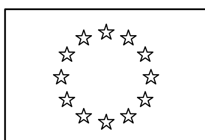

EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

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# SWEDEN: MACRO FISCAL ASSESSMENT

## AN ANALYSIS OF THE JANUARY 2010 UPDATE OF THE CONVERGENCE PROGRAMME

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 29 January 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 17 March 2010. Comments should be sent to Oskar Grevesmühl (oskar.grevesmuhl@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 2009 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 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 17 March 2010. The ECOFIN Council is expected to discuss the opinion on the programmes on 16 April 2010.

* * *

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/sgp/index_en.htm**

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## 1. INTRODUCTION

This document assesses the January 2010 update of Sweden's convergence programme, which was submitted on 29 January 2010 and covers the period 2009-2012. The programme builds on the 2010 budget proposal and the 2010-2012 central government spending limits decision. The Standing Committee on Finance of the Swedish parliament was informed about the programme on 15 December 2009. Additional information has been made available, notably concerning the budgetary impact of the additional fiscal package announced on 5 December 2008. This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Sweden. 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[1]. Section 4 analyses the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

[1] This assessment uses the Commission services' 2009 autumn forecast, as published on 3 November 2009, as a benchmark. However, more recent information that has become available has also been taken into account to assess the risks to the programme scenarios.

**Table 1. Comparison of key macroeconomic and budgetary projections**

| | | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| Real GDP (% change) | **CP Jan 2010** | **-0.2** | **-5.2** | **0.6** | **3.1** | **3.8** |
| | COM Nov 2009 | -0.2 | -4.6 | 1.4 | 2.1 | n.a. |
| | *CP Feb 2009* | *1.5* | *1.3* | *3.1* | *3.5* | *n.a.* |
| HICP inflation (%) | **CP Jan 2010** | **2.1** | **2.0** | **0.4** | **0.6** | **0.9** |
| | COM Nov 2009 | 3.3 | 1.9 | 1.7 | 1.7 | n.a. |
| | *CP Feb 2009* | *3.6* | *1.5* | *n.a.* | *n.a.* | *n.a.* |
| Output gap[1] (% of potential GDP) | **CP Jan 2010** | **1.7** | **-4.1** | **-3.6** | **-1.3** | **1.5** |
| | COM Nov 2009[2] | 0.9 | -4.5 | -4.1 | -3.3 | n.a. |
| | *CP Feb 2009* | *0.7* | *-1.9* | *-2.0* | *n.a.* | *n.a.* |
| Net lending/borrowing vis-à-vis the rest of the world (% of GDP) | **CP Jan 2010** | **7.8** | **7.2** | **7.1** | **7.4** | **7.4** |
| | COM Nov 2009 | 8.1 | 7.6 | 7.7 | 8.1 | n.a. |
| | *CP Feb 2009* | *8.2* | *8.2* | *8.3* | *8.1* | *n.a.* |
| General government revenue (% of GDP) | **CP Jan 2010** | **55.6** | **54.9** | **54.6** | **54.3** | **53.9** |
| | COM Nov 2009 | 55.6 | 53.8 | 52.3 | 52.0 | n.a. |
| | *CP Feb 2009* | *55.4* | *54.1* | *53.8* | *53.3* | *n.a.* |
| General government expenditure (% of GDP) | **CP Jan 2010** | **53.1** | **57.1** | **58.0** | **56.3** | **54.9** |
| | COM Nov 2009 | 53.1 | 55.9 | 55.6 | 54.6 | n.a. |
| | *CP Feb 2009* | *52.5* | *53.1* | *52.2* | *50.8* | *n.a.* |
| General government balance (% of GDP) | **CP Jan 2010** | **2.5** | **-2.2** | **-3.4** | **-2.1** | **-1.1** |
| | COM Nov 2009 | 2.5 | -2.1 | -3.3 | -2.7 | n.a. |
| | *CP Feb 2009* | *2.8* | *1.1* | *1.6* | *2.5* | *n.a.* |
| Primary balance (% of GDP) | **CP Jan 2010** | **4.2** | **-0.9** | **-2.2** | **-0.8** | **0.4** |
| | COM Nov 2009 | 4.2 | -0.8 | -2.1 | -1.4 | n.a. |
| | *CP Feb 2009* | *-4.7* | *-2.6* | *-3.0* | *-3.8* | *n.a.* |
| Cyclically-adjusted balance[1] (% of GDP) | **CP Jan 2010** | **1.5** | **0.2** | **-1.3** | **-1.4** | **-2.0** |
| | COM Nov 2009 | 1.9 | 0.5 | -1.0 | -0.7 | n.a. |
| | *CP Feb 2009* | *1.9* | *-0.2* | *-0.2* | *n.a.* | *n.a.* |
| Structural balance[3] (% of GDP) | **CP Jan 2010** | **1.2** | **0.3** | **-1.3** | **-1.5** | **-2.1** |
| | COM Nov 2009 | 1.6 | 0.3 | -1.0 | -0.7 | n.a. |
| | *CP Feb 2009* | *1.6* | *-0.3* | *-0.2* | *n.a.* | *n.a.* |
| Government gross debt (% of GDP) | **CP Jan 2010** | **38.0** | **42.8** | **45.5** | **45.6** | **45.2** |
| | COM Nov 2009 | 38.0 | 42.1 | 43.6 | 44.1 | n.a. |
| | *CP Feb 2009* | *35.5* | *32.2* | *28.3* | *23.8* | *n.a.* |

