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NOVEMBER 2004 UPDATE OF THE CONVERGENCE PROGRAMME OF SWEDEN (2004-2007)

AN ASSESSMENT

Table of contents

SUMMARY AND CONCLUSIONS[1]

The sixth updated Swedish convergence programme was sent to the Commission on 18 November and covers the period 2004 to 2007. The programme is based on the Budget Bill for 2005 adopted by Parliament on 16 December 2004. The programme broadly complies with the data requirements of the “code of conduct on the content and format of stability and convergence programmes”[2] with some data not fully in line with ESA95 standards[3].

The 2004 update projects GDP growth of 3.5% in 2004, 3.0% in 2005, 2.5% in 2006 and 2.3% in 2007. Despite high growth in 2004, employment growth was negative but is expected to recover in the coming years. Overall, on the basis of currently available information, the macroeconomic scenario underlying the update seems plausible and is broadly in line with the Commission services’ evaluation including the autumn 2004 forecast. Moreover, for the later years the growth assumptions appear cautious and below estimated potential growth rates.

Inflation in Sweden has fallen gradually since the beginning of 2003, partly as a result of earlier energy price increases falling outside the base reference period**,** and is currently clearly below the Riksbank 2% target level. The krona has been relatively stable vis-à-vis the euro in 2003 and 2004 but has appreciated recently, reflecting Sweden’s stable macroeconomic environment and solid growth outlook, large current account surpluses, and market expectations of relatively higher policy rates in the course of 2005. Over the past year, developments in Swedish bond yields have been in line with trends in major bond markets. The positive yield differential between long-term government bonds in Sweden and the euro area fluctuated around 50 basis points over recent years but declined in the course of 2004.

The budgetary framework in Sweden includes a general government surplus objective of 2% of GDP on average over the cycle, multi-annual nominal ceilings for central government expenditures and a balanced budget requirement for local governments. The update foresees a general government surplus of 0.7% in 2004, 0.6% in 2005, 0.4% in 2006 and 0.9% in the final year, 2007. Both expenditure and revenue ratios are on a gradually declining trend over the projection period. Adjusting for the estimated impact of the cycle using the common methodology, the cyclically-adjusted budget balance is in surplus throughout the projection period. Compared to previous updates, budget targets

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[1] This technical analysis, which is based on information available up to 22 December 2004, accompanies the recommendation by the Commission for a Council opinion on the update of the convergence programme, which the College adopted on 11 January 2005. It has been carried out by the staff of and under the responsibility of the Directorate-General for Economic and Financial Affairs of the European Commission. Comments should be sent to Jonas Fischer (jonas.fischer@cec.eu.int).

[2] Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, document EFC/ECFIN/404/01 - REV 1 of 27.06.2001 endorsed by the ECOFIN Council of 10.07.2001.

[3]Compared to the Commission assessment (available at http://europa.eu.int/comm/economy_finance/about/activities/sgp/year/year20042005_en.htm), the evaluation of compliance follows a reclassification of the degree of compliance into four categories (namely "fully complies", "complies", "broadly complies" and "partly complies"), replacing the previous three-way classification ("complies", "largely complies" and "partly complies")".

for 2005 and 2006 have been revised downwards despite growth assumptions now being significantly higher. This can partly be explained by lower projected tax revenues in line with recent outturns. Tax reductions introduced in the 2004 Spring Bill and the 2005 budget also contribute to the projected slight weakening in 2005 and 2006. While the pension system and the local government sub-sector are expected to show stable surpluses, the central government deficit is increasing in 2005 and 2006, thus driving the deterioration in the general government position in these years.

The risks to the budgetary projections in the programme appear broadly balanced. On the one hand the budgetary projections seem plausible and Sweden has a very good track record in not exceeding set expenditure ceilings. In addition, the financial situation at local government level seems to be improving. On the other hand, tax revenues have been quite volatile over the last few years. In addition, the budgetary margin against the central government expenditure ceilings is very narrow not only for 2004 but, according to the 2005 budget, also for 2005 and 2006. Furthermore, elections scheduled for 2006 might influence the budget for that year. In view of this risk assessment, the budgetary stance in the programmes seems sufficient to maintain a medium-term budgetary position of “close to balance or in surplus” as required by the Stability and Growth Pact throughout the programme period. It also provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations. However, cyclically-adjusted budget positions as well as average surpluses over the programme period remain below the domestic objective of a surplus of 2% of GDP.

The gross debt ratio - below 60% of GDP since 2000 - is projected to continue to decline and reach 49% of GDP in 2007. Debt is mainly issued by the central government sector - which runs budget deficits - and the surplus in the pension system is mainly invested in non-government assets, thus slowing the reduction in the gross debt ratio. The debt ratio net of financial assets is projected to improve from some -2% of GDP in 2004 to below -4% in 2007. These projections seem reasonable.

The programme reviews the government’s wider structural reform programme which focuses on improving the functioning of the labour market, increasing employment and reducing the number of working days lost to sick leave. A broad range of measures have been implemented but the results have so far been mixed. A further step has been taken to complete the tax reform and to ease labour taxation further in the framework of the ‘green tax swap’ strategy, though this has been partially offset by increases in local government tax rates in both 2003 and 2004. Completion of 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 continue to have priority within the framework of sound public finances.

Sweden appears to be in a relatively favourable position with regard to long-term sustainability of the public finances, of which the projected budgetary cost of an ageing population is an important element. A sustainability gap of around 2% of GDP arises if the country wants to ensure full sustainability over time. Given the projected increase in the old-age dependency ratio and in the absence of further reforms that would modify the trends in healthcare-related expenditures, labour force participation and employment, a budgetary surplus over the next 10 years of 2% of GDP, in line with the government’s budgetary target, will become a key factor in addressing sustainability over the longer term.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007
Real GDP (% change)	**CP Nov 2004**	**3.5**	**3.0**	**2.5**	**2.3**
	COM Oct 2004	3.7	3.1	2.9	n.a.
	CP Nov 2003	2.0	2.6	2.5	n.a.
HICP inflation (%)	**CP Nov 2004**[2]	**1.3**	**1.5**	n.a.	n.a.
	COM Oct 2004	1.1	1.5	1.9	n.a.
	CP Nov 2003[2]	1.7	n.a.	n.a.	n.a.
General government balance (% of GDP)	**CP Nov 2004**	**0.7**	**0.6**	**0.4**	**0.9**
	COM Oct 2004	0.6	0.6	0.8	n.a.
	CP Nov 2003[3]	0.6	1.4	1.9	n.a.
Primary balance (% of GDP)	**CP Nov 2004**[1]	**2.8**	**2.8**	**2.7**	**3.3**
	COM Oct 2004	2.7	2.8	3.0	n.a.
	CP Nov 2003	0.9	1.7	2.1	n.a.
Cyclically-adjusted balance (% of GDP)	**CP Nov 2004**[4]	**0.8**	**0.5**	**0.5**	**1.2**
	COM Oct 2004	**0.7**	**0.4**	**0.6**	n.a.
	CP Nov 2003[4]	**1.3**	**1.8**	**2.0**	n.a.
Government gross debt (% of GDP)	**CP Nov 2004**	**51.7**	**50.5**	**50.0**	**49.0**
	COM Oct 2004	51.6	50.6	49.7	n.a.
	CP Nov 2003	51.5	50.0	48.3	n.a.

Note:
[1] In the update, the Swedish authorities provide primary balances excluding net interest and not the conventional gross interest. However, in the table, primary balances are given excluding gross interest using data from the update.
[2] % change Dec-Dec
[3] For comparability,net lending reported for the 2002 and 2003 updates refers to figures calculated taking into account the full periodisation of taxes (while this accounting change was not formally introduced until 2004).
[4] Commission services calculations on the basis of information in the programme.
Sources:
Updated Swedish Convergence Programme, November 2003 and November 2004 (CP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations

1. INTRODUCTION

The 2004 update of the Swedish convergence programme, covering the period 2004 to 2007, was adopted by the Swedish government on 18 November 2004 and submitted to the Commission the same day. The programme is based on the economic projections in the government's budget for 2005 presented to the parliament on 20 September 2004 and adopted on 16 December 2004. The programme has been presented and discussed in Parliament subcommittees for financial affairs and EU affairs.

