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**SWEDEN: MACRO FISCAL ASSESSMENT**  
**AN ANALYSIS OF THE NOVEMBER 2007 UPDATE OF THE CONVERGENCE**  
**PROGRAMME**

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The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called “stability programme” for countries that have adopted the euro as their currency and “convergence programme” for those that have not. The most recent update of Sweden’s convergence programme was submitted on 27 November 2007.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 6 February 2008. Comments should be sent to Ann Westman ([ann.westman@ec.europa.eu](mailto:ann.westman@ec.europa.eu)). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services’ autumn 2007 forecast, (ii) the code of conduct (“Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, endorsed by the ECOFIN Council of 11 October 2005) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying “methodological paper” prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 23 January. The ECOFIN Council is expected to adopt its opinion on the programme on 12 February 2008.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

[http://ec.europa.eu/economy\\_finance/about/activities/sgp/main\\_en.htm](http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm)

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## SUMMARY AND CONCLUSIONS

As part of the preventive arm of the Stability and Growth Pact, each Member State that does not use the single currency, such as Sweden, has to submit a convergence programme and annual updates thereof. The most recent programme, covering the period 2007-2010, was submitted on 27 November 2007.

The Swedish economy has performed well in recent years. In 2007, the economy has entered into a more mature phase that is reflected by a solid domestic demand boosted by buoyant investment and private consumption growth. Against this background, Swedish public finances have also been strong with consistent and sizable general government surpluses. The healthy public finances have been supported by a stability-oriented macroeconomic framework, healthy economic growth and a national rules-based budgetary framework. While economic activity is forecast to decelerate gradually in coming years, both economic fundamentals and the fiscal situation are expected to remain favourable. Against this background it is important that the room for manoeuvre provided by strong public finances is not used to permanently increase public consumption expenditure. Notably if local governments were to increase expenditure in the current good times this could lead to permanently higher public expenditure in the future, which would interfere with the plans for a moderate reduction of the expenditure-to-GDP ratio over time and the government's strategy of lowering taxes aimed at enhancing incentives to work.

The programme contains three different scenarios for the macroeconomic and budgetary projections: a “base” scenario, a “low growth” scenario and a “high growth” scenario. The “base” scenario is considered the reference scenario for assessing budgetary projections because, assessed against currently available information<sup>1</sup>, it appears to be based on plausible growth assumptions. It envisages that real GDP growth will slow down from 3.2 % in 2007 to 2.6% on average over the rest of the programme period. National accounts' data for the third quarter 2007, released on 30 November 2007, confirm the picture in the programme and in the Commission services' autumn forecast of strong domestic growth, notably private consumption, and weak external demand. The Swedish quarterly data, together with indicators for the EU as a whole, point to a possible sharper deceleration of economic activity than earlier envisaged. It is, however, too early to draw any firm conclusions from the quarterly data for the whole year and the period up until 2010. The programme's projections for inflation, which foresee an increase above the 2% Riksbank target, also appear realistic. Higher wage growth combined with weaker productivity growth than in recent years is predicted to raise unit labour costs, which could add to inflationary pressures.

The Commission services' calculations of the output gap, which is estimated to remain positive, and other relevant variables, suggests that the Swedish economy is currently in good times, but that economic times can be expected to gradually normalise over the programme period.

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<sup>1</sup> The assessment takes notably into account the Commission services' autumn forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

For 2007, the general government surplus is estimated at 3.0% of GDP in the Commission services' autumn 2007 forecast, against a target of 1.2% of GDP set in the previous update of the convergence programme. The better-than-targeted balance is notably due to a base effect (reflecting a stronger outturn in 2006 than projected in the previous programme) and to a stronger than anticipated labour market in 2007, which had a more favourable impact on revenue and, to a lesser extent, expenditure than anticipated. In line with the implicit policy invitation in the Council opinion of 27 February 2007 on the previous update of the convergence programme<sup>2</sup>, the structural balance is estimated to improve significantly in 2007, indicating that the fiscal stance has been counter-cyclical in 2007.

The main goal of the medium-term budgetary strategy in the programme is to achieve a nominal budget surplus of 1% of GDP on average over the business cycle, supported by multi-annual expenditure ceilings for the central government and a balanced budget requirement for local governments. This surplus target corresponds to Sweden's medium-term objective (MTO) for the budgetary position of a 1% of GDP structural surplus (i.e. cyclically adjusted surplus net of one-off and temporary measures). It should be noted that the MTO target has been revised downward from 2% in the previous update. This is a purely technical revision and due to the implementation of the March 2004 Eurostat decision on the recording of second-pillar pension funds outside the government sector as from April 2007.<sup>3</sup> Hence, the new target confirms the same level of fiscal ambition as the old.

The general government surplus is estimated to decline slightly in 2008 to 2.8%, from 3.0% of GDP in 2007. Thereafter the balance is projected to recover progressively to 3.6% in 2010. The weakening in 2008 reflects significant income tax cuts for low and middle income earners by means of a strengthened in-work tax credit, which are only partly financed through other revenue-increasing and expenditure-decreasing measures. In view of better-than-expected outturns in 2006 and 2007, however, these surplus projections are overall higher than in the previous update. The primary balance and the structural balance show a path that is broadly similar to that of the headline balance.

The risks to the budgetary projections in the programme appear relatively neutral. While GDP growth is projected to decelerate gradually over the programme period, the composition of growth is still foreseen to remain favourable from the point of view of public finances, notably given the solid private consumption growth. Sweden has also demonstrated a good track record, supporting the budget projections.

In view of this risk assessment, the budgetary stance in the programme allows meeting the MTO by a comfortable margin throughout the programme period, as envisaged in the programme. Nonetheless, if the economy continues to be in good times, which is not certain in the light of the most recent developments, there is a risk that the fiscal policy stance implied by the programme may turn out to be mildly pro-cyclical in 2008. The budgetary deterioration in 2008, which is linked to continued structural reforms aimed at encouraging labour force participation and increasing the economy's growth potential, also foreseen to be temporary as it is not expected to spill over into subsequent years.

Sweden appears to be at low risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is lower than the EU average, with pension

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<sup>2</sup> OJ C 72, 29.3.2007, p. 2.

<sup>3</sup> See Eurostat News Release No 30/2004 of 2 March 2004 and No 117/2004 of 23 September 2004.

expenditure projected to remain relatively stable as a share of GDP over the long term, influenced by the considerable expenditure-reducing impact of the reform of the pension system adopted in 1998. The budgetary position in 2007 as estimated in the programme with a high primary surplus contributes to a continued reduction of gross debt. Maintaining sound government finances with continued surpluses as planned in the programme would contribute to limiting risks to the sustainability of public finances.

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Sweden's national reform programme.<sup>4</sup> The 2006 updated national reform programme, which was presented by the new government, broadly confirmed the key challenges identified by the old government, namely the need for high levels of labour market participation and hours worked as well as the promotion of a knowledge-based economy with environmentally-efficient production processes, and put increased focus on the need to increase labour supply and conditions for job creation. On the basis of the 2007 implementation report, the Commission's assessment concluded that Sweden has made very good progress in implementing its national reform programme over the 2005-2007 period. Against the background of the strengths and weaknesses identified and the evidence on progress made, the Commission stressed the need for Sweden to focus on increasing competition, notably in services, and on the implementation and impact evaluation of recent reforms to increase work incentives.

The convergence programme is fully consistent with the October 2007 implementation report of the national reform programme. In particular, both include fiscal measures aimed at increasing incentives to work and increasing labour supply. Focussing on the measures with a direct budgetary impact, income taxes are to be further reduced in 2008 and both the unemployment and the sickness insurance systems are to be reformed to better integrate people that currently stand outside the labour market. The updated convergence programme also describes in qualitative terms the overall impact of the National Reform Programme within the medium term fiscal strategy, in particular with regard to the increase in labour supply on the public finance position at large and the growth potential of the economy. Moreover, the convergence programme confirms the Swedish budgetary framework and recalls the measures taken in 2007 aimed at further increasing the transparency of the budgetary rules and enhancing the assessment of fiscal policies.

The overall conclusion is that the medium-term budgetary position is sound with high general government surpluses and Sweden is at low risk with regard to the sustainability of public finances. While the planned fiscal stance in 2008 might be mildly pro-cyclical in good times, the weakening of the structural budgetary position is linked to continued structural reforms aimed at encouraging labour force participation and thus increasing the growth potential and is not envisaged to spill over into subsequent years.

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<sup>4</sup> Communication from the Commission to the European Council, "Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)", 11.12.2007, COM(2007)803.

### Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	<b>CP Nov 2007</b>	<b>4.2</b>	<b>3.2</b>	<b>3.2</b>	<b>2.5</b>	<b>2.2</b>
	COM Nov 2007	4.2	3.4	3.1	2.4	n.a.
	CP Dec 2006	4.0	3.3	3.1	2.7	n.a.
HICP inflation (%)	<b>CP Nov 2007</b>	<b>1.4</b>	<b>1.7</b>	<b>2.7</b>	<b>2.5</b>	<b>2.1</b>
	COM Nov 2007	1.5	1.6	2.0	2.0	n.a.
	CP Dec 2006	1.9	2.2	1.5	1.9	n.a.
Output gap <sup>1</sup> (% of potential GDP)	<b>CP Nov 2007</b>	<b>0.6</b>	<b>0.3</b>	<b>0.6</b>	<b>0.5</b>	<b>0.3</b>
	COM Nov 2007 <sup>2</sup>	0.5	0.6	0.8	0.5	n.a.
	CP Dec 2006	0.0	0.3	0.3	0.3	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	<b>CP Nov 2007</b>	<b>6.5</b>	<b>7.1</b>	<b>7.2</b>	<b>7.4</b>	<b>7.7</b>
	COM Nov 2007	6.3	7.0	6.9	7.2	n.a.
	CP Dec 2006	6.1	7.5	7.4	7.5	n.a.
General government balance (% of GDP)	<b>CP Nov 2007</b>	<b>2.5</b>	<b>3.0</b>	<b>2.8</b>	<b>3.1</b>	<b>3.6</b>
	COM Nov 2007	2.5	3.0	2.8	3.0	n.a.
	CP Dec 2006	1.8	1.2	1.5	2.0	n.a.
Primary balance (% of GDP)	<b>CP Nov 2007</b>	<b>4.2</b>	<b>4.6</b>	<b>4.4</b>	<b>4.5</b>	<b>4.8</b>
	COM Nov 2007	4.2	4.7	4.3	4.5	n.a.
	CP Dec 2006	3.5	3.0	3.1	3.5	n.a.
Cyclically-adjusted balance <sup>1</sup> (% of GDP)	<b>CP Nov 2007</b>	<b>2.2</b>	<b>2.8</b>	<b>2.4</b>	<b>2.8</b>	<b>3.4</b>
	COM Nov 2007	2.1	2.7	2.3	2.8	n.a.
	CP Dec 2006	1.8	1.0	1.3	1.9	n.a.
Structural balance <sup>3</sup> (% of GDP)	<b>CP Nov 2007</b>	<b>1.7</b>	<b>2.4</b>	<b>2.1</b>	<b>2.8</b>	<b>3.4</b>
	COM Nov 2007	2.1	2.7	2.3	2.6	n.a.
	CP Dec 2006	1.8	1.0	1.3	1.9	n.a.
Government gross debt (% of GDP)	<b>CP Nov 2007</b>	<b>47.0</b>	<b>39.7</b>	<b>34.8</b>	<b>29.8</b>	<b>24.5</b>
	COM Nov 2007	47.0	41.1	35.7	30.5	n.a.
	CP Dec 2006	47.0	42.0	37.9	33.5	n.a.

Notes:

<sup>1</sup>Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

<sup>2</sup>Based on estimated potential growth of 3.3%, 3.4%, 2.9% and 2.7% respectively in the period 2006-2009.

<sup>3</sup>Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.5% of GDP in 2006, 0.4% in 2007 and 0.3% in 2008; all deficit-reducing according to the most recent programme and 0.2% of GDP in 2009; deficit-reducing in the Commission services' autumn forecast. The Commission services do not take into account the effect identified in the programme for 2006 and 2007 in its assessment as they are not considered as one-offs or other temporary measures.

Source:

Convergence programme (CP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations



## **1. INTRODUCTION**

The 2007 update of Swedish convergence programme, which covers the period from 2007 to 2010, was submitted to the Commission on 27 November 2007.<sup>5</sup> The programme is consistent with the Budget for 2008, approved on 20 December 2007. The programme was presented to Parliament's Standing Committee on Finance. The present update is the ninth update of the original convergence programme submitted in December 1998.

This assessment is further structured as follows. Section 2 discusses the key challenges for public finances in Sweden, with a particular focus on strong public finances and the need for containing public expenditure. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the convergence programme against the background of the Commission services' economic forecasts. Section 3 analyses budgetary implementation in the year 2007 and the medium-term budgetary strategy outlined in the new programme. Taking into account risks attached to the budgetary targets, it also assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses the quality of public finances and structural reforms, while Section 7 analyses the consistency of the budgetary strategy outlined in the programme with the national reform programme and its implementation reports and with the broad economic policy guidelines. The annexes provide a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme (Annex 1) and selected key indicators of past economic performance (Annex 2).

## **2. KEY CHALLENGES FOR PUBLIC FINANCES WITH A PARTICULAR FOCUS THE NEED FOR CONTAINING PUBLIC EXPENDITURE**

From an EU perspective, Swedish public finances are strong and the financial situation is expected to remain solid in the coming years, supported by continued healthy economic growth. Against this background, this section describes the Swedish budgetary framework and discusses the framework from the point of view how it contributes to ensuring prudent fiscal policies, in particular in good times, and to achieving fiscal sustainability. The measures taken by the government in 2007 aimed at enhancing and clarifying the framework are described. Finally, some still outstanding issues that would seem to warrant further consideration are presented, which may serve as input in the government's ongoing discussions on a further strengthening of the framework that is envisaged during its current term of office.

### **2.1. Main characteristics of the budgetary framework**

As part of the stability-oriented macroeconomic framework that was put in place in Sweden after the severe economic and financial crisis in the early 1990s, a national rule-based budgetary framework was introduced over the 1997-2000 period. This framework consists of three main elements:

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<sup>5</sup> The English version was also submitted on 27 November 2007.

- a multi-annual (3 year) nominal expenditure ceiling for the central government;
- a balanced budget rule for local governments; and
- a surplus target of 1% of GDP for the general government to be achieved over the business cycle.

The 3-year expenditure ceiling was introduced to enhance and establish a medium-term framework for the budgetary process, thereby contributing to achieving the budgetary target. It consists of an upper limit for total central government expenditure plus a contingency margin, which provides room for possible unexpected expenditure and automatic stabilisers. The total ceiling is broken down for each individual expenditure subtitle of the budget including for the pension system, but excludes interest payments which are considered difficult to influence in the short term. The overall ceiling and the breakdown on individual subtitles is adopted by the Parliament in the context of the yearly budget in its entirety, thereby limiting the possibility of discretionary increases in certain expenditures. The ceiling is also aimed at a gradual reduction of the GDP expenditure ratio.<sup>6</sup>

Local governments are responsible for a large share of public expenditure. The requirement of balanced budgets was introduced in 2000 as a complement to the expenditure ceiling for the central government.<sup>7</sup> According to the rule, local governments must in their budgets aim at a surplus. They are allowed to borrow to finance investments, but the servicing cost of the loans has to be covered by the budget.<sup>8</sup> In case of a deficit in the execution of the budget, a consolidation rule applies which stipulates that own capital has to be restored in the subsequent years. However, there is no explicit sanctioning mechanism in place in case the consolidation rule is not adhered to. In 2005, a few changes to the rule were introduced to make it more flexible. The balanced budget rule is no longer strictly applied if there are "special circumstances", such as an overall healthy balance sheet or particular needs for structural measures. Moreover, while an action programme has to be established for restoring own capital after a deficit has occurred, the timeframe for consolidating the financial position was increased from two to three years. The longer respite makes it easier for the communities to compensate for budget slippages without risk of running pro-cyclical policies. At the same time as more flexibility was introduced, the system for state support to local governments was strengthened and a requirement of prudent economic management at the local level was introduced. A balanced budget is not considered sufficient to meet this requirement. Rather, local governments have to define clear financial targets and guidelines for the activities in their budgets so that the results contribute to fiscal consolidation.<sup>9</sup>

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<sup>6</sup> The view of the Swedish government is that government expenditure-to-GDP ratio should be reduced moderately. See "Budget policy guidelines and, government and public sector finances", 2007 Spring Fiscal Policy Bill 2006/07:100.

