

Ministry of Finance November 2003

Updated Swedish Convergence Programme



REGERINGSKANSLIET

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I Introduction

In accordance with the Council's regulation (EC) 1466/97, Sweden submitted its convergence programme in December 1998. 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 of 1999, 2000, 2001 and 2002 and approved early the following year. This update has been drawn up in parallel with the Government Budget Bill for 2004, which was presented to the Riksdag on 22 September 2003. The Government Budget Bill is based on an agreement between the Social Democratic government, the Green Party and the Left Party.

The update of the convergence programme is based on the assessment of Sweden's economy contained in the Government Budget Bill for 2004. The forecasting work was completed on 12 September. This assessment involves a weaker outlook for 2003 compared with the forecast in the updated programme for 2002. The assessment for 2004 estimates that Swedish economic activity will rise but at a slower rate than forecast in last year's programme. The economic policy stance and the budget policy targets presented in the convergence programme for 1998 remain unchanged. This means, among other things, that public finances must show a surplus of 2 per cent of GDP on average over a business cycle and that central government expenditure must not exceed the expenditure ceilings set.

II Economic policy framework and targets

Economic policy continues to focus on full employment and increased prosperity through good, sustainable growth. Stable price developments and sound public finances are a precondition for achieving this. Sweden's long-term prerequisites for growth are to be strengthened so that the target of 80 per cent regular employment and a halving in the number of persons receiving social benefits can be achieved.

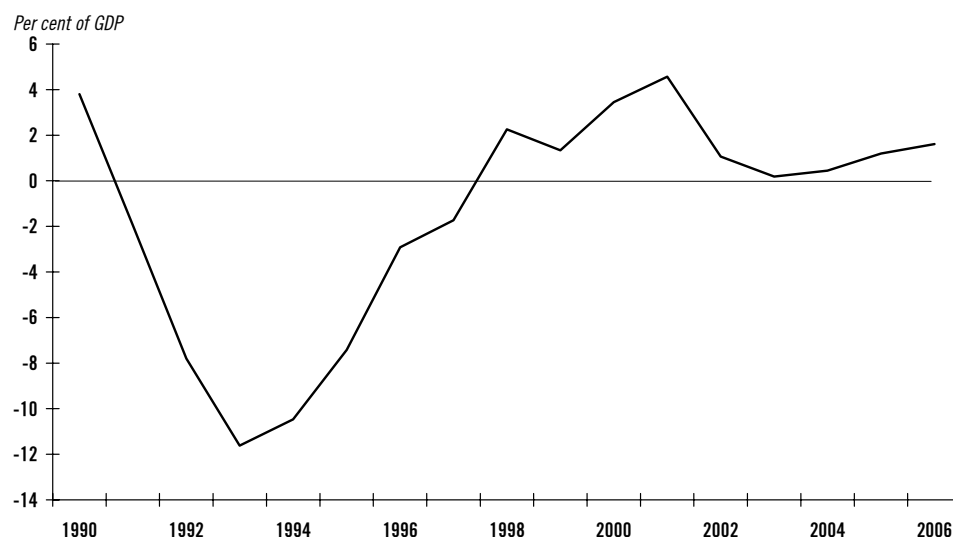
In accordance with the Stability and Growth Pact, Member States shall aim for public finances which are close to balance or in surplus in a medium-term perspective. The Riksdag supports the government's target of a surplus in general government net lending equivalent to 2 per cent of GDP on average over a business cycle. Such a surplus provides a stable basis for the challenges resulting from the sharp increase in the percentage of older people in the population in the future. The surplus also provides a safety margin in public finances, making it possible to counter a recession with a counter cyclical fiscal policy.

In the 2003 Spring Fiscal Policy Bill, the government stated that a specified target for the surplus will now only be proposed for the coming budget year, unlike for three years as before. To secure the overall target, the government proposes in the Budget Bill for 2004 that the net lending of general government, measured with accrued taxes, is to amount to at least 0.5 per cent of GDP in 2004. The fiscal policy stance means that the accrued surplus is estimated to amount to 0.6 percent of GDP in 2004. This leaves some margin of

uncertainty in the forecasts. If the economy recovers more quickly than currently forecast, the surplus will be larger.

From now on, Statistics Sweden will be reporting net lending with fully accrued taxes. This means that taxes and charges will refer to the year the tax liability arises. This will clarify the connection between taxes and real economic growth. The surplus target for 2004 is stated in accrual terms to facilitate follow-ups.

Diagram 1: General government net lending



Sources: Statistics Sweden and the Ministry of Finance.

The overall surplus target of 2 per cent of GDP over a business cycle remains unchanged. The surplus target of 2 per cent of GDP has applied since 2000. During the period 2000–2006, the average surplus, measured as accrued net lending, will amount to 1.7 per cent of GDP. A gradual tightening of fiscal policy will be taking place until 2006 so that the structural surplus reaches 2 per cent of GDP in 2006. Taken together, the estimated surpluses until 2006 are expected to stay in line with the overall surplus target determined by the Riksdag.

Since 1997, a new budget process has applied, which includes three-year nominal ceilings determined by the Riksdag for central government expenditure, including expenditure on old-age pensions. The ceilings determined for 2004–2006 are SEK 856 billion, SEK 894 billion and SEK 931 billion respectively, or 33.9, 33.9 and 33.8 percent of GDP. The measures to limit expenditure announced earlier by the government and its supporting parties to ensure staying within the ceilings of 2003 and 2004 will be undertaken.

From the year 2000, a balanced budget requirement as stipulated by law applies to municipalities and county councils.

In the legislation concerning 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 legislation 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, +/-1 percentage point, measured by the consumer price index (CPI). The Riksbank has clarified when a deviation from this rule may be justifiable. This may apply if the CPI is affected by temporary factors which are not expected to have a permanent impact on inflation, or if major deviations occur and a rapid return to the target would be associated with large real economic costs. In such situations, the Riksbank makes clear in advance how large a deviation from the inflation target may be justified in a 1–2 year term.

The result of the referendum concerning the introduction of the euro will not bring about any changes in the monetary and exchange rate policy regime. It will remain unaffected. In exchange rate policy, the government decides on the exchange rate system, while the Riksbank is responsible for the practical application, e.g. which central rate applies in a fixed exchange rate system. Sweden's experiences of the current monetary policy regime, with an inflation target and a floating exchange rate, are favourable. Pegging the Swedish krona to ERM2 is not under consideration.

Table 1: Proposed central government budget expenditure and revenue reforms in 2004

SEK billion

Revenue reforms		
Taxes on labour		-1.9
Taxes on capital		-0.6
Taxes on goods and services		1.3
Other		-0.4
Total revenue reforms¹		-1.6
Expenditure reforms		
U0 ² 1–U0 4	Administration and legal system	1.1
U0 5–U07	International development aid	1.5
U0 9	Health and medical care, social services	1.0
U0 10	Economic security in case of illness and disability	0.1
U0 12	Economic security for families and children	0.6
U0 16–U0 17	Education, research and culture	1.1
U0 18	Housing	0.1
U0 20	Environment	0.5
U0 21	Energy	0.4
U0 22	Communications, incl. loans	2.8
U0 23–24	Agriculture, forestry, business sector	0.3
U0 25	General grants to municipalities	1.4
Total expenditure reforms		10.8
Financing, reduced expenditure		7.3
Increased expenditure including financing, etc.		3.4
Reforms including financing		5.1

¹ Gross effects of rule changes, accrual accounting.

² Expenditure area.

Source: Ministry of Finance.

III Economic policy

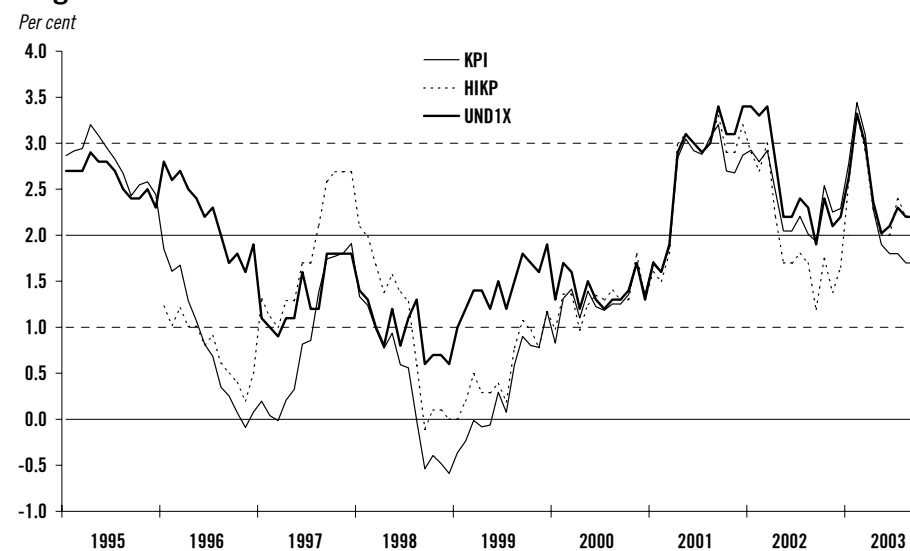
Fiscal policy

Together with the reforms suggested in the Government Budget Bill and earlier decisions, expenditure reforms totalling around SEK 11 billion will be carried out in 2004. This is equivalent to 0.4 per cent of GDP. Major initiatives will be undertaken in health and medical care, partly through increases in the general grants to local government as well as international development aid and infrastructure. In 2004, savings will also be made and programmes phased out equivalent to approximately SEK 7 billion, or 0.3 per cent of GDP.

Between 2000 and 2002, the first three stages of a reform of household income tax were implemented. The central government financial situation permitting, the government will later in its mandate period propose implementation of the final stage of this tax reform. In 2003, the municipal tax levy has been increased by approximately SEK 8 billion. A “green tax shift” is proposed for 2004, which involves raising energy taxes and lowering employer contributions and income taxes correspondingly. In addition, certain cuts will be made in wealth and inheritance taxes. The tax changes proposed in the Government Budget Bill will involve a reduction in the central government tax levy of nearly SEK 2 billion compared with 2003. At the same time, the municipal tax levy is estimated to rise by SEK 2 billion.