Notes:

[1]Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 2.0%, 0.9%, 0.9% and 1.3% respectively in the period 2008-2011

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.3% of GDP in 2008 and 0.1% in both 2011and 2012, all deficit-reducing, and 0.1% of GDP in 2009, deficit increasing, according to the most recent programme and 0.3% of GDP in 2008 and 0.2% of GDP in 2009, all deficit-reducing, in the Commission services' autumn 2009 forecast.

Source:
*Convergence programme (CP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations*

## 2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

This section describes recent economic and budgetary developments for Sweden, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

As a small open economy with an export structure oriented towards investment goods and transport equipment, Sweden was hit relatively hard by the global recession. While the headwinds from the global slowdown were already discernible in early 2008, it was not until the final quarter of the year that the full force of the global financial crisis impacted the Swedish economy, with GDP shrinking by almost 4½% compared with the preceding quarter. After a weak start to 2009, when falling investment and continued subdued exports led to a further drop in activity, the Swedish economy subsequently stabilised somewhat, remaining basically flat for two quarters, before declining by 0.6% (quarter-over-quarter, seasonally adjusted) in the fourth quarter. All in all, GDP dropped by 4.9% in 2009 compared to 2008. Somewhat uncharacteristically at this stage of the cycle, the main positive contribution to growth has been consumer demand, whereas industrial production, investment activity and exports have at best bottomed out after previous deep falls.

Household spending has been helped by supportive macroeconomic policies. Discretionary fiscal measures of about 1½% of GDP were enacted in 2009 and further measures amounting to around 1% of GDP were announced in the budget for 2010. As the economy stalled and inflation fell sharply towards the end of 2008, the monetary policy stance shifted quickly with the central bank lowering the key policy rate from 4.75% to 0.25% in less than eight months time. The rate has been kept at this exceptionally low level since July 2009. Moreover, partly thanks to a swift and powerful policy reaction to shore up confidence in the financial sector, the situation in the financial markets gradually stabilised in the course of 2009. As the economy slipped into recession, the Swedish currency weakened by almost 30% on a trade-weighted basis in less than a year, but has since recovered about three quarters of its lost value. Its recent appreciation should contribute to further dampen the already subdued inflationary pressures stemming from significant slack in the economy.

Reflecting the improving financing conditions and an improving economic outlook, the main Swedish stock market index rose by about 40% in 2009. This contributed to strengthen consumer confidence, which has recovered strongly from the very low levels recorded in the first half of 2009. The optimism of households is also underpinned by the apparent resilience of the housing market, where prices – contrary to what has happened in many other countries – have resumed its strong upward trend after falling back somewhat in the autumn of 2008. This has gone hand in hand with rapidly rising household indebtedness, which currently stands at around 160% of disposable income.

Another factor supporting household demand is the improving outlook for the labour market. As the downturn has been concentrated to the manufacturing sector, with the service and public sectors holding up rather well, the impact of the recession on employment has been less severe than initially feared. The unemployment rate has risen from less than 6% of the labour force at its trough to 9.4% in January 2010, but there are clear signs that the deterioration is decelerating, with the number of redundancy notices having fallen significantly.

The combined effect of relatively strong automatic stabilisers and significant discretionary fiscal stimulus measures has swung the public sector balance from a sizeable surplus of 2.5% of GDP in 2008 to a deficit of more than 1½% in 2009. Both from an economic and public finance perspective, a key challenge will be to avoid that a potentially rather job-anaemic recovery leads to hysteresis in the labour market with permanent loss of labour supply. Ensuring that active labour market policies remain of high quality even as they expand in scope will be important in this regard. Another challenge for policy makers will be to carefully calibrate the withdrawal of the various stimulus measures in such a way as neither to nip the recovery in the bud nor to contribute to the build-up of potentially destabilising household-sector imbalances.

