REGERINGSKANSLIET

Ministry of Finance

Update of Sweden's convergence programme

December 2006

I Introduction

In accordance with the Council's regulation (EC) 1466/97, Sweden submitted its convergence programme in December 1998.[1] The programme was evaluated and approved by the Council during the spring of 1999. In accordance with the Council's regulation, an update of the convergence programme is to be submitted annually. Updates were submitted in November during the period 1999–2005 and approved early the following year. This update has been drawn up in parallel with the Government Budget Bill for 2007, which was presented to the Riksdag on 16 October 2006. The government, which took office on 6 October 2006 following the general election on 16 September, comprises a coalition between the Moderate Party, the Liberal Party, the Center Party and the Christian Democratic Party. The Riksdag's Standing Committee on Finance and the Committee on EU affairs were informed about the programme on November 28 and December 1 2006.

The update of the convergence programme is based on the assessment of Sweden's economy contained in the Government Budget Bill for 2007. Forecasting was completed on 6 October 2006. This assessment involves a stronger outlook for 2006 than the forecast in the updated convergence programme for 2005. In 2007, activity in the Swedish economy is also estimated to be stronger than in the assessment in last year's programme. The budget policy targets presented in the convergence programme for 1998 remain unchanged. Consequently, public finances should show a surplus of 2 per cent of GDP on average over a business cycle and central government expenditure should not exceed the expenditure ceilings set.

II Economic policy framework and targets

Economic policy strategy for full employment and sustainable public finances

In the Government Budget Bill for 2007, the Government firstly proposes reforms making it profitable to work. A major income tax reform is being implemented, in which the main emphasis is on making it more profitable for low and medium-income earners to work. In the long term, the Government will propose further income tax cuts in addition to those proposed in the Budget Bill for 2007. In addition, the policy for more jobs should be clarified in unemployment insurance. Secondly, a number of reforms are being implemented to make hiring simpler and less expensive. "New start jobs" are to be introduced to provide a fresh chance for those who have not worked for a long time to return to work. The government will come back with proposals to reduce employer contributions in some service sectors. Thirdly, the government proposes a number of measures to improve Sweden's corporate climate, including halving the wealth tax on

[1] Council Regulation (EC) 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions as well as the surveillance of economic policies.

financial assets as a first stage. The reforms aim at increasing long-term employment in Sweden, which in turn is the single most important factor in achieving sustainable public finances.
The surplus target for general government net lending is to be maintained. Given a surplus in net lending, fiscal policy is aimed at reducing general government indebtedness and increasing its net wealth. The maintenance of long-term sustainable public finances enables the demographic challenge, which is set to increase in the next few decades, to be met.

Experiences of the fiscal policy framework with surplus targets and expenditure ceilings are, on the whole, favourable and there are strong reasons to mainly retain it. At the same time, experiences from the ten-year period that the framework has been in force show that a review of the fiscal policy framework is necessary. For example, measures, which have led to a deterioration in net lending, but have not affected the expenditure ceiling, were previously taken through, for example, tax expenditure and net budgeted expenditure. Apart from the actual restriction of the expenditure ceiling decreasing to some extent, this process may lead to the credibility of budget policy being questioned. The expenditure ceiling is an important instrument for securing sustainable public finances. In the Budget Bill for 2007, the Government therefore took measures to strengthen the expenditure-limiting function of the expenditure ceiling by proposing a reduction in some tax expenditure that constitutes a close substitute for direct expenditure.

The framework should be improved and further developed to provide an increased degree of transparency and clarity, in order to improve the opportunity for evaluation. The credibility of a responsibly drawn-up fiscal policy is thereby secured. The Government intends to return with a review of the fiscal policy framework in the 2007 Spring Fiscal Policy Bill. During the coming term of office, each reform will be carefully tested against what the national economy can stand.

Fiscal policy targets

In accordance with the Stability and Growth Pact, the Member States shall in a medium–term perspective, aim for general government net lending being within the range –1 per cent of GDP and balance or surplus.[2] The Riksdag supports the government's target of a surplus in general government net lending of 2 per cent of GDP on average over a business cycle. Such a surplus provides a stable basis for the challenges resulting from the sharp increase in the proportion of older people in the population in the future. The surplus also provides a general safety margin in public finances.

[2] In accordance with Council Regulation (EC) No. 1055/2005.

The surplus target constitutes Sweden's medium-term objective (MTO) as stated in the Stability and Growth Pact.[3] This target provides an adequate margin to the reference value[4] of –3 per cent of GDP and also aims to strengthen the sustainability of public finances.[5]

For each budget year, the Budget Bill establishes a target for general government net lending, while taking into account the state of the economy as well as the current situation in relation to the overall target. In the Budget Bill for 2006, the previous government proposed that the target for 2006 was to be set at no less than 0.5 per cent of GDP, which was also passed by the Riksdag. The surplus is now estimated to far exceed the target, mainly as a result of higher GDP growth and exceptionally high tax revenues from capital gains. Since actual net lending is forecast at 2.8 per cent of GDP, the surplus target for 2006 will be achieved with a broad margin. The fiscal policy stance for 2007 results in an estimated surplus for 2007 of 2.3 per cent of GDP. In order to avoid jeopardising the overall target, the surplus should not be allowed to fall below 1.0 per cent of GDP, leaving a margin for uncertainty in the forecasts (see Diagram 1 below).

In 1997, Eurostat, the EU's official statistics body, decided that the new Swedish pension system in its entirety was to be classified as part of the general government sector. In 2004, Eurostat changed its decision, leading to the prefunded pension system not being included in general government net lending as from 2007. For Sweden, this results in a reduction in general government net lending of approximately 1 per cent of GDP and a rise in general government consolidated debt of approximately 0.5 per cent of GDP. However, the transfer of the prefunded pension system to the household sector does not affect the long-term sustainability of public finances. The government will return in the 2007 Spring Fiscal Policy Bill to how Eurostat's decision will affect the target for general government net lending.

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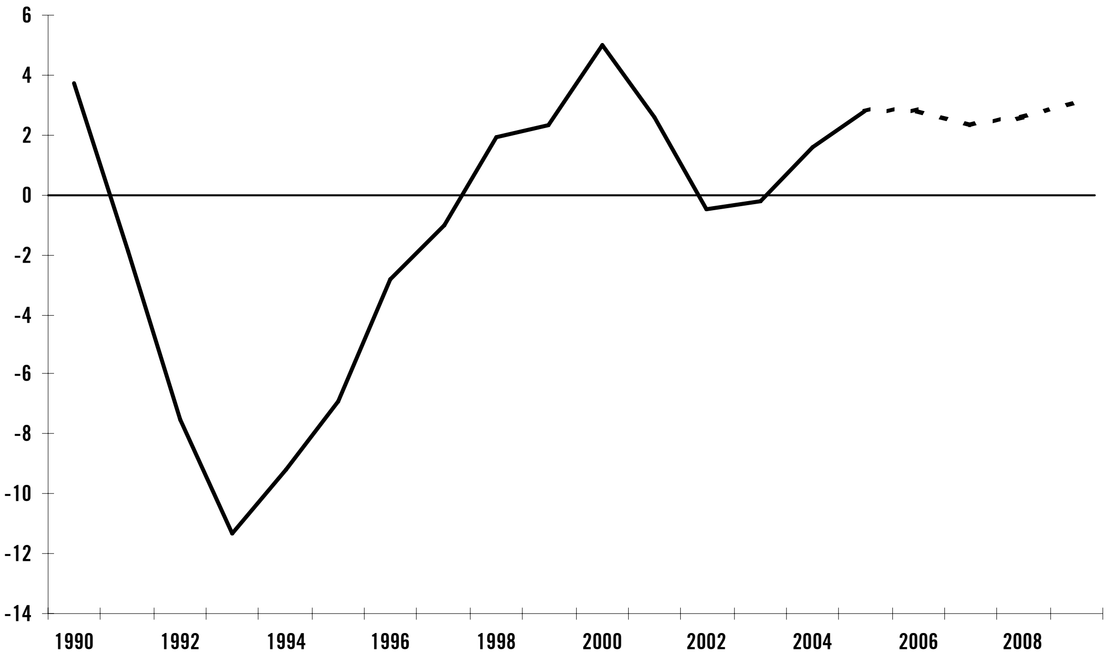
[3] In accordance with the Specifications on the Implementation of the Stability and Growth Pact. (Council 2005). The target coincides with the medium-term objective defined in the Pact, which is stated in structural terms, in the sense that accumulated net lending over a business cycle is the same as the accumulated structural balance over the same time period, apart from one-off effects which are removed from the structural balance.

[4] The maximum permissible deficit in general government net lending allowed in accordance with the EU's fiscal policy framework.

[5] Sweden's initial gross debt amounts to 46.5 per cent of GDP in 2006 and will decline in the future. In accordance with the EU commission's report "The Long-term Sustainability of Public Finances in the European Union", European Economy no 4/2006, Sweden's public finances are considered to be sustainable in the long term.

Diagram 1: General government net lending

Per cent of GDP



Note: The dashed line is the forecast in the Budget Bill for 2007.
Sources: Statistics Sweden and the Ministry of Finance.

Since 1997, a new budget process has been applied, which includes three-year nominal ceilings determined by the Riksdag for central government expenditure, including expenditure on old-age pensions.[6] The ceilings determined for the years 2007 and 2008 amount to SEK 938 billion and SEK 971 billion, or 31.2 and 30.7 per cent of GDP, respectively. This entails a downward adjustment of the previously determined ceiling for 2007 and of the previous assessment of the ceiling for 2008 of SEK 11 billion. For 2009, the government considers that an expenditure ceiling of SEK 1,003 billion, or 30.2 per cent of GDP, is a suitable level. During 2007, the government intends to determine an expenditure ceiling for 2009 and to submit a proposal for an expenditure ceiling for 2010.

In accordance with the balanced budget requirement, which was introduced in 2000, municipalities and county councils have, in accordance with the Local Government Act, a duty to draw up their budgets so that revenues exceed expenditure. Any deficit should be restored within a three-year period. As from the 2005 budget, it is possible, however, to determine a budget that is not balanced, if there are special circumstances such as major restructuring measures.

Monetary policy target

In the act regulating the status of the Riksbank, which came into force in 1999, it is laid down that the objective of monetary policy is to maintain price stability. The act also stipulates that independent monetary policy decisions are to be made by an Executive Board of the Riksbank. The Riksbank has defined the target as 2 per cent inflation

[6] Section VIII provides an account of the Swedish budget process and the fiscal policy framework.

measured by the consumer price index (CPI), with a tolerance range of ±1 percentage point. Monetary policy is also guided by various measures of underlying inflation. There is no single measure of inflation that at each given point in time always shows the monetary policy required. Monetary policy takes effect with a time lag and is normally aimed at achieving the inflation target within two years. The two-year horizon also provides scope for taking account of developments in the real economy. In exceptional cases, the Riksbank may allow inflation adjustments to take somewhat longer than two years, but this will then be clearly clarified in connection with the monetary policy decisions.

The result of the referendum in September 2003 on the introduction of the euro resulted in no changes in the monetary and exchange rate policy regime. The present regime prevails. In exchange rate policy, the government decides on the exchange rate system, while the Riksbank is responsible for practical application, such as which central rate applies in a fixed exchange rate system. Sweden's experience of the current monetary policy regime, with an inflation target and a floating exchange rate, is favourable. Pegging the Swedish krona to ERM2 is not under consideration.

III Economic policy

Budget policy

The measures proposed or announced in the Budget Bill on the expenditure and revenue sides of the central government budget lead to public finances weakening by SEK 6 billion in 2007, compared with the level in the 2006 Spring Fiscal Policy Bill, which is equivalent to 0.2 per cent of GDP (see Table 1).

On the revenue side of the central government budget, the government proposes a number of tax measures to increase the demand for and the supply of labour. These proposals include an earned income tax credit which concerns income from employment and active business activity, a reduction in employer social security contributions and self-employed social security contributions, and abolition of the tax credit for trade union dues and unemployment insurance contributions. The proposals for reforms on the budget's expenditure side mainly include measures aimed at increasing the labour supply (see Chapter VII).

Table 1: Reforms proposed for 2007 in relation to the 2006 Spring Fiscal Policy Bill

SEK billion

	2007
Revenue changes, net total	**–26**
of which	
Reduced taxes to increase labour supply	–40
Reduced taxes to increase demand for labour	–4
Other tax cuts	–10
Financing (tax increases, abolished tax allowances)	14
Reduced tax credits on revenue side of central government budget	4
Increased self-financing of unemployment insurance	10
Expenditure changes, net total	**–20**
of which	
Increased appropriations	13
Reduced appropriations	–33
Net change in public finances	**–6**

Note: Reduced appropriations mainly include reduced expenditure within labour market policy and unemployment insurance. Moreover, the Government also proposes, among other things, a reduction in the health insurance ceiling.
Source: Ministry of Finance.

Table 2 below illustrates the total budget effects (relating to the reforms coming into force on 1 January 2007) in relation to the previous year of major decided reforms, those proposed and announced in the Budget Bill or previously announced as well as their financing. The table shows that the calculated expenditure increases in some areas, such as the judicial system, dental care, communications and general grants to municipalities. Expenditure declines in other areas, such as in particular expenditure in the labour market, reflecting the substantial reduction in labour market policy measures. Expenditure decreases overall by just under SEK 1 billion, while revenue decreases by SEK 20 billion. Overall, reforms, including financing, equivalent to approximately SEK 19 billion, or 0.6 per cent of GDP, are thus proposed for 2007.

Table 2: Decided and proposed expenditure and revenue reforms for 2007

(Minus sign indicates an increase in general government tax revenues.)

SEK billion

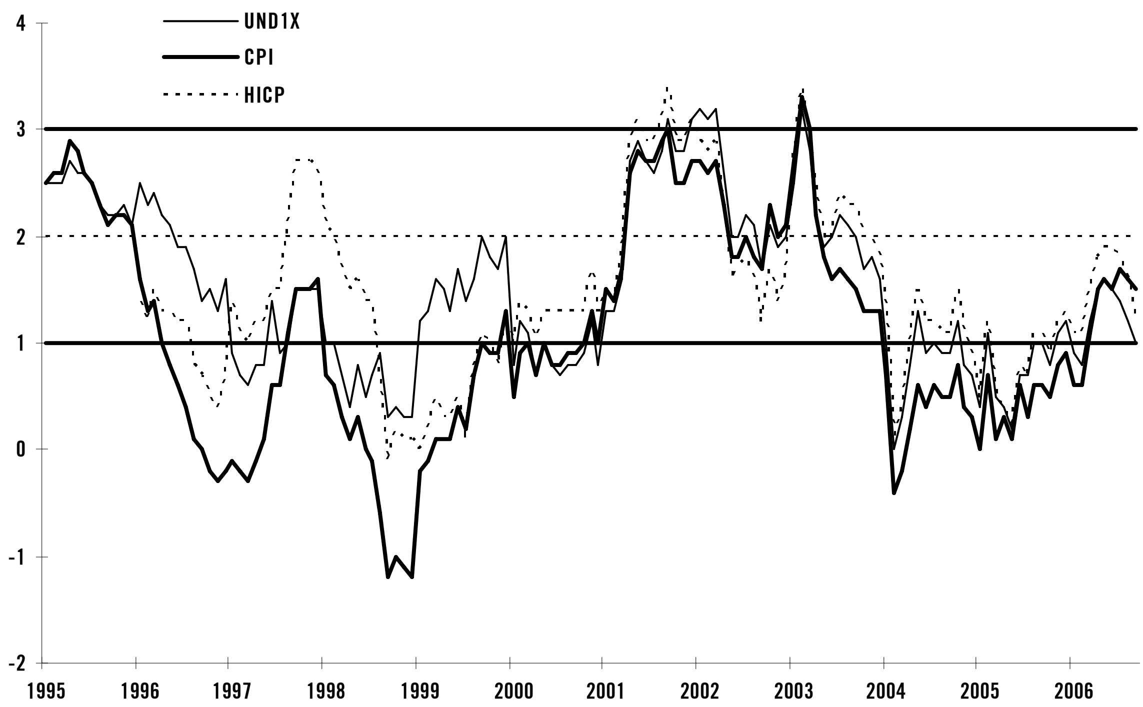
Revenue changes[1]	**20.0**
Taxes on labour	34.1
Taxes on capital	5.7
Taxes on goods and services	–1.5
Other income: unemployment insurance contributions	–10.0
Reductions of tax credits	–6.1
Other[2]	–2.1
Expenditure changes	**–0.8**
Administration and judicial system, Expenditure areas (EA) 1-4	1.2
International cooperation and development aid, EA 5 and 7	–0.5
Defence, preparedness and vulnerability, EA 6	–1.1
Migration, EA 8	–0.5
Health care and social care, EA 9	2.6
Financial security in event of illness and disability, EA 10	–3.0
Financial security for families, children and old people, EA 11-12	0.1
Labour market, EA 13	–11.3
Study allowance, EA 15	–1.0
Education, research and culture, EA 16-17	–2.7
Social planning, EA 18	–1.3
Environment, EA 20	0.2
Energy, EA 21	1.0
Communications, including loans, EA 22	2.6
Loan-funded infrastructure investment	–1.3
Agriculture, forestry and business sector, EA 23	0.8
General grants to municipalities, EA 25	12.3[3]
Other, EA 14, 19, 24 and 27	0.6
Reforms including financing	**19.2**

[1] Gross effects of rule changes in the three types of tax, accrual accounting.
[2] Indirect effects of revenue changes.
[3] Includes employment subsidies, SEK 7 billion, which are transferred from the revenue side of the central government budget to the general central government grant. Also included are tax adjustments and adjustments for the equalisation system for LSS costs.
Source: Ministry of Finance.

