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EUROPEAN CENTRAL BANK

CONVERGENCE REPORT 2002

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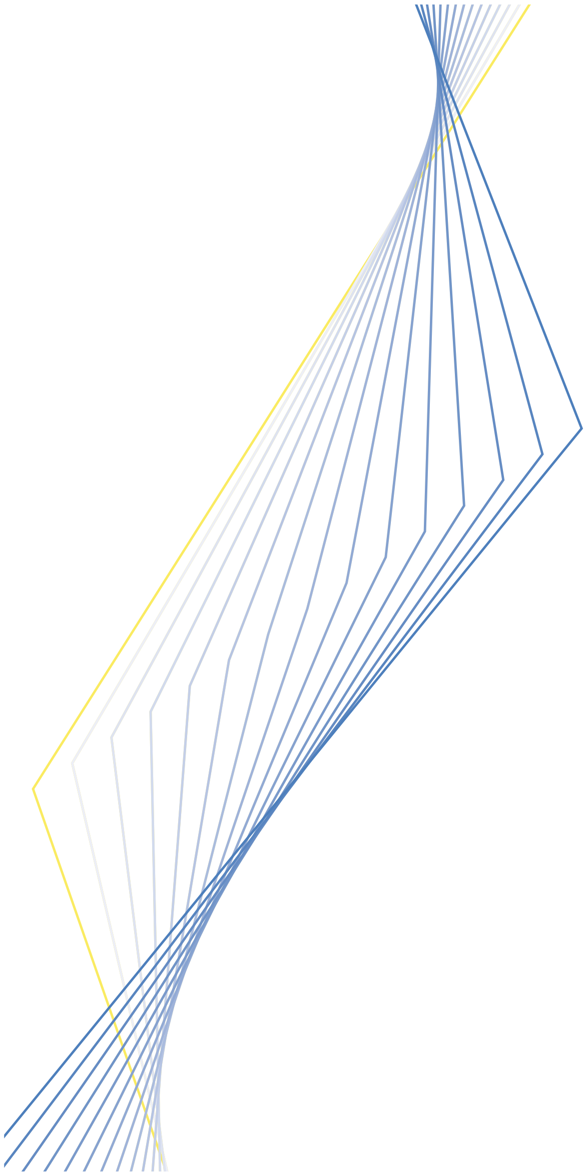

CONVERGENCE REPORT

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Contents

Abbreviations

Countries

BE	Belgium
DK	Denmark
DE	Germany
GR	Greece
ES	Spain
FR	France
IE	Ireland
IT	Italy
LU	Luxembourg
NL	Netherlands
AT	Austria
PT	Portugal
FI	Finland
SE	Sweden
UK	United Kingdom
JP	Japan
US	United States

Others

CPI	Consumer Price Index
ECB	European Central Bank
ECU	European Currency Unit
EMI	European Monetary Institute
ESA 95	European System of Accounts 1995
ESCB	European System of Central Banks
EU	European Union
EUR	euro
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
ILO	International Labour Organization
IMF	International Monetary Fund
NCBs	national central banks
repos	repurchase agreements

In accordance with Community practice, the EU countries are listed in this Report using the alphabetical order of the country names in the national languages.

Introduction and country summary

Introduction

In this year's Convergence Report under Article 122 (2) of the Treaty[1], the European Central Bank (ECB) uses the framework applied in the Convergence Reports produced by the European Monetary Institute (EMI) in March 1998 and the ECB in May 2000 to examine, with regard to Sweden, whether a high degree of sustainable convergence has been achieved, as well as compliance with the statutory requirements to be fulfilled for national central banks (NCBs) to become an integral part of the European System of Central Banks (ESCB).

Following the introduction of the euro on 1 January 1999 in 11 Member States and on 1 January 2001 in Greece, three Member States of the European Union (EU) are not yet full participants in Economic and Monetary Union (EMU). Two of these Member States, namely Denmark and the United Kingdom, have a special status. In accordance with the terms of the relevant protocols, annexed to the Treaty, these countries gave notification that they would not participate in Stage Three of EMU on 1 January 1999. As a consequence, convergence reports for these two Member States only have to be provided if they so request. Since no such request has been made, this year's Convergence Report covers only Sweden.

In producing this report, the ECB fulfils the requirement of Article 122 (2) in conjunction with Article 121 (1) of the Treaty to report to the Council of the European Union (EU Council) at least once every two years or at the request of a Member State with a derogation "on the progress made in the fulfilment by the Member States of their obligations regarding the achievement of economic and monetary union". The same mandate has been given to the European Commission, and the two reports have been submitted to the EU Council in parallel.

This year's Convergence Report contains three chapters. Chapter I describes the key aspects of the examination of economic convergence in 2002. Chapter II assesses the state of economic convergence in Sweden, and Chapter III investigates the compatibility of Sweden's national legislation, including the Sveriges Riksbank Act, with Articles 108 and 109 of the Treaty and the Statute of the ESCB.[2]

Country summary

Sweden

Over the reference period Sweden achieved a 12-month average rate of HICP inflation of 2.9%, which is below the reference value stipulated by the Treaty. Over a number of years, HICP inflation in Sweden has been at levels that are consistent with price stability. Nevertheless, inflation rose rapidly during 2001, possibly due to strained resource utilisation but also on account of various supply shocks which had only a temporary effect. This increase came against the background of several years of relatively high real wage growth and declining profit share in the economy. As the economy stabilises and recovers, strained resource utilisation could have an upward effect on wage developments and domestically generated inflation. Additional labour market reform and strengthened competition in certain product markets would, however, support lower inflation and higher potential GDP growth. Looking ahead, most forecasts indicate that inflation will be slightly above 2% in 2002 and 2003. The level of long-term interest rates was 5.3% over the reference period, i.e. below the respective reference value. However, the differential between long-term interest rates in Sweden and the lowest interest rates in the euro area increased in 2001, reflecting the rise in inflation, tendencies towards higher inflation

1 References to the Treaty are references to the Treaty establishing the European Community (as amended by the Treaty of Amsterdam).

2 References to the Statute of the ESCB are references to the Statute of the European System of Central Banks and of the European Central Bank, annexed to the Treaty.

expectations in financial markets and increased global uncertainty.

Sweden does not participate in ERM II. As was recalled in the Convergence Report 2000, Sweden has a derogation but no special status as regards Stage Three of EMU. Sweden is thus committed by the Treaty to adopt the euro, which implies that it has to strive to fulfil all the convergence criteria, including the exchange rate criterion. Over the reference period, the Swedish krona depreciated significantly from its May 2000 average exchange rate against the euro, which is used as a benchmark for illustrative purposes in the absence of central rates, until September 2001. The decline amounted to some 18% and seems to have been related to export developments and net capital outflows from Sweden. Since September 2001, the global outlook has improved, net capital flows have normalised and the krona has recovered by some 8%.

In the reference year 2001, Sweden recorded a fiscal surplus of 4.8% of GDP, thereby comfortably meeting the 3% reference value for the deficit ratio. The debt-to-GDP ratio was 55.9%, i.e. below the 60% reference value. If fiscal balances turn out as projected in the Spring Budget Bill for the period 2002-2004, Sweden will maintain a budget surplus of close to 2% of GDP throughout this period. Concomitantly, the debt level will decrease further. Against this background, Sweden is expected to comply with the medium-term objective of the Stability and Growth Pact, even if growth rates are somewhat lower than expected. The future fiscal stance and the implementation of tax reforms and off-setting expenditure restraint should take into account the prevailing macro-economic environment and the expected impact from other policy developments.

With regard to the long-run sustainability of public finances, in 1999 Sweden reformed its pay-as-you-go pension system. Moreover, compliance with the 2% surplus rule in the medium term, as well as the further implementation of measures aimed at increasing labour force participation, is appropriate for preserving the sustainability of public finances. At the same time, Sweden may need to reduce its tax burden in the long run, which is still high compared with other industrialised countries.

With regard to other factors, the deficit ratio has not exceeded the ratio of public investment to GDP since 1997. In fact, there have been budget surpluses since 1998. In addition, Sweden has recorded current account surpluses while maintaining a net external liability position.

With regard to legal convergence, the following summary may be given. In view of the right of the Swedish Parliament to decide on the distribution of Sveriges Riksbank's profit, a statutory framework should be established containing clear provisions on the limitations applicable to decisions concerning profit distribution in order to safeguard the financial independence of Sveriges Riksbank. Swedish legislation, and in particular the Sveriges Riksbank Act, does not anticipate the Riksbank's legal integration into the ESCB, although Sweden is not a Member State with a special status and must therefore comply with all adaptation requirements under Article 109 of the Treaty. As far as legislation other than the statute of Sveriges Riksbank is concerned, the ECB notes that legislation on access to public documents and the law on secrecy need to be reviewed in the light of the confidentiality regime under Article 38 of the Statute of the ESCB. The ECB is not aware of any other statutory provisions that would require adaptation under Article 109 of the Treaty.

Chapter 1

Key aspects of the examination of economic convergence in 2002

According to Article 122 (2) of the Treaty, the Commission and the ECB shall, at least once every two years, or at the request of a Member State with a derogation, provide reports on the progress made by such Member States with a view to the fulfilment of their obligations regarding the achievement of EMU ("convergence reports").

This Report summarises the evidence available for Sweden from a comprehensive examination of economic convergence. This examination refers to a number of economic criteria related to the development of prices, government fiscal positions, exchange rates and long-term interest rates, and also takes other factors into account. Boxes 1 to 4 briefly recall the provisions of the Treaty and provide methodological details which outline the application of these provisions by the ECB. Chapter II describes in greater detail the range of indicators that are considered in order to examine the sustainability of developments. All of these indicators were used in previous reports of the EMI and the ECB. First, evidence is reviewed from a backward-looking perspective, covering the past ten years. This should help to better determine the extent to which current achievements are the result of genuine structural adjustments, which in turn should lead to a better assessment of the sustainability of economic convergence. Second, and to the extent appropriate, a forward-looking perspective is adopted. In this context, particular attention is drawn to the fact that the sustainability of favourable economic developments hinges critically on appropriate and lasting policy responses to existing and future challenges. Overall, it is emphasised that ensuring the sustainability of economic convergence depends both on the achievement of a sound starting position and on the policies pursued after the adoption of the euro.

As regards price developments, the Treaty provisions and their application by the ECB are outlined in Box 1.

Box 1

Price developments

1 Treaty provisions

Article 121 (1), first indent, of the Treaty requires:

"the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability".

Article 1 of the Protocol on the convergence criteria referred to in Article 121 of the Treaty stipulates that:

"the criterion on price stability referred to in the first indent of Article 121 (1) of this Treaty shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis, taking into account differences in national definitions."

2 Application of Treaty provisions

In the context of this report, the ECB applies the Treaty provisions as outlined below:

– First, with regard to "an average rate of inflation, observed over a period of one year before the examination", the inflation rate has been calculated using the increase in the latest available 12-month average of the Harmonised Index of Consumer Prices (HICP) over the previous 12-month average. Hence, with regard to the rate of inflation, the reference period considered in this report is May 2001 to April 2002.

– Second, the notion of "at most, the three best performing Member States in terms of price stability", which is used for the definition of the reference value, has been applied by using the unweighted arithmetic average of the rate of inflation in the three EU countries with the lowest inflation rates, given that these rates are compatible with price stability. Over the reference period considered in this report, the three countries with the lowest HICP inflation rates were the United Kingdom (1.4%), France (2.0%) and Luxembourg (2.1%); as a result, the average rate is 1.8% and, adding 1½ percentage points, the reference value is 3.3%.

To allow a more detailed examination of the sustainability of price developments, the average rate of HICP inflation over the 12-month reference period from May 2001 to April 2002 is reviewed in the light of the Swedish economy's performance over the last ten years in terms of price stability. In this connection, attention is drawn to the orientation of monetary policy, in particular whether the focus of the monetary authorities has been primarily on achieving and maintaining price stability, as well as to the contribution of other areas of economic policy to this objective. Moreover, the implications of the macroeconomic environment for the achievement of price stability are taken into account. Price developments are examined in the light of demand and supply conditions, focusing on, inter alia, factors influencing unit labour costs and import prices. Finally, price trends across other relevant price indices (including the national Consumer Price Index (CPI), the private consumption deflator, the GDP deflator and producer prices) are taken into account. From a forward-looking perspective, a view is provided of prospective inflationary developments in the immediate future, including forecasts by major international organisations. Moreover, structural aspects which are relevant for maintaining an environment conducive to price stability after adoption of the euro are discussed.

With regard to fiscal developments, the Treaty provisions and their application by the ECB, together with procedural issues, are outlined in Box 2.

Box 2

Fiscal developments

1 Treaty provisions

Article 121 (1), second indent, of the Treaty requires:

"the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive, as determined in accordance with Article 104 (6)". Article 2 of the Protocol on the convergence criteria referred to in Article 121 of the Treaty stipulates that this criterion "shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 104 (6) of this Treaty that an excessive deficit exists".