## 3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

The main macroeconomic scenario presented in the updated Convergence Programme (henceforth referred to as "the reference scenario") is the one used as base scenario in the 2010 Budget Bill presented in September 2009. According to this scenario, GDP is expected to continue to contract until the first quarter of 2010, when a gradual recovery gets under way. GDP is expected to contract by 5.2% in 2009 and then to grow at a meagre pace of 0.6% in 2010. The return to positive growth is based on a stabilisation in export demand coupled with expansionary fiscal and monetary policies having its full effect on private consumption. While stabilising, external demand is not forecast to act as locomotive for the Swedish economy, as the recession is a global phenomenon. Household consumption is held back by continued negative employment growth and a weak trend in disposable income. Unemployment is expected to continue to rise rapidly in 2010 before peaking at 11.6% in 2011. Weak domestic demand in combination with low capacity utilisation should also hold back investment growth. In 2011-12, however, the recovery is expected to gain significant momentum, with GDP forecast to grow by 3.1% and 3.8%, respectively, i.e. clearly above the potential growth rate.[2] The expected strengthening of the Swedish currency is consistent with very subdued price pressures over the programme period, even in the years when the recovery gains momentum. Low inflation is mainly stemming from the large amount of slack in the economy

While the scenario of an export- and investment-led downturn leading to rising unemployment, which in turn dampens household consumption, is similar to the Commission services autumn forecast, the reference scenario describes a deeper and more protracted downturn in 2009-10 and a much stronger recovery phase in 2011-12. According to the programme, the output gap as recalculated by Commission services based on the information in the programme, following the commonly agreed methodology, is expected to have bottomed out in 2009.

In view of the signs of a strengthening economic outlook during the autumn of 2009, the Swedish government has in successive forecast updates published in November 2009 and January 2010, respectively, revised up its GDP forecast significantly for 2010 and somewhat for 2011, with concomitant improvements in labour market and fiscal indicators. The 2012 GDP forecast has been revised down somewhat. The November update was not complete enough to be included as the main scenario. The same applies to the January update, which, in addition, was not published early enough to be mentioned in the updated convergence programme. Between the 2010 Budget Bill and the January update, GDP growth has been revised up by 0.7, 2.4 and 0.5 percentage points for 2009,

[2] The updated programme expects a strong rebound in the global economy, in particular the EU, in the outer years of the programme period. The reference scenario assumes annual GDP growth in the euro zone to reach 3.2% and 3.3% in 2011 and 2012, respectively, compared with a Commission autumn forecast of only 1.6% in the EU in 2011. The rosier scenario for the global economy in the reference scenario is expected to spill over into higher oil prices, which are assumed to reach 95USD/barrel in 2011, compared to 80.5USD/barrel in the Commission autumn forecast. In the reference scenario, the Swedish currency is expected to appreciate against the euro to a larger extent than assumed in the Commission autumn forecast (SEK/EUR 9.60 against SEK/EUR 10.33 in 2011).

2010 and 2011, respectively, and revised down by 0.6 percentage points for 2012[3]. Given the uncertainties in the current situation, the updated programme also presents two alternative scenarios. One implies a significantly better macroeconomic performance based on the current upturn in confidence translating into a stronger recovery in the 2009-11 period and somewhat slower growth in 2012. The other scenario is based on more permanent negative effects of the financial crisis, notably on investment, productivity growth and consumption growth. Neither of the two alternative scenarios in the updated Convergence Programme is, however, sufficiently detailed to be considered as the reference scenario in this analysis. From the data available, however, it is clear that the more pessimistic alternative scenario is very close to the reference scenario. The more optimistic alternative scenario is slightly more optimistic than the January forecast update.