The 2004 update broadly complies with the data requirements of the code of conduct agreed for stability and convergence programmes. The breakdown of government expenditure does not follow completely the code of conduct and expenditure and revenue aggregates are not provided according to the agreed ESA95 definition[4]. HICP inflation projections are missing for the period after 2005. Furthermore, GDP potential growth rates are not given. Even if optional, this is important information to explain the output gap and cyclically-adjusted balance figures provided in the programme using national methods. On the positive side, the analysis of the long-term sustainability of public finances is elaborate and extensive.

2. MACROECONOMIC DEVELOPMENTS

Over the period 2004-2007, real GDP growth in the update is forecast to fall gradually from 3.5% to 2.3%. For 2004 and 2005, the growth rates of 3.5% and 3.0% respectively are a substantial upwards revision compared to the previous update (see section 5.1) but are close to the Commission services autumn 2004 forecast. For 2006 and 2007, the update seems relatively prudent, also in comparison to potential growth rate estimates using the commonly agreed method (see Table 1). Overall, the medium-term macroeconomic scenario in the update is plausible although towards the cautious side.

The scenario is based on 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 continuing robust performance of net exports. This is similar to the Commission services' views. The composition of growth foreseen in the update is also broadly in line with the Commission services autumn forecast. Against the background of the global recovery, in 2004 there was a strong growth impulse from exports while also investment and private consumption contributed. In 2005, domestic demand takes over as the main driver. For 2006, the update is more conservative than the Commission services forecast with a more pessimistic view of domestic demand growth, while net exports are expected to contribute relatively strongly. Both the programme projections and the Commission services forecast expect inflationary pressures to remain subdued while wage increases remain moderate. Despite high growth in 2004, employment growth was negative but is expected to recover in the coming years.

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4 In a footnote to Table 5 of the update, revenues and expenditures ratios according to ESA95 definition are indicated for 2003. On this basis, expenditure and revenue ratios are both some 3%-points lower than according to ESA standards. The difference reflects greater netting in the Swedish data: balances are not affected. As regards the breakdown of expenditures, collective consumption and social transfers in kind are not separated; the same is true for social transfers other than in kind and subsidies. In addition, primary balances are recorded excluding net interest rather than gross interest.

The external assumptions are in line with the Commission services autumn forecast with a gradual decline of world output growth and a stable Swedish krona against the euro. As regards Swedish long-term interest rates, the programme assumes a gradual increase over the projection period.

Table 1: Comparison of macroeconomic developments and forecasts

	2004		2005		2006		2007
	COM	**CP**	**COM**	**CP**	**COM**	**CP**	**CP**
Real GDP (% change)	3.7	3.5	3.1	3.0	2.9	2.5	2.3
Contributions:							
- Final domestic demand	1.8	2.1	2.6	2.1	2.7	2.1	2.0
- Change in inventories	-0.3	-0.1	0.2	0.2	0.0	0.0	0.0
- External balance on g&s	2.3	1.7	0.3	0.6	0.1	0.5	0.5
Employment (% change)	-0.5	-0.6	0.4	0.8	1.0	0.8	0.7
Unemployment rate (%)	5.6	5.6	5.1	5.1	4.3	4.4	4.2
HICP inflation (%)[1]	1.1	1.3	1.5	1.5	1.9	n.a.	n.a.
GDP deflator (% change)	1.1	0.9	2.0	2.4	1.9	2.3	2.3
Current account (% of GDP)	7.3	7.1	7.1	7.7	6.7	8.1	8.6

Note:
[1] The COM figure is annual average, while the CP figure is % change Dec-Dec
Sources:
Commission services autumn 2004 economic forecasts (COM); Updated Swedish Convergence Programme, November 2004 (CP)

On the basis of the information provided in the programme, Table 2 presents the potential growth and output gap estimates using the commonly agreed methodology. The estimates are very similar to those made on the basis of the Commission services autumn 2004 forecast. The figures suggest that the economy closed the negative output gap through strong growth in 2004, and that output will remain close to potential over the programme period even if a small negative gap opens up towards the end. In 2005, the potential growth rate is substantially boosted by a strong increase in employment. Overall, this picture seems broadly consistent with inflation gradually approaching target levels and unemployment approaching NAIRU levels.

In the update the Swedish authorities provide output gap figures based on their national method[5]. The calculated gaps indicate a fairly large amount of free resources in 2004 (-1.3% of GDP) and thereafter a gradual closing of the output gap. While the method used is not explained in the update, probably about half of the difference is explained by the treatment of the 2004 “leap year effect”[6]. In addition, the update refers to free resources in the labour market as an explanation for the large negative gap.

Table 2: Sources of potential output growth

	2004		2005		2006		2007
	COM	**CP[3]**	**COM**	**CP[3]**	**COM**	**CP[3]**	**CP[3]**

5 In the programme the Swedish authorities estimate the output gap to be -1.4% in 2003, -1.3% in 2004, -0.5% in 2005, -0.2% in 2006 and to be closed in 2007.

6 The National Institute for Economic Research (NIER) has estimated that the impact on GDP from the additional working days in 2004 is 0.6% of GDP. It appears that the Swedish authorities have added this effect to potential GDP while it is not taken into account in the common methodology.

Potential GDP growth[1]	2.2	2.2	2.8	2.8	3.0	2.9	2.5
Contributions:							
- Labour	0.0	0.0	0.5	0.6	0.6	0.6	0.2
- Capital accumulation	0.4	0.4	0.5	0.4	0.6	0.5	0.6
- TFP	1.9	1.7	1.9	1.7	1.8	1.7	1.6
Output gap[1,2]	0.0	-0.1	0.3	0.1	0.2	-0.2	-0.4

Notes:
[1]based on the production function method for calculating potential output growth
[2]in percent of potential GDP
[3]Commission services calculations on the basis of the information in the convergence programme update

Sources:
Commission services autumn 2004 economic forecasts (COM); Commission services calculations

3. Medium-term monetary policy objectives and their relationship to price and exchange rate stability

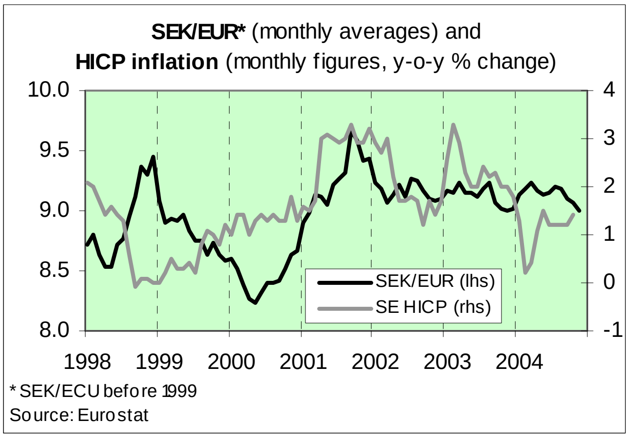
The rejection of euro area membership by Swedish voters in the September 2003 referendum meant that the exchange rate policy regime remained unchanged. The Riksbank has continued to conduct monetary policy on the basis of a national inflation target in terms of the CPI of 2.0 percent, with a tolerated deviation of ± one percentage point[7]. The updated convergence programme reiterates that ERM II membership is not under consideration.

