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2003 UPDATE OF THE CONVERGENCE PROGRAMME OF SWEDEN (2003-2006)

AN ASSESSMENT

TABLE OF CONTENTS

SUMMARY AND CONCLUSIONS [1]

The 2003 updated Swedish convergence programme covers the period 2003 to 2006 and is based on the Budget Bill for 2004. The Budget was adopted by parliament in December 2003. The updated programme provides detailed information and an elaborated description of structural issues, including the cyclical position of the economy together with its impact on public finances. In addition, the long-term sustainability of public finances is covered in some detail. This is largely in line with Code of Conduct. According to the 2003 update, the focus of economic policy continues to be full employment and increased prosperity through high, sustainable growth. The stability-oriented macro-economic policy framework of stable prices and sound public finances remains in place.

As in the rest of the EU, the Swedish economy has developed less favourably than foreseen in the 2002 update. The 2003 update projects GDP growth of 1.4% in 2003, 2.0% in 2004, 2.6% in 2005 and 2.5% in 2006. The labour market has deteriorated in 2003, with negative employment growth and a rise in the unemployment rate, and it is not expected to recover until 2005. This scenario is broadly in line with the Commission's evaluation including the Autumn forecast, though the Commission's forecast foresees somewhat weaker labour market developments.

Public finances in Sweden remain 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 surplus target 2% of GDP on average over the cycle. In the 2003 update, a surplus of 0.4% of GDP in 2003 is targeted, followed by gradually higher surpluses in the years to 2006. Moreover, the gross debt ratio – below 60% of GDP since 2000 - is projected to continue to decline and reach 48.3% of GDP in 2006 and the low net debt ratio is expected to turn into a net claim in 2006. The Commission's view is in line with these projections.

The considerable fiscal stimulus in 2002 - which was possible given the existing sound fiscal position - and the prolonged period of relatively subdued economic growth weighs on the government finances. Nevertheless, the cyclically-adjusted fiscal position is expected to remain sound and to strengthen gradually, although remaining lower than 2% of GDP in each year to 2005, according to both the Commission's analysis and the estimates in the 2003 update.

The main instruments for maintaining sound government finances continue to be i) the expenditure ceilings for central government and ii) the balanced budget constraint for local governments. The budgetary margin included under the ceiling for 2004 is very narrow, suggesting that close monitoring remains important and corrective measures might be called for in case of worse-than-expected developments. For 2005 and 2006, the budgetary margins are appropriately larger. According to calculations in the update, the 2% of GDP surplus target will be met on average over the period 2000-2006. However, this hinges inter alia on the achievement of the expenditure ceiling in 2004 and expenditure plans in 2005 and 2006 for central government, suggesting that there is little room, if any, for further deterioration in this respect. The 2003 update projects that the balanced budget requirement is met for the local government sector during the period 2004-06. In order for local governments to comply with the balanced budget constraint,

[1] This assessment has been carried out on the basis of information available as of 22.12.2003.

several local governments raised tax rates in 2003. Some additional rises are foreseen in 2004. Despite this, some of the larger local governments appear to face great difficulties in achieving balance, resulting in proposed rises in both taxes and charges. If local governments are to achieve a balanced budget, they may be forced to raise taxes further. This could, all else equal, reverse the achievement in recent years of reducing the overall tax burden, which in turn could have adverse effects on economic growth.

The 2003 update includes a detailed section on the likely impact of ageing population on public finances. Age-related expenditures are expected to increase by 6.7% of GDP between 2007 and 2050. On the basis of current policies, Sweden appears to be in a relatively good position to meet the budgetary costs associated with ageing populations. Long term projections show that gross debt will stay below 60% of GDP at all times and that the adjusted gross debt will fall close to zero. This is largely due to the reformed pension system and the medium term strategy to come back to a structural surplus of 2% of GDP. However, the increase of health care expenditure, including expenditure related to ill health, foreseen in the projections needs to be addressed as the update notes that further measures are necessary in order to achieve the target of half the number of sick days. Moreover, according to the Commission's analysis the medium term target has to be reached; failure to do so can determine some budgetary unbalances in the very long term. In addition, as noted in the Broad Economic Policy Guidelines, "additional efforts appear necessary to improve further the incentives to work, notably as Sweden still has the highest overall tax burden in the EU and relatively generous benefit schemes in an international perspective".

Inflation in Sweden has come down recently, after having been relatively high due to temporary factors in the beginning of 2003. New wage agreements for the most part of the labour market are expected to be reached in the beginning of 2004. So far, it appears likely that wage increases will remain moderate, in party linked to poor labour market developments.

Over the past year, developments in Swedish bond yields have been in line with trends in international bond markets. The 2003 update states that entering ERM II is not under consideration. Compared to developments in previous years, the krona has been relatively stable in 2002 and 2003.

In order to obtain 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 of raising employment, reducing the number of social security recipients and days of sick-leave should be given priority within the framework of sound public finances.

1. INTRODUCTION

The 2003 updated Swedish convergence programme was adopted by the Swedish government on 27 November 2003 and submitted to the Commission on 1 December 2003. The programme is based on the economic projections in the government's Budget Bill for 2004 presented to the parliament on 22 September 2003. The Budget was adopted by parliament in December 2003. The present update, covering the period up to

2006, is the fifth update of the convergence programme of December 1998[2]. The 2003 update complies largely with the Code of Conduct which has been agreed for stability and convergence programmes[3]. The elaborated description of structural issues, including the cyclical 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.

The overall economic policy, emphasised in the 2003 update, of sound government finances has since 1997 focused on two main targets for the public finances:

Firstly, the public finances should show a surplus of 2% of GDP on average over the business cycle. The 2003 CP update projects continued and gradually higher surpluses in the public finances in 2003-2006. This is broadly in line with the Commission's view. However, the Swedish authorities and the Commission estimate that the surplus in the structural balance is below 2% of GDP each year between 2002 and 2005.

Secondly, expenditure ceilings on central government are set three years ahead. The ceilings for 2003 and 2004 were unchanged compared with the 2003 Spring Fiscal Policy Bill. New ceilings were proposed for 2005 and 2006. These new ceilings prohibit expenditures to rise faster than nominal GDP, in line with previous practice. In addition, a balanced budget requirement as stipulated by law applies to local governments since 2000.

Finally, it is noted that the result of the 14 September referendum, when the Swedish people voted against euro introduction, will not result in any changes in the monetary and exchange rate policy regime. Hence, the current monetary policy regime with an inflation target and a floating exchange rate remains in place.

2. MACROECONOMIC DEVELOPMENTS

2.1. External economic assumptions

The 2003 update expects a rebound in global growth in 2004 which is largely in line with the Commission services autumn forecast. For 2005, the 2003 update is slightly more optimistic on growth in the EU. It also assumes a more marked rise in interest rates compared with the Commission, both short- and long-term, to take place already in 2004. The 2003 update assumes a strengthening of the Swedish Krona vis a vis the euro to 9 in 2004 (which in fact materialised shortly after the 14 September euro referendum), and thereafter an assumption of a stable euro exchange rate, which is close to the Commission's usual technical assumption. A comparison of Sweden's and the Commission's basic assumptions is made in Tables 1 and 7 in Annex 1, respectively.