Overall, reforms including financing equivalent to approximately SEK 5 billion or 0.2 per cent of GDP are proposed for 2004.

Diagram 2: Inflation and the Riksbank's tolerance interval



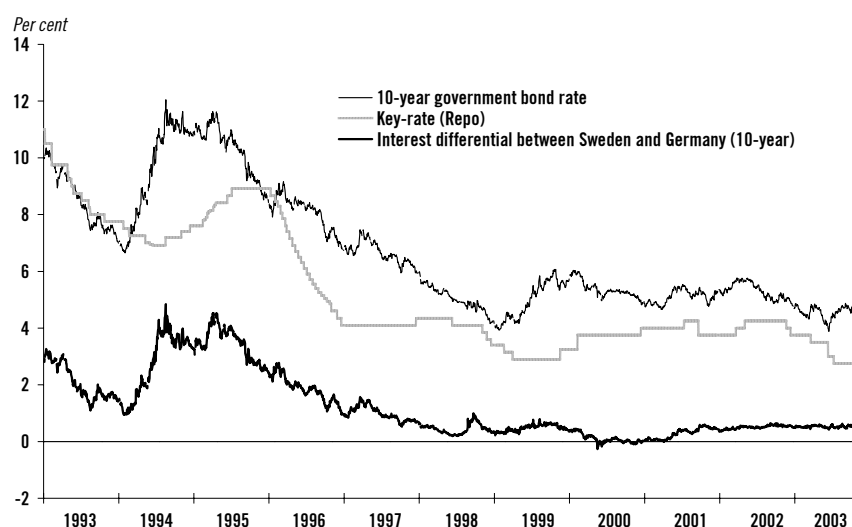
Monetary policy

After the terrorist attacks of 11 September 2001, the repo rate was lowered by 50 basis points to 3.75 per cent. In February 2002, the Riksbank signalled a tightening in monetary policy due to inflationary developments and more signs of an economic upturn. In the

spring of 2002, the Riksbank raised the repo rate by a total of 50 basis points to 4.25 per cent through two hikes based on the judgement that a high level of resource utilisation was threatening the inflation target. In the autumn of 2002, it became clear that an economic recovery was not about to materialize, and during an extra monetary policy meeting, the repo rate was lowered by 25 basis points, to 4.0 per cent. The assessment that resource utilisation would be lower than expected contributed to yet another cut of 25 basis points in 2002. On three occasions in 2003, the Riksbank lowered the repo rate by a total of 100 basis points to 2.75 per cent due to weak Swedish and international economic developments as well as low domestic inflationary pressure. In October, the repo rate was left unchanged at 2.75 per cent and the future rate of inflation is expected to remain in line with the inflation target, while resource utilisation may be somewhat higher than the Riksbank's previous assessment.

Inflation was low during the period of 1998–2000 and was below the Riksbank's inflation target. Inflation rose in 2001, which was mainly due to temporary effects. Price trends have been markedly sluggish since the beginning of 2002. The weak inflationary pressure is related to the fact that price trends for both imported goods and domestically produced goods and services have shown little movement. The domestic situation behind this includes low pay rises, good productivity growth and a low level of resource utilisation. In early 2003, inflation rose temporarily because of higher energy prices. In October 2003, CPI inflation was 1.4 per cent, and as measured by UND1X, 1,9 per cent.

Diagram 3: Interest rates in Sweden



Source: EcoWin.

Market rates

Increased macroeconomic stability with lower inflation and stronger public finances were the basis of falling interest rates in the 1990s. The economic upturn in the late 1990s led to rising long-term rates in 1999 and early 2000. In 2000, growth expectations and interest rates fell. There were an increasing number of negative economic signals in 2001. In 2002, financial market uncertainty grew and uncertainty about the strength of the economic recovery persisted. During the spring of 2003, market rates were at historic lows but as uncertainty on financial markets began to dissipate, market rates rose sharply during the

summer. Swedish market rates have followed the developments of global interest rates. During the period 1997–2001 there was a falling interest differential between Sweden and Germany. Rising inflation and inflation expectations combined with increased nervousness on financial markets during the second half of 2001 led to a rising interest differential compared with Germany. Since 2002, the difference between the Swedish and German 10-year rate has been approximately 50 basis points. Stable public finances in Sweden should cause the interest differential to lessen somewhat in the future.

The Swedish krona

Sweden has had a floating exchange rate since November of 1992, which means that the exchange rate is not a target variable for monetary policy. With an explicit inflation target and a floating exchange rate, the value of the krona is determined by short-term capital flows in addition to fundamental factors such as terms of trade and relative productivity growth. After a considerably weaker krona in 2001, which can largely be explained by financial factors, the krona began to appreciate in the autumn of 2001. The krona has been relatively stable since the autumn of 2002 and during 2003. Decreasing uncertainty on financial markets and a current account surplus comprise factors that contribute to a continued stable krona.

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



Source: EcoWin.

IV Economic forecasts and estimates

Sweden's gross domestic product (GDP) is expected to grow by 1.4 per cent in 2003. After relatively good growth during the first six months, available indicators suggest more subdued growth for the remainder of the year. Swedish economic activity is expected to rise in pace with a global economic recovery next year. GDP growth in 2004 is expected to be 2.0 per cent. The global recession has had a greater impact on Swedish export markets than forecast in the previous convergence programme.

In the medium-term perspective, the repo rate is assumed to be raised to 4.75 per cent in 2006. The exchange rate is assumed to strengthen so that the TCW index is nearly 129 in December 2003 and 127 in 2005 and 2006.

Table 2: Demand and output¹

Annual percentage change in volume

	2002	2003	2004	2005	2006
Household consumption expenditure	1.3	1.9	2.1	2.0	2.0
General government consumption expenditure	2.1	0.7	0.4	0.6	0.6
Gross fixed capital formation	-2.5	-1.8	2.8	5.5	5.1
Change in stocks ²	-0.1	0.2	0.1	0.0	0.0
Exports	0.4	3.7	5.4	6.2	6.1
Imports	-2.7	3.1	5.4	6.0	6.1
GDP	1.9	1.4	2.0	2.6	2.5
GDP level, SEK billion current prices	2 340	2 427	2 521	2 639	2 756

¹ The years 2003–2004 are forecast years. The years 2005–2006 are calculated on the assumption that the output gap will close in 2007.

² Change as per cent of GDP the previous year.

Sources: Statistics Sweden and Ministry of Finance.

After a weakening during the second half of 2002, exports of goods rose steadily again during the first six months of 2003. The recovery for the export industry seems to have lost momentum during the second half of this year. Firms' order books are considered to be unsatisfactory but the prerequisites for increased exports of goods in 2004, however, are relatively promising. The anticipated global economic recovery means that foreign demand for Swedish investment goods is rising. After several years of negative growth, imports of goods rose in the first half of 2003 compared with the same period the previous year. For the whole year 2003, imports of goods are expected to rise by 4.5 per cent. One contributing factor is that import prices for processed goods have fallen as a result of the stronger krona. In 2004, import growth is expected to pick up and amount to 6.1 per cent. It is reasonable to expect the export of services to follow the same pattern as exports of goods and pick up next year. The import of services is expected to benefit from the fact that travel abroad seems to have stabilised and is expected to rise in late 2003.

Table 3: Contribution to GDP growth

Percentage points

	2002	2003	2004	2005	2006
Final domestic demand	0.8	0.8	1.6	2.1	2.1
Household consumption expenditure	0.6	0.9	1.0	1.0	1.0
General government consumption expenditure	0.6	0.2	0.1	0.2	0.2
Gross fixed capital formation	-0.4	-0.3	0.5	0.9	0.9
Change in stocks	-0.1	0.2	0.1	0.0	0.0
Net exports	1.2	0.5	0.4	0.5	0.5
Exports	0.2	1.6	2.4	2.8	2.9
Imports	1.1	-1.1	-2.0	-2.3	-2.5
GDP	1.9	1.4	2.0	2.6	2.5

Sources: Statistics Sweden and Ministry of Finance.

Investment is expected to continue to decline in 2003. The decline is comprehensive and includes both goods and service industries. After a number of years of high growth

figures, housing investment is forecast to decline this year; even local government investment shows negative growth. One exception is central government investment, which is rising as a result of investments in infrastructure. Overall, investment will have fallen 1.8 per cent in 2003. Investment is expected to rise in 2004 to ensure sufficient production capacity for meeting rising demand. A stronger demand from abroad, low interest rates and the fact that capacity utilisation has been rising for quite some time now in several industries are all factors that should contribute to investment in 2004 rising by nearly 3 per cent.

According to the National Accounts, change in stocks contributed to boosting GDP growth during the first six months of 2003. In the quarterly Business Tendency Survey published by the National Institute of Economic Research (NIER), industry and the retail trade report rising dissatisfaction with large stocks. Adjustments of stocks are forecast to take place as soon as the second half of the year, which explains a contribution to GDP growth this year of only 0.2 percentage points. In connection with rising industry output in 2004, stocks will grow further and contribute 0.1 percentage point to GDP growth.

Real household disposable income is estimated to rise approximately 1.5 per cent in 2003 and approximately 1 per cent in 2004. Household consumption is estimated to rise by approximately 2 per cent in both years. Households are consequently expected to save somewhat less. Low interest rates, stable growth in real wealth and rising confidence in the future are factors that support the promising consumption expenditure development in relation to the general state of the economy. Central government consumption expenditure is expected to rise 1 per cent in 2003 but remain unchanged in 2004. Local government consumption expenditure is expected to increase by 0.6 per cent in both 2003 and 2004.

Table 4: Selected statistics¹

Percentage change, unless otherwise stated

	2002	2003	2004	2005	2006
CPI, Dec-Dec	2.3	1.3	2.1	2.3	2.1
HICP, Dec-Dec	1.7	1.8	1.7	–	–
UND1X, Dec-Dec	2.2	1.7	1.5	–	–
GDP deflator	1.3	2.3	1.8	2.0	2.0
Increase in hourly wages	4.1	3.5	3.5	–	–
Number of employed	0.1	–0.2	0.1	0.7	0.7
Open unemployment ²	4.0	4.7	4.7	4.3	4.0
Labour market policy programmes ²	2.6	2.2	2.2	1.9	1.7
Work productivity	3.0	2.3	1.5	1.8	1.8
Current account balance ³	4.5	5.3	5.1	5.1	5.2
Disposable income	4.7	1.6	0.9	0.7	1.5
Savings ratio ⁴	2.8	2.6	1.4	0.2	–0.3

¹ See also Table B.1 for forecast assumptions.

