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2002 UPDATE

OF THE CONVERGENCE PROGRAMME OF SWEDEN

(2002-2004)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS

The 2002 updated Swedish convergence programme covers the period 2002 to 2004 and is based on the Budget Bill for 2003. The Budget was adopted by parliament in December 2002. According to the 2002 update, the focus of economic policy continues to be full employment and increased prosperity through high, sustainable growth. Stable prices and sound public finances are a precondition for achieving this. The updated programme provides detailed information, including the analysis of the long-term sustainability of public finances, which is broadly in line with Code of Conduct. The expenditure ceiling, which forms the basis for the medium-term budgetary plans is normally set three years ahead. However, a ceiling was not set for 2005, as prolonged negotiations with respect to forming a government following the general elections in September 2002 delayed such a decision. The lack of detailed information for 2005 in the programme is not in line with the Code of Conduct. However, the government has declared that new expenditure ceilings for 2005 *and* 2006 will be presented in the 2003 Spring Fiscal Policy Bill, and subsequently included in the Budget Bill for 2004.

The Swedish economy has developed less favourably than foreseen in the 2001 update. GDP growth slowed substantially in 2001, to 0.8%. Stronger growth is expected in both 2002 and 2003, though lower than foreseen in the previous update. Inflation has fallen since the Spring of 2002, partly due to favourable base effects, and is expected to remain close to 2% over the programme period. The labour market has stayed relatively stable, with low employment growth and largely unchanged unemployment. The 2002 update forecasts GDP growth of 2.1% in 2002, 2.5% in 2003-04, and an assumption of 2.3% in 2005. This scenario is more positive than the Commission's Autumn forecast. This can largely be explained by the fact that the Swedish government expect a stronger pick-up in private consumption and project a stronger external recovery than the Commission. This would result in higher GDP growth, compared with the Commission's forecast.

Public finances in Sweden are in good shape, owing to a successful fiscal consolidation programme initiated in the mid-1990s, and a strengthened budgetary framework with an ambitious medium-term fiscal rule of a 2% of GDP surplus over the cycle. In the 2002 update, a surplus of 1.7% of GDP in 2002 is projected, followed by slightly lower surpluses in 2003 and 2004. For 2005, an assumption of a surplus of 2% of GDP is made. Moreover, the debt ratio – below 60% of GDP since 2000 - is projected to continue on a downward trend and reach 48% of GDP in 2005. The Commission's view is for lower surpluses and slower debt reduction, resulting from a less buoyant growth outlook. Therefore, efforts to maintain tight expenditure control and achieving a surplus in accordance with the 2% of GDP surplus target in 2003 are important in the light of the 2002 Broad Economic Policy Guidelines (BEPGs).

According to the Commission's calculations, continued surpluses in the cyclically-adjusted balance in each year over the period underpin that the public finances should remain sound. Taking account of some transitory factors e.g. the change in tax revenues resulting from, in part, the large fluctuations in stock market prices does not alter this view. Therefore, the underlying budgetary position is expected to remain in surplus over the programme period. However, the underlying budgetary surplus is expected to be below Sweden's 2% of GDP fiscal rule in the years to 2004, according to the Commission's analysis. This results from the fact that the considerable fiscal stimulus in 2001 and 2002 is only partially reversed in the following years. Nevertheless, even if growth turned out worse than expected, this would be unlikely to put compliance with the Stability and Growth Pact at risk. It can therefore be concluded that Sweden continues to fully respect the Stability and Growth Pact's requirement of a fiscal position 'close to balance or in surplus' over the programme period.

As in the previous updates strong public finances are considered an important pre-requisite for a stability-oriented macro-economic framework. In 2002, the third tranche of tax cuts, corresponding to 1.1% of GDP, was implemented. This was in line with both the previous Council Opinion[1] and the BEPGs. The expenditure ceilings have been instrumental in strengthening the credibility of sound public finances in recent years. These ceilings remain a key ingredient in achieving expenditure control and the Swedish government's firm commitment to continue to adhere to this is welcome. However, given that there are clear downside risks to the economic outlook presented in the programme and that the budgetary margins within these ceilings are very narrow, some restraining measures may be necessary in order not to breach the expenditure ceilings, in line with the Budget Law.

The attention given in the 2002 update to the sustainability of public finances is welcome, although more prudent assumptions could be used as regards the potential evolution of non-age related spending. On the basis of current policies, public finances appear to be on a sustainable footing to meet the budgetary costs of ageing populations, benefiting from the sustained running of budget surpluses and the ambitious reform of the pension system implemented during the 1990s. The budgetary objective of running budget surpluses of 2% of GDP up to 2015 with a view to running down public debt at a fast pace seems warranted. This may however prove difficult for such a sustained period. It is noted that the tax ratio in Sweden is high compared to other industrialised countries. A challenge will be to complete the tax reform while safeguarding the achievements of the past decade of placing public finances on a sustainable path.

CPI inflation in Sweden fell back towards 2% in the spring of 2002 after having risen sharply one year earlier, influenced by these favourable base effects. The Riksbank's assessment is that looser monetary conditions, as reflected in the recent cuts in the repo-rate in November and December last year (totalling 50 bp and thereby reversing the two increases of 25 bp each made in the Spring 2002), are warranted by a forecast that inflation would be slightly below the inflation target in two years time. However, re-negotiations of wage agreements foreseen in the beginning of 2003 in some sectors might put some upward pressure on wages. Swedish HICP inflation has been on a declining path since March 2002. It was slightly higher than the EU average in October (Swedish 12-month average inflation rate at 2.2% compared with 2% in the EU). Sweden continues to fulfil the convergence criterion for price stability.

Long-term interest rates in Sweden over the past year have been in line with the trend in the international bond and equity markets. Bond yields fell globally during the summer and fall, in response to the gloomier growth outlook and the better inflation outlook, as well as in response to equity market weakness. Sweden continues to fulfil the long-term interest rate convergence criterion. The 2002 update states that Sweden does still not intend to bring the Swedish krona into ERM2. It has recently exhibited some volatility against the euro. Hence, as was the case at the time of the 2001 assessment of convergence, Sweden does not fulfill the exchange rate criterion. The Council has stated in its previous Opinion[2] that "Sweden needs to demonstrate its ability to stay in line with an appropriate parity between the krona and the euro over a sufficient period of time without

[1] OJ, C 33, (2002/C 33/04), 6.2.2002.

[2] OJ, C 33, (2002/C 33/04), 6.2.2002

severe tensions. To this end, the Council expects Sweden to decide to join the ERM2 in due course." Furthermore, current legislation is not in compliance with the statute of the ESCB, as concluded in the Commission's Convergence Report 2002[3].

In order to obtain respectable and sustainable economic growth, structural measures are being undertaken with a view to enhancing the supply side of the economy. In this context, the programme strategy is broadly consistent with the Broad Economic Policy Guidelines. Completing the tax reform and efforts to reach the key policy objectives regarding employment, social security recipients and days of sick-leave should be given priority within the framework of sound public finances.