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[2] Earlier updates and assessments can be found at the following web site http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

[3] 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.

2.2. Macroeconomic developments

2.2.1. Macroeconomic scenarios compared

The macroeconomic projections in the 2003 update are those included in the Budget Bill for 2004. GDP growth in 2003 has been revised downwards by more than one percentage point compared with the 2002 updated convergence programme, but remains unchanged compared with the 2003 Spring Fiscal Policy Bill. The global downturn is said to affect Swedish growth negatively. A substantially lower forecast for investment, lower increases in trade and in private consumption contributes to this downward revision. For 2004, 2005 and 2006, overall GDP growth is forecast to be 2.0%, 2.6% and 2.5%, respectively. Inflation is expected to fall during 2003 and to remain below 2% in 2004. In 2005 and 2006, inflation is forecast to be close to the inflation target of 2%. Wage increases (hourly earnings) are, as usual, assumed (rather than forecast) to be 3.5% per year in 2003 and 2004. Relatively weak economic growth is expected to affect the labour market negatively. Unemployment is expected to rise from 4% in 2002 to 4.7% in 2003 and 2004, and to subsequently fall back and reach 4% in 2006.

Table 2.1 – Forecasts compared

Sweden	**MACROECONOMIC SCENARIOS 2002-2006** (Annual average growth rate, in %)								
	2002		2003		2004		2005		2006
	2003 update	COM	2003 update	COM	2003 update	COM	2003 update	COM	2003 update
GDP	1.9	1.9	1.4	1.4	2.0	2.2	2.6	2.6	2.5
CPI	2.4	2.4	2.0	2.1	1.3	1.3	2.3	1.9	2.1
Employment growth	0.1	0.1	-0.2	-0.2	0.1	0.0	0.7	0.2	0.7
Unemployment a)	4.0	4.0	4.7	4.8	4.7	4.9	4.3	4.8	4.0
Exchange rate SEK/Euro	9.09	9.16	9.10	9.12	9.00	8.99	9.00	9.01	9.00
Budget surplus (% of GDP) b)	0.2	1.3	0.4	0.2	0.6	0.5	1.4	1.0	1.9
Debt (% of GDP)	52.7	52.7	51.7	51.7	51.5	51.4	50.0	50.0	48.3

SOURCES: 2003 updated convergence programme, Budget Bill for 2004 and the Commission's Autumn 2003 forecast.
a) % of Labour Force, national definition. b) the figures from the 2003 update are the 'net lending with accruals taxes', which corresponds to the revised general government finances, released by Statistics Sweden on 17 November, see Annex 2. The Commission's autumn forecast does not incorporate the 'accruals' effect which according to the 2003 update is estimated to be positive in 2003-2006. In 2002, the revised balance was 0.1% of GDP on the ESA95 definition and 0.3% of GDP on the EDP definition.

The macro-economic scenario in the 2003 update is plausible and indeed close to the Commission's assessment, as reflected in the autumn 2003 forecast. Other recent forecasts[4] are broadly in line with this view and indicators of economic activity released so far in 2003 supports the growth outlook. The composition of growth foreseen in the 2003 update is broadly in line with the Commission's view. Despite a slowdown in disposable income growth in 2003, private consumption is expected to continue to grow steadily. Financial wealth has partially recovered from the long slump in the stock markets, with the recent surge in equity prices. House prices have continued to rise steadily, contributing to a relatively strong wealth position of households. In this framework, the saving rate of households is expected to decline in the coming years, after having risen since 2000, which provides room for relatively high consumption

[4] The National Institute of Economic Research (published 17 December) expect GDP growth to be 1.5% in 2003, 2.2% in 2004 and 2.5% in 2005. The Riksbank (published 5 December) expect it to be 1.5% in 2003, 2.4% in 2004 and 2.5% in 2005.

growth over the programme period. Public consumption is expected to be weak over the forecast period, in part due to budgetary constraints at the local and central level. Investment growth is expected to be negative, while gradually improving, in 2003 as business prospects remain uncertain and also due to a negative overhang into 2003. A rise in investment is foreseen for 2004 and further in 2005, as economic activity gathers momentum and the productive capacity needs to be expanded, following a period of falling investment. Swedish exports rises faster in 2003, as external demand growth strengthens. In 2004 and 2005, a further recovery in exports is expected, in line with world markets. Imports too should continue to rise over the forecast period, as final demand recovers gradually. All in all, the macro-economic scenario in the 2003 update is plausible and indeed close to the Commission's assessment, as reflected in the autumn 2003 forecast.

Both scenarios expect inflationary pressures to be very subdued. Wage increases are expected to be moderate over the forecast period. This can partly be attributed to some deterioration in the labour market in 2003. As demand and growth revives further in 2005, inflation is expected to gradually rise to close to 2% towards the end of 2005.

However, the Commission forecasts somewhat lower employment growth in 2005 and therefore a lower reduction in the unemployment rate compared with the 2003 update. Employment growth has been virtually zero since 2002. The unemployment rate has risen so far in 2003, in part as a result of fewer people engaged in labour market programmes. The gradual increase in economic activity foreseen from 2004 onwards is expected to create little in the way of employment until 2005 in the Commission's scenario. A comparison of the macroeconomic scenarios is given in Table 2.1 above.

Information provided in the update does not allow a rigorous assessment of the sectoral balances. However, there would not seem to be any inconsistencies between the financial positions of the general government, the private and the external sectors, as the projections draw fully on the complete macroeconomic scenario included in the Budget Bill for 2004. This scenario implies a gradual recovery in domestic demand both consumption and investment) alongside with a fall in the household savings ratio (from a relatively high level) and a revival of exports coupled with stronger imports which leave the contribution from net exports to growth broadly constant. A fall in the savings ratio of households would appear plausible as the household wealth position is sound, as noted above. In terms of the implied sectoral balances, this could correspond to a weakening of the private sector financial situation and a broadly stable financial position vis a vis the rest of the world, the latter underpinned by the programmes projection of a relatively stable positive current account balance. In this framework a strengthening of the general government financial position would appear plausible.

2.2.2. Potential growth and the output gap

The 2003 update includes estimates of the output gap, suggesting a gradual narrowing of the negative output gap from 2003 to 2006 and it is noted that the gap is assumed to be closed in 2007. The Commission's autumn 2003 forecast estimates an increase of the negative output gap between 2003 and 2004 and virtually unchanged in 2005. The Commission's estimates of potential output growth and the output gap using the agreed method on the basis of the information in the 2003 update also result in a negative output gap which narrows towards the end of the estimation period.