² Per cent of labour force.

³ Per cent of GDP.

⁴ Per cent of disposable income. Excluding saving in pension fund reserves.

Source: Ministry of Finance.

In summary, the decline in GDP growth from 1.9 per cent in 2002 to 1.4 per cent in 2003 can be explained by a lower level of general government consumption expenditure and net exports. This outweighs higher private consumption and the increase in stocks. The somewhat boosted GDP growth of 2004 will primarily be driven by an increased level of investment.

Employment has been relatively stable despite the past few years of weak economic growth. The number of employed in seasonally adjusted terms more or less remained at the same level in the second quarter of 2003 as in early 2001. One reason for this is the fact that falling employment within industry has been balanced by rising employment in the general government sector. The number of hours worked, on the other hand, fell fairly steadily during the same period, partly due to rising numbers of employees on sick leave. The demand for labour is currently low and employment is not expected to pick up until late 2004. The employment ratio for persons between the ages of 20 and 64 is expected to fall from 77.7 per cent this year to 77.3 per cent next year.

Inflationary pressure in the Swedish economy is low and the rate of inflation is expected to be in line with the Riksbank's inflation target in both 2003 and 2004. At the end of 2003, the consumer price index (CPI) and UNDI1X are expected to be slightly under 2 per cent, and at the end of 2004, the CPI is expected to be approximately 2 per cent and the UNDI1X slightly below this figure. The forecast is based on increases in hourly wages in the whole economy being limited to 3.5 per cent.

Medium-term scenario

The Government Budget Bill for 2004 presents forecasts for 2003 and 2004 as well as estimates for 2005 and 2006. In 2003 and 2004, there are assessed to be available resources in the economy equivalent to an output gap of approximately 1 per cent. In 2005 and 2006, the output gap is expected to decrease so that actual output approaches potential output in 2006. The gap is estimated to close in 2007.

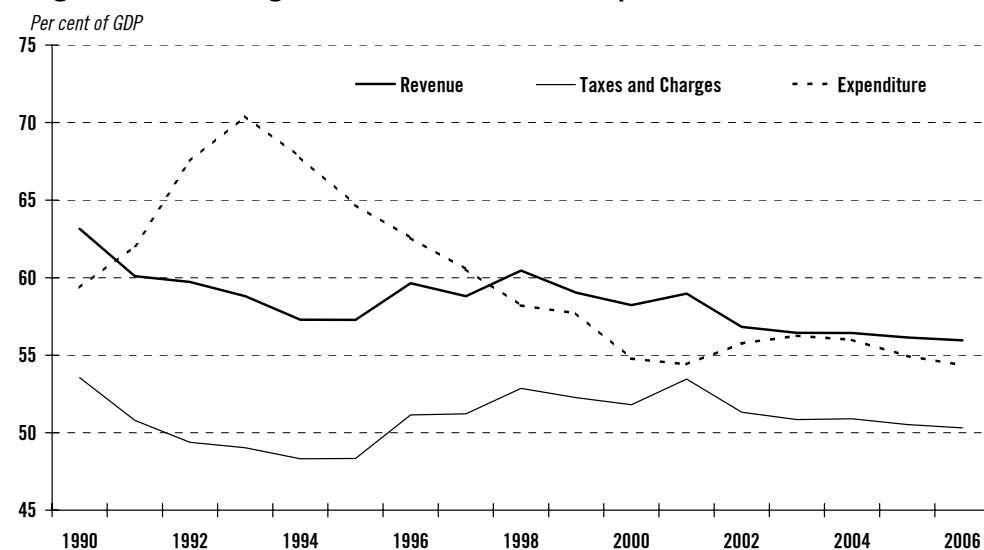
V Public finances

The economic downturn, with lower realized capital gains and an expansionary fiscal policy, meant that the surplus in general government net lending fell sharply in 2002. In 2003, net lending will fall further, to 0.2 per cent of GDP. As a percentage of GDP, revenues will decline from 56.8 per cent to 56.4 per cent while expenditure will rise from 55.8 per cent to 56.3 per cent. In 2004, net lending is expected to rise to 0.4 per cent of GDP since the percentage of expenditure will fall to 56.0 per cent of GDP. The decline in the percentages of revenue and expenditure will continue in 2005 and 2006 as net lending rises.

The National Accounts currently report taxes on corporate profits and capital gains with a one-year time lag, which is largely equivalent to the difference between when the tax liability arises and when the tax is paid. If the taxes are allocated to the income year when the tax liability arises, a more accurate picture of net lending can be obtained. Statistics

Sweden has now decided to report net lending with fully accrued taxes. Eurostat has approved the change.¹

Diagram 5: General government revenue and expenditure



Structural surpluses 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 forms the anchor of fiscal policy. In order to assess whether the surplus target is met in individual years, an indicator is used which reflects the structural level of the surplus, adjusted for temporary effects. Temporary effects mainly consist of cyclical variations in taxes and expenditure, but one-off effects of a different type may also occur, such as one-off tax revenues and accrual effects from the collection of taxes.

An indication that fiscal policy is in balance in relation to the surplus target is when the structural surplus in public finances is in the region of 2 per cent of GDP. A higher or lower structural surplus may, however, be necessary if the initial balance differs greatly from the surplus target or if discretionary policy is used for the purpose of stabilisation. The calculation of the cyclically adjusted balance is based on an assessment of the economic situation via the output gap, as well as on the effects of the economic situation on public finances. The output gap is estimated on the basis of an overall assessment of a number of indicators for output, the labour market and price and wage formation. The Ministry of Finance's assessment is that a 1 per cent change in output has on average an impact on general government net lending of 0.7 per cent of GDP.

¹ After the convergence programme was completed Statistic Sweden (SCB) has published revised National Accounts for the period 1980-2002. Connected to the revision SCB has converted their method to fully accrued income taxes, i.e. taxes are allocated to the income year. This change implies that net lending in 2002 is 0.1 per cent, while the estimated accrual net lending is 0.2 per cent of GDP in the convergence programme.

According to the National Accounts, general government net lending in 2002 amounted to 1.1 per cent of GDP. The reported net lending, however, was affected by the allocation of tax payments. If net lending is adjusted for the incomplete allocation of taxes on capital income in the National Accounts, a more accurate picture of the situation can be obtained. In 2002, net lending with accrual taxes was 0.2 per cent of GDP. The main explanation for the decline in net lending with accrual taxes between 2001 and 2002 was the expansionary budget policy, which last year contributed to a weakening in public finances by 1.8 per cent of GDP. More than half of the expansionary policy consisted of income tax cuts.

Table 5: General government finances¹

Per cent of GDP

	2002	2003	2004	2005	2006
Revenue	56.8	56.4	56.4	56.1	56.0
Taxes and charges	51.3	50.8	50.9	50.5	50.3
Capital income	2.2	2.2	2.1	2.2	2.2
Other revenue	3.3	3.4	3.4	3.4	3.4
Expenditure	55.8	56.3	56.0	54.9	54.3
Transfer payments	21.5	22.2	22.1	21.3	21.0
Consumption	28.0	28.3	28.2	28.0	27.7
Investment	3.1	3.1	3.1	3.0	3.0
Interest expenditure	3.2	2.6	2.6	2.7	2.7
Net lending	1.1	0.2	0.4	1.2	1.6
Primary net lending	2.1	0.6	0.9	1.7	2.1
Allocation of taxes	-0.9	0.2	0.1	0.2	0.2
Net lending with accrual taxes	0.2	0.4	0.6	1.4	1.9
Consolidated gross debt	52.7	51.7	51.5	50.0	48.3
Net debt	3.7	2.6	2.0	0.8	-0.9

Note: Revenues and expenditure are larger according to harmonised accounting principles in the EU, i.e. 2002 revenues totalled 59.5 per cent and expenditure 58.5 per cent of GDP.

¹ A more detailed breakdown is presented in Table B.2.

Sources: Statistics Sweden and Ministry of Finance.

Table 6 shows that the structural surplus in 2002 is estimated at 0.6 per cent of GDP. The weakening of the structural balance supported the monetary policy during the economic downturn.

Table 6: Structural surplus in public finances

Per cent of GDP

	2002	2003	2004	2005	2006
Net lending	1.1	0.2	0.4	1.2	1.6
Periodization of taxes	-0.9	0.2	0.1	0.2	0.2
Net lending with accrual taxes	0.2	0.4	0.6	1.4	1.9
Adjustment for GDP gap	0.4	0.8	0.7	0.4	0.2
Structural surplus	0.6	1.2	1.3	1.8	2.0
GDP gap	-0.6	-1.1	-1.0	-0.6	-0.2

Sources: Statistics Sweden and Ministry of Finance.

In the Government Budget Bill for 2003, the government estimated that the surplus for 2003 would be 1.5 per cent of GDP. The GDP growth forecast has now been revised

downward from 2.5 per cent to 1.4 per cent of GDP and the surplus in general government finances is estimated at 0.2 per cent of GDP. The revised growth forecast explains most of the weakening figures.

The relatively large GDP gap of 2003 means that the structural balance is estimated to be 1.2 per cent of GDP. The postponement of the economic recovery means that resource utilisation in the economy, measured with the output gap, will not improve between 2003 and 2004. The structural surplus will then gradually strengthen and is estimated at 2 per cent of GDP in 2006.

Net lending with accrual taxes for the period 2000–2006 will average 1.7 per cent of GDP. During the period 2004–2006, the surplus will be below 2 per cent of GDP, but the difference will subside over time. The GDP gap is also estimated to be negative during these years, which means that the structural surplus will exceed the actual surplus. Generally, the estimated surpluses until 2006 will be in line with the overall surplus target.

Fiscal policy stance from 2002 to 2006

The yearly changes in net lending with accrual taxes can be seen as a rough indicator of the effect of public finances on private sector revenue. The change can be divided into discretionary policy, automatic stabilisers and other factors.