Inflation in Sweden has fallen gradually since the beginning of 2003, partly explained by earlier energy price increases falling out of the base reference period**,** and is currently clearly below the Riksbank 2% target level. In November 2004, yearly HICP inflation was 1.1%, underlying inflation (UND1X) was 0.9% and CPI inflation was 0.5%. According to survey results reported in the Riksbank's latest Inflation Report, inflation expectations one year ahead are slightly below 2% while they are close to 2% on a two to five years horizon. Wage increases have been moderate against the background of the weak labour market developments.

The krona has been relatively stable vis-à-vis the euro in 2003 and 2004. Since the beginning of 2003, the krona has been fluctuating in the interval SEK 8.88-9.31 per EUR, with an average of SEK 9.13 per EUR. The krona began to appreciate vis-à-vis the euro in mid-August 2004 and had been standing at slightly below EUR 9.0 for several weeks by 21 December 2004, its strongest level since September 2003. Recent developments in the krona's exchange rate vis-à-vis the euro reflect, inter alia, the stable macroeconomic environment and solid growth outlook, the large current account

[7] 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 underlying inflation (UND1X) one to two years ahead. UND1X is defined as the CPI excluding mortgage interest expenditure and direct effects of changes in 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.

surpluses, and market expectations of relatively higher policy rates in the second half of 2005.



The macroeconomic policy framework in Sweden, with sound public finances and low and stable inflation, continues to provide for low long-term government bond yields. Over the past year, developments in Swedish bond yields have been in line with trends in major international bond markets. At the beginning of December 2004, the long-term interest rates in Sweden and the euro area stood at slightly above 4.0% and 3.8%, respectively, down from 4.9% and 4.4% in December 2003.

There is a positive yield differential between long-term government bonds in Sweden and the euro area. The yield spread vis-à-vis the euro area – which has fluctuated around 50 basis points over recent years – declined in the course of 2004 and stood at 25 basis points in early December.

4. BUDGETARY IMPLEMENTATION IN 2004

For 2004, the 2003 update targeted a 0.5% of GDP general government surplus based on a 2% output growth assumption. In the current update the estimated outturn for 2004 is a 0.7% surplus with 3.5% GDP growth. The Commission services autumn forecast projected a 0.6% surplus with 3.7% growth. Thus, while the target set in the previous update is expected to be slightly overachieved, the improvement is small given the much higher growth performance.

The main reason why the surplus has not improved more is to be found on the revenue side. The revenue-to-GDP ratio is 1 percentage point lower than indicated in the previous update, despite tax increases at local level. This is due to tax bases having grown less than forecast in the 2003 update and to the fact that the higher than expected overall growth has mainly been driven by net exports, a composition which is less tax-intensive than one driven by domestic demand. As regards expenditures, developments have been on track compared with the budget. The central government expenditure ceilings for 2004 are most likely going to be met, as has been the case since their introduction in 1997. In nominal terms, general government expenditures are 0.7% of GDP lower than projected in the previous update, which is mainly explained by lower interest expenditures. In combination with the higher GDP, this implies that the expenditure-to-GDP ratio now is 1.2 percentage point lower than indicated in the previous update. Budget positions across general government sub-sectors are broadly as envisaged in the previous update, showing a marginal surplus at local level (0.1% of GDP), a 2.0% of GDP surplus in the social security sector and a 1.3% deficit for central government (as compared to a budgeted 1.6% deficit). The stronger-than-budgeted central government performance essentially explains the improvement in the general government balance.

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

5.1. Evolution of budgetary targets in successive programmes

Maintaining sound public finances is a key objective in Swedish economic policy. Balanced budgets or surpluses have been recorded each year since 1998 and continued surpluses are projected over the programme period in the present update. The update confirms that the achievement of a 2% of GDP surplus averaged over the cycle remains the key guiding fiscal rule. This objective is formulated with a view to addressing the expected budgetary impact of the ageing of the population and ensuring the sustainability of public finances in the long term.

The fiscal rule of an average 2% of GDP surplus over the cycle is supported by two key budgetary instruments. First, in line with previous practice, central government expenditure ceilings are set three years ahead in nominal terms to constrain expenditures not to rise faster than nominal GDP. Secondly, a balanced budget requirement as stipulated by law has applied to local governments since 2000.

As compared to budgetary targets in the last few programmes, the new update represents a downward revision despite a general upward revision of output growth prospects. For example, the 2005 budget target is now a surplus of 0.6% of GDP in comparison to a 1.2% target in the previous update, despite higher growth both in 2004 and 2005. For 2006 the downward revision is even larger, to a surplus of 0.4% of GDP from 1.6% set in the previous update (see figure 1).

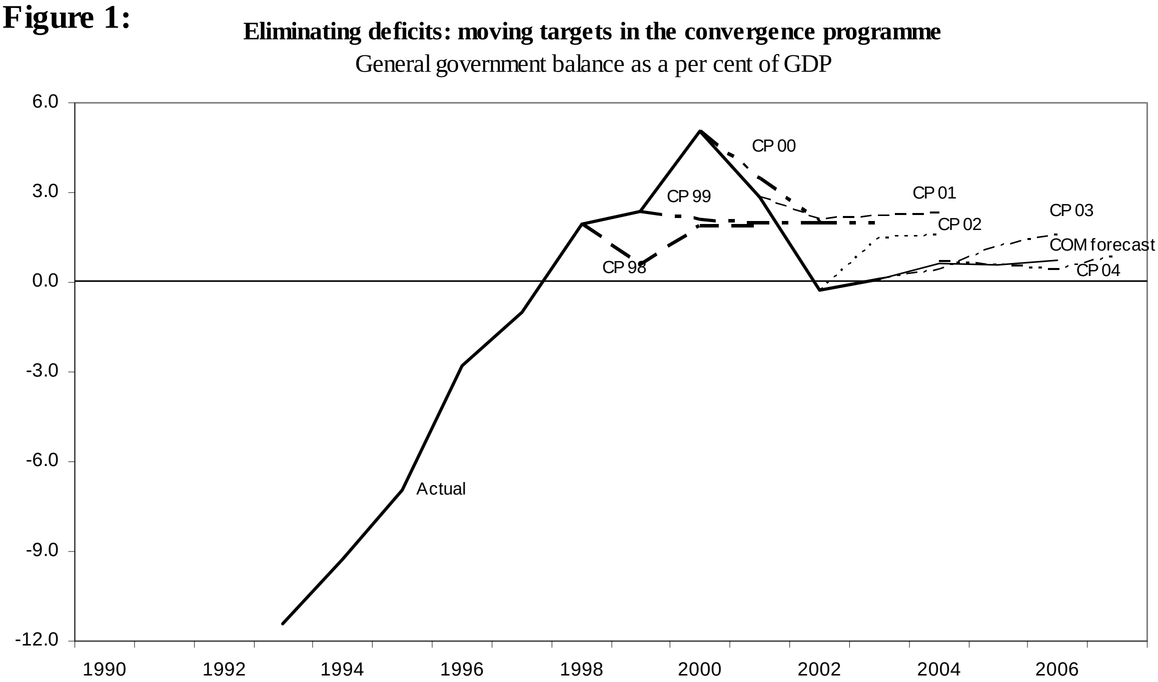
Table 3: Evolution of budgetary targets in successive programmes[1]

		2003	2004	2005	2006	2007
General government balance (% of GDP)	**CP Nov 2004**	**0.5**	**0.7**	**0.6**	**0.4**	**0.9**
	CP Nov 2003	0.2	0.4	1.2	1.6	n.a.
	CP Nov 2002	1.5	1.6	n.a.	n.a.	n.a.
General government expenditure (% of GDP)	**CP Nov 2004**	**55.6**	**54.8**	**54.0**	**53.9**	**53.2**
	CP Nov 2003	56.3	56.0	54.9	54.3	n.a.
	CP Nov 2002	54.5	53.8	n.a.	n.a.	n.a.
General government revenues (% of GDP)	**CP Nov 2004**	**56.1**	**55.5**	**54.7**	**54.3**	**54.1**
	CP Nov 2003	56.4	56.4	56.1	56.0	n.a.
	CP Nov 2002	55.9	55.4	n.a.	n.a.	n.a.
Real GDP (% change)	**CP Nov 2004**	**1.6**	**3.5**	**3.0**	**2.5**	**2.3**
	CP Nov 2003	1.4	2.0	2.6	2.5	n.a.
	CP Nov 2002	2.5	2.5	n.a.	n.a.	n.a.