**Table 2: Comparison of macroeconomic developments and forecasts**

| | 2009 | | 2010 | | 2011 | | 2012 |
|---|---|---|---|---|---|---|---|
| | COM | CP | COM | CP | COM | CP | CP |
| Real GDP (% change) | -4.6 | -5.2 | 1.4 | 0.6 | 2.1 | 3.1 | 3.8 |
| Private consumption (% change) | -1.3 | -1.8 | 1.0 | 1.2 | 1.5 | 3.0 | 3.4 |
| Gross fixed capital formation (% change) | -17.0 | -16.6 | -1.5 | -6.6 | 3.2 | 4.0 | 8.4 |
| Exports of goods and services (% change) | -14.4 | -15.3 | 1.9 | 2.2 | 7.1 | 6.7 | 7.9 |
| Imports of goods and services (% change) | -15.9 | -16.1 | 1.3 | 1.3 | 7.0 | 6.2 | 7.8 |
| *Contributions to real GDP growth:* | | | | | | | |
| - Final domestic demand | -3.5 | -3.7 | 0.4 | -0.3 | 1.4 | 2.0 | 2.9 |
| - Change in inventories | -0.7 | -0.7 | 0.5 | 0.4 | 0.1 | 0.4 | 0.2 |
| - Net exports | -0.4 | -0.8 | 0.4 | 0.5 | 0.7 | 0.7 | 0.7 |
| Output gap[1] | -4.5 | -4.1 | -4.1 | -3.6 | -3.3 | -1.3 | 1.5 |
| Employment (% change) | -2.2 | -2.6 | -1.8 | -3.5 | 0.0 | -0.5 | 0.9 |
| Unemployment rate (%) | 8.5 | 8.8 | 10.2 | 11.4 | 10.1 | 11.6 | 10.9 |
| Labour productivity (% change) | -2.4 | -2.6 | 3.2 | 4.0 | 2.1 | 3.7 | 3.2 |
| HICP inflation (%) | 1.9 | 2.0 | 1.7 | 0.4 | 1.7 | 0.6 | 0.9 |
| GDP deflator (% change) | 3.4 | 20.4 | 2.3 | 0.6 | 2.0 | 0.4 | 0.9 |
| Comp. of employees (per head, % change) | 2.3 | n.a. | 2.1 | n.a. | 2.3 | n.a. | n.a. |
| Net lending/borrowing vis-à-vis the rest of the world (% of GDP) | 7.6 | 7.2 | 7.7 | 7.1 | 8.1 | 7.4 | 7.4 |

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

*Source*:

*Commission services' autumn 2009 forecasts (COM); Convergence programme (CP).*

As the reference scenario does not to the same extent as the Commission autumn forecast incorporate the improvement in the economic outlook, it foresees GDP growth in 2009 and 2010 that is 0.6 and 0.8 percentage points lower, respectively, compared to the Commission autumn forecast. For 2011, the reference scenario foresees GDP growth that is one percentage point higher than the Commission autumn forecast and for 2012, its forecast growth rate is significantly higher than the potential growth rate.

[3] The November update put annual GDP growth for the years 2009, 2010, 2011 and 2012 at -4.9%, 2.0%, 3.4% and 3.3%, respectively, whereas the January update put GDP growth rates at -4.5%, 3.0%, 3.6% and 3.2%, for the same years.

As to the composition of growth, the reference scenario is relatively more pessimistic on the contribution of net exports in 2009, whereas for the 2010-11 period the main difference stems from domestic demand, with the reference scenario being more pessimistic on investment growth in 2010 and more optimistic on private consumption growth in 2011. Private consumption in 2011 is expected to expand by 3.0% in the reference scenario, double the rate foreseen in the Commission autumn forecast.

Altogether, the programme's macroeconomic outlook is based on cautious growth assumptions until 2010 and markedly favourable growth assumptions thereafter.

The updated programme foresees a continued sharp deterioration in the labour market situation in 2010, with employment decreasing by 3.5% and unemployment rising to 11.4% of the labour force. A further limited deterioration is expected in 2011, with unemployment rising to 11.6% before falling back to 10.9% in 2012. This compares to a somewhat less negative scenario in the Commission autumn forecast, which foresees unemployment to peak already in 2010 at 10.2% of the labour force. Taking into account more recent developments, notably the sharp fall in redundancy notices and the rise in the number of vacancies, also the Commission autumn forecast looks rather pessimistic.

The updated programme's path for the unemployment rate is not so well synchronised with the cyclical conditions as measured by the recalculated output gap. Whereas the recalculated output gap peaks in 2009, unemployment is only forecast to peak in 2011.

As a result of high unemployment and a gradually strengthening exchange rate, the updated programme foresees inflationary pressures to be subdued over the whole programme period, with HICP inflation forecast to remain below 1%. The 2010 wage round, covering the vast majority of salary earners, is expected to result in low nominal wage increases, which given the low inflation rate nevertheless should yield annual real income gains of about 1%. As there is plenty of unused capacity, the corporate sector is not expected to start hiring on a large scale even as production gains momentum, which means that the programme foresees high rates of productivity gains over the 2010-12 period. These developments would compensate for a strengthening currency from a competitiveness point of view. The Commission autumn forecast projects a slower increase in the unemployment rate, somewhat stronger nominal wage increases and a higher inflation rate than the forecast contained in the reference scenario. With output forecast to expand faster in 2010, this means that productivity should rise almost as fast as in the reference scenario in 2010, whereas productivity gains are more modest in 2011 as employment stabilises and output does not accelerate as fast as in the reference scenario.