Table 7 shows that the discretionary policy of the central government budget was very expansionary in 2002. Minor stimuli were affected by the automatic stabilisers since the GDP gap increased somewhat between 2001 and 2002. Other factors that affect the balance also contributed to the stimuli. A major factor was reduced tax revenues from household capital gains and corporate profits from exceptionally high levels. Thus, fiscal policy, together with the automatic stabilisers, contributed to boosting economic activity despite the global economic downturn.

Table 7: Indicator of effects on demand

Change in per cent of GDP

	2002	2003	2004	2005	2006
General government net lending	-3.5	-0.9	0.3	0.8	0.4
Periodization of taxes	1.1	1.1	-0.1	0.1	0.0
Net lending with accrual taxes	-2.4	0.3	0.2	0.8	0.4
Automatic stabilisers	-0.1	-0.3	0.1	0.3	0.3
Structural surplus	-2.2	0.6	0.1	0.5	0.2
Discretionary fiscal policy	-1.8	-0.6	-0.2	0.1	0.0
Other factors	-0.4	1.2	0.3	0.4	0.1
<i>GDP gap, change in percentage points</i>	<i>-0.2</i>	<i>-0.5</i>	<i>0.1</i>	<i>0.4</i>	<i>0.4</i>

Sources: Statistics Sweden and Ministry of Finance.

In 2003, net lending with accrual taxes is estimated to strengthen only slightly, which means that public finances overall will have a slight tightening effect on the economy. The automatic stabilisers contribute with some stimuli, but they are counteracted by the strengthening in the structural surplus. Thus the fiscal policy stance, measured as the change in the structural surplus, is contractionary. The discretionary policy of the central

government budget continues to be expansionary. However, the finances of the local government sector will strengthen through municipal tax hikes. The improved net interest for the central government contributes to a strengthening of public finances.

The economy will only improve marginally between 2003 and 2004. Further tightening to strengthen the structural surplus would risk hampering the anticipated economic recovery. Therefore, the fiscal policy stance will be to maintain an unchanged structural surplus between 2003 and 2004. The discretionary policy of the central government budget is slightly expansionary but the anticipated municipal tax hikes will counteract it.

During the period 2005–2006, the net lending position with accrual taxes will gradually improve. The automatic stabilisers and a continued strengthening of the structural balance will contribute to this improvement. The contractionary fiscal policy of these years will lessen the need for a tightening of monetary policy during the economic recovery. The composition of stabilisation policy therefore becomes conducive to growth and employment in the medium term.

Net financial wealth and gross debt

General government net financial wealth amounted to over SEK 100 billion in 1990, or 8 per cent of GDP. During the severe crisis of the early 1990s, the financial position deteriorated rapidly. Net wealth was replaced by a net debt of SEK 467 billion or almost 27 per cent of GDP in 1996. Since 1996, the financial position has improved and net debt was in turn replaced by positive net wealth in 2001.

Table 8: Consolidated gross debt

Per cent of GDP

	2002	2003	2004	2005	2006
Consolidated gross debt	52.7	51.7	51.5	50.0	48.3
Change in gross debt compared with previous year	-1.6	-1.0	-0.3	-1.5	-1.6
<i>contribution to change</i>					
Net lending, excl. interest	-4.0	-2.6	-2.8	-3.6	-4.1
Interest (consolidated)	2.9	2.4	2.4	2.4	2.5
Consolidation	-1.2	0.0	-0.2	-0.2	-0.2
Nominal GDP growth	-1.7	-1.9	-2.0	-2.3	-2.2
Other factors	2.3	1.1	2.4	2.2	2.3

Note: Consolidated interest is calculated by the Ministry of Finance on the assumption that interest on the consolidated debt is as large as on the gross debt.

Sources: Statistics Sweden and Ministry of Finance.

Sharp drops in share prices in 2002 once again meant a net debt despite the continuing net lending surplus. The forecast assumes no future changes in value with the exception of effects on central government debt as a result of changes in the exchange rate. This means that the net debt will develop in pace with net lending. The net lending surplus means that net debt will be reduced during the forecast period, and in 2006, the general government's financial assets are expected to once again exceed debts.

The allocation of net lending between central government and the old-age pension system will mean an improvement in the financial position through increased assets in the

pension system. The net lending deficit means that the debt side of the general government's balance sheet will increase during the forecast period. This increase in debt, however, will not prevent central government debt and consolidated gross debt continuing to decrease as a percentage of GDP.

Consolidated gross debt consists of the nominal value of central government debt and the local government sector's debts on the credit market minus the old-age pension system's holdings of treasury bonds. Table 8 shows the contribution of various factors to gross debt. At the end of 2002, consolidated gross debt was 52.7 per cent of GDP, which is well below the EU's reference value of 60 per cent of GDP. The gross debt of 2002 is somewhat below the forecast in the 2002 convergence programme. At the end of 2006, the consolidated gross debt is expected to be under 50 per cent of GDP.

Allocation of net lending between sectors

The allocation of net lending in 2003 takes place between the three general government sectors so that the central government shows a deficit of 2.2 per cent of GDP, while the old-age pension system shows a surplus of 2.1 per cent of GDP and the local government sector a surplus of 0.3 per cent of GDP. The central government deficit is estimated to shrink during the forecast period while the pension system's surplus rises somewhat. Local government net lending is expected to show a deficit during the period 2004–2006 following a surplus in 2003. The deficits are judged to be in line with a positive financial result for the sector as a whole as defined by the balanced budget requirement for local government and county councils.

Table 9: Net lending and central government budget balance

Per cent of GDP

	2002	2003	2004	2005	2006
General government sector	1.1	0.2	0.4	1.2	1.6
Central government	-0.6	-2.2	-1.6	-1.0	-0.4
Old-age pension system	2.0	2.1	2.2	2.2	2.1
Local government sector	-0.4	0.3	-0.1	0.0	-0.1
Central government budget balance	0.1	-1.8	-1.6	-0.5	-0.5
Central government debt	49.8	48.8	48.5	47.0	45.4

Sources: Statistics Sweden and Ministry of Finance.

VI Comparison with updated programme for 2002

Table 10 compares this programme with the updated programme for 2002. GDP growth in 2002 was 0.2 percentage points lower than stated in the previous year's programme. The forecast GDP increase for 2003 has been revised downward by 1.1 percentage points, and for 2004 by 0.5 percentage points in comparison with the programme for 2002.

In 2002, net lending was 0.6 percentage points less than expected in the convergence programme for 2002. The forecasts for 2003 and 2004 have been revised downward by 1.3 and 1.2 percentage points, respectively. The lower GDP forecasts in this year's programme explain most of the downward revisions.

Table 10: Comparison with updated convergence programme for 2002

	2002	2003	2004	2005	2006
GDP, percentage change in volume					
Updated convergence programme for 2002	2.1	2.5	2.5	–	–
Updated convergence programme for 2003	1.9	1.4	2.0	2.6	2.5
Difference, percentage points	–0.2	–1.1	–0.5		
Net lending, per cent of GDP					
Updated convergence programme for 2002	1.7	1.5	1.6	–	–
Updated convergence programme for 2003	1.1	0.2	0.4	1.2	1.6
Difference, percentage points	–0.6	–1.3	–1.2		
Consolidated gross debt, per cent of GDP					
Updated convergence programme for 2002	53.6	50.9	49.3	–	–
Updated convergence programme for 2003	52.7	51.7	51.5	50.0	48.3
Difference, percentage points	–0.9	0.8	2.2		

Sources: Statistics Sweden and Ministry of Finance.

Consolidated gross debt in 2002 was 0.9 percentage points lower than forecast in the previous updated programme. For 2003 and 2004, consolidated gross debt is expected to be 0.8 and 2.2 percentage points higher, respectively, than last year's forecast. This is largely due to a somewhat lower level of net lending.

VII Structural policy and the quality of public finances

Since the mid-1990s, general government sector expenditure as a percentage of GDP has fallen from almost 68 to 56 per cent (see Diagram 5, page 12). It is impossible to precisely determine how the size of the general government sector and the taxes used to finance general government expenditure affect growth and the prerequisites for effective use of resources. One reason is that the composition of general government expenditure is probably very important. In order to assess the quality of public finances, information is required concerning the purposes of the expenditure and how the composition has changed over time. In general, a high proportion of investment in physical capital, human capital and R&D can be assumed to increase the quality of general government expenditure and thus its contribution to growth and employment.

Overall, general government expenditure can be justified for the achievement of economic or distribution policy objectives. In line with the economic policy targets, reforms for increased employment, sustainable growth and justice have been in progress during the past few years. The reforms concern both the revenue and expenditure side and have resulted in some change in the composition of general government expenditure. As can be seen from Table 1, expenditure reforms of approximately SEK 11 billion are proposed for 2004. The areas in which major initiatives have been carried out in the past few years or are proposed are discussed below.

The labour market

If an active labour market policy is to be effective, it needs to be adapted to the needs of the labour market. In pace with falling unemployment and increased focus on the employment target, the emphasis of labour market policy has changed from quantity to that of quality. A particular emphasis is being placed on improved job matching, support and training for the individual. Here, public employment services' efforts are very important, which is why these centres have been granted increased resources and more time to provide support and suggest jobs to job seekers. In addition, the temporary grants from the recession totalling approximately SEK 700 million are now permanent.

Efforts to achieve the 80 per cent employment target are continuing. To achieve the target, employment within all groups must rise but special initiatives also need to be aimed at groups having particular difficulties in entering the labour market, such as young people and immigrants. In the spring of 2003, a bill was presented with the aim of strengthening the position of immigrants on the labour market. The bill involved an improved workplace introduction and opportunities for job training where there is a labour shortage. The temporary recruitment incentive for local government and county councils will also be supplemented in 2004.

Structural education and training initiatives

In order to raise competence and increase the supply of skilled labour, significant initiatives have been undertaken in the education and training sector in the past few years. The Adult Education Initiative and the considerable expansion of universities and university colleges have given new groups access to higher education and created strong schools that pursue development in all counties. The quality of education for young people is probably of major importance to long-term growth prerequisites. A major initiative for higher quality in schools is therefore being carried out. So that more teachers and specialists can be hired at schools, municipalities will receive additional earmarked central government grants during the period 2001–2006 of SEK 1 billion per year until a total of SEK 5 billion has been reached.