Monetary policy

During the period 2003–2005, the Riksbank lowered the key rate by 225 points. Weak economic activity and a weak labour market, low import prices and high productivity growth contributed to low inflationary pressure and justified the cuts to a varying degree. The most recent cut was decided in June 2005, when the Riksbank lowered the key rate by 50 points to a historic low of 1.50 per cent. This was based on the assessment that inflationary pressure would remain weak. In early 2006, the Riksbank began to tighten monetary policy and the key rate has then been raised from 1.50 per cent to 2.75 per cent. The Swedish economy is developing strongly. Since inflation has risen more than the short-term interest rate, the real key rate *ex post* has fallen somewhat since the year-end, despite the Riksbank's interest rate rises. However, inflation is still below the Riksbank's target in the autumn of 2006 (see Diagram 2). In pace with the continued strong development of the Swedish economy, a further rise in the key rate is forecast in the coming year.

Diagram 2: Inflation and the Riksbank's tolerance interval



Source: Statistics Sweden.

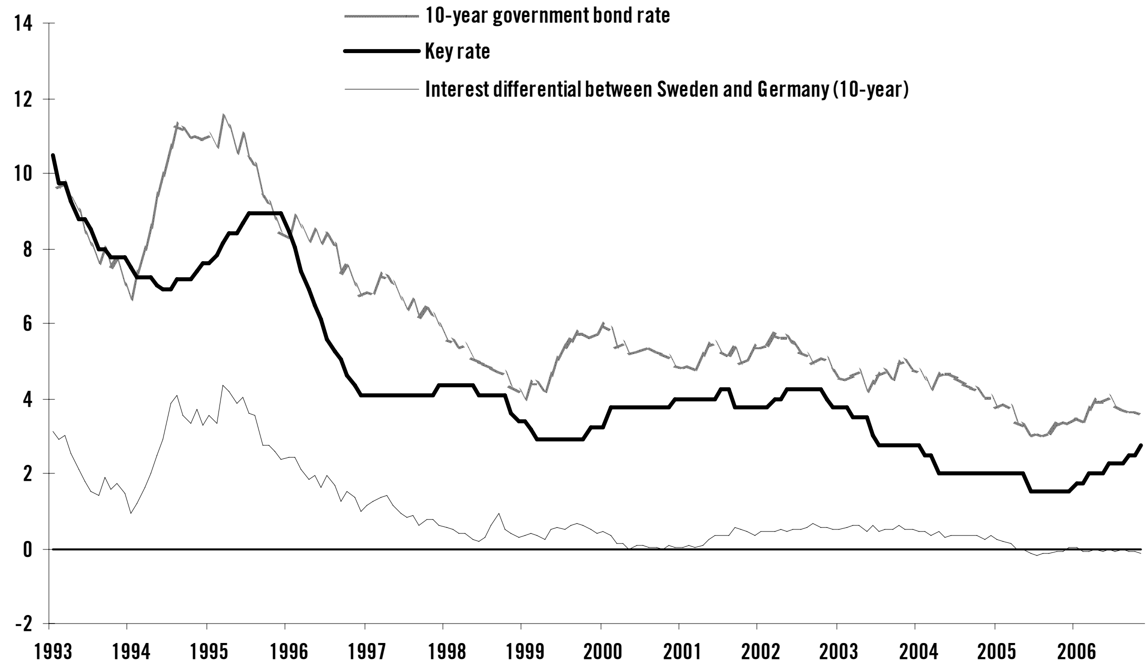
Market rates

Falling inflation and a weaker economic outlook were the main reasons for the interest rate trend during the period 2001–2005. Interest rates probably bottomed out in the autumn of 2005. The Swedish ten-year government bond yield was then below 3 per cent, following a decline of more than 1 percentage point since the year-end 2004/05. The ten-year bond yield has risen since the autumn of 2005. The trend has been in line with that of international bond yields. In the light of the strong economic activity, bond yields are, however, still at low levels.

The interest rate differential between Sweden and Germany has shown a declining trend for a long time. Stable Swedish public finances, as well as a narrowed differential between key rates in Sweden and the euro zone, have contributed to this trend. Since May 2005, the Swedish ten-year bond yield has been lower than the German equivalent, which is unusual in a historical perspective. This is mainly due to the Swedish key rate having been lower than that of the European Central Bank. But it is also partly due to the new rules and regulations for pension funds having led to an increased demand for long term Swedish bonds.[7]

Swedish bond yields are forecast to rise during 2006 and 2007 in pace with available resources in the economy declining and monetary policy tightening. Swedish bond yields are expected to rise somewhat more than German yields, when the key rate differential against the euro zone gradually narrows (see Diagram 3).

Diagram 3: Interest rates in Sweden



Source: Reuters Ecowin.

The Swedish krona

Since November 1992, Sweden has had a floating exchange rate, which means that the exchange rate is not a target variable for monetary policy. With a floating exchange rate, the value of the krona is determined, among other things, by capital flows, in addition to fundamental factors such as terms of trade and relative productivity growth. Following a considerable depreciation of the krona in 2001, which can largely be explained by financial factors, the krona began to strengthen during the autumn that same year (see Diagram 4). The krona increasingly stabilised during 2002 and exchange rate fluctuations were relatively small during 2003 and 2004. The krona weakened during 2005, which was largely a result of Swedish government bond yields and the Riksbank's key rate being lower than in the euro zone. However, the krona has strengthened against both the US

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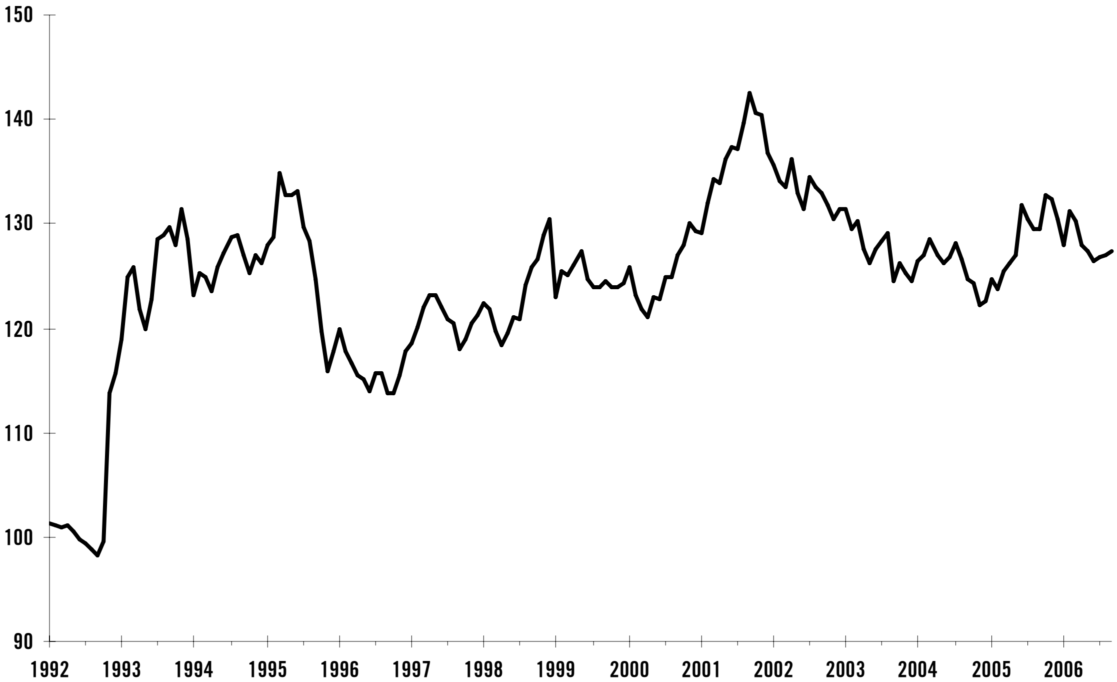
[7] The new rules and regulations for pension funds have led to an increased demand for long Swedish bonds. At the same time, Swedish central government debt is contracting and relatively small, resulting in a limited supply of long government bonds.

dollar and the euro during 2006. The anticipated interest rate differential against the rest of the world has narrowed and Swedish monetary policy is expected to tighten. The Swedish key rate is forecast to be higher than that of the European Central Bank during the course of 2007. Macroeconomic factors, such as the Swedish current account surplus, stable public finances and favourable economic growth, are then expected to determine the krona exchange rate. Overall, this indicates that the krona can continue appreciating in the future.

Diagram 4: The krona against a trade-weighted index, TCW



Source: Reuters Ecowin.

IV Forecasts and scenarios for the Swedish economy

International developments

Global growth is expected to remain high in 2006 and 2007. The US economy is forecast to slow down, while the Asian economies are forecast to continue growing rapidly and the euro zone is expected to make a recovery. Growth will be driven to a smaller extent by strong industrial activity and to an increased extent by a consumption upturn. Global GDP growth is estimated at 5.0 per cent in 2006, 4.6 per cent in 2007 and around 4 per cent in 2008 and 2009, which is in line with average growth over the past 10 years.

GDP growth in Sweden

Sweden's GDP growth was very strong during the first half of 2006, driven by strong global economic activity and high domestic demand. Growth is forecast at 4.0 per cent for the full year, which is the highest growth rate since the beginning of the decade. In 2007, growth is forecast to slow as a result of a declining growth rate for investment and exports, but this is expected to be offset to some extent by increasingly strong household consumption growth. Growth is expected to be historically high that year as well and is estimated at 3.3 per cent. In 2006 and 2007, the number of working days is fewer than in 2005 and calendar-adjusted growth will therefore to be even higher, 4.4 per cent and 3.4 per cent respectively (see Table 3). GDP growth is also expected to be favourable in 2008 and 2009.[8]

Table 3: Demand and output[1]

Annual percentage change in volume

	SEK billion 2005	2005	2006	2007	2008	2009
Household consumption expenditure	1,283	2.4	3.6	4.2	3.6	3.1
General government consumption expenditure	728	0.7	1.4	1.5	1.0	0.6
Gross fixed capital formation	455	8.5	7.2	3.3	3.6	3.6
Change in stocks[2]	2	–0.2	–0.2	0.1	0.1	0.0
Exports	1,299	6.4	8.3	6.4	6.1	5.9
Imports	1,093	7.3	7.6	7.1	6.4	6.1
GDP	**2,673**	**2.7**	**4.0**	**3.3**	**3.1**	**2.7**
GDP, calendar-adjusted	-	**2.7**	**4.4**	**3.4**	**3.0**	**2.7**

[1] 2006 and 2007 are forecast years. The years 2008 and 2009 are calculated based on the assumption that the output gap will close in 2009.
[2] Change as per cent of GDP compared with the previous year.
Sources: Statistics Sweden and the Ministry of Finance.

Foreign trade and the current account balance

Exports developed strongly during the first half of 2006. World market demand is forecast to remain high during the rest of the year and the competitiveness of Swedish firms is good, creating favourable conditions for high export growth overall in 2006. Growth is forecast to be somewhat slower in 2007, as the global demand for Swedish exports slows, while the Swedish krona strengthens. Imports are forecast to grow strongly in 2006, supported by strong industrial output, high consumption growth, small stocks and low import prices. Weaker investment growth is expected to contribute to reducing imports somewhat in 2007. The total contribution of foreign trade to GDP growth is estimated at 0.9 percentage points in 2006 and 0.2 percentage points in 2007. In subsequent years, the contribution is estimated at 0.4 per cent (see Table 4).

[8] Calculations for the medium term 2008 and 2009, are based on assessments of resource utilisation and the potential growth rate of the economy.

Table 4: Contribution to GDP growth

Percentage points

	2005	2006	2007	2008	2009
Final domestic demand	**2.7**	**3.3**	**3.0**	**2.6**	**2.3**
Household consumption expenditure	1.1	1.7	2.0	1.7	1.5
General government consumption expenditure	0.2	0.4	0.4	0.3	0.2
Gross fixed capital formation	1.4	1.2	0.6	0.6	0.6
Change in stocks	**–0.2**	**–0.2**	**0.1**	**0.1**	**0.0**
Net exports	**0.2**	**0.9**	**0.2**	**0.4**	**0.4**
Exports	2.9	4.0	3.2	3.2	3.2
Imports	–2.7	–3.1	–3.0	–2.8	–2.8
GDP	**2.7**	**4.0**	**3.3**	**3.1**	**2.7**

Sources: Statistics Sweden and Ministry of Finance.

The current account surplus amounted to 6.4 per cent of GDP in 2005, which was a decline compared with the previous year. This was due to a lower trade surplus, which was partly offset by a substantial increase in the net services balance. This year, the strong growth in exports of goods contributes to strengthening the trade balance, while the net services balance continues increasing. Next year, the surplus from trade in both goods and services is forecast to increase further. Overall, the current account surplus is estimated at 6.8 per cent of GDP in 2006 and 7.7 per cent of GDP in 2007. In 2008–2009, the current account surplus is expected to remain high.

Investment

Gross fixed capital formation has risen at an accelerating rate since 2003 and investment activity has spread to a growing share of the economy. Investment rose substantially during the first half of 2006, driven by continued high capacity utilisation and favourable financial conditions in the corporate sector. Consequently, 2006 is expected to be another strong year for investment. After that, investment growth is expected to slow down as an increasing number of firms have already expanded their production capacity, while global demand is expected to develop more slowly. Despite strong demand for housing and satisfactory profitability, housing investment is forecast to slow down, compared with the strong period 2002–2005. This is due to both higher interest rates and costs. General government investment is expected to increase at a favourable rate during the forecast period. Overall, gross fixed capital formation is estimated to increase by 7.2 per cent in 2006 and 3.3 per cent in 2007. The proposals in the Budget Bill are expected, among other things, to result in a permanently higher employment level in the long term, increasing the capital investment requirements of firms. In the medium-term estimates, investment is therefore expected to rise at a relatively rapid rate in 2008–2009.

Household consumption

Household consumption expenditure grew somewhat more strongly in 2005 than in the preceding years. This was mainly due to the improvement in the labour market. In addition, household disposable income continued rising and household real and financial assets continued appreciating.

Household disposable income is expected to increase relatively strongly during the forecast period, partly as a result of the tax relief announced in the Budget Bill in the form of an earned income tax credit, a halving of wealth tax and a freezing of real estate tax. Households also benefit from both their financial and real assets having appreciated substantially over several years. Rising interest rates will lead to higher interest expenditure for households, but the levels are nevertheless considered relatively low. Developments in the labour market, in the form of both incomes and confidence in the future and thus a propensity to consume instead of save, are important for consumption growth. Overall, household consumption expenditure is estimated to rise by 3.6 per cent in 2006 and 4.2 per cent in 2007. Consumption growth is expected to be favourable in subsequent years, as a result of continued high income growth and a strong wealth position.

Labour market and wages

The situation in the labour market has improved over the past year, but open unemployment has not fallen to the same extent as employment has risen. Total unemployment has remained largely unchanged. The conditions for continued strong developments in the labour market are favourable. GDP growth is high and indicators, such as the number of vacancies newly reported to the National Labour Market Board and hiring plans in accordance with the National Institute of Economic Research's Business Tendency Survey, suggest strong employment growth. Firms do not appear to have any general recruitment problems. Employment is forecast to rise by 1.7 per cent in 2006 and 1.5 per cent in 2007. Adjusted for calendar effects, the number of hours worked rises to almost the same extent.