The output gap estimates on the basis of the Commission's autumn 2003 forecast and on the basis of the agreed method using the information in the 2003 update are fairly similar, suggesting a continued negative output gap until 2005 and a narrowing is projected beyond that on the basis of a technical extrapolation to 2008. Overall, the assumption in the 2003 update of a closing of the output gap in 2007 is broadly consistent with the Commission's estimates on the basis of the Commission's autumn 2003 forecast as well as on the Commission's calculations using the information provided in the programme (see Table 2.2)[5]. The analysis of the cyclically adjusted budgetary position is made in section 4.5 below.

Table 2.2 – Potential growth and output gaps

	2003 updated convergence programme Swedish authorities calculations	2003 updated convergence programme Commission's calculation			Commission's autumn 2003 forecast Commission's calculation[2]		
	Output gap	GDP growth	PF Potential growth[1]	Output gap[1]	GDP growth	PF Potential growth	Output gap
2002	-0.6	1.9	2.5	0.7	1.9	2.6	0.7
2003	-1.1	1.4	2.3	-0.2	1.4	2.4	-0.3
2004	-1.0	2.0	2.5	-0.6	2.2	2.5	-0.6
2005	-0.6	2.6	2.6	-0.7	2.6	2.7	-0.7
2006	-0.2	2.5	2.5	-0.6	*2.8*	*2.5*	*-0.5*
2007		*2.5*	*2.3*	*-0.4*	*2.6*	*2.4*	*-0.2*
2008		*2.3*	*2.1*	*-0.2*	*2.5*	*2.2*	*0.0*

[1] Commission's calculations using the agreed method on the basis of the information in the 2003 update.
[2] Calculated using the Commission's estimate of potential growth on the basis of the autumn 2003 forecast, including a technical extrapolation beyond 2005.
Note: the output gap estimates on the basis of the programme information incorporates the revised GDP figures released by Statistics Sweden on 17 November 2003.

3. MONETARY POLICY

3.1. Inflation developments

The 2003 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)[6] one to two years ahead.

Inflation in Sweden has come down recently, after having been relatively high due to temporary factors in the beginning of 2003. HICP inflation was 2.0%, underlying inflation (UND1X) was 1.9% and CPI inflation was 1.4% in October. According to

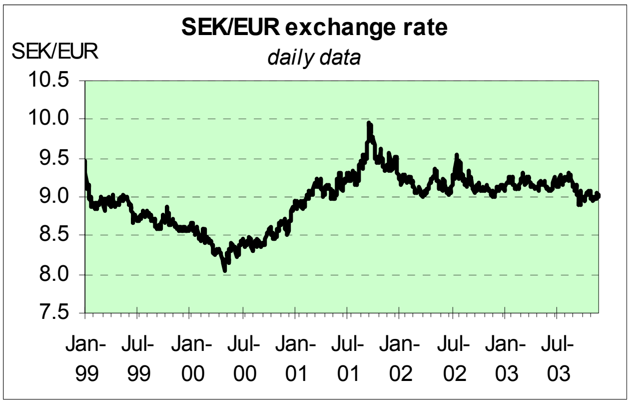
[5] The 2003 CP estimate a mostly negative output gap in the period 2000-2006 (the average output gap over this period is –0.5 p.p.). At any rate, all estimates suggest a negative output gap at present which is narrowing towards the end of the estimation period.

[6] UND1X is defined as the CPI excluding mortgage interest expenditure and direct effects of altered indirect taxes and subsidies. It covers approximately 94% of the CPI basket. Certain factors considered to have a temporary effect on the UND1X are also taken into account by the Riksbank. In 2003, monetary policy was based on an assessment of UND1X excluding energy.

survey results reported in the Riksbank's latest Inflation Report, inflation expectations one and two years ahead are generally close to 2%. New wage agreements for the most part of the labour market are expected to be reached in the beginning of 2004. So far, it appears likely that wage increases will remain moderate, in part linked to poor labour market developments. Domestic underlying inflation remains higher than the UND1X, as evident from the underlying inflation excluding primarily imported goods (UNDINHX)[7] at 3.6% in October.

3.2. Exchange rate developments

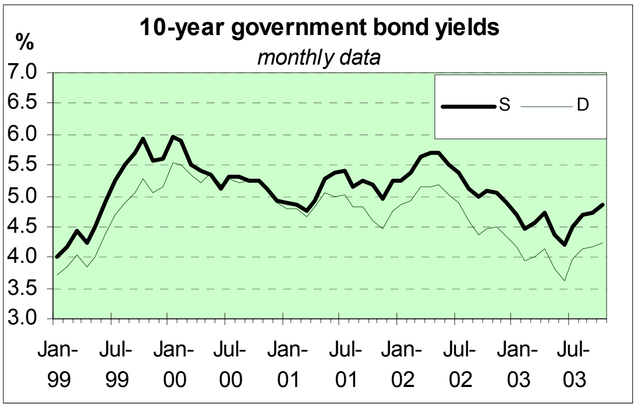
The rejection of euro area membership by Swedish voters meant that the exchange rate policy regime will remain unaffected and that the Riksbank will continue to conduct monetary policy on the basis of a national inflation target of 2 per cent, with a tolerated deviation interval of plus/minus one percentage point. The updated convergence programme states that pegging the krona to ERM II is not under consideration.



Compared to developments in previous years, the krona has been relatively stable in 2002 and 2003. Since the beginning of 2002, the krona has been fluctuating in the interval SEK 8.88-9.55 per EUR, with an average of SEK 9.15 per EUR. Following the referendum, notwithstanding a slight and temporary depreciation, the krona appreciated against the euro and has since on average been trading close to SEK 9.0 per EUR. A SEK/EUR exchange rate close to this level corresponds to what many market participants, think-tanks and institutions considered an appropriate central rate in the ERM II, if Sweden had decided to apply for membership in the ERM II following the referendum.

3.3. Interest rate developments

The macroeconomic policy framework in Sweden, with sound public finances and low and stable inflation, continue to provide for low long-term bond yields. Over the past year, developments in Swedish bond yields have been in line with trends in international bond markets.



The interest rate differential between Swedish and German long-term government bonds, mainly as a consequence of exchange rate uncertainty, is a cost Sweden incurs by not having joined the euro area. The yield spread vis-à-vis German 10-year government bonds has fluctuated around 50 basis points over the past two years. Following the referendum the yield spread increased slightly.

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

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

4.1. Programme overview

Table 4.1 – General government finances compared

% of GDP		2002	2003	2004	2005	2006
Net lending						
2002 update		1.7	1.5	1.6	2.0	-
2003 update		0.2	0.4	0.6	1.4	1.9
Total revenue						
2002 update		56.5	55.9	55.4	-	-
2003 update		56.8	56.4	56.4	56.1	56.0
Total expenditure						
2002 update		54.8	54.5	53.8	-	-
2003 update		55.8	56.3	56.0	54.9	54.3

Note: Statistics Sweden released revised general government finances on 17 November. In 2002, the balance was 0.1% of GDP on the ESA95 definition and 0.3% of GDP on the EDP definition. For the period 2003-2006, the figures from the 2003 update are the 'net lending with accruals taxes', which corresponds to the revised general government finances, see Annex 2. A direct comparison of the 2002 and 2003 update's figures is therefore not possible.

