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Financial and Economic Crisis as a Challenge for Sweden's EU Presidency

by Marcin Koczor

The task facing the Swedish presidency of the EU Council is largely determined by the dynamics and nature of the ongoing financial and economic downturn. Sweden will have to cope with such challenges as defining the manner and pace of a return to fiscal stability or a smooth adoption of the proposed new financial oversight architecture. How effectively this task is dealt with will provide a major test for the presidency's administrative and political capabilities.

Condition of Public Finances in the EU. Bent on countering the financial and economic crisis, Community member states have embraced wide-scale fiscal interventionism. According to estimates by the EU's Economic and Financial Committee, the member states have so far channeled some €1.48bn (equivalent of 13% of the EU's GDP) towards banking sector assistance. The amount includes mostly guarantees, bank recapitalization programmers and liquidity support. Over 2009–2010, the resources made available through stimulus packages may actually reach some 1.8% of GDP, leading to a considerable increase in budget deficits and public debt. European Commission projections put the overall budget deficit for the whole EU as possibly rising to 6% in 2009 (from 0.8% in 2007) and 7.3% next year, with the debt ratios at, respectively 72.6% (up from 58.7% in 2007) and 79.4%. That is why the European Council, at its June 18–19 session, reiterated the need to define a strategy for phasing out the crisis (so called exit strategy). Sweden emphasizes that the strategy should provide for a return to the Stability and Growth Pact rules, oriented to balanced budgets. The government in Stockholm also believes that balanced public finances should be added to Lisbon Strategy pillars after 2010. The new presidency plans to introduce that exchange information about good budget practices between member states as a means of improving the quality of their public finances.

Yet despite the political agreement on the need for budget reduction in future, major differences of opinion have emerged about the pace of the reduction. Germany has traditionally been in favor of budget rebalancing, to be achieved as soon as possible. With a view to protection against excessive deficit in the future, the country amended its constitution towards capping the maximum federal budget deficit at 0.35% of GDP (to take effect from 2016). At the same time, President Sarkozy gave it to understand, while addressing a session of both houses of parliament, that budget reduction will not be France's top goal. This approach hardly squares with the circumstance that the country—under excessive deficit procedure from April 2009—is required to cut its deficit to below 3% of the GDP by 2012.

In this dispute, Sweden takes an unequivocal position, which may help strengthen that group of member states which seek a swift reduction of deficit and public debt. On the other hand, this approach may render more difficult an agreement on strategy to overcome the crisis. The Swedish government is unlikely to seek exasperating the conflict, which may lead it to present a compromise strategy or, perhaps, avoid taking binding decisions while at the Council's helm.

The Case of Latvia. An important task for Sweden will be to closely monitor developments in Latvia, one of the European countries worst hit by the financial crisis (reporting an annualized 18.6% decline in GDP in Q1). If deepening further, Latvia's economic collapse could have a knock-on effect on other Baltic states, and also on Sweden itself, where banks have sizeable exposures to Latvian assets. It is, therefore, not inconceivable that Sweden will seek to use the leverage it gets as the EU

presidency to persuade the European Commission towards taking a more flexible stance on releasing successive tranches of the bailout package for Latvia, as part of the EU's balance-of-payments support facility. In all, as of December 2008, Latvia received total aid of €7.5bn, largely from the EU and the IMF. With a view to the strings attached, in mid-June the Latvian Parliament approved a programme to cut budget spending by 500m lats (more than €700m), to be achieved e.g. by slashing public sector salaries by 20% and pensions by 10%. The consent to budget retrenchment has reduced the risk of devaluation of the lats, which since May 2005 has been in ERM2, with the range of fluctuations against the euro limited to +/-1%.

Challenges to the Financial System. A swift adoption by the Council of legislative proposals on new financial oversight, to be presented by the Commission in the autumn, is seen by Sweden as one of its most urgent tasks. A general outline of oversight architecture, based on the conclusions of de Larosière report, received the European Council's approval on 18–19 June.

Under the agreement then reached, a European Systemic Risk Board (ESRB) is to operate on the macro level, to indentify and analyze threats and risks to the EU's financial stability.

The Commission proposed that the Board's chairmanship should go to the ECB president, but the UK strongly objected, fearing that as a non-eurozone country it will see its influence diminished. In a compromise solution, member states agreed that the ECRB chairman would be appointed by the ECB General Council, a gathering of all heads of EU national central banks. The second oversight tier will be provided by the European System of Financial Supervisors (ESFS), composed of three new European bodies to oversee banking, the capital market and insurance (European Supervisory Authorities, ESA). Unlike the ESRB, these entities will have legal personality- and be empowered to adjudicate on disputes between national supervisory authorities, oversee rating agencies, and define binding harmonized standards in areas to be specified in Community legislation. But their activities must not encroach on the member states' fiscal responsibility , which means that they will not be empowered to issue decisions that would entail spending by MS.

Another challenge for Sweden will be perceptible improvement in coordinating the approach to toxic assets, a task that proved beyond the reach of the Czech presidency. As a result the Commission's guidelines of last February on how to deal with the problem have yet to translate into member states' coordinated measures. Only several states (i.e. Belgium, France, Ireland, Germany) have adopted, or are in the process of adopting, instruments to cope with the issue. If left unresolved, the problem may slow the pace of overcoming the financial crisis in Europe, which in turn may affect the speed of overall economic recovery.

The new presidency will also strive to work out a cohesive EU position for the next G20 summit, to be held on 24–25 September in Pittsburgh. It is important here that Sweden should persuade the other member states to deliver as soon as possible on the promise of providing €75bn loan resources to the IMF, as declared before the G20 summit in London.

Conclusions. Sweden is taking over the EU presidency at a time when—despite improvement in optimism indicators in manufacturing, services and among consumers, as registered over the past months—a lasting recovery of the European economy is yet to be seen. Meanwhile, anti-crisis measures have already widened member states' budget imbalances. Many of these states may, therefore, be cautiously moving away from the stimulation stage and towards a return to fiscal equilibrium, so as not to add to the risk of slowing down recovery. Sweden has gained experience in combating the consequences of a financial crisis (which it faced early in the past decade), especially with regard to banking sector restructuring. This may prove instrumental in the Stockholm government's engagement in crisis management at the EU level. But the Swedes first have to demonstrate their political skills, without which an effective management of EU-wide measures (including those to counter the crisis) will not be possible.