Employment and the labour supply are also affected by the number of participants in labour market policy programmes. In the light of the current favourable economic situation and the high demand for labour, the Government proposes in the Budget Bill that the number of participants in such programmes should decline substantially in 2007 and 2008. Other proposed reforms to stimulate labour supply proposed are a earned income tax credit to strengthen the incentive of low and medium-income earners to work and changes in unemployment insurance. Overall, the above changes are expected to contribute to an increase in the labour supply and in the long term, in employment as well. Technically speaking, a reduction in the number of participants in labour market policy programmes has, however, a somewhat slowing effect on employment growth, since many participants are classified as employed in the statistics. Regular employment, which excludes those employed in labour market policy programmes, is therefore forecast to increase more rapidly than total employment in the coming years. Total unemployment is expected to decline continuously and is estimated at 5.8 per cent in 2009.

The low resource utilisation of the past few years has resulted in relatively low wage increases. However, resource utilisation has risen since 2005 and the 2007 wage round, which affects approximately 80 per cent of all employees, will take place in a more favourable situation for employees than the last major wage round in 2004. The agreements are therefore expected to reach a somewhat higher level this time. As a result of the broad consensus that the Industry Agreement should set the standard for subsequent agreements, however, the risk of substantially higher negotiated wage increases is considered relatively small. The Government consequently assumes responsible wage formation that takes necessary account of the economic situation. Negotiations within the framework of the Industry Agreement assume that the wage scope should be determined on the basis of the view of economic activity presented by the Economic Council for Industry, and that the export industry, which is exposed to competition, should function as a target for other industries and sectors.

Overall, wages are forecast to rise by 3.2 per cent in 2006 and 3.7 per cent in 2007. Wage growth is expected to increase in all sectors, but more rapidly in the business sector than in the general government sector. During the medium-term years 2008–2009, wages are expected to increase at around the same rate as in 2007.

Table 5: Selected statistics[1]

Percentage change, unless otherwise stated

	2005	2006	2007	2008	2009
CPI, Dec-Dec	0.9	2.6	2.3	1.7	2.1
HICP, Dec-Dec[2]	1.3	1.9	2.2	1.5	1.9
UND1X, Dec-Dec	1.2	1.8	1.7	1.5	1.9
Import price deflator	4.7	3.5	–3.0	–0.3	0.8
Export price deflator	3.3	3.0	–1.3	–0.3	0.8
GDP deflator	1.1	1.8	2.9	2.0	2.2
Increase in hourly wages[3]	3.1	3.2	3.7	3.7	3.8
Number of employed	0.8	1.7	1.5	1.0	0.6
Open unemployment[4]	6.0	5.6	5.8	5.0	4.3
Labour market policy programmes	2.7	3.1	1.9	1.4	1.5
Total unemployment	8.7	8.7	7.7	6.4	5.8
Regular employment ratio	77.4	77.7	79.0	79.8	80.2
Work productivity[5]	2.0	2.7	1.8	2.1	2.2
Current account balance[6]	6.4	6.8	7.7	7.6	7.7
Wage bill	4.1	5.0	5.3	4.9	4.6
Read disposable income	1.8	3.0	4.2	2.4	2.3
Savings ratio[7]	4.1	3.6	3.7	2.6	1.9

[1] See also Table C.1 for forecast assumptions.
[2] In 2008 and 2009, HICP is assumed to follow UND1X.
[3] Wages are on an hourly basis in accordance with the National Mediation Office's wage statistics. The definition in the National Accounts differs from that used in the National Mediation Office's wage statistics. If the definition in the National Accounts is used, wages are forecast to rise by 3.4 per cent in 2006, 3.8 per cent in 2007, 4.0 per cent in 2008 and 4.1 per cent in 2009.
[4] Per cent of labour force.
[5] Calendar adjusted.
[6] Per cent of GDP.
[7] Per cent of disposable income. Own savings, i.e. excluding saving in pension fund reserves.
Sources: The Riksbank, Statistics Sweden, the National Mediation Office and the Ministry of Finance.

Medium-term scenario

The Government Budget Bill presents forecasts for 2006 and 2007 as well as estimates for 2008 and 2009, which are based on assessments of the resource situation and the potential growth rate in the economy. The proposals announced in the Budget Bill are forecast to have significant effects on the potential labour supply, employment, unemployment, average hours worked and GDP.

In 2006 and 2007, total resource utilisation is restrained by the available resources in the labour market (see Table 6). However, resource utilisation in the labour market is expected to increase gradually and the economy is therefore estimated to reach a situation of full resource utilisation in 2009. The combination of available resources initially and a better-functioning supply side, as a result of the reforms in the Budget Bill, is forecast to lead to the strong economic development having a moderate impact on wages and prices.

Resource utilisation in the labour market is considered to be low in 2006 and despite rising GDP and employment, it is nevertheless forecast to be lower than normal in 2007. This is also illustrated by the fact that the GDP gap is forecast to be negative. As a result, both GDP and employment can increase more than the potential growth rate in subsequent years without wage and price inflationary shortages arising in the labour market. The GDP gap is expected to narrow gradually and close in 2009.

Table 6: Resource situation

Per cent of potential level

	2005	2006	2007	2008	2009
GDP gap[1]	–1.0	–0.1	–0.1	–0.2	0.0
of which					
Employment gap	–1.7	–1.1	–0.4	–0.2	0.0
Productivity gap	0.4	0.7	0.2	0.0	0.0
Gap in average hours worked	0.1	0.2	0.1	0.0	0.0

[1] The gaps are calculated as (actual-potential)/potential. The figures do not add up due to rounding.
Sources: Statistics Sweden and the Ministry of Finance.

V Public finances

Accounting principles

Reporting of general government net lending in this section as well as in the Budget Bill for 2007 follows EU regulations for the National Accounts (ESA 95). As a result, revenues and expenditures are reported in the established formats used by both the Ministry of Finance and the National Institute of Economic Research (NIER). This accounting principle is slightly different from the one used by the EU for the surveillance of public finances in connection with the Excessive Deficit Procedure (EDP) and the Stability and Growth Pact (SGP). Unlike ESA 95, these contexts include the effect of swaps on interest flows in net lending, while revenues and expenditures are defined differently.

Table 7: General government finances according to ESA 95 and EDP
Per cent of GDP

	2005	2006	2007	2008	2009
ESA 95 and BB07					
Revenue	56.3	55.6	53.6	53.1	52.8
Expenditure	53.5	52.8	51.3	50.5	49.8
Net lending	2.8	2.8	2.3	2.6	3.1
EDP and SGP					
Revenue	59.0	58.2	56.1	55.6	55.3
Expenditure	56.0	55.2	53.7	52.9	52.2
Net lending	3.0	3.0	2.4	2.7	3.1

Sources: Statistics Sweden and the Ministry of Finance.

As can be seen from Table 7, net lending is higher during the period 2005–2008 according to EDP and SGP than according to ESA 95. The effect of swaps on interest flows is positive. Revenues and expenditures according to EDP and SGP are higher than the figures presented in the Budget Bill for 2007 (BB07). This is largely because the user's fees for public services are reported on the revenue side of EDP/SGP, whereas they are reported net in general government consumption expenditure in BB07. A detailed account of general government finances in accordance with EDP is provided in Table C.2 in Appendix C.

The development of public finances

The economic upturn of the past few years has contributed to net lending strengthening. The surplus rose to 2.8 per cent of GDP in 2005, a level that is estimated to be maintained in 2006. In 2007, the surplus is estimated to decrease to 2.3 per cent of GDP. This is due partly to the proposals in the Budget Bill for 2007, which mainly comprise tax cuts, and partly to the fact that extraordinary high tax revenues from corporate profits and household capital gains in 2005 and 2006 are forecast to return to more normal levels. In the medium-term estimates for 2008 and 2009, the surpluses are estimated to increase again (see Table 8). Both general government revenue and expenditure are decreasing as a percentage of GDP. In 2005, revenue amounted to 56.3 per cent of GDP and expenditure to 53.5 per cent. These percentages are estimated to fall by 3.5 and 3.7 percentage points respectively between 2005 and 2009. During the same period, tax revenues as a percentage of GDP are estimated to fall by 3.4 percentage points to 47.4 per cent of GDP in 2009. Table 8 also shows net lending and consolidated gross debt excluding prefunded pension saving (PPS).

Table 8: General government finances

Per cent of GDP

	SEK billion 2005	2005	2006	2007	2008	2009
Revenue	**1,505**	**56.3**	**55.6**	**53.6**	**53.1**	**52.8**
Taxes and charges	1,357	50.8	50.2	47.9	47.6	47.4
Capital income	58	2.2	2.3	2.3	2.1	2.1
Other revenue	89	3.3	3.1	3.5	3.4	3.3
Expenditure	**1,430**	**53.5**	**52.8**	**51.3**	**50.5**	**49.8**
Transfer payments	578	21.6	21.2	19.9	19.4	19.0
Consumption	728	27.2	26.9	26.6	26.4	26.3
Investment	73	2.7	2.9	2.9	2.8	2.8
Interest expenditure	52	1.9	1.9	1.9	1.8	1.7
Net lending	**74**	**2.8**	**2.8**	**2.3**	**2.6**	**3.1**
Primary net lending	*68*	*2.5*	*2.4*	*2.0*	*2.3*	*2.6*
Consolidated gross debt	**1,346**	**50.3**	**46.5**	**41.5**	**37.4**	**33.0**
Net debt	**–331**	**–12.4**	**–15.4**	**–16.9**	**–18.7**	**–20.8**
Net lending excl. PPS	**48**	**1.8**	**1.8**	**1.2**	**1.5**	**2.0**
Consolidated gross debt excl. PPS	**1,361**	**50.9**	**47.0**	**42.0**	**37.9**	**33.5**

Note: The calculation of net lending excluding PPS excludes the extra transfer of funds in 2006.
Sources: Statistics Sweden and the Ministry of Finance.

Allocation of net lending between sectors

This section describes the allocation of net lending between the sub-sectors of the general government sector. A summary of net lending in other sectors (household, corporate and abroad) is to be found in Table C.4 in Appendix C. In 2006, net lending is allocated between the three areas of the general government sector, so that central government shows a deficit of 0.7 per cent of GDP, while the old-age pension system and the local government sector show surpluses equivalent to 2.8 per cent of GDP and 0.7 per cent of GDP respectively (see Table 9). The central government deficit and the temporarily high net lending in the old-age pension system are due to a double transfer of prefunded pension funds from temporary administration by the Swedish National Debt Office to the funds managed by the Premium Pension Authority. Excluding this transfer, central government shows positive net lending in 2006. In 2007, central government is estimated to show a small surplus, while the surpluses in the local government sector and the old-age pension system are expected to decrease somewhat. In 2008–2009, central government surpluses are estimated to strengthen, while the trend for weaker surpluses in the local government sector and the old-age pension system is expected to continue (see Table 9).

Table 9: Net lending and the central government budget balance
Per cent of GDP

	2005	2006	2007	2008	2009
General government sector	**2.8**	**2.8**	**2.3**	**2.6**	**3.1**
Central government	0.4	–0.7	0.1	0.6	1.4
Old-age pension system	1.9	2.8	1.7	1.6	1.3
Local government sector	0.5	0.7	0.5	0.4	0.3
Central government budget balance	0.5	–0.3	2.1	2.0	2.7
Central government debt	47.2	43.7	38.9	35.0	30.6

Sources: Statistics Sweden and the Ministry of Finance.

Net financial wealth and consolidated gross debt

At the end of 2005, financial assets exceeded liabilities by SEK 331 billion, or 12.4 per cent of GDP. The surpluses in general government net lending result in net financial wealth growing to approximately 20 per cent of GDP and contribute to reducing consolidated gross debt. Another contributory factor is the repayment of central government debt resulting from the planned disinvestments of state shareholdings. Overall, general government gross debt is forecast to decline by SEK 250 billion between 2005 and 2009 and is estimated at 33 per cent of GDP in 2009 (see Table 8 and Table C.3 in Appendix C).

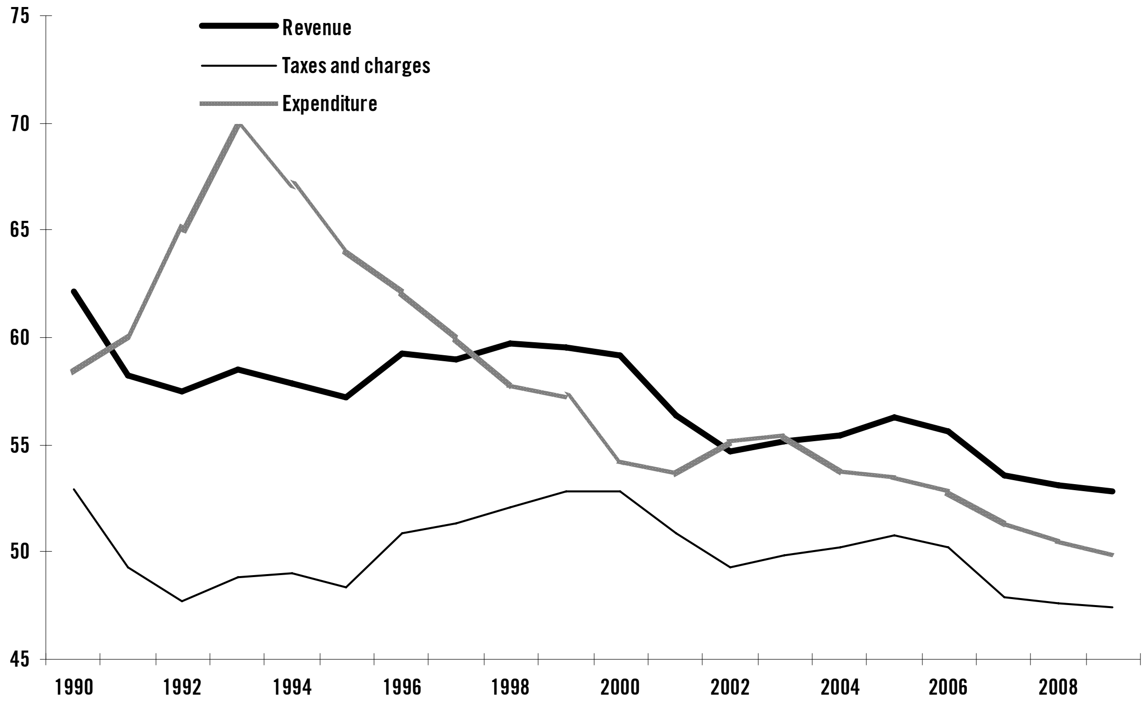
Indicators of target fulfilment and fiscal policy stance

The target of a surplus in general government net lending equivalent to 2 per cent of GDP on average over a business cycle, together with the expenditure ceilings, forms the basis of fiscal policy. An evaluation of the fulfilment of the surplus target should take into account the fact that the length of a business cycle is uncertain and may vary over time. The following section describes two types of indicators for an assessment of target fulfilment: averages over time periods and structural balances.

Average net lending since 2000

Average net lending is estimated at 2.0 per cent of GDP for the period 2000–2006. It is estimated to exceed 2.0 per cent of GDP for the period 2007–2009, amounting to 2.7 per cent of GDP on average.

Diagram 5: General government revenue and expenditure
Per cent of GDP



Sources: Statistics Sweden and the Ministry of Finance.

Public finances are affected by variations in tax revenues and expenditure over the business cycle. Together with the normally prevailing uncertainty about the business cycle, this means that surpluses in individual years can diverge from 2 per cent of GDP without the medium-term target being jeopardised.

Structural balance

In order to assess whether net lending in individual years is in line with the target, it may also be adjusted for cyclical variations in general government revenue and expenditure as well as for other temporary effects. The idea is that this adjusted net lending should reflect the underlying or structural level of net lending.

The adjustment of net lending for economic activity is based on an assessment of the economic situation and its effects on public finances. One way of describing the economic situation is the GDP gap, which is the percentage difference between actual and potential GDP. The Ministry of Finance's assessment is that a 1 percentage point change in the GDP gap has on average an impact on general government net lending of 0.7 per cent of GDP.[9] It should be emphasised that the calculation of structural lending is uncertain, since the assessment of the level and composition of potential output is

[9] A review of the level of the budget sensitivity is currently in progress and the latter may be revised during the coming year.

uncertain, and that the sensitivity of public finances to cyclical fluctuations is difficult to measure.

Table 10: Structural surplus in public finances

Per cent of GDP

	2005	2006	2007	2008	2009
Net lending	**2.8**	**2.8**	**2.3**	**2.6**	**3.1**
One-off effects	–0.4	0.0	0.0	0.0	0.0
Extraordinary capital taxes	–0.3	–0.4	0.0	0.0	0.0
Adjustment for GDP gap	0.7	0.1	0.1	0.1	0.0
Structural balance	**2.7**	**2.4**	**2.4**	**2.7**	**3.1**
Net capital income	–0.2	–0.4	–0.4	–0.3	–0.5
Structural primary balance	**2.5**	**2.0**	**2.0**	**2.4**	**2.7**
GDP gap	–1.0	–0.1	–0.1	–0.2	0.0

Sources: Statistics Sweden and the Ministry of Finance.