<sup>7</sup> Local governments are responsible for the majority of welfare services and represent more than 20% of GDP. They are accountable for about 40% of public primary expenditures and for about 70% of public sector investments and consumption. Moreover, about 25% of all employees have municipalities or county councils as their employer.

<sup>8</sup> It is the servicing cost of the loan and not the investment expenditures that affect the result. As a consequence, the balance requirement can not be satisfied by simply postponing investment expenditures into the future.

<sup>9</sup> A common financial target for prudent economic management is that budget surplus should correspond to 2% of the total sum of tax revenue and general state support.

The aim of the surplus target is to ensure a reduction of government debt over time and thereby to contribute to long-term sustainability of public finances and thus preparing the economy for the effects of the ageing population. It was initially set at 2% of GDP, but was revised to 1% of GDP in 2007, taking account of the implementation of Eurostat decision on the classification of second-pillar funded pension schemes outside the government sector as from April 2007. This revision was of purely technical nature and did not have any impact on the achievement of fiscal sustainability.

## **2.2. Strengths and weaknesses**

### *The overall framework*

Overall, the rule-based budgetary framework has served Sweden well. It has contributed to a culture of budgetary prudence, medium-term planning and a significant consolidation of public finances. The design of the framework is also economically adequate as it contributes to address fiscal sustainability, while at the same time allowing business cycle fluctuations to be taken into account and automatic stabilisers to play freely in economic downturns. In particular, the expenditure ceilings are transparent and easily understood by the public as they are set in nominal terms. Ex post assessment of compliance by the National Financial Management Authority is therefore also rather straightforward. The balanced budget rule for local governments is also clear-cut and contributes to a prioritisation of expenditure by municipalities and county councils.<sup>1011</sup>

The national framework is compatible with the EU rules defined in the Stability and Growth Pact (SGP) and the 1% of GDP surplus objective, which corresponds to the medium-term objective (MTO) for the budgetary position, is more demanding than the minimum benchmark estimated at a deficit of 1% of GDP. As Sweden already incorporates long-term sustainability concerns into the MTO, a surplus target of 1% of GDP appears broadly appropriate in view of coping with the sustainability challenge.

Nevertheless, maintaining sound fiscal positions is a priority. The favourable starting point of the structural budgetary position may be overestimated, as increases in revenues that are treated as permanent could turn out to be temporary. Moreover, not all future risks to fiscal sustainability are necessarily reflected in the implicit liabilities figures (e.g. possible future pressures for higher pensions) and it is possible that technological progress may lead to even higher health care expenditure. While these concerns apply also to many other countries, the room of manoeuvre to adjust the budget on the revenue side is rather limited for Sweden, which has the highest taxation level in the EU.

While the overall framework is functioning well, it also has its shortcomings.<sup>12</sup>

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<sup>10</sup> See "Swedish budget rules: praise from Brussels, pressure at home", by Jonas Fischer, ECFIN Country Focus, Volume 2, Issue 4, March 2005.

<sup>11</sup> "National numerical fiscal rules and institutions for sound public finances", Public Finances in EMU 2006, European Economy, No. 3 – 2006.

<sup>12</sup> See "The Swedish budget "model": a genuine beauty or in need of a face lift?", by Robert Boije and Jonas Fischer, European Economy - Economic Papers, No. 275 - April 2007.

### *The surplus target*

The surplus target has contributed to a significant consolidation of public finances since the public finance crisis in the early 1990's and to prepare the Swedish economy for the budgetary impacts of ageing populations, by ensuring a reduction of government debt.

However, it is not straightforward to assess compliance with the surplus target. The concept of "on average over the business cycle" is ambiguous and leaves room for various interpretations as the business cycle is not clearly observable or defined (at least not *ex ante*).<sup>13</sup> Moreover, large revisions of the general government balance also make the assessment more difficult. In fact, the reliability of public finance data in Sweden is among the lowest in the EU.<sup>14</sup> Data reported in EDP notifications show a large dispersion over time, implying that data are subject to frequent and large revisions not only for the previous year but also several years back in time. The large revisions can only partly be explained by structural breaks in reported data, which are relatively frequent in the case of Sweden. It should be noted, however, that the revisions do not appear to be biased and deficit/surplus increasing or reducing revisions appear to cancel out over time.

Despite these difficulties, the track record has been mixed when basing the assessment on simple averages since 2000. The very expansionary fiscal stance in the 2002 budget (an election year) and the subsequent deteriorations of public finances led to a few years of non-compliance. In the following years, 2004 and 2005, the target was only met *ex post*, due to stronger than expected revenues, while the *ex ante* budgetary planning and the path for the central government balance projected in the respective convergence programmes did not conform with the target. More recently, however, the budgetary situation has improved markedly and the present budgetary policies appear to be well in line with the objective.<sup>15</sup>

### *The expenditure ceiling*

While the expenditure ceilings have been respected in all years, there is no clear principle for how the ceiling should be set. Moreover, there exists no direct link to the surplus target. During the first years the ceiling was set so as to reduce public expenditure and the central government expenditure ratio fell from 35 to 32 per cent of GDP. Since 2000, however, the ratio has remained rather stable. In 2006, the ceiling was set to increase at the same rate as potential GDP. Due to actual GDP growth outstripping potential growth the expenditure ratio actually fell. The expenditure ceiling 2007 was set to decrease as a share of potential GDP. Owing partly to GDP growth above potential and a policy aimed at lower expenditure, the expenditure ratio is expected to have fallen to below 30% of GDP in 2007.

The practical implementation of the expenditure ceilings suggests however that the contingency margins provided under the ceiling have been used to introduce additional discretionary spending. As a consequence, the margins have sometimes successively been shrinking and even eroded for individual years. According to the National Financial

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<sup>13</sup> See "The Government's monitoring of the surplus target", English summary of RiR 2006:27 [http://www.riksrevisionen.se/templib/pages/NormalWithIntrosPage\\_881.aspx](http://www.riksrevisionen.se/templib/pages/NormalWithIntrosPage_881.aspx)

<sup>14</sup> See "How reliable are the statistics for the Stability and Growth Pact", by Luis Gordo Mora (Banco de España) and Joao Nogueira Martins (DG ECFIN), European Economy - Economic Papers, No. 273 - February 2007.

<sup>15</sup> See "Economic trends and policy challenges", Economic Assessment of the Convergence Programme of Sweden (Update of December 2006), ECFIN/G1/2007/REP50672-EN, February 2007.

Management Authority, which closely monitors the execution of the budget, the contingency margin should be at least 1.5 percent of the expenditure ceiling, while in reality the actual margin has only been higher than 1 per cent of the ceiling on two occasions. This has had a negative impact on the room for active stabilisation policies and has also contributed to the use of flexible budget accounting.

In addition, the respect of the expenditure ceilings has sometimes also been achieved by using the leeway provided by the ESA 95 rules and shifting payments across years or treating certain expenditure as tax credits. The shifting of expenditure may not necessarily be a problem as long as the ceilings are not revised. The habit of treating certain expenditure as tax credits is however more questionable from the point of view of meeting expenditure ceiling as they are recorded on the revenue side of the budget. These expenditures are therefore not subject to the ceilings and risk reducing the transparency of the budgetary process as well as undermining the rationale for the expenditure ceiling.

Finally, since 2002 until recently, the government has abstained from establishing a ceiling for the third year in the future. As a consequence, the framework has become gradually more short-term oriented and the medium-term orientation has mainly been ensured on the basis of projections for the subsequent years provided in the budget.

#### *The balanced budget rule*

The requirement of balanced budgets has contributed to a marked improvement of local government's financial situation. Since 1997, local authorities have generally recorded small surpluses or deficits, broadly in line with the balanced budget rule. However, balanced budgets are not a sufficient condition for ensuring fiscal prudence. As exemplified by the developments in the late 1990s and the first years of the new millennium, it has not effectively managed to contain pro-cyclical expansions in good times. As local government revenue grew strongly in line with an overall strong economy an expansion of consumption was facilitated. In the back-drop of the economic slow-down in 2001, this expansion became visible and during the 2001-2003 period, the local government sector as a whole recorded deficits of about 0.2-0.5% of GDP. While measures were taken to curb the growth in local government consumption in 2003 and 2004, the average local tax rate also had to be increased in both years, in total by about 1 percentage point (see Table 1). In 2004, the sector showed a small surplus again, partly owing to increased sales of real estate and a further tax increase. Since then the average tax rate has remain at the same level and the tax increases have largely neutralised the central government's efforts of lowering income taxes in order to promote incentives to work.

**Table 1 : Average local government tax rate 2001- 2007, % of labour income**

2001	2002	2003	2004	2005	2006	2007
30.5	30.5	31.2	31.5	31.6	31.6	31.6

*Source: Swedish Ministry of Finance*

The financial problems at the local level also had an impact on the central level. As there is an implicit commitment by the government to secure the provision of public services, the central government responded in 2001 and 2002 with significant increases in state support to uphold local services. This increase in government support was made up of both direct support and effects of tax shifts increasing local government tax revenue (see Table 2). With support to local governments representing about 15% of central

government expenditure, increased government support contributed to the deterioration of public finances. The strengthening of the system for state support to local governments and the introduction of the requirement of prudent economic management at the local level has contributed to reducing the overall level of direct government support. However, the implicit bail-out commitment still remains and may contribute to moral hazard problems that undermine the balanced budget rule, by still not sufficiently stressing the need for prudent policies also in good times.

In 2006, the local government sector as a whole showed a small surplus of about 0.4% of GDP. Moreover, almost all individual local governments recorded a positive result (280 out of 290 municipalities and 18 out of 20 county councils), compared with 2004, when about 40% of all municipalities and 60% of all county councils did not meet the balanced budget requirement. Looking forward, the financial situation is expected to remain fairly healthy in coming years with continued surpluses, albeit gradually smaller. Looking even further ahead, considering that local governments are notably responsible for health and elderly care, the effect of ageing populations will be felt by them. According to the Swedish government, the currently healthy position will provide room for an increase in local government consumption by about 1.7% in 2008 and about 0.7% in 2009 and 2010 in real terms, without endangering the soundness of local government finances. It would however point to the need to slow down local government consumption growth compared with 2006, when real consumption increased by 2%.

**Table 2: Local government finances 1997-2006 (% of GDP)**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
<b>Revenue</b>	<b>22.1</b>	<b>23.4</b>	<b>23</b>	<b>22.2</b>	<b>22.6</b>	<b>23</b>	<b>23.4</b>	<b>23.1</b>	<b>23.6</b>	<b>23.3</b>
Taxes	15.4	15.4	15.4	15.2	15.7	16	16.4	16.4	16.3	16.1
Central gov. support	4.3	5.5	5.3	5	5	5	5	4.8	5.3	5.3
Other	2.5	2.5	2.4	2	1.9	2	2	2	1.9	1.9
<b>Expenditure</b>	<b>22.6</b>	<b>23.2</b>	<b>22.9</b>	<b>22</b>	<b>22.8</b>	<b>23.6</b>	<b>23.6</b>	<b>22.9</b>	<b>23</b>	<b>22.9</b>
Consumption	18.4	19.3	19.1	18.6	19.2	19.9	20.1	19.8	19.7	19.5
Other	4.2	3.9	3.8	3.4	3.6	3.7	3.5	3.1	3.3	3.4
<b>Net lending</b>	<b>-0.5</b>	<b>0.2</b>	<b>0.1</b>	<b>0.2</b>	<b>-0.2</b>	<b>-0.5</b>	<b>-0.2</b>	<b>0.2</b>	<b>0.6</b>	<b>0.4</b>

### 2.3. Further developments

The shortcomings with the budgetary framework have been acknowledged by the Swedish government and in the context of the 2007 Spring Budget Bill various measures were announced that address some of these shortcomings.

The main measures that have already been announced and partly implemented are the following:

First, as regards the surplus target, the government presented a new measure for assessing the fulfilment, which will be used as one important indicator among other. The new indicator is a 7-year moving average, made up by the actual or projected budget balance for the three preceding years, the current year and the three following years. The indicator expected to increase transparency of the objective and also make it easier to assess compliance. Increased transparency of the surplus target, together with more explicit explanations of the considerations on which the expenditure ceilings are set, is also foreseen to strengthen the link between the expenditure ceilings and the surplus target.

Second, the government confirmed the principle of multi-annual expenditure ceilings and the need for a budgetary margin. It was noted that this margin should provide room for possible unexpected expenditure and for possible active measures that may be considered needed to stabilise the economy and not for regular expenditure. To ensure the medium-term orientation of the expenditure ceilings, the government also declared that it would return to the principle of defining ceilings for three years, instead of lately only for two years. Moreover, it was announced that the expenditure ceiling would be set in relation to the development of the government balance and with the view that central government expenditure as a share of GDP decrease over time.

Third, the government stated that the practice of recording certain expenditure as tax reductions on the revenue side of the budget is to be discontinued and more strictly impose the policy of gross accounting of all expenditure. There is also a clear intention to take further measures to further enhance the transparency of the expenditure ceiling in the near future.

Finally, a Fiscal Policy Council has been established that will be responsible for following-up on and examine the targets for fiscal policy. The Council will be responsible for assessing the aim of fiscal policy and to what extent it contributes to the achievement of long-term sustainability, long-term economic growth and full employment. This Council will be an authority under the government and will present its assessment of public finances in a yearly report to the government.

## 2.4. Conclusions

Public finances in Sweden are strong by EU standards. The national rules-based budget framework that guides fiscal policy is overall well designed, economically adequate and has contributed to a marked consolidation of public finances. Many of the shortcomings that have been identified with the framework are also currently being addressed. Announced measures go in the right direction by enhancing transparency of the rules. While it is too early to assess the exact impact of announced measures, certain features of the framework seem to warrant further consideration.

First, while the new 7-year indicator for assessing the fulfilment of the surplus target is only one indicator among others, the forward-looking element of the indicator may create incentives for optimistic economic forecasts on which the government budget is based. Such incentives may in particular arise in situations when the surplus target is likely to be binding. By basing the budget on favourable assumptions and for example an optimistic scenario for labour market developments, the government may seemingly respect the surplus target *ex ante* and thereby postpone the consolidation effort to later years. In this perspective, it would seem advisable that the quality of the governments economic forecasts are regularly assessed.<sup>16</sup> Moreover, it is important that the new indicator will be interpreted with some caution and that the surplus target *de facto* will continue to be assessed also against other indicators, as intended by the government.

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<sup>16</sup> According to the Swedish National Audit Office the macroeconomic data underlying the budget bills are of good quality in many respects. However, they have pointed out that there has been a systematic underestimation of open unemployment. They have also suggested that it might be advisable to present a risk assessment and documentation of the methods and models used in the macroeconomic forecasts. See "The macroeconomic forecasts in the budget bills", English summary of RiR 2006:23. [http://www.riksrevisionen.se/templib/pages/NormalWithIntrosPage\\_881.aspx](http://www.riksrevisionen.se/templib/pages/NormalWithIntrosPage_881.aspx)

Second, large revisions of fiscal data also complicate the ex-post assessment of the surplus target. Whereas the assessment of compliance with the surplus target has been made easier with the recent clarification of the time-frame for which the target has to be achieved, more reliable fiscal turn-out data would further enhance the assessment of compliance with the surplus target.

Third, while the revised rules clarify the recording of expenditures, the link between the setting of expenditure ceiling and the surplus target still remains weak. In the ongoing work aimed at further strengthening the budgetary framework it would seem desirable that the expenditure ceilings are more clearly set in line with budgetary objectives, so that they more directly contribute to the government's objective of reducing expenditure to GDP ratio over time.