1. INTRODUCTION

The updated Swedish convergence programme was adopted by the Swedish government on 29 November 2002 and submitted to the Commission on the same day. The programme is based on the economic projections in the government's Autumn Budget Bill for 2002 presented to the parliament on 8 October 2002. The Budget Bill is based on an agreement between the governing Social Democratic Party (SDP) and the Left Party (V). The Green Party (MP) has, by a joint budgetary bill together with (SDP) and (V), subsequently supported the agreement reached between (SDP) and (V) as regards the direction of economic policies and expenditure and revenue in 2003. The Budget was adopted by parliament in December 2002. The present update, covering the period up to 2004, is the fourth update of the convergence programme of December 1998[4]. The 2001 update conforms to a large degree to the Code of Conduct which has been agreed for stability and convergence programmes[5]. The elaborated description of structural issues, including the structural position of the economy together with its impact on public finances are welcome. The same applies to the analysis of the long-term sustainability of public finances However, the lack of detailed information and projections as regards the year 2005 is not in line with the Code of Conduct[6]. No information on the developments in the exchange rate vis à vis the euro is included, in contrast to the previous update.

2. IMPLEMENTATION OF THE PREVIOUS UPDATE

The Swedish economy has developed less favourably than foreseen at the presentation of the 2001 update. Output growth was lower than expected in 2001 and is set to be lower than foreseen also in 2002. However, employment growth came out above expectations in 2001, but is likely to be weaker than was foreseen in 2002. Unemployment fell in 2001 and has remained low so far in 2002, broadly in line with the projections in the 2001 update. Inflation increased substantially in 2001, partly due to temporary factors, and was

3 COM(2002) 243, 22.5.2002.

4 The first update covered the period 1999 - 2002 and was assessed by the Commission and the Council gave its opinion in January 2000 (OJ, C 60, (2000/C 60/05), 2.3.2000). The second update covered the period 2000 - 2003 and was assessed by the Commission and the Council gave its opinion in January 2001 (OJ, C 73, (2001/C 73/01), 6.3.2001). The third update covered the period 2001 - 2004 and was assessed by the Commission and the Council gave its opinion in January 2002 (OJ, C 33, (2002/C 33/04), 6.2.2002).

5 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

6 The omission of certain economic projections (in particular investment) does not allow the Commission to calculate the cyclically-adjusted balance implicit in the update, from 2005 onwards.

higher than expected. It has come down in 2002 but is likely to be slightly higher than foreseen in the 2001 update. The Swedish Krona has appreciated somewhat (in effective terms) in the period since the previous update, whereas a stronger appreciation was expected.

The budget surplus was close to the projection of the previous update in 2001, at 4.5% of GDP, but is likely to be lower in 2002 than the 2.1% of GDP previously foreseen. The debt-to-GDP ratio increased slightly in 2001, whereas a reduction was foreseen. This was mainly due to the National Pension Fund's shift from bonds to shares that year. In 2002 it should be slightly higher than expected, linked to the higher than expected debt ratio in 2001, while resuming a downward path. (A comparison with the previous update is given in Table 5 in Annex 1).

3. MACROECONOMIC ASSESSMENT

3.1. External economic assumptions

The 2002 update foresees a somewhat stronger rebound in global growth compared with the Commission services. This is due to stronger extra-EU growth in 2002 and stronger EU growth in 2003-04. It also assumes higher interest rates in 2003, both short- and long-term, and marginally so in 2004. The 2002 update also assumes a strengthening of the Swedish Krona in each year to 2004, whereas the Commission makes the usual technical assumption of a constant real exchange rate. A comparison of Sweden's and the Commission's basic assumptions is made in Tables 1 and 7 in Annex 1, respectively.

3.2. Macroeconomic developments

3.2.1. Macroeconomic scenarios compared

Medium-term macroeconomic projections in the 2002 update are those included in the Budget Bill for 2003. GDP growth in 2002 is forecast to be 2.1% after 0.8% in 2001[7], and to rise to 2.5% in 2003-04 and is assumed to be 2.3% in 2005. Labour market developments have been relatively stable in 2002 and unemployment has remained at a low level. A slight improvement is expected in 2003, with unemployment falling to 3.8%. These views are more positive than the Commission's (see Table 3.1). This can be attributed to the Commission's less optimistic outlook for the world economy referred to above together with a more subdued domestic recovery. In particular, the Commission services have taken the view that private consumption will rise less than foreseen in the 2002 update. The Swedish authorities expect it to be 2.0% in 2002. Given the outturn for private consumption growth for the first three quarters of 2002 of 0.9% on the year, the Swedish authorities forecast would imply growth higher than 5% on the year in the fourth quarter of 2002. This is considered to be on the high side at this juncture. Moreover, the Swedish authorities expect a stronger rebound in exports. As a result, the Commission

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7 Revised National Accounts were published on 5 December, i.e. after the submission of the updated convergence programme. They were as follows: GDP growth (previous estimate in brackets); 1994: 4.2% (4.1%), 1995:4.0% (3.7%), 1996:1.3% (1.1%), 1997:2.4% (2.1%), 1999:4.6% (4.5%), 2000: 4.4% (3.6%), 2001: 0.8% (1.2%). General government net lending in % of GDP (previous estimate in brackets); 2000: 3.5% (3.7%), 2000: 4.5% (4.8%).

foresees a slower acceleration of GDP in 2002-03 and marginally so in 2004. Other recent forecasts are more in line with the Commission's view[8].

Table 3.1 – Forecasts compared

Sweden	**MACROECONOMIC SCENARIOS 2002-2005** (Annual average growth rate, in %)						
	2002		**2003**		**2004**		**2005**
	Convergence Program	Commission Autumn forecast	Convergence Program	Commission Autumn forecast	Convergence Program	Commission Autumn forecast	Convergence Program
GDP	**2.1**	**1.6**	**2.5**	**2.2**	**2.5**	**2.4**	2.3
CPI	2.3	2.4	2.3	2.3	2.1	2.3	2.0
Employment growth	0,0	0.1	0.2	-0.1	0.5	0.2	
Unemployment (National) a)	3.9	4.0	3.8	4.4	3.8	4.4	3.7
Exchange rate (effective)	-1.6	2.6	-3.7	0.8	-1.4	-0.7	
Budget surplus **(% of GDP)**	**1.7**	**1.4**	**1.5**	**1.2**	**1.6**	**1.5**	2.0
Debt (% of GDP)	53.6	53.8	50.9	51.7	49.3	50.3	48.0

SOURCES: 2002 update convergence programme, Budget Bill for 2003 and the Commission Services.
a) % of Labour Force

Inflation has come down markedly in 2002 and both the 2002 update and the Commission services expect inflation to remain close to the inflation target of 2% in 2003 and beyond. However, wage re-negotiations foreseen in the beginning of 2003 in some sectors might put some upward pressure on wages, although this is not expected to change the inflation outlook.

3.2.2. Potential growth and the output gap

The 2002 update includes a section on structural public finances. The size of the budget balance adjusted for the cycle hinges upon the estimated output gap which in turn hinges upon the estimated potential output growth rate. These estimates can be quite different depending on the modelling approach used. Indeed, in the 2002 update, the government estimates the output gap to be negative, -0.9%, in 2002 and gradually be reduced and reach zero in 2005 (see Table 4 in Annex 1)[9]. By contrast, when the Commission method[10] is used to estimate the output gap based on the programme's information, the result is a positive output gap in 2002-04 (of the order of 0.9%). On the other hand, and according to the Commission's autumn forecasts, the output gap is estimated to be close to zero in the years to 2004 (see Table 3.2).