Since 2000, structural lending has both exceeded and fallen below 2 per cent of GDP and is estimated at 2.4 per cent in 2006. Resource utilisation in the economy, measured as the GDP gap, is expected to be largely unchanged between 2006 and 2007. The GDP gap is close to zero both years. Structural lending is estimated at 2.4 per cent of GDP in 2007 as well. The assessment is that it will then increase in 2008 and 2009 (see Table 10) in pace with actual net lending strengthening.

Fiscal policy in line with target

Overall, the indicators show that fiscal policy is in line with the target of a surplus equivalent to 2 per cent of GDP on average over a business cycle.

Fiscal policy stance 2006–2009

The annual changes in net lending measure the general government sector's *impulse* to demand in the private sector, but are only a rough indicator of the effects of public finances on demand in the economy. The changes in net lending between years can in turn be divided into two factors affecting the balance: *the automatic stabilisers* and the change in *structural balance*. The latter is an indicator of fiscal policy stance. This indicator not only includes decisions on reforms and economies in the central government budget, but also other factors affecting the balance, such as structural changes in the economy. Changes in general government net lending consequently comprise the total of these two components.

Since structural balance is largely constant between 2005 and 2006, the fiscal policy stance remains unchanged. The economic upturn leads to the GDP gap narrowing, which results in the automatic stabilisers operating in a tightening direction. Overall, general government net lending remains unchanged between 2005 and 2006 (see Table 11).

Table 11: Indicator of effects on demand

Change in per cent of GDP

	2005	2006	2007	2008	2009
General government net lending	**1.2**	**0.0**	**–0.5**	**0.3**	**0.5**
Automatic stabilisers	0.0	0.7	0.0	0.0	0.1
One-off effects	–0.1	–0.4	0.0	0.0	0.0
Extraordinary capital taxes	0.4	0.1	–0.4	0.0	0.0
Structural balance	**0.8**	**–0.3**	**–0.1**	**0.4**	**0.4**
GDP gap, change in percentage points	*–0.1*	*1.0*	*0.0*	*–0.1*	*0.2*

Sources: Statistics Sweden and the Ministry of Finance.

The fiscal policy stance also remains unchanged between 2006 and 2007. However, general government net lending weakens somewhat, which is due to previous exceptionally high tax revenues from capital gains being forecast to decline to a more normal level.

VI Alternative scenarios and comparison with the updated programme for 2005

Alternative scenarios

There is considerable uncertainty regarding assessments of future economic development. This is due not least to difficulties in assessing the extent of the long-term effects of the government's policy. Two alternative scenarios are presented below, which illustrate the effects on the real economy and public finances, if development differs from the base scenario. Sensitivity estimates for net lending in the event of changes in GDP, interest rates and the exchange rate were presented in the updated convergence programme for 2005, Chapter VI. In the *high-growth scenario*, the government's policy is assumed to have a larger impact on supply than in the base scenario. The labour supply increases more, while wage growth and inflation are lower than in the base scenario.

Table 12: Key statistics for alternative scenarios

Percentage change, unless otherwise stated

	2007			2008			2009		
	Base	Low	High	Base	Low	High	Base	Low	High
GDP	3.3	3.3	3.5	3.1	2.5	3.5	2.7	1.9	3.1
GDP gap[1]	–0.1	1.1	–0.1	–0.2	0.6	–0.2	0.0	0.0	0.0
Regular employment ratio, aged 20–64[2]	79.0	79.0	79.1	79.8	79.3	80.3	80.2	79.0	81.0
Open unemployment, level	5.8	5.8	5.7	5.0	5.4	4.6	4.3	5.6	3.6
Total unemployment, level	7.7	7.7	7.6	6.3	6.8	5.9	5.8	7.1	5.1
Repo rate, closing rate	3.75	4.50	3.25	3.75	4.50	3.25	4.00	4.00	4.00
Hourly wages	3.7	4.3	3.2	3.7	4.4	3.2	3.8	4.4	3.2
CPI, annual average	2.5	2.8	2.3	2.0	2.6	1.7	1.9	2.5	1.6
General government net lending, per cent of GDP	2.3	2.3	2.3	2.6	2.4	2.7	3.1	2.5	3.5

[1] Difference in per cent between actual and potential output.

[2] Number of employed aged 20–64, excluding those employed in labour market policy programmes, as a percentage of the population in that age group.

Sources: The Riksbank, Statistics Sweden, the National Mediation Office and the Ministry of Finance.

Stronger employment growth and lower inflation lead to household real disposable income developing more strongly than in the base scenario, despite lower wage growth. Moreover, interest rates are assumed to be lower. Consequently, household consumption increases more rapidly.

Public finances strengthen markedly in the high-growth scenario. The hourly wage development is lower than in the base scenario, while the number of hours worked is higher, which overall results in a largely unchanged wage bill. Direct taxes from households and social security contributions therefore reach the same level as taxes in the base scenario. VAT revenue is higher. Public finances also strengthen as a result of lower expenditure. Lower wage increases result in lower expenditure on general government consumption and on household transfer payments that are dependent on the hourly wage development, such as sickness benefit. Expenditure that is assumed to be adjusted for the price trend also declines as a result of lower inflation. Overall, the expenditure ratio falls more markedly than the tax ratio, resulting in stronger public finances than in the base scenario.

In the *low-growth scenario*, the labour market and wage formation are assumed to function less well than in the base scenario. The effects of the government's policy to increase the labour supply and employment are assumed to be delayed. Consequently, shortages in the labour market that increase wage growth and inflation arise in the low-growth scenario. Inflation is higher, but does not increase to the same extent as wages. Wage growth slows in 2009, but wages still rise more than is consistent with balanced development.

Public finances weaken close to 0.6 per cent of GDP in 2009 in the low-growth scenario. In nominal terms, general government revenue increases as a direct consequence of the increase in hourly wages and tax bases, but this does not, however, offset the weakening of public finances resulting from expenditure increases. The latter have a number of underlying causes. Among household transfer payments, some types of transfer payments, such as supplementary housing benefit for pensioners and child benefit, are assumed to change in pace with inflation and consequently remain unchanged in real terms between the years. The higher inflation in the low-growth scenario is therefore assumed to result in increased expenditure on this type of transfer payment. Other transfer payment expenditure, such as sickness benefit and unemployment benefit, increases in the low-growth scenario as a result of the higher wage growth. In addition, expenditure linked to unemployment increases as a result of the rise in unemployment. General government consumption expenditure also increases sharply as a result of rising wages.

Comparison with the updated programme for 2005

Table 13 compares the current convergence programme with the updated programme for 2005. GDP growth in 2005 was 0.3 percentage points higher than stated in the previous year's programme. The GDP growth forecast has been revised upward by 0.9 percentage points for 2006 and 0.5 percentage points for 2007.

Net lending in 2005 was 1.4 percentage points stronger than forecast in the convergence programme for 2005. The stronger outcome for net lending was largely due to unexpectedly high revenue from corporate and capital taxes. Only a small part of the deviation from the forecast for net lending was due to stronger macroeconomic development than forecast. The net lending forecast has been revised upward by 2.1 percentage points for 2006 and 1.2 percentage points for 2007. Consolidated gross debt in 2005 was 0.6 percentage points lower than forecast in the previous updated programme. Gross debt is forecast to be 2.9 percentage points lower for 2006 and 6.3 percentage points lower for 2007 than in the previous programme.

Table 13: Comparison with the updated convergence programme for 2005

	2005	2006	2007	2008	2009
GDP, percentage change in volume					
Updated convergence programme for 2005	2.4	3.1	2.8	2.3	–
Updated convergence programme for 2006	2.7	4.0	3.3	3.1	2.7
Difference, percentage points	0.3	0.9	0.5	0.8	–
Net lending, per cent of GDP					
Updated convergence programme for 2005	1.4	0.7	1.1	1.6	–
Updated convergence programme for 2006	2.8	2.8	2.3	2.6	3.1
Difference, percentage points	1.4	2.1	1.2	1.0	–
Consolidated gross debt, per cent of GDP					
Updated convergence programme for 2005	50.9	49.4	47.8	46.0	–
Updated convergence programme for 2006	50.3	46.5	41.5	37.4	33.0
Difference, percentage points	–0.6	–2.9	–6.3	–8.6	–

Sources: Statistics Sweden and the Ministry of Finance.

VII Quality in public finances and structural policy

In recent years, the importance of quality in public finances has been increasingly emphasised in Sweden as well as the rest of the EU. In Sweden, general government expenditure accounts for just over 50 per cent of GDP, while other EU member states also have high general government expenditure. Government-funded welfare services will increase as a result of the demographic trend and rising revenues. Increased quality requirements in general government activities, such as care and schooling, may be expected. In order to meet this increased demand, general government funds need to be utilised effectively and the joint resources created today need to bolster the economy for future challenges.

This chapter shows firstly how Swedish general government expenditure developed during the period 1995–2004, analysed according to the allocation of expenditure between different purposes. Secondly, the structural reforms proposed and announced by the Government in the Budget Bill for 2007 are presented.

Quality in public finances

The EU is currently in the process of compiling uniform statistics on the allocation of public finances by each member state. Uniform statistics enable cross-country as well as intertemporal comparisons of the general government expenditure. In order to evaluate whether a change in the composition of general government expenditure has affected long-term growth, further and more detailed information is required. However, the allocation of general government expenditure between different purposes and the change in allocation over time provide an indication of how different types of expenditure and purposes are prioritised.

Table 14: General government expenditure by purpose
Per cent of GDP

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Change 1995–2004
General public administration	12.0	11.7	12.0	11.0	10.2	10.2	8.7	9.1	8.2	7.6	–4.4
interest	6.6	6.5	6.2	5.4	4.7	4.0	3.0	3.2	2.4	1.9	–4.6
other	5.4	5.2	5.8	5.7	5.6	6.2	5.7	5.9	5.9	5.7	0.2
Defence	2.5	2.5	2.4	2.4	2.4	2.4	2.2	2.1	2.1	1.9	–0.5
Social responsibility and judicial system	1.4	1.4	1.4	1.4	1.4	1.3	1.4	1.4	1.4	1.4	–0.1
Economic issues and economic policy	6.0	4.9	4.5	4.6	4.9	4.1	4.4	4.8	4.9	4.8	–1.2
Environmental protection	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.2
Provision of housing and social planning	2.8	2.6	2.0	1.7	1.3	0.9	1.0	0.9	0.9	0.8	–2.0
Health and medical care	6.3	6.6	6.3	6.3	6.4	6.3	6.7	7.0	7.2	7.0	0.7
Leisure, culture and religion	1.9	1.9	1.8	1.8	1.8	1.1	1.1	1.1	1.1	1.0	–0.8
Education	7.1	7.0	7.1	7.4	7.5	6.8	7.2	7.4	7.3	7.4	0.3
Social security	26.9	25.9	24.7	23.4	23.7	23.5	23.5	23.7	24.7	24.3	–2.6
Total expenditure	**67.1**	**64.8**	**62.5**	**60.3**	**59.8**	**56.8**	**56.5**	**57.9**	**58.2**	**56.7**	**–10.4**
excluding interest	60.5	58.4	56.3	54.9	55.1	52.8	53.5	54.7	55.8	54.8	–5.8

Sources: Statistics Sweden and the Ministry of Finance.

It may be stated that expenditure on social security in Sweden accounts for one-quarter of general government expenditure as a percentage of GDP and just over 40 per cent of total expenditure. Moreover, it has risen as a percentage of total expenditure. Expenditure on health and medical care also accounts for a significant percentage of total expenditure and has shown the highest increase.

Table 15: Distribution of general government expenditure
Per cent of total expenditure

	1995	1997	1997	1998	1999	2000	2001	2002	2003	2004	Change 1995–2004
General public administration	17.9	18.1	19.2	18.3	17.1	18.0	15.5	15.7	14.1	13.4	–4.5
interest	9.8	10.0	9.9	8.9	7.8	7.1	5.4	5.6	4.0	3.4	–6.4
other	8.1	8.1	9.3	9.4	9.3	10.9	10.1	10.1	10.1	10.0	1.9
Defence	3.7	3.9	3.9	4.0	4.1	4.2	3.9	3.7	3.6	3.4	–0.3
Social responsibility and judicial system	2.1	2.2	2.2	2.3	2.3	2.3	2.4	2.5	2.5	2.4	0.3
Economic issues and economic policy	9.0	7.5	7.2	7.6	8.1	7.2	7.8	8.3	8.5	8.5	–0.5
Environmental protection	0.3	0.3	0.3	0.3	0.3	0.5	0.6	0.6	0.6	0.6	0.4
Provision of housing and social planning	4.2	4.1	3.3	2.9	2.2	1.6	1.7	1.5	1.5	1.5	–2.7
Health and medical care	9.4	10.1	10.2	10.4	10.6	11.0	11.9	12.1	12.4	12.4	2.9
Leisure, culture and religion	2.8	2.9	2.9	3.0	3.0	1.9	2.0	1.9	1.9	1.8	–1.0
Education	10.6	10.8	11.4	12.4	12.5	12.0	12.7	12.8	12.6	13.1	2.5
Social security	40.1	40.0	39.5	38.9	39.7	41.3	41.6	41.0	42.4	43.0	2.8
Total expenditure	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	
excluding interest	90.2	90.0	90.1	91.1	92.2	92.9	94.6	94.4	96.0	96.6	6.4

Sources: Statistics Sweden and the Ministry of Finance.

Structural reforms

Economic policy strategy for growth and employment

One of the government's most prioritised issues during this term of office is the labour market. An increase in the labour supply, increased employment, reduced unemployment and an increase in the number of hours worked in the business sector are central to promoting economic growth, meeting the demographic challenge and increasing the long-term sustainability of public finances. The Government has proposed a number of structural reforms to achieve this. Further, the Government proposes a number of measures to increase the effectiveness of the utilisation of general government funds. For a more detailed account of the reform programme, see Sweden's Reform Programme for Growth and Jobs.

The following section describes the government's measures to increase employment in particular within the scope of labour market policy, tax policy education policy and entrepreneurship.

Labour market

Labour market policy should contribute to enabling people to move from one job to another as quickly as possible, or from unemployment to a job in the regular labour market.

- The Government intends to introduce "new-start jobs" as from 1 January 2007 in the form of a subsidy to the employer, to increase the opportunities of those far outside the labour market to return to work. New-start jobs entail an amount equivalent to the employer social security contribution being deducted for those who have been unemployed, participated in labour market policy programmes or received support in the form of sickness benefit or sickness and activity compensation full time for more than a year. New-start jobs are estimated to include approximately 10,000 people on average per month during 2007, which is estimated to increase tax expenditure by SEK 697 million that year.

- Change in unemployment insurance:
    - Self-financing of unemployment insurance is to increase by SEK 10 billion.
    - The increased benefit during the first 100 benefit days is to be abolished.
    - The right to benefit during study vacations is to be abolished.
    - The work condition is to be tightened.
    - The study condition is to be removed.
    - Benefit is to be based on income for the past 12 months instead of 6 months.
    - Benefit is 80 per cent of lost income during the first 200 days and 70 per cent up to 300 days (450 for unemployed people with dependents). When the benefit period is over, the unemployed person is transferred to a job and development guarantee with 65 per cent benefit. The maximum benefit is

SEK 680 per day. This stepped construction increases the incentive structure of unemployment insurance.
- Work is in progress to tighten the application of the unemployment benefit rules.
- The changes in unemployment insurance rules are estimated to reduce expenditure by approximately SEK 3.7 billion. Revenue is estimated to increase by approximately SEK 10 billion as a result of increased self-financing.

- Labour market policy resources should prioritise matching job applicants to vacancies, increased competition in recruitment services and improved control.
- The number of people in labour market policy programmes is to be reduced by 52,000 in 2007 and several measures are to be abolished, such as the sabbatical year. This change is estimated to reduce expenditure by approximately SEK 7.2 billion.
- Labour market training should focus on strengthening the unemployed person's competence and concentrate on areas with a labour shortage in a national and regional perspective.
- In 2007, the Government intends to introduce a job and development guarantee for the long-term unemployed and a special job guarantee for young people.

Tax policy

Over the next few years, tax policy will focus on making it more profitable to work, strengthening the labour supply and promoting the demand for labour and the growth of new enterprises. The following tax reforms may be mentioned:

- An earned income tax credit from employment will be introduced on 1 January 2007 for those with jobs, strengthening the incentive of in particular low and medium-income earners to work. This reduction is larger for those aged 65 and over. The tax relief will reduce income tax by in the region of SEK 40 billion in 2007.
- In order to promote the employment of older people, the payroll tax of approximately 16 per cent is abolished for pensioners born in 1938 and later. In order to facilitate the entry of young people into the labour market, a special allowance when calculating employer social security contributions for those aged 19 to 24 will be introduced as from 1 July 2007.
- A tax credit for the purchase of household services by private individuals is intended to be introduced as from 1 July 2007.
- The 3:12 rules for close companies are to be reformed. The standard amount in the simplification rule is increased and the scope for capital-taxed income based on the wage bill is broadened.
- Wealth tax is to be phased out during the term of office. The tax rate is halved as a first stage. Single-family dwellings and owner-occupied apartments are excluded from this reduction at this stage.
- Co-financing by the employer after the employee's second week of sick leave is abolished.

