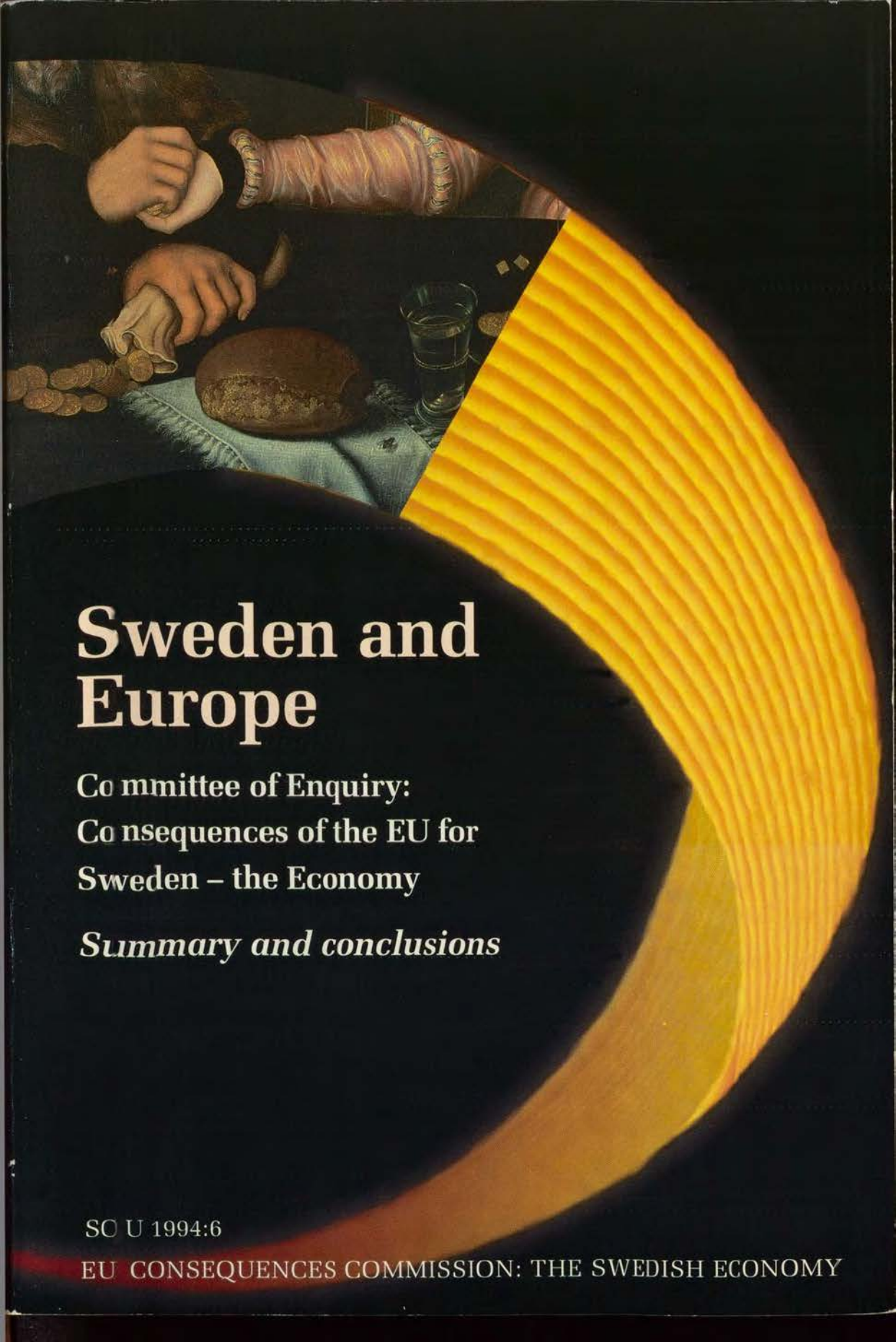




Sweden and Europe

Committee of Enquiry:
Consequences of the EU for
Sweden – the Economy

Summary and conclusions

SO U 1994:6

EU CONSEQUENCES COMMISSION: THE SWEDISH ECONOMY

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Foreword

To the Minister of Finance, Sweden

On January 28, 1993, the Government authorised the Minister of Finance, Anne Wibble, to appoint a commission to investigate the economic consequences for Sweden of various types of participation in the process of integration in Western Europe.

On March 15, 1993, on the basis of this authority, the Minister of Finance appointed Björn Molin (county governor) to chair the Commission. The following individuals were appointed members of the Commission: Professor Arstin Fredga, Dr Pehr G. Gyllenhammar, Claes Hellgren (non general secretary), Professor Yvonne Hirdman (resigned as of April 1, 1993), Ulf Jakobsson (senior economist at the Federation of Swedish Industries), Eugene Kazamaki Ottersten, Ph.D., Britt Bergård (former county governor), Ingrid Segerstedt Wiberg, Ph.D., Michael Sohlman (former official of Ministry of Finance, director general of the Nobel Foundation), Jan Palmstierna and Gunnar Wetterberg participated as experts from the Ministry.

On the same day, Pernilla Sten (editor) was appointed senior secretary of the Commission. On June 9, 1993, Arvid Wallgren and Martina Wodtke were appointed secretaries of the Commission.

The Commission took the name: Commission on the Consequences of the EU; the Economy. The Commission met on nine occasions.

A number of experts were directed to investigate certain specific problem areas. Their reports are incorporated in separate appendices to the main report. Some of these appendices were used in the work

of the Commission, while others should be seen more as complementing the main report. The authors themselves accept responsibility for the conclusions and recommendations in the appendices.

The Commission's conclusions and recommendations are presented in this report, the submission of which marks the completion of the Commission's work.

Stockholm, January, 1994

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Nine appendices are used in or complement the main report and cover the following areas:

1. Textiles and clothing
2. Macro-economic shocks
3. Agriculture and the food industry
4. Micro-economic aspects of a monetary union
5. Swedish influence in the EU
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8. Direct investments
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10. Welfare and living standards in Western Europe

Summary

I Background

Chapter 1

The Commission's terms of reference

Sweden applied for membership of the European Community on July 1, 1991. The negotiations started on February 1, 1993. The task of the commission has been to analyse the economic consequences for Sweden of various forms of participation in the process of European integration. The effects have primarily been considered in the medium-term perspective, i.e. what will happen over the coming five to ten years.

Three possible scenarios have been examined.

Sweden with the EEA agreement

This is the commission's reference alternative. By virtue of the EEA agreement, Sweden is, as of January 1 1994, included with the four freedoms of movement, and is also within the internal market. There are still some limitations on access to markets for food and in the agricultural sector. Sweden is not a member of the customs union. Border controls remain and so does the need to mark products with their country of origin.

The EEA agreement may be terminated subject to one year's notice on either side. To incorporate new directives into the EEA agreement, supplementary negotiations will be required and the EEA

Committee must be unanimous in its decision to introduce new directives.

Sweden as a member of the EU

As a member of the European Union, Sweden would participate fully in the activities of the internal market. Trade policy vis-à-vis third-party countries would become a common policy. All internal border controls could consequently be abolished. The need to mark products with their country of origin would disappear.

Membership differs from the EEA agreement in two important respects:

EU membership would add stability to the conditions that apply to the internal market. EU membership also provides influence. As a member, Sweden would have to contribute to the financing of the community budget, but Sweden would, in return, benefit from a certain returning flow of funds. If the EU countries decide to realise their plans for a currency union, Sweden could also participate on certain conditions.

Sweden outside the internal market

Sweden could find itself in a situation where it is left outside the internal market, either because the EEA agreement is cancelled or because it is gradually eroded and loses in importance.

This would not necessarily mean that Sweden remains outside other European or international trade associations. A scenario outside the internal market would not, however, involve returning to the situation prevailing before the ratification of the EEA agreement. We have, however, assumed that this scenario would be based on the earlier free trade agreement of 1973.

The Swedish economy is heavily internationalised. In many respects, the choice of form for membership of the internal market will only marginally affect the challenges facing the Swedish economy. Demands for adjustment and change will arise whatever attitude Sweden adopts vis-à-vis the EU.

Chapter 2

Sweden and the international economy

Sweden's economy depends to a great extent on developments in the international economy. Foreign trade represents almost 30 per cent of Sweden's GDP, and 75 per cent of Sweden's foreign trade is carried out with EFTA and EU countries.

The flows of capital among and within the OECD countries has increased rapidly, and some 90 per cent of current capital flows are believed to be purely financially motivated. This indicates that competition on product market has spread to the factors of production. The mobility of the labour force remains quite limited, however.

The process of internationalisation has mostly been observed in the expansion in foreign direct investments. The object is often to enter new markets. It is consequently less a question of new production capacity than of changes in the ownership of already existing capacity. Japanese investments abroad are, however, an exception.