It is important to note that the Commission's estimates of the potential growth rate in 2002-04 on the basis of the information contained in the programme are broadly similar to the Commission's autumn forecasts. This results from broadly similar views on labour potential and capital accumulation in the context of the PF approach. However, the output gap estimates are different. The Commission forecasts a closed output gap in 2002-04. The closing of the output gap already in 2002 on the basis of the Commission's forecast arises from the forecast actual growth rate being significantly below the potential growth rate.

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8 The National Institute of Economic Research (published 17 December) expect GDP growth to be 1.6% in 2002, 1.8% in 2003 and 2.7% in 2004 and the Riksbank (published 5 December) expect it to be 1.5% in 2002, 2.1% in 2003 and 2.3% in 2004.

9 It is not clear from the 2002 update how the output gap has been estimated by the Swedish authorities.

10 The Commission's method is based on the Production Function (PF) approach and has been agreed by the ECOFIN Council on 12 July 2002.

This is less so using the programme's information[11]. At this juncture, the Commission's view on the cyclical position of the Swedish economy over the coming years is considered to be more reasonable. The analysis of the underlying budgetary position is made in section 5 below.

Table 3.2 – Potential growth and output gaps

	2002 updated convergence programme			Commission's autumn 2002 forecast		
	GDP growth	PF Potential growth[1]	Output gap[1]	GDP growth	PF Potential growth	Output gap
2000	3.6	2.4	2.4	3.6	2.5	2.3
2001	1.2	2.5	1.1	1.2	2.7	0.8
2002	2.1	2.4	0.9	1.6	2.4	0.1
2003	2.5	2.5	0.9	2.2	2.4	-0.1
2004	2.5	2.5	0.9	2.4	2.4	-0.1
2005	2.3	-	-	-	2.4	-

[1] Commission services calculations.
Comments:
1) GDP and potential growth as percentage change. The HP trend growth rate is 2.4% each year in the period 2001-2004.
2) The overall picture given in the table above does not significantly change by taking into account the revised National Accounts described in footnote 7.
3) Calculation of PF potential growth post-2004 was not possible, as information on investment developments was not included in the 2002 update.

4. MEDIUM TERM MONETARY POLICY OBJECTIVES AND THEIR RELATIONSHIP TO PRICE AND EXCHANGE RATE STABILITY

4.1. Inflation developments

The 2002 update notes that the monetary framework for the Riksbank is an explicit inflation target of 2%, based on headline CPI, with a tolerance interval of one percentage point either side of the target. Departures from this target might be warranted for two reasons. Firstly, the CPI can be affected by factors that are not considered to affect inflation permanently. Secondly, a quick return to the target in the event of a sizeable deviation may be costly for the real economy. Against this background, the Riksbank has declared that current monetary policy is based on an assessment of the underlying inflation (UND1X)[12] two years ahead.

Inflation in Sweden fell back towards 2% in the Spring of 2002 after having risen sharply one year earlier; influenced by these favourable base effects. HICP inflation was 1.7% in October, underlying inflation (UND1X) was 2.5% and CPI inflation was 2.4% in October. According to survey results reported in the Riksbank's latest Inflation Report, inflation expectations (two-years ahead), while having fallen since the middle of 2002, remain slightly above the 2% target. These results are likely to be linked to the observed fall in the inflation rate during 2002 and signs of a weaker than previously expected recovery of

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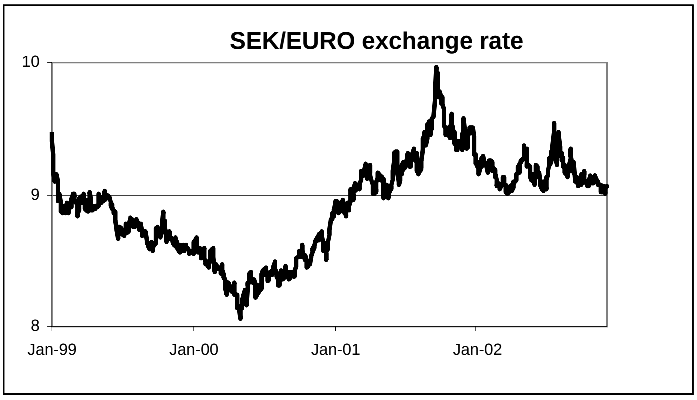
[11] When taking the revised National Accounts data into account (see footnote 7), the potential growth rate is higher and the output gap is lower in 2002-04. This applies both to the Commission's autumn forecast and the Commission's estimations on the basis of the 2002 update. However, the output gap on the basis of the 2002 update remains higher than on the basis of the Commission's forecast.

[12] UND1X is defined as the CPI excluding mortgage interest expenditure and direct effects of altered indirect taxes and subsidies. It covers 94% of the CPI basket.

economic activity. The Riksbank's assessment is that looser monetary conditions, as reflected in the recent cuts in the repo-rate in November and December last year (totalling 50 bp and thereby reversing the two increases of 25 bp respectively made in the spring 2002), are warranted by a forecast that inflation would be slightly below the inflation target in two years time. However, re-negotiations of wage agreements foreseen in the beginning of 2003 in some sectors might put some upward pressure on wages. Domestic inflation remains higher than the Riksbank's current inflation measure (UND1X), as evident from the underlying inflation excluding primarily imported goods (UNDINHX)[13] at 2.9% in October. In Maastricht terms, Swedish HICP inflation has been on a declining path since March 2002. It was slightly higher than the EU average in October (Swedish 12-month average inflation rate at 2.2% compared with 2% in the EU). Sweden continues to fulfil the convergence criterion for price stability.

4.2. Exchange rate developments



The program notes that pegging the krona to ERM2 is currently not under consideration. The monetary framework of explicit inflation forecast targeting means that the exchange rate is not a target variable for monetary policy, but rather that the value of the krona is determined in the exchange rate market. The absence of an explicit exchange rate commitment means that the stability of the exchange rate of the krona cannot be assessed in the same way as for participants in the ERM2 (i.e. on the basis of deviations from the central rate).

From the beginning of 1999 throughout April 2000, the krona was on an appreciating trend against the euro, rising by some 15% from 9.47 SEK to 8.06 SEK against the euro. In 2001, the krona depreciated to weak levels, due among other things to a weak stock market trend in particular for information technology and telecom. In September 2001, it reached its lowest level ever in trade weighted terms and fell to almost 10 SEK/euro.

The krona subsequently began to strengthen in the Autumn of 2001. During the Summer of 2002 there were again periods when the Swedish krona temporarily weakened against the euro, partly as a result of financial market unrest. Even so, the SEK/euro exchange rate has strengthened recently to close to 9.00, perhaps as a result of less uncertainty regarding the EMU process in connection with the outcome of Sweden's general election in September 2002 and the referendum on participation in the third stage of EMU to be held on 14 September 2003.

The absence of an exchange rate commitment is reflected in the krona's volatility against the euro. In particular, the krona being a small currency tends be affected in times of financial market uncertainty.