Article 104 sets out the excessive deficit procedure. According to Article 104 (2) and (3), the Commission shall prepare a report if a Member State does not fulfil the requirements for fiscal discipline, in particular if:

(a) the ratio of the planned or actual government deficit to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 3% of GDP), unless:
   – either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively,

– the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

(b) the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

In addition, the report prepared by the Commission shall take into account whether the government deficit exceeds government investment expenditure and all other relevant factors, including the medium-term economic and budgetary position of the Member State. The Commission may also prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State. The Economic and Financial Committee shall formulate an opinion on the report of the Commission. Finally, in accordance with Article 104 (6), the EU Council, on the basis of a recommendation from the Commission and having considered any observations which the Member State concerned may wish to make, shall, acting by qualified majority, decide, after an overall assessment, whether an excessive deficit exists in a Member State.

2 Procedural issues and the application of Treaty provisions

For the purpose of examining convergence, the ECB expresses its view on fiscal developments. With regard to sustainability, the ECB examines key indicators of fiscal developments from 1992 to 2001, considers the outlook and challenges for public finances and focuses on the links between deficit and debt developments.

The potential future course of the debt ratio in Sweden is not considered in detail as Sweden has had a debt ratio of below 60% of GDP since 2000.

The examination of fiscal developments is based on comparable data compiled on a national accounts basis, in compliance with the European System of Accounts 1995 (ESA 95) (see the statistical annex to Chapter II). Most of the figures presented in this report were provided by the Commission in April 2002 and include government financial positions in 2000 and 2001 as well as Commission estimates for 2002.

With regard to the sustainability of fiscal developments, the outcome in the reference year, 2001, is reviewed in the light of Sweden's performance over the last ten years. As a starting-point, the evolution in the government debt ratio in this period is considered, as well as the factors underlying it, i.e. the difference between nominal GDP growth and interest rates, the primary balance, and the deficit-debt adjustments. Such a perspective can offer further information on the extent to which the macroeconomic environment, in particular the combination of growth and interest rates, has affected the dynamics of debt. It can also provide more information on the contribution of fiscal consolidation efforts as reflected in the primary balance and on the role played by special factors as included in the deficit-debt adjustment. In addition, the structure of government debt is considered, focusing in particular on the share of debt with a short-term maturity and foreign currency debt, as well as their evolution. By comparing these shares with the current level of the debt ratio, the sensitivity of fiscal balances to changes in exchange rates and interest rates is highlighted.

In a further step, the evolution of the deficit ratio is investigated. In this context it is considered useful to bear in mind that the change in a country's annual deficit ratio is typically influenced by a variety of underlying forces. These influences are often sub-divided into "cyclical effects" on the one hand, which reflect the reaction of deficits to changes in the output gap, and "non-cyclical effects" on the other, which are often taken to reflect structural or permanent adjustments to fiscal policies. However, such non-cyclical effects, as quantified in this report, cannot necessarily be seen as entirely reflecting a structural change to fiscal positions, because they will also include the impact of policy measures and special factors with only temporary effects on the budgetary balance. To the extent possible, a distinction is made between measures which improve the budgetary outcome in one year only and therefore require compensation in the following year ("one-off" measures), and measures which have the same implication in the short run but, in addition, lead to extra borrowing in later years, thereby first improving and later burdening the budget ("self-reversing" measures).

Past public expenditure and revenue trends are also considered in more detail. In the light of these trends, a view is put forward of the broad areas on which future consolidation may need to focus.

Turning to a forward-looking perspective, budget plans and recent forecasts for 2002 are recalled and account is taken of the medium-term fiscal strategy as reflected in the Convergence Programme. Furthermore, long-term challenges to the sustainability of budgetary positions are emphasised, particularly those related to the issue of unfunded public pension systems in connection with demographic change.

It should be noted that, in assessing the budgetary positions of EU Member States, the impact on national budgets of transfers to and from the EU budget is not taken into account by the ECB.

With regard to exchange rate developments, the Treaty provisions and their application by the ECB are outlined in Box 3.

Box 3

Exchange rate developments

1 Treaty provisions

Article 121 (1), third indent, of the Treaty requires:

"the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State".

Article 3 of the Protocol on the convergence criteria referred to in Article 121 (1) of the Treaty stipulates that:

"the criterion on participation in the exchange-rate mechanism of the European Monetary System referred to in the third indent of Article 121 (1) of this Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against any other Member State's currency on its own initiative for the same period."

2 Application of Treaty provisions

The Treaty refers to the criterion of participation in the European exchange rate mechanism (ERM until December 1998; superseded by ERM II as of January 1999).

– First, the ECB assesses whether the country has participated in ERM II "for at least the last two years before the examination", as stated in the Treaty.

– Second, with regard to the definition of "normal fluctuation margins", the ECB recalls the formal opinion that was put forward by the EMI Council in October 1994 and its statements in the November 1995 report entitled "Progress towards convergence":

  In the EMI Council's opinion of October 1994 it was stated that "the wider band has helped to achieve a sustainable degree of exchange rate stability in the ERM", that "the EMI Council considers it advisable to maintain the present arrangements", and that "member countries should continue to aim at avoiding significant exchange rate fluctuations by gearing their policies to the achievement of price stability and the reduction of fiscal deficits, thereby contributing to the fulfilment of the requirements set out in Article 121 (1) of the Treaty and the relevant Protocol".

  In the November 1995 report entitled "Progress towards convergence" it was recognised by the EMI that "when the Treaty was conceived, the 'normal fluctuation margins' were ±2.25% around bilateral central parities, whereas a ±6% band was a derogation from the rule. In August 1993 the decision was taken to widen the fluctuation margins to ±15%, and the interpretation of the criterion, in particular of the concept of 'normal fluctuation margins', became less straightforward". It was then also proposed that account would need to be taken of "the particular evolution of exchange rates in the European Monetary System (EMS) since 1993 in forming an ex post judgement".

  Against this background, in the assessment of exchange rate developments the emphasis is placed on exchange rates being close to the ERM II central rates.

– Third, the issue of "severe tensions" is generally addressed by examining the degree of deviation of exchange rates from the ERM II central rates against the euro, by using such indicators as short-term interest rate differentials vis-à-vis the euro area and their evolution, and by considering the role played by foreign exchange interventions.

For Sweden, a Member State which is not participating in ERM II, the performance of the Swedish krona is shown against the euro and the currencies of the non-euro area Member States during the period from May 2000 to April 2002.

In addition to the performance of the nominal exchange rate over the reference period from May 2000 to April 2002, evidence relevant to the sustainability of the current exchange rate is briefly reviewed. This is derived from the real exchange rate pattern vis-à-vis major trading partners, the current account of the balance of payments, the degree of openness of the Member State, its share of intra-EU trade and its net foreign asset or liability positions.

With regard to long-term interest rate developments, the Treaty provisions and their application by the ECB are outlined in Box 4.

Box 4

Long-term interest rate developments

1 Treaty provisions

Article 121 (1), fourth indent, of the Treaty requires:

"the durability of convergence achieved by the Member State and of its participation in the exchange-rate mechanism of the European Monetary System being reflected in the long-term interest-rate levels".

Article 4 of the Protocol on the convergence criteria referred to in Article 121 of the Treaty stipulates that:

"the criterion on the convergence of interest rates referred to in the fourth indent of Article 121 (1) of this Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions."

2 Application of Treaty provisions

In the context of this report the ECB applies the Treaty provisions as outlined below:

– First, with regard to "an average nominal long-term interest rate" observed over "a period of one year before the examination", the long-term interest rate has been calculated as an arithmetic average over the latest 12 months for which HICP data were available. The reference period considered in this report is May 2001 to April 2002.

– Second, the notion of "at most, the three best performing Member States in terms of price stability" which is used for the definition of the reference value has been applied by using the unweighted arithmetic average of the long-term interest rates of the three countries with the lowest inflation rates (see Box 1). Over the reference period considered in this report the long-term interest rates of these three countries were 5.1% (the United Kingdom), 5.0% (France) and 4.9% (Luxembourg); as a result, the average rate is 5.0% and, adding 2 percentage points, the reference value is 7.0%.

Interest rates have been measured on the basis of harmonised long-term interest rates, which were developed for the purpose of assessing convergence (see the statistical annex to Chapter II).

As mentioned above, the Treaty makes explicit reference to the "durability of convergence" being reflected in the level of long-term interest rates. Therefore, developments over the reference period from May 2001 to April 2002 are reviewed against the background of the path of long-term interest rates over the last ten years and the main factors underlying differentials vis-à-vis those interest rates prevailing in the EU countries with the lowest long-term rates.

Finally, Article 121 (1) of the Treaty requires this report to take account of several other factors, namely "the development of the ECU, the results of the integration of markets, the situation and development of the balances of payments on current account and an examination of the development of unit labour costs and other price indices". These factors are reviewed in the following chapter under the individual criteria listed above. In the light of the launch of the euro on 1 January 1999 there is no longer a specific discussion of the development of the ECU.

Chapter II

Convergence criteria

Sweden

1 Price developments

Over the reference period from May 2001 to April 2002, the average rate of HICP inflation in Sweden was 2.9%, i.e. below the reference value of 3.3% as defined in Article 121 (1) of the Treaty and Article 1 of the Protocol on the convergence criteria referred to in that Article. It was also below this reference value in 2001 as a whole. In 2000, average HICP inflation was 1.3% (see Table 1). Seen over an extended period of time, HICP inflation in Sweden has been at levels which are consistent with price stability, while in the spring of 2001 it rose rapidly to around 3%, on account of both temporary factors and increasing cost pressures.

Looking back over a longer period of time, consumer price inflation in Sweden followed a downward trend throughout most of the 1990s (see Chart 1). CPI inflation fell below 3% in 1994 and below 1% in the period between 1996 and 1999, and stood at 1.3% in 2000. HICP inflation broadly followed these developments. This progress towards price stability reflects a number of important policy choices, including a shift in the orientation of monetary policy towards the primary objective of price stability. Since 1993, following Sweden's departure from the fixed exchange rate regime against the ECU, the objective for monetary policy has been expressed as an explicit inflation target. Initially, the aim was to prevent the underlying rate of inflation from rising due to the depreciation of the krona after the floating and effects of indirect tax changes. Since 1995, the inflation target has been quantified as a 2% increase in the CPI with a tolerance margin of ±1 percentage point. New central bank legislation, which entered into force in 1999, confirmed price stability as the overriding objective of monetary policy in Sweden. Monetary policy was supported by a sizeable consolidation of public finances and greater product market competition, linked partly to Sweden's accession to the EU in 1995. The very low inflation between 1996 and 2000 stemmed in part from the liberalisation and increased competition in markets such as telecommunications and electricity. The macroeconomic environment also helped to contain upward pressures on prices as resource utilisation recovered only gradually from the severe recession in the early 1990s (see Table 2). Furthermore, a number of temporary factors contributed to the very low inflation rates in the late 1990s. For instance, lower mortgage interest expenditure contributed to lower CPI inflation from the start of 1996, reflecting declining short-term and long-term interest rates. Changes in indirect taxes and subsidies also had significant downward effects on inflation at times. Given the importance of temporary factors, monetary policy decisions have in practice been based on an assessment of underlying inflation, defined as the CPI excluding interest expenditure and direct effects of altered indirect taxes and subsidies (UND1X), although headline CPI remains the official target variable of monetary policy in Sweden. This is also consistent with the Riksbank's clarification of its monetary policy strategy in 1999, which stated that departures from the CPI inflation target may be warranted if inflation is influenced by temporary factors. Low rates of inflation in recent years are also apparent when inflation is measured in terms of other relevant price indices (see Table 2).

Throughout most of the 1990s, developments in compensation per employee, labour productivity and unit labour costs were broadly supportive of price stability. Nevertheless, while wage increases generally adjusted to the low-inflation environment and were historically low, real wages were at times high in relation to labour productivity growth. This is also reflected in the continued compression of the profit share in the economy since 1995.

Following the steep increase in the first half of the 1990s, the unemployment rate has declined rapidly since 1997 as a result of both labour market measures focusing on education and rapid employment growth, in particular in the private service sector. Some signs of labour shortages emerged in 2000. Labour market policies have not changed significantly in recent years and reforms have mainly concentrated on reducing income tax rates, which remain high by international standards, in order to increase labour supply and on measures with a strong emphasis on retraining and education.

Looking at recent trends and forecasts, the annual rate of HICP inflation was 2.2% in April 2002 (see Table 3a). This should be seen against the background of the rapid increase in HICP inflation in the spring of 2001, from 1.5% in February to 3.0% in April. Subsequently, HICP inflation remained largely stable until March 2002. Part of the price increases in 2001 can be explained by various supply shocks, such as foot-and-mouth disease and BSE, and unfavourable weather conditions. These shocks mainly affected the price of meat, fruit and vegetables and electricity (the latter being caused by lower water supply in hydro-electric power production). In addition, the unwinding of price effects following the liberalisation of the telecommunications and electricity markets, which had resulted in a continued downward shift in the price level in 2000, had an upward effect on headline inflation in 2001. These price increases did not appear to be related to the general demand situation and could thus be judged to be mostly of a temporary nature. However, in addition to the supply-related price increases, other prices also increased more than expected, in particular domestically generated prices, while the effects on imported goods prices stemming from the sizeable depreciation of the krona were surprisingly small. Underlying domestic inflation, excluding interest expenditure, the effects of altered indirect taxes and subsidies, and goods that are mainly imported, peaked at 5.0% in January 2002, with large contributions stemming from domestic services and rent prices. This could be interpreted as a sign of high resource utilisation, as reflected by high employment growth and rising wage costs. According to Eurostat data, the unemployment rate declined to around 5% in the first half of 2001 and remained remarkably stable at this level despite the rapid slowdown in growth. In March 2002, unemployment was 5.2% of the labour force. Total unemployment, including persons in labour market programmes, amounted to 6.4% in 2001 according to the Riksbank. In 2001, wage costs were further exacerbated by the cyclical deceleration in labour productivity, which resulted in a rapid increase in unit labour costs (4.4%)[1] and a continued decline in the profit share. While the profit share started from a historically high level, it has declined to below the historical average since 1970. This increases the risks of cost-induced inflation if unit labour costs continue to be high, as companies' ability to accommodate cost increases in their profits is lower. The rapid pass-through of wages into prices in 2001 could also reflect a lack of competition in certain sectors, such as construction, retail and insurance.