## 4. General government balance

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

### 4.1. Budgetary implementation in 2009

The programme foresees the general government balance to show a deficit of 2.2% of GDP in 2009. This represents a deterioration of 4.7 percentage points compared to 2008, reflecting the effect of automatic stabilisers as the economy went deeper into recession towards the end of 2008 and a series of discretionary fiscal packages in line with the EERP. Given the comfortable starting position, the government took advantage of the available fiscal space, undertaking discretionary fiscal measures amounting to

approximately 1.7% of GDP in 2009. A large share of these measures consisted of cuts in labour income taxes through the introduction of a third step of the so called in-work tax credit and a lifting of the threshold for paying state tax. General and targeted cuts in social security contributions account for a further significant share.

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new convergence programme with the targets from the previous update of the programme. Differences between outcome and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the 'denominator effect') are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates[4].

The difference between the new and the previous update of the convergence programme is mainly explained by worse-than-expected revenue and expenditure developments and only to a lesser extent a worse starting position by end 2008. In particular, revenue developments are expected to have fallen short, as taxes on labour income fell along with hours worked. Uncertainty with regard to the labour market outlook is also expected to have dampened consumption as household save more, with concomitant negative effects on revenues from taxes on products. Moreover, the recession together with the financial crisis is likely to have lead to a significant drop in revenue from taxes on corporate profits and capital gains. Revenue decreased by 4.1%, compared to planned increase of 1.5%. Public expenditure, on the other hand, is forecast to have been much less affected by the cyclical downturn. To be sure, some elements, in particular automatic or discretionary spending triggered by negative labour market developments, have increased more than expected as a result of the recession, but low inflation and the balancing mechanism in the pension system[5] have both contributed to a slower-than-expected increase in some other expenditure categories linked to price developments. On balance, the latter effect even outweighed the former. This is reflected in the fact that expenditure rose by 4.4% compared to a planned 5.1%.The expenditure surprise was negative only because of a more negative starting position than foreseen in the previous programme.

[4] Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p}\Delta\rho_{-1}}_{\text{Base effect}} + \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta r}_{\text{Revenue growth effect}} - \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho^o_{-1}\left(r^o g^p - r^p g^o\right)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

[5] The so called balancing mechanism kicks in to restore financial sustainability in the pension system when the buffer funds of the public pension scheme have fallen below a certain threshold. After the steep stock market fall of 2008, this would have triggered significant cuts in pension payments as from 2010. A five-party agreement last year introduced a smoothing mechanism, implying that the full adjustment effect will be spread out over three years instead of falling on one year.

**Table 3: Budgetary implementation in 2009**

| | 2008 | | 2009 | |
|---|---|---|---|---|
| | Planned | Outcome | Planned | Outcome |
| | CP Feb 2009 | CP Jan 2010 | CP Feb 2009 | CP Jan 2010 |
| Government balance (% of GDP) | 2.8 | 2.5 | 1.1 | -2.2 |
| Difference compared to target [1] | -0.3 | | -3.3 | |
| **Difference excluding denominator effect [1,2]** | | | **-3.4** | |
| *Of which* : due to a different starting position end 2008 | | | -0.4 | |
| due to different revenue / expenditure growth in 2009 | | | -2.7 | |
| p.m. Residual [3] | | | -0.2 | |
| *p.m. Nominal GDP growth (planned and outcome)* | | | *3.9* | *-2.9* |
| Revenue (% of GDP) | 55.4 | 55.6 | 54.1 | 54.9 |
| Revenue surprise compared to target [1] | 0.2 | | 0.8 | |
| **Revenue surprise excluding denominator effect [1,2]** | | | **-2.9** | |
| *Of which* : due to a different starting position end 2008 | | | 0.2 | |
| due to different revenue growth in 2009 | | | -3.1 | |
| p.m. Residual [3] | | | -0.1 | |
| *p.m. Revenue growth rate (planned and outcome)* | | | *1.5* | *-4.1* |
| Expenditure (% of GDP) | 52.5 | 53.1 | 53.1 | 57.1 |
| Expenditure surprise compared to target [1] | -0.6 | | -4.0 | |
| **Expenditure surprise excluding denominator effect [1,2]** | | | **-0.4** | |
| *Of which* : due to different starting position end 2008 | | | -0.6 | |
| due to different expenditure growth rate in 2009 | | | 0.4 | |
| p.m. Residual [3] | | | -0.2 | |
| *p.m. Expenditure growth rate (planned and outcome)* | | | 5.1 | 4.4 |

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

*Source : Commission services*

### 4.2. The programme's budgetary strategy for 2010

The updated programme foresees the general government deficit to widen to 3.4% of GDP in 2010. The revenue ratio is expected to fall slightly to 51.7% of GDP while the expenditure ratio is expected to rise by one percentage point to 55.1% of GDP. These projections are based on the 2010 Budget Bill presented to Parliament in September 2009 and adopted by Parliament in November 2009.