The EU countries account for some 40 per cent of the world's trade. Economic developments in these countries have, in many ways, been weaker than in numerous other developed, industrial nations. However, during the second half of the 1980s, economic growth in the EC exceeded the growth rate in the United States. Investments increased rapidly, with Sweden also contributing large amounts.

In the post-war era, the Swedish economy has been characterised by low unemployment, relatively high and evenly distributed incomes and a generous supply of public sector services. The problems have been slow economic growth, inflation and recurring currency crises. During the past 25 years, economic growth in Sweden has been about one per cent below the OECD average.

The recession that followed the overheating of the 1980s has been the deepest since the 1930s. Inflation fell from 8 per cent to 2 per cent within the space of a few months. Combined with high interest rates, this resulted in a severe financial and property crisis. The Swedish currency has declined by more than 20 per cent against the ecu, and unemployment has soared.

Chapter 3

The EC's path towards a European Union

The foundations of the EC are laid down in the Treaty of Rome, which dates from 1958. Peace, stability and rising standards of living were to be achieved through closer economic, commercial and political co-operation.

The EC originally consisted of six members: German Federal Republic, France, Belgium, the Netherlands, Luxembourg and Italy. In 1960, the European Free Trade Association (EFTA) was created, partly as a response to the EC.

Co-operation within the EC has evolved through various phases.

During the 1960s, economic co-operation was intensified and consolidated. The common agricultural policy (CAP) was introduced in 1964, and its financing soon became a bone of contention.

The Community's political objectives became more ambitious during the 1970s. During this period, the Community was affected by economic problems in the wake of the oil crises, and the breakdown of the Bretton Woods system. In 1973, the Six became the Nine when the United Kingdom, Denmark and Ireland joined the Community.

A free trade agreement between the EFTA countries and the EC, and covering manufactured products, came into effect in the same year. Sweden's trade relations with the EC were based on this agreement until the EEA agreement came into effect on January 1, 1994.

In 1971, the Werner plan proposed that the EC countries should form an economic and monetary union with a common currency and – eventually – a common economic policy. This plan was never put into effect. A system of economic and monetary co-operation, (the European Monetary System, EMS) began in January 1979. A decision was made to introduce the ecu, a common currency unit based on the currencies of the member countries. In the same year, direct elections of members to the European Parliament were held for the first time.

“Euro-sclerosis” plagued the EC at the beginning of the 1980s, while “Europhoria” might be an appropriate term to describe the end of the decade. With the entry of Greece, and shortly afterwards of Spain and Portugal, the Nine became the Twelve. As before, when the Community was enlarged, this resulted in discussions on the decision-making process and the means of governing the EC. The

result was the Single Act, which came into effect in 1987. Under the terms of this Act, majority decisions were to be accepted on certain issues. By passing the Single Act, the member countries also accepted the principle of mutual recognition: what has been approved by one country should be regarded as approved by the other member countries. The 1985 White Book described 282 measures that would have to be implemented before 1992 to realise the plans for a single market.

At the end of the 1980s, the ideas from the early 1970s about forming an economic and monetary union with a common central bank and a common currency were re-awakened. A decision on this was taken in Maastricht in 1991. On that occasion, the countries also resolved to form a European Union, the EU, with expanded co-operation. Over and above the EC as such, two new multilateral areas of co-operation emerged: security policy and domestic policy. The Maastricht Treaty was ratified in October 1993.

The future of the European Union is to be discussed at a summit conference in 1996. It is possible that by the time of this conference the Twelve will have expanded to become the Sixteen. This would be the case if the four EFTA countries – of which Sweden is one – which have applied to become members of the EU have joined.

II Sweden, the EC and the Market

Chapter 4

Economic growth and its significance

The purpose of the internal market is to facilitate growth through increased competition and economies of scale. Economic growth means that the real value of available goods and services will increase. Growth expands freedom of action and increases freedom of choice in an economy. These additional resources do not necessarily have to be used for private consumption but could also be directed towards achieving other goals, such as improved public services.

When an economy is growing, the risk of disputes over distribution policy are reduced. It is also easier to meet employment-targets and avoid chronic unemployment in an economy characterised by high growth.

Growth depends on a number of factors.

One of the questions the Commission has attempted to answer in this investigation is how Sweden's economic growth rate will be affected by the EEA agreement, by EU membership or by a situation in which Sweden remains outside the internal market.

Chapter 5

The internal market

The internal market was already described in the Treaty of Rome. Even though customs and tariffs had already been abolished by the end of the eighties, the free flow of goods and services has been hindered by physical, technical and fiscal barriers to trade.

The internal market is being created by the free movement of goods, services, capital and labour. In the Cecchini Report, the EC Commission sought to explain what benefits could be expected to come from having a common market – as well as what losses would be caused by a decision to refrain from implementing it.

The benefits, according to the report, are of two types: firstly, direct benefits resulting from the elimination of barriers to trade and falling production costs; secondly, there are indirect benefits from the fact that larger markets make economies of scale and stiffer competition possible.

As far as consumers are concerned, the internal market means that companies can no longer market split up and differentiate prices. Companies will be exposed to stiffer competition from foreign competitors, but will in return gain greater access to foreign export markets.

As a member of the EU, Sweden would gain full access to the internal market. The EEA agreement does allow for certain exceptions: trade in agricultural products and food, for example, is generally not covered.

Countries which are outside the internal market can also benefit from its creation. For these, too, it will be easier to carry on business on a large common market instead of in twelve, separate and national markets.

The internal market will lead to stiffer competition in Sweden. The sheltered sector – which includes both public and private sector activities – represents almost half of GDP. Competition may increase, partly as result of the direct establishment of foreign companies in Sweden, and partly on account of higher imports. For small countries such as Sweden, with its relatively small domestic market, the rewards could be considerable from a process involving stiffer competition.

The creation of the internal market will involve more stringent rules regulating competition. In some respect, they will restrict the types and amount of support and industrial policy measures the governments of the member states can make use of. Companies which are domiciled outside the EU may also be investigated by the EU Commission and be subject to fines. Sweden's competition laws satisfy the rules which apply within the EU.

One important aspect of the internal market is that of the procurement for which central government agencies, local governments and public institutions are responsible. Overall, this represents some 15 per cent of GDP. So far, public sector procurement in most EU countries has been run on strictly national grounds. With the implementation of the internal market, the public procurement market is also being opened to suppliers tendering from other countries. Sweden has a large number of companies whose businesses depend on sales to the public sector. Sweden could therefore be said to be in a particularly strong position to benefit from the opening up of public procurement to foreign companies with the formation of the internal market.

Chapter 6

Investments and capital formation

Capital investments play a central role in any economy – in the short term as a result of the demand that they help to stimulate, and in the somewhat longer term through the increased production capacity and growth capacity which they create.

Sweden's investment ratio – i.e. investments as a share of GDP – is at present at the lowest level in over more than 40 years. A decision on Sweden's EU membership could have considerable effects on the level of investments in both the short and the long term.

Investment decisions are influenced by many considerations, in the case of local manufacturers as well as of internationally active major enterprises. Sweden depends on its large companies to a far greater extent than any other country. For them the alternative to increasing production in Sweden would be to expand abroad.

The EEA agreement gives Swedish companies access to the business sector's most important export markets. EU membership would guarantee that this becomes permanent, since stability is a key factor. In this context, the EEA agreement has definite limitations:

- it can be terminated at one year's notice,
- it could be eroded if the EFTA countries do not agree on the introduction of new rules,
- interest in the EEA could fade away as the number of EU members is enlarged.

For companies with activities in the EU area there is a further factor which distinguishes the EEA agreement from EU membership:

- EU membership provides influence over product standards, norms, and the regulatory framework which influences conditions for enterprise.

Investment decisions are very much determined by expectations about the future. Several investigations indicate that investors – above all non-European companies – make a sharp distinction between Sweden as a member of the EU and Sweden as an EEA country.

A major proportion of the investments we are considering consists of direct investments, in other words, new ventures or company acquisitions made by foreign companies in Sweden or by Swedish companies abroad. Inward direct investment generates a transfer of technology. Outward direct investments have tended to complement Swedish production and brought larger market shares and higher total production volumes. During the eighties, there was a serious imbalance. Outward investment was considerably larger than inward investment. Some of this lack of balance was due to uncertainty regarding Sweden's relationship with the EU and the internal market.

In an expert report appended to the Commission's report (Appendix 7 "Sweden's choice, the EU and direct investment"), the

judgement is made that membership of the EU would increase the overall investment ratio since direct investment would increase by up to one percentage point of GDP. Moreover, these investments would be more specialised ("vertically integrated"). They would differ from market-oriented investments ("horizontal") as they depend on trade, whilst in the latter case they could to some extent replace foreign trade. Specialised investments are expected to give rise to a higher level of value added and would have beneficial effects on the economic growth rate.