Note:
[1] In 2004, the Swedish statistical office changed the accounting of taxes by applying a more complete accruals based periodisation. The figures from the 2002 and 2003 updates of the convergence programme are therefore not in fully periodised terms. However, the main impact of this change concerns the 2000-2002 period, which is not shown in the table.
Sources: *Swedish updated convergence programmes (CP), November 2002, November 2003 and November 2004*

There appear to be several reasons behind these downward revisions. First, planned expenditure has increased. Previously allocated contingency margins under the central government expenditure ceiling have effectively been used and are now already projected to be minimal for both 2005 and 2006. Second, forecast tax revenues have been revised down in line with recent experience. Third, as compared to the previous update, a number of expansionary measures for 2005 and 2006 were introduced in the Spring 2004 Budget Bill and the recent 2005 budget (see section 5.2).

Figure 1:



Source: Commission services autumn 2004 economic forecast (COM), convergence programmes (CP)

5.2. Budgetary targets in the updated programme

The update aims at maintaining a surplus position throughout the programme period while reducing both the expenditure and revenue ratios. The update foresees the general government surplus declining from 0.7% of GDP in 2004 to 0.4% in 2006 but then increasing to 0.9% in 2007[8]. The time profile of the primary surplus is similar, with an improvement from 2.8% in 2004 to 3.3% at the end of the programme period.

Based on Commission services calculations according to the commonly agreed methodology, the cyclical budgetary impact is limited over the period (as output gaps are small throughout). The cyclically-adjusted surplus is estimated to have weakened quite substantially in 2004 (partly explained by the fact that taxes have not grown in line with expected elasticities) and to fall further in 2005. After remaining stable in 2006, the surplus is estimated to recover to 1.2% of GDP in 2007.

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[8] In March 2004, Eurostat decided that defined-contribution pension schemes cannot be classified as a social security scheme inside the government sector. However, in Swedish accounts, the funded part of the pension system continues to be recorded within government as allowed by the transition period granted by Eurostat. The transition period ends in March 2007, at which point the accounting treatment should change to follow that agreed in ESA95. In Sweden, the estimated annual impact on the general government balance would be a weakening of about 1% of GDP.

Table 4: Composition of the budgetary adjustment

(% of GDP)	2003	2004	2005	2006	2007	Change: 2007-2004
Revenues	56.1	55.5	54.7	54.3	54.1	**-1.4**
of which:						
- Taxes & social security contributions	50.5	50.0	49.2	49.0	48.7	**-1.3**
- Other (residual)	5.6	5.5	5.4	5.4	5.4	**-0.1**
Expenditure	55.6	54.8	54.0	53.9	53.2	**-1.6**
of which:						
- Primary expenditure	53.4	52.7	51.9	51.6	50.8	**-1.9**
of which:						
Gross fixed capital formation	2.9	2.9	2.9	2.9	2.9	**0.0**
Consumption	28.3	28.0	27.6	27.3	26.9	**-1.1**
Transfers other than in kind & subsidies	22.2	21.8	21.4	21.4	21.0	**-0.8**
Other (residual)						
- Interest payments	2.2	2.1	2.2	2.3	2.4	**0.3**
Budget balance	**0.5**	**0.7**	**0.6**	**0.4**	**0.9**	**0.2**
Primary balance[1]	**2.7**	**2.8**	**2.8**	**2.7**	**3.3**	**0.5**

1) The update provides primary balances with net interest excluded. In the Table are the primary balances shown excluding gross interest as is conventional.
Sources:
Updated Swedish Convergence Programme, November 2004 (CP); Commission services calculations

As discussed in Box 2 below, neither average actual surpluses nor cyclically-adjusted surpluses are close to the 2% national surplus objective at any point over the programme period. The operational status of the 2% target for the medium-term strategy therefore seems in question. In this context it is also relevant to consider the fiscal stance. Using the common methodology, after a quite expansionary 2004 and a further expansionary impulse in 2005, the fiscal stance is basically neutral over the remainder of the programme period[9]. A key factor why neither the nominal nor the cyclically-adjusted budget balances strengthen more over the coming years, despite the relatively high growth, is the expansionary measures in the 2005 budget, complementing the measures taken in Spring 2004 (see Box 1). Indeed, the update indicates that for 2005, as compared to 2004, proposed measures weaken the central government budget by about 1% of GDP with a basically permanent impact. For 2006, according to the 2005 budget, discretionary measures weaken the state budget by a further 0.4% of GDP. Overall, both general government expenditure and revenue ratios decline over the programme period. However, while tax reductions take place in 2005 and 2006 on the basis of budget decisions already taken, a large part of the reduction in the expenditure ratio is assumed to take place only in 2007, partly explained by an assumed lower growth of local government consumption and a reduction of labour market expenditures.

[9] On the basis of the Swedish authorities' own figures in the update, the structural balance substantially weakens over the period (see also Box 2).

Table 5: Output gaps and cyclically-adjusted (primary) balances (CA(P)B)

	2003		2004		2005		2006		2007	Change: 2007-2004
	COM	CP[1]	COM	CP[1]	COM	CP[1]	COM	CP[1]	CP[1]	CP[1]
Budget balance[2]	0.3	0.5	0.6	0.7	0.6	0.6	0.8	0.4	0.9	0.2
Output gap[1,3]	-1.5	-1.4	0.0	-0.1	0.3	0.1	0.2	-0.2	-0.4	-0.3
CAB[1,2]	1.4	1.4	0.7	0.8	0.4	0.5	0.6	0.5	1.2	0.4
CAPB[1,2]	3.3	3.6	2.8	2.9	2.6	2.7	2.9	2.8	3.6	0.7

Notes:
[1]Commission services calculations on the basis of the information in the convergence programme (CP)
[2]in percent of GDP
[3]in percent of potential GDP
Sources: Commission services autumn 2004 economic forecasts (COM); Commission services calculations

Across sub-sectors of government, the update indicates that the pension system will continue to show surpluses of about 2% of GDP over the period. Local governments will strengthen from a 0.2% deficit in 2003 to surpluses of about 0.2% over the programme period. Over the last few years, in spite of increases in central government transfers to support local government consumption, local governments have had to increase income taxes substantially to address their financial imbalances. On the basis of the projections in the update, the financial stress at local government level will be reduced in the coming years as revenue growth strengthens and growth in expenditures moderates. Hence, it is the central government deficit that drives changes in the general government position, with a 1.3% deficit in 2004, increasing to 1.8% in 2005 and 2006 before contracting to 1.3% in 2007.

Overall, the risks to the budgetary projections in the programme appear balanced. On the one hand, compared with the Commission services autumn forecast, the targets seem plausible at least to 2006 (the horizon of the autumn forecast)[10]. The macroeconomic scenario is also in line with the Commission services forecast and is below estimated potential growth rates at the end of the period. Moreover, Sweden has a very good track record in not exceeding central government expenditure ceilings. As the financial situation at local government level is improving, the budgetary risk from this source should be reduced. On the other hand, the budgetary margins included under the central government expenditure ceilings are already very narrow, not only in 2004, but also for 2005 and 2006. Also, on the revenue side, taxes have shown to be quite volatile over the last few years. In addition, the budgetary impact from changes in the composition of growth has been significant. Moreover, the 2006 budget is for an election year with the well-known risks that may carry, and contrary to normal practice expenditure ceilings for 2007 have not yet been presented. Lastly, the government has announced its ambition to complete in the 2006 budget the final step of the tax reform, should this be possible within a framework of continued sound public finances (as recommended in the BEPGs).