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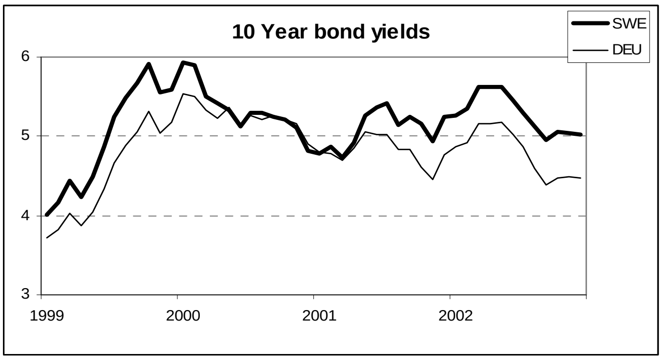
[13] UNDINHX is defined as the UND1X excluding mainly imported goods. It covers 65% of the CPI basket.

The Swedish krona has not participated in the ERM2 and it has recently fluctuated markedly against the euro and the Danish krone. Hence, as was the case at the time of the 2001 assessment of convergence, Sweden does not fulfill the exchange rate criterion.

4.3. Interest rate developments



The improved macroeconomic framework in Sweden, with low and stable inflation and sound public finances, continues to result in low long-term bond yields. Developments in Swedish bond market yields over the past year have been in line with the trend in the international bond and equity markets. Bond yields fell globally during the Summer and Autumn, in response to the gloomier growth outlook and the better inflation outlook, as well as in response to equity market weakness. The bond yield spread vis-à-vis Germany, has fluctuated around some 50 basis points over the last year. Hence, as was the case at the time of the 2001 assessment of convergence, Sweden currently fulfills the long-term interest rate convergence criterion.

5. BUDGETARY TARGETS AND MEDIUM-TERM PATH OF PUBLIC FINANCES

5.1. Programme overview

Table 5.1 – Net lending and gross debt compared

% of GDP		2001	2002	2003	2004	2005
Net lending						
2001 update		4.6	2.1	2.2	2.3	
2002 update		4.8	1.7	1.5	1.6	*2.0*
Gross debt						
2001 update		52.3	49.7	47.3	45.2	
2002 update		56.6	53.6	50.9	49.3	*48.0*

Strong public finances are a major element in Swedish economic policy. Surpluses have been recorded each year since 1998 and continued surpluses are projected over the programme period in the present update. The debt ratio – below 60% of GDP since 2000 - is projected to continue on a downward trend. In the 2002 update, the Swedish fiscal rule of a 2% of GDP surplus over the cycle is maintained and the underlying budgetary position, according to the programme, is expected to remain close to the target over the programme period. This encompasses the SGPs requirement of a budgetary position 'close to balance or in surplus'. This target is also intended to address the ageing problem and the sustainability of public finances in the long-term.

The target for government finances in 2002 is a surplus of 1.7% of GDP (see Table 5.1). The large reduction in the balance, from 4.5% of GDP in 2001 to 1.7% in 2002, results from (i) the effect of the cycle, (ii), discretionary expansionary measures, in particular the third step of tax cuts out of four and (iii) transitory factors[14]. The change in the underlying budgetary position, taking into account the effect of the cycle and the transitory factors, is smaller, about 1 percentage point, and this is to a large extent attributable to the tax cuts mentioned above (the cyclically adjusted balances in Table 5.2 are calculated using the output gaps given in section 4 above). Cash outturns for central government for the first 10 months of 2002 suggest that a surplus should be achieved this year. However, it cannot be excluded that the surplus could be somewhat lower than projected in the 2002 update, as forecast by the Commission services (see Table 5.2). For 2003 and 2004, the 2002 update projects lower surpluses while the GDP growth forecasts are broadly similar compared with the previous update (see Table 5 in Annex 1). This suggests a less ambitious budgetary strategy.

Table 5.2 – Public finances

	2002 updated convergence programme			Commission's autumn 2002 forecast		
	Budget balance	CAB[1]	CAB[1] – adjusted for transitory factors	Budget balance	CAB	CAB – adjusted for transitory factors
2000	3.7	2.1	3.1	3.7	2.1	3.1
2001	4.8	4.0	1.5	4.8	4.2	1.7
2002	1.7	1.1	0.6	1.4	1.3	0.8
2003	1.5	0.9	1.0	1.2	1.3	1.4
2004	1.6	1.0	1.2	1.5	1.5	1.7
2005	2.0	-	-	-	-	-

[1] Commission services calculations.
Comments:
1) Budget balance and CAB in % of GDP.
2) The adjustment transitory factors is made on the basis of the information in the 2002 updated convergence programme, described further in footnote 14.
3) Calculation of CABs was not possible post-2004, as information an output gap estimate could not be calculated due to missing information in the 2002 update.

Indeed, the underlying budgetary surplus is expected to be below Sweden's 2% of GDP surplus target in the years to 2004, according to the Commission's analysis. This results from the fact that the considerable fiscal stimulus in 2001 and 2002 is only being partially reversed in the following years. As mentioned above, maintaining high surpluses is an integral part of Sweden's strategy for the long-term sustainability of the public finances. Maintaining strong budgetary discipline is therefore important.

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[14] In the 2002 update some adjustments in addition to the effect of the cycle are made (adjusting for the timing of recording of taxes), which reduces the balance in particular in 2001 but also in 2002. The difference between the preliminary and final taxation as regards households is to a large extent due to capital gains, real estate tax and wealth tax. This because no preliminary taxation are made for these. With regard to corporate taxation, the preliminary taxation for the current year is based on the final tax two years earlier. In case of large changes in corporate profits, the tax revenues are therefore affected with a one-year lag. In short, it involves attributing the difference between the preliminary and final taxation for year t, made in year t+1, to year t. The Swedish approach of adjusting the periodisation of taxes give considerable effects for some years. This explains that the budget balance for 2000 is strengthened by 1 percentage point and weakened by 2.5 and 0.5 percentage points in 2001 and 2002, respectively. Smaller effects are projected for 2003 and 2004.

5.2. Public finances in 2003

5.2.1. The State Budget for 2003[15]

Expenditure

Total expenditure reforms in 2003, comprising both measures included in the Budget for 2003 and previously decided ones amount to SEK 12.9 billion, which includes SEK 6.9 billion in expenditure cuts.

The expenditure ceilings for central government

In the Budget for 2003, the government remains committed to maintain its previously set expenditure ceiling for the central administration. However, given the very small budgetary margins within the expenditure ceilings, some restraining measures may be necessary in case of worse-than-projected developments (see Table 5.3)[16].

The budgetary margins for 2003 (and 2004) are indeed very narrow. Moreover, SEK 4 billion of planned expenditure has been advanced from 2003 to 2002 in order to improve the chances of not breaking through next year's expenditure ceiling. The government recognises that the margins are small and that they build upon expectations of a favourable macroeconomic climate and the assumption that proposed reforms will be successful in achieving a halt, or in some cases a reversal, of negative trends.

It can be argued that the government takes a rather optimistic view in that it expects that the unemployment rate will slide further downwards, and that the trend of spiralling costs for long-term sick leave will reverse and the aggregate days spent on sick leave will decline by 10% in 2003, and a another 5% in 2004. Few analysts support these forecasts and the government, recognising this possibility, hints that it might have to carry out additional restraining measures on expenditure in the near future if current reforms fail to pay off[17].