Education

Sweden needs a well-educated labour force to meet international competition and create economic growth and increased prosperity. Initiatives are being taken throughout the education chain, with the aim of strengthening the whole knowledge society.

- Increased resources for the further training of teachers and reforms to facilitate the validation and supplementary training of unqualified teachers. These initiatives are equivalent to a total of SEK 410 million in 2007.
- A review is to be carried out of all targets in the nine-year compulsory school. National goals related to skills in the Swedish language are to be introduced from year 3 and checkpoints are to be introduced in years 3, 5 and 8 with compulsory national tests.
- Grading criteria are to be reviewed with the objective of awarding marks earlier and in several stages.
- The government's proposal for increased resources for research results in an increase in research grants for the next three-year period of SEK 900 million.
- In order to guarantee the independence and integrity of universities and university colleges, the procedure for the appointment of university senates is to be reviewed and the senates are to be depoliticised.
- The Government intends to return with a proposal for changes in upper secondary education, including a new apprentice training programme.

Entrepreneurship

In the Budget Bill, the Government proposes a number of measures to promote entrepreneurship. These measures aim to make it more profitable to hire staff, improve the capital provision of enterprises and cut their administrative costs by reducing complicated rules and bureaucracy.

Measures proposed to increase the demand for labour, such as abolished employer contributions for certain services and tax-deductible household services, aim to promote the development of existing firms in the private service sector.

During its term of office, the Government also intends to make it easier to start up and operate firms in the welfare sector.

Other

Good management of the joint resources entails *counteracting overutilisation and fraud* in the tax and benefit systems and *increasing the efficiency of the general government sector*. The Government is announcing a number of measures to reduce fraud and overutilisation in the tax and benefit systems. The Government also proposes the closure of a number of governmental agencies and a review of the whole structure of public administration, in order to reduce central government bureaucracy.

Health insurance should function as a safety net and as a support for a return to work. A reduction in the health insurance ceiling is proposed. The Government intends to review how a more active rehabilitation for a return to work can be structured.

The Government also intends to propose changes aimed at *increasing the diversity of players in the care and education sectors*. As a result, efficiency can increase and the development of supervisory and production forms can be accelerated. This will also lead to increased quality and greater choice for the individual as well as improving the opportunities for increased female enterprise. The Government proposes increased resources for business advice to female entrepreneurs and research on female enterprise.

VIII The budget process and the fiscal policy framework

In the mid-1990s, the Swedish budget process was reformed. The reform involved both the formulation of the national budget proposal and the process with which the Riksdag (Swedish Parliament) approves the central government budget. Follow-ups of passed central government budgets were also improved.

A key characteristic of the budget process—in both the Government and the Riksdag—is the fact that it is a top-down process. Government drafting starts from the targets of budget policy and its limitations. The Swedish Riksdag has accepted the government's medium-term target regarding a surplus in general government net lending equivalent to 2 per cent of GDP on average over a business cycle. The most important limitation is the rolling multi–year expenditure ceilings for central government expenditure that is set three years in advance for central government expenditure.

The expenditure ceiling is expressed in nominal terms for each of the next three years. This means that the following year always has an expenditure ceiling which was decided earlier and thus governs the budget process. The expenditure ceiling constitutes a limitation during the drafting of the central government budget and the implementation of the approved budget. As a consequence, budget follow-ups are very thorough. When required, steps are taken to keep expenditure under the agreed ceiling.

The expenditure ceiling encompasses central government expenditure—except expenditure for national debt interest payments—and expenditure related to the pension system outside the central government budget. It covers approximately two-thirds of all consolidated general government expenditures. Cyclical expenditure, such as expenditure for labour market policy programmes and unemployment insurance, is included. Variations in such expenditure are to be covered by the margin between the expenditure ceiling and agreed expenditure. Alongside the expenditure ceiling, there are interest rates for central government debt which the government cannot influence in the short term. Local government and county councils are largely financial autonomous and their expenditures are not affected by expenditure ceiling for the central government.

Based on the previous decided expenditure ceiling and the net lending target, the government distributes the total expenditure into 27 areas according to political priorities. The expenditures are then allocated by appropriation amount. There are a total of approximately 490 appropriation amounts. This constitutes a clear top-down procedure.

The Riksdag determines the expenditure ceiling for year t+3 [10] and the size of each of the 27 expenditure areas for year t+1. This decision includes the estimation of central government revenue for year t+1. Having been drafted by the Standing Committee on Finance, this decision determines the main outline of the central government budget. The task of the standing committees in parliament is to allocate the funds by appropriation amount in the various expenditure areas with the restriction that the limitations decided by the parliament may not be exceeded. The decision-making process is also characterised by a clear top-down procedure.

The legal framework for the budget process can be found in the constitution, the Riksdag Act, and the State Budget Act.

Expenditure ceilings

Multi-year expenditure ceilings for the central government are an important budget policy undertaking for the Riksdag and the government, and promote the credibility of the economic policy. They contribute to good budgetary discipline and support the surplus target, which is defined as net lending which on average correspond to 2 per cent of GDP over an economic cycle.

Expenditure ceilings contribute to good budgetary discipline by preventing temporarily higher income from being used to finance permanently higher expenditure. The expenditure ceiling for the central government also clarifies the need for setting priorities among expenditure areas, and prevents a development in which the tax rate has to be raised due to inadequate control of expenditure. The rest of the world also gains greater confidence in the Swedish budgetary policy because of the expenditure ceilings.

Table 16: Expenditure ceiling adjusted for technical changes
SEK billion

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Expenditure ceiling, SEK billion	**702**	**699**	**714**	**723**	**749**	**773**	**803**	**836**	**870**	**907**	**938**	**971**	**1,003**
per cent of GDP	37.2	35.4	34.4	32.9	33.0	32.9	32.9	32.5	32.5	32.1	31.2	30.7	30.2

Note: Expenditure ceiling adjusted for changes based solely on a technical redefinition of the composition of public finances, and which therefore are neutral for aggregate public expenditures and net lending.
Source: Ministry of Finance.

Since the system was implemented the expenditure ceiling has been met every year. However, measures have been taken that entailed a worsening of net lending, but were not charged against the expenditure ceiling. Such measures include tax expenditures and net budgeted expenditures. In addition to the fact that the expenditure ceiling's actual

[10] Certain years, however, the expenditure ceiling was only determined for year t+2.

restriction decreased to some extent, this procedure could lead to questioning of the credibility of budgetary policy. The expenditure ceiling is an important tool for ensuring sustainable public finances. The Government therefore took measures in the Budget Bill for 2007 to strengthen the ability of the expenditure ceiling to limit expenditures by proposing a reduction of certain tax expenditures which constitute a close substitute for direct expenditures (see table 17).

Table 17: Expenditures posted as tax credits on the income side of the budget

SEK billion

Budget year	Outcome 2004	Outcome 2005	Forecast 2006	2007	2008	2009
Tax credits	**–7.7**	**–13.6**	**–14.7**	**–7.8**	**–4.0**	**–2.4**
Employment support	–2.1	–3.2	–3.4	–2.1	–1.5	–1.5
Energy investments in public premises	0.0	0.0	–0.3			
Inv. waste sorting facilities	0.0	0.0	–0.1	–0.3	–0.1	0.0
Bonus jobs	0.0	0.0	–1.7	–3.8	–1.5	–0.1
Educational leave replacement positions	0.0	0.0	–0.2	–0.1	0.0	0.0
Public sheltered employment	–0.8	–0.7	–0.8	–0.8	–0.8	–0.8
Employment support regional governments, county councils	–4.4	–8.8	–7.0	0.0	0.0	0.0
Training of healthcare and social services personnel	0.0	–0.4	–0.3	–0.3	0.0	0.0
Broadband installation	–0.4	–0.5	–0.6	–0.2	0.0	0.0
Support for conversion from direct electric heating	0.0	0.0	–0.2			
Support for conversion from oil heating systems	0.0	0.0	–0.2	–0.3	0.0	0.0

Note.: Figures are rounded off and do not always sum up to totals.
Source: Ministry of Finance.

The Government also intends to return in the 2007 Spring Fiscal Policy Bill with an overview of the budget policy framework. In part, the purpose to increase the transparency of the fiscal policy and thus promote credibility for the total economic policy. The medium-term budget perspective is an essential component for ensuring long-term sustainable government finances, and the expenditure ceilings should usually be determined for the coming three years. The Government has departed from the principle of three-year expenditure ceilings on several occasions in recent years. The Government has now determined that it is essential to return to a medium-term budget perspective based on three-year expenditure ceilings. The Government intends to propose in 2007 an expenditure ceiling for 2009 and also to put forward a proposal for expenditure ceilings for 2010.

Balance target

The target for net lending pertains to the entire general government. It was determined in 1997 and has been in force since 2000. This target requires consolidated general government net lending to be 2 per cent of GDP on average over a business cycle. The target is defined in ESA95-terms.

A surplus of 2 per cent means that the central government debt can decrease as a percentage of GDP at the same time that assets are built up in the form of funds in the national pension system. A surplus in government net lending means that buffers are created to handle future demographic strains on the public welfare system It also allows for a reasonable distribution of taxes and benefits among the generations and provides a satisfactory margin to the deficit limit of 3 per cent of GDP in the EU's Stability and Growth Pact.

Net lending varied markedly between 2000 and 2006, but on average the surplus is calculated to be 2 per cent of GDP. Over the next few years the surplus is expected to be just over 2 per cent of GDP. Most years, the structural balance has been close to 2 per cent of GDP, with the exception of 2002 and 2003, when fiscal policy was clearly expansionary. For the next few years, the structural balance is expected to be over 2 per cent of GDP (see table 18).

Table 18: General government net lending

Per cent of GDP, unless stated otherwise

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Net lending, SEK billion	**110**	**60**	**–11**	**–4**	**41**	**74**	**80**	**70**	**82**	**102**
Net lending	5.0	2.6	–0.5	–0.2	1.6	2.8	2.8	2.3	2.6	3.1
Temporary effects	–0.5	0.0	0.0	0.0	–0.5	–0.4	0.0	0.0	0.0	0.0
Adjustment for economic situation, etc.	–2.6	–0.5	0.4	1.1	0.8	0.4	–0.4	0.0	0.1	0.0
Structural surplus/deficit	1.8	2.1	–0.1	1.0	1.9	2.7	2.4	2.4	2.7	3.1
Net lending, average from 2000	5.0	3.8	2.4	1.7	1.7	1.9	2.0	2.1	2.1	2.2
Output gap, per cent	*2.5*	*0.6*	*–0.2*	*–1.3*	*–1.0*	*–1.0*	*–0.1*	*–0.1*	*–0.2*	*0.0*

Note: The structural balance is calculated by adjusting net lending for the economic situation and temporary effects. An adjustment is also made for income from extraordinary capital gains.
Sources: Statistics Sweden and Ministry of Finance.

Framework for production of statistics

Sweden

The Riksdag decided in the Official Statistics Act (2001:99) that official statistics shall be available in Sweden for general information, investigatory activities and research. The Government decides in the Official Statistics Ordinance (2001:100) on the areas in which official statistics shall be produced and which authorities shall be responsible for the statistics. Under this ordinance Statistics Sweden is responsible, among other things, for sector-based statistics. Moreover, the authority responsible for statistics determines which studies should be conducted in consultation with important statistics users and taking EU requirements into account.

The ordinance (1988:137) with instructions for Statistics Sweden states, that Statistics Sweden shall be responsible for coordination of central government statistics production and promote coordination between government and other production of statistics. The ordinance also stipulates that Statistics Sweden shall have a Council for Official Statistics. The Council consists of a chairperson and six other representatives, who are managers of the statistical authorities. Statistics Sweden's Director General is the chairperson of the Council.

Within the framework of activities in the Council for Official Statistics criteria for "adequate quality" in the official statistics have been formulated and adopted by the council. Each statistical authority undertakes to comply with the criteria for adequate quality with respect to official statistics. The criteria address issues such as user contacts, that EU ordinances are followed, relevant standards and scientific methods are used, the burden of the person providing the information burden be considered, and quality studies are conducted.

EU

In February 2005, the Statistical Programme Committee (SPC), which consists of the heads of Member States' national statistical offices and with the head of Eurostat as its chairperson) unanimously adopted the European Statistics Code of Practice (CoP). It includes 15 principles divided into three sections: Institutional Environment, Statistical Processes and Outputs. The idea is that if the EU countries work in compliance with these principles, the CoP will strengthen the statistics system and ensure the quality of the statistics. Eurostat will submit a final report on the implementation of the CoP to EKOFIN in March 2008. The implementation plan includes activities in Member States such as self-assessment based on a standardised survey, initiatives involving several development projects and implementation of peer review.

The implementation of the CoP in Sweden has been carried out in several steps. Statistics Sweden conducted a self assessment in autumn 2005. Information on CoP and Statistics Sweden's work with this project has been distributed on several occasions to other authorities that provide statistics to the EU. A peer review will preliminarily be conducted at Statistics Sweden in March 2007. The two other authorities in Sweden that deliver the most data to Eurostat—the Swedish Institute for Transport and Communications Analysis and the Swedish Board of Agriculture—will also conduct a self assessment as a basis for this peer review. In addition to the authorities mentioned above, fourteen other authorities in Sweden provide data to Eurostat. Statistics Sweden has also encouraged these authorities to audit their organisations and their statistics production process by conducting a self assessment.

IX. Sustainability of public finances

In Sweden, as in most other western industrialised countries, the proportion of older people in the population will rise substantially over the next few decades. An increased number of people of non-working age in relation to those of working age will put pressure on tax-funded welfare systems. This trend is already placing demands on economic policy today. In order to retain well-developed and tax-funded welfare in the future, high net lending is required in the general government sector over the next few years; also, efforts must be made to increase the number of persons in employment.

A high level of general government net lending today is fundamentally motivated by a more even distribution of the financial burden of care provisions between generations. A high level of net lending today can help the large generations of tomorrow who in the future will need medical and health care, to contribute themselves to such financing. Depending solely on the labour force of tomorrow to finance these services entails a shift of the financial responsibility for care provisions that would place a greater burden on future generations than on currently active generations. This section presents a scenario illustrating how demographic trends in Sweden may impact public finances.

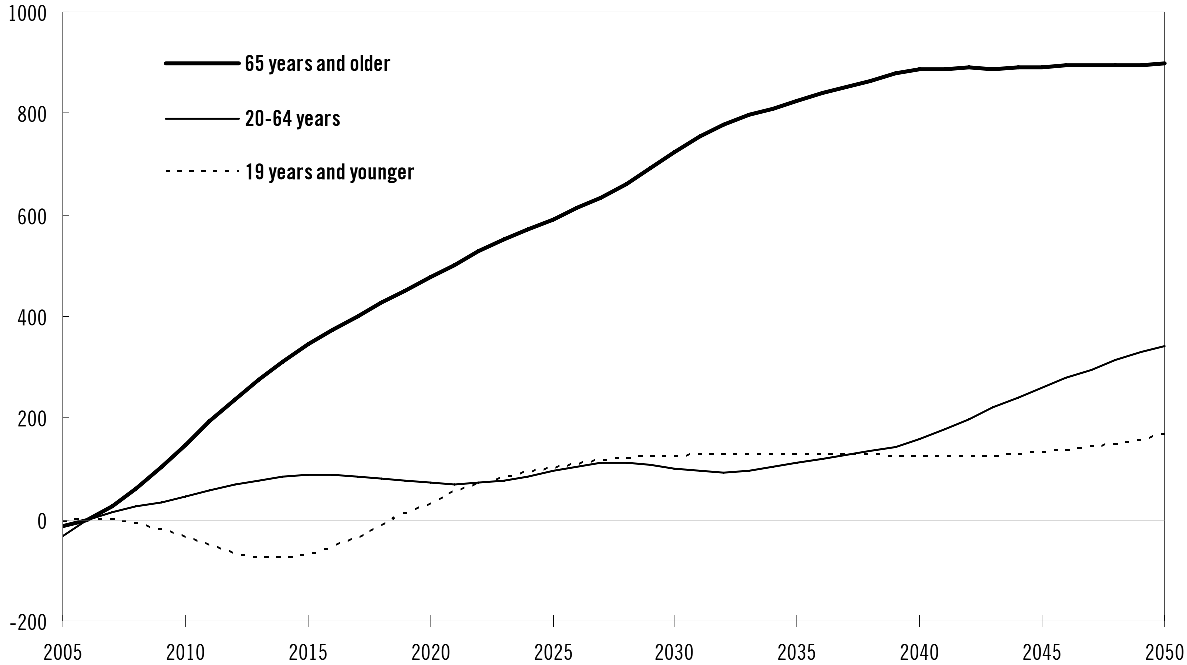
The demographic trend

Sweden's population is currently almost 9.1 million people. According to the population forecast presented by Statistics Sweden in the spring of 2006, the population will have grown to just over 10.5 million by 2050.