In its March 2002 inflation report, Sveriges Riksbank expected CPI inflation to average 2.3% in 2002 and 2.2% in 2003, and the repo rate has since been raised by 0.5 percentage point. Over the same period, HICP inflation is not expected to differ markedly from CPI inflation. Most other inflation forecasters suggest similar rates in the coming two years, except for the OECD, which expects a continued high inflation rate in 2002 and 2003 (see Table 3b). Inflation expectations edged upwards in the course of 2001 before declining in late 2001 and early 2002. Most forecasters anticipate that wage growth will remain around 4% in the coming two years, while unit labour costs are expected to moderate due to the recovery in labour productivity growth. Risks to inflation appear to be mainly on the upside and stem from domestic price pressures linked to high resource utilisation. In addition, the recent higher inflation may affect inflation

1 *Partly on account of the significant variation in the wage measure "compensation of employees", the Riksbank and other institutions in Sweden base their analyses on monthly wage statistics provided by Statistics Sweden. These wage statistics exclude volatile items such as wage bonuses and payroll taxes. For 2000, growth in unit labour costs based on this measure is considerably lower, while for 1999 it is higher.*

expectations and forthcoming wage negotiations, as already evidenced by threats of demands for compensation by some trade unions under existing wage deals. Other factors, such as a rapid recovery of labour productivity growth, could, however, mitigate upward pressures on prices, which would, as necessary, be held in check by a tighter monetary policy stance.

Looking further ahead, maintaining an environment conducive to price stability is linked in Sweden to, inter alia, the conduct of balanced monetary and fiscal policies over the medium to long term. With a stability-oriented economic policy framework in place, it is crucial to strengthen national policies aimed at enhancing competition in product markets and further improving the functioning of labour markets. Social partners will need to contribute to price stability and employment growth by keeping wage increases in line with labour productivity growth and developments in competitor countries. Moreover, following the broad reform agenda as agreed in Lisbon, reforms in product, capital and labour markets as well as in tax and benefit systems appear warranted in order to reduce price pressures and maintain favourable conditions for economic expansion and growth in employment.

2 Fiscal developments

In the reference year 2001 Sweden recorded a general government surplus of 4.8% of GDP, thereby comfortably meeting the 3% reference value for the deficit ratio. Compared with the previous year, the budget surplus as a share of GDP increased by about 1.1 percentage points. This increase is largely explained by the lagged allocation of revenues from capital gains and corporate income in 2000. At the same time, the debt ratio rose by 0.6 percentage point to 55.9% of GDP, i.e. below the 60% reference value. The deficit-debt adjustment producing this increase in the debt ratio, despite the sizeable government surplus, results mainly from a sale of government bond holdings by social security funds. In 2002 a surplus of 1.7% of GDP is expected, while the debt ratio is projected to decrease to 52.6% (see Table 4). Since 1997 the deficit ratio has not exceeded the ratio of public investment expenditure to GDP. In fact, there have been budget surpluses since 1998.

Looking back over the years 1992 to 2001, the Swedish *debt-to-GDP* ratio decreased overall by 9.2 percentage points. Initially, the Swedish Government's finances deteriorated sharply, with the debt ratio rising to 77.7% in 1994. This took place against the background of a strong economic and financial crisis in the early 1990s. Subsequently, the debt ratio decreased to stand at 55.3% in 2000 (see Chart 2a), i.e. a decline of 22.4 percentage points over six years. When looking at the factors underlying debt developments, the primary balance has been in surplus since 1996, more than compensating for the unfavourable growth/interest rate differential since 1997 (see Chart 2b). In 2000 and 2001 sizeable primary surpluses of 7.9% and 8.2% of GDP respectively were recorded. The pattern observed during the early 1990s is an illustration of the powerful effects of a strong deterioration in the macroeconomic environment and exceptional events on the debt ratio, particularly in the absence of a sufficient primary surplus to compensate for these factors. Determined fiscal adjustment in recent years has helped to more than offset the initial increase in the debt ratio after 1992.

The share of debt with a short-term maturity is still noticeable, but it has declined from the high levels of the early 1990s, making fiscal balances less sensitive to changes in interest rates. The proportion of domestic currency debt increased to 81.6% in 2001, although fiscal balances remain sensitive, in principle, to changes in exchange rates.

During the 1990s a pattern of initially sharply deteriorating and subsequently improving out-turns can be observed in the *budget balance-to-GDP* ratio. Starting from a sizeable surplus position at the end of the 1980s, the balance had reached a deficit of 11.9% of GDP by 1993; this deficit subsequently declined year by year, turning into a surplus of 1.9% of GDP in

1998 and improving further to 4.8% in 2001 (see Chart 3a). As is shown in greater detail in Chart 3b, which focuses on changes in fiscal balances, cyclical factors, according to Commission estimates, contributed negatively to the fiscal position in 1992/3 and again in the years of relatively slow growth 1996 and 2001. Strong growth had a positive effect on the fiscal balance in 1994/5 and again from 1998 to 2000. The annual non-cyclical improvements of between 1.7 and 5.1 percentage points during the period from 1995 to 1998 reflect a lasting, structural move towards more balanced fiscal policies and, to a limited extent, a variety of measures with temporary effects, including changes in the tax system and collection owing to EU membership. Subsequently, non-cyclical factors contributed to a deterioration of the budget balance in 1999, while they helped to improve the balance in 2000 and 2001.

Turning to trends in other fiscal indicators, it can be seen from Chart 4 that the general government *total expenditure-to-GDP ratio* declined rapidly after peaking at 73% in connection with the economic crisis in the early 1990s. All major expenditure categories contributed to the decline, and the overall expenditure ratio eventually reached 57.5% of GDP in 2001. A significant contribution to this development resulted from social transfers, which decreased continuously from 23.3% of GDP in 1993 to 18.1% in 2001. By comparison, government compensation of employees declined by 2.4 percentage points over the same period. Public capital expenditure, which stood at 6.1% of GDP in 1993, only accounted for 2.7% of GDP in 2001. Interest expenditure started to decline in relation to GDP from 1997 onwards. *Government current receipts* experienced only moderate changes in relation to GDP between 1993 and 2001. After reaching a temporary peak of 60.9% of GDP in 1998, current revenues declined somewhat and reached 60.2% of GDP in 2001. Despite this small reduction, they may still be at a level which is detrimental to economic growth.

According to the Swedish *medium-term fiscal policy strategy*, as presented in the November 2001 update of the Convergence Programme for 2001 to 2004, the general government financial position is expected to remain in surplus in 2002 while the debt ratio is planned to reach a level of around 50% in that year and to decrease further thereafter. The budget plan for 2002 is in line with these targets. The Swedish Government has announced that it will continue its budgetary strategy of maintaining a surplus of at least 2% of GDP on average over the business cycle. According to the Spring Budget Bill, which revises the relatively favourable projections from early September 2001 on which the Convergence Programme was based, a surplus of 1.8% of GDP is envisaged for 2002 to 2004. These budget surplus targets take into account a significant tax reduction and government expenditure increase in 2002. However, corrective expenditure measures may be necessary to stay below the nominal spending ceilings for the budget. Moreover, the implementation of the final stage of the income tax reform is conditional on the achievement of a sufficient surplus, and it may be postponed. If fiscal balances turn out as targeted in the Spring Budget Bill for 2002 to 2004 and budgetary surpluses are attained for the coming years, Sweden will have complied with the requirements of the Stability and Growth Pact of maintaining a medium-term position close to balance or in surplus. There thus seems to be little risk of Sweden breaching the 3% deficit limit if public finances develop as planned, or, indeed, even if they worsen somewhat.

With regard to the potential future course of the debt ratio, calculations are presented in line with the 2000 Convergence Report of the ECB. Assuming that fiscal balances as projected by the European Commission for 2002 are achieved, maintaining an overall balance-to-GDP ratio for 2002 of 1.7% would reduce the debt-to-GDP ratio to 52.6%. Projected developments for Sweden underline the benefits of the surplus position achieved since 1998 for rapidly reducing the debt ratio. Maintaining a sufficient surplus until 2015 is a pillar of Sweden's strategy to cope with the fiscal pressure emerging from demographic changes. As is highlighted in Table 8, a marked ageing of the population is expected from around 2010 onwards. Concomitantly, ageing-related expenditure on pensions, health care and long-term care would then increase significantly in relation to GDP if policies regarding benefits were to continue unchanged. It is therefore essential to reduce net debt and debt servicing costs before the costs of population ageing start to rise significantly so that sufficient room for manoeuvre can be created and an excessive deficit avoided.

To address these challenges, Sweden reformed its pension system in 1999. As a result, the public pay-as-you-go pension scheme now works as a notional defined contribution system where pension benefits are automatically adjusted to changes in the contributions base and life expectancy. Consequently, the system should remain balanced with stable contribution rates despite the ageing of the population. With individual benefits tightly linked to contributions, the new system also reduces tax distortions. The system is complemented by a mandatory funded pillar and by a range of occupational pension arrangements, which will provide additional sources of retirement income. Moreover, the implementation of further measures aimed at increasing labour force participation (e.g. reducing the tax burden on low wage earners), is important, inter alia, for coping with an ageing population.

3 Exchange rate developments

During the reference period from May 2000 to April 2002 the Swedish krona did not participate in ERM II (see Table 9a). Instead, Swedish monetary policy is oriented towards the primary objective of price stability by means of an explicit inflation target of 2% for annual increases of the CPI in the context of a flexible exchange rate regime.

During the reference period, the krona consistently traded at a weaker level than its May 2000 average exchange rate against the euro (8.241 SEK/EUR), which is used as a benchmark for illustrative purposes in the absence of a central rate (see Chart 5 and Table 9a). The depreciating trend of the krona against the euro, which lasted from early May 2000 until late September 2001 and amounted to some 18% as measured by daily exchange rates, seems to have been associated with the global economic slowdown, affecting Sweden more than the euro area as a result of the higher dependence of the Swedish economy on exports in general and the information and communication technology sector in particular. There were also sizeable net capital outflows from Sweden, caused mainly by significant losses in the Swedish equity market as well as by the relaxation from the beginning of 2001 of restrictions regarding foreign currency investment by Swedish institutional investors. By the second quarter of 2001, against a background of high resource utilisation and unexpectedly rapid price increases in Sweden, the weakness of the krona was considered by the Riksbank to pose a risk of generating inflationary expectations. Consequently, and given that the depreciation was seen at the time as a krona-specific phenomenon in the international foreign exchange markets, in June 2001 the Riksbank carried out a series of foreign exchange interventions in support of the krona. From late September 2001 until the end of the reference period, the krona appreciated by almost 8% against the euro. This strengthening seems to have been mostly associated with the improvement in the Swedish economic outlook in line with the signs of a global recovery and a reversal in capital outflows during the earlier part of the reference period. Overall, the changes in the level of the krona-euro exchange rate were somewhat more pronounced during the period under review than over the longer period between the euro launch in January 1999 and the end of April 2002.

Between May 2000 and April 2002 the volatility of the krona's exchange rate against the euro, measured by annualised standard deviations of daily percentage changes, generally fluctuated in the vicinity of 7% (see Table 9b). Volatility increased around

September 2001, but declined as the krona recovered against the euro thereafter, and at the beginning of 2002 it was clearly below the average level for the period under review. Short-term interest rate differentials against the weighted average of euro area interbank deposit bid rates turned negative in 2000, but in the course of 2001 short-term interest rates edged above the euro area average. At the beginning of 2002, short-term interest rates were around 0.8 percentage point higher than the euro area average (see Table 9b).

In a longer-term context, when measured in terms of real effective exchange rates, the current exchange rate levels of the Swedish krona are clearly weaker than the historical average values and the 1987 average values (see Table 10). As regards other external developments, Sweden has maintained a sizeable current account surplus since 1994 against the background of a relatively large net external liability position (see Table 11). It may also be recalled that Sweden is a small open economy with, according to the most recent data available for 2001, a ratio of foreign trade to GDP of 46.7% for exports and 40.6% for imports, and a share of intra-EU trade of 54.7% for exports and 65.1% for imports.

4 Long-term interest rate developments

Over the reference period from May 2001 to April 2002 long-term interest rates in Sweden were 5.3% on average, and thus stood below the reference value for the interest rate criterion of 7.0%, defined as the average long-term interest rates of the three best-performing Member States in terms of price stability plus 2 percentage points. Swedish long-term interest rates were also below the reference value in 2000 as well as in 2001 as a whole (see Table 12).