In the light of this risk assessment, the budgetary stance in the programme is sufficient to maintain the close-to-balance-or-surplus requirement of the Stability and Growth Pact throughout the programme period. Furthermore, there is a sufficient safety margin

[10] However, it is expected that as from March 2007 recorded budget balances will be revised downwards as the defined-contribution pension schemes are reclassified outside the general government sector (see footnote 8).

against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations[11].

Box 1: The budget for 2005

The Budget Bill for 2005 was presented by the government on 20 September and adopted by Parliament on 16 December. It is based on a “pre-agreement” between the governing Social Democratic Party, the Left Party and the Green Party. It complements the measures for 2005 already advertised in the 2004 Spring Bill (presented on 15 April and adopted by Parliament in June).

According to the 2005 budget, new and previously proposed expenditure and income measures for 2005 weaken the central government budget by 28bn SEK (1.1% of GDP) compared to 2004. New measures in the 2005 budget are estimated to reduce the general government budget position by 19 bn SEK in 2005, 27 bn SEK in 2006 and 32 bn SEK in 2007. On a national accounts basis, the central government deficit in 2005 is expected by the authorities to be 47 bn SEK (1.8% of GDP) while at the general government level there is a surplus taking into account the local government and the social security system positions. The budget sets a target for the 2005 general government surplus of 0.5% of GDP.

The main budget measures are:

- State support to local government consumption is increased over the 2005-2007 period with increases of 14.5 bn SEK (0.6% of GDP) in 2005 slightly increasing in the following years. This is done both through higher direct grants and tax expenditures (while the first are limited by the expenditure ceilings, the latter are not).

- Half of the fourth and last step of the income tax reform is carried out in 2005. This implies an increase in the tax reduction linked to pension contributions as a compensation for earlier increases in social security charges. This effect on revenue is estimated to be 6.5 bn SEK (0.3% of GDP), with a permanent impact.

- Inheritance and gift taxes are abolished as from 2005. This measure is expected to reduce revenues by 2.6 bn SEK (0.1% of GDP) permanently. In addition, the threshold for paying wealth taxes is raised from 2 to 3 bn SEK with a budgetary effect of 1.1 bn SEK.

- Further steps are taken in the “green tax swap” strategy. Various energy taxes are increased to finance higher basic tax allowances for low and middle income earners (the overall size of this swap is valued at 3.7 bn SEK or 0.1% of GDP).

As concerns the central government expenditure ceilings, the 2005 budget makes proposals only for 2005 and 2006 while not yet for 2007 (this is postponed to the 2006 budget). The proposed ceilings imply a small decline in the GDP-share of central government expenditures, from 32.8% of GDP in 2004 to 32.2% in 2006. The forecasted contingency margins under the ceiling are very narrow over the 2004-2006 period. The government has committed itself to respect the ceilings, taking measures if necessary. For 2004, such measures mainly consist of shifting expenditures forward to 2005.

[11] The Commission services most recent calculation of the “minimal benchmark” indicates that a safety margin of 2.2% of GDP is necessary for the avoidance of breaching the 3% of GDP deficit reference level as a consequence of normal macro economic cyclical swings, implying that the cyclically-adjusted deficit should be no higher than 0.8% of GDP (see Public Finance Report 2002).

5.3. Sensitivity analysis

The update includes a section on the sensitivity of the public finances with respect to economic activity. Two alternative scenarios are described, “low growth” and “high growth”. Compared to the baseline scenario, based on lower net exports through higher oil prices and lower world demand, the low growth scenario shows an accumulated 0.7% lower growth over the 2004-2007 period with the main shortfall appearing in 2005 (2.5% growth instead of 3.0%). The scenario indicates that the budget balance would show a 0.2% surplus in 2007, 0.7 percentage point of GDP lower than in the base scenario. The result is broadly in line with those obtained from using standard elasticities of revenues and expenditure to GDP[12].

Commission services simulations of the cyclically-adjusted balances under the assumptions of (i) a sustained 0.5 percentage point deviation from the growth targets in the programme over the 2004-2007 period; (ii) trend output based on the HP-filter[13] and (iii) no policy response (notably, the expenditure level is as in the central scenario[14]), reveal that, by 2007, the cyclically-adjusted balance is 0.6 percentage point of GDP below the central scenario. Hence, according to this exercise, in the case of persistently lower growth, additional measures of around 0.6 percentage point of GDP would be necessary to keep the public finances on the path targeted in the central scenario. These calculations suggest that even if economic growth were weaker than expected, a fiscal position close to balance or in surplus in the medium term would still be achieved.

6. Evolution of the debt ratio

The update projects that the debt-to-GDP ratio is reduced progressively over the projection period to reach 49.0% of GDP in 2007, down from 51.7% in 2004. This development is very similar to that in the Commission services autumn forecast. Since debt is mainly issued by the central government – which runs budget deficits – and the surplus in the pension system is mainly invested in non-government assets, gross debt increases over the period (but at a slower pace than nominal GDP). The debt ratio net of financial assets is projected to stand at -3.7% in 2007.

Sweden would thus further reduce its debt ratio below the Treaty reference level. Nevertheless, the projected pace of debt reduction is somewhat slower compared with previous updates, mainly reflecting the downward revisions of the central government balance. This is of relevance to the strategy for preparing for the budgetary impact of the ageing population and is further analysed in section 8.

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[12] In the update there is also a “high growth” scenario. However, this scenario is not a risk assessment proper as it rather reflects an assumed substantial increase in potential growth over the coming years due to structural changes in the functioning of the labour market.

[13] In the absence of a fully-specified macro-economic scenario that would underlie such deviations, it is not possible to derive new estimates of potential growth from the agreed production function method.

[14] The effect of lower/higher growth on revenues is captured by using the conventional sensitivity parameters adopted in cyclical adjustment procedures.

Table 6: Debt dynamics

	average 2000-2003	2004		2005		2006		2007
	COM	COM	CP	COM	CP	COM	CP	CP
Government gross debt ratio	52.9	51.6	51.7	50.6	50.5	49.7	50.0	49.0
Change in debt ratio (1 = -2+3+7)	-2.7	-0.4	-0.3	-1.0	-1.2	-0.9	-0.5	-1.0
Contributions:								
- **Primary balance** (2)	**-5.1**	**-2.7**	**-2.8**	**-2.8**	**-2.8**	**-3.0**	**-2.7**	**-3.3**
- **"Snow-ball" effect** (3 = 4+5+6)	**0.8**	**-0.3**	**-0.1**	**-0.4**	**-0.5**	**-0.1**	**0.0**	**0.2**
- Interest expenditure (4)	3.1	2.1	2.1	2.2	2.2	2.3	2.3	2.4
- Real GDP growth (5)	-1.2	-1.9	-1.7	-1.6	-1.5	-1.4	-1.2	-1.1
- Inflation – GDP deflator (6)	-1.0	-0.5	-0.5	-1.0	-1.2	-1.0	-1.1	-1.1
- **Stock-flow adjustment** (7)	**1.5**	**2.6**	**2.6**	**2.1**	**2.1**	**2.2**	**2.2**	**2.1**
- Cash/accruals	-0.4							
- Accumulation of financial assets	2.6							
of which: Privatisation proceeds	-0.1							
- Valuation effects & residual adj.	-0.6							

Note:
The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth

Sources:

Updated Swedish Convergence Programme, November 2004 (CP); Commission services autumn 2004 economic forecasts (COM); ECFIN calculations

7. STRUCTURAL REFORM AND THE QUALITY OF PUBLIC FINANCES

The update provides an overview of the quality of public finances and recent structural policies being pursued to improve the functioning of the supply side of the economy.