Direct investments are only one element – although an important element – in the total investments which determine the volume of investment, and thus the level of activity, in the economy. Our view is that other investments in Sweden would also be affected. This would be the case directly in the manufacturing and services sectors, which are dependent on the realisation and sustainability of the four freedoms. It would be the case indirectly through the diffusion effects throughout economy – for example, in the case of sub-contractors, consultants, the financial sectors and construction – that an upsurge in the level of investments in the sectors facing competition could give rise to.

In the short term, a decision on Sweden's membership of the EU could have an immediate effect in the form of a higher level of investment. Demand effects on production and employment could thus be strong. The rejection of Swedish membership could have the equivalent negative short-term effects on the level of economic activity.

In the somewhat longer term, the various alternative investment scenarios would affect Sweden's economic growth rate. The internal market – in which Sweden would participate as a member of the EEA – means that profitability could be raised by improving efficiency. Other things being equal, this could lead to a higher investment ratio in the longer term.

The decision on membership of the EU will influence the structure of business as the investments would have a more specialised character. Larger flows of direct investments and a higher degree of value added, in combination with a generally higher investment ratio, would lead to a faster rate of capital formation, a more modern production structure and more favourable growth conditions.

However, investment decisions are complex. Disadvantages in one area are offset by advantages elsewhere. Poorer stability and less influence could be compensated for by improvements in the investment climate in other respects, for example, in the form of more

favourable corporate taxation or a higher profit ratio. Our view, however, is that maintaining the volume of investments would in the final analysis be accomplished at the cost of lower real wages.

Chapter 7

Industrial restructuring and technical development

Changing industrial structures is a necessary aspect of all economic development. Existing capital and old production methods become out of date, new methods and new capital are created. The smoother transitional mechanisms in the form of capital markets and labour markets actually function, the lower will be the cost of the restructuring process.

Industrial restructuring is influenced by competition and the pressures for change in the economy. The driving forces can be weakened or strengthened.

The formation of new capital includes investments in both real capital and human capital. To a great extent, the formation of new capital takes place through technical development, research and the development of patents. The capacity to imitate, and develop production methods and work organisations is also of importance. Knowledge is often disseminated via company acquisitions.

In the eighties Swedish industry went through a process of specialising on goods with a low level of value added per employee. Sweden invests a high proportion of its GDP in research and development.

Swedish companies have tended to concentrate their R & D activities in Sweden. Ten enterprises together account for some 90 per cent of the research investments of the private sector. This makes Sweden very vulnerable.

The process of industrial restructuring will probably be especially far reaching in hitherto sheltered sectors and industries. This is true, for example of the service sector. However, the process of adaptation is not expected to be excessively far reaching as very large proportion of Swedish trade takes the form of an exchange of goods of the same type. This means that the process of industrial restructuring would occur within individual industries rather than between different industries.

Participation in the internal market will speed up this process as competition will increase the pressure on companies and force

previously sheltered, uncompetitive activities off the market. Capital formation will also be affected. The transfer of resources will be facilitated by the four freedoms. Investments are expected to increase, the capital stock will be renewed at a faster pace, the technical content will increase, and productivity, and consequently the growth rate are expected to rise.

Membership of the EU means that production would become more specialised. This could give rise to cluster effects, in other words, companies with similar production being grouped in particular centres. Membership would also affect the process of restructuring within agriculture and the food industry.

If Sweden remains outside the internal market, this would mean in the short term that the immediate pressure to discontinue uncompetitive activities would be reduced. At the same time, however, the relative competitive position of the Swedish companies outside the EU would deteriorate. In the long term, a decision to remain outside could lead to a greater pressure to close down businesses in the sectors facing foreign competition. Transfer mechanisms could moreover be expected to function less efficiently as Sweden no longer has access to the four freedoms.

The formation of new capital would proceed more slowly as both direct investment and aggregate domestic investment would be smaller.

Compared with the other alternatives, remaining outside the internal market would mean that the pressure to change in the economy would ease, the process of industrial restructuring would slow, the transfer mechanisms function less efficiently, and that economic growth would be lower.

Chapter 8

Labour market

In 1993 registered unemployment in Sweden was running at an average level of around 8 per cent. To this should be added a further 5-6 per cent, who were occupied on labour market programmes. Sweden thus has a level of unemployment which is broadly the same or even higher than the level in many EU countries.

However, Sweden has not been affected by the same high chronic unemployment and permanently higher unemployment that several countries on the Continent have experienced. One of the major

questions for the future is by how much unemployment will fall when the economy begins to recover.

In the final analysis, it is the ability of Swedish companies and labour market organisations to handle price, wage and cost trends in Sweden that will determine the extent to which unemployment and inflation can be kept under control. In our view, membership will make it possible to create an environment for growth and real wage development which will facilitate the wage formation process.

In volume terms, Sweden invests no more than other countries on labour policy. On the other hand, Sweden has traditionally devoted more resources to job-creating measures.

The free movement of labour means that a person can stay in another country for three months while he or she is looking for a job. Thereafter, they must be able to support themselves. The movement of labour among EU countries has so far been low. Only 1.5 per cent of the population works in a country which is not their own.

The effects of the internal market on wages in Sweden can be analysed from several angles:

- How total wage levels are affected
- How incomes differentials are affected

This depends very much on how mobile the labour force is.

Different groups are more or less willing to relocate. Even if the flows of labour are limited, the effects could be marked if key groups migrate in either direction.

There has been some concern about the possibility of a brain drain as a consequence of Sweden's participating in the internal market. Danish studies have shown, however, that a majority of those who emigrate return within five years.

They will then be capable of functioning as importers of technology who have added to their knowledge and their competence by a few years of work abroad.

If qualified people are to be able to return, it is, however, necessary to have qualified jobs and occupations for them to return to. From this perspective, a key issue is where the head offices and specialist functions of companies are located.

The difference between the EEA agreement and membership of the EU lies in the possibility of attracting vertical – specialised – investments. This leads to more qualified jobs, faster productivity growth and thus in the long term to a greater capacity to pay wages.

Mobility can influence wage formation in that large differences in expected levels of economic compensation are one of many forces lying behind migration. The difference between the highest and lowest wages can therefore be broadened slightly. This is a process that is already occurring, and which is due to changes in the nature of production and new demands being made regarding the competence of the employees.

Membership of the EU means that the demand for highly qualified and specialist personnel can be expected to increase as a result of a shift in the structure of the business community towards a higher degree of specialisation and the fact that more head offices remain in Sweden. Other things being equal, this means a higher level of value added and an improved capacity to pay wages.

Remaining outside the internal market would mean that the labour market would still be national or, perhaps, Nordic. In such a situation, Sweden would no longer have access to the four freedoms through a large, common labour market. The effects are probably asymmetrical. As far as highly qualified labour is concerned, an internationally mobile specialist market already exists in some respects.

This environment would have a detrimental effect on investment. This in turn would hold down productivity, and there would be less resources available to pay high wages.

III Sweden, the EU and policy

Chapter 9 Integration and influence

As a result of the EEA agreement, a number of institutions have been created for co-operation between the EU and the EFTA countries. Decisions in both the EEA Council and the EEA Committee require unanimity.

In those questions concerning the EEA agreement, the EFTA countries are able to influence events since experts are entitled to participate in the planning process on the same terms as experts from

the EU countries. EFTA representatives are also entitled to be members of the committees which support the EC Commission. However, the EFTA countries are not entitled to take part in decision-making within the EU.

In other areas, there is no formal basis for Swedish influence on the EU.

As a member, Sweden will gain full access to all institutions in the EU on the same terms as other member countries. Sweden will thus be represented on:

- The Council of Europe
- The Council of Ministers (4-5 votes out of 90)
- The European Parliament (21-25 seats out of some 600)
- The EC Commission (one Swedish Commissioner)
- The EU Court (one Swedish judge)
- The Economic and Social Committee (11-12 seats) and
- The Regional Committee (11-12 seats)

Sweden's ability to exert influence depends on the rules relating to qualified majorities. These rules enhance the importance of small countries when qualified majorities are to be formed, as small countries are over-represented in relation to their population.

In those cases where the Nordic countries can adopt a common standpoint, the influence of the Nordic *bloc* will be quite considerable. Jointly, Denmark, Finland, Norway and Sweden could have 13 or 14 votes, which means they would control 15 per cent of the votes. Together with one large and one small country they could achieve a blocking minority.