The recalculated structural balance is foreseen to decrease by about 1½ percentage points from 2009 to 2010. This includes the effect of discretionary fiscal measures contained in the 2010 Budget Bill of about 1% of GDP.

The general government's deficit stems almost completely from a deficit at central government level. This is explained by relatively weak tax receipts at central government level and higher labour-market-related expenditures. There is also the effect of increased state transfers to the municipalities, without which the latter most likely would have shown a deficit. The municipalities are now expected to have zero net lending in 2010 and 2011, after showing a deficit of 0.3% of GDP in 2009. Thanks to the relatively low increases in pensions, the old-age pension system exhibits a surplus over the 2009-11 period, before posting a small deficit in 2012.

**Table 4. Main budgetary measures for 2010**

| Revenue measures[1] | Expenditure measures[2] |
|---|---|
| Fourth step in in-work tax credit (-0.3% of GDP)<br>Tax reduction on pensions (-0.1% of GDP) | State transfer to the municipalities (0.3% of GDP)<br>Crime control and judicial system (0.1% of GDP)<br>Education and training activities (0.1% of GDP)<br>Measures to support the growth of small enterprises (0.1% of GDP) |
| Notes:<br>[1] Estimated impact on general government revenue<br>[2] Estimated impact on general government expenditure<br>*Source: Commission services and 2010 Budget Bill* | |

### 4.3. 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

The programme states that the government believes that the expected cyclical upswing will be sufficient to bring the general government balance back into surplus without recourse to structural consolidation efforts. This is based on the forecast in the 2010 Budget Bill plus new information made available thereafter as contained in the November 2009 update of the macroeconomic forecast. The reference scenario, however, foresees the headline general government deficit to gradually narrow from 3.4% of GDP in 2010 to 2.1% of GDP in 2011 and 1.1% of GDP. The primary balance is expected to have a similar profile, going from a deficit of 2.2% of GDP in 2010 to a deficit of 0.8% in 2011, before swinging into a surplus of 0.4% of GDP in 2012. This is a fairly significant improvement, in particular since it does not include any consolidation measures and the number of hours worked – an important tax base for income tax – does not rebound strongly in 2011-12. The structural deficit, on the other hand, is expected to widen further from 1.3% of GDP in 2010 to 1.5% of GDP and 2.1% of GDP in 2012. The structural balance may, however, be underestimated, as there are lags in the cyclical evolution of the general government balance that are not fully captured in the cyclical adjustment.

The updated programme maintains the surplus target of 1% of GDP over the cycle as Sweden's Medium-Term Objective (MTO) (See Box 2). According to the Commission services' calculations on the basis of the information in the programme according to the commonly agreed methodology, the general government structural balance is below the MTO and continues to diverge from it during the whole programme period. The reference scenario does not contain any fiscal policy effort to bring the structural deficit in line with the MTO. Also based on the structural balance in the programme taken at face value, the MTO is not expected to be achieved during the programme period,

although the gap is rather minor in 2011-12.[6] The programme does not mention a target year for achieving the MTO.

The improvement in the headline fiscal balance rests solely on expenditure restraint, with general government expenditure decreasing by more than 3% of GDP between 2010 and 2012. The revenue ratio is expected to fall by 0.7% of GDP over the same period.

**Box 1: The medium-term objective (MTO) for Sweden**

As noted in the Code of Conduct[7], the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the MTO of Sweden is to achieve a surplus of 1% of GDP over the cycle. In view of the new methodology and given the most recent projections and debt level, the MTO more than adequately reflects the objectives of the Pact.

[6] The programme also presents two other indicators of target fulfilment, notably average net lending since the introduction of the target in 2000 and a seven-year rolling average of net lending plus cyclically-adjusted series of these two indicators. The cyclically-adjusted series of both indicators show that the MTO is fulfilled with a small margin over the whole programme period.