As regards the quality of public finances, the update looks at the developments across expenditure categories over the 1995-2002 period. The analysis indicates that over this period expenditure ratios have been reduced by about 9% points of GDP with main contributions from reductions in interest expenditures and social transfers. However there is no similar analysis covering the programme period. The update projections nevertheless indicate that the expenditure to GDP ratio will continue to be reduced, driven by reduced shares of government transfers and consumption expenditures. The government investment share, however, remains constant. This reduced expenditure ratio is used to provide room for a reduction in the tax ratio in a context of continued surpluses, even though surpluses fall short of the 2% surplus objective.

As regards structural reform, the areas which are described in the update are (i) the labour market, (ii) education and training activities, (iii) healthcare and care of the elderly, and (iv) fiscal policy. At the centre of all described reforms stands the labour market strategy which appears appropriate given the goal of containing the public expenditure pressures from ageing (see section 8).

Box 2: The 2% surplus target over the cycle

Since 2000, the Swedish government has set a 2% of GDP surplus target over the cycle as a key objective in the fiscal policy framework. Compliance with this objective should ensure that government debt is reduced to help prepare for the budgetary costs of ageing.

The objective should be understood as requiring the average budget surplus over the period of a cycle to be 2% of GDP.. A problem in implementing and assessing compliance with such a rule is that the business cycle is not a directly observable variable and there is no declared government position on when the current cycle began or when it ends. Moreover, there is no declared policy on the response should the budget position depart from the objective.

Nevertheless, the government analyse compliance in the Budget Bill by looking at the average budget surplus since the introduction of the objective in the year 2000. While the budget surplus was very high at the beginning of this period, lower surpluses in recent years have driven down the average. It is now estimated by the authorities to be 1.8% over the 2000-2004 period, while, including also the budgetary projections in the update, the average would be reduced to 1.4% over the 2000 to 2007 period. Over the programme period only the average surplus is 0.7% of GDP. To assess to what extent the budget position in a single year is in line with the ambition of the 2% objective, the government also estimates the cyclically-adjusted budget balance (CAB) according to its own methodology. Here, the update gives a CAB surplus of 1.7% in 2004 (CAB-SE), falling progressively to 0.9% by the end of the programme period. Applying the common methodology to the figures provided in the update, the CAB surplus is 0.8% in 2004, 0.5% in both 2005 and 2006 and 1.2% in 2007 (CAB-COM).

	2000	2001	2002	2003	2004	2005	2006	2007
Net lending	5.1	2.8	0.0	0.5	0.7	0.6	0.4	0.9
Average	5.1	4.0	2.6	2.0	1.8	1.6	1.4	1.4
CAB-SE	n.a.	n.a.	n.a.	1.5	1.7	1.0	0.6	0.9
CAB-COM	4.2	3.1	0.5	1.4	0.8	0.5	0.5	1.2
OG-SE	n.a.	n.a.	n.a.	-1.4	-1.3	-0.5	-0.2	0.0
OG-COM	1.3	-0.4	-0.8	-1.4	-0.1	0.1	-0.2	-0.4

Source: Updated Swedish convergence programme, November 2004 (CP), Budget 2005 and Commission services

It would therefore appear on the present policy stance that the 2% target would not be met over the 2000-2007 period. However, what this may mean in terms of future policy decisions is unclear. First, it is not apparent what the Swedish authorities consider should be the relevant time span within which corrective action, if any, should be taken. In the update, the Swedish authorities assume that the output gap closes, and thus indicating the current cycle ends, only in 2007 (OG-SE). However, according to the common methodology the gap closed in 2004 (OG-COM). For illustrative purposes, assume that 2010 is chosen as the end point of the cycle since 2000. Then, for the target to have been met over the 2000-2010 period, taking into account the projections in the update until 2007, the surplus over the 2008-2010 period would need to be 3.75% of GDP per year on average to compensate for the current relatively low surpluses. This would imply that an important consolidation effort would be necessary after the end of the current projection period.

On structural training there has been an expansion of places in labour market programmes[15]. As regards ill health at work, the objective of halving the number of sick leave days by 2008 is important also in a public finance perspective. A number of broad measures have been taken over the last few years but so far without clear results[16]. On fiscal policy, the tax reform initiated in 2000 is aimed at reducing the high marginal and average tax rates. The reform is being implemented in four stages, with three quarters of the reform completed by 2002; half of the final fourth step will be implemented in 2005. The objective of the reform is to compensate households for previous increases in pension fees. Concerning the composition of the tax take, there has been some easing of labour taxation in the framework of the 'green tax swap' strategy. However, local government tax rates were increased both in 2003 and 2004. All in all, the objectives of the labour market strategy are pertinent, but the actual and planned measures do not appear fully adequate to achieve them.

8. THE SUSTAINABILITY OF THE PUBLIC FINANCES

The assessment of the sustainability of Swedish public finances is based on an overall judgement of the results of quantitative indicators and qualitative features. The quantitative indicators project debt developments according to two different scenarios, to take into account different budgetary developments over the medium term. The "programme" scenario (baseline) assumes that the medium-term objective set in the programme is actually achieved, while the "2004" scenario assumes that the underlying primary balance remains throughout the programme period at the 2004 level.

The graph below presents gross debt developments according to the two different scenarios. On the basis of the programme and additional information provided in the framework of the exercise conducted by the Economic Policy Committee, age-related expenditure is foreseen to increase by 6% points of GDP between 2008 and 2050 (see Annex 2 for a breakdown of different age-related expenditures). Gross debt is projected to decrease in the next 10 to 15 years as a consequence of still positive primary balances. However, once the impact of ageing on expenditures kicks in, the debt dynamics become unfavourable.[17]

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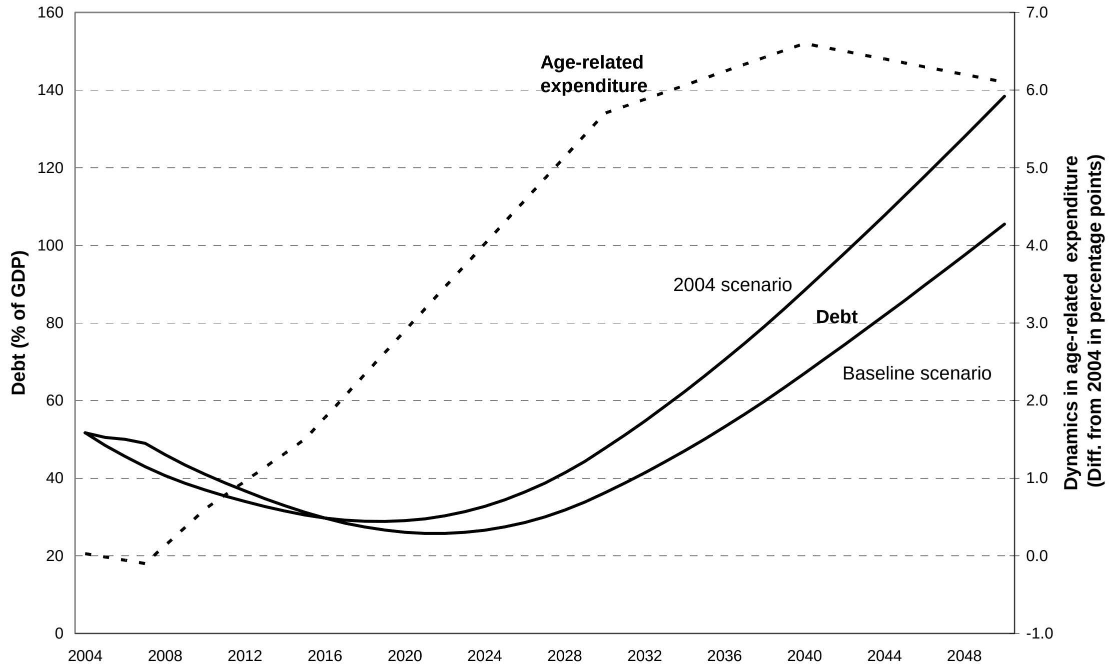
[15] However, some new initiatives such as the extension throughout the country of the 'free-year' initiative (under which an employee can, while paid a salary-linked benefit, take up to one year off work under certain conditions) do not obviously contribute to increase labour supply.