Sound 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 to decline. The net debt-to-GDP ratio is also projected to decline; from 2.6% in 2003 to -0.9% in 2006 (i.e. a net claim that year). The 2003 update confirms that the Swedish fiscal rule of a 2% of GDP surplus on average over the cycle is maintained and the structural budgetary position, according to the programme, is considered to be compatible with this target. This target is intended to address the expected budgetary impact of the ageing of the population and the sustainability of public finances in the long-term. However, the projected surpluses of the 2003 update are lower than 2% of GDP in each year to 2006 and the same applies to the projected structural surpluses up to 2005 (see Table 4.2).

The cyclical downturn weighs on the *general government finances*. According to the 2003 update, expenditure in relation to GDP is expected to rise in 2003. From 2004 onwards, this is expected to reverse, i.a. as the economy is expected to gradually return towards productive potential and transfer payments as a proportion of GDP should decline. The projected decline in the expenditure ratio to slightly below 54% in 2004 in the previous update is now projected to be almost achieved in 2006. Revenues by contrast are expected to rise faster than nominal GDP in 2003[8] on an accruals basis and remain unchanged in 2004, influenced by the (expected) local government tax hikes in these years. The technical extrapolations for 2005 and 2006 on an announced policies basis imply a slight fall in the revenue-to-GDP ratio in these years. The overall tax burden (taxes and charges in relation to GDP) is projected to remain above 50% of GDP during the programme period. The Swedish medium-term strategy for a return to a

[8] According to the information in the 2003 update, a fall in the revenue-to-GDP ratio is projected in 2003. However, according to the revised general government statistics on an accruals basis released on 17 November 2003, tax revenue in 2002 were close to 1 percentage point lower, which results in an increase in the ratio between 2002 and 2003. This is partly due to the changeover to a taxed guaranteed pension, which is balanced by an equivalent increase in expenditure.

general government surplus of 2% of GDP beyond 2006 therefore relies crucially on expenditure restraint, which in turn hinges upon the expenditure plans in the Budget. Broadly, this is in line with the Commission's view[9].

With the Budget Bill for 2004, the planned 'reforms' (discretionary changes) taking effect in the period 2004-2006 are fairly small in size in relation to the previous year. The upward revisions of the *central government* deficits budgeted and projected in 2004-06 are mostly due to lower revenues now being projected. The relatively small (upward) revisions to budgeted and projected expenditures suggest that the national budgetary procedure with expenditure ceilings does limit spending increases, considering the cyclical downturn of the economy in 2003 and also with a view to the Swedish experiences in such situations prior to the reformed Budget Law.

The 2003 CP projects that the balanced budget requirement is met for the *local government sector* during the period 2004-06. In order for local governments to comply with the balanced budget constraint, several local governments raised tax rates in 2003. Some additional rises are foreseen in 2004. Despite this, some of the larger local governments appear to face great difficulties in achieving balance, resulting in proposed rises in both taxes and charges and expenditure cuts. Containing expenditure further might not be easy, as about 85% of local government expenditure is consumption. Wages, both directly and indirectly, account for the largest part therein. To this end, the usual assumption (rather than forecast) of wage increases, though for the whole economy, of 3.5% per year might be too optimistic (low) for the local governments, in view of developments in recent years. Moreover, the tasks assigned to and pursued by local governments on current policies may create some difficulties in cutting the wage bill by reducing the number of employed to any great extent[10].

[9] The overall expenditure- and revenue-to-GDP ratios in the 2003 update are different from those in the Commission's autumn 2003 forecast, which are in accordance with Eurostat's harmonised definition. This is due to the exclusion of certain items in the 2003 update that net out. Therefore, the concepts are the same, except for the EDP/ESA95 difference.

[10] However, if implemented and (un-specified) future measures aimed at reducing the number of people on sick-leave are successful, this could increase hours worked and ease the pressure on expenditure. From 1 July 2003 onwards, the employer pays the sick insurance benefits for the first three weeks instead of, as previously, for the first two weeks. This is a part of the government's initiative to strengthen the financial incentives to work, in this particular case to strengthen employer's financial incentives to make people work. Of those receiving sick benefits, a significantly larger proportion are public sector employees and in particular local government sector employees.

The expenditure ceilings for central government

In the Budget Bill, the government remains committed to maintain the expenditure ceilings for the central administration set in the Budget for 2003, which were subsequently technically revised in the 2003 Spring Fiscal Policy Bill[1]. 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. The expenditure ceilings and plans from the Budget Bill for 2004 are given in the Table below. For (2003 and) 2004, the budgetary margins under the ceiling are negligible, implying that corrective measures will have to be proposed if there are signs of overruns overall, in line with the Budget Law. For 2005 and 2006, the budgetary margins are larger and therefore better reflect the original intention of the margins, namely a safeguard against forecast errors. However, the central government is projected to remain in deficit, although gradually lower, over the period. This is mainly due to a downward revision of tax revenues for this period compared with one year ago.

To this end, one possible risk as regards central government expenditure is to what extent the budgetary margins included under the expenditure ceilings in 2005 and 2006 will be used. In previous years, these budgetary margins have been shrinking as the year in question has approached, one aspect that many economists have pointed out as something that could be improved upon. During the 'good' years 1999-2001, Sweden posted large surpluses in the overall public finances and the government paid attention mainly to the expenditure *ceilings* and not to the expenditure *plans*, which were often breached. At this juncture, the prospects for the economy and the public finances are less bright, in view of the overall 2% of GDP surplus target on average over the cycle for the public finances. According to calculations in the 2003 CP, this 2% of GDP surplus target will be met on average between 2000-2006. Whether this holds is debatable in itself[2], but there is at any rate little room, if any, for further deterioration. Therefore, in the years to 2006, it is not the expenditure ceilings for central government that are binding. It is the 2% of GDP surplus target and, closely linked to that, the expenditure plans for central government that are binding.

Table – Expenditure ceilings on central government

Ceilings and expenditure for central government

SEK billions	**2002**	**2003**	**2004**	**2005**	**2006**
Ceiling	812	822	856	894	931
% of GDP	34.7	*33.9*	*33.9*	*33.9*	*33.8*
Expenditure[1]	811.6	821.9	855.8	880.1	902.4
Contingency reserve[1]	0.4	0.1	0.2	13.9	28.6

Source: Budget Bill for 2004 (September 2003)
[1] *Outturn for 2002, planned for 2003-06*

[1] An upward adjustment of the ceilings for 2003 and 2004 set in the Budget for 2003 were proposed in the 2003 Spring Bill. These involved raising the ceilings by SEK 3 billion in each year, as the basis for the tax equalisation system between local governments are projected to be higher of that magnitude.