With the exception of 1994, long-term interest rates were on a declining trend between the early 1990s and the beginning of 1999 (see Chart 6a). Subsequently, Swedish bond yields began to increase broadly in line with long-term interest rates in the euro area. This increase in long-term Swedish yields reflected influences from rising international yields as well as a gradual improvement of the economic outlook in Sweden. From the mid-1990s until around 1998 Swedish long-term bond yields tended to converge towards the rates of those EU countries with the lowest bond yields. Since then, long-term bond yields in Sweden have stabilised and remained close to those of the countries with the lowest bond yields. The long-term interest rate differential with these Member States has oscillated between 0 and 0.5% for much of the period since early 1998 (see Chart 6b). Since mid-2001, however, this differential has been closer to the upper bound of this range against the background of an increase in HICP inflation, tendencies towards higher inflation expectations in financial markets and increased global uncertainty following the events of 11 September. Furthermore, a weakening of the Swedish krona against the euro has typically been associated with a widening of the interest rate differential. Nevertheless, the improvement in the country's public finances has helped to contain the long-term interest rate differential.

5 Concluding summary

Over the reference period Sweden achieved a 12-month average rate of HICP inflation of 2.9%, which is below the reference value stipulated by the Treaty. Over a number of years, HICP inflation in Sweden has been at levels that are consistent with price stability. Nevertheless, inflation rose rapidly during 2001, possibly due to strained resource utilisation but also on account of various supply shocks which had only a temporary effect. This increase came against the background of several years of relatively high real wage growth and declining profit share in the economy. As the economy stabilises and recovers, strained resource utilisation could have an upward effect on wage developments and domestically generated inflation. Additional labour market reform and strengthened competition in certain product markets would, however, support lower inflation and higher potential GDP growth. Looking ahead, most forecasts indicate that inflation will be slightly above 2% in 2002 and 2003. The level of long-term interest rates was 5.3% over the reference period, i.e. below the respective reference value. However, the differential between long-term interest rates in Sweden and the lowest interest rates in the euro area increased in 2001, reflecting the rise in inflation, tendencies towards higher inflation expectations in financial markets and increased global uncertainty.

Sweden does not participate in ERM II. As was recalled in the Convergence Report 2000, Sweden has a derogation but no special status as regards Stage Three of EMU. Sweden is thus committed by the Treaty to adopt the euro, which implies that it has to strive to fulfil all the convergence criteria, including the exchange rate criterion. Over the reference period, the Swedish krona depreciated significantly from its May 2000 average exchange rate against the euro, which is used as a benchmark for illustrative purposes in the absence of central rates, until September 2001. The decline amounted to some 18% and seems to have been related to export developments and net capital outflows from Sweden. Since September 2001, the global outlook has improved, net capital flows have normalised and the krona has recovered by some 8%.

In the reference year 2001, Sweden recorded a fiscal surplus of 4.8% of GDP, thereby comfortably meeting the 3% reference value for the deficit ratio. The debt-to-GDP ratio was 55.9%, i.e. below the 60% reference value. If fiscal balances turn out as projected in the Spring Budget Bill for the period 2002-2004, Sweden will maintain a budget surplus of close to 2% of GDP throughout this period. Concomitantly, the debt level will decrease further. Against this background, Sweden is expected to comply with the medium-term objective of the Stability and Growth Pact, even if growth rates are somewhat lower than expected. The future fiscal stance and the implementation of tax reforms and offsetting expenditure restraint should take into account the prevailing macroeconomic environment and the expected impact from other policy developments.

With regard to the long-run sustainability of public finances, in 1999 Sweden reformed its pay-as-you-go pension system. Moreover, compliance with the 2% surplus rule in the medium term, as well as the further implementation of measures aimed at increasing labour force participation, is appropriate for preserving the sustainability of public finances. At the same time, Sweden may need to reduce its tax burden in the long run, which is still high compared with other industrialised countries.

With regard to other factors, the deficit ratio has not exceeded the ratio of public investment to GDP since 1997. In fact, there have been budget surpluses since 1998. In addition, Sweden has recorded current account surpluses while maintaining a net external liability position.

List of Tables and Charts

Sweden

Table 1

Sweden: HICP inflation

(annual percentage changes)

	1998	1999	2000	2001	2002 Jan.	2002 Feb.	2002 Mar.	2002 Apr.	May 2001 to Apr. 2002
HICP inflation [1)]	*1.0*	*0.6*	*1.3*	*2.7*	*2.9*	*2.7*	*3.0*	*2.2*	*2.9*
Reference value [2)]	*2.2*	*2.1*	*2.8*	*3.3*	*–*	*–*	*–*	*–*	*3.3*
Euro area average [3)]	*1.1*	*1.1*	*2.3*	*2.5*	*2.7*	*2.5*	*2.5*	*2.4*	*2.5*

Source: Eurostat.

1) *As from January 2000/January 2001 the coverage of the HICP has been extended and further harmonised. See the statistical annex for details.*

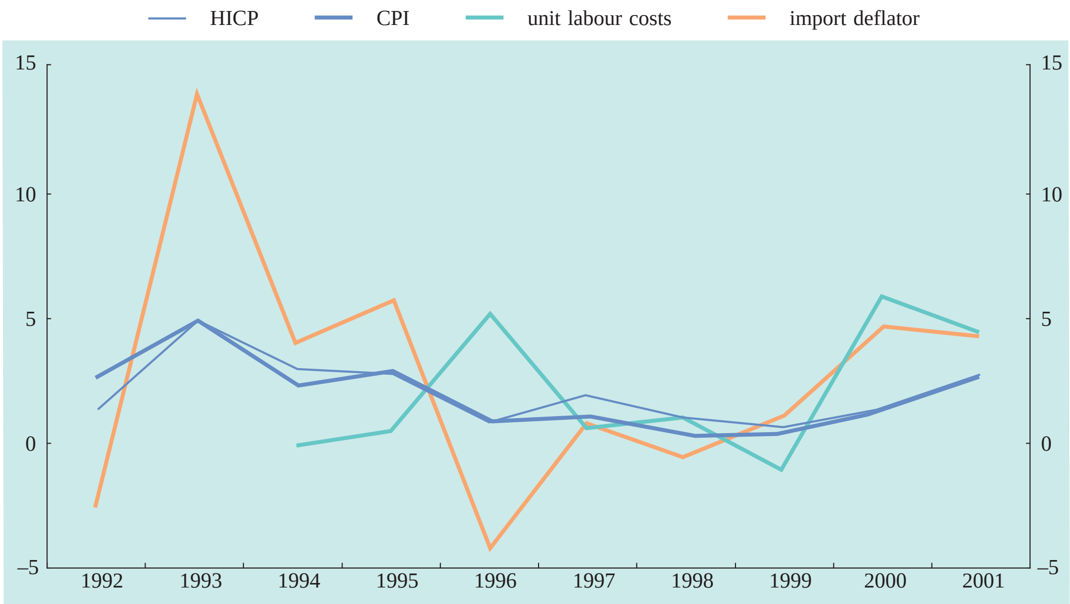
2) *Calculation for the May 2001 to April 2002 period is based on the unweighted arithmetic average of the annual percentage changes of the United Kingdom, France and Luxembourg, plus 1.5 percentage points.*

3) *The euro area average is included for information only.*

Chart 1

Sweden: Price developments

(annual percentage changes)



Sources: National data and Eurostat.

Table 2

Sweden: Measures of inflation and related indicators

(annual percentage changes unless otherwise stated)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Measures of inflation										
Harmonised Index of Consumer Prices (HICP)	1.3	4.8	2.9	2.7	0.8	1.8	1.0	0.6	1.3	2.7
Consumer Price Index (CPI)	2.5	4.7	2.3	2.8	0.8	0.9	0.4	0.3	1.3	2.6
CPI excluding changes in net indirect taxes	4.2	4.4	1.4	1.6	0.0	-1.5	-1.9	-1.1	2.1	2.7
Private consumption deflator	2.1	5.8	2.8	2.9	1.4	2.3	1.0	1.0	1.0	1.6
GDP deflator	1.0	2.7	2.4	3.5	1.4	1.7	0.9	0.7	1.0	2.0
Producer prices [1]	0.2	1.9	4.1	7.0	1.2	0.8	-1.4	-1.2	3.4	4.5
Related indicators										
Real GDP growth	-1.7	-1.8	4.1	3.7	1.1	2.1	3.6	4.5	3.6	1.2
Output gap (percentage points)	-1.8	-5.0	-2.6	-0.8	-1.7	-1.9	-0.7	1.3	2.3	0.9
Unemployment rate (%) [2]	5.6	9.1	9.4	8.8	9.6	9.9	8.3	7.2	5.9	5.1
Unit labour costs, whole economy	–	–	-0.1	0.5	5.1	0.6	0.9	-1.0	5.8	4.4
Compensation per employee, whole economy	–	–	4.8	2.8	6.8	3.8	3.3	1.3	7.3	3.8
Labour productivity, whole economy	2.8	3.6	4.9	2.3	1.6	3.2	2.3	2.3	1.5	-0.6
Imports of goods and services deflator	-2.4	13.9	4.0	5.7	-4.2	0.8	-0.5	1.0	4.6	4.2
Exchange rate [3]	0.6	-16.1	-0.8	-1.3	9.1	-2.6	-2.7	0.2	3.0	-8.4
Money supply (M3)	1.3	7.0	4.5	-1.3	10.0	4.2	3.5	6.8	6.2	2.0
Stock prices (OMX index) [4]	7.6	53.1	3.4	18.8	38.9	27.8	16.9	71.0	-11.9	-19.8
House prices [5]	-9.2	-10.7	4.0	0.5	0.5	7.0	9.6	9.2	10.5	.

Sources: Eurostat, national data (CPI, money supply, stock prices, house prices) and European Commission (output gap, nominal effective exchange rate).

1) *Total industry excluding construction, domestic sales.*
2) *Definition conforms to International Labour Organisation (ILO) guidelines*
3) *Nominal effective exchange rate against 24 industrialised countries.*
Note: a positive (negative) sign indicates an appreciation (depreciation).
4) *End of period.*
5) *Residential property prices, owner-occupied dwellings.*

Table 3

Sweden: Recent inflation trends and forecasts

(annual percentage changes, unless otherwise stated)

(a) Recent trends in the Harmonised Index of Consumer Prices

	Dec. 01	Jan. 02	Feb. 02	Mar. 02	Apr. 02
Harmonised Index of Consumer Prices (HICP)					
Annual percentage change	3.2	2.9	2.7	3.0	2.2
Change in the average of the latest 3 months from the previous 3 months, annualised rate, seasonally adjusted	1.6	1.5	1.1	1.5	2.3
Change in the average of the latest 6 months from the previous 6 months, annualised rate, seasonally adjusted	3.0	2.6	2.1	1.7	1.8

Sources: Eurostat and ECB calculations.

(b) Inflation forecasts

	2002	2003
European Commission (spring 2002), HICP	2.2	2.2
OECD (April 2002), CPI	2.6	2.8
IMF (May 2002), CPI	2.3	2.2

Sources: European Commission, the OECD (preliminary edition) and the IMF.

Table 4

Sweden: General government financial position

(as a percentage of GDP)

	2000	2001	2002 [1]
General government surplus (+) / deficit (-)	3.7	4.8	1.7
Reference value	-3	-3	-3
Surplus (+) / deficit (-), net of government investment expenditure [2]	6.2	7.3	4.3
General government gross debt	55.3	55.9	52.6
Reference value	60	60	60

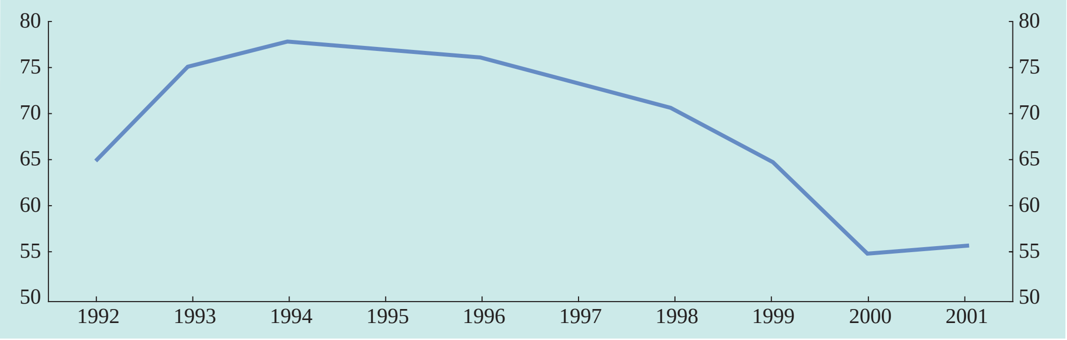
Sources: European Commission (spring 2002 forecasts) and ECB calculations.
1) European Commission forecast.
2) A negative sign indicates that the government deficit is higher than investment expenditure.