[16] Among them efforts to shift more of the financial responsibility towards employers with a view to increasing positive incentives to address the problem at the workplace (however, there has been a reversal of previous cuts in benefit levels). In addition, measures have been taken to strengthen compliance with the rules of the system. There has been some reduction in the volume of compensated sick days as compared to one year ago but the number of people in early retirement seems to be increasing.

[17] It should be recalled that, being a mechanical, partial-equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of likely outcomes and should not be taken at face value.

Long-term sustainability: summary results



Sustainability indicators

	S1*	S2**	RPB***
Programme scenario	0.7	1.9	5.0
2004 scenario	1.3	2.5	4.8

Notes:

* It indicates the required change in tax revenues as a share of GDP over the projection period that guarantees to reach debt to GDP ratio of 60% of GDP in 2050.

** It indicates the required change in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon to the debt as existing at the outset of the projection period.

*** Based on S2, the Required Primary Balance (RPB) indicates the average minimum required cyclically adjusted primary balance as a share of GDP *over the first five years* of the projection period that guarantees the respect of the intertemporal budget constraint of the government over this period.

On the basis of the debt projections, it is possible to calculate a set of sustainability indicators to measure the gap between the current policies and a sustainable one. The S1 indicator shows the permanent change in the primary balance in order to have a debt to GDP ratio in line with the Maastricht Treaty reference value in the very long run (year 2050).[18] S2 shows the gap between the current tax policies and those that would ensure respect of the intertemporal budget constraint given the future impact of ageing on public expenditure, namely the change in the tax ratio that would equate the present discounted value of future primary balances to the current stock of gross debt. According to the latter, in order to tackle the cost of ageing entirely through a budgetary strategy Sweden should increase its primary surplus permanently by around 2-2.5 percentage points, depending on the profile in the medium-term. In terms of the S2 indicator, this would imply that a debt ratio at -15% by the middle of the century in the baseline scenario is compatible with the intertemporal budget constraint, thus considerably below the 60%

[18] The respect of the underlying debt path does not ensure sustainability over an infinite horizon, but only that debt remains below 60% up to 2050. In most cases, this would imply an increasing trend and possible imbalances after the end of the projection period.

reference value[19]. The budgetary effort over the first 5 years of the projections (i.e. after the end of the programme period) to respect the intertemporal budget constraint requires a primary surplus of about 5% of GDP on average, about 1.5 percentage points higher than that projected for the last year of the programme period (measured in underlying terms).

These results are broadly in line with those presented in the programme where a sustainable position is reached with an assumed average budget surplus of 2% of GDP up to 2015[20].In interpreting these results, several factors must be taken into account. First, filling the sustainability gap on the revenue side may prove difficult given the already high level of taxation, suggesting budgetary consolidation should preferably take place on the expenditure side. Second, public pension funds in general government hold liquid assets of around 20% of GDP. This leads to a current adjusted gross debt of less than 30% that helps in coping with the future cost of ageing (see annex 2[21]). Third, the update projects health care related expenditure to increase substantially up to 2050. In this context, the Swedish government target to halve the number of working days lost to sick leave between 2002 and 2008 is pertinent. As noted in section 7 on structural reforms, there are some limited signs of progress as regards sickness insurance payments as compared to one year ago. Overall, the need to carry on with reforms in view of containing healthcare-related expenditure and to reduce the extent of sick leave remains central.

This links directly to the challenge to strengthen labour force participation. The update scenario assumes continued high but declining labour force participation and the employment ratio remains below the government target of 80% over the whole period. The update points to the importance of relatively high immigration for the growth of the working-age population over the coming decades. Moreover, a key assumption is that the employment rate among immigrants will increase substantially over time, gradually approximating average levels. While such an evolution is important, it may not stem automatically from the ageing process per se. Indeed, it rather points to the need for a successful integration strategy as an integral part of the response to the ageing challenge.

[19] The debt ratio of -15% in 2050 according to the S2 indicator illustrates that the tax gap is higher in order to ensure a sustainable evolution of gross debt beyond 2050, compared with the S1 tax gap, which illustrates that a lower tax increase is compatible with the 60% reference value in 2050.

[20] In the update, the 2% surplus target is assumed to be maintained until 2015. The necessary residual budgetary strengthening to reach the target is introduced through a mechanical increase in (household) taxes and could therefore be interpreted in a similar way as a tax gap.

[21] The S2 indicator is calculated on a gross debt basis. In the case of Sweden, for illustrative purposes, should it be calculated on the basis adjusted gross debt, the S2 tax gap (baseline scenario) would be somewhat smaller at about 1.5.

Annex 1: Summary tables from the convergence programme update

Table 1. Growth and associated factors

	ESA Code	2003	2004	2005	2006	2007
GDP *growth* at *constant* market prices (7+8+9)	B1g	1.6	3.5	3.0	2.5	2.3
GDP *level* at *current* market prices	B1g	2439	2548	2687	2817	2946
GDP deflator		2.3	0.9	2.4	2.3	2.3
HICP change		1.8	1.3	1.5		
Employment growth[22]		-0.3	-0.6	0.8	0.8	0.7
Labour productivity growth [23]		3.5	3.2	2.5	2.3	2.3
Sources of growth: percentage changes at constant prices						
1. Private consumption expenditure	P3	1.9	2.4	2.7	2.0	2.0
2. Government consumption expenditure	P3	0.6	0.9	0.8	0.6	0.1
3. Gross fixed capital formation	P51	-2.0	3.2	4.0	5.2	5.1
4. Changes in inventories and net acquisition of valuables as a % of GDP	P52 + P53	0.2	-0.1	0.2	0.0	0.0
5. Exports of goods and services	P6	5.5	8.8	7.5	6.1	5.9
6. Imports of goods and services	P7	5.0	5.9	7.4	6.1	6.0
Contribution to GDP growth						
7. Final domestic demand (1+2+3)		0.8	2.1	2.1	2.1	2.0
8. Change in inventories and net acquisition of valuables (=4)	P52 + P53	0.2	-0.1	0.2	0.0	0.0
9. External balance of goods and services (5-6)	B11	0.6	1.7	0.6	0.5	0.5

[22] Occupied population, domestic concept, persons, national accounts definition

[23] Growth of GDP at market prices per person employed at constant prices

Table 2. General government budgetary developments

% of GDP	ESA code	2003	2004	2005	2006	2007
Net lending (B9) by sub-sectors						
1. General government	S13	0.5	0.7	0.6	0.4	0.9
2. Central government	S1311	-1.4	-1.3	-1.8	-1.8	-1.2
3. State government	S1312					
4. Local government	S1313	-0.2	0.1	0.3	0.3	0.2
5. Social security funds	S1314	2.0	2.0	2.1	1.9	1.9
General government (S13)						
6. Total receipts	ESA[24]	56.1	55.5	54.7	54.3	54.1
7. Total expenditures	ESA[24]	55.6	54.8	54.0	53.9	53.2
8. Budget balance	B9	0.5	0.7	0.6	0.4	0.9
9. Net interest payments		0.0	-0.1	0.0.	0.1	0.2
10. Primary balance		0.6	0.6	0.6	0.5	1.0
Components of revenues						
11. Taxes	D2+D5	36.3	36.1	35.3	35.2	35.0
12. Social contributions	D61	14.2	13.9	13.9	13.8	13.7
13. Interest income	D41	2.2	2.2	2.2	2.2	2.2
14. Other		3.4	3.3	3.2	3.2	3.2
15. Total receipts	ESA	56.1	55.5	54.7	54.3	54.1
Components of expenditures						
16. Collective consumption	P32+D63	28.3	28.0	27.6	27.3	26.9
17. Social transfers in kind	D63	-	-	-	-	-
18. Social transfers other than in kind	D62+D3	22.2	21.8	21.4	21.4	21.0
19. Interest payments	D41	2.2	2.1	2.2	2.3	2.4
20. Subsidies	D3	-	-	-	-	-
21. Gross fixed capital formation	P51	2.9	2.9	2.9	2.9	2.9
22. Other		-	-	-	-	-
23. Total expenditures	ESA	55.6	54.8	54.0	53.9	53.2