[2] The estimation of a structural or cyclically adjusted balance depends crucially on how to account for the cycle. As shown in Table 2.2, estimates of the cyclical position of the economy, or the output gap, can vary depending both on the method and on the forecasts for output and its contributing factors. As a result, the estimated structural or cyclically adjusted balance can also vary.

If local governments are to achieve a balanced budget, they may be forced to raise taxes further, given the very tight fiscal position in this sector. This could, all else equal, reverse the achievement in recent years of reducing the overall tax burden, which in turn could have adverse effects economic growth.

As in previous years, surpluses a bit above 2% of GDP are generated in the *old-age pension system* for the programme period (see Table 2 in Annex 1). The fully-funded part of the reformed pension system (the PPM) contributes with approximately 1 percentage points of GDP per year.

4.2. Public finances in 2003

The projection for the general government finances in 2003 is a surplus of 0.4% of GDP[11] (see Table 4.1), slightly up compared with the position in 2002. Relatively weak economic growth weighs on the general government finances, with GDP growth forecast to be 1.4% in 2003, compared with 1.9% in 2002. Compared with the previous update, the general government balance has been revised downwards considerably. This reflects in part the downward revisions to GDP growth of 1.1 percentage points, which in turn weighs on tax revenue. However, the tax rises in local governments strengthens the financial position in this sector. A general government surplus of 0.4% of GDP is plausible and close to the forecast by the Commission services.

Looking at the sectors[12], *the central government deficit* is expected to be 2.2% of GDP in 2003, which is higher than in the previous year. On expenditure, the largest difference is lower interest payments on central government debt than originally planned. However, primary expenditure is expected to be slightly higher. Other differences are: higher block grants to local governments, higher expenditure for the labour market, mainly unemployment benefits, higher spending for sickness benefits (despite the discretionary cuts in levels and the transfer of part of these costs to employers introduced in the 2003 Spring Fiscal Policy Bill), higher spending on health-care. Central government revenue (cash basis) is expected in the present Budget to be substantially lower than projected in the Budget for 2003. Lower tax revenue accounts for two thirds of this and other revenues account for the remaining third. The downward revision of tax revenues can mainly be attributed to lower-than-expected corporate and income tax receipts, which is mainly cyclical. A slightly higher surplus is projected for the *local government sector*, influenced by the implemented tax increases in 2003. As noted above, a surplus close to 2% of GDP is projected in the *old-age pension system*, slightly lower than projected in the previous update.

4.3. Public finances in 2004

For 2004, the surplus in the *general government finances* is projected to rise slightly to 0.6% of GDP. Again, this is significantly below the projections made in the 2002 CP. The lower surplus projected is mainly due to a larger deficit in the central government sector, compared with the plans in the 2002 CP. As noted above, projected central government tax revenues have been revised downwards substantially. Moreover, the fiscal position for both the old-age pension system and the local government sector –

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11 In the 2003 update, an adjustment for the timing of recording of taxes is made. As noted in the update, Statistics Sweden changed method for the calculation of taxes with the release of 17 November 2003. 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 new method for calculating taxes gives considerable effects for some years. This explains that the budget balance for 2002 is weakened by almost 1 percentage point. Small and positive effects, between 0.1 and 0.2 percentage points of GDP, are projected for 2003 and beyond (see Annex 2).

12 The 2003 update provides figures according to the new method (see footnote 11 and Annex 2) for the general government sector as a whole, but not for the sub-sectors. Therefore, there is a discrepancy (which in small for the period 2003-2006) between the general government balance according to the new method and the sum of balances for the sub-sectors according to the old method.

despite the expected tax rises - has been revised down too to some extent (see Table 2 in Annex 1). The Swedish authorities' current projection for the fiscal position appears plausible and is close to the Commission's autumn forecast.

Looking at the sectors, *the central government* deficit is expected to be somewhat less negative than in 2003, at -1.6% of GDP in 2004. The expenditure plans for central government presented in the Budget Bill for 2004[13] are quite close to those presented in the Budget for 2003. By contrast, downward revision on the revenue side account for most of worsened outlook for the central government finances. The *new reforms* included in the Bill (in relation to the 2003 Spring Fiscal Policy Bill) amounts to a negligible weakening and the overall effect, comprising *both new and previously decided reforms* taking effect in 2004 (in relation to 2003) amount to a weakening of SEK 5.1 billion. On taxes, the continuation of the 'green tax swap' strategy is included; i.e. a re-composition of tax revenues aimed at shifting taxation from labour to non-environmental friendly activities – mainly energy taxation. Interestingly, though very small in terms of lost tax intake, the Bill includes easing of wealth, inheritance and corporation taxation. In all, the relatively tight stance of the State budget, as measured by the rule-changes taking effect in 2004 (in relation to the previous year), almost entirely stem from 'old' measures. This reflects to a large degree the virtually non-existing budgetary margin included under the expenditure ceiling for 2004. Therefore, the previously announced expenditure ceiling for 2004 may be considered to have been binding for the government when preparing the Budget. The fiscal position for the *local government sector* has been revised downwards despite the expected tax increases in 2004 and a small deficit is projected. As noted above, a surplus close to 2% of GDP is projected in the *old-age pension system*, slightly lower than projected in the previous update.

4.4. Public finances in 2005 and beyond

According to the projections for 2005 and 2006, higher surpluses of 1.4% and 1.9% of GDP, respectively, are foreseen in the *general government finances*. This is a downward revision compared with the plans in the 2003 Spring Fiscal Policy Bill and the lower surpluses projected is mainly due to a larger deficit in the central government sector. As noted above, projected central government tax revenues have been revised downwards substantially. The Swedish authorities' current projection for the fiscal position is plausible and close to the Commission's autumn forecast.

Looking at the sectors, *the central government* deficit is expected to be smaller than in 2004, at -1.0% of GDP in 2005, and -0.4% of GDP in 2006. In relation to the 2003 Spring Bill, this is a downward revision, which can to a large extent be attributed to a projection of lower revenues. The *new reforms* included in the Budget Bill for 2004[14] (in relation to the 2003 Spring Fiscal Policy Bill) amounts to a weakening of the central government finances in 2005 and 2006. The largest change is permanently higher block grants to the local governments from 2005 onwards. This replaces the temporary support of the same magnitude provided in 2004. The Bill states that this initiative is made in order to improve the core components of welfare provision – health care, schools and social services, in the light of the local governments having some difficulties in achieving balanced budgets. The overall effect, comprising *both new and previously decided reforms* taking effect in 2005 and 2006 (in relation to the previous year) amount

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13 This is based both on information contained in the 2003 update and on the Budget Bill for 2004 on which the update is based.

14 See footnote 13.

to a slight strengthening in 2005 and 2006. In all, the tight stance of the budget reflects to a large degree the 'tight' position of the Swedish central government finances. The fiscal position for the *local government sector* is projected to continue to be close to balance in 2005 and 2006. As noted above, a surplus close to 2% of GDP is projected in the *old-age pension system*.