Fourth, the framework does not contain elements that directly address the problem of pro-cyclical fiscal policies. In times of large budget surpluses and a surplus target that is not restraining public finances, the government can respect the target while at the same time implementing rather expansive fiscal policies. Moreover, the implicit commitment by the central government to provide support to local authorities in case of financial distress may also provide incentives for expansionary policies in good times. The balanced budget requirement of local government is conducive to good financial management but does not appear to be a sufficient tool to limit expenditure growth when revenue growth is strong and to ensure prudent financial management over time.

Finally, in view of the future effects of ageing populations and with a view to ensuring fiscal sustainability, it would seem important that the current strong tax revenues at the local level do not translate into an expansion of local government consumption, as was the case in the late 1990s and in the beginning of the new millennium. If not, needs to increase local taxes may emerge that would interfere with the central government's policy of lowering taxes and increasing incentives to work. Moreover, considering that the level of taxation is among the highest in the EU, the scope for adjusting the budget on the revenue side is limited and emphasises the need for reducing public expenditure as a share of GDP over time.



### 3. MACROECONOMIC OUTLOOK

This section assesses the plausibility of the macroeconomic scenario (economic activity, labour market, costs and prices) underpinning the public finance projections of the programme. It also examines whether good or bad economic times in the sense of the Stability and Growth Pact prevail.

#### 3.1. Economic activity

The outlook for economic activity in the updated programme remains rather bright. The cyclical conditions are also favourable, with a positive and increasing output gap in 2008. Nevertheless, after growing by 4.1% in 2006, economic activity has entered into a more mature phase in 2007 and GDP growth is expected to gradually decelerate over the programme period (see Table 3). In 2007 and in 2008, the economy is projected to grow by 3.2%, which is still in line with the average growth recorded over the 1996-2005 period, but is thereafter forecast to continue its slowdown to 2.5% in 2009 and 2.2% in 2010 (see Annex 2).<sup>17</sup>

The more mature economic growth development is also demonstrated by the composition of demand with a continued strong domestic economy but deteriorating external demand. Domestic demand is boosted in particular by strong investment growth and a pick-up in private consumption. External demand and notably export growth for goods has declined, notably due to a weakening in the international investment cycle and slower economic activity in the US. Over the programme period, private consumption is forecast to remain robust, supported by favourable domestic conditions, such as a marked increase in disposable incomes and a continued increase in employment. While export growth is foreseen to recover somewhat, net exports are still foreseen to contribute only marginally to economic growth as the strong private consumption is increasing the demand for imports. In parallel, investment growth is expected to normalise as interest rates are increasing and monetary conditions tighten.

The programme is based on overall plausible macroeconomic assumptions. Both the outlook for economic activity and the composition of growth in the programme are similar to the Commission services' autumn forecast for the 2007-2009 period. It is also broadly in line with Commission services' estimate for potential growth. National accounts' data for the third quarter 2007, released on 30 November 2007, confirm the picture of strong domestic growth, in particular private consumption, and weak external demand. However, indicators for the EU as a whole and the Swedish quarterly data point to a possible sharper deceleration of economic activity than envisaged in the programme and in the Commission services' forecast. While this points to a negative risk as concerns the GDP growth outlook in the programme, it is too early to draw any firm and precise conclusions from the quarterly data for 2008 and the period up until 2010.

Based on the information provided in the programme and on the basis of the Commission services' calculations of the output gap according to the commonly agreed methodology, the level and the path for the changes of the output gap are similar. The output gaps are estimated to remain positive over the programme period, but to decrease after peaking in

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<sup>17</sup> The external outlook behind the programme is broadly in line with that in the Commission services' autumn 2007 forecast for most variables. However, the oil price assumptions for 2008 and 2009 in the programme are significantly lower than those applied in the autumn forecast.

2008. This confirms the assumptions that the Swedish economy will be operating at or slightly above potential throughout the programme period.

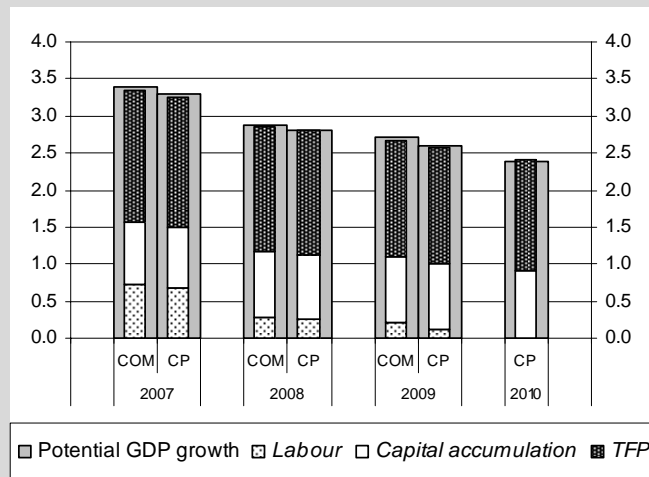
**Table 3: Comparison of macroeconomic developments and forecasts**

	2007		2008		2009		2010
	COM	CP	COM	CP	COM	CP	CP
Real GDP (% change)	3.4	3.2	3.1	3.2	2.4	2.5	2.2
Private consumption (% change)	3.0	3.0	3.5	3.8	3.0	3.2	2.3
Gross fixed capital formation (% change)	10.1	9.4	4.6	4.6	2.5	3.5	3.4
Exports of goods and services (% change)	5.6	5.3	6.0	6.0	5.7	6.0	6.0
Imports of goods and services (% change)	7.2	7.4	6.4	6.5	6.0	6.5	6.3
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	3.7	3.5	2.8	3.0	2.1	2.3	1.8
- Change in inventories	0.0	0.2	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.3	-0.5	0.3	0.3	0.3	0.2	0.3
Output gap <sup>1</sup>	0.6	0.3	0.8	0.6	0.5	0.5	0.3
Employment (% change)	2.0	2.3	1.0	1.2	0.3	0.3	-0.2
Unemployment rate (%) <sup>2</sup>	6.1	4.4	5.8	4.0	5.7	4.1	4.3
Labour productivity (% change)	1.4	0.6	2.1	1.7	2.0	2.2	1.7
HICP inflation (%)	1.6	1.7	2.0	2.7	2.0	2.5	2.1
GDP deflator (% change)	2.4	3.0	2.5	2.6	2.4	3.0	2.7
Comp. of employees (per head, % change)	4.2	4.6	4.3	2.1	4.2	4.8	4.2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.0	7.1	6.9	7.2	7.2	7.4	7.7
<b>Note:</b>							
<sup>1</sup> In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.							
<sup>2</sup> Data in convergence programme is based on national definition							
<i>Source:</i>							
Commission services' autumn 2007 economic forecasts (COM); Convergence programme (CP)							

### Box 1: Potential growth and its determinants

On the basis of the macroeconomic scenario in the programme and the Commission services' calculations according to the commonly agreed methodology, potential GDP growth is estimated to gradually fall over the programme period, from above 3% in 2007 to below 2.5% in 2010. A lower contribution is expected to come from labour, while the contribution from Total Factor Productivity is estimated to remain strong and the contribution from capital accumulation is forecast to increase slightly. This is in line with potential growth rates according to the Commission services' autumn 2007 forecast for the period up until 2009 and it is also broadly in line with trend growth over the past 10 years (see Annex 2).

#### Potential growth and its determinants



### 3.2. Labour market and cost and price developments

The improvement of the labour market, which was initiated by the cyclical upturn in 2006, is expected to continue over the programme period. It is foreseen to be sustained by policy measures aimed at increasing labour supply and employment, including lower income taxes, labour market measures, as well as reforms of unemployment and sickness insurance systems.

Employment growth is set to increase by more than 2% in 2007, in response to already enacted reforms, and is expected to continue to grow robustly also in 2008, by about 1.2%. As employment is forecast to grow faster than labour supply, the unemployment rate is also estimated to come down further. After 2008, however, employment is projected to grow somewhat slower than labour supply and a small pick-up in the unemployment rate is expected towards the end of the programme period.

With a relatively strong increase in employment growth in the programme, the labour content of economic growth is expected to intensify and to contribute markedly more than the historical average in 2007 and 2008.

The scenario for employment and unemployment is consistent with the cyclical conditions in the programme, measured by the output gap. It is also similar to the scenario presented in the Commission services' autumn forecast. The outlook for inflation in the programme is somewhat less favourable than in the Commission services' autumn forecast, but is plausible considering the continued increase in oil prices since October, when the underlying assumptions in the forecast were fixed.

Low resource utilisation on the labour market, moderate wage growth and strong productivity growth have in previous years helped to keep firms' labour costs down and contributed to low inflation. As employment is set to continue to grow strongly and more

firms are starting to report shortages of labour, wages are expected to increase more rapidly over the programme period. This is also supported by the outcome of the 2007 wage negotiation round covering the three year period up until 2009, with average yearly nominal wage increases above 4%.

Higher wage growth, combined with weaker productivity growth than in recent years is predicted to increase unit labour costs, to add to inflationary pressures and to have a negative impact on competitiveness and export growth. However, a strengthening of the Swedish krona exchange rate and falling oil prices are expected to hold inflation back somewhat. At the same time, a stronger krona is foreseen to reduce competitiveness and export growth, in line with the development of external demand presented in the programme.

**Box 2: The Riksbank is publishing its forecast for the repo rate**

In February 2007, the Sveriges Riksbank (the Riksbank) decided to publish its own forecasts for the key policy interest rate (the repo rate). The main aim with publishing its own forecasts is to enhance transparency of monetary policy.

Up to late 2005, the Riksbank based its inflation forecasts on the assumption that the repo rate would remain constant during the forecast period. This assumption was easily understood by financial markets and the general public but had the weakness of being unrealistic. Moreover, it gave no clear guidance as to how the Riksbank viewed future interest rate developments. In order to mitigate these problems, the Executive Board decided to base its forecast on market expectations, as reflected in implied forward rates. However, basing forecasts on market expectations may give rise to problems if the market's view differs from the central bank's view of a reasonable future development for the policy rate. In addition, the interpretation of implied forward rates is not clear-cut as forward rates include risk premiums related to e.g. credit and liquidity risks. Estimating these premiums is complicated and can be disputed.

Thus, the Riksbank decided to make its own forecasts for the repo rate and to publish this forecast. This would give them the opportunity to explain more clearly how it envisages future interest rate developments and how it reasons when making monetary policy decisions. Nevertheless, there are problems also with this approach.

In particular, new information is constantly received and leads to a new interest rate path. Frequent altering of the communicated interest rate path might be perceived as a weakness in the central bank's analytical capacity. However, the Riksbank has so far not seen this as a major problem. They assume that it should be possible to avoid risks to credibility by emphasising that there is considerable uncertainty in the assessments and that there is a constant flow of new information, which may radically change the conditions for monetary policy assessments. Moreover, the Riksbank has at several occasions stressed that the published interest path does not constitute an explicit commitment.

In response to increasing underlying inflationary pressures the Riksbank has continued to raise the key policy interest rate (the repo rate) by in total 1 p.p. to 4%, in four steps during 2007. It has also announced that a further tightening by 0.25 p.p. is likely to be necessary in course of the first half of 2008 (see Box 2) to ensure that inflation develops in line with the target of 2%.

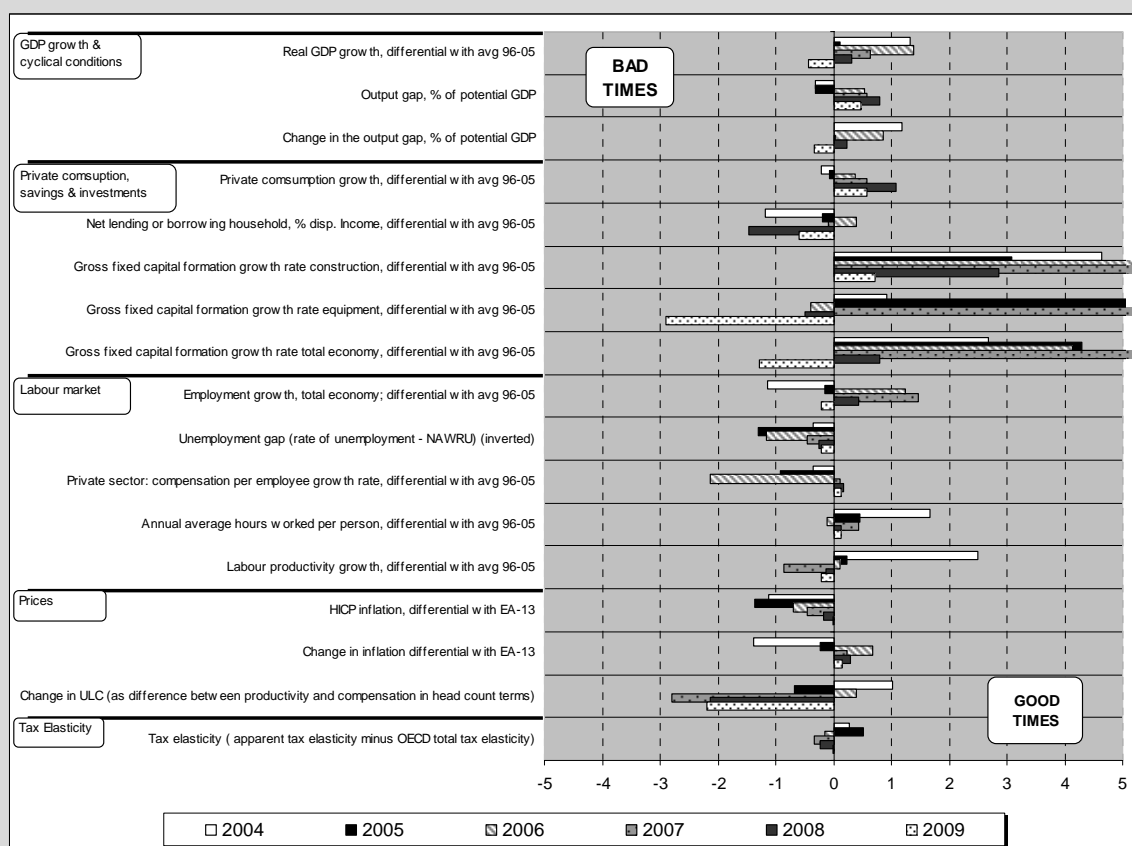
### Box 3: Good or bad economic times?

According to the code of conduct, the assessment of whether the economy is experiencing good or bad economic times starts from the output gap, but draws on an overall economic assessment, which should also take into account tax elasticities. The figure below presents a set of macroeconomic indicators drawn from the Commission services' autumn 2007 forecast. Overall, in the near term the economy seems to be in good economic times taking into account tax elasticities.

According to the Commission services' autumn forecast, the output gap is estimated to remain positive in 2007-2009, suggesting that the Swedish economy will remain in good times over the entire period. However, the development of other relevant variables, notably the change in the output gap; annual real GDP growth compared with the average growth level recorded over the 1996-2005 period; and gross fixed capital formation, point to a gradual normalisation of economic times towards the end of the period. On the basis of recent indicators about economic activity in the EU as a whole and in Sweden, it is possible that this normalisation may materialise somewhat earlier than implied in the programme and the Commission services' forecast.

The assessment of tax elasticities is complicated by various discretionary measures, including reduction of income taxes and the abolition of wealth taxes from 2007, but does not appear to contradict the assumption of good economic times in 2007 and 2008.

#### Good versus bad times



#### 4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first part discusses budgetary implementation in the year 2007 and the second presents the medium-term budgetary strategy in the new update. The third analyses the risks attached to the budgetary targets in the programme. The final part assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact.