Chart 2

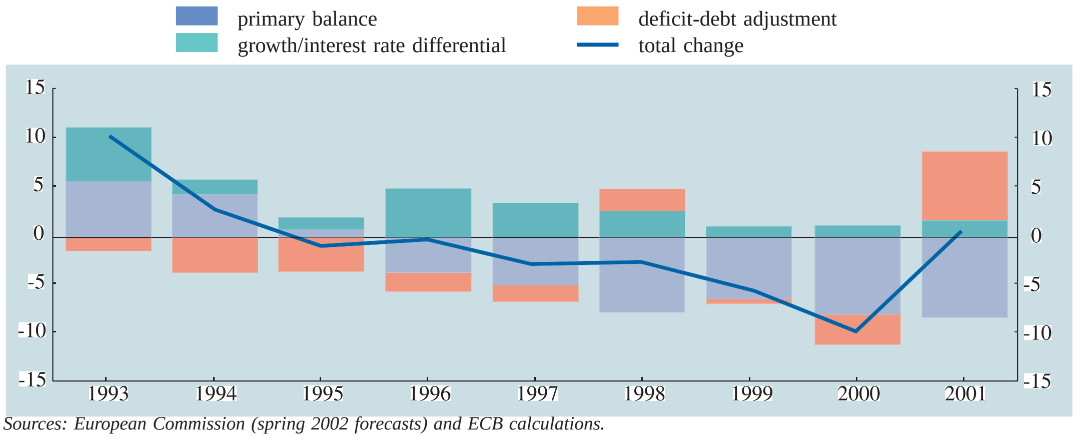
Sweden: General government gross debt

(as a percentage of GDP)

(a) Levels



(b) Annual changes and underlying factors



Sources: European Commission (spring 2002 forecasts) and ECB calculations.
Note: In Chart 2 (b) negative values indicate a contribution of the respective factor to a decrease in the debt ratio, while positive values indicate a contribution to its increase.

Table 5

Sweden: General government gross debt – structural features

(as a percentage of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total debt (as a percentage of GDP)	65.1	75.1	77.7	76.6	76.0	73.1	70.5	65.0	55.3	55.9
Composition by currency (% of total)										
In domestic currency	–	–	68.6	70.0	69.9	70.7	72.8	77.5	79.3	81.6
In foreign currencies	–	–	31.4	30.0	30.1	29.3	27.2	22.5	20.7	18.4
Euro or participating foreign currencies	–	–	–	–	–	–	–	–	–	–
Non-participating foreign currencies	–	–	–	–	–	–	–	–	–	–
Domestic ownership (% of total)	–	–	54.5	56.2	49.9	52.9	53.6	58.0	63.2	–
Average residual maturity	–	–	–	–	–	–	–	–	–	–
Composition by maturity [1] (% of total)										
Short-term (up to and including one year)	–	–	27.2	20.0	19.4	15.0	19.3	17.6	19.7	19.0
Medium and long-term (over one year)	–	–	72.8	80.0	80.6	85.0	80.7	82.4	80.3	81.0

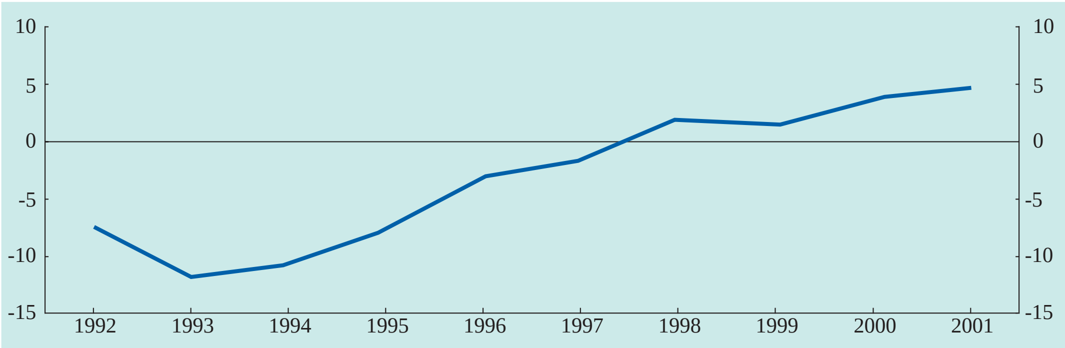
Sources: ESCB, except total debt (European Commission (spring 2002 forecasts). Year-end data.
Note: Differences between totals and the sum of their components are due to rounding.
1) Original maturity.

Chart 3

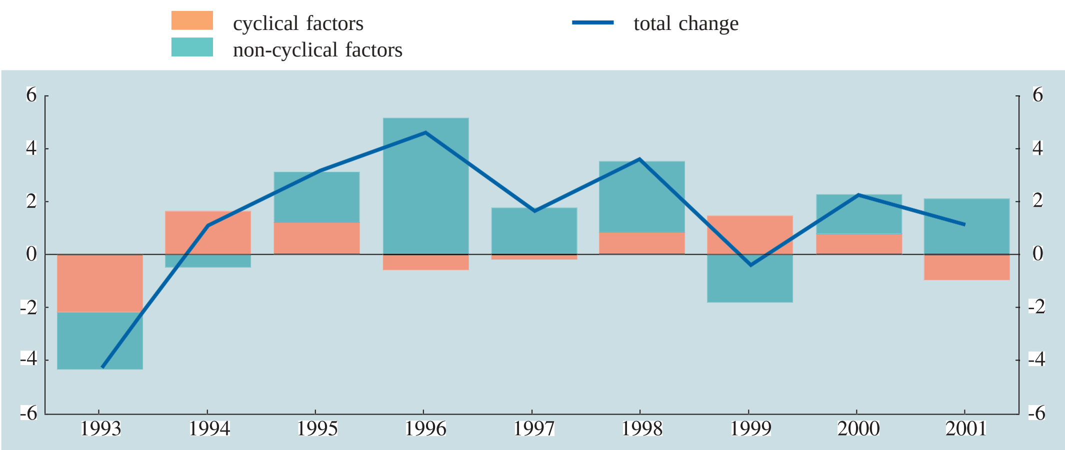
Sweden: General government surplus (+) / deficit (-)

(as a percentage of GDP)

(a) Levels



(b) Annual changes and underlying factors



Sources: European Commission (spring 2002 forecasts) and ECB calculations.
Note: In Chart 3 (b) negative values indicate a contribution to an increase in deficits, while positive values indicate a contribution to their reduction.

Table 6

Sweden: General government deficit-debt adjustment

(as a percentage of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Change in general government debt	13.5	10.5	7.2	4.2	1.3	-0.1	0.5	-2.0	-6.8	2.4	-1.3
General government surplus (+) / deficit (-)	-7.5	-11.9	-10.8	-7.8	-3.2	-1.6	1.9	1.5	3.7	4.8	1.7
Deficit-debt adjustment	**5.9**	**-1.4**	**-3.6**	**-3.6**	**-1.9**	**-1.7**	**2.5**	**-0.5**	**-3.1**	**7.2**	**0.5**
Net acquisitions (+) / net sales (-) of financial assets	**–**	**–**	**-2.8**	**-0.5**	**-1.1**	**0.3**	**2.1**	**0.0**	**-2.0**	**4.4**	**–**
Currency and deposits	–	–	-1.5	1.1	-1.6	-0.3	-0.1	0.9	-0.2	-0.1	–
Loans and securities other than shares	–	–	-1.4	-1.8	0.6	1.1	0.8	-0.9	-1.7	-3.4	–
Shares and other equity	–	–	-0.6	-0.3	-0.2	-0.9	1.0	-0.1	-0.0	7.7	–
Privatisations	–	–	0.0	-0.0	0.0	-0.1	-0.1	0.0	-3.0	0.0	–
Equity injections	–	–	0.0	-0.0	-0.0	0.0	0.0	0.0	0.1	-0.2	–
Other	–	–	-0.6	-0.2	-0.1	-0.8	1.1	-0.1	2.8	7.9	–
Other financial assets	–	–	0.7	0.5	0.1	0.4	0.3	0.1	-0.0	0.1	–
Valuation changes of general government debt	**–**	**–**	**-0.4**	**-2.5**	**0.5**	**-1.1**	**0.0**	**-2.1**	**0.0**	**1.0**	**–**
Foreign exchange holding gains (-) / losses (+)	–	–	–	–	–	–	0.1	-1.4	0.9	1.1	–
Other valuation effects [1]	–	–	–	–	–	–	-0.0	-0.7	-0.9	-0.1	–
Other changes in general government debt [2]	**–**	**–**	**-0.4**	**-0.5**	**-1.2**	**-0.8**	**0.3**	**1.6**	**-1.2**	**1.7**	**–**

Sources: ESCB, except change in general government debt, general government surplus/deficit and deficit-debt adjustment (European Commission (spring 2002 forecasts)).

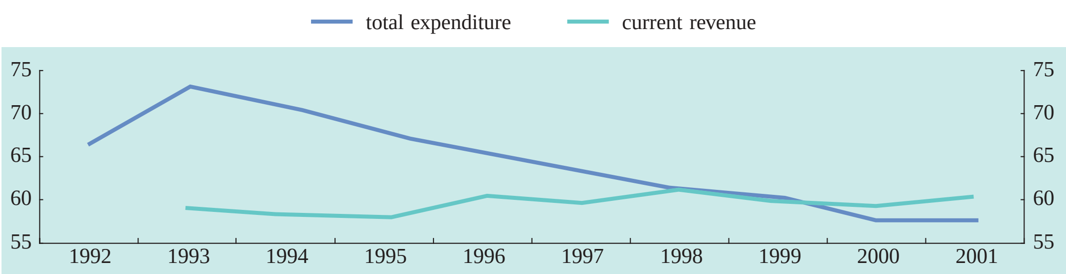
1) Includes the difference between the nominal and market valuation of general government debt at issue.

2) Transactions in other accounts payable (government liabilities) and sector reclassifications. This item may also cover certain cases of debt assumption.

Chart 4

Sweden: General government expenditure and receipts

(as a percentage of GDP)



Source: European Commission (spring 2002 forecasts).

Table 7

Sweden: General government budgetary position

(as a percentage of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total revenue	59.1	61.1	59.9	60.0	62.2	61.6	62.9	61.6	61.4	62.3
Current revenue	–	59.3	58.5	58.0	60.7	59.6	60.9	59.7	59.5	60.2
Direct taxes	19.9	19.9	19.7	20.2	21.6	21.7	22.4	22.0	22.2	23.4
Indirect taxes	15.8	15.1	14.4	13.7	14.3	14.8	15.3	16.8	14.5	14.6
Social security contributions	14.4	13.8	13.8	14.2	15.2	15.0	15.0	13.7	15.8	16.3
Other current revenue	–	10.6	10.6	9.8	9.5	8.2	8.1	7.2	7.0	6.0
Capital revenue	–	1.8	1.4	2.1	1.6	2.0	1.9	2.0	1.9	2.0
Total expenditure	66.7	73.0	70.7	67.8	65.5	63.1	60.9	60.2	57.7	57.5
Current expenditure	64.0	67.1	66.3	63.8	62.4	59.8	59.0	57.2	55.2	54.9
Compensation of employees	18.8	19.1	18.2	17.3	17.8	17.4	16.8	16.4	16.4	16.7
Social benefits other than in kind	22.9	23.3	22.8	21.3	20.3	19.6	19.3	18.8	18.3	18.1
Interest payable	5.2	6.0	6.6	6.9	6.9	6.4	5.8	4.8	4.2	3.5
Of which: impact of swaps and FRAs	–	–	–	0.1	0.1	-0.1	0.1	-0.1	-0.0	0.1
Other current expenditure	17.1	18.6	18.7	18.2	17.5	16.4	17.0	17.2	16.3	16.5
Capital expenditure	2.6	6.1	4.4	4.0	3.0	3.3	2.0	2.9	2.5	2.7
Surplus (+) / deficit (-)	-7.5	-11.9	-10.8	-7.8	-3.2	-1.6	1.9	1.5	3.7	4.8
Primary balance	-2.3	-5.9	-4.3	-0.8	3.7	4.9	7.7	6.3	7.9	8.2
Surplus (+) / deficit (-), net of government investment expenditure	–	–	-7.3	-4.4	-0.2	1.1	4.6	4.2	6.2	7.3

Source: European Commission (spring 2002 forecasts). Differences between totals and the sum of their components are due to rounding.
Note: Interest payable as reported under the excessive deficit procedure. The item "impact of swaps and FRAs" is equal to the difference between the interest (or deficit/surplus) as defined in the excessive deficit procedure and in the ESA 95. See European Parliament/Council Regulation 2558/2001 on the reclassification of settlements on swaps and FRAs.

Table 8

Sweden: Projections of elderly dependency ratio

	2000	2010	2020	2030	2040	2050
Elderly dependency ratio (population aged 65 and over as a proportion of the population aged 15-64)	27.0	29.0	35.0	39.0	42.0	41.0

Source: ESCB.

Table 9

(a) Sweden: Exchange rate stability

Membership of the exchange rate mechanism (ERM II)	No	
Devaluation of bilateral central rate on country's own initiative	No	
Maximum upward and downward deviations [1]	Maximum upward deviation	Maximum downward deviation
1 May 2000 to 30 April 2002:		
Euro	1.0	-16.3
For information only:		
Danish krone	1.0	-16.5
Greek drachma (up to 31 December 2000 only)	0.9	-5.0
Pound sterling	4.8	-12.8

Source: ECB; daily data at business frequency, ten-day moving average.

1) *Maximum upward (+) and downward (-) deviations (in %) from May 2000 in bilateral exchange rates against the currencies shown.*

(b) Sweden: key indicators of exchange rate pressure for the Swedish krona

	2000		2001				2002	
Average of three months ending	July	Oct.	Jan.	Apr.	July	Oct.	Jan.	Apr.
Exchange rate volatility [1]	7.1	5.5	6.1	6.2	7.0	8.6	7.8	4.7
Short-term interest rate differentials [2]	0.0	-0.3	-0.3	-0.2	0.2	0.4	0.5	0.8

Sources: National data and ECB calculations.