The main increase is in the number of persons aged 65 and over during the next 30 years. In 2035 over 2.4 million people will be in this age group – over 800,000 more than today. The number of persons between the ages of 20 and 64 is forecast to grow by almost 90,000 until 2015, and rise only slightly during the subsequent 20-year period. In other words, most of the population increase will consist of persons who are not of working age (see Diagram 6). After 2035, however, the number of people of working age is expected to increase once again.

Diagram 6: Sweden's population

Change compared with 2006, thousands

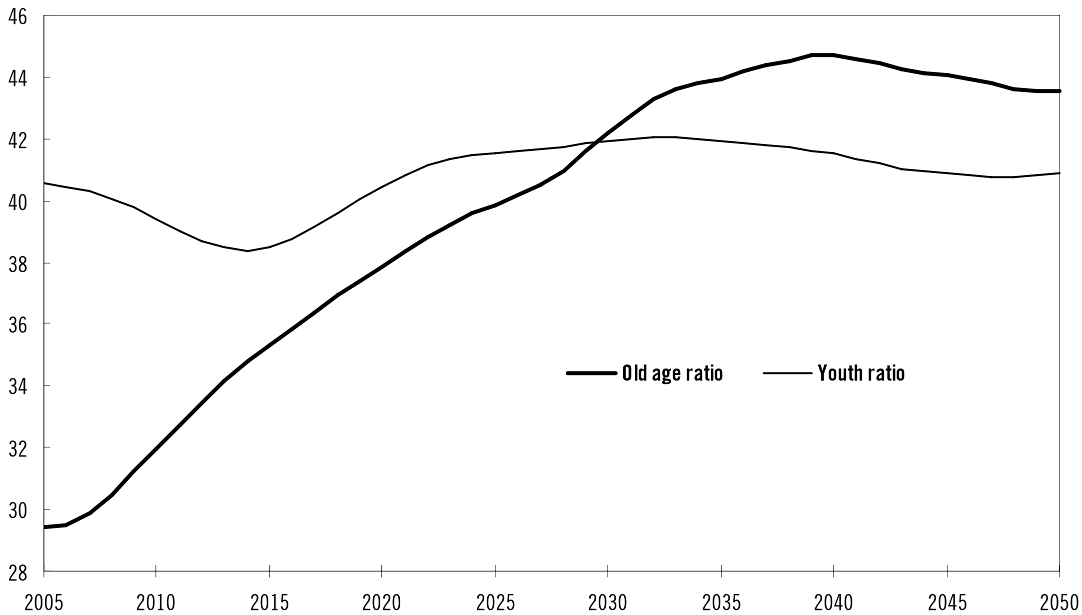


Sources: Statistics Sweden and Ministry of Finance.

The demographic trend may be summarised in dependency ratios, i.e. the ratio between the number of persons of non-working age and the number of persons of working age. The dependency ratio for older people, measured as the number of persons aged 65 and older per 100 persons aged 20 to 64, is estimated to rise from approximately 29 persons in 2006 to around 42 persons in 2030. The dependency ratio for young people, measured as the number of persons under the age of 20 per 100 persons aged 20 to 64, is more stable and fluctuates at around 39–41 persons (see Diagram 7).

Diagram 7: Demographic dependency ratios

Per cent

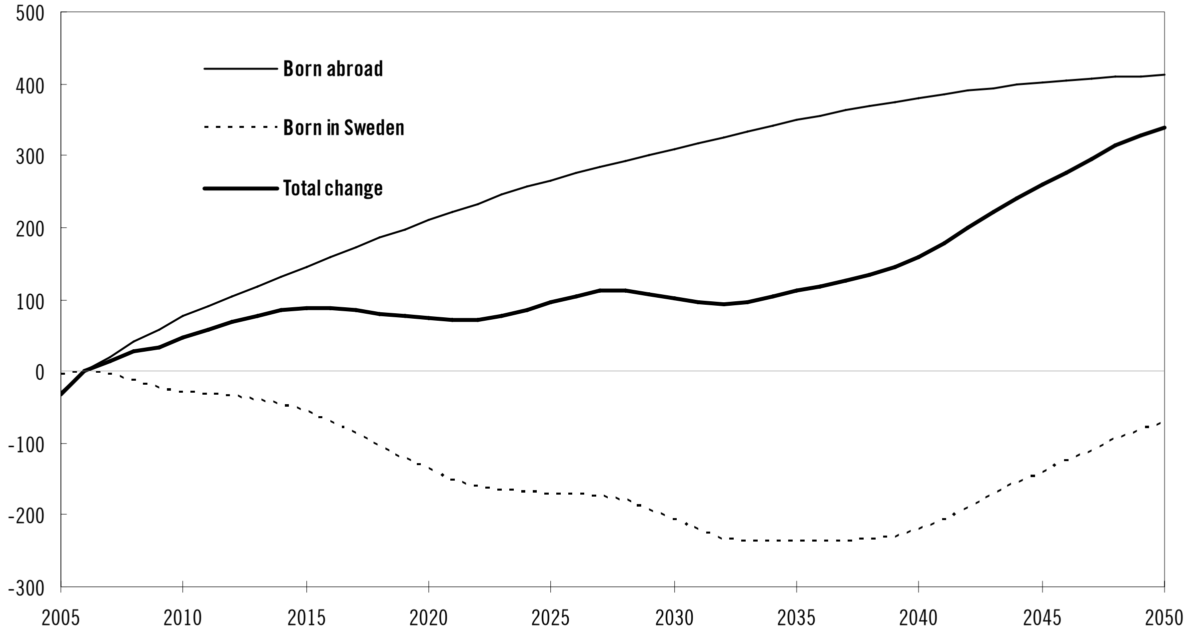


Sources: Statistics Sweden and Ministry of Finance.

According to Statistics Sweden's population forecast, immigration accounts for a major part of the population growth. Immigration is of particular importance for growth in the number of people of working age. Without immigrants, the number of persons in the 20–64 age group would decline (see Diagram 8). The vast majority of immigrants are persons born outside of the EU. The employment ratio of this group is currently far below the average, which is why it is crucial that such groups are integrated in the labour market. If this is not realised, the population growth foreseen for the 20–64 age group will result in much slower growth in the number of employed. This kind of development would seriously undermine the possibilities to sustain the quality and scope of welfare systems.

Diagram 8: Population between 20 and 64

Change compared with 2006, thousands



Sources: Statistics Sweden and Ministry of Finance.

Economic development after 2009

The long-term projection of economic development is based on the estimate for the Swedish economy up to 2009 described in previous sections. Employment growth after 2009 is based partly on the anticipated population trend, and partly on assumptions concerning how the employment ratio and the number of working hours will develop for different population groups.

In the short term, the change in the age structure will play a major role. The number of persons aged 20 to 29, with a relatively low labour supply, will represent the entire population growth in the 20–64 age group over the next few years, while the number of persons of other ages will drop. In a somewhat longer perspective, changes related to origin in the composition of the population are more important. According to the population forecast, the proportion of immigrants, and particularly those born outside the EU in the 20–64 age group, will grow rapidly.

In the estimate, Swedish-born individuals are assumed to work to the same extent in the future as today, while immigrants will gradually have a stronger position in the labour market. Up to 2020, the difference in the employment ratio between Swedish-born and foreign-born individuals is assumed to decline by one-third. Residual differences are assumed to persist beyond 2020. With such a trend, the proportion of persons employed among foreign-born individuals aged 20 to 64 will rise to just over 65 per cent.

Up until 2012, it is also assumed that some adjustment as a result of the stimulus measures proposed in the Budget Bill will still be taking place. In addition to the demographically determined development, employment and the number of hours worked are expected to increase by 0.35 per cent in 2010 and 0.25 per cent annually in 2011 and 2012. The majority of this increase is due to decreased unemployment. A smaller part can be attributed to the fact that the size of the labour force is growing.

All together, this results in a regular employment rate that exceeds 80 per cent from 2009.

GDP growth is also affected by the average working hours per person employed. In the scenario, average hours worked are assumed to decline somewhat in the long term. Such a decline can be explained by the fact that demand for leisure time will probably increase, as household income and consumption opportunities in general grow. However, households mainly choose to increase consumption of goods and services. Working hours are assumed to decline by only 0.2 per cent per year, which is equivalent to a reduction in weekly working hours of approximately 3.5 hours by 2050. The number of hours worked will therefore be at the same level in 2050 as in 2006, even though the 20 to 64 age group will increase by about 6 per cent. For comparison purposes, the number of hours worked in 2005 was more or less unchanged since 1970, while the 20 to 64 age group grew by some 12.5 per cent.

Productivity in the business sector will rise by an average of 2.6 per cent per year during the period ending 2015. This is in line with the past few years of relatively rapid productivity growth, but is much higher than the rates of growth seen in the 1970s and 1980s. After 2015, productivity growth in the business sector is expected to fall gradually to an average of 2.3 per cent per year. Productivity growth in the general government sector is assumed to be zero in accordance with the method of calculation used by the national accounts. Overall, this leads to a productivity increase in the entire economy of approximately 2.2 per cent per year initially and by 1.9 per cent thereafter. Productivity growth varies somewhat over time due to changes in the composition of private and general government sector output of goods and services.

The increase in productivity, combined with the growth of the labour force, causes GDP to grow on average by 2 per cent per year during the period 2006–2050. GDP per capita grows on average by 1.7 per cent per year. This means that GDP will be some 60 per cent higher in 2030 than in 2006 and barely 140 per cent higher in 2050, while GDP per capita will be almost 50 per cent higher in 2030 and more than doubled by 2050. The most important calculation assumptions are summarised in Table 19.

Table 19: Macroeconomic conditions

	2000	2006	2010	2015	2020	2030	2040	2050
Percentage change								
Population aged 20–64, thousands	0.5	0.6	0.2	0.1	–0.1	0.1	0.1	0.3
Employed, thousands	2.2	1.7	0.9	0.3	0.2	0.0	0.2	0.3
Number of hours worked, million	1.0	1.1	0.8	0.1	–0.1	–0.2	0.0	0.1
Productivity in the business sector	4.0	3.5	2.6	2.6	2.5	2.3	2.3	2.3
GDP, fixed prices	4.3	4.0	3.0	2.4	2.0	1.5	1.9	2.0
GDP per capita, thousands SEK	4.1	3.5	2.5	2.0	1.5	1,2	1.6	1.8
GDP productivity	3.7	2.8	2.1	2.1	1.9	1.7	1.8	1.9
GDP deflator	1.4	1.8	2.4	2.4	2.4	2.5	2.3	2.1
CPI	0.9	1.6	2.1	2.0	2.0	2.0	2.0	2.0
Hourly earnings	5.4	3.3	4.1	4.7	4.6	4.4	4.3	4.1
Per cent								
Real rate of interest	4.5	2.2	3.0	3.0	3.0	3.0	3.0	3.0
Labour force participation in 20–64 age group	81.2	80.9	80.6	81.2	81.9	81.3	81.8	81.8
Women	78.4	78.2	77.9	78.6	79.4	78.9	79.4	79.3
Men	84.0	83.4	83.2	83.8	84.4	83.7	84.2	84.2
Open unemployment	5.0	5.6	4.1	3.7	3.6	3.7	3.7	3.7

Note: In the estimate of GDP growth it is assumed,
in accordance with the convention in the Swedish National Accounts, that productivity growth in the general government sector is zero. An increased percentage of general government consumption thus entails reduced GDP productivity.
[1] For the period 2010—2050, the average percentage change from the previous period is stated.
[2] National definition. Students looking for work are counted as unemployed in international statistics.
Sources: Statistics Sweden and Ministry of Finance.

General government revenue

The long-term development of tax revenues is largely dependent on employment growth. Most taxes directly or indirectly represent taxation on work. The majority of households' income taxes and social security contributions are deducted from wages. These taxes account for over half of general government revenues. The development of the labour market is also of major importance to revenue from taxes on household consumption expenditure, such as VAT and excises duties. Even if the tax rates remain unchanged in relation to the respective tax base, the total tax ratio, i.e. taxes and charges in relation to GDP, will change somewhat over the next few decades because a number of important tax bases may be expected to grow more rapidly than GDP. This trend applies to figures such as household consumption expenditure and taxed transfer payments, which grow as the number of pensioners increase.

A small proportion of the costs of providing welfare services is financed through user fees. The calculations assume that fees for childcare, etc., rise in pace with production costs. This means that fee revenues rise at a much higher rate than if today's maximum charges will be kept also in the long term, but at a slower rate than household disposable income.

General government expenditure

The change in the population structure has major effects on public finances. The increasing number of older people in the population affects expenditure on pensions, medical care and care of the elderly. The estimate of pension expenditure is based on the demographic trend, the macroeconomic assumptions and current rules and regulations. Pension expenditure as a percentage of GDP is estimated to increase from 8.5 per cent in 2006 to 9.5 per cent in 2020, after which the level will remain unchanged until the middle of the 2030s when it will decline somewhat. Expenditure on medical care and care of the elderly is estimated to increase from 10.1 per cent of GDP in 2006 to 14.0 per cent of 2050. Overall, expenditure on pensions, medical care and care of the elderly will increase as a percentage of GDP by almost 4 percentage points during the estimate period.

The estimates assume a standard guarantee in general government transfer payment systems. For a large proportion of transfer payments, there are rules and regulations which automatically increase benefits in line with the wage trend. This applies to pensions, which are adjusted upward in line with the earnings index, and partly to transfer payments, which compensate for loss of earnings, e.g. health and parental insurance. Transfer payments which lack this type of automatic standard guarantee, e.g. child benefit and study allowance, are assumed in the estimate to increase in line with the nominal wage trend. Such a standard guarantee offsets the erosion which would take place in the longer term if the estimate were based on strictly unchanged regulations. The standard guarantee therefore assumes that certain reforms are implemented in pace with economic growth.

Staff intensity, e.g. the number of teacher hours per student, may be regarded as an indicator of the quality of general government services output. In the estimates, it is assumed that these services are carried out with the same staff density as today. This means that the number of persons employed in the general government sector needs to increase by approximately 160,000 persons between 2005 and 2020 during an expansion in pace with the demographic needs. Since the average age of staff in many operations is relatively high today, the recruitment needs will be considerably larger. The number of public sector employees needs to increase by an additional 375,000 or so net between 2020 and 2050 in order to sustain the standard of welfare and for tax-funded welfare services to be produced as they are today. The considerable recruitment needs are likely to contribute to wages being driven up relative to other areas of the economy. The age structure in local government, however, is such that due to the large number of employees reaching retirement age, the average age among municipality and county council employees, will decline more than in other sectors. This trend has a restraining effect on the wage trend since younger newly hired personnel usually have lower salaries than those employees who retire. However, the effect of recruitment needs is assessed to be of greater significance and it is therefore assumed in the estimates that on average, the increase in hourly wages in municipalities and county councils will be 0.5 per cent faster per year than in the rest of the economy up until 2020.

Between 2006 and 2020, primary general government expenditure, i.e. expenditure excluding interest, is estimated to fall as a percentage of GDP (see Table 20). The total demographic pressure on expenditure is still limited. Fewer children and young people of school age mean that expenditure on their schooling may decline as a percentage of GDP, while the demand for medical care and care of the elderly will only rise slightly. Until around 2015, local government consumption does not need to grow in order for the number of services produced to rise in pace with demographic demand. During the next

15-year period, the demand for tax-funded welfare services will rise by an average of 1 per cent per year. This assumes that municipalities are able to contract operations in areas where demand declines. Transfer payments linked to persons under the age of 20 will also fall as a percentage of GDP in the next few years. However, pension expenditure will increase, which leads to total household transfer payments decreasing slightly as a percentage of GDP until 2020.

Table 20: Primary expenditures as a percentage of GDP

Change in percentage points

	2006–2020	2020–2050
Primary expenditures	**–2.1**	**1.5**
Transfers to households	–0.7	–0.5
General government transfer payments to firms and abroad	–0.6	0.1
General government consumption	–0.3	2.6
Investments	–0.6	–0.6

Sources: Statistics Sweden and Ministry of Finance.