[7] "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 on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

**Table 5: Composition of the budgetary adjustment**

| (% of GDP) | 2008 | 2009 | | 2010 | | 2011 | | 2012 | Change: 2009-2012 |
|---|---|---|---|---|---|---|---|---|---|
| | COM | COM | CP | COM | CP | COM[1] | CP | CP | CP |
| **Revenue** | **55.6** | **53.8** | **54.9** | **52.3** | **54.6** | **52.0** | **54.3** | **53.9** | **-1.0** |
| *of which:* | | | | | | | | | |
| - Taxes on production and imports | 18.2 | 17.9 | 18.6 | 17.6 | 18.0 | 17.4 | 17.8 | 17.6 | -1.0 |
| - Current taxes on income, wealth, etc. | 17.4 | 16.0 | 16.6 | 15.4 | 16.7 | 15.6 | 16.8 | 16.9 | 0.3 |
| - Social contributions | 11.9 | 11.8 | 11.6 | 11.4 | 12.0 | 11.2 | 11.9 | 11.7 | 0.1 |
| - Other (residual) | 8.0 | 8.0 | 8.1 | 7.8 | 7.9 | 7.7 | 7.8 | 7.7 | -0.4 |
| **Expenditure** | **53.1** | **55.9** | **57.1** | **55.6** | **58.0** | **54.6** | **56.3** | **54.9** | **-2.2** |
| *of which:* | | | | | | | | | |
| - Primary expenditure | 51.4 | 54.6 | 55.8 | 54.4 | 56.8 | 53.4 | 55.1 | 53.4 | -2.4 |
| *of which:* | | | | | | | | | |
| Compensation of employees | 14.9 | 15.6 | 15.6 | 15.2 | 15.7 | 15.0 | 15.2 | 14.8 | -0.8 |
| Intermediate consumption | 9.7 | 10.2 | 10.4 | 10.2 | 10.5 | 10.0 | 10.1 | 9.7 | -0.7 |
| Social payments | 18.2 | 19.9 | 20.2 | 20.0 | 20.7 | 19.5 | 20.1 | 19.5 | -0.7 |
| Subsidies | 1.5 | 1.5 | 1.6 | 1.5 | 1.6 | 1.4 | 1.6 | 1.5 | -0.1 |
| Gross fixed capital formation | 3.3 | 3.5 | 3.7 | 3.6 | 3.6 | 3.6 | 3.5 | 3.4 | -0.3 |
| Other (residual) | 3.8 | 3.9 | 4.4 | 3.9 | 4.7 | 3.9 | 4.6 | 4.5 | 0.1 |
| - Interest expenditure | 1.7 | 1.3 | 1.3 | 1.2 | 1.2 | 1.2 | 1.2 | 1.5 | 0.2 |
| **General government balance (GGB)** | **2.5** | **-2.1** | **-2.2** | **-3.3** | **-3.4** | **-2.7** | **-2.1** | **-1.1** | **1.1** |
| **Primary balance** | **4.2** | **-0.8** | **-0.9** | **-2.1** | **-2.2** | **-1.4** | **-0.8** | **0.4** | **1.3** |
| One-off and other temporary measures | 0.3 | 0.2 | -0.1 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 |
| **GGB excl. one-offs** | **2.2** | **-2.4** | **-2.1** | **-3.3** | **-3.4** | **-2.7** | **-2.2** | **-1.2** | **0.9** |
| Output gap[2] | 0.9 | -4.5 | -4.1 | -4.1 | -3.6 | -3.3 | -1.3 | 1.5 | 5.6 |
| Cyclically-adjusted balance[2] | 1.9 | 0.5 | 0.2 | -1.0 | -1.3 | -0.7 | -1.4 | -2.0 | -2.1 |
| **Structural balance[3]** | **1.6** | **0.3** | **0.3** | **-1.0** | **-1.3** | **-0.7** | **-1.5** | **-2.1** | **-2.3** |
| *Change in structural balance* | | *-1.4* | *-1.4* | *-1.2* | *-1.6* | *0.2* | *-0.2* | *-0.6* | |
| Structural primary balance[3] | 3.3 | 1.6 | 1.6 | 0.3 | -0.1 | 0.5 | -0.3 | -0.6 | -2.1 |
| *Change in structural primary balance* | | *-1.7* | *-1.8* | *-1.3* | *-1.7* | *0.2* | *-0.2* | *-0.3* | |

Notes*:*

[1]On a no-policy-change basis.

[2]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.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

*Source :*

*Convergence programme (CP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations*

## 4.4. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated programme. However, although the assessment uses the Commission services' forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

The main risks to the budgetary projections stems from the macroeconomic outlook. The reference scenario in the updated programme dates from the 2010 Budget Bill published in September 2009. Since then, the economic outlook for 2009-10 has improved markedly, with stronger consumer confidence on the back of a more favourable labour market outlook and rising house prices and stock indices. Part of this improved picture was reflected already in the Commission autumn forecast. Since the publication of the Commission autumn forecast, however, these positive trends have continued, which means that even the latter now looks fairly cautious. As indicated in section 3, the government in January 2010 forecast a much stronger recovery, mainly based on buoyant

consumer spending. Based on the reference scenario, the risks to the general government balance stemming from the macroeconomic outlook therefore seem clearly tilted to the upside for 2009 and 2010. In its most recent update of the public finance outlook, presented on 17 February 2010, the government foresees a general government deficit of 1.6% of GDP in 2009, partly based on higher-than-expected receipts from income taxes and VAT due to more hours worked and stronger consumer spending in the final months of year. This spills over into the forecast for subsequent years, with the deficit widening to only 2.5% of GDP in 2010.