Table 5.3 – Expenditure ceilings on central government

[15] This section is based both on information contained in the 2002 update and on the Budget Bill for 2003 on which the update is based.

[16] The expenditure ceiling, which is normally set three years ahead, is not given for 2005, as prolonged negotiations with respect to forming a government delayed such a decision. Instead, the government has declared that new expenditure ceilings for 2005 *and* 2006 will be presented in the 2003 Spring Fiscal Policy Bill, and subsequently included in the Budget Bill for 2004.

[17] The Budget Law requires the government to evaluate the budgetary situation twice a year and if necessary propose restraining measures to the parliament if it considers that expenditure, globally, can be expected to breach the ceilings set. Given the risks for breaching the ceilings at this juncture, these evaluations, normally made in association with the presentation of the Fiscal Policy Bill (in April) and the Budget Bill (in September), shall prove interesting to monitor closely.

Ceilings and expenditure for central government					
SEK billions	**2000**	**2001**	**2002**	**2003**	**2004**
Ceiling	765	791	812	818	852
% of GDP	36.7	*36.5*	*36.1*	*34.6*	*34.3*
Expenditure[1]	760.0	786.3	811.7	817.6	851.4
Contingency reserve[1]	5.0	4.7	0.3	0.4	0.6

Source: Budget Bill for 2003 (October 2002)

[1] *Outturn for 2000-01, planned for 2002-04*

Revenue

Total measures on the revenue side in 2003, comprising both measures included in the Budget for 2003 and previously decided ones amount to lower revenue of SEK 2.0 billion. The new tax measures include a green tax swap where reductions in income tax for low-income households (raised basic tax allowances) are met by increases in environmental taxes

It should be noted that the previously expected main tax measure is missing, i.e. the fourth and final step of tax cuts, compensating for earlier rises in pension contributions, is not considered to be a priority at present.

Overall, the effect of expenditure and revenue measures proposed in the Budget Bill for 2003 and previously decided ones involve a weakening of the Budget in relation to the previous year by SEK 14.8 billion in 2003 (0.6% of GDP).

5.2.2. General government finances

For 2003 a surplus of 1.5% of GDP is projected. A sectoral breakdown of the general government balance reveals that the surplus results entirely from a strong surplus in the old-age pension system. By contrast, the central government is projected to show a deficit of the order of 1% of GDP whereas the local government sector is projected to, largely, be in balance (see Table 2 in Annex 1).

The Commission's assessment, as reflected in the Autumn 2002 economic forecasts, is for a lower actual surplus of 1.2% of GDP. The Commission's less optimistic view on the public finances stems mainly from a lower forecast for economic growth, compared with the government's projections.

In addition, differences also exist as regards the underlying budgetary position. While these different estimates lead to different *levels* of the cyclically-adjusted balance in relation to GDP, both measures indicate a surplus in the underlying balance in 2003[18].

However, on the basis of both the Commission's autumn forecast and on the information in the programme, the underlying budgetary position would fall below the Swedish government's own fiscal rule of a 2% of GDP surplus in 2003.

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[18] According to the Commission's calculations based on the 2002 update, the underlying budgetary position shows a surplus of 1.0% of GDP, compared with the Commission's forecast of 1.4% of GDP. As already mentioned above, this mainly reflects the different estimates of the output gaps.

5.3. Targets and adjustment in 2004 and beyond

5.3.1. The State Budget[19]

Expenditure

In 2004, total expenditure reforms is SEK 9.8 billion, which includes expenditure cuts of SEK 2.3 billion. The budgetary margins included in the expenditure ceilings for 2004 are very narrow, as described in section 5.2 above.

Revenue

In 2004, total measures on the revenue side are expected to result in a rise of SEK 1.9 billion.

Overall, the effect of expenditure and revenue measures proposed in the present Budget Bill and previously decided ones involve a weakening of the Budget in relation to the previous year by SEK 7.9 billion (0.3% of GDP) in 2004.

5.3.2. General government finances

For 2004, a surplus of 1.6% of GDP is projected and in 2005 a surplus of 2% of GDP is assumed. The assumption for 2005 reflects the Swedish fiscal rule of a surplus of 2% of GDP. A sectoral breakdown of the general government balance in 2004 reveals that the surplus described above results entirely from the old-age pension system. By contrast, the central government is projected to show a deficit of the order of 1% of GDP whereas the local government sector is projected to be, largely, in balance. As mentioned above, detailed information for the public finances in 2005 and beyond were not included in the 2002 update. The Commission's forecast is broadly in line with the projection in 2002 update and a surplus in the public finances of 1.5% of GDP is projected in 2004.

Also in 2004 some differences exist as regards the underlying budgetary position, stemming from the adjustment of the cycle. While these different estimates lead to different *levels* of the cyclically-adjusted balance in relation to GDP, both measures indicate a strong fiscal position in 2004[20].

However, on the basis of both the Commission's Autumn forecast and on the information in the programme, the underlying budgetary position would again fall below the Swedish government's own fiscal rule of a 2% of GDP surplus in 2004, although slightly.

All in all, with the projections foreseen both in the 2002 update and on the basis of the analysis above, Sweden continues to meet the budgetary requirements of the Stability and Growth Pact, as was the case in the previous update.

5.4. Sensitivity analysis

The 2002 update recognises that there are considerable risks to the forecast. It is estimated that an increase in GDP of one percentage point results in an increase in government net

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[19] See footnote 15.

[20] According to the Commission's calculations based on the 2002 update, the underlying budgetary position shows a surplus of 1.2% of GDP, compared with the Commission's forecast of 1.7% of GDP. As already mentioned above, this mainly reflects the different estimates of the output gaps.

lending by 0.75 percentage points. This is in line with the Commission's calculations of the budget elasticity.

Although not being the typical sensitivity analysis approach, the low and high growth scenarios included in the 2002 update are illustrative. According to the 2002 update, the public finances would remain in surplus in each year to 2004 if economic growth turned out much lower. Analysis made by the Commission services broadly support the ‘risk’ scenarios included in the 2002 update. In particular, a worsened growth outlook in the years to 2004 (of 0.5 percentage points lower GDP growth using the 2002 update as a baseline) would not lead to the public finances going into deficit[21]. In all, these calculations suggest that a worsened growth outlook would be unlikely to put compliance with the SGP at risk.

5.5. Debt ratio

The debt ratio fell below the reference value of 60% of GDP in 2000. In the 2001 update, a marked reduction in the debt ratio was foreseen. By contrast, the outturn for 2001 (included in the 2002 update) reveals that the debt ratio rose. The rise observed in 2001 was the result of the National Pension Fund’s very large shift from bonds to shares that year, enabled by changed rules as regards the Fund’s investment profile[22]. This affects the targeted adjustment path in 2002-04, i.e. a higher debt ratio in 2001, in the 2002 update and explains the deviation from the 2001 update. Table 5.4 compares the debt developments according to the previous update, the current update and the Commission’s scenario.