4.5. Cyclically adjusted balances

According to the 2003 CP, departures from the surplus target of 2% of GDP on average over the cycle target may be necessary if the initial balance differs greatly from the surplus target or if discretionary policy is used for the purpose of stabilisation. According to the update, the structural surpluses are below 2% of GDP in each year between 2002 and 2005. The average structural surplus over the period 2000-2006 is however 2% of GDP and in 2006 it is estimated to be 2% of GDP. By contrast, the average actual surplus over this period is 1.8% of GDP, thus reflecting the 2003 update's view of a mostly negative, though narrowing output gap towards the end of this period.

The 2003 update estimates that the fiscal stance is tight in 2004-06 and a further tightening to strengthen the structural surplus in 2004 would risk hampering the anticipated economic recovery. It is noted that this stance lessens the need for a tightening of monetary policy in the recovery and that the composition of stabilisation policy therefore becomes conducive to growth and employment in the medium-term.

It should be noted that the figures from the 2003 update are the 'net lending with accruals taxes', which corresponds to the revised general government finances, released by Statistics Sweden on 17 November, see Annex 2. On the other hand, the Commission's autumn forecast does not incorporate the 'accruals' effect which according to the 2003 update is estimated to be positive in 2003-2006. The figures in Table 4.2 are therefore not directly comparable, as they are calculated on the basis of different methodologies. For example, the Commission's estimate of the CAB in 2002 using the revised figure for the actual balance, would be -0.1% of GDP, instead of 0.8% as given below.

Table 4.2 – Public finances

	2003 updated convergence programme		Commission's autumn 2003 forecast	
	Budget balance	CAB[1]	Budget balance	CAB
2002	0.2	-0.3	1.3	0.8
2003	0.4	0.5	0.2	0.4
2004	0.6	1.0	0.5	0.9
2005	1.4	1.8	1.0	1.5
2006	1.9	2.3	-	-

[1] Commission's calculations using the agreed method on the basis of the information in the 2003 update.

Despite these differences between the 2003 update's and the Commission's estimates of the cyclically-adjusted balances over the programme period, both measures indicate a sound and gradually stronger cyclically adjusted fiscal position in these years. However, the cyclically-adjusted balance is expected to be lower than 2% of GDP in each year to 2005, according to the Commission's forecast and analysis as well as according to the estimates in the 2003 update. (see Table 4.2 and Table 4 in Annex 1).

4.6. Sensitivity analysis

The 2003 update includes a section on the sensitivity of the public finances with respect to economic activity. It is estimated that an increase in GDP of one percentage point results in an increase in government net lending by 0.7 percentage points. This is in line with the Commission's calculations of the budget elasticity.

Analysis made by the Commission suggests that a worsened growth outlook in the years to 2006 (of 0.5 percentage points lower GDP growth per year using the 2003 update as a baseline) would result in lower cyclically adjusted balances over the programme period. However, these calculations suggest that even if economic growth would turn out weaker than expected, a fiscal position close to balance or in surplus in the medium-term would still be achieved.

4.7. Debt ratio

The debt-to-GDP ratio is projected to fall in each year to 2006, when it reaches 48.3% of GDP. As the gross debt mainly lies in the central government sector – which runs deficits each year – the debt increases over the period but at a slower pace than nominal GDP. The net debt-to-GDP ratio is low, at 3.7% in 2002, and is projected to fall and to turn negative (i.e. a net claim) in 2006.

Table 4.3 – Debt developments compared

% of GDP		2002	2003	2004	2005	2006
Gross debt levels						
2002 update		53.6	50.9	49.3	*48.0*	
2003 update		52.7	51.7	51.5	50.0	48.3
Commission scenario		52.7	51.7	51.4	50.0	-

The debt reduction in relation to GDP foreseen in the 2003 update lends support to the view that the public finances are in good shape (see also Table 3 in the Annex 1). However, the projected pace of debt reduction is slower compared with the previous update, reflecting to a large degree the downward revisions to the central government balance. Similar developments are present in the Commission’s forecast.

All in all, under plausible macroeconomic and budgetary assumptions, the Stability and Growth Pact’s medium-term objective of a budgetary position of close to balance or in surplus should be maintained throughout the programme period.

5. THE QUALITY OF PUBLIC FINANCES

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 on current policies. 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 2003 update are (i) the labour market, (ii) structural education and training activities, (iii) healthcare, care of the elderly, and (iv) fiscal policy. A description of these measures is 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 implemented in 2002 to ¾, which should stimulate labour supply and economic growth. The 2003 update states that the government will propose the implementation of the fourth and final stage of this reform before next general elections in 2006 if the central government financial situation permits. 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 remain important. While several measures have been taken, including a cut in the sick insurance level, the 2003 update recognises this challenge and assesses that further initiatives will be required in order to reach the target set. A strong emphasis is placed on education and training, efforts to integrate long-term unemployed and also the young and immigrants into the labour market. However, there are also some elements that may have an adverse impact on labour supply. Preparations are underway to extend the 'free-year' initiative (an employee can, while paid a salary-linked benefit, take up to one year off under certain conditions) throughout the country, aimed at taking effect in 2005. Another measure that could have a negative impact on supply is the plans to reduce working time, for which a pilot is starting in 2004. On the tax side, there has been some easing of labour taxation in the framework of the 'green tax swap' strategy. However, local government tax rates were increased in 2003 and further increases have been announced for 2004. The price level in Sweden remains among the highest in the EU, 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.

6. THE SUSTAINABILITY OF PUBLIC FINANCES

6.1. Quantitative indicators

The assessment of the sustainability of Swedish public finances is based on both quantitative and qualitative indicators. The quantitative indicators project debt and budget balance developments according to two different scenarios, to take into account uncertainties over the medium term. The "programme" scenario is calculated on the following basis:

- Macroeconomic assumptions on GDP growth, interest rates and inflation are based on the agreed assumptions used in the EPC;
- The projections for age-related expenditures come from the convergence programme. They include all information provided, including items not projected by the EPC.
- The projections for government revenues come from the programme. They are kept constant at the (cyclically adjusted) level in 2006, except a projected increase due to tax revenues from net pension payments.
- The starting point for gross debt and the primary balance are the 2006 levels reported in the programme. Adjusted gross debt (consolidated gross debt minus pension system assets in addition to government securities) is calculated assuming the actual value of pension assets constant at the 2006 level.

A "2003 position" scenario is based on the budgetary data for 2003 in the programme. Debt levels are extrapolated from 2007 to 2050 assuming that no budgetary consolidation is achieved, i.e. the cyclically adjusted primary balance in 2006 remains the same as the 2003 level and no stock-flows operations take place.

Table below presents the debt and the budget balance development according to the two different scenarios. Overall, age-related expenditure is foreseen to increase by 6.7% of GDP between 2007 and 2050. Compared with last year assessment, a lower increase in pension expenditure is foreseen as a result of revised demographic projections.