Sweden will be represented in the European Parliament in the event of membership among both the Government and the opposition parties. However, influence over EU decisions is largely a matter of participation and informal procedures. By being involved in the planning process for parliamentary business, Sweden can exert influence at those stages of the decision-making process which are often regarded as being the most critical, for example at an early stage in the Technical Committees.

Outside the internal market, Sweden's ability to exert influence will be small. Its formal influence would be limited to international fora, such as the United Nations and the multinational GATT organisation. In such a situation, Sweden could possibly exert an indirect influence on the EU countries. In this case, Sweden's lobbying activities would, however, rest on a considerably weaker

foundation than if the country participated in the EEA agreement or was a member of the EU.

Chapter 10

Trade policy

Sweden is a country with strong free trade traditions. The EEA agreement will extend free trade between the EFTA countries and the EU to cover all goods and services. Exceptions will be made for agricultural produce and certain foodstuffs. In this alternative, as in the situation where Sweden remains entirely outside the internal market, Sweden will retain the formal independence needed to formulate its trade policy in relation to third countries.

As a result of the EEA agreement, border controls have been simplified, public procurement has been deregulated and technical standards harmonised. Anti-dumping measures against other EEA countries are prohibited. As a result, competition has increased, the real trading costs have declined and markets have been enlarged from including Sweden and EFTA to encompass the whole EEA area. Stiffer competition, increased trade and greater efficiency will have a favourable effects on growth rates.

Membership of the EU means that Sweden would join a customs union and participate in the formulation of the common trade policy. The EU regulatory system differs from that in Sweden in several respects - including the use of import quotas of various kinds, preferential treatment systems and the application of restrictions and anti-dumping measures.

Membership would bring substantial commercial benefits. Trade with the EU countries will be cheaper as border controls will be dismantled. It will no longer be necessary to indicate the country of origin of products. The savings are estimated at 4-7 billion kronor. All goods and services (including agricultural produce) will be free from customs tariffs and quotas.

However, membership of the EU also involves certain commercial disadvantages. The cost of imports will be raised by 2-2.7 billion kronor as Sweden would have to apply the same trade policy in relation to third countries as the EU. Among the reasons for this increase in the cost of imports are the use of quotas on textile and clothing imports and somewhat higher tariffs. However, restrictions on imports of textiles and clothing are to be phased out over the

next ten years, according to the GATT agreement. The cost of these quotas could therefore be only temporary.

A further important cost, but one that is difficult to assess, is derived from the economic inefficiencies which accompany the use of anti-dumping rules. This is due to the fact that indirect costs that arise because the pricing policies of foreign competitors are influenced, should be added to the direct increases in price.

Should Sweden find itself outside the internal market, trading relationships will initially be regulated through the free trade agreement for industrial products dating from 1973 and through the rules of GATT (GATT). (It is likely that such a situation would require new negotiations with the EU countries.) The cost of trading will increase as non-tariff barriers to trade will be introduced. There is a risk that Swedish companies would be discriminated against in connection with public sector procurement. Border controls will become more complex. Free trade will be limited. Competition will weaken. It will become relatively less attractive to invest in Sweden.

The absence of certain benefits may be offset to some extent by unilateral trade and fiscal policy measures. However, access to the internal market will inevitably become poorer.

Chapter 11

Agriculture and the food industry

Agriculture is only touched upon to a limited extent in the EEA agreement. The major difference in this area as far as Sweden is concerned thus arises in connection with membership of the EU.

One difficulty in the analysis is caused by the fact that Sweden has unilaterally begun to harmonise its agricultural policy with the rules that are applied within CAP, the EU's Common Agricultural Policy. As a reference alternative in the comparison we have used a situation in which the food policy reform of 1990 (sic) is brought to completion (with a delay of some years). The purpose of the Swedish reform was to abolish all internal controls but to retain border controls against outside suppliers. CAP involves both internal and external regulations.

The depreciation of the Swedish krona has reduced the difference between food prices in Sweden and in the EU countries. Nonetheless, membership of the EU would mean that food prices would fall

by over 6 per cent more than they would in the event of internal Swedish deregulation.

There should therefore be room for price cuts at the consumer level too. One reason for believing this is that the entire food industry would be exposed to the competition that exists on the EU market, which should also pave the way for price cuts in retail outlets. On the other hand, the structure of both the wholesale and the retail trade is very concentrated in Sweden. This suggests that it could take some time before the pressure on prices begins to show through. The likelihood of price reductions is probably greatest in Southern Sweden and in the major cities, which offer the greatest attractions to foreign companies.

In the event of Swedish membership of the EU all foods would be covered by the same free trade rules as have only benefited a few in the EEA agreement. Probably, therefore, supply would increase, to the benefit of consumers.

As far as agricultural producers are concerned, membership means that the economic environment for the growing of crops would be sharply improved, as shown in the calculations in Appendix 3. (Consequences of Membership of the EU on Agriculture and Food). The production of pork will, however, decline. Production of beef would also fall. As milk production is protected by the EU system of quotas, the decrease in output would be rather modest – despite higher Swedish processing costs.

On aggregate, production will be relatively unaffected in the various alternatives. Fears concerning the extensive withdrawal of land from agricultural use are probably exaggerated. On the other hand, Swedish participation in CAP would mean that the plains will benefit in relation to agricultural production in forested and mixed regions.

Compensation to producers will be considerably higher in the event of membership. The difference amounts to around six billion kronor, depending on the outcome of the Swedish negotiations. The principal reason is the system of direct support for farmers. This direct support raises the return on crop cultivation. The annual yield from the land – known as the agricultural rent – will rise. This in turn will lead to a dramatic increase in land values compared with a Swedish deregulation.

As far as the food industry is concerned, membership will mean firstly that it would have access to the same input items as its European competitors (and at the same prices), and secondly that it

be able to market its products throughout the whole of the internal market.

Large sectors of the Swedish food industry may be regarded as competitive. They should therefore have every chance of maintaining their position on the internal market. Those industries which lack experience of international competition, such as dairies, and meat-processing industries should be able to adjust the costs of their activities so that they can match competition from the EU. In this context, the depreciation has changed the situation for the better.

Chapter 12

Regional policy

Sweden's budget for direct regional aid amounts to some 2.5 billion kronor. Some 40 per cent of this is spent on regional development measures in the form of aid and grants to enterprises in sparsely populated areas.

This financial aid is linked to support zones. These zones cover 60 per cent of Sweden's area, but have only 8 per cent of the country's population.

Under the EEA agreement matters relating to competition will be handled by the EFTA Supervisory Authority. The agreement could influence the formulation of Sweden's regional policy. Financial aid for specific enterprises – such as aid to defray operating costs – is in principle not allowed. Regional reductions in social security charges could also be affected. There is much to suggest, however, that these types of aid will be accepted provided they do not distort competition. On account of the EEA agreement, however, the maximum level for localisation grants will probably have to be reduced to the levels that apply in the richer member countries. This means that the present ceiling of 35 per cent will be lowered to 20-30 per cent.

Regional policy in the EU has several different objectives:

- to promote development in under-developed regions
- to restructure regions experiencing industrial decline
- to combat long-term unemployment
- to make it easier for young people to enter the labour market
- to restructure agricultural and forestry areas
- to facilitate the development of agricultural areas

The predominant objective is to help poorly developed regions. Financing is arranged through the EU's structural funds. Their total budgets amount to some 20 billion Ecu per year. With effect from 1999 the resources of the structural funds will be increased to some 30 billion Ecu.

In the event of Sweden joining the EU, the same rules of competition would apply as under the EEA agreement. The difference is that the EU Commission's competition directorate will take over the role as the licensing authority and supervisor of various types of aid. In principle, Sweden can pursue the same regional policy under the EEA agreement as with EU membership.

The major difference is that in the event of membership, Sweden would receive its share of the structural funds. Grants from these funds would facilitate the financing of further regional policy measures. The principle of additionality involves demands for joint financing. Regions which at present receive financial aid via regional policy could thus have more resources at their disposal.

If Sweden remained outside the internal market there would be no rules which limit the formulation and scope of regional policy. Sweden's existing policy could be retained.

It is very difficult to judge the long-term effects of membership or a position outside the internal market on the regions. Regional policy measures would only have a limited influence on the general conditions for regional development.

Chapter 13

Public finances and the Budget

Participation in the internal market, either via the EEA agreement or through membership of the EU, would bring considerable economic benefits but also costs to be borne by public finances.

Under the EEA agreement Sweden has to pay annual contributions (for five years) totalling 800 million kronor. These contributions will be charged against the budget and Sweden's public finances.

As a member of the EU Sweden would contribute to the financing of the joint budget and various financial institutions, for example. In the negotiations Sweden has requested a phasing-in period. The budget contribution is expected to increase from 20 billion kronor per year to some 25 billion kronor in 1999.