Table 5.4 – Debt developments compared

% of GDP		2001	2002	2003	2004	2005
Gross debt levels						
2001 update		52.3	49.7	47.3	45.2	
2002 update		56.6	53.6	50.9	49.3	*48.0*
Commission scenario		56.6	53.8	51.7	50.3	

The debt reduction foreseen in the 2002 update lends support to the view that the public finances are in good shape (see Table 3 in the Annex 1). Continued primary balances, reflecting continued surpluses in the public finances, contribute to the downward trend in the debt ratio foreseen in the 2002 update. Similar developments are present in the Commission’s forecast, although a slower debt reduction is foreseen, i.e. a slightly higher debt ratio is projected over the period.

6. THE SUSTAINABILITY OF PUBLIC FINANCES

The 2002 updated convergence programme contains detailed and very useful information on the sustainability of public finances, complete with budgetary projections up to 2050.

[21] By lowering the growth outlook by 0.5 percentage points, the estimated cyclically-adjusted balance is reduced by between 0.2 and 0.4 percentage points in 2002-04.

[22] From 1 January 2001, the National Pension Funds’ may invest a maximum of 70% of their assets in shares. In 2001, the Funds proportion of shares was 57.7% of total assets, compared with 28.6% in 2000.

They show that age-related expenditures are projected to increase by some 5 percentage points of GDP between 2005 and 2050, which will be offset by an increase in the tax ratio of 2.5 percentage points of GDP over the same period.

It is first necessary to consider whether current budget polices and the medium-term target can ensure that the SGP will continue to be respected in the future in light of the budgetary implications of ageing populations. The Commission's analysis support the conclusion of the programme that public finances in Sweden are in good position to meet the budgetary consequences of ageing populations (see Annex 2). This is largely due to debt reduction as a result of sustained budget surpluses, and also because of the substantial reforms of the pension system implemented during the 1990s[23]. However, demographic change may have a more pronounced impact on the budget compared to what is indicated in the programme, as the Commission has made more prudent assumptions as regards long-run budgetary developments. For example, as regards the projected evolution of non-age-related expenditure, it is by no means certain that such expenditures will decline as a share of GDP. Finally, considerable uncertainty surrounds the projected impact of ageing populations on tax revenues.

A second issue is whether the budgetary strategy outlined in the programme is compatible with improving the sustainability of public finances. The strategy outlined in the programme hinges upon achieving a fast pace of debt reduction by running surpluses of 2% of GDP up to 2015. This focus on debt reduction appears to be appropriate, given the substantial reform of the pension system during the 1990s. However, recent experiences demonstrate just how hard it is in practice for governments to run large budget surpluses over the long-run.

Finally, it is necessary to consider the type and scale of the budgetary challenges that will emerge in coming years to ensure sustainable public finances. While public finances in Sweden appear to be sustainable in terms of avoiding budgetary imbalances and debt accumulation, it should be borne in mind that this is based on an assumption of a tax ratio above 50% of GDP in coming decades. It is up to each Member State to determine its tax ratio: however, the projected level in Sweden is high relative to those observed in other industrialised countries and the desirability of maintaining such high tax ratios over the very long-run could be called into question by the increasing mobility of production factors (and consequently tax bases) increases in light of globalisation. Indeed the projections of the Swedish authorities project an increasing tax ratio in coming decades.

7. STRUCTURAL MEASURES AND OTHER REFORMS WITH LIKELY BUDGETARY IMPACT

The present update outlines structural policies being pursued to improve the functioning of the supply side of the economy. The main policy objective is one of achieving an employment ratio of 80% in 2004. This objective is however not expected to be achieved according to the main scenario in the updated programme. Other objectives are the target of halving the number of people receiving social benefits between 1999 and 2004 and a new target of halving the number of sick leave days by 2008. The areas which are given prominence in the latest Budget Bill are (i) the labour market, (ii) education, (iii) fiscal and

[23] One feature of the reformed pension system is that it has a built-in balancing mechanism, in the sense that disbursements made equals contributions made in a medium-term perspective. This feature, together with the pension system being a defined contribution system, suggest that it is sustainable in the longer term.

family policy ,and (iv) health and medical care. A description of these measures are given in the programme. First and foremost, the tax reform initialised in 2000 aimed at reducing the, still, high marginal and average tax rates was – with the Budget for 2002 – implemented to ¾, which should stimulate labour supply and growth[24]. This was in line with the Council's Opinion on the 2001 update and with the Broad Economic Policy Guidelines. However, the last step of this reform was not proposed in the Budget Bill for 2003. A successful implementation of the measures in place, and proposed, should support the overall objective of employment creation. In some aspects however it remains to be seen whether the reforms proposed will pay off, for example concerning the Government's 11-point programme aimed at improving occupational health. This issue deserves particular attention, as the budgetary implications of bad health in working life and persons receiving early retirement pensions has become more important. Moreover, the problem of people going between unemployment and various labour market programmes is recognised. Several measures are in place and additional resources are made available to remedy this. A stronger emphasis is placed on vocational training, efforts to integrate long-term unemployed into the labour market and a sharpening, in terms of eligibility and duration, of unemployment insurance. Measures to reduce distortionary effects arising from income-dependent fees and benefits have also been implemented. More resources are made available to education and training and in particular to higher education, in order to strengthen employability. As regards welfare policies, rises in certain benefit levels have been implemented. The price level in Sweden is almost 30% above the EU average, partly due to lack of competition in certain sectors. Therefore, enhancing the functioning of product and capital markets in the framework of the Cardiff process remains an important issue.

8. OVERALL ASSESSMENT OF COMPLIANCE WITH THE SGP

On the basis of the analysis above, the Swedish public finances are expected to remain in surplus over the programme period. The Commission services estimate that the underlying budgetary position would be in surplus in each year to 2004. Moreover, if growth turned out worse than expected, this would be unlikely to result in the public finances breaching the 3% of GDP deficit threshold.

The debt ratio – below 60% of GDP since 2000 - is expected to continue on a downward trend in the years to 2004, supported by continued primary surpluses.

The sustainability of the public finances is a core policy objective of the 2002 update. It involves a budgetary objective of running budget surpluses of 2% of GDP up to 2015 with a view to running down public debt at a fast pace. However, recent experiences demonstrate just how hard it is in practice for governments to run large budget surpluses over the long-run.

The 2002 update also addresses structural issues with a view to enhance the supply side of the economy. In this context, the programme strategy is broadly consistent with the Broad Economic Policy Guidelines and the Lisbon strategy. Indeed, efforts to lower the tax

[24] The recent 'tax reform' report (Our Taxes?, SOU 2002:47) submitted on 29 November by the Tax Base Commission to the Government presents an overall assessment of how the Swedish tax structure should be designed in a globalized world. The main aim is to achieve a tax system that is more rational in economic terms, more robust and more equitable by broadening tax bases, reducing marginal tax rates and simplifying certain features. It provides several proposals as to how a 'new tax reform' should be designed.

burden appear motivated in light of ensuring sustainable growth. To this end, completing the tax reform and efforts to reach the key policy objectives regarding employment, social security recipients and days of sick-leave should be given priority within the framework of sound public finances.

It can be concluded that Sweden continues to comply with the requirements of the Stability and Growth Pact.