To better utilise R&D, promoting university entrepreneurship is imperative as well as strengthening ties with the business sector. During the period 2000–2004, central government grants for basic research and postgraduate studies will be increased by nearly SEK 1.5 billion.

Healthcare, care of the elderly and sick leave

The sharp increase in the number of persons in receipt of a disability pension and on sick leave entails considerable costs for the central government, the individual and society in general. The government's goal is to reduce the number of sick days by half by 2008 while the number of new cases of activity and sickness benefit are to be reduced. In the autumn of 2001, the government presented an 11-point action programme for better occupational health. Some of these measures have been implemented.

These efforts have included a SEK 70 million initiative to promote better occupational health in the general government sector. The special healthcare initiative which the Riksdag approved is to be fully implemented which means an additional SEK 9 billion supplement during the period 2001–2004. An additional SEK 3.6 billion is to be spent from 2002 to 2004 to reduce waiting times in healthcare. The social insurance office has received just over SEK 500 million for 2003 and 2004 to improve its rehabilitation measures. In a special bill, the government has also proposed that the sick pay period be extended and that the calculation of sickness benefit be changed so that the compensation is equivalent to 77.6 per cent of one's income instead of 80 per cent. The amendments were adopted as of 1 July 2003. To achieve the target of half the number of sick days, the government assesses that further initiatives will be required.

The structure of the pension system has an impact on the labour supply. In order to stimulate older people to remain longer in working life, a new pension system was introduced in 1999 with a clear link between pension payments and lifetime earnings. A number of initiatives have also been implemented to increase the welfare of the elderly. A maximum charge and an allowance have been introduced in elderly care. In 2003, pensions for those with the lowest pensions were raised by SEK 300–600. An additional SEK 1 billion is being invested in improved dental care support.

Fiscal policy

The income tax reform described in Chapter II aims to reduce marginal taxes for low-wage and middle-wage earners through gradual compensation for social security contributions and to gradually reduce the percentage of wage earners paying central government tax. The reform has so far resulted in a reduction in marginal tax of almost 4 percentage points for wage earners not paying central government income tax. The maximum childcare charge introduced in 2002 is a further part of the efforts to reduce marginal effects and thus stimulate the labour supply.

The government strives for tax rules for various forms of small companies and their owners, which are as consistent and straightforward as possible. SEK 1 billion is therefore being earmarked for a reform of the particular rules applying to small companies in those cases the shareholder is very active in the company (the "3:12 rules").

Table 11: General government expenditure in 1995 and 2001 by purpose

Percentage of total expenditure

	1995	2001	Growth 1995–2000
Health and medical care	9.4	11.6	2.2
Education, etc.	13.3	15.5	2.2
Social security	40.2	41.7	1.5
Other	27.3	26.6	–1.6
Total expenditure, excluding interest	90.2	94.4	4.2
Interest	9.8	5.6	–4.2
Total expenditure, including interest	100.0	100.0	

Sources: Statistics Sweden and Ministry of Finance.

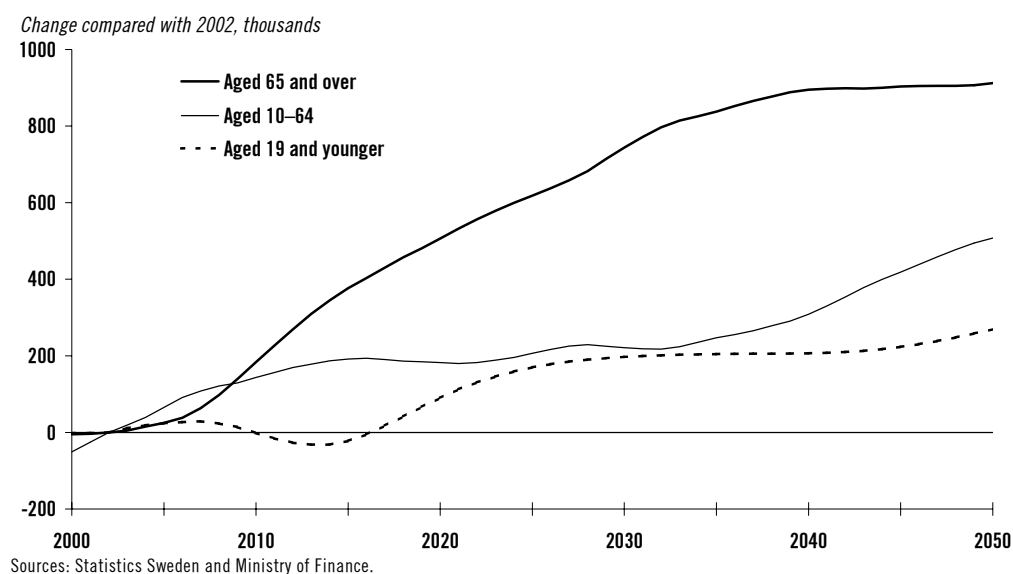
Summary

Overall, the reforms emphasise measures for increased employment, higher education and increased welfare. Expenditure in the education and training sector and expenditure in the care sector have increased as a percentage of total general government expenditure, while interest payments have declined as a percentage. In order to assess how a change in the composition affects the quality of public finances with regard to their effects on growth and conditions for effective resource allocation, more detailed analyses of the effectiveness of individual measures and programmes are required.

VIII Sustainability of public finances

During the first half of this century, public finances will come under major strain when the number of people over the ages of 65 and 80 rises sharply in relation to the working age population. This trend is already having an impact on today's economic policy. To be able to retain our extensive public welfare system in the long term, a high level of general government net lending will be needed in the next few years at the same time as measures are needed to boost employment. This chapter describes a scenario for public finances in a long-term perspective.

Diagram 6: Population changes

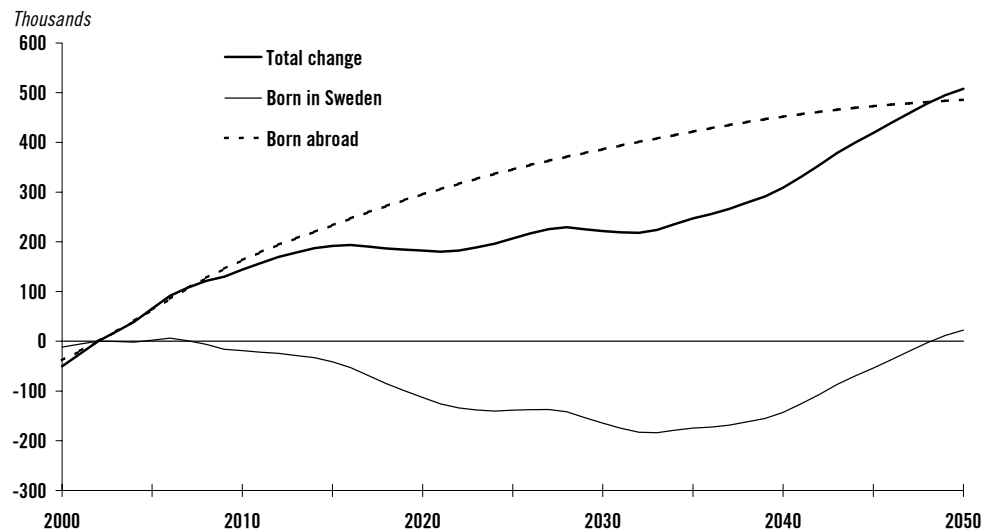


Demographics

According to the population forecast presented by Statistics Sweden in the spring of 2003, Sweden's population is expected to be 10.6 million in 2050. This is an increase of 1.7 million people compared with 2002. During the same period, the number of those between the ages of 20 and 64 will rise by 500,000 to 5.8 million people. The number of people aged 65 or older will increase by over 900,000 to nearly 2.5 million (see Diagram 6). In other words, most of the population increase will comprise people who are not of working age. In addition, the 25–54 age group, which has the highest employment ratio, will shrink as a percentage of the population between the ages of 20 and 64. The changing

age structure of the population will therefore contribute to limitations in the future labour supply.

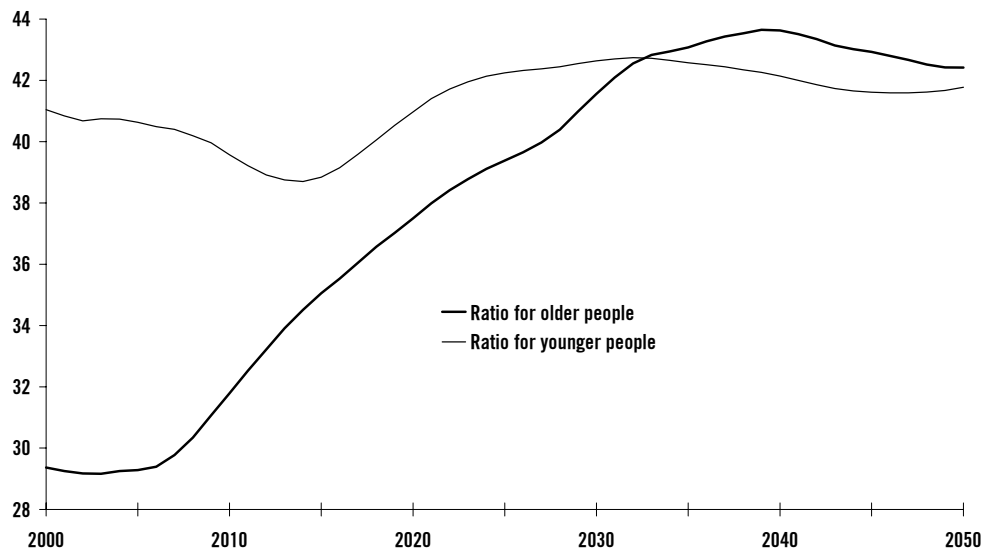
Diagram 7: Population in the 20–64 age group



Sources: Statistics Sweden and Ministry of Finance.

Another future demographic trend worth noting is the importance of immigration. Diagram 7 shows that net immigration during the current fifty-year period will comprise all working age population growth. Without immigration, the number of people in the 20–64 age group would decline. The improved integration of immigrants in the labour market will be a major challenge in the future. If integration fails, the forecast growth in the 20–64 age group will result in a greatly reduced increase in employment.

Diagram 8: Demographic dependency ratios



Sources: Statistics Sweden and Ministry of Finance.