The flow of funds back to Sweden would largely be channelled into agriculture and for regional purposes. As far as the central government budget is concerned, this recycling of funds would be of limited importance. It is largely a matter of direct grants to individuals and/or organisations. The net cost to be borne by the state may be estimated at approximately 19 billion kronor for 1995.

The EEA agreement has no formal demands for harmonisation of Swedish taxation. Membership of the EU, on the other hand, would involve both formal and economic harmonisation requirements.

In the area of taxation the EU countries have so far opted to use minimum levels. Only in exceptional cases will direct demands be made for Sweden to harmonise its tax system. The growing competition and the abolition of border controls could, on the other hand, lead to the adjustment of certain tax rates. Which taxes these would be would depend largely on the mobility of the tax bases.

Sweden would probably need to cut its taxes on tobacco and alcohol as a result of increased border traffic. In the case of other products, the risk of leakage via border traffic is less. In the long term, Sweden could need to adjust its value added tax. However, this is by no means necessarily the case.

The sum of the long-term formal and economic harmonisation requirements could correspond to tax reductions of 4-21 billion kronor.

The difference between the EEA and EU membership as far as public finances are concerned lies not only in the size of the grants to the EEA and the EU budget to which they give rise. It is also reflected in differences in growth rates that a changed volume of investments could be expected to involve. Faster growth would lead to higher tax revenues. Our view is that the long-term benefits of faster growth would after some years exceed the short-term costs that contributions to the EU budget would involve in the event of membership of the EU.

EU membership could have a moderating effect on Swedish interest rates. This would influence the public sector's resources as the interest rate plays a major role in the financing of the national debt.

Consumption of welfare services does not differ markedly between Sweden and the EU countries. The difference lies in the fact that Sweden, rather more than the other countries, has opted to finance these services via the public sector. Sweden's weak public finances and relatively high tax ratio (total taxes and charges as a

proportion of GDP) limit the scope to earmark further resources for such purposes.

In order to assess the economic consequences of the state's expenditure and revenues, it is essential to look at how the costs are financed and how the income is distributed throughout the entire economy.

If the charge on central government finances is financed by means of tax increases the cost to the economy would probably be greater than the charge on the state's finances. However, it is not necessary to finance budget contributions by raising taxes. It could also be done by redistribution within the existing budget.

However, in the final analysis, the structuring and financing of the activities of the public sector are a matter of political priorities to be decided by the Swedish Parliament and local governments. The size and structure of the tax-financed sector are choices that Sweden has to make for itself. International integration will play an important role, but Sweden's relationship with Western Europe and the EU will at most only have a marginal effect.

Chapter 14

Stabilisation policy

Stabilisation policy has two main objectives: to keep inflation in check and to keep unemployment down. The means used are primarily monetary policy and fiscal policy.

Full employment was the overall aim of economic policy for a long period. With the tying of the Swedish currency to the ecu, greater emphasis was placed on combating inflation.

The Swedish currency has been floating since the autumn of 1992. The effects of fiscal policy are limited by the fact that expansive measures also influence the exchange rate and interest rates. The potential for monetary policy measures has instead increased. Further constraints influence stabilisation policy in Sweden:

- a rapidly growing deficit on public finances
- a fluctuating currency
- free movement of capital, and
- an internationalised business sector

These constraints will remain regardless of what form Sweden's relationship with the EU assumes.

The EU countries' choice of exchange rate regime – fixed or floating exchange rates – is of great importance for stabilisation policy. Floating exchange rates limit the impact of fiscal policy measures. Some of the stimuli that higher public spending, for instance, is intended to generate, are vitiated by an inflow of foreign currency and a higher exchange rate. A system of fixed exchange rates reduces the role of monetary policy to defending exchange rate parities.

The wide band currently used in the European exchange rate mechanism (± 15 per cent) is in effect a system of floating exchange rates. This situation will probably be retained for some time to come.

Sweden has declared its interest in participating in the European monetary system, but the country will determine its own exchange rate policy either as a member or as a non-member.

Should the EU countries revert to a more fixed exchange rate system by having a narrower band, this will make heavy demands for fiscal policy discipline and on the wage-formation process, should Sweden decide to join. If Sweden fails to meet these requirements, measures to maintain a fixed exchange rate could become very costly.

Membership does, however, mean that Sweden will be able to influence the co-ordination of the EU's fiscal policy. Closer co-ordination will give fiscal policy greater impact. Efforts to co-ordinate policies within the EU countries have become more extensive lately. One example is the White Paper on growth, competitiveness and employment that was presented in December 1993.

Membership would limit the resources available for fiscal policy for the first few years, due to the annual contribution to the EU, before faster growth results in higher tax revenues. The contribution would be financed either by tax increases or by redistribution among the budget headings.

Stabilisation policy in a situation where Sweden remains outside the internal market would be determined by two factors.

Firstly, the mobility of the labour force would be reduced. Consequently, the risk of bottle-necks arising and leading to pay and price spirals during a boom would increase. This would make more difficult the role of economic policy in holding inflation and unemployment down.

However, secondly, remaining outside the internal market would provide greater freedom to design the tax system.

As far as the overall aspects of stabilisation policy are concerned, Sweden's major challenge lies not in the form in which it decides to join the internal market, but in how to overcome the problems and deficits the country has created quite independently, regardless of the EU.

Chapter 15

The monetary union

According to the Maastricht Treaty, the EU countries are to introduce a common currency and a common monetary policy. At present, it remains to be seen whether these plans are implemented and in that case how. Our view is that this is not likely to happen before the turn of the century, and that Sweden will have the opportunity to decide whether or not to join the monetary union at that time.

The pros and cons of a monetary union have been debated frequently over the past few years. Its advocates emphasise that economic efficiency would improve, while the opposition highlights the tensions that might result from a cumbersome wage and price-formation system.

The advantages and disadvantages for Sweden as a member of a future monetary union are discussed in two appendices to this investigation (Appendix 2 "Macro-economic shocks and economic structure" and "Micro-economic aspects of a monetary union"). The final conclusion of these surveys is that neither the costs nor the risks, neither the threats nor the opportunities, are of such a magnitude that they would in themselves justify a decisive influence on the question of Sweden's membership of the EU in the future.

If a monetary union is instituted, the Maastricht Treaty stipulates that the countries should comply with a number of convergence requirements. Sweden does not fulfil these requirements today. Our view is, however, that the convergence requirements do not involve greater strains on the Swedish economy than the targets formulated by the Swedish Parliament in its effort to reduce the budget deficit and keep prices under control.

A monetary union would make monetary policy the responsibility of the common central bank, the ECB. According to the treaty,

the overall aim of its activities should be to stabilise prices. The wisdom of focusing so sharply on this function has been questioned, but the Swedish Riksbank has also decided that price stabilisation is its major objective.

As far as fiscal policy is concerned, the Maastricht Treaty lacks formal rules for co-ordination. There are some hopes regarding the desirable effects of such co-ordination, should it ever materialise. A common currency would improve the efficiency of fiscal policy.

As a participant in a monetary union, Sweden could no longer fix interest rates or exchange rates autonomously. The exchange rate would disappear as a means of fine tuning the economy. Experiences of Swedish exchange rate changes indicate, however, that the resulting long-term economic policy losses would be limited. The transaction costs in foreign trade could be reduced, but the gains would probably be relatively modest.

A credible Swedish anti-inflationary policy could involve lower interest rates and a slight easing of the burden of debt. To what extent the effects of participation in a monetary union – whether positive or negative – would in the final analysis be determined by the policy pursued within the monetary union.

IV Conclusions

Chapter 16 Conclusions and epilogue

The conclusions and recommendations of the Commission are presented in the following pages.

Conclusions and epilogue

The committee's terms of reference are to investigate the economic consequences for Sweden of different forms of participation in European co-operation.

One of the difficulties in performing our analysis is that both Sweden and the EU are in a state of change. It is not the Sweden of today that should be compared with the EU of today. Nor will Sweden remain the same as it is today by virtue of a decision not to join the EU.

However, on two issues the uncertainties have been removed in the course of our investigation.

1. The Uruguay Round was concluded in December 1993. A number of barriers to global trade were lowered or eliminated. The agreement will have a major impact on Sweden's relationship with the EU, since the Community's own trade restrictions, in the clothing and agricultural industries, for instance, will be eased or removed. Eventually, therefore, the difference between membership and an EEA agreement (or a situation in which Sweden remains entirely outside the EU) will be less than if an international trade agreement had not been concluded.
2. The EEA agreement came into force on January 1 1994. Sweden will thereby no longer be discriminated against with regard to trade with goods and services, or freedom of movement of labour and capital. Sweden will, to a certain extent, be able to influence decision-making via the common EEA institutions.