ANNEX 1. SUMMARY TABLES DERIVED FROM THE 2002 UPDATED CONVERGENCE PROGRAMME

Table 1. Growth and associated factors

		2001	2002	2003	2004	2005
GDP *growth* at *constant* market prices (7+8+9)		1.2	2.1	2.5	2.5	*2.3*
GDP *level* at *current* market prices		2,167	2,249	2,366	2,484	
GDP deflator		2.0	1.7	2.6	2.4	
HICP change		3.2	1.4	2.1	-	
Employment growth		1.9	0.0	0.2	0.5	
Labour productivity growth		0.6	2.6	2.0	1.8	
Sources of growth: percentage changes at constant prices						
1. Private consumption expenditure		0.2	2.0	2.6	2.5	
2. Government consumption expenditure		1.4	1.7	0.8	0.3	
3. Gross fixed capital formation		1.5	-1.5	4.6	5.1	
4. Changes in inventories and net acquisition of valuables as a % of GDP		-0.5	-0.4	0.4	0.0	
5. Exports of goods and services		-1.4	3.8	6.3	6.2	
6. Imports of goods and services		-3.9	1.0	7.8	6.6	
Contribution to GDP growth						
7. Final domestic demand (1+2+3)		0.7	1.2	2.3	2.2	
8. Change in inventories and net acquisition of valuables (=4)		-0.5	-0.4	0.4	0.0	
9. External balance of goods and services (5-6)		1.0	1.3	-0.2	0.3	
Basic assumptions						
Short-term interest rate (annual average)		4.1	4.4	4.7	4.7	
Long-term interest rate (annual average)		5.1	5.4	5.3	5.3	
USD/€ exchange rate (annual average)						
(for non-euro countries) exchange rate vis-à-vis the € (annual average)						
World excluding EU,GDP growth		2.6	3.2	3.9	4.3	
EU-15 GDP growth		1.6	1.0	2.3	2.9	
Growth of relevant foreign markets						
World import volumes, excluding EU		0.8	4.4	7.3	7.8	
Oil prices		24.5	25.3	26.0	--	

Table 2. General government budgetary developments

% of GDP		2001	2002	2003	2004	2005
Net lending by sub-sectors						
1. General government		4.8	1.7	1.5	1.6	*2.0*
2. Central government		9.5	-0.4	-1.1	-1.0	
3. State government						
4. Local government		0.1	0.0	0.2	0.1	
5. Social security funds		-4.7	2.1	2.4	2.4	
General government						
6. Total receipts		59.2	56.5	55.9	55.4	
7. Total expenditures		54.4	54.8	54.5	53.8	
8. Budget balance		4.8	1.7	1.5	1.6	*2.0*
9. Net interest payments		1.2	0.6	0.5	0.5	
10. Primary balance		6.0	2.3	2.0	2.1	
Components of revenues						
11. Taxes		38.0	35.1	35.1	34.9	
12. Social contributions		15.4	15.5	15.1	15.0	
13. Interest income						
"Capital Income"		2.3	2.3	2.3	2.3	
14. Other ***(revenue)***		3.4	3.4	3.3	3.2	
15. Total receipts		59.2	56.5	55.9	55.4	
Components of expenditures						
16. Collective consumption		26.7	27.2	26.8	26.4	
17. Social transfers in kind						
18. Social transfers other than in kind		22.0	22.1	22.3	22.2	
19. Interest payments		3.4	3.0	2.8	2.8	
20. Subsidies		1.8	1.7	1.6	1.7	
21. Gross fixed capital formation		2.6	2.6	2.6	2.6	
22. Other						
23. Total expenditures		54.4	54.8	54.5	53.8	

Table 3. General government debt developments

% of GDP		2001	2002	2003	2004	2005
Gross debt level		56.6	53.6	50.9	49.3	*48.0*
Change in gross debt		1.3	-2.9	-2.7	-1.6	
Contributions to change in gross debt						
Primary balance		-8.0	-4.5	-4.1	-4.1	
"Consolidation"		8.8	-0.1	-0.2	-0.2	
Interest payments		3.2	2.8	2.6	2.5	
Nominal GDP growth		-1.9	-2.0	-2.7	-2.5	
Other factors influencing the debt ratio		-0.8	0.9	1.6	2.6	
Of which: Privatisation receipts						
p.m. implicit interest rate on debt						

Table 4. Cyclical developments

% of GDP		2001	2002	2003	2004	2005
1. GDP growth at constant prices		1.2	2.1	2.5	2.5	*2.3*
2. Actual balance		4.8	1.7	1.5	1.6	*2.0*
3. Interest payments		3.4	3.0	2.8	2.8	
4. Potential GDP growth						
5. Output gap		–0.8	-0.9	-0.5	-0.2	
6. Cyclical budgetary component						
7. Cyclically-adjusted balance (2-6)						
8. Cyclically-adjusted primary balance (7-3)						

Table 5. Divergence from previous update

% of GDP		2001	2002	2003	2004	2005
GDP growth						
previous update		1.7	2.4	2.6	2.3	
latest update		1.2	2.1	2.5	2.5	*2.3*
Difference		–0.5	-0.3	-0.1	0.2	
Actual budget balance						
previous update		4.6	2.1	2.2	2.3	
latest update		4.8	1.7	1.5	1.6	
Difference		0.2	-0.4	-0.7	-0.7	
Gross debt levels						
previous update		52.3	49.7	47.3	45.2	
latest update		56.6	53.6	50.9	49.3	*48.0*
Difference		4.3	3.9	3.3	3.9	

Table 6. Long-term sustainability of public finances

% of GDP	**2000**	**2005**	**2010**	**2020**	**2030**	**2050**
Total expenditure	55.4					
Old age pensions	9.0	6.6	7.1	8.4	9.3	9.5
Health care (including care for the elderly)	9.6	9.8	9.9	10.8	12.8	14.4
Interest payments	4.3					
Total revenues	59.5					
of which: from pensions contributions	7.0	7.0	7.0	7.0	7.1	7.2
National pension fund assets (if any)	37.3	32.6	41.2	45.9	44.1	23.5
Assumptions						
Labour productivity growth	2.2	1.8	1.9	1.7	1.6	1.7
Real GDP growth	3.6	2.3	2.1	1.6	1.4	1.8
Participation rate males (aged 20-64)	84.0	83.6	83.2	83.8	83.3	83.2
Participation rates females (aged 20-64)	78.4	78.4	77.9	78.5	78.1	77.9
Total participation rates (aged 20-64)	81.2	81.0	80.6	81.2	80.7	80.6
Unemployment rate	4.7	3.7	3.7	3.7	3.7	3.7

Table 7. Basic assumptions from the Commission's 2002 autumn forecast

		2001	2002	2003	2004
Basic assumptions					
Short-term interest rate (annual average)		4.1	4.3	4.4	4.6
Long-term interest rate (annual average)		5.1	5.3	4.7	5.0
USD/€ exchange rate (annual average)		0.89	0.93	0.98	0.98
(for non-euro countries) exchange rate vis-à-vis the € (annual average)		9.26	9.13	9.14	9.19
World excluding euro area, GDP growth		2.3	2.9	3.8	4.2
EU-15 GDP growth		1.5	1.0	2.0	2.6
Growth of relevant foreign markets		-0.1	2.4	5.3	5.5
World import volumes, excluding euro area		-1.4	3.0	6.5	7.1
Oil prices		25.0	25.5	24.1	22.5

1. Information content of programme and data used by the Commission

This is the second assessment of the sustainability of Swedish public finances as part of the stability and Growth Pact. The quantitative indicators used for this are similar to those used last, but have been adjusted in line with the recommendations of the Ageing Working Group to the EPC.[25]

The Swedish convergence programme contains a detailed section assessing the sustainability of public finances with an in-depth presentation of national budgetary projections for public expenditures and revenues up to 2050, see Table 1 below . This is to be commended. They cover additional age-related expenditures items which not been projected by the EPC (e.g. education, child care). The programme also includes a projection for revenues as a share of GDP based on an assumption of constant tax rates. These projections were made on the basis of a different demographic projection to that used by the EPC, as well as different assumptions on labour market developments, productivity growth and interest rates.