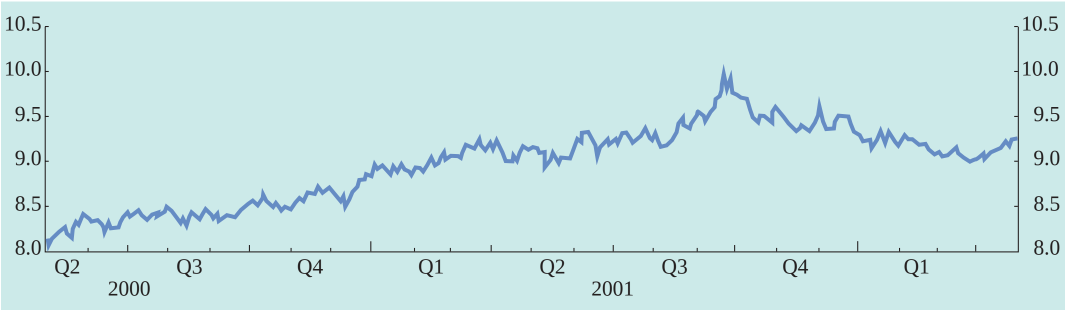
1) *Annualised monthly standard deviation of daily percentage changes of the exchange rate against the euro (in %).*

2) *Differential of three-month interbank interest rates against a weighted average of euro area interbank deposit bid rates, in percentage points.*

Chart 5a

Swedish krona: Exchange rate against the euro over the last two years

(daily data: 1 May 2000 to 30 April 2002)

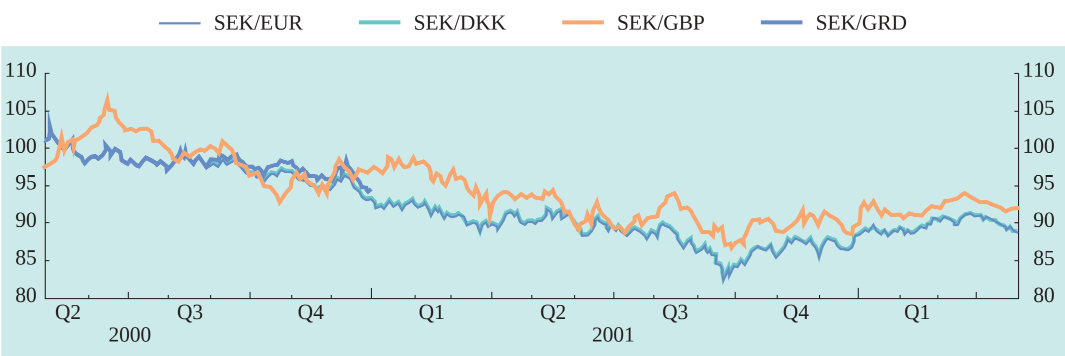


Source: ECB.

Chart 5b

Swedish krona: Bilateral exchange rates index

(daily data: average of May 2000 = 100; 1 May 2000 to 30 April 2002)



Source: ECB.

Table 10

Swedish krona: Measures of the real effective exchange rate vis-à-vis EU Member States

(quarterly data; percentage deviations; Q4 2001 compared with different benchmark periods)

	Average 1974-2001	Average 1991-2001	Average 1987
Real effective exchange rates:			
Unit wage costs (total economy)-based	-25.5	-12.9	-21.2
Private consumption deflator-based	-14.8	-11.8	-12.4
GDP deflator-based	-20.1	-12.8	-17.4
Exports of goods and services deflator-based	-17.1	-9.3	-16.1
Memo item:			
Nominal effective exchange rate	-26.2	-10.5	-23.1

Sources: European Commission and ECB calculations.
Note: A positive (negative) sign indicates an appreciation (depreciation).

Table 11

Sweden: External developments

(as a percentage of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Current account balance	-2.9	-1.3	1.2	3.4	3.2	3.8	3.4	3.6	3.3	3.2
Net foreign assets (+) or liabilities (-)	-36.8	-43.8	-41.9	-33.4	-39.2	-42.2	-38.5	-35.6	-31.6	-21.2
Exports of goods and services [1]	28.0	32.4	36.0	40.5	39.1	42.7	43.7	43.6	47.3	46.7
Imports of goods and services [1]	26.4	28.5	31.3	33.7	32.4	35.5	37.5	37.7	41.9	40.6
Intra-EU exports of goods [2] [3]	68.4	64.6	58.6	59.6	57.1	55.6	57.9	58.4	55.9	54.7
Intra-EU imports of goods [2] [3]	69.4	68.6	64.8	68.6	68.5	67.7	69.2	67.7	64.2	65.1

Sources: Eurostat (intra-EU exports and imports of goods), national data and ECB calculations.
1) *Balance of payments statistics.*
2) *External trade statistics.*
3) *As a percentage of total exports and imports.*

Table 12

Sweden: Long-term interest rates

(percentages)

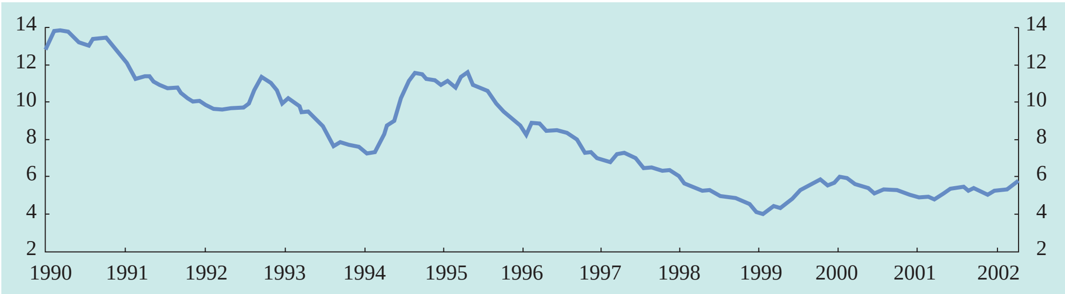
	2000	2001	2002 Feb.	2002 Mar.	2002 Apr.	May 2001 to Apr. 2002
Long-term interest rate	5.4	5.1	5.4	5.6	5.7	5.3
Reference value	*7.4*	*7.0*	–	–	–	*7.0*
Euro area average	*5.4*	*5.0*	*5.1*	*5.3*	*5.3*	*5.1*

Sources: ECB, European Commission services.
Note: The reference value is based on the three best-performing Member States in terms of price stability (the United Kingdom, France and Luxembourg, for the period from May 2001 to April 2002) plus 2 percentage points. The euro area average is included for information only.

Chart 6

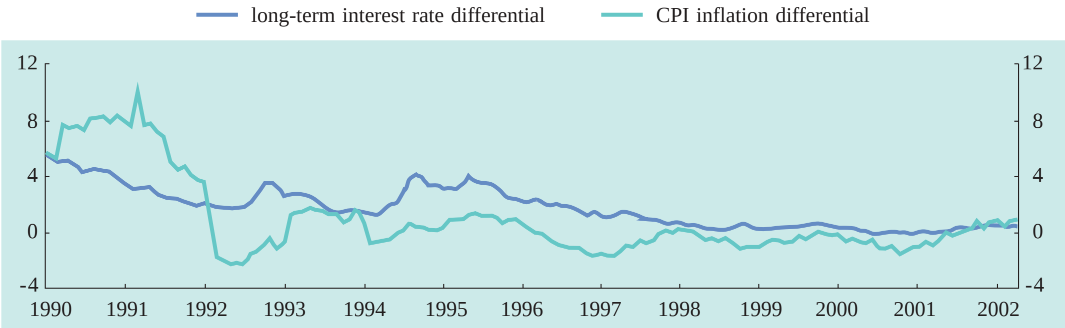
(a) Sweden: Long-term interest rate

(monthly averages in percentages)



Source: ECB.

(b) Sweden: Long-term interest rate and CPI inflation differentials vis-à-vis EU Member States with the lowest long-term interest rates[1)]



Sources: ECB, European Commission Services. The CPI data are non-harmonised.
1) Germany, Austria, Luxembourg, the Netherlands and France.

Annex: Statistical methodology of convergence indicators

This annex provides information on the statistical methodology of the convergence indicators and details of the harmonisation achieved in these statistics.

Consumer prices

Protocol No. 21 on the convergence criteria referred to in Article 121 of the Treaty requires price convergence to be measured by means of the national consumer price indices on a comparable basis, taking into account differences in national definitions. The conceptual work on the harmonisation of CPIs is carried out by the Commission (Eurostat) in close liaison with the National Statistical Institutes (NSIs). As a key user, the ECB has been closely involved in this work, as was its predecessor, the EMI. In October 1995 the EU Council adopted a Regulation concerning HICPs, which serves as the framework for further detailed harmonisation measures.

The harmonisation measures introduced for HICPs have been based on several Commission and EU Council Regulations. HICPs use a common coverage in terms of the items, the territory and the population included (all three issues are major reasons for differences between national CPIs). Common standards have also been established in several other areas (for example, the treatment of new goods and services). Some of these are minimum standards and are being developed further.

In accordance with EU Council Regulations adopted in 1998 and 1999, the coverage of HICPs has been further extended and harmonised in all Member States with effect in most instances as from January 2000 and January 2001. The annual rates of inflation in 2000 and 2001 reflect this only partially, since the changes in coverage were incorporated in January each year and, in general, no revision of data for earlier periods has been carried out.

The HICP covering the euro area as a whole has been the main measure of consumer prices for the single monetary policy of the ECB since January 1999.

Public finances

Protocol No. 20 on the excessive deficit procedure annexed to the Treaty, together with an EU Council Regulation of November 1993, define "government", "surplus/deficit", "interest expenditure", "investment", "debt" and "gross domestic product" by reference to the European System of Accounts (ESA, second edition[1]). Whereas the ESA, second edition, was the statistical standard for the first Convergence Report, since 2000 the excessive deficit procedure has been based on the ESA 95, as laid down in a Council Regulation[2]. The ESA 95 is consistent with other international standards such as the System of National Accounts 1993 (SNA 93).

"Government" comprises central government, state government (in Member States with a federal structure), regional or local government and social security funds. It does not include public enterprises and is therefore to be distinguished from a more broadly defined public sector.

"Government surplus/deficit" is the net lending (+)/net borrowing (-) as defined in the ESA 95, but including interest payments resulting from swap arrangements and forward rate agreements. "Government debt" is the sum of the outstanding gross liabilities at nominal value as classified in the ESA 95 categories currency and deposits, securities other than shares excluding financial derivatives (e.g. government bills, notes and bonds), and loans. Government debt does not cover financial derivatives such as swaps, trade credits or other liabilities which are not

1 *Eurostat: "European System of Integrated Economic Accounts" (ESA), second edition, Statistical Office of the European Communities, Luxembourg 1979.*
2 *Council Regulation (EC) No 2223/96 of June 1996 on the European system of national and regional accounts in the Community, Annex V.*

represented by a financial document, such as overpaid tax advances, nor does it include contingent liabilities such as government guarantees and pension commitments. While government debt is a gross concept in the sense that assets are not deducted from liabilities, it is consolidated within the government sector and does not therefore include government debt held by other government units. "Total revenue" and "total expenditure" are defined in a Commission Regulation of July 2000. They comprise, respectively, the transactions increasing and decreasing net lending (+)/net borrowing (-), and the difference between them is equal to net lending (+)/net borrowing (-).

The definitions of government deficit and government debt imply that the change in government debt outstanding at the end of two consecutive years may differ substantially from the government deficit for the year under consideration. For example, government debt may be reduced by using the receipts from privatising public enterprises or by selling other financial assets without any (immediate) impact on the government deficit. The explanation of the difference between the deficit and the change in government debt, the "deficit-debt adjustment", is also important for assessing the statistical quality of the reported data.

The measure of GDP used for compiling deficit and debt ratios is the ESA 95 GDP.

Since the beginning of 1994 EU Member States have reported data related to their government deficit and government debt to the Commission at least twice a year. The Treaty gives responsibility to the Commission for providing the statistical data to be used for the excessive deficit procedure. Against this background, Eurostat monitors the consistency of the statistical data reported in accordance with the ESA 95. A detailed explanation of the application of the ESA 95 is provided in the Manual on Government Deficit and Debt.

Exchange rates

Exchange rates of the currency of the Member State under review vis-à-vis the euro are daily reference rates recorded by the ECB at 2.15 p.m. (following the daily concertation procedure between central banks). They are published on the ECB's website and are also available via electronic market information providers. Exchange rates vis-à-vis the ECU (up to end-1998) are daily official rates as published in the Official Journal of the European Communities. European cross rates used in this report are derived from these euro or ECU exchange rates. The nominal and real effective exchange rates to which the report refers are based on series calculated by the Commission.

Long-term interest rates

Article 4 of Protocol No. 21 on the convergence criteria referred to in Article 121 of the Treaty requires interest rates to be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions. While Article 5 assigns the responsibility for providing the statistical data for the application of the Protocol to the Commission, the ECB, given its expertise in the area, assists by defining representative long-term interest rates and collects the data from the NCBs for transmission to the Commission. This is a continuation of the work carried out by the EMI as part of the preparations for Stage Three of EMU in close liaison with the Commission.