Against this background, it has, of course, been natural for us to use the EEA agreement as a reference alternative. This, in turn, has been compared first of all to a situation in which Sweden were to be a full member of the EU, and secondly, to an alternative in which Sweden were to stand entirely outside the common market.

In this study, we have given particular attention to two main subjects. One is the market, its demands and opportunities. The other is policy, its potential and actual content.

1. How will economic growth be affected when Sweden becomes a part of the internal market? What will the difference be if Sweden participates as a member of the EU compared to as a party to agreements in the EEA?
2. What will happen in areas which would become subject to common decision-making if Sweden became a member? How will agricultural and regional policies be affected? What will happen to trade policy? What are the prospects for stabilising policies?

The greatest difficulty is the fact that we have had to compare processes – not conditions. There is no status quo, no alternative in which everything would remain as it is today. Reality is changing. Forecasts turn out to be wrong.

When comparing processes – which are unpredictable – it is practically impossible to quantify the results. Some of our readers will probably search in vain for calculations, forecasts and statements expressed in billions of ecu.

It would have been an advantage if we could have described the differences in figures, as we have done wherever this was possible.

However, numerical values often lead our thoughts in the wrong direction. They give a misleading impression of exactitude and precision; they put the focus on details when we ought to lift our eyes from net budgets and percentages.

It is not always possible to express important issues in figures or to lay them out as an income statement for the next three, five or ten years. It is far more important to see what general developments can be expected, what forces will be set in motion, what opportunities may be generated – if we seize the chance.

The time perspective is central. The consequences of membership of the EU may emerge in the short-, medium- or long-term perspective. Our conclusion is that the principal consequences will emerge in the long term.

* * * * *

Sweden is a country with a large land area and a small population. Over the past century, Sweden has built up an industrial structure based principally on domestic raw materials that has generated strong economic growth and an immense improvement in living standards, thanks to international trade.

This trend came to a halt in the early 1970s. Since then, Sweden has encountered economic problems.

In the past few years, the international recession has tended to aggravate these problems. At the bottom of it all we find problems that are shared by the rest of Europe:

- Unemployment is high, growth relatively weak. Competition against the other giants on the global market – the USA and Japan – is uncertain. Western Europe is caught between high technology from the USA and Japan, and low-cost competition from Eastern Europe and Asia. The population is ageing, which puts demands on the system of public transfer payments. Moreover, there are heavy migratory pressures from countries outside Europe.
- International integration limits the scope for national economic policy measures. The economies of individual countries have become successively more intimately intermeshed. Today, the national state is in many instances unable to make central economic policy decisions autonomously.
- New, complex and indefinable conditions thus apply in the world of politics. The Swedish krona is floating. Sweden is experiencing a deep recession. Unemployment is higher than it has been since the thirties. Public finances are seriously unbalanced. Large budget deficits and a high national debt mean that a go-it-alone policy of stimuli would be hazardous.

The framework for the economy and politics is determined by the fact that Sweden is a small, open country that is dependent on exports, with an economy in which large enterprises hold an extremely dominant position.

Its very size and openness limit Sweden's ability to pursue policies or set up targets that differ radically from the rest of the world.

More than half of Sweden's industrial output – more than one fourth of the country's GDP – is exported. Products that are essential for production and consumption must be imported. Therefore access, without discrimination, to foreign markets is crucial to Sweden's development and prosperity.

The dependence on large enterprises also forces Sweden to take account of the investment options and market options facing these companies. The decisions made by 15 or 20 of the large corporate head offices therefore have untold effects on the level of unemployment in Sweden and on the country's total investment ratio. Regardless of the type of relationship, these enterprises will leave their mark on the Swedish economy for the foreseeable future.

For Sweden, consequently, the rules for international trade relations are of particular importance, and participation in the international institutions dealing with trade and monetary co-operation is crucial. It is against this background that we have examined the consequences of Swedish membership of the EU, continuation of the EEA agreement and a situation in which Sweden is completely excluded from the co-operation within the EU.

Many of the effects which we have described in this report will already arise from the EEA agreement. This applies not least to the implementation of the four freedoms. Consequently, Sweden has already become a part of the internal market, with the exception of agriculture and the food industry.

Under the EEA agreement, Sweden and the other affiliated Efta countries must either accept the rules that the EU countries decide among themselves – or not, thereby running the risk of watering down the EEA agreement.

As a member of the EU, Sweden would achieve a completely different level of participation in decision-making processes by virtue of its representation on the Council of Ministers, the European Parliament and committees, and opportunities for exercise of both formal and informal influence.

As a member, Sweden could actively influence decisions such as which questions are put onto – or removed from – the agenda. Moreover, Sweden would have greater influence on technical standards in cases where the EU countries are striving to achieve uniform standards. This is of great importance to Swedish companies for which Western Europe is their domestic market.

Sweden could also, if it were a member, expect to influence policy decisions on issues which would indirectly affect the Swedish economy, regardless of whether Sweden were a member or not. This

is the case, for instance, with the economic benefits and disadvantages for Sweden and Swedish industry which could arise as a result of a more open EU approach towards Eastern Europe and the Baltic states. Sweden may gain more opportunities to persuade the EU to adopt a more positive attitude towards free trade in areas where there would otherwise be a state of balance between countries which shared Sweden's attitude and countries with different trade policy traditions. This also applies to efforts in the area of environmental policy, where common decisions on carbon dioxide tax could have significant effects on the economy in Sweden.

Membership will also have very tangible psychological effects, which could be of great importance both to business and to the economy in general.

This is true not least of the economic consequences of the fact that business enterprises and investors give membership and the EEA agreement different values.

The most important economic differences between membership, the EEA agreement and a situation in which Sweden remains entirely outside the internal market, are caused by the fact that investments are expected to move in different directions and to a different extent in the three scenarios.

- An EEA agreement means that Sweden will be included in the internal market. The four mobilities mean that most obstacles to trade will disappear. Investments will above all be based on the increase in the size of the market.
- EU membership means that Sweden will remain permanently within the internal market. Membership means that Sweden will participate in the future development of the internal market and that access to this market would neither be eroded, nor could it be terminated at one year's notice. Sweden could consequently attract a higher proportion of specialised investments in advanced production, which are intended above all for exports and further sale.

After a few years, these differences in investment flows would have an effect on the business structure as well as on the growth rate. When making investment decisions, companies are not only concerned about where the return is highest and market conditions most favourable. Their considerations also include more elusive judgements about how stable and long term the conditions known today will be.

This applies to the whole of the Swedish investment environment, not only to the choice between Sweden and other countries that large enterprises make. The views of investors and markets about Sweden's economic future will also influence the growth potential of small and medium-sized firms as well as the ability to finance public-sector investments and/or activities.

It is naturally very difficult to quantify expectations. The studies that have been made have tended to be interview surveys, with all the drawbacks and shortcomings as forecasting information that such studies can have. It is seldom possible, even with hindsight, to say definitely that an observed development was due to certain factors.

After having examined surveys and scientific reports as well as the views of decision-makers, union representatives and industrialists, our view is that during the coming ten years, the question of membership of the EU will have a major impact on the development of investments in Sweden, into Sweden and out of Sweden, and on the accompanying business structure, productivity, ability to pay wages and economic prosperity.

Membership of the EU

Membership of the EU differs from the EEA agreement in two important respects:

1. The total volume of investment may be expected to increase as a result because companies that are dependent on exports and trade know that the conditions for participation in the internal market will be stable. Investments by manufacturers of products can be expected to increase, as well as producers of services. The upswing in the short term could be substantial, and it would spread via multiplier effects into other areas of the economy.
2. As long as companies do not regard the EEA agreement as fully comparable to membership in terms of stability and long-term character, there will be differences in the direction of investments. EU membership could mean more specialised investments, a large proportion of head offices with research departments and specialist functions in Sweden, higher productivity, higher value added, faster growth and more resources for payment of wages. The Swedish economy would

thus move onto a stronger long term growth track with, we believe, lasting effects in the form of higher productivity and more favourable prospects for greater prosperity.

This view is applied primarily to the somewhat longer term, which was the main time horizon of the commission. However, our view is that the decision on the EU could also be of great importance to developments in the more immediate future. A decision on membership could trigger the investments that are needed to prevent a recovering economy from hitting its capacity limits too soon. A decision on membership could also have a favourable effect on the long-term interest rate, which reflects expectations regarding the future development of the Swedish economy.

As far as consumers are concerned the advantages will largely be generated by the EEA agreement, as they can then benefit from stiffer internal market competition, lower prices and a wider range of goods and services. However, food and agricultural produce are also covered by EU membership. In these areas, membership would lead to lower consumer prices than the EEA agreement.