Table 1

Budgetary projections for 2005-2050 in the Swedish convergence programme

	2005	2010	2020	2030	2040	2050	change 2000-50
Government consumption	26,3	16,9	25,9	28,1	28,3	28,9	2,6
Childcare	1,5	1,5	1,6	1,7	1,7	1,8	0,3
Primary and secondary education	3,9	3,5	3,4	3,6	3,5	3,4	-0,5
Adult education	1,9	2	1,8	1,8	1,8	1,8	-0,1
Medical care	5,9	6	6,4	6,9	7,1	7,3	1,4
Care of the elderly	3,9	3,9	4,4	5,9	6,5	7,1	3,2
Other activities	9,2		8,3	8,2	7,7	7,5	-1,7
Total Government transfer payments	22,1	22,1	22,6	23,4	23,1	22,7	0,6
Transfer payments to households	18,9	18,9	19,4	20,2	20	19,5	0,6
Old age	9,1	9,3	10,4	11,1	11,4	10,9	1,8
Ill health	4,7	4,6	4,5	4,5	4,3	4,4	-0,3
Children/studies	2,4	2,4	2,2	2,3	2,2	2,2	-0,2
Labour market	1,1	1,1	1	1	0,9	0,9	-0,2
Other	1,5	1,4	1,3	1,3	1,2	1,1	-0,4
Transfer payments to firms	1,8	1,8	1,8	1,8	1,7	1,8	0
Transfer payments abroad	1,4	1,4	1,4	1,4	1,4	1,4	0
Public investment	2,5	2,3	2	1,8	1,6	1,4	-1,1
Primary revenue	53,1	53,6	54,5	55,3	55,6	55,6	2,5

Source: Updated Swedish Convergence programme, November 2002

[25] 'How the sustainability of public finances was assessed using the 2001 updates of stability and convergence programmes: recommendations for improvements in future years', Note from the AWG to the EPC, EPC/ECFIN/396-02 of 23 July 2002.

In assessing the sustainability of public finances under the SGP, the Commission has to draw a balance between using national projection which may be more comprehensive and up to date, and the need to ensure comparability across countries. Table 2 presents the budgetary data used by the Commission in running the sustainability indicators, and several differences are worth noting.

- the Commission did use the budgetary projections provided by the Swedish authorities for age-related public expenditures, including those expenditure items not yet projected by the EPC. In this context, it should be noted that the differences between the EPC and Swedish projections for pension and health care are relatively small, whereas the convergence programme projects a much larger increase in spending on care for the elderly compared with the EPC results.
- the Commission, however, did not use the national projections for non-age related expenditures, but instead assumed that they remain constant as a share of GDP over the projection period. The convergence programme projects a large reduction in spending as a share of GDP on 'other government consumption activities'[26] (1.7 p.p. of GDP between 2005 and 2050) and in spending on 'public investment (1.1 p.p. of GDP). This results from an assumption that the price of government investment and consumption follows the consumer price index which develops more slowly than the GDP deflator.
- in the absence of analysis of the EPC on the impact of ageing populations on tax revenues, the Commission did not use the projections for primary revenues included in the Swedish convergence programme, but instead assumed that the tax ratio remains constant as a share of GDP at the level indicated in the programme for 2005. The Commission acknowledges the argument made in the programme that the assumption of a constant tax ratio implicitly assumes changes in tax regulations given that tax bases will alter over time.
- Sweden has large financial assets in pension funds which can be used to meet future expenditure needed. The Swedish convergence programme provides a measure of 'adjusted gross debt' (see table 15 on page 26), which is defined as consolidated gross debt minus pension system assets in addition to government securities. The Commission took due account of these financial assets, as they can be used to meet future current expenditures. The same yield was assumed to apply to assets as on the debt side.
- the projections for debt in the Swedish convergence programme are based on the assumption that the policy objective of running a budget surplus of 2% of GDP over the economic cycle up to 2015. This requires an additional adjustment item to be introduced to the calculations which in table 15 of the programme is referred to as 'scope for reform'. The Commission calculations of sustainability do not include such an assumption.

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[26] This consists of general administration, the legal system and defence

Table 2 - Quantitative indictors of the sustainability of public finances

Main assumptions - baseline scenario (as % GDP)	2005	2010	2020	2030	2040	2050	change
Total age-related spending	36,0	35,8	37,0	40,1	40,6	40,9	4,9
Pensions	9,1	9,3	10,4	11,1	11,4	10,9	1,8
Health care	5,9	6,0	6,4	6,9	7,1	7,3	1,4
Other age related expenditures	21,0	20,5	20,2	22,1	22,1	22,7	1,7
*Total non age-related spending**	14,9						
Total revenues	55,4	55,4	55,0	54,8	54,6	54,5	-0,9

*constant

Results (as % GDP)	2005	2010	2020	2030	2040	2050	change
Programme scenario							
Debt (1)	18,0	3,4	-24,6	-44,7	-40,9	-34,8	-52,8
Net borrowing	1,7	2,9	3,4	1,6	1,0	0,4	-1,3
2002 situation scenario							
Debt (1)	13,4	-2,6	-33,9	-57,8	-58,5	-57,4	-70,8
Net borrowing	2,1	3,5	4,1	2,5	2,1	1,8	-0,4

Tax gaps	T1*	T2**	T3***
programme scenario	-0,6	-1,1	0,2
2002 situation scenario	-0,9	-1,4	-0,1

* it expresses the constant difference between projected revenues and the revenues required to reach in 2050 the same debt to GDP ratio as the close to balance position holds for the whole projection period.

** it expresses the constant difference between projected revenues and the revenues required to reach in 2050 a debt to GDP ratio equals to 40%.

***It indicates the change in tax revenues as a share of GDP that guarantees the respect of the interteporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

(1) Adjusted gross debt as defined in the convergence programme

Table 2 above presents the debt and budget balance development according to two scenarios, a “programme scenario” and the “2002 situation scenario”. The “programme scenario” is the one outlined by the Swedish convergence programme, i.e. government revenues, gross debt and the primary surplus are the 2002-2004 levels reported in the programme and projections start in 2005.

The “2002 situation scenario” only differs from the “programme scenario” in one respect: the starting position is always 2005, but the primary surplus is assumed to be the same as the primary balance in 2002. In other words, the sustainability indicators are run on the basis of no change being recorded in the underlying budget position over the life time of the convergence programme: this enables one to compare the change in the projected deficit and debt positions at the beginning and end of the convergence programme.

On the basis of both scenarios, public finances appear to be sustainable in terms of respect of SGP requirements.