This conceptual work carried out by the EMI resulted in the definition of seven key features to be considered in the calculation of long-term interest rates, as presented in the table below.

Box 1

Statistical framework for defining long-term interest rates for the purpose of assessing convergence

Concept	Recommendation
Bond issuer	Long-term government bonds or comparable securities issued by the central government
Maturity	As close as possible to ten years' residual maturity. Any replacement of bonds should minimise maturity drift; the structural liquidity of the market must be considered.
Coupon effects	No direct adjustment
Taxation	Gross of tax
Choice of bonds	The selected bonds should be sufficiently liquid. This requirement should determine the choice between benchmark or sample approaches, depending on national market conditions.
Yield formula	"Yield to maturity" ISMA formula 6.3
Aggregation	Where there is more than one bond in the sample, a simple average of the yields should be used to produce the representative rate.

Harmonised representative long-term interest rates are produced by the NCBs, and fully harmonised data are used in this Convergence Report.

Other factors

The last paragraph of Article 121 (1) of the Treaty states that the reports of the Commission and the ECB shall, in addition to the four main criteria, also take account of the development of the ECU, the results of the integration of markets, the situation and development of the balances of payments on current account and an examination of the development of unit labour costs and other price indices.

Whereas for the four main criteria Protocol No. 21 stipulates that the Commission will provide the data to be used for the assessment of compliance and describes that data in more detail, it makes no reference to these "other factors".

For the balance of payments and net foreign assets and liabilities, the data used are compiled by the NCB following the IMF Balance of Payments Manual, fifth edition. Data are not fully comparable over time due to new definitions from October 1997.

Unit labour cost data as well as national accounts deflators are derived from data provided under the ESA 95. Producer price indices are based on harmonised definitions, which provide results comparable among Member States and refer to domestic sales of total industry excluding construction.

Cut-off date

The cut-off date for the statistics included in this Convergence Report was 30 April 2002, with the exception of the HICPs published by the Commission (Eurostat) on 16 May 2002 and for the United Kingdom on 21 May 2002.

Chapter III

Compatibility of national legislation with the Treaty

1 Introduction

1.1 General remarks

Article 122 (2) of the Treaty requires the ECB (and the Commission) to report, at least once every two years or at the request of a Member State with a derogation, to the EU Council in accordance with the procedure laid down in Article 121 (1). Each such report must include an examination of the compatibility between the national legislation of each Member State with a derogation, including the statute of its NCB, and Articles 108 and 109 of the Treaty and the Statute of the ESCB (also referred to as "legal convergence"). The only Member State with a derogation to be considered in the present report is Sweden. The ECB has therefore examined the legal situation in Sweden and the legislative measures that have been taken or need to be taken by Sweden with a view to achieving compatibility of its national legislation with the Treaty and the Statute of the ESCB.

This report draws on the ECB's and the EMI's previous reports on legal convergence: in particular, the ECB's Convergence Report of 2000 and the EMI's Convergence Report of 1998, but also the 1995 and 1996 reports on "Progress towards convergence", as well as the legal update thereof dated October 1997. Accordingly, the following text should be read in conjunction with the relevant parts of those reports. The examination of the compatibility of national legislation considers any legislative amendments which have been enacted, or are in the process of being enacted, in Sweden since the observations made in the 2000 Convergence Report.

1.2 Denmark and the United Kingdom

This report covers only Sweden because the other two Member States of the EU that have not adopted the euro, Denmark and the United Kingdom, are Member States with a special status.

The Protocol on certain provisions relating to Denmark, annexed to the Treaty, states that the Danish Government shall notify the EU Council of its position concerning participation in the third stage of EMU before the Council makes its assessment under Article 121 (2) of the Treaty. Denmark gave notification that it would not participate in the third stage of EMU. In accordance with Article 2 of the Protocol, this means that Denmark is treated as a "Member State with a derogation". The implications for Denmark were elaborated in a Decision taken by the Heads of State or Government at their Edinburgh summit meeting on 11 and 12 December 1992. This Decision states that Denmark retains its existing powers in the field of monetary policy according to its national laws and regulations, including the powers of Danmarks Nationalbank in the field of monetary policy. As Article 108 of the Treaty, in accordance with Article 122 (3) of the Treaty, applies to Denmark, Danmarks Nationalbank has to fulfil the requirements of central bank independence. The 1998 EMI Convergence Report concluded that this requirement had been fulfilled; this position has not changed. The legal integration of Danmarks Nationalbank into the ESCB does not need to be provided for and no other legislation needs to be adapted as long as Denmark does not notify the EU Council that it intends to adopt the single currency.

According to the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, annexed to the Treaty, the United Kingdom shall be under no obligation to move to the third stage of EMU unless it notifies the EU Council that it intends to do so. On 30 October 1997 the United Kingdom informed the Council that it did not intend to adopt the single currency on 1 January 1999 (and this situation has not changed). Pursuant to this notification, certain provisions of the Treaty (including Articles 108 and 109) and of the Statute of the ESCB do not apply to the United Kingdom. Accordingly, there is no current legal requirement to ensure that national legislation (including the statute of the Bank of England) is compatible with the Treaty and the Statute of the ESCB.

2 Scope of adaptation

2.1 Areas of adaptation

For the purpose of identifying those areas in which national legislation needs to be adapted, the ECB follows the same general structure it has followed in the past:

– the independence of the NCBs (see in particular Article 108 of the Treaty and Articles 7 and 14.2 of the Statute of the ESCB);

– the legal integration of the NCBs into the ESCB (see in particular Articles 12.1 and 14.3 of the Statute of the ESCB); and

– legislation other than NCB statutes.

2.2 "Compatibility" versus "harmonisation"

Article 109 of the Treaty requires national legislation to be "compatible" with the Treaty and the Statute of the ESCB; incompatibilities with the Treaty and the Statute in national legislation must therefore be removed. Neither the supremacy of the Treaty and the Statute over national legislation, nor the nature of the incompatibility, affects this obligation.

The term "compatible" does not mean that the Treaty requires "harmonisation" of the statutes of the NCBs, either inter se or with that of the ESCB. National particularities may continue to exist. Indeed, Article 14.4 of the Statute of the ESCB permits NCBs to perform functions other than those specified in the Statute, to the extent that these do not interfere with the objectives and tasks of the ESCB. Provisions enabling such additional functions in NCB statutes would be a clear example of circumstances in which differences may remain. Rather, the term "compatible" implies that national legislation and the statutes of the NCBs need to be adjusted in order to eliminate inconsistencies with the Treaty and the Statute of the ESCB and to ensure the necessary degree of integration of the NCBs into the ESCB. In particular, all provisions that infringe on an NCB's independence as defined in the Treaty and its role as an integral part of the ESCB have to be adjusted.

The obligation in Article 109 of the Treaty extends only to incompatibilities with the provisions of the Treaty and Statute of the ESCB. However, national legislation that is incompatible with secondary EC or ECB legislation will, of course, also have to be brought into line with such secondary legislation. This general requirement derives from the case law of the European Court of Justice.

Finally, the Treaty and the Statute of the ESCB do not prescribe the manner in which national legislation needs to be adapted. This may be achieved by making references to the Treaty and the Statute, by incorporating provisions thereof, by simply deleting incompatibilities or by a combination of these methods.

3 Central bank independence

The features of central bank independence were described extensively in the 1998 EMI Convergence Report, to which reference may be made. It stated that incompatibilities in the area of central bank independence needed to be effectively removed by the date of the ESCB's establishment (i.e. 1 June 1998) at the latest. This implied that the respective amendments should not only have been adopted, but should also have entered into force by that date. This requirement applied also to Member States with a derogation.

4 Legal integration of NCBs into the ESCB

Article 14.3 of the Statute of the ESCB states that fully participating NCBs are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. Provisions in national legislation (particularly in NCB statutes) which would prevent the execution of ESCB-related tasks or compliance with decisions of the ECB would be incompatible with the effective operation of the ESCB. Adaptations would therefore have to be made to national legislation and the NCB statutes to ensure compatibility with the Treaty and the Statute of the ESCB. In order to comply with Article 109 of the Treaty, national legislative procedures had to be adjusted in such a way as to ensure the compatibility of national legislation by the date of the establishment of the ESCB. However, statutory requirements relating to the full legal integration of an NCB into the ESCB need only enter into force at the moment that full integration becomes effective. In the case of a Member State with a derogation, this means the date on which it adopts the single currency. The main areas for attention are those in which statutory provisions may obstruct compliance by an NCB with the requirements of the ESCB. This would include provisions that may hinder the fulfilment by a governor of his/her duties as a member of the Governing Council of the ECB, or that do not respect the prerogatives of the ECB. A distinction is made in the following between the different areas of which NCB statutes are usually composed: statutory objectives, tasks, instruments, organisation and financial provisions, as well as other areas where adaptations of an NCB's statute may be necessary.

4.1 Statutory objectives

The full integration of the NCBs into the ESCB requires that their statutory objectives be compatible with the ESCB's objectives as laid down in Article 2 of the Statute of the ESCB. This means, inter alia, that statutory objectives with a "national flavour" – for example, where a statutory provision refers to an obligation to conduct monetary policy within the framework of the general economic policy of the Member State concerned – need to be adapted.

4.2 Tasks

The tasks of an NCB of a fully participating Member State are predominantly determined by its status as an integral part of the ESCB and, thus, by the Treaty and the Statute of the ESCB. In order to comply with Article 109 of the Treaty, provisions on tasks in NCB statutes therefore need to be compared with the relevant provisions of the Treaty and the Statute of the ESCB[1] and incompatibilities removed. This applies to any provisions that, after adoption of the euro and integration into the ESCB, would constitute an impediment to the execution of ESCB-related tasks and, in particular, to provisions which do not respect the ECB's competences under Chapter IV of the Statute of the ESCB.

1 *See, in particular, Articles 105 and 106 of the Treaty and Articles 3 to 6 of the Statute of the ESCB.*

4.3 Instruments

The statute of an NCB will naturally contain provisions on monetary policy instruments. Again, national provisions on such instruments are to be compared with those contained in the Treaty and the Statute of the ESCB. Incompatibilities need to be removed in order for the statutes to comply with Article 109 of the Treaty.

4.4 Organisation

The prohibition of soliciting or taking instructions, and of giving instructions, as laid down in Article 108 of the Treaty, must be ensured irrespective of the organisation of an NCB. In addition, there must be no mechanisms in the statute of an NCB which could bind a governor in his or her voting behaviour in the Governing Council of the ECB, in which he or she acts in a separate capacity as a member of that Council. Neither must there be any mechanisms in the statute of an NCB that could prevent its decision-making bodies from complying with rules adopted at the level of the ECB.

4.5 Financial provisions

The financial provisions in the Statute of the ESCB, which may be of particular relevance for the identification of incompatibilities in NCB statutes, comprise rules on accounting,[2] auditing,[3] capital subscriptions,[4] transfer of foreign reserve assets[5] and monetary income.[6] NCBs need to be able to comply with their obligations under these provisions.

4.6 Miscellaneous

In addition to the above-mentioned issues, there may be other areas in which the adaptation of an NCB's statute is required. For example, the obligation of professional secrecy for staff of the ECB and NCBs as laid down in Article 38 of the Statute of the ESCB may have an impact on similar provisions in NCB statutes. This area of law might alternatively be covered by legislation other than the statute of the NCB.

5 Legislation other than the statutes of the NCBs

The obligation under Article 109 of the Treaty to bring about legal convergence applies to those areas of legislation which are affected by the full participation of a Member State in EMU and which would be incompatible with the Treaty and the Statute of the ESCB if they were to remain unchanged. The ECB's assessment in this field focuses in particular on laws with an impact on an NCB's performance of ESCB-related tasks and laws in the monetary field. Again, in order to comply with Article 109, national legislative amendments had to be introduced so as to ensure the compatibility of national legislation by the date of the establishment of the ESCB. In any event, the removal of any incompatibility of national legislation will need to be effective by the date on which a Member State adopts the euro. Legislation requiring adaptation may be found in the areas of banknotes, coins, foreign reserve management, exchange rate policy and other areas which may have an impact on an NCB's performance of ESCB-related tasks.

5.1 Banknotes

The currency acts and other legal provisions of a Member State assigning the exclusive right to issue banknotes to its NCB must recognise the Governing Council of the ECB's exclusive right to authorise the issuance of banknotes as laid down in Articles 106 (1) of the Treaty and

2 *Article 26 of the Statute of the ESCB.*
3 *Article 27 of the Statute of the ESCB.*
4 *Article 28 of the Statute of the ESCB.*
5 *Article 30 of the Statute of the ESCB.*
6 *Article 32 of the Statute of the ESCB.*

Article 16 of the Statute of the ESCB. Provisions enabling governments to exert influence on issues such as the denominations, production, volume and withdrawal of banknotes must also recognise the ECB's powers with regard to the euro banknotes as laid down in the above Articles.

5.2 Coins

A Member State may have laws on the issuance, production and distribution of coins. The government or, more specifically, the minister of finance may have the exclusive right to mint coins, while the NCB may be involved in their distribution. Alternatively, the right to print banknotes and mint coins may be combined within an NCB. Irrespective of the division of responsibilities in this field between government and NCB, the relevant provisions have to recognise the ECB's power of approval of the volume of issuance of coins.