In terms of public finances, EU membership would involve a considerable strain in the short term. The cost to the treasury as a result of the EEA agreement amounts to some 800 million kronor per year for five years, whilst EU membership would require a gross budgetary contribution of some 20 billion kronor with the possibility of some degree of phasing in, but no longer than to the end of 1999. This would probably be accompanied by cuts in certain taxes and tax payments.

These are large amounts, but if membership leads to lower interest rates, the cost of government borrowing will also decrease. The pressures on the state's finances are also temporary, if seen in relation to the positive investment effects that membership could give rise to. We believe that this will result in a lasting, higher growth rate in the Swedish economy. In the two- to three-year perspective, Sweden's total assets and public finances would therefore be strengthened. In economic terms, there would also be some recycling back into Sweden via the EU budget and the structural funds. These funds would primarily benefit the agricultural sector and be used for regional policy objectives.

The demand for economic adjustment should not be confused with the formal payments. In the event that membership, via the abolition of border controls, led to cuts, for example in taxes on consumption in the future, this would represent a cost to the state's

finances, but not to the economy in general. The resources would remain in the Swedish economy, but in the hands of consumers (see Figure 16.1).

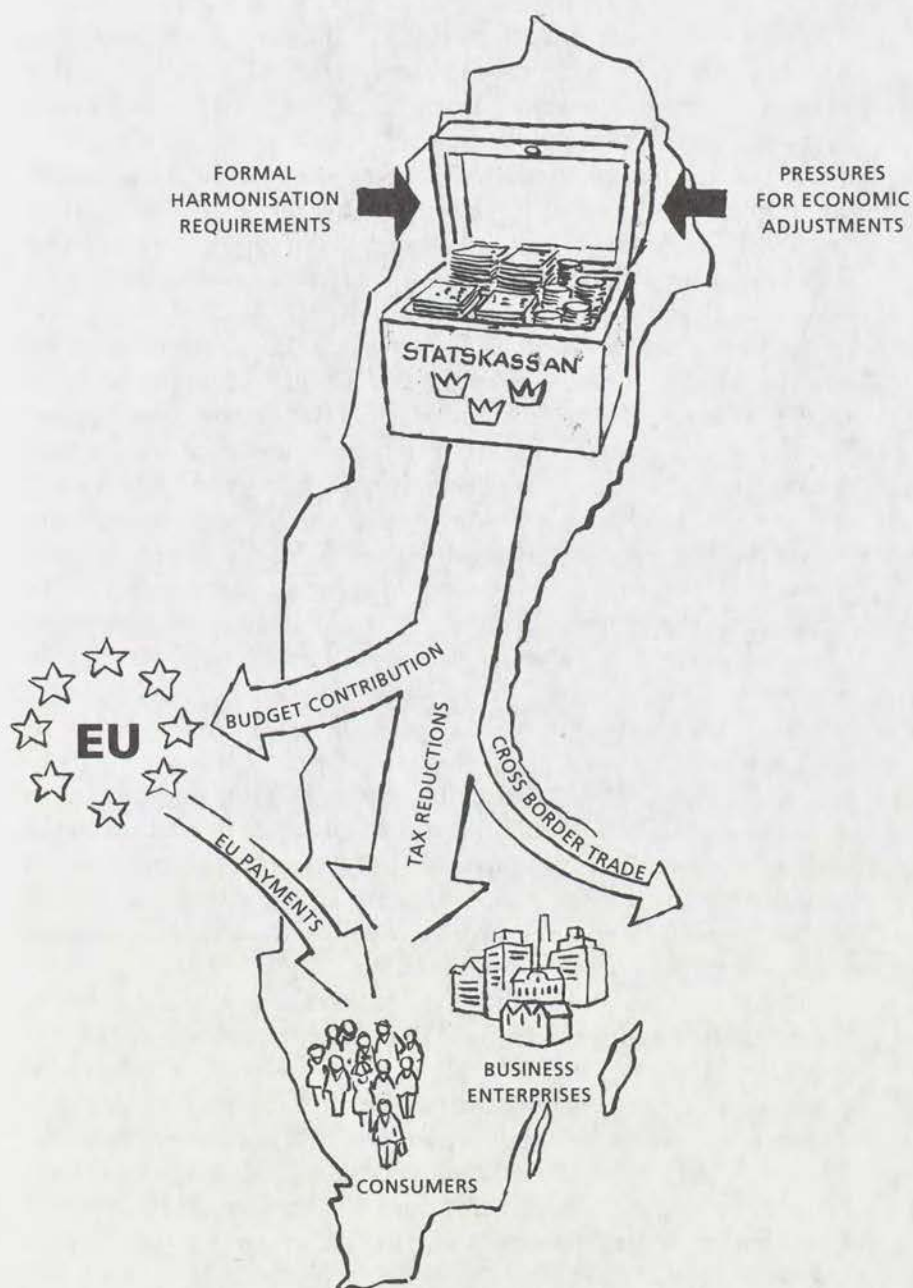
EU membership will not automatically solve the problems the Swedish economy has to overcome, but we believe that the chances of overcoming them will be better with higher investments and the more favourable productivity trend that this could lead to.

Higher investments mean that production capacity would be expanded. Consequently, there would be less of a risk that Sweden would yet again hit its capacity limits very soon, with wage drift and overheating as a result.

Higher investment speeds up the restructuring process, which brings about higher productivity and higher value added. This in turn means a stronger international competitive position and the ability to achieve a higher level of real wages in the economy. A stronger international competitive position would mean improvements in foreign trade and, moreover, would in the long term make it possible to reduce the public finance deficits and the national debt. Lower interest payments would release resources for other priorities in the budget – either in the form of tax reductions or higher targets for those services and products which are made available through the public sector.

We do not regard it as likely that a monetary union in which Sweden could participate, as described in the Maastricht Treaty, can be realised before the year 2000. But if this were to happen, and if co-operation within such a union actually helps to improve macro-economic stability, a further reduction in interest rates as a consequence could help to underline the positive effects. However, we do not see a monetary union as a key factor in an assessment of EU membership. The day the decision about a possible union is to be made, Sweden, as a member, will be able to influence the structure of the union and whether Sweden, in such a case, would decide to join or not.

Figure 16.1 Flow of funds between the Swedish treasury, the EU and the economy



Outside the internal market

The EEA agreement came into effect at the turn of the year. The period of notice for withdrawal is one year. We do not believe that there is any reason to believe that in the short term Sweden would find itself outside the internal market.

However, in the somewhat longer term the EEA agreement could gradually be eroded. The reason for this is that the participating EFTA countries have to be agreed on new points and that decisions made within the EU have to be incorporated into the EEA agreement. If any country opposes the new rules, the "relevant parts" of the framework collapse. The effect of the EEA agreement could thus be steadily diminished as the EU countries co-operate more closely. Moreover, several of today's EFTA countries have applied for membership in the EU, which could mean that the interest among the EU countries in developing the EEA could fade away.

Some of the criticism directed against the EU focuses primarily on the EEA agreement. Some of the measures that have been proposed to mitigate the consequences of rejecting membership – for example tighter currency controls – would conflict with the rules in the agreement. This could become a further factor leading to Sweden being left outside the internal market.

We do not consider the likelihood of Sweden really losing its EEA status to be very great. But the possible costs, were this to occur, are regarded by many companies as so great that this fact is influencing their actions and investment strategies in relation to the internal market. The risk is small, but the potential costs are so considerable that for this reason numerous companies do not regard the EEA agreement as stable enough to fully guarantee them a secure place as members of the internal market.

Outside the internal market, the business sector would experience considerably tougher conditions than its competitors in the EU countries. The real costs of trading would increase, which would place both exports and production for the domestic market at a disadvantage. Investments in Sweden would consequently decrease. Above all, they would be concentrated on supplying a limited local market. The flow of investments out of Sweden could be expected to be higher, as large companies will wish to protect their export markets.

Our view is that such a situation could lead to a lower total investment ratio, different directions for investment flows, a slower process of restructuring and renewal, lower productivity and a slower growth rate. In such an event, Sweden would probably be compelled to offset its reduced attractiveness by offering other incentives in order to overcome the poorer climate for investment and growth. This could take the form of more favourable tax conditions, which would put an even greater strain on public finances. Alternatively, it could take the form of poorer pay and employment conditions as a means of providing resources for companies to earn higher profits.

Admittedly, the room to manoeuvre in the economic policy field would formally be greater outside the internal market. Trade policy and agricultural policy could then be determined fully and completely by Sweden itself. The same applies to the formulation of various state aid schemes.

However, a lower growth rate could make it more difficult to control public finance deficits and reduce the national debt. De facto, therefore, Sweden's freedom of action would be less. Nor is it certain that it would always be politically possible to utilise this freedom to make the most rational economic decisions. The problems many countries are experiencing in changing their agricultural policies are evidence of this.