A rough measure of the dependency burden consists of 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 over the age of 64 per hundred people between the ages of 20 to 64, is estimated to rise from around 29 people in 2002 to nearly 44 people in 2040. At the same time, more stable developments are forecast for the dependency ratio for young people, measured as the number of people under the age of 20 per hundred persons in the 20–64 age group (see Diagram 8). After 2010, developments in the total dependency burden will be dominated by the steadily rising dependency ratio for older people.

Employment and economic growth

The long-term projections are based on the forecasts and estimates for the period 2002–2006 described in Chapter IV.

The employment developments described in the scenario are partly based on anticipated demographic developments and partly on the assumption that up until 2050, women and men of different ages will be working to the same extent as they are today. A departure from the assumption of unchanged behaviour patterns has been made concerning the employment ratio and unemployment rate for persons who were born abroad. The estimate assumes that immigrants' position on the labour market will continue to improve. The assumption concerning improved integration is justified by the developments in the past few years, which have entailed more favourable developments for immigrants than for the labour market as a whole. Until 2020, today's differences in employment ratios and unemployment between those born in Sweden and abroad are expected to be reduced by one-third. Thereafter, remaining differences are expected to persist during the rest of the estimate period. The percentage of employed persons among those born abroad in the 20–64 age group is expected to stabilise at just over 65 per cent after 2020.

In summary, this estimate assumes that the total employment ratio will fall by 1.5 percentage points until 2050 while unemployment rises by 0.3 percentage points (see Table 12). Excluding the assumed increase in employment among immigrants, the equivalent changes in employment and unemployment rates would be a fall by 3.2 and an increase by 0.6 percentage points, respectively, until 2050.

The calculations also assume that the trend in average hours worked per employee will fall by 0.2 per cent per year, which is equivalent to a 3.5 hour shorter work week until 2050. This development can be explained by the likely demand for increased leisure time as household income rises and as other opportunities for consumption grow. However, households will generally choose to increase their consumption of goods and services.

Business sector productivity is expected to grow by 2.2 per cent per year. However, productivity growth in the general government sector is assumed to be zero in accordance with the calculation principles used in the National Accounts. Overall, this leads to an annual increase in productivity in the whole economy of approximately 1.8 per cent. The rate of productivity growth varies somewhat over time depending on changes in the

composition of private and general government production of goods and services. The increase in productivity, together with labour force developments, means that GDP will grow by an average of 1.7 per cent annually until 2050. GDP per capita will grow at a somewhat slower pace by an average of approximately 1.4 per cent annually.

Household savings are used to accumulate assets that can be used after retirement. A growing percentage of pensioners in the population therefore means that household saving is declining. The estimate assumes increased consumption since imports are growing more quickly than exports. Therefore, the large current account surplus is gradually declining. The estimates assume that the real interest rate will be 3 per cent and the rate of inflation 2 per cent.

Table 12: Macroeconomic assumptions

	2000	2006	2010	2015	2020	2030	2040	2050
Percentage change¹								
Population in the 20-64 age group	0.5	0.5	0.2	0.2	0.0	0.1	0.2	0.4
Number of employed	2.2	0.7	0.1	0.1	0.1	0.0	0.2	0.3
Hours worked	1.0	0.6	-0.1	0.0	-0.1	-0.2	0.0	0.1
Business sector productivity	4.3	2.1	2.2	2.2	2.1	2.0	2.2	2.3
GDP	4.4	2.5	1.7	1.8	1.6	1.3	1.8	2.0
GDP per capita	4.1	2.0	1.2	1.3	1.1	0.9	1.5	1.7
GDP productivity	3.3	1.9	1.8	1.8	1.7	1.6	1.8	1.9
GDP deflator	1.3	2.0	2.4	2.4	2.4	2.5	2.3	2.2
CPI	1.3	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Hourly wage	5.0	3.5	4.3	4.3	4.3	4.2	4.2	4.2
Per cent								
Real interest rate	4.1	3.7	3.0	3.0	3.0	3.0	3.0	3.0
Labour force participation in 20-64 age group	81.2	80.8	80.4	80.7	81.1	80.4	80.5	80.3
Women	78.4	78.4	78.0	78.2	78.7	77.9	77.9	77.6
Men	84.0	83.1	82.8	83.1	83.5	82.9	83.0	82.8
Open unemployment ²	4.7	4.0	4.3	4.2	4.1	4.2	4.3	4.3

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 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 employed in the national definition but as unemployed in international statistics. Sources: Statistics Sweden and Ministry of Finance.

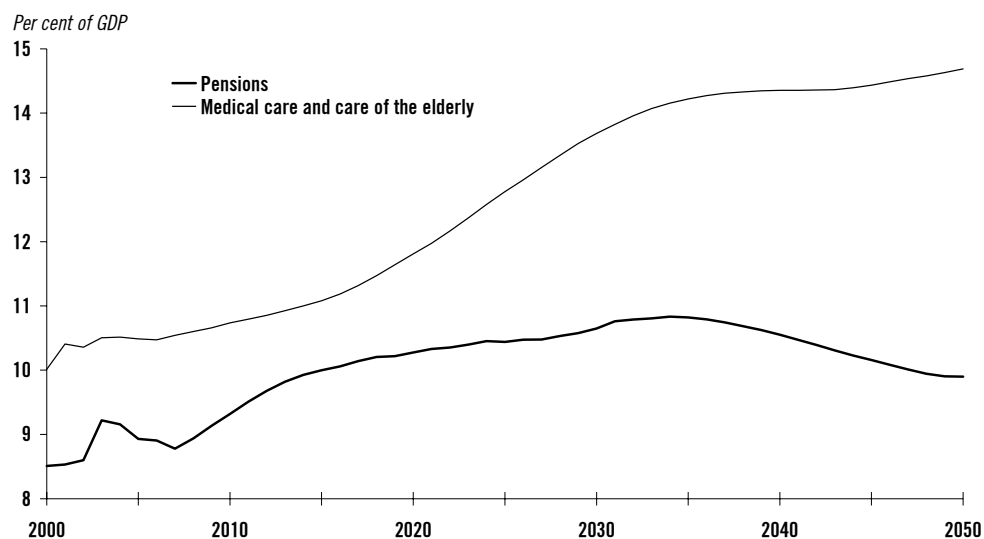
Surplus target

To ensure the long-term sustainability of public finances, the fiscal policy stance aims to maintain a surplus in public finances of 2 per cent of GDP. The described scenario assumes that the surplus target will be maintained until 2015. The surpluses and subsequent reductions in public debt will lead to net capital income and net interest as a percentage of GDP strengthening by approximately 1.1 percentage point between 2000 and 2015, which is required to create scope for the anticipated increase in expenditure.

An ageing population causes rising general government expenditure

The increasing percentage of older people in the population has an impact on public finances through increased expenditure on pensions, health care and care of the elderly. Estimates of pension expenditure are based on demographic developments, macroeconomic prerequisites and applicable regulations. Old-age pension expenditure as a percentage of GDP is estimated to rise from 9 per cent in 2003 to nearly 11 per cent in the early 2030s, and later decline somewhat. Expenditure for medical care and care of the elderly is estimated to rise from 10.5 per cent to 14.7 per cent of GDP (see Diagram 9). In the cost estimate for care of the elderly, an increase in average life expectancy is expected to mean that the average state of health at a given age will be improved. Half of the forecast increase in average life expectancy is expected to lead to healthy years of life with a more limited need for elderly care. This will postpone costs for elderly care until patients are older, leading to savings of approximately 1.3 per cent of GDP in 2050. No such assumption has been made as regards health care since the result of medical advances is often seen as leading to improved quality in healthcare, new treatment methods for new groups of patients, etc. Overall expenditure for pensions, medical care and care of the elderly as a percentage of GDP is estimated to rise by nearly 6 percentage points during the estimate period.

Diagram 9: General government expenditure for pensions, medical care and care of the elderly



Sources: Statistics Sweden and Ministry of Finance.

Primary expenditure and revenue

Between 2003 and 2015, primary general government expenditure, i.e. expenditure excluding interest, is estimated to decline by 0.6 percentage points of GDP (see Table 13). General government consumption is estimated based on the demand resulting from demographic developments. This will result in an overall rate of increase for consumption expenditure more or less on a par with GDP growth in current prices. A lower number of school-age children and teenagers means that costs for primary and secondary education can be cut somewhat while the demand for medical and elderly care will only increase slightly. A precondition for this development is that local governments can revise their

costs downward in areas with falling demand. Transfer payments linked to persons under the age of 20 will also fall as a percentage of GDP. On the other hand, pension expenditure will rise, which will lead to household transfer payments as a percentage of GDP rising somewhat overall. General government investment will fall as a percentage of GDP during the entire period. The estimate is based on investment volume rising in pace with general government consumption volume and the assumption that the prices of investment goods will lag somewhat behind average price increases in the economy.

Table 13: Primary expenditure as a percentage of GDP

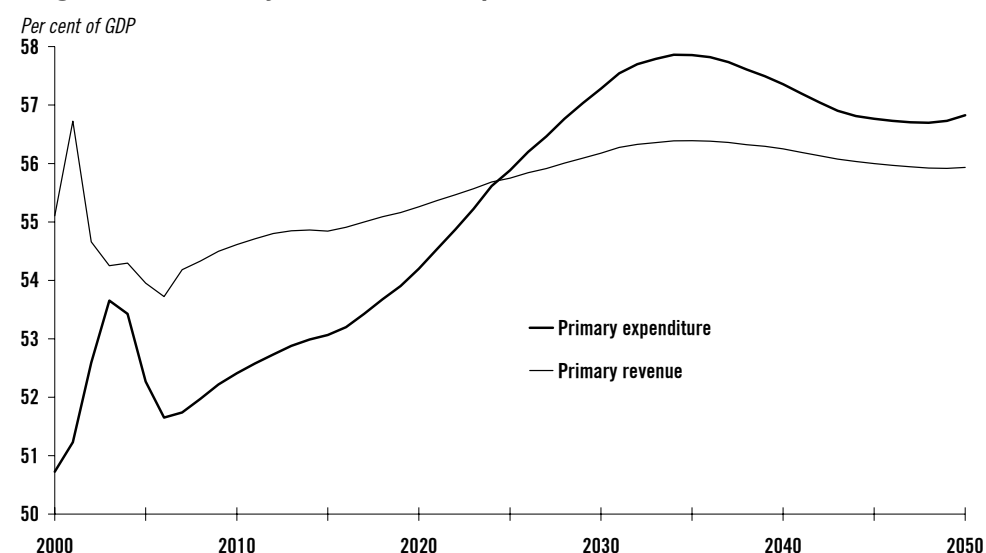
Change in percentage points

	2003–2015	2015–2050
Primary expenditure	–0.6	3.8
Household transfer payments	0.2	0.9
General government transfer payments to firms and abroad	–0.2	0.0
General government consumption	0.0	4.1
Investment	–0.6	–0.1

Sources: Statistics Sweden and Ministry of Finance.