##### 4.1. Budgetary implementation in 2007

Table 4 compares the 2007 revenue and expenditure targets (as a percentage of GDP) from the previous update of the convergence programme with the results of the Commission services' autumn 2007 forecast. The difference between the revenue and expenditure targets for 2007 and the projected outcome is decomposed into a base effect, a GDP growth effect on the denominator and a revenue / expenditure growth effect<sup>18</sup>:

- The base effect captures the part of the difference that is due to the actual outcome for 2006 being different from what was projected in the previous update in the programme (either because the actual revenue / expenditure level in 2006 was different from the estimated outturn in the previous programme or because GDP turned out to be different from the scenario in the previous update of the programme). The base effect therefore also captures the effect of revisions to the GDP series.
- The GDP growth effect on the denominator captures the part of the difference that is related to current GDP growth projections for 2007 turning out higher or lower than anticipated in the previous update of the programme (therefore reducing / increasing the denominator of the revenue and expenditure ratio).
- The revenue / expenditure growth effect captures the part of the difference related to the revenue / expenditure growth rate in 2007 turning out to be higher or lower than targeted in the previous update of the programme. This would typically be due to GDP developments different from those expected in the previous update of the programme, or as a result of apparent tax elasticities different from the ex ante tax elasticities (or both).

Both according to the Commission services' autumn forecast and the programme update the budgetary outcome for 2007 is projected to be about 1.8% of GDP better than targeted in the previous programme (see also Table 7). The better than targeted balance is in large part due to a base effect reflecting a higher-than-projected surplus in 2006, by about 0.7% of GDP, than in the previous programme. However, it is also an effect of the stronger-than-anticipated labour market in 2007, implying higher revenue and to a lesser extent also lower expenditure ratios to GDP (see Table 4). The composition of GDP growth also contributes, in so far as domestic demand and in particular private consumption is one of the main drivers of economic activity.

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<sup>18</sup> A fourth, residual component is usually small, except if there are very large differences between the autumn forecast and the target (the full mathematical decomposition is in the methodological paper mentioned above).

**Table 4: Budgetary implementation in 2007**

	2006		2007	
	Planned <sup>1</sup>	Outcome	Planned <sup>1</sup>	Outcome
	CP Dec 2006	COM	CP Dec 2006	COM
Revenue (% of GDP)	57.3	57.8	55.2	56.7
Expenditure (% of GDP)	55.4	55.4	53.8	53.6
Government balance (% of GDP)	1.8	2.5	1.2	3.0
Nominal GDP growth (%)			6.2	5.9
Nominal revenue growth (%)			2.3	3.8
Nominal expenditure growth (%)			3.1	2.6
<b>Revenue surprise compared to target (% of GDP)</b>			<b>1.5</b>	
<i>Of which</i> <sup>2</sup> : 1. Base effect			0.5	
2. GDP growth effect on the denominator			0.2	
3. Revenue growth effect			0.8	
<i>Of which: due to a marginal elasticity of total revenue w.r.t. GDP larger than</i> <sup>3</sup>			0.9	
<b>Expenditure surprise compared to target (% of GDP)</b>			<b>-0.2</b>	
<i>Of which</i> <sup>2</sup> : 1. Base effect			0.0	
2. GDP growth effect on the denominator			0.2	
3. Expenditure growth effect			-0.3	
<b>Government balance surprise compared to target (% of GDP)</b>			<b>1.8</b>	
<i>Of which:</i> 1. Base effect			0.5	
2. GDP growth effect on the denominator			0.0	
3. Revenue / expenditure growth effect			1.0	
<b>Notes:</b>				
<sup>1</sup> Adjusted for the impact of the Eurostat decision of 2 March 2004 on the classification of funded pension schemes, which was implemented at the time of the spring 2007 EDP notification				
<sup>2</sup> A positive base effect points to a higher-than-anticipated outcome of the revenue / expenditure ratio in 2006. A positive GDP growth effect (on the denominator) indicates lower-than-anticipated economic growth in 2007. A positive revenue / expenditure growth effect points to higher-than-anticipated revenue / expenditure growth in 2007. The three components may not add up to the total because of a residual component, which is generally small.				
<sup>3</sup> Equal to (2)+(3). A positive sign means that the marginal elasticity of revenue with respect to GDP exceeds one.				
<i>Source:</i> Commission services				

As in 2006, the programme considers that extraordinarily high revenue for taxes on realised capital gains in 2007 (above a long-term average) is of a temporary nature and, hence, has an effect on the structural balance (about 0.4% of GDP). In the Commission services' autumn forecast, however, this revenue is not defined as a one-off or temporary measure, as it is not linked to an active policy decision.

On the basis of the assessment of the previous convergence programme the Council commended Sweden for its medium-term budgetary position and also its budgetary strategy. However, in the Council opinion of 27 February 2007, it was also pointed out that "..., it will be important to contain the risk of pro-cyclicality by ensuring that a deterioration of the structural budgetary position in 2007, which is linked to structural reforms aimed at encouraging greater participation in the labour market, will not spill over to subsequent years." While this invitation is mainly forward looking, it should be noted that the actual budgetary stance in 2007, measured as the change in the structural balance recalculated by the Commission, is estimated to be restrictive (see Table 5). Instead of an estimated reduction of the structural balance in 2007 by 0.8 p.p., the balance is in the present programme foreseen to improve significantly in 2007. Also when excluding the impact on the structural balance of the temporary effects of the above mentioned extraordinarily high realised capital gains, an improvement of the structural balance of a similar magnitude is foreseen.

## **4.2. The programme's medium-term budgetary strategy**

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with the one in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

### *4.2.1. The main goal of the programme's budgetary strategy*

The programme confirms the overall fiscal policy framework presented in previous convergence programmes. The strategy, which was introduced over the 1997-2000 period, aims at ensuring sustainable government finances; an even distribution of resources between generations; a predictable development of taxes and expenditure; and adequate margins against large deficits in recessions. The guiding principle of the fiscal strategy is a surplus target for the general government balance,

The main goal of the medium-term budgetary strategy in the programme is to achieve a nominal budget surplus of 1% of GDP on average over the business cycle, supported by multi-annual expenditure ceilings for the central government and a balanced budget requirement for local governments (cf. also section 2.1). The surplus target put forward in the programme corresponds to Sweden's MTO of a 1% of GDP structural surplus (i.e. cyclically adjusted surplus net of one-off and temporary measures), which is projected to be maintained throughout the programme period.

As reported in section 2.3, the surplus target has been revised down from 2% to 1% of GDP in the update, in response to the implementation as from April 2007 of the March 2004 Eurostat decision on the recording of second-pillar pension funds outside the government sector. This downward revision is, however, purely technical and the new surplus target confirms the same level of fiscal ambition as the earlier target.

Compared with the 2006 programme, the nominal budgetary targets have been markedly revised upwards in the update against a broadly similar macroeconomic background. This upward revision follows partly from the better than expected outcome for 2006 and partly from a stronger labour market in 2007, which had a more favourable impact on revenue and, to a lesser extent, on expenditure than anticipated. The macroeconomic outlook underlying the budgetary targets is overall largely similar to that in the previous update. The forecast for GDP growth has been slightly adjusted downwards for 2007 and 2008, while unemployment and employment variables are more positive in the updated programme, reflecting a marked improvement in the course of 2007.

Owing to further tax cuts in 2008, the nominal budgetary surplus is predicted to fall slightly from 3.0% of GDP in 2007 to 2.8% of GDP in 2008. The balance is thereafter projected to improve slightly to 3.1% of GDP in 2009 and further to 3.6% of GDP in 2010. The same holds true for the change in the primary balance and the structural balance. With no foreseen one-off or temporary effects contributing to the adjustment, the structural balance is, on the basis of the Commission services' calculations of the output gap according to the commonly agreed methodology, forecast to improve by some  $\frac{3}{4}$  percentage points of GDP in 2009 and about  $\frac{1}{2}$  percentage points of GDP in 2010.



**Table 5: Evolution of budgetary targets in successive programmes**

		2006	2007	2008	2009	2010
General government balance (% of GDP)	<b>CP Nov 2007</b>	<b>2.5</b>	<b>3.0</b>	<b>2.8</b>	<b>3.1</b>	<b>3.6</b>
	<i>CP Dec 2006</i>	<i>1.8</i>	<i>1.2</i>	<i>1.5</i>	<i>2.0</i>	<i>n.a.</i>
	COM Nov 2007	2.5	3.0	2.8	3.0	n.a.
General government expenditure (% of GDP)	<b>CP Nov 2007</b>	<b>55.0</b>	<b>53.3</b>	<b>52.6</b>	<b>51.8</b>	<b>51.1</b>
	<i>CP Dec 2006</i>	<i>55.4</i>	<i>53.8</i>	<i>53.0</i>	<i>52.3</i>	<i>n.a.</i>
	COM Nov 2007	55.4	53.6	53.0	52.6	n.a.
General government revenue (% of GDP)	<b>CP Nov 2007</b>	<b>57.5</b>	<b>56.3</b>	<b>55.5</b>	<b>54.9</b>	<b>54.6</b>
	<i>CP Dec 2006</i>	<i>57.3</i>	<i>55.2</i>	<i>54.7</i>	<i>54.4</i>	<i>n.a.</i>
	COM Nov 2007	57.8	56.7	55.8	55.6	n.a.
Structural balance <sup>1</sup> (% of GDP)	<b>CP Nov 2007</b>	<b>1.7</b>	<b>2.4</b>	<b>2.1</b>	<b>2.8</b>	<b>3.4</b>
	<i>CP Dec 2006</i>	<i>1.8</i>	<i>1.0</i>	<i>1.3</i>	<i>1.9</i>	<i>n.a.</i>
	COM Nov 2007	2.1	2.7	2.3	2.6	n.a.
Real GDP (% change)	<b>CP Nov 2007</b>	<b>4.2</b>	<b>3.2</b>	<b>3.2</b>	<b>2.5</b>	<b>2.2</b>
	<i>CP Dec 2006</i>	<i>4.0</i>	<i>3.3</i>	<i>3.1</i>	<i>2.7</i>	<i>n.a.</i>
	COM Nov 2007	4.2	3.4	3.1	2.4	n.a.
<b>Note:</b>						
<sup>1</sup> Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. One-off and other temporary measures are 0.5% of GDP in 2006, 0.4% in 2007 and 0.3% in 2008; all deficit-reducing according to the most recent programme and 0.2% of GDP in 2009; deficit-reducing according to the Commission services' autumn forecast. The Commission services do not take into account the effect identified in the programme for 2006 and 2007 in its assessment as they are not considered as one-offs or other temporary measures.						
<b>Source :</b>						
<i>Convergence programmes (CP); Commission services' autumn 2007 economic forecasts (COM)</i>						

In 2008, the structural balance is estimated to weaken by about ¼ percentage point, indicating a mildly expansionary fiscal stance. The weakening is importantly due to a further reduction of income taxes amounting to about 0.6% of GDP in 2008, which is only partly financed by other revenue-increasing and expenditure-decreasing measures (see Box 4). As mentioned above, however, the programme considers that extraordinarily high revenue for taxes on realised capital gains in 2007 to be of a temporary nature and to have an effect on the structural balance (of about 0.4% of GDP). Excluding this "temporary" effect in 2007, which is not linked to a policy measure, the structural deterioration in 2008 would be somewhat more pronounced. Nevertheless, the effect is linked to a normalisation of revenue and the standard sensitivities used in the Commission calculations of the cyclical component, and hence the cyclically-adjusted balances, are unlikely to fully capture the "cyclical" effects on asset prices. Considering the uncertainty about these revenues, the change in the structural balance needs to be interpreted carefully when assessing the fiscal stance.

#### 4.2.2. *The composition of the budgetary adjustment*

As in the previous programme both revenue and expenditure ratios are projected to decline gradually over the programme period. This declining trend is mainly due to the mentioned structural reforms aimed at increasing incentives to work, notably lower income taxes as well as new rules applying to unemployment and sickness insurance systems. The expenditure ratio is estimated to be reduced rather evenly over the whole period covered by the programme, by in total 2.2 percentage points of GDP. The reduction of the revenue ratio, on the other hand, is slightly more frontloaded, as income tax cuts become effective in 2007 and 2008. Overall, the revenue ratio is forecast to fall by in by 1.7 percentage points of GDP.

**Table 6: Composition of the budgetary adjustment**

(% of GDP)	2006	2007	2008	2009	2010	Change: 2010-2007
<b>Revenue</b>	<b>57.5</b>	<b>56.3</b>	<b>55.5</b>	<b>54.9</b>	<b>54.6</b>	<b>-1.7</b>
<i>of which:</i>						
- Taxes on production and imports	17.1	17.2	18.3	17.8	17.6	<b>0.4</b>
- Current taxes on income, wealth, etc.	20.2	18.9	18.6	18.8	18.8	<b>-0.1</b>
- Social contributions	12.9	13.1	11.5	11.3	11.3	<b>-1.8</b>
- Other (residual)	7.3	7.1	7.1	7.0	6.9	<b>-0.2</b>
<b>Expenditure</b>	<b>55.0</b>	<b>53.3</b>	<b>52.6</b>	<b>51.8</b>	<b>51.1</b>	<b>-2.2</b>
<i>of which:</i>						
- Primary expenditure	53.3	51.7	51.1	50.4	49.8	<b>-1.9</b>
<i>of which:</i>						
Compensation of employees	15.5	15.5	15.2	15.1	15.0	<b>-0.5</b>
Intermediate consumption	10.1	9.8	9.7	9.5	9.3	<b>-0.5</b>
Social payments	19.7	18.6	18.0	17.8	17.7	<b>-0.9</b>
Subsidies	1.6	1.5	1.5	1.4	1.4	<b>-0.1</b>
Gross fixed capital formation	3.1	3.0	3.0	2.9	2.9	<b>-0.1</b>
Other (residual)	3.3	3.3	3.7	3.5	3.5	<b>0.2</b>
- Interest expenditure	1.7	1.6	1.5	1.4	1.3	<b>-0.3</b>
<b>General government balance (GGB)</b>	<b>2.5</b>	<b>3.0</b>	<b>2.8</b>	<b>3.1</b>	<b>3.6</b>	<b>0.6</b>
<b>Primary balance</b>	<b>4.2</b>	<b>4.6</b>	<b>4.4</b>	<b>4.5</b>	<b>4.8</b>	<b>0.2</b>
One-off and other temporary measures	0.5	0.4	0.3	0.0	0.0	<b>-0.4</b>
<b>GGB excl. one-offs</b>	<b>2.0</b>	<b>2.6</b>	<b>2.5</b>	<b>3.1</b>	<b>3.6</b>	<b>1.0</b>
Output gap <sup>1</sup>	0.6	0.3	0.6	0.5	0.3	<b>0.0</b>
Cyclically-adjusted balance <sup>1</sup>	2.2	2.8	2.4	2.8	3.4	<b>0.6</b>
<b>Structural balance<sup>2</sup></b>	<b>1.7</b>	<b>2.4</b>	<b>2.1</b>	<b>2.8</b>	<b>3.4</b>	<b>1.0</b>
<i>Change in structural balance</i>		0.8	-0.3	0.7	0.6	
Structural primary balance <sup>2</sup>	3.4	4.0	3.6	4.2	4.7	<b>0.7</b>
<i>Change in structural primary balance</i>		0.7	-0.4	0.6	0.5	
<b>Notes:</b>						
<sup>1</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance as recalculated by Commission services on the basis of the information in the programme.						
<sup>2</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.						
<i>Source:</i>						
Convergence programme; Commission services' calculations						

In 2008, the budgetary adjustment partly hinges on revenue-increasing one-off that arises due to new rules for VAT on construction. These new rules will temporarily increase tax receipts of about 0.3% of GDP.

Other than the income tax cuts and the reforms of the unemployment and sickness insurance system mentioned above, the programme does not contain additional specific measures beyond 2008 and the targets therefore broadly correspond to a no-policy change scenario.

The overall development of general government lending is expected to be driven by developments at the central government level. While the surpluses from both the old-age pension system and local governments are projected to decline gradually over the programme period, increasing surpluses at central government level are set to more than compensate.