In practice, we believe that Sweden – outside the internal market – would face a choice of two different strategies:

1. An extremely outward-oriented economy with aggressive wage formation and intense competition, but with favourable tax conditions for business, and a nation that will be disciplined the hard way into achieving high growth and stronger finances.
2. A more closed economy sheltered by protectionist barriers, which in the short term would moderate the effects of stiffer competition from other countries, but which in the longer term would lead to slower growth, a weaker business sector and economic stagnation.

The outcome for consumers and producers will depend in such a case on which strategy is chosen.

The first strategy would mean that Sweden has to attempt to compete by offering lower labour costs than other countries. In this case, competition would come not only from companies in countries

having access to the benefits of EU membership. It would also come from competitors in those countries which have already adopted or)are about to introduce this low-cost strategy. Primarily, this group includes countries in East Asia and Eastern Europe. The pressure on manufacturers would be even greater.

Consumers would benefit from lower prices, but would probably also earn lower real wages and have lower purchasing power.

The second strategy would lead to higher prices for consumers.

A protectionist strategy would initially protect Swedish manufacturers from foreign competition, but in the longer term would lead to more companies being driven out of business. The restructuring process that is required if real incomes are to improve at a satisfactory rate, would become more difficult. There is a risk that consumers would lose, in the form of higher prices as well as lower real incomes. The process of restructuring and renewal would be delayed as far as producers are concerned, but in the long run, it can hardly be avoided. The conditions for renewal would be even more rigorous.

Our view is that the situation outside the internal market is the alternative which involves the greatest measure of uncertainty and which in the long term would lead to the harshest demands for adjustment and the most intense strains on the Swedish economy.

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The following pages present a brief review of the effects on enterprises and consumers, as well as on certain central areas.

Enterprises

Producers

EEA: Access to internal market, stiffer competition, more opportunities to break into other markets themselves, excellent opportunities for companies which are involved in public procurement. More difficult for industries which have so far been protected by trade barriers and regulations.

- EU: Over and above the EEA, chance to exert influence over standards and rules of competition. Guarantees of sustained and more stable investment conditions. Heavy subsidies and recycling of EU funds into agriculture and regional support zones.
- Outside: Relatively poorer position in relation to competitors within the market. Higher trading costs.

Competition

- EEA: Tough. Becomes tougher as the internal market is fully implemented.
- EU: Same as EEA. Sweden will have more influence over rules of competition.
- Outside: Depends on strategy. A decision to remain outside the internal market would probably lead to a choice between a more closed economy or an extremely open economy. In the former case, there will be protectionist elements and protection for Swedish companies. In the latter case, competition will be tougher than inside the internal market.

Investment climate

- EEA: Depends on assumptions regarding future economic performance in Sweden and EU countries. The EEA agreement means, for example, that companies competing with foreign companies are not discriminated against in relation to EU companies.
- EU: Improvement in relation to EEA as membership provides guarantee that participation in the internal market will be permanent. Favourable effects on investments that are particularly dependent on stability and on the permanent nature of the four mobilities. Possibility of lower interest rates.
- Outside: Poor on account of the risk of discrimination against Swedish companies in connection with public procurement and the formulation of product standards within EU.

Direct investments

- EEA: Investments are based primarily on access to the market. Difficult to attract non-European investments.

- EU: Greater stability will enable Sweden to attract specialised investments which will provide a basis for higher value added, higher productivity and more favourable growth prospects.
- Outside: Poor investment growth. Sweden would no longer be attractive for large-scale investment projects.

Restructuring and renewal

- EEA: Faster than in the past due to tougher competition and thus greater pressure forcing non-competitive companies and industries out of business.
- EU: Faster than with the EEA, since the formation of new capital via higher proportion of specialised investments over and above the competitive effect, would be stimulated.
- Outside: Initially slower. Sweden could adopt a more protectionist strategy which, however, will harm the growth potential. Eventually the process would gather momentum with poorer conditions for renewal.

Conditions for R&D-intensive production

- EEA: Relatively good.
- EU: Better than with the EEA, since the proportion of specialised investments is expected to rise.
- Outside: Would require more incentives to attract R&D and to offset the higher real trading costs and the poorer market access which is the result of remaining outside the market.

Households

Consumers

- EEA: Benefit from competition on the internal market. Lower prices. Wider product range available.
- EU: Same effects as EEA. Food prices would also be lower. However, clothing prices could be slightly higher for a few years.
- Outside: Depends on what strategy Sweden adopts. Extreme openness in trade policy and agricultural policy and free

trade would benefit consumption. A more protectionist attitude would mean lower efficiency and higher prices.

Employment

- EEA: The internal market will mean tougher competition with stiffer demands for restructuring. Some of these adjustments have already been made.
- EU: Membership will strengthen confidence in the Swedish economy, have a positive effect on interest rates and trigger off investments which will increase employment and reduce the risk of over-heating.
- Outside: Slower growth in real wages would make it more difficult to reach a balance between wage demands and higher unemployment in the wage formation process.

Real incomes

- EEA: Could be affected to the extent that the internal market increases the efficiency and thus the competitiveness of Swedish enterprises.
- EU: Possibilities for more specialised production and more well-paid jobs will lead to higher value added and resources to pay higher real wages.
- Outside: Lower due to the reduction in investments, and less specialisation. The process of restructuring and renewal will go more slowly and productivity trends will be weaker.

Labour market

- EEA: Part of the internal labour market with new education and job opportunities. Some risk of brain drain affecting highly qualified people with specialist expertise and skills.
- EU: A higher proportion of jobs with specialist orientation in Sweden as a result of further specialisation. More possibilities of "brain return".
- Outside: A more restricted labour market, somewhat lower supply in terms of variety and demand. Significantly less exchange with other countries' labour markets.

Economic policy

Taxes

- EEA: Some limited adjustment of tax rates, due to mobility of production factors.
- EU: Some increase in demands for adjustment, due to abolition of border controls. No need to change total level of taxation.
- Outside: Formal autonomy. Depending on choice of strategy, this might require lower capital taxes and higher profit ratio in order to offset the disadvantages of location and poorer market access.

Public finances

- EEA: Approximately 800 million kronor per year in contributions to funds and institutions as well as demands for economic adjustment.
- EU: Approximately 20 billion kronor in contributions as well as demands for harmonisation of taxation. Lower interest rates could reduce the cost of borrowing.
- Outside: Formally no charges against public finances. Demand for economic adjustment would depend on which strategy Sweden adopts.

Trade policy

- EEA: Sweden would apply its own trade policy to third-party countries. Border controls and need to mark with country of origin remain.
- EU: Sweden would belong to a customs union. In the short term, re-regulation of imports of textiles and clothing. Internal border controls will be abolished.
- Outside: Trading relationships would be based initially on the free-trade agreement for industrial products and on the GATT rules. Tighter border controls. Risk of anti-dumping measures and discrimination in connection with public procurement.

Agricultural policy

- EEA: Not covered by the internal market. Bilateral agreements on free trade for certain foodstuffs. Formal autonomy.

- EU: Part of CAP, which is financed via the common budget. Recycling of community funds from the EU to Swedish farmers. Lower prices of raw materials and lower consumer prices, but a larger production surplus on account of the agricultural rent.
- Outside: Formal autonomy as in the EEA, viz. possibility of pursuing a more efficient agricultural policy for the economy as a whole.

Regional aid and development

- EEA: Government financial aid limited by EC's rules of competition.
- EU: No further restrictions over and above EEA. Aid from structural funds together with higher budgets from public finances would mean more resources for regional aid zones.
- Outside: Effects unclear. Possibility of more autonomous regional aid policy could be offset by slower growth rate and poorer general economic developments.

Growth

- EEA: Potential due to stiffer competition and higher efficiency in the economy.
- EU: Better conditions than with EEA through greater stability. Higher investment ratio and higher proportion of specialised investments will make possible additional productivity gains.
- Outside: Slower due to lower investment ratio, slower restructuring process and possibly poorer competitive position.

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We have investigated the effects on Sweden of various alternatives in relation to the EU and the internal market. Our view involves a fair measure of uncertainty in many individual respects, but nonetheless it provides sufficient facts to form an overall view.

Sweden is going through a process of change. In ten years' time, Sweden will not be the same as it is today. In ten years' time, the EU will not be the same as it is today.

Sweden is already being affected by the EU. Our conclusion is that the effects of membership will benefit Sweden's business sector, Swedish consumers and the economy in general.

As a member, Sweden will also exert influence over the EU.

We are convinced that Swedish membership of the EU will also make a positive contribution to the future evolution of the EU.