Table 3. General government debt developments

% of GDP	ESA code	2003	2004	2005	2006	2007
Gross debt level		52.0	51.7	50.5	50.0	49.0
Change in gross debt		-0.6	-0.3	-1.2	-0.5	-1.0
Contributions to change in gross debt						
Primary balance		-0.5	-0.6	-0.5	-0.6	-1.1
Interest payments	D41	2.0	1.5	1.8	2.0	2.1
Nominal GDP growth	B1g	-2.0	-2.3	-2.8	-2.4	-2.2
Other factors influencing the debt ratio		-0.1	1.2	0.3	0.5	0.4
Of which: Privatisation receipts						
p.m. implicit interest rate on debt						

[24] The figures in the programme on total government expenditures and revenues do not follow the ESA95 harmonised principles (the difference being in the netting conventions). However, there is no impact on net lending (see footnote 4).

Table 4. Cyclical developments[25]

% of GDP	ESA Code	2003	2004	2005	2006	2007
1. GDP growth at constant prices	B1g	1.6	3.5	3.0	2.5	2.3
2. Actual balance	B9	0.5	0.7	0.6	0.4	0.9
3. Interest payments (net)	D41	0.0	-0.1	0.0.	0.1	0.2
4. Potential GDP growth						
5. Output gap		-1.4	-1.3	-0.5	-0.2	0.0
6. Cyclical budgetary component		1.0	0.9	0.4	0.1	0.0
7. Cyclically-adjusted balance (2-6)		1.5	1.7	1.0	0.6	0.9
8. Cyclically-adjusted primary balance (7-3)		1.6	1.6	1.0	0.7	1.0

Table 5. Divergence from previous update

% of GDP	ESA Code	2003	2004	2005	2006	2007
GDP growth	B1g					
previous update		1.4	2.0	2.6	2.5	n.a.
latest update		1.6	3.5	3.0	2.5	2.3
Difference		0.2	1.5	0.4	0.0	n.a.
Actual budget balance	B9					
previous update		0.4	0.6	1.4	1.9	n.a.
latest update		0.5	0.7	0.6	0.4	0.9
Difference		0.1	0.1	-0.8	-1.5	n.a.
Gross debt levels						
previous update		51.7	51.5	50.0	48.3	n.a.
latest update		52.0	51.7	50.5	50.0	49.0
Difference		0.3	0.2	0.5	1.7	n.a.

Table 6. Long-term sustainability of public finances [26]

% of GDP	**2000**	**2007**	**2010**	**2020**	**2030**	**2050**
Total expenditure	**50.6**	**50.9**	**51.3**	**52.9**	**55.7**	**55.2**
Old age pensions	8.5	8.5	8.9	98	10.1	9.4
Health care (including care for the elderly)	10.1	10.2	10.4	11.4	13.3	14.2
Interest payments	1.0	0.1	0.2	-0.8	-0.9	-0.2
Total revenues	**56.6**	**51.8**	**53.5**	**53.9**	**54.6**	**54.2**
of which: from pensions contributions						
National pension fund assets (if any)	**35.6**	**30.4**	**33.2**	**34.5**	**34.3**	**31.6**
Assumptions						
Labour productivity growth	**3.9**	**2.3**	**2.2**	**2.2**	**2.2**	**2.2**
Real GDP growth	**4.3**	**2.3**	**1.6**	**1.7**	**1.4**	**1.9**
Participation rate males (aged 20-64)	**84.0**	**82.8**	**82.5**	**82.5**	**81.8**	**81.7**
Participation rates females (aged 20-64)	**78.4**	**77.9**	**77.4**	**77.0**	**76.0**	**75.7**
Total participation rates (aged 20-64)	**81.2**	**80.4**	**80.0**	**79.8**	**78.9**	**78.7**
Unemployment rate	**4.7**	**4.2**	**4.0**	**4.0**	**4.0**	**4.0**

[25] Member States can fill-in lines 4-8 using either own figures or Commission figures.

[26] Information in this table, if provided, should be updated at least every 3 years.

Table 7. Basic assumptions[27]

(to be transmitted to the EFC and the Commission together with the SCP update[28])

		2003	2004	2005	2006	2007
Short-term interest rate[29] (annual average)		3.0	2.4	3.0	3.8	4.4
Long-term interest rate[3] (annual average)		4.6	4.7	5.1	5.3	5.5
USA: short-term (3-month money market)						
USA: long term (10-year government bonds)						
USD/€ exchange rate[3] (annual average)		1.22	1.25	1.30	1.30	1.30
Nominal effective exchange rate (euro area)		127.7	126.4	124.2	123.3	123.3
Nominal effective exchange rate (EU)						
(for non-euro countries) exchange rate vis-à-vis the € (annual average)[3]		9.02	9.10	9.00	9.00	9.00
World excluding EU,GDP growth		4.4	5.3	4.6	4.4	4.3
US						
Japan						
EU-15 GDP growth		0.8	2.1	2.3	2.4	2.4
Growth of relevant foreign markets						
World import volumes, excluding EU		5.0	9.8	9.4	8.3	7.5
World import prices, (goods, in USD)						
Oil prices, (Brent, USD/barrel)		30	37	34	32	32
Non-oil commodity prices (in USD)						

27 Provision of data on variables in bold characters is a requirement. Provision of data on other variables is optional but highly desirable.

28 Member States may include their basic assumptions in their SCP updates if they so wish

29 Purely technical assumptions

Annex 2: Long-term sustainability of public finances in Sweden – quantitative scenarios

Main assumptions - baseline scenario (as % GDP)	2008	2010	2020	2030	2040	2050	changes
Total age-related spending	34.4	34.9	37.2	40.0	40.9	40.4	6.0
Pensions	8.6	8.9	9.8	10.1	10.2	9.4	0.8
Health care	10.8	10.9	11.7	12.5	12.8	13.1	2.3
Care of the elderly	4.0	4.1	4.4	5.7	6.0	6.2	2.2
Education	8.1	8.1	8.2	8.5	8.7	8.5	0.4
Unemployment benefits	1.3	1.2	1.2	1.2	1.2	1.2	-0.1
*Total primary non age-related spending**	16.6						
Total revenues	54.4	54.5	54.8	54.9	54.9	54.6	0.2

* constant

Results (as % GDP)	2008	2010	2020	2030	2040	2050	changes
Programme scenario							
Gross debt	46.0	41.0	26.1	36.2	67.0	105.4	59.4
i + 0.5*	46.3	41.7	28.6	41.0	75.5	120.3	74.0
p.m. Adjusted gross debt**	23.3	17.7	-1.4	3.5	28.1	59.6	36.3
2004 scenario							
Gross debt	40.4	36.7	28.8	47.3	88.1	137.9	97.5
i + 0.5*	40.7	37.3	31.2	52.2	97.5	155.3	114.7
p.m. Adjusted gross debt**	17.8	13.4	1.3	14.6	49.1	92.1	74.4

* i + 0.5 represents the evolution of debt under the assumption of the nominal interest rate being 50 basis points higher throughout the projection period.

** Adjusted gross debt equals Gross debt (Maastricht) net of consolidated public pension fund assets in the general government sector accumulated for the strict purpose of covering pension-related expenditure.