Long term sustainability: summary results
Sweden

Main assumptions - baseline scenario (as % GDP)	**2007**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Total age-related spending	35,0	35,4	38,1	41,1	41,7	41,7	6,7
Pensions	9,0	9,3	10,3	10,6	10,6	9,9	0,9
Health care **	11,0	11,1	11,9	12,9	13,1	13,4	2,5
Education	8,2	8,1	8,4	8,7	8,7	8,7	0,5
Labour market***	1,1	1,1	1,1	1,2	1,2	1,3	0,2
Other ****	5,7	5,8	6,4	7,7	8,1	8,4	2,7
*Total primary non age-related spending**	16,8						
Total revenues	56,3	56,4	56,7	56,8	56,8	56,6	0,3

* constant

*** It includes ill health and medical care*

**** It includes unemployment benefits, labour market training grants and wage guarantee*

***** Childcare and care of elderly.*

Results (as % GDP)	**2007**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Programme scenario							
Gross debt	44,6	33,7	8,6	8,1	25,5	50,8	6,2
Adjusted gross debt	25,0	16,4	-3,3	-0,4	19,6	46,7	21,7
Net borrowing	1,8	2,1	1,3	-1,5	-3,0	-4,6	-6,4
2003 scenario							
Gross debt	40,9	32,6	17,0	28,2	59,8	101,7	60,8
Adjusted gross debt	21,3	15,2	5,1	19,8	53,9	97,6	76,3
Net borrowing	1,2	1,3	0,0	-3,4	-5,7	-8,2	-9,4

Sustainability gap	**S1***	**S2****
Programme scenario	0,6	0,2
2003 scenario	1,4	1,0

* 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. P.m. debt to GDP at the end of the period: 9.7%

** 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.

It is possible to verify whether the projected level of gross debt respects the requirement to stay below 60% of GDP reference value for public debt at all times. Failure to do so would *a priori* indicate that there may be a risk of budgetary imbalances emerging in light of ageing population and that measures may be required to place public finances on a more sustainable footing. However, it warrants attention that Sweden has large financial assets in pension funds which can be used to meet future expenditure needs. A measure of adjusted gross debt is therefore presented in the programme and replicated in the assessment exercise.

According to the quantitative indicators run on the basis of the gross debt, Sweden is on a sustainable path. Gross debt is expected to fall close to zero over the next 20-30 years while an upward trend will emerge afterwards without compromising the SGP requirement on debt. However, some risks emerge if Sweden failed to return to a structural surplus of 2% of GDP within the programme period. The 2003 scenario shows that, if the cyclically adjusted primary balance remains at the 2003 level the pressure on expenditures due to ageing population can lead to high deficit and a debt to GDP ratio above 60% could materialize at the end of the projection period. In the “programme” scenario no sustainability gap arises while in the “2003 scenario” a gap of around 1% of GDP emerges in order to comply with the SGP requirement on budget balance (see S1 indicator).

6.2. Additional qualitative features

As underlined in the EPC report on “The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme”[15] (October 2003), several qualitative factors should be taken on board to avoid a mechanistic interpretation of the quantitative indicators. On the positive side, Sweden has implemented substantial pension reforms during the 1990s that ensure the financial sustainability of the pension system. However, health expenditure is foreseen to increase substantially over the projection period: reforms that aim at increase the efficiency oh the health care sector and to reduce the number of sick days are under way but further measures will be required.

In addition, as noted in the Broad Economic Policy Guidelines, “additional efforts appear necessary to improve further the incentives to work, notably as Sweden still has the highest overall tax burden in the EU and relatively generous benefit schemes in an international perspective”.

6.3. Overall assessment

The Commission considers that, on the basis of the current policies, Sweden appears to be in a relative good position to meet the budgetary costs associated with ageing populations. Long term projections show that gross debt will stay below 60% of GDP at all times and that the adjusted gross debt will fall close to zero. This is largely due to the reformed pension system and the medium term strategy to come back to a structural surplus of 2% of GDP. However, the increase of health care expenditure, including expenditure related to ill health, foreseen in the projections needs to be addressed as the update notes that further measures are necessary in order to achieve the target of half the number of sick days. Moreover, according to the Commission’s analysis the medium term target has to be reached; failure to do so can determine some budgetary unbalances in the very long term.

[15] Available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

ANNEX 1. SUMMARY TABLES DERIVED FROM THE 2003 UPDATED CONVERGENCE PROGRAMME

Table 1. Growth and associated factors

		2002	2003	2004	2005	2006
GDP *growth* at *constant* market prices (7+8+9)		1.9	1.4	2.0	2.6	2.5
GDP *level* at *current* market prices		2 340	2 427	2 521	2 639	2 756
GDP deflator		1.3	2.3	1.8	2.0	2.0
HICP change, Dec-Dec		1.7	1.8	1.7	-	-
Employment growth		0.1	-0.2	0.1	0.7	0.7
Labour productivity growth		3.0	2.3	1.5	1.8	1.8
Sources of growth: percentage changes at constant prices						
1. Private consumption expenditure		1.3	1.9	2.1	2.0	2.0
2. Government consumption expenditure		2.1	0.7	0.4	0.6	0.6
3. Gross fixed capital formation		-2.5	-1.8	2.8	5.5	5.1
4. Changes in inventories and net acquisition of valuables as a % of GDP		-0.1	0.2	0.1	0.0	0.0
5. Exports of goods and services		0.4	3.7	5.4	6.2	6.1
6. Imports of goods and services		-2.7	3.1	5.4	6.0	6.1
Contribution to GDP growth						
7. Final domestic demand (1+2+3)		0.8	0.8	1.6	2.1	2.1
8. Change in inventories and net acquisition of valuables (=4)		-0.1	0.2	0.1	0.0	0.0
9. External balance of goods and services (5-6)		1.2	0.5	0.4	0.5	0.5
Basic assumptions						
Short-term interest rate (annual average)		4.1	3.3	3.7	4.6	4.9
Long-term interest rate (annual average)		5.3	4.7	5.2	5.7	5.8
USD/€ exchange rate (annual average)		1.02	1.08	1.10	1.10	1.10
(for non-euro countries) exchange rate vis-à-vis the € (annual average)		9.09	9.10	9.00	9.00	9.00
World excluding EU,GDP growth		3.5	3.7	4.5	4.1	4.1
EU-15 GDP growth		1.1	0.7	1.9	2.8	2.7
Growth of relevant foreign markets						
World import volumes, excluding EU						
Oil prices		25.1	28.6	26.0	--	--