Between 2020 and 2030, primary expenditure increases as a percentage of GDP by a further 2.5 percentage points. The expenditure ratio peaks in the middle of the 2030s. General government consumption of medical care and care of the elderly increases the most markedly, but household transfer payments in the form of pensions also grow. However, general government investment expenditure falls as a percentage of GDP throughout the period. The municipalities' investment volume increases in pace with municipal consumption volume, in the central government sector investments outpace consumption slightly, and overall, this leads this to a decline in general government investments as a percentage of GDP.

Table 21: Public Finances

Per cent of GDP

	2000	2006	2010	2015	2020	2030	2040	2050
Primary revenue	56.0	53.3	49.5	49.2	49.3	49.6	49.3	48.8
Taxes and charges	52.8	50.2	46.3	46.2	46.4	46.9	46.9	46.6
Other revenue	3.2	3.2	3.3	3.0	2.9	2.7	2.5	2.3
Primary expenditures	50.2	50.9	48.0	48.0	48.8	51.3	51.1	50.3
Transfer payments	21.2	21.2	19.2	19.8	20.0	20.4	20.2	19.5
Consumption	26.4	26.8	26.1	25.8	26.5	28.7	29.0	29.1
Investments	2.6	2.9	2.7	2.5	2.3	2.1	1.9	1.7
Primary net lending	5.9	2.4	1.5	1,2	0.5	–1.7	–1.9	–1.5
Net capital income	–0.9	0.4	0.5	0.8	1.1	1.0	0.3	–0.5
Net lending	5.0	2.8	2.0	2.0	1.6	–0.7	–1.6	–1.9
Financial position								
Consolidated gross debt	52.3	46.5	31.2	21.7	14.3	15.1	29.6	45.8
Adjusted gross debt[1]	31.6	14.3	–0.8	–9.7	–16.1	–13.1	4.7	16.8
Net debt	1.2	–15.5	–22.5	–30.0	–35.7	–32.2	–15.0	–1.2

[1] Consolidated gross debt minus pension system assets in addition to government securities.
Sources: Statistics Sweden and Ministry of Finance.

Balance target and sustainable public finances

The sustainability of public finances may be defined in various ways. Within the EU, the Commission evaluates EU member countries' public financial sustainability. The main indicator that the EU commission uses during this assessment stipulates the budget strengthening required in order for the present value of all future revenue and expenditure to be the same as the amount of debt at the beginning of the period. The idea is that future revenue not only covers future expenditure, but is moreover sufficiently large to reduce the debt in the long term. The problem with this definition is that revenue and expenditure must be projected over very long time periods with all the inherent uncertainty.

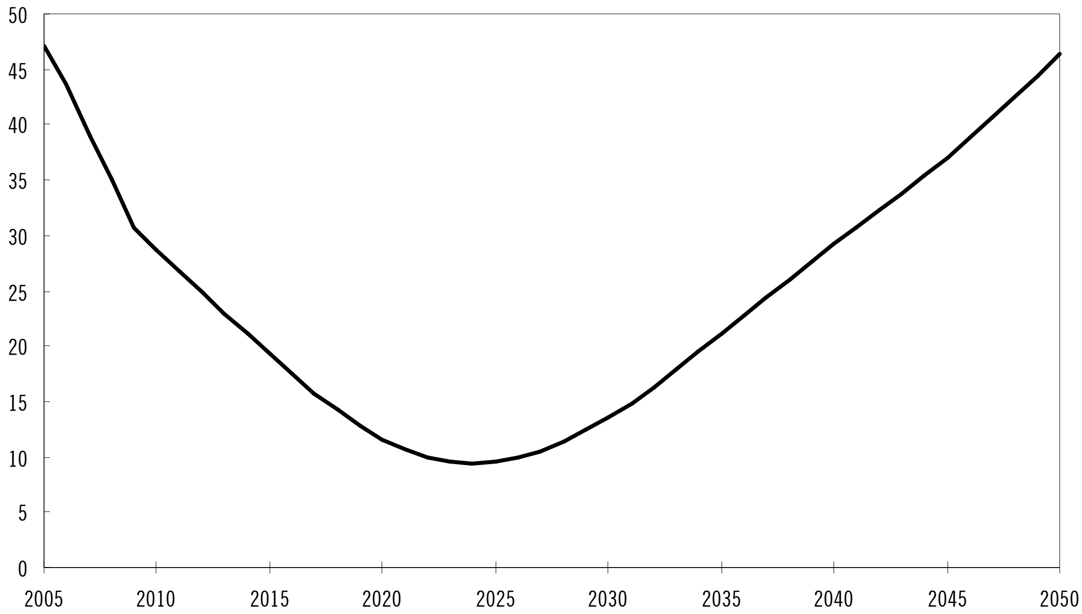
The sustainability calculations in the convergence programme use the sustainability criterion to prevent the debt situation from worsening over a foreseeable period, which is long enough to include the demographic structural change. If general government debt as a percentage of GDP is no larger at the end of the period than at the beginning, fiscal policy may be considered sustainable.

Diagram 9 illustrates the development of central government debt as a percentage of GDP up to 2050. In the estimate, it is assumed that tax regulations will be adapted so that public finances show a surplus of 2 per cent of GDP until 2015. The calculation results in a debt ratio in 2050 which is somewhat lower than in 2005. Consequently, the development of public finances may be considered sustainable throughout the period until 2050. At the same time, the increase in the debt ratio during the latter part of the period shows that sustainability problems may arise after 2050.

The scenario illustrates the importance of the surplus target in order to be able to maintain the standard in tax-funded welfare systems. In order to prevent central government debt as a percentage of GDP from approaching unsustainable levels over the long term and forcing cutbacks, the debt ratio must decrease rapidly over the next few years.

Diagram 9 Central government debt

Per cent of GDP



Sources: Statistics Sweden and Ministry of Finance.

The assessment that the public finances are sustainable in the long-term is dependent on the assumptions made in the calculations. It is crucial that public expenditures do not increase more than what is demographically determined. This means that expected future growth may not be used in any way to increase the quality or scope of public service. If households wish to consume more of the services currently provided by the general government this must be financed.

Another crucial factor is that a high level of employment can be maintained. If employment declines, the tax burden on those who are working will need to be increased in order to retain the same level of ambition with respect to the public commitment. Higher productivity could compensate a decreased supply of labour with respect to the aggregate production in the economy, but the tax rate would still have to be raised. However, such a measure could further reduce the supply of labour.

Appendix A: Calculation assumptions

The calculation methods used in the estimate of public finances during the period 2010–2050 are discussed in more detail below.

Demographic assumptions

The estimate is based on Statistics Sweden's population forecast of May 2006 shown in Table A.1.

Table A.1: Demographic assumptions

	2000	2005	2010	2020	2030	2040	2050
Birth rate	1.55	1.77	1.85	1.85	1.85	1.85	1.85
Average life expectancy, women	82	82.8	83.3	84.3	85.1	85.8	86.3
Average life expectancy, men	77.4	78.4	79.2	80.8	82	82.9	83.6
Net migration, thousands	24,600	27,100	25,900	24,800	24,700	24,100	23,600

Sources: Statistics Sweden and Eurostat.

Table A.2: Taxes and charges
Per cent of GDP

	2000	2005	2010	2015	2020	2030	2040	2050
Taxes and charges	**52.8**	**50.8**	**46.3**	**46.2**	**46.4**	**46.9**	**46.9**	**46.6**
Household direct taxes and charges								
Proportion of GDP	21.3	19.3	15.6	14.8	14.9	15.0	15.0	15.0
Implicit tax rate for direct taxes	29.5	26.4	21.9	20.5	20.5	20.5	20.5	20.5
Tax base for direct taxes as percentage of GDP	62.6	62.5	59.5	59.7	60.1	60.6	60.4	60.0
Implicit tax rate for charges	6.0	5.9	5.8	5.8	5.8	5.8	5.8	5.8
Tax base for charges as percentage of GDP	47.3	46.7	44.1	43.7	44.1	44.9	45.3	45.8
Corporate direct taxes								
Proportion of GDP	3.8	3.4	3.5	3.5	3.4	3.3	3.3	3.3
Implicit tax rate	13.7	12.8	12.3	12.3	12.3	12.3	12.3	12.3
Tax base as percentage of GDP	28.0	26.8	28.8	28.4	28.0	27.1	26.8	26.7
Indirect taxes[1]								
Proportion of GDP	13.5	14.1	14.0	14.8	14.9	15.2	15.1	14.7
Implicit tax rate	27.3	29.5	28.6	28.1	28.0	27.9	27.7	27.6
Tax base as percentage of GDP	49.4	48.0	48.9	52.7	53.4	54.5	54.4	53.4
Employer social security contributions and self-employed social security contributions[2]								
Proportion of GDP	14.1	13.9	13.2	13.1	13.2	13.4	13.5	13.6
Implicit tax rate	34.6	34.5	33.4	33.3	33.2	33.2	33.2	33.1
Tax base as percentage of GDP	40.9	40.5	39.4	39.3	39.6	40.2	40.7	41.1

[1] Excluding wage-dependent indirect taxes.
[2] Including wage-dependent indirect taxes.
Sources: Statistics Sweden and Ministry of Finance.

General government revenue

A standard method for projections of general government revenue is to set taxes and charges as a constant percentage of GDP. In practice, this method means that tax regulations are assumed to change if the tax bases do not grow in pace with GDP. The estimates described here are based on an assumption of constant tax rates relative to the tax bases. Consequently, the aggregate tax ratio will vary if the tax bases develop in a different way than GDP. This method reflects unchanged tax regulations. Stable tax rates over time are advantageous both on grounds of effectiveness and redistribution policy. Table A.2 shows in detail general government taxes and charges as a percentage of GDP and as a percentage of the respective tax base (implicit tax rate) as well as the tax base as a percentage of GDP.

In order for the surplus target to be met each individual year up to and including 2015, a certain budget attenuation may be permitted in 2010, is deducted from household income tax. It is assumed that the tax rules will remain unchanged after 2015. Overall, this means the tax ratio (taxes and charges as a percentage of GDP) will be reduced by 4.2 percentage points during the period 2005–2050.

General government consumption expenditure

The estimate of general government consumption expenditure is based on age- and gender-distributed unit costs[11] for childcare, primary and secondary education (compulsory school and upper secondary school), adult education (municipal adult education and higher education), medical care (outpatient and inpatient care), care of the elderly (home help service and sheltered accommodation), and labour market measures. All these expenditure areas are projected in volume terms by the population change in the relevant age group for women and men. Other consumption expenditure, which mainly consists of general administration, the judicial system and defence, is assumed to follow the change in the total population. The price trend in general government consumption is a weighting of the wage trend and the price trend, with weights reflecting the composition of consumption in the respective operating area. It is assumed in the estimates that productivity growth in all general government activities is zero, which results in the price of general government consumption growing approximately 1.5 percentage points more rapidly than the consumer price index per year (see Appendix B in the Swedish convergence programme for 2004).

Table A.3: General government consumption

Per cent of GDP

	2000	2005	2010	2015	2020	2030	2040	2050
Total consumption	27.0	27.2	26.1	25.8	26.5	28.7	29.0	29.1
Childcare	1.6	1.6	1.6	1.6	1.7	1.8	1.7	1.8
Primary and secondary education	3.8	3.8	3.5	3.2	3.4	3.6	3.5	3.4
Adult education	2.1	2.0	2.0	1.9	1.8	1.8	1.8	1.8
Medical care	6.0	6.2	6.0	6.1	6.4	6.9	7.1	7.1
Care of the elderly	3.7	4.1	4.0	4.1	4.5	6.0	6.5	6.9
Labour market measures	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other activities	9.7	9.5	8.9	8.6	8.5	8.5	8.2	7.9

Sources: Statistics Sweden and Ministry of Finance.

[11] These unit costs are based on 1999 consumption patterns.

Transfer payments

The estimates assume a certain standard increase in the general government transfer payment system. For many transfers, regulations automatically raise expenditures to keep pace with real growth in the economy. This applies to pensions, which are adjusted upward in line with the earnings index, and also partly to transfer payments, which compensate for loss of earnings, e.g. health and parental insurance. Transfer payments which lack an automatic standard guarantee, e.g. child benefit and study allowance, are assumed to increase in line with wages. A standard increase like this offsets the erosion of household transfer payments that would take place if the estimate were only based on a price projection for a horizon of around fifty years.

Table A.4: General government transfer payments

Per cent of GDP

	2000	2005	2010	2015	2020	2030	2040	2050
Total transfer payments	21.2	21.6	19.2	19.8	20.0	20.4	20.2	19.5
Transfer payments to households	18.2	18.2	16.3	16.8	17.0	17.4	17.1	16.5
Old-age	8.4	8.7	8.6	9.3	9.5	9.5	9.2	8.5
Ill health	3.8	4.3	3.6	3.5	3.5	3.7	3.7	3.8
Children/studies	2.3	2.2	2.1	2.0	2.1	2.2	2.2	2.2
Labour market	1.9	1.6	0.8	0.8	0.8	0.8	0.8	0.8
Other	1.7	1.4	1,2	1.2	1.2	1.2	1.2	1,2
Transfer payments to firms	1.8	1.8	1.3	1.3	1.4	1.4	1.4	1.4
Transfer payments abroad	1,2	1.5	1.6	1.6	1.6	1.6	1.6	1.6

Note: "Old age" comprises old-age pension, survivor's pension, central government and municipal pensions as well as supplementary housing benefit to pensioners. "Ill health" comprises health insurance, occupational injury insurance, disability pension and carer's allowance. "Children/studies" comprises child benefit, parental insurance, maintenance support and study allowance. "Labour market" comprises unemployment benefit, labour market training grants and wage guarantee.
Sources: Statistics Sweden and Ministry of Finance.

Old-age pension system

Table A.5 shows the old-age pension system's revenue and expenditure and its financial position. Net lending deteriorates as pension expenditure increases, as a result of the increasing number of pensioners. Despite the growing expenditure, the old-age pension system has considerable assets at the end of the estimate period.

Table A.5: Old-age pension system

Per cent of GDP

	2000	2005	2010	2015	2020	2030	2040	2050
Revenue	10.7	8.3	7.9	8.0	8.0	8.1	8.0	8.3
Charges	6.6	6.7	6.1	6.0	6.0	6.2	6.2	6.3
Premium pension funds	2.5	0.9	0.9	0.9	0.9	0.9	1.0	1.0
Interest, dividends, etc.	1.5	0.8	1.0	1.1	1.1	1.0	0.9	1.0
Expenditure	8.5	6.5	6.8	7.4	7.6	7.6	7.4	6.9
Pensions	6.3	6.3	6.7	7.3	7.4	7.5	7.3	6.8
Other	2.2	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Net lending	2.2	1.9	1.1	0.6	0.5	0.5	0.7	1.4
Net financial assets	35.2	36.3	35.9	34.0	31.9	29.5	27.6	31.0

Sources: Statistics Sweden and Ministry of Finance.

Table A.6 presents a number of key variables from the Swedish convergence programme in the form recommended by the European Commission.

Table A.6: Long-term sustainability of public finances

	2000	2005	2010	2015	2020	2030	2040	2050
Per cent of GDP								
Total expenditure	**54.2**	**53.5**	**49.6**	**49.2**	**49.6**	**52.1**	**52.6**	**52.6**
Age-related [1]	28.8	29.7	28.0	28.5	29.5	31.9	32.2	31.9
Pensions [2]	10.2	11.0	10.3	10.9	11.1	11.3	10.9	10.3
Guarantee pensions	0.5	0.9	0.6	0.7	0.7	0.7	0.7	0.6
Old-age pensions	6.3	6.3	6.7	7.3	7.4	7.5	7.3	6.8
Other pensions (disability and survivor)	2.8	3.2	2.5	2.4	2.4	2.5	2.4	2.3
Public pension fund reserves	0.6	0.6	0.5	0.6	0.6	0.6	0.6	0.6
Medical care	6.0	6.2	6.0	6.1	6.4	6.9	7.1	7.1
Care of the elderly	3.7	4.1	4.0	4.1	4.5	6.0	6.5	6.9
Childcare	1.6	1.6	1.6	1.6	1.7	1.8	1.7	1.8
Education	5.9	5.8	5.4	5.1	5.2	5.4	5.4	5.2
Unemployment benefit	1.4	1.2	0.6	0.6	0.6	0.6	0.6	0.6
Other age-related expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest expenditure	4.0	1.9	1.6	1.2	0.8	0.8	1.4	2.3
Total revenues	**59.2**	**56.3**	**51.6**	**51.2**	**51.2**	**51.4**	**51.0**	**50.6**
Capital income	3.1	2.2	2.0	2.0	1.9	1.8	1.7	1.8
of which the pension system	1.5	0.8	1.0	1.1	1.1	1.0	0.9	1.0
Assets in pension funds	**35.4**	**36.7**	**35.9**	**34.0**	**31.9**	**29.5**	**26.2**	**30.6**
of which other government securities	20.7	31.4	31.9	31.5	30.4	28.1	24.9	29.1
Assumptions								
Growth in work productivity, GDP level	3.7	3.1	2.1	2.1	1.9	1.7	2.0	1.9
GDP growth	4.3	2.7	2.8	2.3	1.8	1.5	2.0	1.8
Labour force participation, men 20–64 years of age	84.0	83.8	83.2	83.8	84.4	83.7	84.2	84.2
Labour force participation, women 20–64 years of age	78.4	78.7	77.9	78.6	79.4	78.9	79.4	79.3
Labour force participation, both sexes 20–64 years of age	81.2	81.3	80.6	81.2	81.9	81.3	81.8	81.8
Unemployment	5.0	6.0	4.1	3.7	3.6	3.7	3.7	3.7
Population 65 years of age and older as a percentage of the population	17.2	17.3	18.7	20.3	21.2	22.9	24.0	23.6

[1] Age-related expenditures includes childcare. These expenditures are not included in the age-dependent expenditures which an EU work group used in its calculations, presented in appendix B.
[2] Pensions includes both old-age pension and disability pension.
Sources: Statistics Sweden and Ministry of Finance.