Between 2015 and 2050, primary expenditure as a percentage of GDP is estimated to rise by nearly 4 percentage points as a result of the rising percentage of older people. In the mid-2030s, the expenditure ratio will peak (see Diagram 10). General government expenditure for medical and elderly care in particular will rise, but also household transfer payments in the form of pensions. At the same time, the primary income ratio will rise during the estimate period as a result of rising tax bases (see Appendix A). However, the primary revenue will be rising at a lower rate than the expenditure expressed as a percentage of GDP, which will lead to a weakening trend in net lending.

Diagram 10: Primary revenue and expenditure



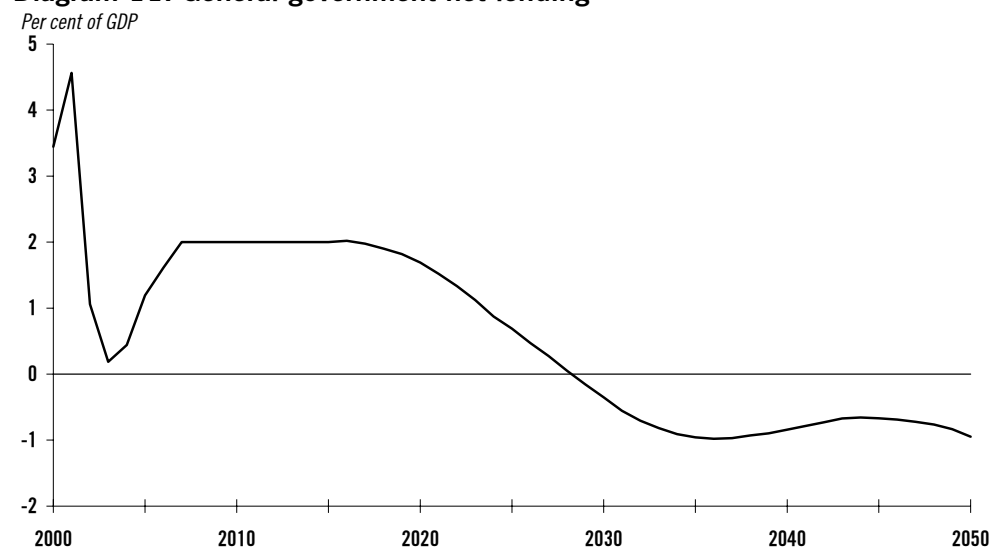
Sources: Statistics Sweden and Ministry of Finance.

General government net lending and debt

The above-mentioned conditions will initially lead to a surplus in public finances, which will eventually lead to a deficit as the expenditure ratio rises. After 2020, net lending will

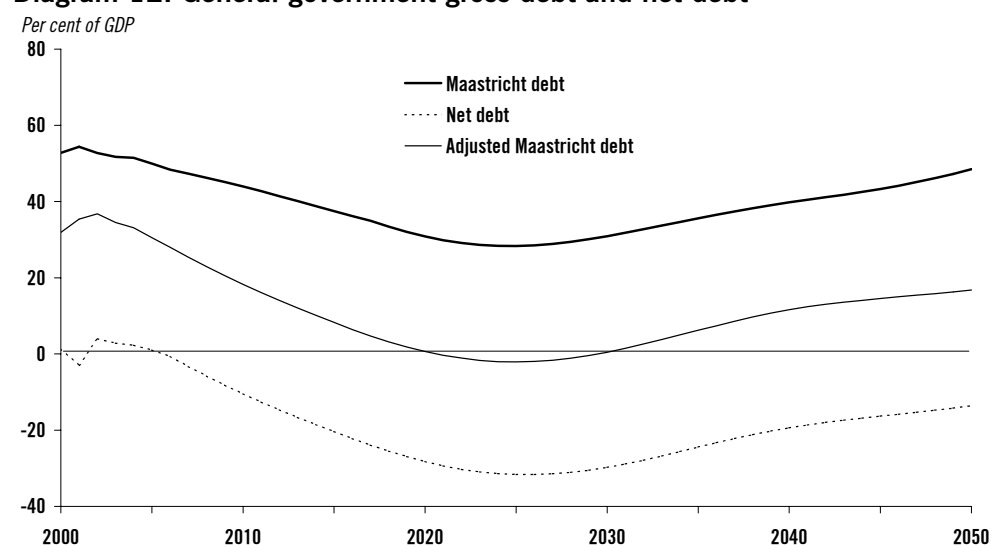
weaken as demographically induced expenditure pressure increases (see Diagram 11). Towards the end of the period, revenues will once again be more or less in line with expenditure, evening out the financing of future demographic cost increases over time. Net capital income will be negative in 2004 but will be positive during the estimate period since the net debt will be replaced by net assets (see Table 14).

Diagram 11: General government net lending



General government gross debt and net debt will fall at the beginning of the estimate period, when public finances show a surplus (see Diagram 12). The debt will rise once again as net lending weakens. Despite this weakening, both the gross debt and net debt are forecast to be at lower levels (measured as percentages of GDP) at the end of the estimate period compared with the beginning. This scenario suggests that the indicated fiscal policy stance will lead to public finances that are stable in the long term (see Diagram 12).

Diagram 12: General government gross debt and net debt



Gross debt is shown in Table 14 in accordance with the Maastricht definition. The table also shows adjusted gross debt in which pension system assets in addition to government securities have been consolidated. The development of adjusted gross debt follows the development of net debt (see Diagram 12), but at a much lower level.

Table 14: Public finances

Per cent of GDP

	2000	2004	2006	2010	2015	2020	2030	2040	2050
Primary revenue	55.1	54.3	53.7	54.6	54.8	55.3	56.2	56.3	55.9
Taxes and charges	51.8	50.9	50.3	51.3	51.6	52.2	53.2	53.4	53.2
Other revenue	3.3	3.4	3.4	3.3	3.2	3.1	3.0	2.9	2.7
Primary expenditure	50.7	53.4	51.7	52.4	53.1	54.2	57.3	57.4	56.8
Transfer payments	21.3	22.1	21.0	21.6	22.3	22.7	23.6	23.5	23.2
Consumption	26.8	28.2	27.7	28.1	28.3	29.3	31.8	32.3	32.4
Investment	2.6	3.1	3.0	2.8	2.5	2.3	1.9	1.5	1.2
Primary net lending	4.4	0.9	2.1	2.2	1.8	1.1	-1.1	-1.1	-0.9
Net capital income	-0.9	-0.4	-0.5	-0.2	0.2	0.6	0.8	0.3	-0.1
Net lending	3.4	0.4	1.6	2.0	2.0	1.7	-0.4	-0.8	-0.9
Financial position									
Consolidated gross debt	52.8	51.5	48.4	43.9	37.5	30.8	30.9	39.8	48.5
Adjusted gross debt ¹	21.2	28.2	23.4	15.5	8.2	1.7	2.1	13.5	18.9
Net debt	1.4	2.3	-0.6	-10.5	-20.4	-28.2	-29.8	-19.4	-13.6

¹Consolidated gross debt minus pension system assets in addition to government securities.

Sources: Statistics Sweden and Ministry of Finance.

Appendix A: Appendix to Chapter VIII, calculation methods

The calculation methods used in the estimate of public finances during the period 2005–2050 are discussed in more detail below.

General government revenue: Taxes and charges

A standard method of making projections of general government revenue is to set taxes and charges as a constant percentage of GDP. In practice, this method assumes that tax regulations will change unless the tax bases grow in pace with GDP. The calculations presented here are based on the assumption of constant tax rates in relation to tax bases. As a result, the aggregated tax ratio will vary as the tax bases will develop differently than GDP. This method reflects unchanged tax regulations. Stable tax rates over time are advantageous for both efficiency and wealth distribution policy reasons.

Table A1: General government taxes and charges

Per cent of GDP

	2000	2006	2010	2015	2020	2030	2040	2050
Taxes and charges, per cent of GDP	51.8	50.3	51.3	51.6	52.2	53.2	53.4	53.2
Household direct taxes and charges								
Percentage of GDP	21.3	19.4	20.3	20.3	20.5	20.9	21.0	21.1
Implicit tax rate for direct taxes	29.3	26.5	27.5	27.0	27.0	27.0	27.0	27.0
Tax base for direct taxes as percentage of GDP	63.0	62.5	63.4	64.4	65.2	66.6	66.9	66.8
Implicit tax rate for charges	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Tax base for charges as percentage of GDP	46.0	45.2	45.5	45.7	46.0	46.8	47.2	47.8
Corporate direct taxes								
Percentage of GDP	2.9	2.3	2.3	2.3	2.3	2.2	2.2	2.2
Implicit tax rate	10.3	8.8	8.8	8.8	8.8	8.8	8.8	8.8
Tax base as percentage of GDP	28.3	26.7	26.5	26.2	25.8	24.8	24.5	24.5
Indirect taxes¹								
Percentage of GDP	13.7	14.3	14.4	14.8	15.0	15.5	15.5	15.1
Implicit tax rate	27.9	29.7	29.6	29.4	29.2	29.1	28.9	28.8
Tax base as percentage of GDP	49.1	48.2	48.6	50.3	51.2	53.0	53.5	52.5
Employer contributions and self-employed contributions²								
Percentage of GDP	13.9	14.2	14.3	14.3	14.4	14.6	14.7	14.9
Implicit tax rate	33.6	34.2	34.2	34.1	34.1	34.1	34.1	34.1
Tax base as percentage of GDP	41.3	41.6	41.8	41.9	42.2	42.8	43.2	43.6

¹ Excluding wage-dependent indirect taxes.