#### Box 4: The budget for 2008

On 20 September 2007, the government presented the budget proposal for 2008, entitled "Putting Sweden to work – increasing opportunities". The Budget was approved by the Riksdag (Parliament) on 20 December 2007.

The main new reforms presented in the 2008 budget aim at creating clearer incentives to work and to better include groups currently outside the labour market. In addition to already announced measures, the single largest measure pertains to a further reduction of income taxes for low and middle income earners by means of a strengthened in-work tax credit. Lower income taxes are partly financed by a decline of expenditure related to the unemployment insurance and sickness insurance system as well as a reduction of labour market measures. Besides partly financing the income tax cut, these also aim at increasing labour supply and at better reintegrating people on long-term sick leave. On the revenue side higher taxes on tobacco and alcohol as well as increased 'green' taxes (CO<sub>2</sub>, energy and road traffic) contribute to the financing. The financing of the budget relies on indirect effects of tax measures of about 0.1% of GDP. Finally, the loss of revenue due to the abolition of the wealth tax as from 1 January 2007 is to some extent compensated in 2008 by a further limitation of the tax deductibility of yearly private pension fund savings. The effect on the budget of this measure is, however, limited.

Overall, new discretionary measures announced in the 2008 Budget amount to a small reduction of the surplus of about SEK 3.3 billion (-0.1% of GDP). Already announced measures correspond to an additional weakening of a good -0.1% of GDP. The overall effect on 2008 of new and earlier announced measures amounts to about -0.2% of GDP. Hence, the budget contributes to a small deterioration of the surplus of the general government balance, which is projected to fall to 2.8% in 2008, before increasing the following years up until 2010.

#### Main measures in the budget for 2008

Revenue measures*	Expenditure measures**
<ul style="list-style-type: none"><li>○ Taxes on labour (-0.6% of GDP)</li><li>○ Taxes on tobacco, alcohol and CO<sub>2</sub> (0.1% of GDP)</li><li>○ Other taxes on energy, environment and road traffic (0.1% of GDP)</li></ul>	<ul style="list-style-type: none"><li>○ Labour market measures; and unemployment and sickness insurance (-0.2% of GDP)</li><li>○ Sickness reform (-0.1% of GDP)</li><li>○ Grants to local governments (0.1% of GDP)</li></ul>

\* Estimated impact on general government revenues.

\*\* Estimated impact on general government expenditure.

Sources: Commission services and Swedish Ministry of Finance.

### 4.3. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2009, Table 7 compares the detailed revenue and expenditure projections in the Commission services' autumn 2007 forecast, which are derived under a no-policy change scenario, with those in the updated programme.

As noted in Section 3.1, the programme is based on overall plausible macroeconomic assumptions, though with some negative risk on the basis of more recent data, and the composition of growth in the programme is also similar to in the Commission services' forecast. The composition of growth and the fiscal projections in the programme are also comparable.

The risks to the budgetary projections in the programme appear broadly balanced. While GDP growth is projected to decelerate gradually over the programme period (see Section

3), the composition of growth still remains favourable from the point of view of public finances, notably with solid private consumption growth.

The programme includes a sensitivity analysis on public finances with respect to the uncertainty about actual economic developments and changes to the baseline scenario of which the programme is based. It presents two alternative scenarios: a 'high-growth scenario' and a 'low-growth scenario', which notably consider the consequences of higher or lower growth on the labour market and on productivity developments.

In the *low-growth scenario*, weak productivity growth is assumed to be more prolonged. Nominal wages, however, are not expected to adjust and, hence, wage growth is expected to remain high until the next major wage negotiation round in 2010. This will have a major impact on unit labour costs and translate into higher prices. As inflationary pressure builds up more quickly than in the base scenario, interest rates are set to increase more rapidly. Unemployment is foreseen to decline initially as firms must hire more staff to meet demand. Since wages are not adjusted, government revenue is estimated to increase as a share of GDP. However, government expenditure also increases. Higher inflation implies larger pension payments and transfer payments would increase, as they are linked to hourly wages. Overall, the expenditure ratio increases more than the revenue ratio, translating into a weakening of the budget balance compared with the base scenario by 0.1% of GDP in 2007 and 0.3% of GDP in 2008, 2009 and 2010, respectively.

In the *high-growth scenario*, government policies aimed at stimulating supply are expected to have a more rapid effect than in the base scenario. Productivity is however estimated to be lower due to the assumption that newly hired will have lower productivity than the average of those already employed. The sharp increase in the labour force implies that employment increases rapidly without resource utilisation in the labour market becoming more strained. As a result, wage growth and inflationary pressure are reduced. Lower interest rates and higher employment are expected to increase investment, household disposable income and private consumption. Higher consumption results in higher revenue from VAT, while expenditure linked to inflation declines both in nominal terms and as a percentage of GDP. Overall, compared with the base scenario, public finances are strengthened by 0.1% of GDP in 2007; 0.3% of GDP in 2008; and 0.5% of GDP in 2009 and 2010.

Commission services' simulations of the cyclically-adjusted balance under the assumptions of (i) a sustained 0.5 percentage point negative deviation from the real GDP growth projections in the programme over the 2007-2010 period, (ii) trend output based on the HP-filter and (iii) no policy response (notably, the expenditure level is as in the central scenario), reveal that, by 2010, the cyclically-adjusted balance would be 0.9 percentage point of GDP below the central scenario. Hence, in the case of persistently lower real growth, additional measures of around 0.9 percentage point of GDP would be necessary to keep the public finances on the path targeted in the central scenario.

As noted in Section 4.2.2 above, the programme provides sufficient information about the measures underlying the budgetary targets, thereby supporting the plausibility of the programme targets. Beyond 2008 these targets broadly correspond to a no-policy change scenario. The expected budgetary impacts of policy measures are also clearly spelled out in the programme.

**Table 7: Comparison of budgetary developments and projections**

(% of GDP)	2006	2007		2008		2009		2010
	COM	COM	CP	COM	CP	COM <sup>1</sup>	CP	CP
<b>Revenue</b>	<b>57.8</b>	<b>56.7</b>	<b>56.3</b>	<b>55.8</b>	<b>55.5</b>	<b>55.6</b>	<b>54.9</b>	<b>54.6</b>
<i>of which:</i>								
- Taxes on production and imports	17.1	17.1	17.2	18.2	18.3	17.9	17.8	17.6
- Current taxes on income, wealth, etc.	20.2	19.2	18.9	18.9	18.6	19.1	18.8	18.8
- Social contributions	13.2	13.2	13.1	11.6	11.5	11.5	11.3	11.3
- Other (residual)	7.3	7.2	7.1	7.1	7.1	7.1	7.0	6.9
<b>Expenditure</b>	<b>55.5</b>	<b>53.8</b>	<b>53.3</b>	<b>53.1</b>	<b>52.6</b>	<b>52.6</b>	<b>51.8</b>	<b>51.1</b>
<i>of which:</i>								
- Primary expenditure	53.7	52.0	51.7	51.5	51.1	51.1	50.4	49.8
<i>of which:</i>								
Compensation of employees	15.7	15.6	15.5	15.4	15.2	15.4	15.1	15.0
Intermediate consumption	9.7	9.6	9.8	9.4	9.7	9.3	9.5	9.3
Social payments	19.7	18.6	18.6	18.1	18.0	18.1	17.8	17.7
Subsidies	1.6	1.5	1.5	1.4	1.5	1.4	1.4	1.4
Gross fixed capital formation	3.1	3.0	3.0	3.1	3.0	3.0	2.9	2.9
Other (residual)	3.8	3.7	3.3	4.0	3.7	3.9	3.5	3.5
- Interest expenditure	1.8	1.8	1.6	1.6	1.5	1.4	1.4	1.3
<b>General government balance (GGB)</b>	<b>2.5</b>	<b>3.0</b>	<b>3.0</b>	<b>2.8</b>	<b>2.8</b>	<b>3.0</b>	<b>3.1</b>	<b>3.6</b>
<b>Primary balance</b>	<b>4.2</b>	<b>4.7</b>	<b>4.6</b>	<b>4.3</b>	<b>4.4</b>	<b>4.5</b>	<b>4.5</b>	<b>4.8</b>
One-off and other temporary measures	0.0	0.0	0.4	0.0	0.3	0.1	0.0	0.0
<b>GGB excl. one-offs</b>	<b>2.5</b>	<b>3.0</b>	<b>2.6</b>	<b>2.8</b>	<b>2.5</b>	<b>2.9</b>	<b>3.1</b>	<b>3.6</b>
Output gap <sup>2</sup>	0.5	0.6	0.3	0.8	0.6	0.5	0.5	0.3
Cyclically-adjusted balance <sup>2</sup>	2.1	2.7	2.8	2.3	2.4	2.8	2.8	3.4
<b>Structural balance<sup>3</sup></b>	<b>2.1</b>	<b>2.7</b>	<b>2.4</b>	<b>2.3</b>	<b>2.1</b>	<b>2.6</b>	<b>2.8</b>	<b>3.4</b>
<i>Change in structural balance</i>		<i>0.6</i>	<i>0.8</i>	<i>-0.4</i>	<i>-0.3</i>	<i>0.3</i>	<i>0.7</i>	<i>0.6</i>
Structural primary balance <sup>3</sup>	3.8	4.4	4.0	3.9	3.6	4.1	4.2	4.7
<i>Change in structural primary balance</i>		<i>0.5</i>	<i>0.7</i>	<i>-0.5</i>	<i>-0.4</i>	<i>0.2</i>	<i>0.6</i>	<i>0.5</i>
<b>Notes:</b>								
<sup>1</sup> On a no-policy-change basis.								
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.								
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
<b>Source :</b>								
<i>Convergence programme (CP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations</i>								

As also indicated in Section 4.2.2, the achievement of the budgetary target in 2008 partly hinges on a revenue-increasing one-off but its impact on the budget balance is well-specified and can be regarded as relatively certain. Over the remainder of the programme period, in 2009 and 2010, the achievement of the budgetary targets is not subject to one-offs or temporary measures.

**Table 8: Assessment of tax projections**

	2008			2009			2010
	CP	COM	OECD <sup>3</sup>	CP	COM <sup>1</sup>	OECD <sup>3</sup>	CP
Change in tax-to-GDP ratio (total taxes)	-0.8	-0.8	-0.2	-0.5	-0.2	-0.1	-0.2
Difference (CP – COM)	0.0		/	-0.4		/	/
<i>of which</i> <sup>2</sup> :							
- discretionary and elasticity component	-0.2		/	-0.2		/	/
- composition component	0.2		/	-0.1		/	/
Difference (COM - OECD)	/	-0.7		/	0.0		/
<i>of which</i> <sup>2</sup> :							
- discretionary and elasticity component	/	-0.5		/	-0.3		/
- composition component	/	0.4		/	0.4		/
p.m.: Elasticity to GDP	0.7	0.7	0.9	0.8	0.9	0.9	0.9

Notes:

<sup>1</sup>On a no-policy change basis.

<sup>2</sup>The composition component captures the effect of differences in the composition of aggregate demand (more tax rich or more tax poor components). The discretionary and elasticity component captures the effect of discretionary fiscal policy measures as well as variations of the yield of the tax system that may result from factors such as time lags and variations of taxable income that do not necessarily move in line with GDP, e.g. capital gains. The two components may not add up to the total difference because of a residual component, which is generally small.

<sup>3</sup>OECD ex-ante elasticity relative to GDP.

Source:  
Commission services' autumn 2007 economic forecasts (COM); Convergence programme (CP); Commission services' calculations; OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434).

Overall, the tax revenue projections in the programme appear to mirror plausible assumptions about the tax intensity of economic activity. Table 8 shows that the tax-to-GDP ratio in 2008 and 2009 falls to a larger extent than would be explained by the OECD's ex ante elasticity. The fall in the tax-to-GDP ratio in 2008 reflects the further reduction of income taxes in the 2008 budget aimed at increasing labour supply. The elasticities of indirect taxes are considerably higher both in the programme and in the Commission services' autumn forecast than the OECD ex ante values. This is notably due to a tax shift between social contributions and wage taxes.

**Table 9: Experience of expenditure ceilings**

	2002	2003	2004	2005	2006	2007
<b>Central government expenditure (SEK billion)</b>						
Ceiling	773.0	803.0	836.0	870.0	907.0	<b>938.0</b>
Outcome	772.6	800.1	833.5	864.3	895.0	<b>919.0</b>
<i>Margin (ceiling minus outcome)</i>	0.4	2.9	2.5	5.7	12.0	<b>19.0</b>
<b>Central government expenditure (% of GDP)</b>						
Ceiling	32.9	32.9	32.5	32.5	32.0	<b>31.1</b>
Outcome	32.6	32.5	32.4	32.3	31.6	<b>30.5</b>
<i>Margin (ceiling minus outcome)</i>	0.3	0.4	0.1	0.2	0.4	<b>0.6</b>

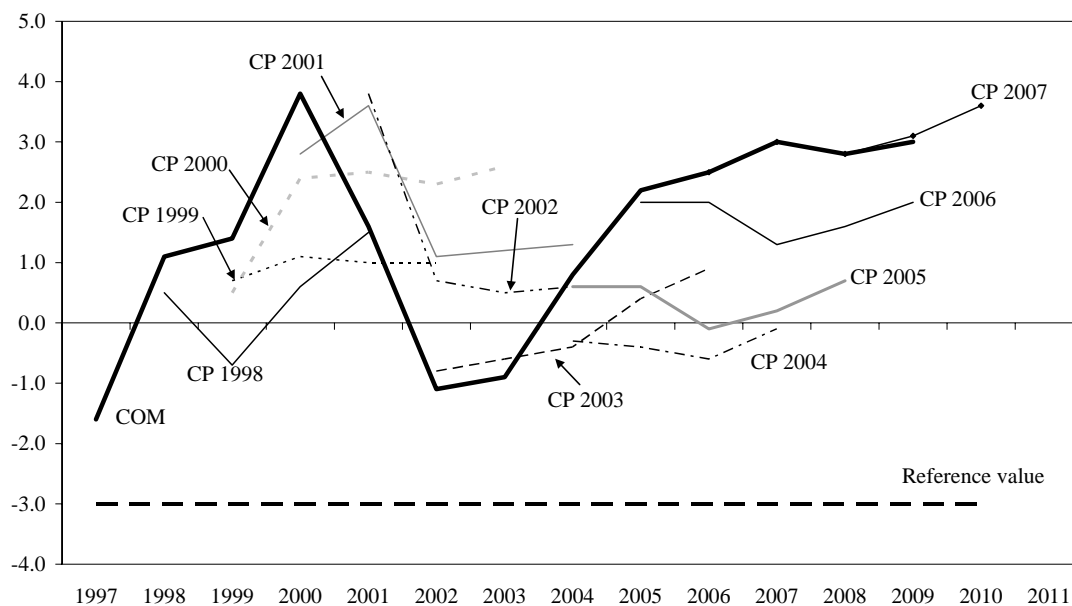
Source:  
Successive convergence programmes; Commission services' calculations

As described in more detail in Section 2, multi-annual ceilings for central government expenditure were introduced in 1997. The instrument has promoted budgetary discipline

and constitutes a key element of the overall budgetary framework. As can be seen in Table 9, the ceilings have been met every year, although this was sometimes achieved by moving expenditure between years and recording certain expenditures as tax credits. In the context of the 2007 spring budget the government has declared the intention to apply the principle of gross accounting more strictly than in the past and also not to use the budgetary margin provided for unforeseen exceptional expenditure under the ceiling for regular purposes. This should promote a greater respect for the principle of the ceilings and also enhance the assessment of adherence to the ceilings by increasing transparency.

Since 2003, Sweden has overall demonstrated a good track record with regard to respecting its budgetary targets in successive convergence programmes. The track record is also good with regard to achieving the surplus target and, as pointed out above, respecting the expenditure ceilings. Looking over a longer period, the achievement of budgetary objectives in successive convergence programmes illustrates the cyclical sensitivity of the Swedish public finances. Figure 1 shows that the objectives in the first few programmes were overachieved as revenue growth was generally stronger than projected ex ante. The rapid slowdown in growth in 2001, initially did not have a strong negative effect on the budget as it was mainly export growth that fell behind. However, the slowdown in combination with the very expansionary fiscal stance in the 2002 budget led to some years of underachievement. Thereafter, programme objectives have again been overachieved as revenue has surprised on the upside, reflecting the expenditure framework and the tax revenue volatility that to some extent may be inherent in a very open economy with a large public sector.

