Council of the European Union

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To:	Permanent Representatives Committee/Council
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2016 national reform programme of Sweden and delivering a Council opinion on the 2016 convergence programme of Sweden

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2016) 347 final.

COUNCIL RECOMMENDATION

of…

on the 2016 National Reform Programme of Sweden

and delivering a Council opinion on the 2016 Convergence Programme of Sweden

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report, in which it identified Sweden as one of the Member States for which an in-depth review would be carried out.

(2) The 2016 country report for Sweden was published on 26 February 2016. It assessed Sweden's progress in addressing the country-specific recommendation adopted by the Council on 14 July 2015 and Sweden's progress towards its national Europe 2020 targets. It also included the in-depth review under Article 5 of Regulation (EU) No 1176/2011. On 8 March 2016, the Commission presented the results of the in-depth review. The Commission's analysis leads it to conclude that Sweden is experiencing macroeconomic imbalances. In particular, high and increasing household debt associated with high and growing house prices in a context of positive credit flows pose risks of disorderly correction with implications for the real economy and the banking sector. Policy measures have been taken in the macroprudential domain, which may however remain insufficient. Policy gaps remain in the area of housing-related taxation, the amortisation of mortgages, the functioning of housing supply and the rental market.

(3) On 28 April 2016, Sweden submitted its 2016 National Reform Programme and its 2016 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[3], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking effectiveness of the European Structural and Investment Funds to sound economic governance.

(5) Sweden is currently in the preventive arm of the Stability and Growth Pact. In its 2016 Convergence Programme, the Government plans to achieve a headline balance of -0,4 % of GDP and to continue to meet the medium-term budgetary objective — a structural deficit of 1 % of GDP — throughout the programme period. According to the Convergence Programme, the government debt-to-GDP ratio is expected to fall to 42,5 % in 2016 and to continue declining to 39,1 % in 2019. The macroeconomic scenario underpinning these budgetary projections is plausible until 2016 and cautious thereafter. Based on the Commission 2016 spring forecast, the structural balance is forecast to be at -0,5 % in 2016 and -0,9 % of GDP in 2017, above the medium-term budgetary objective. Possible future deviations would be assessed against the requirement to maintain the structural balance at the medium-term budgetary objective. Based on its assessment of the Convergence Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that Sweden is expected to comply with the provisions of the Stability and Growth Pact.

[3] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(6) Household debt is at a very high level in Sweden and has been growing at one of the fastest rates in the Union over the past decade. Household debt to annual disposable income was 175 % in 2015 according to Riksbank (Sweden's central bank) estimates, and in relation to GDP it was 87 %. Sweden has one of the highest tax incentives for home ownership in the Union due to relatively low property taxes and high mortgage interest deductibility. The high level of household indebtedness constitutes a risk for macroeconomic stability. The Government has taken some steps to stem household indebtedness, including legislation aimed at imposing mandatory amortisation requirements on new mortgage loans, which the parliament adopted on 23 March 2016. Adoption of this key measure was significantly delayed due to questions being raised about Sweden's macroprudential authority's legal mandate to introduce this requirement. There is a risk that further measures that may be needed to address Sweden's rising imbalances may be similarly delayed unless the legal framework concerning the macroprudential authority's remit is revised. Finally, the Government has taken no action to adjust fiscal incentives by, for instance, reducing the tax deductibility of mortgage interest or revising property taxation.

(7) The Swedish housing market remains a potential source of instability. House prices have risen almost constantly over the last 20 years, in particular in the metropolitan areas of Stockholm and Gothenburg. House prices keep growing, not only caused by strong fundamentals, such as disposable income growth, but also due to structural inefficiencies in the housing market. Housing supply is hampered by ineffective use of the existing housing stock, a high degree of rent control, weak competition in the construction sector, insufficient availablity of land for new construction and lengthy and complex planning procedures. The existing design of the transaction tax on capital gains from real estate sales limits the potential for more efficient use of the existing housing stock. Structural inefficiencies result in insufficient investment in housing and widespread housing shortage, and contribute to the persistent increase in house prices. Lack of available and affordable housing also limits labour market mobility and is a constraint for the effective integration of migrants into the labour market. The Government has taken some measures, including increasing public funding for investments in the housing sector and simplifying some planning procedures. In December 2015, an inquiry into competition in the construction sector came up with a series of possible measures, such as enhancing transparency in the field of public housing contracts. However, the Government made no progress in reforming the rent-setting system.

(8) Despite relatively good investment performance, Sweden faces challenges that may have a negative impact on the long-term competitiveness of the country. In particular, structural inefficiencies in the housing market hamper investment in this area. Investment in infrastructure to improve connectivity within and between urban areas is insufficient in view of the constraints caused by the housing shortage.

(9) Sweden experienced the sharpest decline in the educational performance of 15-year-olds of any OECD country over the past decade in the PISA survey, and is now performing below both the EU and OECD averages. Deteriorating outcomes of school education risk putting pressure on Sweden's competitiveness and innovation capacity in the long run. An important performance gap between students with and without a migrant background adds to the education challenge. This gap deserves particular attention in light of the large number of newly arrived young migrants to be integrated into the education system. Unclear school funding mechanisms paired with unsystematic monitoring of the use of funding at different levels of the school system hinder the efficient use of resources. The Government has made additional funding available to improve school outcomes and equity, and it is taking steps to integrate the newly arrived migrants in education.

(10) The high influx of refugees experienced in the past year has a number of social and economic consequences for Sweden. While in the short run, the inflow of refugees is set to increase public expenditure and to create additional domestic demand, thereby raising GDP, the medium-term effect on employment and growth hinges on refugees' successful labour market and social integration, including via educational support. This issue is high on the political agenda both at the EU and Member State level and will be monitored and analysed closely, including in the 2017 country report.

(11) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Sweden's economic policy and published it in the 2016 country report. It has also assessed the Convergence Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Sweden in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Sweden but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendation (1) below.

(12) In the light of this assessment, the Council has examined the Convergence Programme, and is of the opinion[4] that Sweden is expected to comply with the Stability and Growth Pact.

(13) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendation (1) below.

[4] Under Article 9(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Sweden take action in 2016 and 2017 to:

1. Address the rise in household debt by adjusting fiscal incentives, in particular by gradually limiting the tax deductibility of mortgage interest payments or by increasing recurrent property taxes. Ensure that the macro-prudential authority has the legal mandate to implement measures to safeguard financial stability in a timely manner. Foster investment in housing and improve the efficiency of the housing market, including by introducing more flexibility in setting rental prices and by revising the design of the capital gains tax to facilitate more housing transactions.

Done at Brussels,

For the Council
The President