Appendix B Comparison with long-term projections to EU

A work group (Ageing Working Group) under the Economic Policy Committee (EPC), together with Commission, has projected for the development of expenditures until 2050[12]. The estimates in this publication, however, are based on the information presented to the Riksdag in the Budget Bill for 2007, Appendix 1, Sweden's Economy. This section compares the demographic and macroeconomic key figures as well as the demographic dependent expenditures from these two sources.

Table B.1: Macroeconomic assumptions in the EPC estimates and in the Swedish convergence programme

Index 2005=100 unless otherwise stated

	2005	2010	2015	2020	2030	2040	2050
Population 15–64 years of age							
EPC	100	102.1	100.6	100.5	101.2	101.5	103.2
Convergence programme	100	101.5	100.3	100.7	101.9	103.3	106.0
Employed 15–64 years of age							
EPC	100	103.7	104.7	105.3	105.8	106.3	108.5
Convergence programme	100	105.5	106.8	107.7	107.6	109.5	112.9
Unemployment, per cent of labour force [1]							
EPC	5.0	4.3	4.3	4.3	4.3	4.3	4.3
Convergence programme	6.0	4.1	3.7	3.6	3.7	3.7	3.7
Hours worked							
EPC	100	103.2	104.2	104.8	105.3	105.9	108.0
Convergence programme	100	104.3	104.9	104.7	102.3	102.2	103.1
Labour productivity							
EPC	100	111.9	127.6	144.4	176.8	209.7	248.5
Convergence programme	100	111.5	123.7	136.1	160.8	193.0	233.7
GDP							
EPC	100	115.4	133.0	151.3	186.2	221.9	268.4
Convergence programme	100	117.0	132.1	145.5	169.6	203.8	248.2
GDP per capita							
EPC	100	113.2	127.8	142.4	169.3	198.8	237.0
Convergence programme	100	114.4	126.3	136.0	152.7	179.6	213.8

[1] National definition. Students looking for work are counted as unemployed in international statistics.
Sources: European Commission and the Ministry of Finance.

The EPC's calculations utilise a population forecast prepared by Eurostat during the spring of 2005. It shows slightly stronger population growth for people of working age during the next decade than Statistics Sweden's forecast of May 2006. In the longer term, however, the population grows at a higher rate in Statistics Sweden's forecast. EPC assumes that open unemployment will be somewhat higher. Meanwhile, open unemployment is not completely comparable since students seeking jobs are not counted as unemployed under the national definition, but they are included in the international

[12] The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004–2050). Report prepared by the Economic Policy Committee and the European Commission (DG ECFIN). Special Report no 1/2006.

definition[13]. With higher open unemployment and the assumption that a lower percentage of the professionally active population will be employed, employment growth is weaker in EPC's projection. The number of working hours in the EPC's projection develops on a par with employment growth, while Sweden's convergence programme assumes that average hours worked gradually declines. As a consequent the number of hours worked increases at a slower pace in the Swedish convergence programme than in the EPC estimates.

Work productivity shows somewhat stronger growth in the EPC's scenario than in the Swedish convergence programme, though this difference is relatively minor. On average, GDP per hour worked grows by 2.04 per cent annually in the EPC's estimates and by 1.97 per cent per year in the convergence programme. Stronger growth in both hours worked and productivity will lead to GDP growth rates in volume rising faster than according to the EPC's estimates.

Diagram B.1 Differences between the EPC and the convergence programme

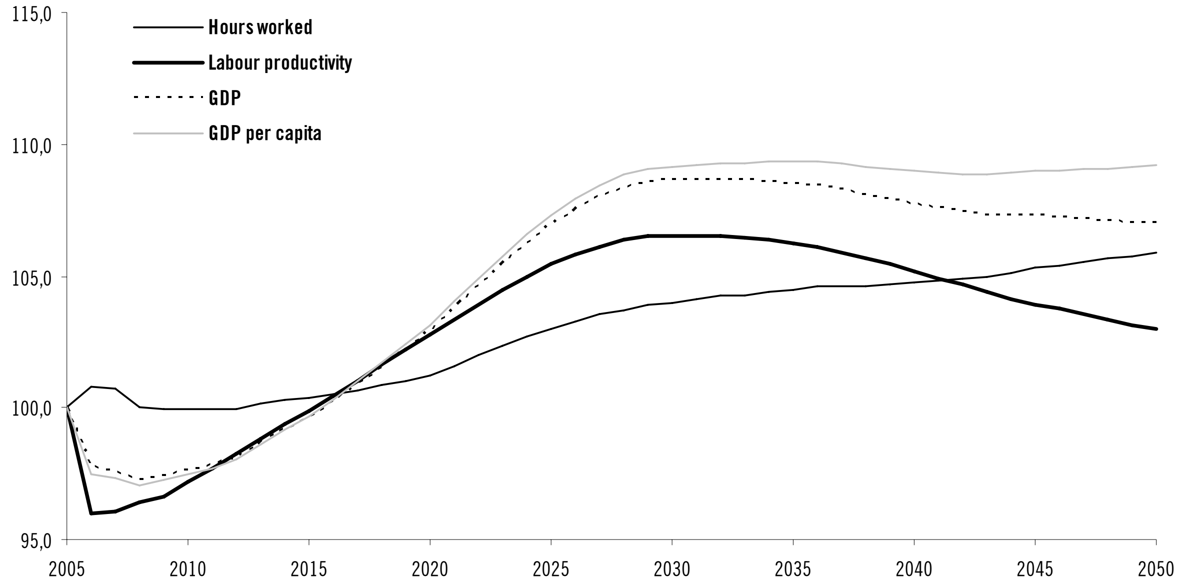


Diagram B.1 illustrates how the number of hours worked, work productivity, GDP and GDP per capita develop from 2005 forward in the EPC's projection in relation to Sweden's convergence programme. The relation between the number of hours worked in the EPC estimates and in the convergence programme is largely unchanged through 2015. However, work productivity is expected to develop faster in the convergence programme for the current year based on the outcome for the first six months of 2006. Beginning next year the pace of development in productivity will be somewhat faster in EPC's assessment. In 2015 the relationship will once again be the same as 2005. The

[13] Unemployment in the age group 20–64 including full-time students looking for employment, amounted to 6,8 per cent of the labour force in 2005.

development of the number of hours worked and work productivity will result in GDP and GDP per capita in EPC's projection remaining below the level of the convergence programme through 2015.

After 2015 the number of hours worked will develop stronger in the EPC projections than in the convergence programme. In 2050 about 6 per cent more hours will be worked in the EPC scenario than in the Swedish convergence programme. Work productivity develops faster in EPC's projection to the beginning of the 2030s, when over 6 per cent more goods and services are produced per working hour than in the Swedish convergence programme. After 2030, the situation is the opposite. Productivity rises faster in the scenario upon which the estimates in this publication are based, but the level of productivity is still significantly higher in the EPC's estimates for 2050. The development of number of hours worked and work productivity result in GDP and GDP per capita rising faster in the EPC's projection until around the mid-2030s. During the years thereafter the growth rate will be somewhat slower in EPC's estimates, but the GDP level is about 7 to 8 per cent higher in the figures used for EPC's estimates. Long-term population growth is somewhat stronger in the Swedish estimates, leading to GDP per capita increasing somewhat faster than GDP in EPC's estimates than in the Swedish convergence programme.

The EPC have identified five expenditure items which are affected by changes in the population structure. These age–related expenditures are pensions, health care, long term–care, education and unemployment transfers. Several factors affect the calculations of demographic-dependent expenditure over the long term in addition to the demographic trend and the economic assumptions. These factors include the end point for the medium-term estimates, which serve as the starting point for the long-term scenario. The choice of calculation methods also affects the development of expenditures. An increase in average length of life in the population projection can, for example, be due to the fact that more "healthy years" are added to expected lifetime. With such an assumption the costs for health care and care of the elderly do not increase at the same rate as the increase of the number of elderly persons.

Table B.2: Changes in age-related public expenditures in EPC's estimates and in the Swedish convergence programme.

Proportion of GDP.

	Change 2004–2050			Change 2004–2010			Change 2010–2050		
	Convergence programme	EPC	CP - EPC	Convergence programme	EPC	CP - EPC	Convergence programme	EPC	CP - EPC
Pensions	–0.8	0.6	–1.4	–0.7	–0.5	–0.2	–0.1	1.1	–1.2
Health care	0.8	1.0	–0.2	–0.3	0.1	–0.4	1.2	0.9	0.3
Long-term care	2.7	1.7	1.0	–0.1	–0.1	0.0	2.8	1.8	1.0
Education	–0.8	–0.9	0.1	–0.6	–0.6	0.0	–0.2	–0.3	0.1
Unemployment transfers	–0.7	–0.2	–0.5	–0.6	–0.2	–0.4	0.0	0.0	0.0
Total	1.3	2.2	–0.9	–2.4	–1.3	–1.1	3.7	3.5	0.2

Note: CP is the abbreviation for convergence programme.
Sources: European Commission and the Ministry of Finance.

Table B.2 presents the increase in age-related expenditures as a percentage of GDP in EPC's estimates and in the Swedish convergence programme. In this publication the total increase in demographic-dependent expenditure during the period 2004–2050 is estimated to amount to 1.3 percentage points of GDP. The corresponding increase is somewhat higher in EPC's estimates, 2.2 percentage points of GDP. The biggest difference can be found in the pension calculations where EPC's scenario points to an increase, while the Swedish convergence programme reports a decrease. Estimates of pension expenditure for the convergence programme have not been updated with respect to the new medium-term assumptions, which means that they are somewhat underestimated. Expenditure for long–term care is assumed to be purely demographically determined in the Swedish convergence programme, while consideration is taken to assumed improvements in health and therefore decreased care needs with an increased average length of life in EPC's calculations. If the convergence programme's figures are compared instead with EPC's estimate under the assumption of a pure demographic projection, the difference in the rate of increase is only 0.4 percentage points.

If this change in the development is divided into the medium term (2004–2010) and long term (2010–2050), respectively, the major difference can be found in the assessment of the development over the coming years. In both estimates expenditures are expected to be reduced until 2010, before the demographic pressure begins to be felt. The decline is sharper in the Swedish convergence programme than in EPC's estimates. The new and more positive outcome plays a role, which has been incorporated into the Swedish convergence programme, but which was not available for EPC's calculations.

As the number of elderly persons increases, age-related expenditure in both the convergence programme and EPC's estimates also increases. The increase during the period 2010–2050 in both estimates is about 3.5 percentage points of GDP. In the Swedish convergence programme pension expenditure is expected to remain essentially unchanged during the period, while EPC's estimates indicate an increase of over 1 percentage point of GDP. Expenditure for long-term care of the elderly is expected to increase 1 percentage point more in the Swedish convergence programme than in EPC's estimates, which take into account health improvements with an increased average life span.

Appendix C Tables

Table C.1: Assumptions for the forecast

Annual average, unless otherwise stated

	2005	2006	2007	2008	2009
GDP, world[1]	4.7	5.0	4.6	4.2	4.0
GDP eurozone [1]	1.4	2.3	1.9	1.9	1.9
HICP EU[1]	2.1	2.3	2.2	2.0	1.9
Hourly wages in Sweden[1]	3.1	3.2	3.7	3.7	3.8
TCW index	128	128	124	122	122
SEK/EUR[2]	9.44	9.20	9.00	8.90	8.90
EUR/USD[2]	1.19	1.30	1.35	1.35	1.35
German 10-year government bond rate, annual average	3.38	3.81	4.01	4.18	4.20
Swedish 10-year government bond rate, annual average	3.38	3.75	4.02	4.25	4.33
Swedish 6-month interest rate, annual average	1.75	2.49	3.53	3.88	4.00
Oil price, (Brent, USD/barrel)	54	66	58	62	55

[1] Annual percentage change.
[2] Exchange rate at year-end.
Source: Ministry of Finance.

Table C.2: General government finances

Per cent of GDP, unless stated otherwise

	Level 2005, SEK billion	2005	2006	2007	2008	2009
Revenue	**1,577**	**59.0**	**58.2**	**56.1**	**55.6**	**55.3**
Taxes and charges	1,365	51.1	50.5	48.1	47.8	47.6
Taxes	988	37.0	37.1	35.0	34.9	34.9
Direct taxes	532	19.9	19.9	17.8	17.8	17.9
Product and production taxes	455	17.0	17.2	17.2	17.1	17.0
Taxes on capital	1	0.0	0.0	0.0	0.0	0.0
Social security contributions	383	14.3	13.6	13.7	13.5	12.9
Capital income	56	2.1	2.1	2.1	1.9	1.9
Other revenue	149	5.6	5.4	5.3	5.2	5.6
Expenditure	**1,496**	**56.0**	**55.2**	**53.7**	**52.9**	**52.2**
Collective consumption	721	27.0	26.5	26.1	26.0	25.9
Total social security transfer payments	545	20.4	19.8	18.8	18.4	18.3
Benefits in kind	79	3.0	2.9	2.9	2.9	2.9
Transfer payments	466	17.4	16.9	15.9	15.5	15.4
Interest	44	1.6	1.5	1.6	1.5	1.5
Subsidies	40	1.5	1.6	1.4	1.3	1.3
Investments	80	3.0	3.0	3.0	2.9	2.9
Other expenditure	67	2.5	2.9	2.7	2.7	2.5
Net lending	**81**	**3.0**	**3.0**	**2.4**	**2.7**	**3.1**
Primary net lending	124	4.6	4.5	4.1	4.2	4.6
Structural surplus/deficit	78	2.9	2.6	2.5	2.8	3.1
Primary structural lending	122	4.6	4.1	4.1	4.3	4.6
Central government	17	0.6	–0.5	0.2	0.7	1.4
Old-age pension system	50	1.9	2.8	1.7	1.6	1.3
Local government	14	0.5	0.7	0.5	0.4	0.3

Sources: Statistics Sweden and Ministry of Finance.

Table C.3: Consolidated gross debt

Per cent of GDP

	2005	2006	2007	2008	2009
Consolidated gross debt	**50.3**	**46.5**	**41.5**	**37.4**	**33.0**
Change in gross debt	–0.2	–3.9	–5.0	–4.1	–4.4
Contribution to change					
Primary net lending	–4.6	–4.5	–4.1	–4.2	–4.6
Interest (consolidated)	1.6	1.5	1.6	1.5	1.5
Stock flows	4.7	1.9	0.2	0.7	0.4
Sale of shares	–0.3	0.0	–1.7	–1.6	–1.5
Allocation of interest and taxes	0.7	0.4	–0.3	0.1	0.3
Old-age pension system investments excl. government bonds	1.9	2.7	1.7	1.5	1.3
Change in central government debt	1.1	–0.9	–0.1	0.0	0.1
Other	1.3	–0.3	0.6	0.7	0.2
Nominal GDP growth	–1.9	–2.8	–2.7	–2.1	–1.8
Implicit interest	3.3	3.2	3.7	3.9	4.2

Sources: Statistics Sweden and Ministry of Finance.

Table C.4: Net lending, sectors

Per cent of GDP

	2005	2006	2007	2008	2009
General government	2.8	2.8	2.3	2.6	3.1
Household sector	3.2	2.9	2.8	2.3	2.0
Corporate sector	0.5	0.4	2.4	2.5	2.5
Abroad, SEK billion	6.5	6.1	7.5	7.4	7.5

Source: Ministry of Finance.