**Figure 1: Government balance projections in successive programmes (% of GDP)**



*Source: Commission services' autumn 2007 forecast (COM) and successive convergence programmes*

Data provided in old convergence programmes have been adjusted for the impact of the Eurostat decision of 2 March 2004, on the classification of funded pension schemes.

Overall, the risks to the budgetary projections in the programme are considered to be neutral. While GDP growth is projected to decelerate gradually over the programme period, and this deceleration may even materialise sooner than expected in the programme, the composition of growth still remains favourable from the point of view of

public finances. This is notably explained by solid private consumption growth. The tax revenue projections therefore appear plausible. Moreover, in recent years Sweden has demonstrated a good track record with regard to meeting the budgetary targets presented in successive convergence programmes and has even been overachieving these targets.

#### 4.4. Assessment of the fiscal stance and budgetary strategy

Table 10 offers a summary assessment of the country's position relative to the budgetary requirements laid down in the Stability and Growth Pact. In order to highlight the role of the preceding analysis of the risks that are attached to the budgetary targets presented in the programme, this assessment is done in two stages: first, a preliminary assessment on the basis of the targets taken at face value and, second, the final assessment also taking into account risks.

**Table 10: Overview of compliance with the Stability and Growth Pact**

	<b>Based on programme<sup>3</sup></b> (with the targets taken at face value)	<b>Assessment</b> (taking into account risks to the targets)
a. Safety margin against breaching 3% of GDP deficit limit <sup>1</sup>	throughout programme period	throughout programme period
b. Achievement of the MTO	throughout programme period	throughout programme period
c. Fiscal stance in line with Pact <sup>2</sup> ?	Risk that it may not be in line in 2008	risk that it may not be in line in 2008, if the economy continues to be in good times.
<p><u>Notes:</u>  <sup>1</sup>The risk of breaching the 3% of GDP deficit threshold with normal cyclical fluctuations, i.e. the existence of a safety margin, is assessed by comparing the cyclically-adjusted balance with the minimum benchmark (estimated as a deficit of around 1% of GDP for Sweden). These benchmarks represent estimates and as such need to be interpreted with caution.  <sup>2</sup>According to the Stability and Growth Pact, countries which have already achieved their MTO should avoid pro-cyclical fiscal policies in "good times".  <sup>3</sup>Targets in structural terms as recalculated by Commission services on the basis of the information in the programme.</p> <p><u>Source:</u>  <i>Commission services</i></p>		

Taking into account the risks to the budgetary targets presented in the programme, Sweden satisfies the requirements of meeting its MTO by a good margin throughout the programme period. The somewhat weaker budgetary position in 2008 is linked to continued structural reforms aimed at encouraging labour force participation by reducing the tax wedge, which thus increases the growth potential of the economy. If the economy continues to be in good times in 2008, which is not fully certain in the light of the most recent developments, there is a risk that the fiscal policy stance implied by the programme may turn out to be mildly pro-cyclical in 2008 (see also Box 3). Anyway, the risk of pro-cyclical policies appears less pronounced in view of the good track record in the past, with stronger than anticipated public finances in recent years. Moreover, the budgetary deterioration would be temporary as it is not expected to spill over into subsequent years.



## 5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

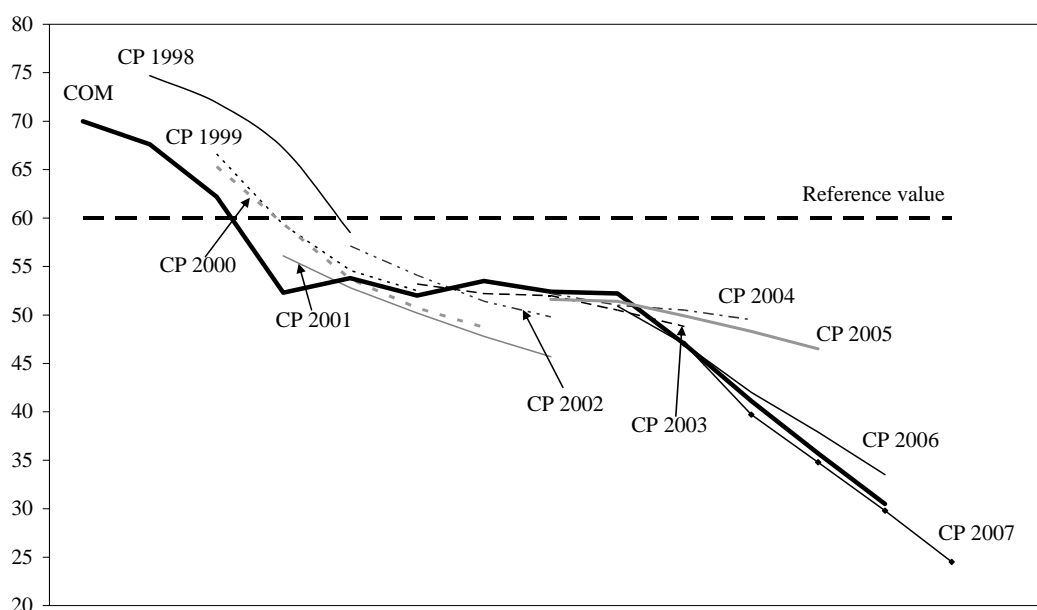
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

### 5.1. Recent debt developments and medium-term prospects

#### 5.1.1. Debt projections in the programme

As can be seen in Table 11 and Figure 2, Sweden's gross debt-to-GDP ratio is already well below the Treaty reference level. On the basis of continued marked budgetary surpluses the programme foresees a continuation of the more accelerated path of debt reduction that was initiated in 2006. Consequently, the debt-ratio will continue to be reduced from about 40% of GDP in 2007 to about 25% of GDP in 2010.

**Figure 2: Debt projections in successive programmes (% of GDP)**



*Source: Commission services' autumn 2007 forecast (COM) and successive convergence programmes.*

Data provided in old convergence programmes have been adjusted for the impact of the Eurostat decision of 2 March 2004, on the classification of funded pension schemes.

The reduction is supported by the government's plans to sell stakes in various state-owned enterprises over the 2007-2010 period, roughly amounting to 1¾ percent of GDP per year. Stock-flow adjustments are forecast to contribute only marginally to the reduction of the gross debt.

As demonstrated in Figure 2, Sweden has a good track record with regard to the achievement of debt targets. Overall, the debt projections in successive convergence programmes have been broadly in line with actual outcomes.

### 5.1.2. Assessment

Overall, the debt estimates presented in the programme are closely in line with the Commission services' projections presented in the autumn forecast. The plans to sell off stakes in government-owned enterprises have been specified with regard to the enterprises concerned and appear plausible. So far, however, the privatisation plans have not been initiated and it is possible that the exact timing of the sell-offs could be influenced by turbulence in financial markets, in particular if the current turbulence is sustained for a longer period.

**Table 11: Debt dynamics**

(% of GDP)	average 2002-05	2006	2007		2008		2009		2010
			COM	CP	COM	CP	COM	CP	CP
<b>Gross debt ratio<sup>1</sup></b>	<b>52.5</b>	<b>47.0</b>	<b>41.1</b>	<b>39.7</b>	<b>35.7</b>	<b>34.8</b>	<b>30.5</b>	<b>29.8</b>	<b>24.5</b>
Change in the ratio	-0.4	-5.2	-5.9	-7.3	-5.4	-4.9	-5.3	-5.0	-5.3
<i>Contributions<sup>2</sup>:</i>									
<b>Primary balance</b>	<b>-2.3</b>	<b>-4.2</b>	<b>-4.7</b>	<b>-4.6</b>	<b>-4.3</b>	<b>-4.4</b>	<b>-4.5</b>	<b>-4.5</b>	<b>-4.8</b>
<b>“Snow-ball” effect</b>	<b>0.1</b>	<b>-1.2</b>	<b>-0.9</b>	<b>-1.2</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.2</b>	<b>-0.4</b>	<b>-0.2</b>
<i>Of which:</i>									
Interest expenditure	2.1	1.7	1.6	1.6	1.5	1.6	1.4	1.4	1.2
Growth effect	-1.4	-2.1	-1.5	-1.4	-1.2	-1.2	-0.8	-0.8	-0.6
Inflation effect	-0.6	-0.9	-1.1	-1.4	-1.0	-1.0	-0.8	-1.0	-0.8
<b>Stock-flow adjustment</b>	<b>1.8</b>	<b>0.3</b>	<b>-0.2</b>	<b>-1.5</b>	<b>-0.4</b>	<b>0.1</b>	<b>-0.6</b>	<b>-0.1</b>	<b>-0.3</b>
<i>Of which:</i>									
Cash/accruals diff.	-0.6	-1.3		n.a.		n.a.		n.a.	n.a.
Acc. financial assets	2.2	2.0		n.a.		n.a.		n.a.	n.a.
<i>Privatisation</i>	<i>0.0</i>	<i>0.0</i>		<i>n.a.</i>		<i>n.a.</i>		<i>n.a.</i>	<i>n.a.</i>
Val. effect & residual	0.1	-0.4		n.a.		n.a.		n.a.	n.a.

**Notes:**

<sup>1</sup>End of period.

<sup>2</sup>The change in the gross debt ratio can be decomposed as follows:

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

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 (in the table, the latter is decomposed into the growth effect, capturing real GDP growth, and the inflation effect, measured by the GDP deflator). The term in parentheses represents the "snow-ball" effect. The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

**Source:**

Convergence programme (CP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations

## 5.2. Long-term debt projections and the sustainability of public finances

### 5.2.1. Sustainability indicators and long-term debt projections

This section analyses the long-term sustainability of public finances. It uses long-term projections of age-related expenditures to calculate sustainability gap indicators and

make long-term government debt projections so as to assess the sustainability challenge the country concerned is facing.

**Table 12: Long-term age-related expenditure: main projections**

(% of GDP)	2004	2010	2020	2030	2040	2050	Change up to 2050
<b>Total age-related spending</b>	29.6	28.2	28.4	30.3	30.9	30.5	0.9
· Pensions *	10.6	10.1	10.2	10.5	10.6	9.9	-0.7
· Healthcare	6.7	6.8	7.2	7.5	7.7	7.7	1.0
· Long-term care	3.8	3.7	3.7	4.9	5.2	5.5	1.7
· Education	7.3	6.7	6.4	6.6	6.6	6.4	-0.9
· Unemployment benefits	1.1	0.9	0.9	0.9	0.9	0.9	-0.2
<b>Property income received</b>	2.4	2.2	2.0	1.8	1.6	1.5	-0.9

*Source: Economic Policy Committee and Commission services.*

\*The figures in this table exclude the part of pensions that is paid by the funded defined-contribution scheme (PPM), which is classified outside general government as of spring 2007. In the Ageing Report (2006), this scheme was included in the projections for public pensions.

The projected increase in age-related spending in Sweden is below the average of the EU, rising by around 1 p.p. of GDP between 2004 and 2050. Public expenditure on pensions is projected to slightly fall in Sweden, to a large extent explained by the comprehensive pension reform enacted in 1998, consisting of a notional defined contribution PAYG scheme and a funded-defined contribution scheme. The increase in expenditure on health-care is projected to be 1.0 p.p. of GDP, lower than on average in the EU while for long-term care an increase of 1.7 p.p. of GDP is projected, among the highest in the EU. Under the hypothesis of no stock flow adjustment assumed in the long-term debt projections, property income received by the general government should decrease over the long-term by 0.9 p.p. of GDP, one of the largest decrease in the EU.

**Table 13: Sustainability indicators and the required primary balance**

Value	2007 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
of which:	-3.0	-1.2	2.9	-3.6	-1.8	2.9
Initial budgetary position (IBP)	-3.4	-3.2	-	-4.0	-3.8	-
Debt requirement in 2050 (DR)	-1.0	-	-	-1.1	-	-
Long-term change in the primary balance (LTC)	1.5	2.0	-	1.5	2.0	-

*Source: Commission services.*

Based on the long-term budgetary projections, sustainability indicators can be calculated. Table 13 shows the sustainability indicators for the two scenarios; the 2007 scenario assumes that the structural primary balance in 2007 is unchanged for the rest of the programme period and the programme scenario assumes that the programme's budgetary plans are fully attained. In the "2007 scenario", the sustainability gap (S2) which satisfies the intertemporal budget constraint would be negative at -1.2% of GDP.<sup>19</sup>

The sustainability gap in the present assessment is close to the result of last year's assessment. Indeed, while the primary balance has improved in structural terms by around ½ p.p. of GDP between 2006 and 2007, the inclusion of property income

<sup>19</sup> The sustainability gap (S1) that assures reaching the debt ratio of 60% of GDP by 2050 would be -3.0% of GDP.

projections has increased substantially the sustainability gap by around  $\frac{3}{4}$  p.p. of GDP. It should be noted that the inclusion of property income projections in the indicators is neutral in terms of overall assessment of long-term sustainability of public finances as property income development used to be assessed as a qualitative factor in the previous round of assessment. Overall, the long-term budgetary prospects of Sweden have slightly improved compared to last year.

The initial strong budgetary position with a structural primary balance of 4.0% of GDP in 2007 contributes to the reduction of gross debt, which is expected to decrease from 39.7% of GDP today to 24.5% of GDP by 2010 according to the programme projections.

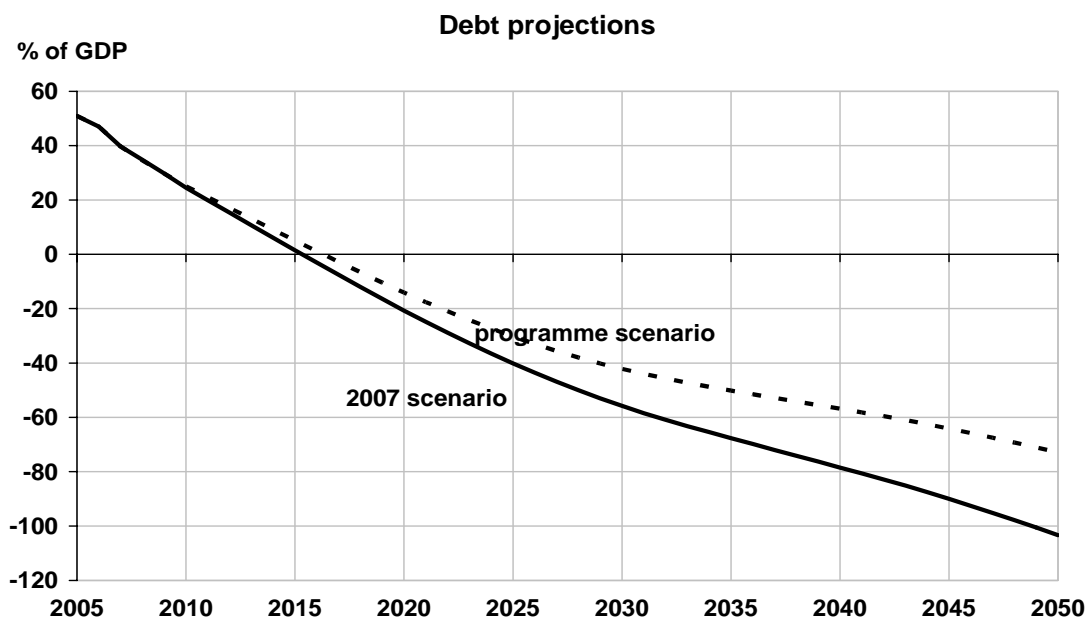
According to both sustainability gaps, the long-term budgetary impact of ageing is limited in particular thanks to the pension reform measures enacted. The programme plans a structural primary budgetary consolidation of 0.7 p.p. of GDP between 2007 and 2010. If achieved, such a consolidation would reduce further the risks to long-term sustainability of public finances.

