded in the Commission's Convergence Report 2000[11]. Sweden does still not fulfil the exchange rate convergence criterion.

In order to obtain high and sustainable economic growth, the strategy of previous programmes is continued and structural measures in this regard have been implemented. Among these measures, the lowering of the, still, high tax burden will provide better incentives to encourage people to work, consistent with the Broad Economic Policy Guidelines. The Council welcomes these structural measures and encourages the Swedish government to implement these initiatives with determination.

[10] OJ C73, 6.3.2001.
[11] COM(2000) 277, 3.5.2000.