Table 2. General government budgetary developments

% of GDP		2002	2003	2004	2005	2006
Net lending by sub-sectors						
1. General government		1.1	0.2	0.4	1.2	1.6
2. Central government		-0.6	-2.2	-1.6	-1.0	-0.4
3. State government						
4. Local government		-0.4	0.3	-0.1	0.0	-0.1
5. Social security funds		2.0	2.1	2.2	2.2	2.1
General government						
6. Total receipts		56.8	56.4	56.4	56.1	56.0
7. Total expenditures		55.8	56.3	56.0	54.9	54.3
8. Budget balance		1.1	0.2	0.4	1.2	1.6
9. Net interest payments		1.0	0.4	0.5	0.5	0.5
10. Primary balance		2.1	0.6	0.9	1.7	2.1
Components of revenues						
11. Taxes		36.5	36.3	36.5	36.2	36.0
12. Social contributions		14.8	14.5	14.4	14.3	14.3
13. Interest income		2.2	2.2	2.1	2.2	2.2
14. Other ***(revenue)***		3.3	3.4	3.4	3.4	3.4
15. Total receipts		56.8	56.4	56.4	56.1	56.0
Components of expenditures						
"Total consumption"		28.0	28.3	28.2	28.0	27.7
18. Social transfers other than in kind						
"Transfer payments"		21.5	22.2	22.1	21.3	21.0
19. Interest payments		3.2	2.6	2.6	2.7	2.7
20. Subsidies						
21. Gross fixed capital formation		3.1	3.1	3.1	3.0	3.0
22. Other						
23. Total expenditures		55.8	56.3	56.0	54.9	54.3

Table 3. General government debt developments

% of GDP		2002	2003	2004	2005	2006
Gross debt level		52.7	51.7	51.5	50.0	*48.3*
Change in gross debt		-1.6	-1.0	-0.3	-1.5	-1.6
Contributions to change in gross debt						
Primary balance		-4.0	-2.6	-2.8	-3.6	-4.1
"Consolidation"		-1.2	0.0	-0.2	-0.2	-0.2
Interest payments		2.9	2.4	2.4	2.4	2.5
Nominal GDP growth		-1.7	-1.9	-2.0	-2.3	-2.2
Other factors influencing the debt ratio		2.3	1.1	2.4	2.2	2.3
Of which: Privatisation receipts						
p.m. implicit interest rate on debt						

Table 4. Cyclical developments

% of GDP		2002	2003	2004	2005	2006
1. GDP growth at constant prices		1.9	1.4	2.0	2.6	2.5
2. Actual balance		1.1	0.2	0.4	1.2	1.6
3. Interest payments		1.0	0.4	0.5	0.5	0.5
4. Potential GDP growth						
5. Output gap		-0.6	-1.1	-1.0	-0.6	-0.2
6. Cyclical budgetary component						
7. Cyclically-adjusted balance (2-6)		0.6	1.2	1.3	1.8	2.0
8. Cyclically-adjusted primary balance (7-3)						

Table 5. Divergence from previous update

% of GDP		2002	2003	2004	2005	2006
GDP growth						
previous update		2.1	2.5	2.5	-	-
latest update		1.9	1.4	2.0	2.6	2.5
Difference		-0.2	-1.1	-0.5	-	-
Actual budget balance						
previous update		1.7	1.5	1.6	-	-
latest update		1.1	0.2	0.4	1.2	1.6
Difference		-0.6	-1.3	-1.2	-	-
Gross debt levels						
previous update		53.6	50.9	49.3	-	-
latest update		52.7	51.7	51.5	50.0	48.3
Difference		-0.9	0.8	2.2	-	-

Table 6. Long-term sustainability of public finances

% of GDP	**2000**	**2006**	**2010**	**2020**	**2030**	**2040**	**2050**
Total expenditure **(primary)**	50.7	51.7	52.4	54.2	57.3	57.4	56.8
Old age pensions **(gen. gov. old age transfer payments)**	8.6	6.7	7.1	8.1	8.4	8.4	7.8
Health care **(gen. gov. consumption on medical care and care of the elderly)**	10.1	10.5	10.7	11.8	12.7	14.4	14.7
Interest payments							
Total revenues **(primary)**	55.1	53.7	54.6	55.3	56.2	56.3	55.9
of which: from pensions contributions							
National pension fund assets **(net)**	35.6	28.0	31.8	32.6	32.3	30.2	33.6
Assumptions							
Labour productivity growth							
Business sector productivity	4.3	2.1	2.2	2.1	2.0	2.2	2.3
GDP productivity	3.3	1.9	1.8	1.7	1.6	1.8	1.9
Real GDP growth	4.4	2.5	1.7	1.6	1.3	1.8	2.0
Participation rate males (aged 20-64)	84.0	83.1	82.8	83.5	82.9	83.0	82.8
Participation rates females (aged 20-64)	78.4	78.4	78.0	78.7	77.9	77.9	77.6
Total participation rates (aged 20-64)	81.2	80.8	80.4	81.1	80.4	80.5	80.3
Unemployment rate	4.7	4.0	4.3	4.1	4.2	4.3	4.3

Table 7. Basic assumptions from the Commission's 2003 autumn forecast

		2002	2003	2004	2005
Basic assumptions					
Short-term interest rate (annual average)		4.2	3.2	3.0	3.8
Long-term interest rate (annual average)		5.3	4.6	4.9	5.3
USD/€ exchange rate (annual average)		0.95	1.13	1.16	1.15
(for non-euro countries) exchange rate vis-à-vis the € (annual average)		9.16	9.12	8.99	9.01
World excluding euro area, GDP growth		3.2	3.8	4.4	4.5
EU-15 GDP growth		1.1	0.8	2.0	2.4
Growth of relevant foreign markets		3.4	3.4	6.2	7.1
World import volumes, excluding euro area		-	5.8	7.9	8.4
Oil prices		25.0	28.3	25.6	24.1

ANNEX 2. THE GENERAL GOVERNMENT BALANCE IN SWEDEN: A CLARIFICATION

The general government balance in Sweden

There are several versions of the Swedish general government balance in this document. This box attempts at clarifying the situation. *Firstly*, Statistics Sweden released revised annual National Accounts for the period 1980-2002 on 17 November. As far as the general government finances are concerned, this involved a change in the method for the calculation of taxes. Specifically, a more complete periodisation of the recording of taxes was introduced. The revisions due to this methodological change were substantial in some years. These figures – the new official statistics - were in general close to the 2003 updates' concept of "net lending with accruals taxes". *Secondly*, there is the 'traditional' issue of the so-called double definitions, resulting from the ESA95 and the EDP definition. The difference between these definitions relates to the treatment of swap interest payments*.

Table: Different definitions and versions of the Swedish general government balance

	Commission forecast (29 October)		Statistics Sweden (17 November)	2003 update (1 December)	
% of GDP	ESA95	EDP	ESA95	ESA95	"net lending with accruals taxes"
2000	3.4	3.4	5.1	3.4	4.9
2001	4.6	4.5	2.9	4.6	2.5
2002	1.1	1.3	0.1	1.1	0.2
2003	0.2	0.2	-	0.2	0.4
2004	0.5	0.5	-	0.4	0.6
2005	1.0	1.0	-	1.2	1.4
2006	-	-	-	1.6	1.9

* see Regulation (EC) No 2558/2001 of the European Parliament and of the Council of 3 December 2001 amending Council Regulation (EC) No 2223/96 as regards the reclassification of settlements under swaps arrangements and under forward rate agreements, OJ, L 344, 28.12.2001.