The required primary balance (RPB) is almost 3% of GDP, lower than the structural primary balance of about 4.7% of GDP in the last year of the programme's period.

Another way to look at the prospects for long-term public finance sustainability is to project the debt/GDP ratio over the long-term using the same assumptions as for the calculations of the sustainability indicators. The long-term projections for government debt under the two scenarios are shown in Figure 3. The gross debt ratio is currently below the 60% of GDP reference value. In both the "2007 scenario" and the "programme scenario", the debt ratio is projected to decrease significantly over the projection period.

The debt projection in both scenarios points to a lower debt level in 2050 than in the convergence programme (25% of GDP). On the one hand, the development of primary expenditure over the long-term is more favourable in the convergence programme than in the Ageing report: age-related expenditure increases by 1.4 p.p. of GDP between 2010 and 2050 (against 2.3 p.p. in the Ageing report) and non age-related government consumption is assumed to decrease by 1.5 p.p. of GDP due to different price dynamics in the public sector and in the economy at large. On the other hand, the convergence programme assumes a technical adjustment in 2015 so that the general government balance in 2015 is 1.0% of GDP. This technical adjustment, which according to the programme "is of a computational nature and in no way reflects expectations regarding actual measures", consists of a permanent increase of expenditure of around 3.9p.p. of GDP as of 2015. Overall, public expenditure is significantly more dynamic in the convergence programme over the long-term and therefore leads to a more adverse debt profile than in figure 3.

**Figure 3: Long-term projections for the government debt ratio**



*Source: Commission services*

### 5.2.2. Additional factors

To reach an overall assessment of the sustainability of public finances, other relevant factors are taken into account, which in addition allow to better appreciate where the main risks to sustainability are likely to stem from.

First, the current level of debt, net of the substantial financial assets accumulated in view of paying public pensions, is currently low (around 14% of GDP)<sup>20</sup>. Maintaining sound government finances, in line with the budgetary plans over the programme period would contribute to contain the risks to the long-term sustainability of public finances.

Second, the benefit ratio<sup>21</sup> in Sweden is projected to decrease relatively markedly, by almost 25% in the period to 2050.<sup>22</sup> This is explained in part by the fact that the pension projections in the Ageing Report assume no change in the retirement age in the future compared with today. However, if people chose to work longer in the future (with the pension reform, it is possible to retire later than at 65), they could increase their pension rights and, therefore, limit the decrease in the benefit ratio. By extending the working life by 2/3 of the increase in life expectancy at 65 by 2050, the replacement rate (the first pension received compared to the last wage) of an individual would remain unchanged.<sup>23</sup>

<sup>20</sup> Gross debt is 39.7% of GDP in 2007 and the amount of consolidated financial assets amounts to around 25.5% in 2007.

<sup>21</sup> i.e. average pension relative to GDP per worker

<sup>22</sup> If the pensions from the private funded scheme are not considered, the reduction in the benefit ratio is larger, 31%.

<sup>23</sup> See e.g. Pensionssystemets årsredovisning (2003, 2005). For Sweden, the increase in life expectancy used in the projections of the Ageing Report is higher than in this example (4 years).

Finally, Sweden has the highest level of taxation in the EU, suggesting that there is limited room of manoeuvre to adjust the budget on the revenue side compared with other countries.<sup>24</sup>

### 5.2.3. *Assessment*

Overall, Sweden appears to be at low risk with regard to the sustainability of public finances.

The long-term budgetary impact of ageing in Sweden is lower than the EU average, with pension expenditure projected to remain relatively stable as a share of GDP over the long term, influenced by the considerable expenditure-reducing impact of the reform of the pension system.

The budgetary position in 2007 as estimated in the programme with a high primary surplus contributes to the reduction of gross debt. Maintaining sound government finances with continued surpluses as planned in the programme would contribute to limiting risks to the sustainability of public finances.

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<sup>24</sup> See "Taxation trends in the EU, 2007 edition", European Commission.

[http://ec.europa.eu/taxation\\_customs/taxation/gen\\_info/economic\\_analysis/tax\\_structures/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_structures/index_en.htm)

## **6. STRUCTURAL REFORM, THE QUALITY OF PUBLIC FINANCES AND INSTITUTIONAL FEATURES**

With a view to maintaining a strong economy, ensuring long-term sustainability of public finances and reducing exclusion, the aim of the government is to focus economic policy and structural reforms on strengthening long-term labour supply and achieving permanently high employment. In order to increase labour supply, the government is continuing to reduce labour taxes, especially aimed at low and middle income earners, which will reduce income taxes by a projected close to SEK 20 billion, or about 0.6% of GDP in 2008. At the same time, the sickness insurance system is being reformed with a view to better reintegrating people on long-term sickness leave and to reducing exclusion (see Box 4). Certain measures are also being taken to facilitate the entry of young people into the labour market and to promote the employment of elderly. In the medium-term, these measures should raise the growth potential of the Swedish economy, thereby constituting a welcome improvement in the quality of public finances.

In addition to measures aimed at increasing labour supply and employment, steps have also been taken that focus on enhancing the functioning of the labour market and the wage formation process. First, an unemployment charge is being introduced so as to clarify the link between the unemployment level and the charges paid to the individual unemployment insurance funds. This reform is expected to have a restraining effect on wage demands. Second, the possibility of receiving part-time unemployment benefits will be restricted to reduce a certain "excess use" of unemployment insurance as well as to diminish the risk of being confined to part-time employment.

The government also considers it important to improve the business climate and to promote entrepreneurship. To this end, measures have been taken to make it more profitable to run and develop businesses. Notably, the wealth tax has been fully abolished retroactively from 1 January 2007. Moreover, a tax credit for the purchase of household services by private individual has been introduced. Finally, in order to create better conditions for companies to grow and contribute to a positive employment development, the government is planning to reduce its ownership of companies over the 2007-2010 period. The privatisation plan concerns six partly or fully state owned enterprises and the targeted privatisation volume amounts to about SEK 50 billion, or approximately 1.6% of GDP, per annum, which the authorities intend to use to reduce central government debt. The current level of state ownership in the economy suggests that this is a realistic target.

The update confirms the Swedish budgetary framework, namely the multi-year expenditure ceilings, the balanced budget rule for local governments and the surplus target for the general government. As discussed in Section 2, the Swedish government has in 2007 presented a number of measures which further clarify and increase the transparency of the framework. Moreover, the government has established a Fiscal Policy Council that will be responsible for assessing the aim of fiscal policy and its contribution to the achievement of long-term fiscal sustainability, long-term economic growth and full employment.

## 7. CONSISTENCY WITH THE NATIONAL REFORM PROGRAMME AND WITH THE BROAD ECONOMIC POLICY GUIDELINES

The updated convergence programme is consistent with the National Reform Programme (the NRP) and also consistent with the October 2007 implementation report of the national reform programme (NRP). It underlines the importance of sustainable public finances over the long-term to meet the demographic challenge (cf. also section 5.2 on sustainability). The measures focus notably on encouraging higher labour force participation through increasing incentives to work and integrating people outside the labour force. The updated convergence programme also describes in qualitative terms the overall impact of the NRP within the medium term fiscal strategy, in particular with regard to the increase in labour supply on the public finance position at large and the growth potential of the economy.

The programme provides systematic information on the direct budgetary costs or savings of the main reforms envisaged in the NRP. At the same time, the updated convergence programme seems to take account of the budgetary implications of the actions envisaged in the Implementation Report.

Overall, the implementation report of the NRP and the convergence programme are fully integrated.

### **Box 5: The Commission assessment of the October 2007 implementation report of the national reform programme**

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Sweden's national reform programme<sup>25</sup>. It can be summarised as follows.

Sweden's national reform programme identified as key challenges the need for high levels of labour market participation and hours worked as well as the promotion of a knowledge-based economy with environmentally-efficient production processes. The 2006 Implementation Report presented as an updated NRP by the new government broadly confirmed these overall objectives but put increased focus on further measures to increase labour supply and conditions for job creation.

The Commission's assessment is that Sweden has made very good progress in implementing its National Reform Programme over the 2005-2007 period. Against the background of progress made, the Commission recommends that Sweden is encouraged to focus on increasing competition, notably in services; and on the implementation and impact evaluation of recent reforms to increase work incentives.

Table 14 provides an overview of whether the strategy and policy measures in the convergence programme are consistent with the broad economic policy guidelines in the area of public finances issued in the context of the Lisbon strategy for growth and jobs, in particular the integrated guidelines for the period 2005-2008, adopted by the Council

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<sup>25</sup> Communication from the Commission to the European Council, "Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)", 11.12.2007, COM(2007)803.



in July 2005. Overall, the budgetary strategy in the convergence programme is broadly consistent with the broad economic policy guidelines.

**Table 14: Consistency with the broad economic policy guidelines (integrated guidelines)**

Broad economic policy guidelines (integrated guidelines)	Yes	Steps in right direction	No	Not applicable
<b>1. To secure economic stability</b>				
– Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it <sup>1</sup> .	X			
– Member States should avoid pro-cyclical fiscal policies <sup>2</sup> .		X		
– Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits <sup>3</sup> .				X
– Member States posting current account deficits that risk being unsustainable should work towards (...), where appropriate, contributing to their correction via fiscal policies.				X
<b>2. To safeguard economic and fiscal sustainability</b>				
In view of the projected costs of ageing populations,				
– Member States should undertake a satisfactory pace of government debt reduction to strengthen public finances.				X
– Member States should reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible (...)		X		
<b>3. To promote a growth- and employment-orientated and efficient allocation of resources</b>				
Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives and ensure the overall coherence of reform packages.	X			
<p>Notes:</p> <p><sup>1</sup>As further specified in the Stability and Growth Pact and the code of conduct, i.e. with an annual 0.5% of GDP minimum adjustment in structural terms for euro area and ERM II Member States.</p> <p><sup>2</sup>As further specified in the Stability and Growth Pact and the code of conduct, i.e. Member States that have already achieved the medium-term objective should avoid pro-cyclical fiscal policies in “good times”.</p> <p><sup>3</sup>As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.</p> <p><i>Source:</i> Commission services</p>				

\* \* \*

## Annex 1: Compliance with the code of conduct

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned.

### (i) Model structure

The update adheres to the code of conduct as far as its table of contents is concerned and broadly follows the model structure in Annex 1 of the code of conduct.

### (ii) Data requirements

The update partly adheres to the code of conduct as far as data requirements are concerned. However, not all optional data are provided as specified in the standard tables in Annex 2 of the code of conduct as amended by the September 2007 EFC.

Gaps in optional data pertain to:

- Net lending of the private sector (Table 1d)
- General government expenditure by function % of GDP 2010 (Table 3)
- Liquid financial assets, level 2006 and % of GDP 2007-2010; net financial debt % of GDP 2006-2010; and break down of stock-flow adjustment (Table 4)
- Potential GDP growth and contributions from labour, capital and TFP 2006-2010 (Table 5)

The tables on the following pages show the data presented in the November 2007 update of convergence programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

### (iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP...	Yes	No	Comments
<i>a. Involvement of parliament</i>			
... mentions status vis-à-vis national parliament.	X		
... indicates whether Council opinion on previous programme has been presented to national parliament.	X		
<i>b. Economic outlook</i>			
... (for euro area and ERM II Member States) uses “common external assumptions” on main extra-EU variables.			Not applicable
... explains significant divergences with Commission services’ forecasts <sup>1</sup> .		X	
... bears out possible upside/downside risks to economic outlook.	X		
... analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.	X		
<i>c. Monetary/exchange rate policy</i>			
... (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.	X		
<i>d. Budgetary strategy</i>			
... presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
... (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.			Not applicable
... (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).			Not applicable
... backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on	X		

The SCP...	Yes	No	Comments
balance.			
... specifies state of implementation of measures.	X		
<i>e. "Major structural reforms"</i>			
... (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.			Not applicable
... includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.			Not applicable
<i>f. Sensitivity analysis</i>			
... includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X		Partial analysis. Sensitivity of the government net lending to deviations from the assumptions on the exchange rate and the extra-EU variables are missing.
... (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			Not applicable
<i>g. Broad economic policy guidelines</i>			
... provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.	X		
<i>h. Quality of public finances</i>			
... describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
<i>i. Long-term sustainability</i>			
... outlines strategies to ensure sustainability.	X		
... includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).		X	The projections in the programme are not the same overall as the AWG, partly due to other assumptions and new measures. The differences are, however, clearly defined.
<i>j. Other information (optional)</i>			
... includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		
<p><b>Notes:</b> SCP = stability/convergence programme; CP = convergence programme  <sup>1</sup>To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.</p> <p><i>Source:</i>  Commission services</p>			

**Table 1a. Macroeconomic prospects**

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. Real GDP</b>	B1*g	2832	4.2	3.2	3.2	2.5	2.2
<b>2. Nominal GDP</b>	B1*g	2832	6.0	6.4	5.9	5.5	4.9
<b>Components of real GDP</b>							
<b>3. Private consumption expenditure</b>	P.3	1338	2.8	3.0	3.8	3.2	2.3
<b>4. Government consumption expenditure</b>	P.3	759	1.8	1.6	1.0	0.3	0.1
<b>5. Gross fixed capital formation</b>	P.51	507	7.9	9.4	4.6	3.5	3.4
<b>6. Changes in inventories and net acquisition of valuables (% of GDP)</b>	P.52 + P.53	0	0.0	0.2	0.0	0.0	0.0
<b>7. Exports of goods and services</b>	P.6	1451	8.7	5.3	6.0	6.0	6.0
<b>8. Imports of goods and services</b>	P.7	1225	7.9	7.4	6.5	6.5	6.3
<b>Contributions to real GDP growth</b>							
<b>9. Final domestic demand</b>		-	3.2	3.5	3.0	2.3	1.8
<b>10. Changes in inventories and net acquisition of valuables</b>	P.52 + P.53	-	0.0	0.2	0.0	0.0	0.0
<b>11. External balance of goods and services</b>	B.11	-	1.0	-0.5	0.3	0.2	0.3

**Table 1b. Price developments**

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. GDP deflator</b>		<i>n.a.</i>	1.8	3.0	2.6	3.0	2.7
<b>2. Private consumption deflator</b>		<i>n.a.</i>	1.3	1.5	2.2	2.4	2.4
<b>3. HICP<sup>1</sup></b>		<i>n.a.</i>	1.4	1.7	2.7	2.5	2.1
<b>4. Public consumption deflator</b>		<i>n.a.</i>	3.0	3.8	4.1	4.1	3.2
<b>5. Investment deflator</b>		<i>n.a.</i>	2.1	2.4	2.3	2.0	2.0
<b>6. Export price deflator (goods and services)</b>		<i>n.a.</i>	2.7	1.6	-0.4	1.2	2.0
<b>7. Import price deflator (goods and services)</b>		<i>n.a.</i>	3.5	0.0	-0.6	0.6	1.7

<sup>1</sup> Optional for stability programmes.

**Table 1c. Labour market developments**

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. Employment, persons<sup>1</sup></b>		<i>n.a.</i>	1.8	2.3	1.2	0.3	-0.2
2. Employment, hours worked <sup>2</sup>		<i>n.a.</i>	1.4	2.8	1.4	0.3	0.3
<b>3. Unemployment rate (%)<sup>3</sup></b>		<i>n.a.</i>	5.4	4.4	4.0	4.1	4.3
<b>4. Labour productivity, persons<sup>4</sup></b>		<i>n.a.</i>	3.1	0.6	1.7	2.2	1.7
5. Labour productivity, hours worked <sup>5</sup>		<i>n.a.</i>	2.8	0.6	1.8	2.2	1.9
<b>6. Compensation of employees</b>	D.1	<i>n.a.</i>	3.7	7.0	3.3	5.1	4.0
<b>7. Compensation per employee</b>		<i>n.a.</i>	1.9	4.6	2.1	4.8	4.2

<sup>1</sup>Occupied population, domestic concept national accounts definition.