5.3 Foreign reserve management

One of the main tasks of the ESCB is to hold and manage the official foreign reserves of the Member States.[7] Member States that do not transfer their official foreign reserves[8] to their NCB are in breach of this requirement of the Treaty. In addition, the right of a third party – for example, the government or parliament – to influence decisions of an NCB with regard to the management of the official foreign reserves would (under Article 105 (2), third indent, of the Treaty) not be in conformity with the Treaty. Furthermore, NCBs have to provide the ECB with foreign reserve assets in proportion to their shares in the subscribed capital of the ECB. This means that there must be no statutory obstacles to the NCBs' transferring foreign reserve assets to the ECB.

5.4 Exchange rate policy

National legislation of a Member State with a derogation may provide that the government be responsible for the exchange rate policy of that Member State, with a consultative and/or executive role being granted to the respective NCB. The statutory provisions have to reflect, however, the fact that the responsibility for the euro area's exchange rate policy has been transferred to the Community level in accordance with Article 111 of the Treaty. The Eurosystem has the task of conducting foreign exchange operations consistent with the provisions of this Article.

5.5 Miscellaneous

There are many other areas in which legislation may have an impact on an NCB's performance of ESCB-related tasks. For example, Member States are free to organise their respective NCBs under public or private law, but provisions governing the legal status of an NCB – for instance, company law – may not infringe on the requirements of the Treaty and the Statute of the ESCB for full participation in the third stage of EMU. Furthermore, the confidentiality regime of the ESCB is governed by Article 38 of the Statute of the ESCB. The supremacy of Community law and rules adopted thereunder implies that national laws on access of third parties to public documents may not lead to infringements of the ESCB's confidentiality regime.

7 *Article 105 (2), third indent, of the Treaty.*
8 *With the exception of foreign exchange working balances, which the governments of the Member States may keep under Article 105 (3) of the Treaty.*

6 Assessment of legal convergence in Sweden

The following assessment considers the state of affairs with regard to legal convergence in Sweden for full participation in the third stage of EMU with respect to the areas indicated above. Following an introduction concerning the Swedish legal regime and legislative developments since the 2000 Convergence Report, the assessment addresses central bank independence with regard to Sveriges Riksbank, the integration of the Riksbank into the ESCB and the need for adaptation of other Swedish legislation.

6.1 Introduction

Sweden is not a Member State with a special status and must therefore comply with all adaptation requirements under Article 109 of the Treaty. The following legislation was identified in the 2000 Convergence Report as requiring adaptation:

– the Constitution Act;[9]

– the Sveriges Riksbank Act (1988:1385), as amended;[10] and

– the Act (1998:1404) on Foreign Exchange Policy.[11]

The Swedish legislation on access to public documents and on secrecy was also identified as in need of review in the light of the confidentiality regime under Article 38 of the Statute of the ESCB.

Moreover, the ECB stated in the 2000 Convergence Report that further amendments would be required for the integration of Sveriges Riksbank into the ESCB. It also noted that some time would be required for all the legislative amendments necessary for the adoption of the euro to be enacted, considering the relevant internal procedures to effectuate such changes in Swedish law. Since then, no new legislation has been enacted in the areas identified by the ECB and the comments in the 2000 report are therefore repeated in this year's assessment.

6.2 Sveriges Riksbank and central bank independence

The ECB's Convergence Report of 2000 contained a review of the situation with regard to central bank independence. This review took account of the remarks made by the EMI in its Convergence Report in 1998. Whilst the amendments to the Sveriges Riksbank Act were still pending before Parliament when the EMI assessed the legal situation in 1998, it was noted in the 2000 Convergence Report that the required amendments had entered into force on 1 January 1999 and that there were no remaining incompatibilities in the area of central bank independence. However, developments in Sweden since then have drawn attention to one area of central bank independence where the legal rules should be further clarified, namely the financial independence of Sveriges Riksbank and the regime for the distribution of its profit.

In accordance with Chapter 10, Section 3, of the Sveriges Riksbank Act, an annual report for Sveriges Riksbank, including a profit and loss account, a balance sheet and an administration report, has to be prepared each year for the previous financial year. The Executive Board of Sveriges Riksbank must submit the annual report to, inter alia, the Riksbank's General Council. The General Council then makes proposals to Parliament and the Parliamentary Auditors for the allocation of the profit of the Riksbank. According to Chapter 10, Section 4, of the Riksbank Act, Parliament approves the profit and loss account and the balance sheet and determines the allocation of the profit.

These provisions of the Riksbank Act are supplemented by non-statutory guidelines regarding the disposition of profit which were prepared by Sveriges Riksbank in conjunction with the establishment of the 1988 accounts and approved by Parliament in 1989. These

9 *Regeringsformen (1974:152).*
10 *Lagen (1988:1385) om Sveriges riksbank, as amended.*
11 *Lagen (1998:1404) om valutapolitik.*

guidelines have since been modified twice, in relation to the 1993 accounts and the 1999 accounts. In general terms, this framework entails the Riksbank paying 80% of its profit, after adjustment for exchange rate and gold valuation effects and based on a five year average, to the state, with the remaining 20% used to increase its own capital. However, these guidelines do not have the status of law and there are no statutory provisions that set a limit on the amount of profit that may be paid out.

This matter was addressed in the Opinion of the European Monetary Institute of 7 November 1997.[12] Referring to its 1996 Convergence Report, the EMI stated "that in situations 'where third parties and, particularly, the government and/or parliament are in a position, directly or indirectly to exercise influence on the determination of an NCB's budget or the distribution of profit, the relevant statutory provisions should contain a safeguard clause to ensure that this does not impede the proper performance of the NCB's ESCB-related tasks' (page 103 of the 1996 Convergence Report). To the extent that the above legislative proposals would provide a means of exercising influence on the determination of [Sveriges Riksbank's] budget or the distribution of its profit, such a statutory safeguard clause should be considered in respect of the [Riksbank's] ESCB-related tasks."

The distribution of Sveriges Riksbank's profit was also referred to in the Swedish Government's revised proposal to amend the Riksbank Act,[13] in which proposal it made the following comments:

"The Parliament should also continue to handle matters regarding the establishment of the Riksbank's profit and loss account and balance sheet. Decisions on the disposition of the Riksbank's profit should be taken by the Parliament, as is presently the case. Since the 1989 Parliament decision, the determination of the disposition of profit is undertaken on objective grounds. The Government takes it for granted that this shall also be the case in the future. Due to this reason, there is no need to introduce a rule, as proposed by the EMI, which ensures that the Parliament shall take account of the Riksbank's possibilities to fulfil its ESCB-related tasks when the Parliament decides on the Riksbank's profits."

In May 2001, the Swedish Parliament decided on the distribution of the profit of Sveriges Riksbank for the year 2000. Part of the amount was not based on the non-statutory guidelines for profit distribution in that it was decided that an additional amount of SEK 20 billion should be paid to the state over and above the ordinary dividend of SEK 8.2 billion. Moreover, the Parliament's Standing Committee on Finance (riksdagens finansutskott) considered that the Riksbank had a sufficient capital base, with less credit risk in relation to its activities today than ten years ago.

In April 2002, the Standing Committee proposed, on the basis of a proposal made by the Riksbank's General Council, another extraordinary transfer of SEK 20 billion to the state in connection with the distribution of the Riksbank's profit for the year 2001.[14] Such a payment was to be made as an extra dividend over and above the regular payments to be calculated in accordance with the non-statutory rules for profit distribution, which for 2001 would be SEK 7.3 billion. The Standing Committee concluded that, after a total dividend of SEK 27.3 billion, the financial position of the Riksbank would still be well consolidated in a longer-term perspective and that the existing rules for profit distribution should apply henceforth, as had been proposed by the General Council.

12 *EMI Opinion CON/97/26. This Opinion was given at the request of the Swedish Ministry of Finance in respect of the draft legislative proposal of 2 October 1997 regarding the status of Sveriges Riksbank (Lagrådsremiss – Riksbankens ställning). The EMI's Opinion was later reproduced and annexed to the Government's revised proposal to Parliament to amend, inter alia, the Sveriges Riksbank Act (Regeringens proposition 1997/98:40 – Riksbankens ställning, bilagorna 10-11).*

13 *The Government's revised proposal to amend, inter alia, the Sveriges Riksbank Act (Regeringens proposition 1997/98:40 – Riksbankens ställning), page 64.*

14 *Report by Parliament's Standing Committee on Finance (Finansutskottets betänkande 2001/02: FiU23 – Penning-politiken och Riksbankens förvaltning 2001), page 28.*

In preparing the basis for the General Council's proposal for profit distribution for 2001, the Executive Board of the Riksbank suggested the inclusion in the Sveriges Riksbank Act of a protective provision which would prevent any allocation of net income restricting the bank's ability to carry out its legally imposed tasks in an independent manner. In the opinion of the General Council, however, the question of legislation should be addressed only in connection with Sweden adopting the euro, and the Parliament's Standing Committee concurred with this view in its report.

The entire matter has now been handed over to Parliament for a decision.

In the light of these developments, and with a view to ensuring the financial independence of Sveriges Riksbank, the ECB reiterates the need to codify the rules on profit distribution. In view of Parliament's right to decide on the distribution of Sveriges Riksbank's profit, such a statutory framework would need to contain clear provisions on the limitations applicable to decisions concerning profit distribution in order to safeguard the financial independence of Sveriges Riksbank. Such a statutory regime would also increase the transparency, legal certainty and predictability of future decisions in this important field.

6.3 Integration of Sveriges Riksbank into the ESCB

In the 2000 Convergence Report, the ECB noted that one area in which Swedish law, and the Sveriges Riksbank Act, remains incompatible with the requirements of the Treaty and the Statute of the ESCB for the adoption of the euro is the full integration of Sveriges Riksbank into the ESCB. No date for the adoption of the euro has been set. Nevertheless, the fact that Swedish law does not as yet anticipate Sveriges Riksbank's full integration into the ESCB implies that it is still not compatible with Treaty requirements. The 2000 Convergence Report stated that this concerns a number of provisions in Sveriges Riksbank's statute, and will require a further thorough legislative review in Sweden before adoption of the euro. No such legislative review has been concluded in the two years since 2000, and no legislative amendments have been enacted in this field since then. Accordingly, the ECB maintains its assessment and the remarks made in the 2000 report with regard to the integration of Sveriges Riksbank into the ESCB, as given in the following paragraphs.

According to Chapter 6, Article 3, of the Sveriges Riksbank Act, the minister appointed by the Government shall be informed prior to Sveriges Riksbank making a monetary policy decision of major importance. Upon Sweden's adoption of the single currency, however, such an arrangement would no longer be appropriate since important monetary policy decisions would be taken not by Sveriges Riksbank but by the Governing Council of the ECB.

In addition, the following areas of Swedish law, as already stated in the 2000 ECB Convergence Report and the 1998 EMI Convergence Report, are still incompatible with the Treaty and the Statute of the ESCB and need to be addressed.

(a) Tasks

Monetary policy
Chapter 9, Article 12, of the Constitution Act and Chapter 1, Article 2, of the Sveriges Riksbank Act, which establish Sveriges Riksbank's powers in the field of monetary policy, do not recognise the ECB's powers in this field.

Issuance of banknotes
Chapter 9, Article 13, of the Constitution Act and Chapter 5, Article 1, of the Sveriges Riksbank Act, which establish Sveriges Riksbank's exclusive right to issue banknotes and coins, do not recognise the ECB's competence in this field.

(b) Instruments

Chapter 6, Article 6, and Chapter 11, Article 1, of the Sveriges Riksbank Act, concerning the imposition of minimum reserves on financial institutions and the payment of a special fee to the state in the case of non-compliance with this requirement, do not respect the ECB's competence in this field.

(c) Exchange rate policy

Chapter 9, Article 11, of the Constitution Act and Chapter 7, Article 1, of the Sveriges Riksbank Act, together with the Act on Foreign Exchange Policy, lay down the Government's and Sveriges Riksbank's respective powers in the area of exchange rate policy. These provisions do not acknowledge the competence of the EU Council and the ECB in this field under Article 111 of the Treaty.

6.4 Adaptation of other Swedish legislation

Article 109 of the Treaty also requires, as of the date of the establishment of the ESCB, the adaptation of other Swedish legislation, which must enter into force by the date of the country's adoption of the euro. This applies in particular to legislation on access to public documents and to the law on secrecy, which need to be reviewed in the light of the confidentiality regime under Article 38 of the Statute of the ESCB. No such legislative review has been concluded in the two years since 2000 and no legislative amendments have been enacted in this field since then.

6.5 Assessment of compatibility

In view of the right of the Swedish Parliament to decide on the distribution of Sveriges Riksbank's profit, a statutory framework should be established containing clear provisions on the limitations applicable to decisions concerning profit distribution in order to safeguard the financial independence of Sveriges Riksbank. Swedish legislation, and in particular the Sveriges Riksbank Act, does not anticipate the Riksbank's legal integration into the ESCB, although Sweden is not a Member State with a special status and must therefore comply with all adaptation requirements under Article 109 of the Treaty. As far as legislation other than the statute of Sveriges Riksbank is concerned, the ECB notes that legislation on access to public documents and the law on secrecy need to be reviewed in the light of the confidentiality regime under Article 38 of the Statute of the ESCB. The ECB is not aware of any other statutory provisions that would require adaptation under Article 109 of the Treaty.

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