² Including wage-dependent indirect taxes.

Sources: Statistics Sweden and Ministry of Finance.

In order to achieve the surplus target for each individual year until 2015, a minor tax hike will be needed in 2007. This tax hike will technically be an increase on household income taxes. After 2015, it is assumed that tax regulations will be unchanged. In spite of this, however, the tax ratio will rise (taxes and charges as a percentage of GDP) by 2.9 percentage points during the period 2006–2050. The reason for this is that important tax bases such as the wage bill, taxable transfer payments (including pensions) and household consumption will increase faster than GDP. Table A1 lists general government taxes and

charges as a percentage of GDP as well as the respective tax bases (implicit tax rate) as a percentage of GDP.

General government consumption expenditure

The estimate of general government consumption expenditure is based on age and gender distributed unit costs 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) and care of the elderly (home help service and sheltered accommodation). All these expenditure areas are projected in volume terms by the change in the relevant age group for men and women. Other consumption expenditure, which mainly consists of general administration, the legal 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 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.

General government output is assumed to take place with the same staffing levels as today. The number of those employed in the general government sector must nevertheless increase by 125,000 people until 2020 to keep in pace with demographic needs, and by another 315,000 people between 2015 and 2050. Since the average age of general government employees is currently relatively high, particularly within local government, there will be a much greater need for recruitment. Around half of those now working in the public sector will be leaving their jobs during the next twenty years. Altogether, nearly 800,000 employees will need to be recruited to the public sector up until 2020. As a result of this considerable need for new employees and the ambition of a more even distribution of male and female general government employees, wages will probably rise relative to the rest of the economy. Therefore, the calculations assume that hourly wages in local government and county councils will rise an average of 0.5 per cent faster than other parts of the economy until 2020. This means that pay levels in local government will grow by approximately 10 percentage points more than other sectors.

Table A.2: General government consumption

Per cent of GDP

	2000	2006	2010	2015	2020	2030	2040	2050
Total consumption	27.9	27.7	28.1	28.3	29.3	31.8	32.3	32.4
Childcare	1.7	1.6	1.7	1.8	1.9	2.0	2.0	2.1
Primary and secondary education	3.9	3.9	3.8	3.6	3.8	4.2	4.2	4.1
Adult education	2.1	1.9	2.0	2.1	1.9	2.0	2.0	2.0
Medical care	6.2	6.4	6.6	6.9	7.3	8.0	8.3	8.4
Care of the elderly	3.9	4.1	4.1	4.2	4.5	5.7	6.1	6.3
Other activities	10.2	9.8	9.8	9.7	9.7	9.9	9.8	9.6

Sources: Statistics Sweden and Ministry of Finance.

Transfer payments

The estimates assume a certain level of standard guarantee as regards the general government transfer payment systems. For many of the transfer payments, regulations ensure that the expenditure is automatically raised in pace with real growth in the economy. This applies to pensions which are linked to an income index as well as certain transfer payments to compensate for loss of income, such as health insurance and parental insurance. Transfer payments that lack an automatic standard guarantee, for example child benefit and study allowance, are assumed to rise in pace with wages. This kind of standard guarantee prevents the erosion in household transfer payments that would otherwise occur if the estimate were only based on a price projection for up to 50 years.

Table A.3: General government transfer payments

Per cent of GDP

	2000	2006	2010	2015	2020	2030	2040	2050
Total transfer payments	21.3	21.0	21.6	22.3	22.7	23.6	23.5	23.2
Transfer payments to households	18.4	18.2	18.8	19.5	19.9	20.8	20.7	20.4
Old age	8.5	8.9	9.3	10.0	10.3	10.6	10.6	9.9
Ill health	3.9	4.5	4.5	4.5	4.6	4.9	4.8	5.0
Children/studies	2.4	2.2	2.3	2.4	2.4	2.5	2.6	2.6
Labour market	1.9	1.1	1.1	1.1	1.1	1.2	1.2	1.3
Other	1.7	1.5	1.5	1.5	1.5	1.6	1.6	1.6
Transfer payments to firms	1.8	1.3	1.3	1.3	1.3	1.4	1.3	1.3
Transfer payments abroad	1.1	1.5	1.5	1.5	1.5	1.5	1.5	1.5

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.4 shows the old-age pension system's revenue and expenditure and its financial position. Net lending deteriorates as pension expenditure rises as a result of an increasing number of pensioners. Despite the increasing expenditure, the old-age pension system holds considerable assets at the end of the estimate period.

Table A.4: Old-age pension system

Per cent of GDP

	2000	2006	2010	2015	2020	2030	2040	2050
Revenue	10.6	8.8	8.9	8.9	9.0	9.1	9.1	9.3
Charges	6.6	6.8	6.8	6.8	6.8	7.0	7.0	7.1
Premium pension funds	2.5	0.9	0.9	1.0	1.0	1.0	1.0	1.0
Interest, dividends, etc.	1.5	1.1	1.1	1.2	1.2	1.1	1.0	1.1
Expenditure	8.6	6.7	7.1	7.8	8.1	8.4	8.4	7.8
Pensions	6.3	6.5	7.0	7.7	8.0	8.4	8.3	7.8
Other	2.3	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Net lending	2.0	2.1	1.8	1.1	0.9	0.7	0.7	1.4
Net financial assets	35.6	28.0	31.8	32.9	32.6	32.3	30.2	33.6

Sources: Statistics Sweden and Ministry of Finance.

Demographic assumptions

The described estimate is based on Statistics Sweden's population forecast of 2003, shown in Table A.5 together with the assumptions stated by Eurostat for Sweden in estimates for the Economic Policy Committee of the European Union.

The birth rate rises at a more rapid rate in Statistics Sweden's forecast, but from 2010, it will level off at approximately 1.85 children per woman, which is somewhat higher than Eurostat assumed (see Table A.5). In addition, Statistics Sweden estimates that net migration will be much higher than Eurostat assumed. These differences will eventually lead to considerable deviations in the total estimated population. Statistics Sweden's forecast assumes more rapid population growth which exceeds Eurostat's forecast by nearly 1.4 million people in the year 2050. The number of people of working age is 0.4 million higher in 2050 in Statistics Sweden's forecast. The number of people under the age of 20 will be nearly 0.5 million higher and the number of persons over 64 years of age will be 0.1 million higher in 2050.

Table A.5: Demographic assumptions

	2000	2006	2010	2020	2030	2040	2050
Statistics Sweden							
Birth rate	1.55	1.78	1.86	1.86	1.86	1.86	1.86
Average life expectancy, women	82.0	82.6	83.2	84.2	85.0	85.7	86.2
Average life expectancy, men	77.4	78.3	79.2	80.8	81.9	82.9	83.6
Net migration, thousands	24 600	32 900	28 300	25 200	24 500	23 700	23 300
Eurostat							
Birth rate	1.50	1.56	1.61	1.70	1.77	1.80	1.80
Average life expectancy, women	82.0	82.4	82.8	83.5	84.3	85.1	86.0
Average life expectancy, men	77.3	77.7	78.2	79.1	80.0	81.0	82.0
Net migration, thousands	15 200	17 600	20 000	20 000	20 000	20 000	20 000

Sources: Statistics Sweden and Eurostat.

Appendix B: Table appendix

Table B.1: Forecast assumptions

Annual average, unless otherwise stated

	2002	2003	2004	2005	2006
GDP global ¹	3.0	3.2	4.0	3.9	3.9
GDP global, excluding EU ¹	3.5	3.7	4.5	4.1	4.1
GDP EU-15 ¹	1.1	0.7	1.9	2.8	2.7
HICP EU ¹	2.1	1.9	1.7	1.9	1.8
Hourly wage in Sweden, cost ¹	4.1	3.5	3.5	3.5	3.5
TCW index	133.7	128.6	127.9	127.0	127.0
EUR/SEK ²	9.09	9.10	9.00	9.00	9.00
EUR/USD ²	1.02	1.08	1.10	1.10	1.10
German 10-year government bond rate, annual average	4.8	4.2	4.8	5.3	5.4
Swedish 10-year government bond rate, annual average	5.3	4.7	5.2	5.7	5.8
Swedish 6-month interest rate, annual average	4.1	3.3	3.7	4.6	4.9
Oil price, (Brent, USD/barrel)	25.1	28.6	26.0		
World market growth, global excl. EU ¹	3.1	4.7	9.2	8.2	8.1

¹ Annual percentage change.

² Value at year-end.

Source: Ministry of Finance.

Table B.2: General government finances

Per cent of GDP

	2002	2003	2004	2005	2006
Revenue	56.8	56.4	56.4	56.1	56.0
Taxes and charges	51.3	50.8	50.9	50.5	50.3
Direct taxes	19.3	18.8	19.0	18.9	18.8
Product and production taxes	17.1	17.4	17.3	17.2	17.1
Social security contributions	14.8	14.5	14.4	14.3	14.3
Capital income	2.2	2.2	2.1	2.2	2.2
Other revenue	3.3	3.4	3.4	3.4	3.4
Expenditure	55.8	56.3	56.0	54.9	54.3
Transfer payments	21.5	22.2	22.1	21.3	21.0
Households	18.6	19.3	18.9	18.4	18.2
Business sector	1.8	1.6	1.7	1.4	1.3
International	1.1	1.3	1.5	1.5	1.5
Consumption	28.0	28.3	28.2	28.0	27.7
Investment, etc.	3.1	3.1	3.1	3.0	2.9
Investments and stocks	3.2	3.2	3.2	3.3	3.2
Purchase and sale of land and properties, net	-0.1	-0.1	-0.1	-0.2	-0.2
Interest expenditure	3.2	2.6	2.6	2.7	2.7
Net lending	1.1	0.2	0.4	1.2	1.6
Primary net lending	2.1	0.6	0.9	1.7	2.1
Fixed capital consumption and capital transfers, net	2.4	2.3	2.3	0.0	0.0
Fixed capital formation	3.1	3.1	3.1	3.0	3.0
Lending, net	1.8	0.9	1.2	4.2	4.6
Consolidated gross debt	52.7	51.7	51.5	50.0	48.3
Net debt	3.7	2.6	2.1	0.8	-0.9

Sources: Statistics Sweden and Ministry of Finance.



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