<sup>2</sup>National accounts definition.

<sup>3</sup>National definition

<sup>4</sup>Real GDP per person employed.

<sup>5</sup>Real GDP per hour worked.

**Table 1d. Sectoral balances**

% of GDP	ESA Code	2006	2007	2008	2009	2010
<b>1. Net lending/borrowing vis-à-vis the rest of the world</b>	B.9	6.5	7.1	7.2	7.4	7.7
<i>of which:</i>						
- Balance on goods and services		8.0	8.0	7.9	8.2	8.4
- Balance of primary incomes and transfers		-0.8	-0.7	-0.5	-0.5	-0.5
- Capital account		-0.7	-0.2	-0.2	-0.2	-0.2
2. Net lending/borrowing of the private sector	B.9	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>
3. Net lending/borrowing of general government	EDP B.9	2.5	3.0	2.8	3.1	3.6
<b>4. Statistical discrepancy</b>		0.0	0.0	0.0	0.0	0.0

Table 2. General government budgetary prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
<b>Net lending (EDP B.9) by sub-sector</b>							
<b>1. General government</b>	S.13	70	2.5	3.0	2.8	3.1	3.6
<b>2. Central government</b>	S.1311	28	1.0	1.7	1.8	2.4	3.2
<b>3. State government</b>	S.1312	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>
<b>4. Local government</b>	S.1313	11	0.4	0.3	0.3	0.2	0.1
<b>5. Social security funds</b>	S.1314	30	1.1	0.9	0.8	0.5	0.3
<b>General government (S13)</b>							
<b>6. Total revenue</b>	TR	1628	57.5	56.3	55.5	54.9	54.6
<b>7. Total expenditure</b>	TE <sup>1</sup>	1558	55.0	53.3	52.6	51.8	51.1
<b>8. Net lending/borrowing</b>	EDP B.9	70	2.5	3.0	2.8	3.1	3.6
<b>9. Interest expenditure</b>	EDP D.41	48	1.7	1.6	1.5	1.4	1.3
<b>10. Primary balance<sup>2</sup></b>		118	4.2	4.6	4.4	4.5	4.8
<b>11. One-off and other temporary measures<sup>3</sup></b>		14	0.5	0.4	0.3	0.0	0.0
<b>Selected components of revenue</b>							
<b>12. Total taxes (12=12a+12b+12c)</b>		1058	37.4	36.1	36.9	36.5	36.5
<b>12a. Taxes on production and imports</b>	D.2	486	17.1	17.2	18.3	17.8	17.6
<b>12b. Current taxes on income, wealth, etc</b>	D.5	573	20.2	18.9	18.6	18.8	18.8
<b>12c. Capital taxes</b>	D.91	0	0.0	0.0	0.0	0.0	0.0
<b>13. Social contributions</b>	D.61	364	12.9	13.1	11.5	11.3	11.3
<b>14. Property income</b>	D.4	59	2.1	2.1	2.0	2.0	1.9
<b>15. Other<sup>4</sup></b>		146	5.2	5.1	5.0	5.0	5.0
<b>16=6. Total revenue</b>	TR	1628	57.5	56.3	55.5	54.9	54.6
<b>p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)<sup>5</sup></b>			50.2	49.2	48.4	47.9	47.7
<b>Selected components of expenditure</b>							
<b>17. Compensation of employees + intermediate consumption</b>	D.1+P.2	724	25.6	25.3	24.8	24.6	24.3
17a. Compensation of employees	D.1	439	15.5	15.5	15.2	15.1	15.0
17b. Intermediate consumption	P.2	285	10.1	9.8	9.7	9.5	9.3
<b>18. Social payments (18=18a+18b)</b>		559	19.7	18.6	18.0	17.8	17.7
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	85	3.0	3.0	3.0	2.9	2.9
18b. Social transfers other than in kind	D.62	474	16.7	15.6	15.0	14.9	14.9
<b>19=9. Interest expenditure</b>	EDP D.41	48	1.7	1.6	1.5	1.4	1.3
<b>20. Subsidies</b>	D.3	45	1.6	1.5	1.5	1.4	1.4
<b>21. Gross fixed capital formation</b>	P.51	89	3.1	3.0	3.0	2.9	2.9
<b>22. Other<sup>6</sup></b>		94	3.3	3.3	3.7	3.5	3.5
<b>23=7. Total expenditure</b>	TE <sup>1</sup>	1558	55.0	53.3	52.6	51.8	51.1
<b>p.m.: Government consumption (nominal)</b>	P.3	759	26.8	26.6	26.4	26.1	25.8

<sup>1</sup> Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

<sup>2</sup> The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

<sup>3</sup> A plus sign means deficit-reducing one-off measures.

<sup>4</sup> P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

<sup>5</sup> Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

<sup>6</sup> D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

**Table 3. General government expenditure by function**

% of GDP	COFOG Code	2005	2010
1. General public services	1	7.7	n.a.
2. Defence	2	1.7	n.a.
3. Public order and safety	3	1.3	n.a.
4. Economic affairs	4	5.1	n.a.
5. Environmental protection	5	0.4	n.a.
6. Housing and community amenities	6	0.9	n.a.
7. Health	7	7.0	n.a.
8. Recreation, culture and religion	8	1.1	n.a.
9. Education	9	7.3	n.a.
10. Social protection	10	23.8	n.a.
11. Total expenditure (=item 7=23 in Table 2)	TE <sup>1</sup>	56.4	51.1

<sup>1</sup>Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

**Table 4. General government debt developments**

% of GDP	ESA Code	2006	2007	2008	2009	2010
<b>1. Gross debt<sup>1</sup></b>		47.0	39.7	34.8	29.8	24.5
<b>2. Change in gross debt ratio</b>		-5.2	-7.3	-4.9	-5.0	-5.3
<b>Contributions to changes in gross debt</b>						
<b>3. Primary balance<sup>2</sup></b>		-4.2	-4.6	-4.4	-4.5	-4.8
<b>4. Interest expenditure<sup>3</sup></b>	EDP D.41	1.7	1.6	1.5	1.4	1.3
<b>5. Stock-flow adjustment</b>		0.3	-1.5	0.1	-0.1	-0.4
<i>of which:</i>						
- Differences between cash and accruals <sup>4</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets <sup>5</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
<i>of which:</i>						
- privatisation proceeds		n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other <sup>6</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
<b>p.m.: Implicit interest rate on debt<sup>7</sup></b>		3.4	3.7	4.1	4.3	4.4
<b>Other relevant variables</b>						
6. Liquid financial assets <sup>8</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

<sup>1</sup>As defined in Regulation 3605/93 (not an ESA concept).

<sup>2</sup>Cf. item 10 in Table 2.

<sup>3</sup>Cf. item 9 in Table 2.

<sup>4</sup>The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

<sup>5</sup>Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

<sup>6</sup>Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

<sup>7</sup>Proxied by interest expenditure divided by the debt level of the previous year.

<sup>8</sup>AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

**Table 5. Cyclical developments**

% of GDP	ESA Code	2006	2007	2008	2009	2010
<b>1. Real GDP growth (%)</b>		4.2	3.2	3.2	2.5	2.2
<b>2. Net lending of general government</b>	EDP B.9	2.5	3.0	2.8	3.1	3.6
<b>3. Interest expenditure</b>	EDP D.41	1.7	1.6	1.5	1.4	1.3
<b>4. One-off and other temporary measures<sup>1</sup></b>		0.5	0.4	0.3	0.0	0.0
5. Potential GDP growth (%)		n.a.	n.a.	n.a.	n.a.	n.a.
contributions:						
- labour		n.a.	n.a.	n.a.	n.a.	n.a.
- capital		n.a.	n.a.	n.a.	n.a.	n.a.
- total factor productivity		n.a.	n.a.	n.a.	n.a.	n.a.
6. Output gap		0.9	0.6	0.9	0.6	0.0
7. Cyclical budgetary component		0.5	0.3	0.5	0.3	0.0
8. Cyclically-adjusted balance (2 - 7)		2.0	2.7	2.3	2.8	3.6
9. Cyclically-adjusted primary balance (8 + 3)		3.7	4.3	3.8	4.2	4.9
10. Structural balance (8 - 4)		1.5	2.3	2.0	2.8	3.6

<sup>1</sup>A plus sign means deficit-reducing one-off measures.

**Table 6. Divergence from previous update**

	ESA Code	2006	2007	2008	2009	2010
<b>Real GDP growth (%)</b>						
<b>Previous update</b>		4.0	3.3	3.1	2.7	n.a.
<b>Current update</b>		4.2	3.2	3.2	2.5	2.2
<b>Difference</b>		0.2	-0.1	0.1	-0.2	n.a.
<b>General government net lending (% of GDP)</b>	EDP B.9					
<b>Previous update</b>		1.8	1.2	1.5	2.0	n.a.
<b>Current update</b>		2.5	3.0	2.8	3.1	3.6
<b>Difference</b>		0.7	1.8	1.3	1.1	n.a.
<b>General government gross debt (% of GDP)</b>						
<b>Previous update</b>		47.0	42.0	37.9	33.5	n.a.
<b>Current update</b>		47.0	39.7	34.8	29.8	24.5
<b>Difference</b>		0.0	-2.3	-3.1	-3.7	n.a.



**Table 7. Long-term sustainability of public finances**

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	54.4	53.8	48.9	51.7	53.8	52.9
Of which: age-related expenditures	29.3	29.7	27.5	28.0	29.9	28.9
Pension expenditure	10.2	11.0	10.1	10.5	10.7	9.5
Social security pension	0.5	0.9	0.5	0.6	0.6	0.5
Old-age and early pensions	6.3	6.3	6.6	7.0	7.1	6.2
Other pensions (disability, survivors)	2.8	3.2	2.5	2.4	2.5	2.3
Occupational pensions (if in general government)	0.6	0.6	0.5	0.6	0.6	0.6
Health care	6.2	6.2	5.9	6.0	6.4	6.3
Long-term care ( <i>this was earlier included in the health care</i> )	3.9	4.1	4.1	4.4	5.7	6.3
Education expenditure	6.0	5.8	5.3	4.9	5.0	4.6
Other age-related expenditures	0.0	0.0	0.0	0.0	0.0	0.0
Interest expenditure	4.2	2.0	1.4	0.5	0.5	1.5
Total revenue	58.3	55.8	52.4	52.4	52.4	51.1
Of which: property income	3.1	2.2	2.2	1.7	1.3	0.8
<i>Of which</i> : from pensions contributions (or social contributions if appropriate)	1.5	0.8	0.8	0.7	0.4	0.0
Pension reserve fund assets	33.0	28.7	26.7	18.3	10.1	-0.2
<i>Of which</i> : consolidated public pension fund assets (assets other than government liabilities)	20.3	25.0	23.3	16.7	9.4	-0.1
<b>Assumptions</b>						
Labour productivity growth	3.7	2.7	1.9	1.7	1.6	1.9
Real GDP growth	4.3	2.9	2.2	1.8	1.6	2.0
Participation rate males (aged 20-64)	84.0	85.5	85.0	85.1	84.4	84.3
Participation rates females (aged 20-64)	78.4	79.5	78.7	78.8	77.9	77.9
Total participation rates (aged 20-64)	81.2	82.6	81.9	82.0	81.2	81.2
Unemployment rate	5.3	6.0	4.3	3.8	3.9	3.9
Population aged 65+ over total population	17.2	17.3	18.6	21.2	22.9	23.7

**Table 8. Basic assumptions**

	2006	2007	2008	2009	2010
Short-term interest rate <sup>1</sup> (annual average)	2.5	3.6	4.4	4.7	4.6
Long-term interest rate (annual average)	3.7	4.4	5.0	5.1	4.9
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.32	1.39	1.37	1.35	1.30
Nominal effective exchange rate	127.0	124.0	122.0	121.0	122.0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	9.0	9.1	8.9	8.9	8.9
World including EU, GDP growth	5.4	5.1	4.9	4.7	4.5
Euro area GDP growth	2.8	2.6	2.2	2.1	2.0
Growth of relevant foreign markets	5.4	5.1	4.9	4.7	4.5
World import volumes, excluding EU	9.7	6.0	6.9	7.2	7.1
Oil prices (Brent, USD/barrel)	62.0	70.0	65.0	60.0	55.0

<sup>1</sup>If necessary, purely technical assumptions.

## **Annex 2: Key indicators of past economic performance**

This annex displays key indicators that summarise the past economic performance of Sweden. To put the country's performance into perspective, right-hand side of the table displays the same set of indicators for the euro area.

### **Table: Key economic indicators**

	Sweden						Euro area					
	Averages			2005	2006	2007	Averages			2005	2006	2007
	'96 - '05	'96 - '00	'01 - '05				'96 - '05	'96 - '00	'01 - '05			
<b>Economic activity</b>												
Real GDP (% change)	2.8	3.2	2.4	2.9	4.2	3.4	2.1	2.7	1.4	1.5	2.8	2.6
<i>Contributions to real GDP growth:</i>												
<i>Domestic demand</i>	1.9	2.5	1.3	2.5	3.2	3.7	2.0	2.7	1.3	1.7	2.6	2.4
<i>Net exports</i>	0.9	0.7	1.1	0.4	1.0	-0.3	0.1	0.0	0.1	-0.1	0.2	0.2
Real GDP per capita (PPS; EU27 = 100)	126	124	127	130	131	131	113	114	112	110	110	109
Real GDP per capita (% change)	2.6	3.1	2.0	2.5	3.6	2.6	1.6	2.5	0.8	0.9	2.3	2.2
<b>Prices, costs and labour market</b>												
HICP inflation (%)	1.4	1.1	1.8	0.8	1.5	1.6	1.9	1.5	2.2	2.2	2.2	2.0
Labour productivity (% change)	2.3	2.4	2.1	2.5	2.4	1.4	1.2	1.5	0.8	1.0	1.4	1.1
Real unit labour costs (% change)	0.5	1.1	0.0	-0.5	-2.1	0.4	-0.5	-0.6	-0.5	-0.8	-0.9	-0.8
Employment (% change)	0.5	0.8	0.3	0.4	1.8	2.0	1.2	1.5	0.9	0.9	1.5	1.6
Unemployment rate (% of labour force)	6.9	8.0	5.8	7.4	7.1	6.1	9.1	9.8	8.5	8.9	8.3	7.3
<b>Competitiveness and external position</b>												
Real effective exchange rate (% change)	0.3	0.9	-0.4	-3.2	-1.3	2.6	-1.3	-5.5	2.8	-2.6	-0.6	0.6
Export performance (% change) <sup>1</sup>	0.4	0.5	0.4	-0.4	0.2	-0.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.7	3.6	5.8	5.9	6.3	7.0	0.8	0.9	0.7	0.3	0.0	0.1
<b>Public finances</b>												
General government balance (% of GDP)	0.4	0.3	0.5	2.4	2.5	3.0	-2.3	-2.1	-2.5	-2.5	-1.5	-0.8
General government gross debt (% of GDP)	58.9	65.0	52.8	52.2	47.0	41.1	70.6	72.2	69.0	70.3	68.6	66.6
Structural balance (% of GDP) <sup>2</sup>	n.a.	n.a.	0.8	2.1	2.1	2.7	n.a.	n.a.	-2.6	-2.1	-1.1	-0.7
<b>Financial indicators</b>												
Short-term real interest rate (%) <sup>3</sup>	2.5	3.3	1.7	0.7	0.8	1.4	1.3	2.5	0.6	0.3	1.2	2.0
Long-term real interest rate (%) <sup>3</sup>	4.0	4.8	3.1	2.2	1.9	1.8	n.a.	n.a.	1.9	1.5	1.9	2.1
<b>Notes:</b>												
<sup>1</sup> Market performance of exports of goods and services on export-weighted imports of goods and services of 35 industrial markets.												
<sup>2</sup> Cyclically-adjusted balance net of one-off and other temporary measures; available since 2003.												
<sup>3</sup> Using GDP deflator.												
<b>Source:</b>												
Commission services												