For the years 2011-12, the reference scenario foresees very strong GDP growth, based on buoyant domestic demand and strong export market growth, notably in the EU. Even after taking into account that the reference scenario includes a possible catching-up effect after very subdued GDP growth in 2010[8], risks remain tilted to the downside in this period. Stimulus withdrawal, in particular a normalisation of interest rates, would mean that a larger share of the disposable incomes of heavily indebted households has to go to debt service costs. Contrary to most other member states, house prices have resumed its upward trend after a short downward adjustment in the autumn of 2008, as households continue to increase their mortgage loans at a double-digit annual rate. Were the cost of credit to rise, this development could easily go into reverse, denting consumer confidence in the process. The updated programme does not discuss this risk, which could be particularly important for public finances, as household consumption is relatively tax rich.

While the situation in the financial sector has stabilised, partly thanks to the willingness of the government to provide guarantees for bank borrowing and the willingness of the central bank to act as lender of last resort, credit losses in some of the big banks are still running high and lending margins are being squeezed. Given the importance of the banking system to the functioning of the economy, possible government interventions in case of a confidence crisis could also have a negative impact on the budget.

2010 being an election year, with parliamentary elections to be held in mid-September, risks stemming from the electoral cycle exist, but are not deemed to be particularly large. The risk consists primarily in the government painting a too rosy macroeconomic picture in order to maintain the positive consumer confidence momentum and to avoid having to foresee painful consolidation measures ahead of the elections. An indication of this is that the government has shifted from being one of the more cautious forecasters until last autumn to being one of the more optimistic ones in recent updates. A concomitant risk pertains to the temptation to use the relatively rosy forecast to project a fiscal space that would allow further stimulus measures. The government recently opened the door to "some limited" additional stimulus measures in the Spring Budget Bill due in April 2010. Tax cuts for pensioners as well as some relief for poor families with children were envisaged without any exact numbers being mentioned[9]. Given that the size of the so

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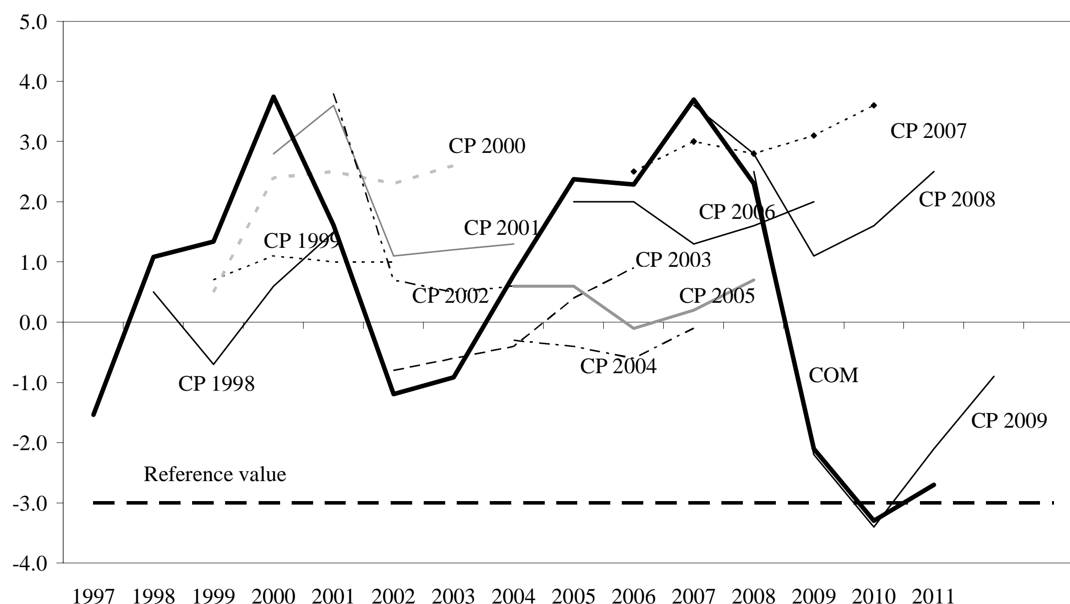
[8] In the January 2010 update of the forecast, the government raises the GDP growth outlook for 2010 by 2.4 percentage points compared to the reference scenario, while cutting it for 2012 by 0.6 percentage points.

[9] Even if tax relief for pensioners turns out to be limited in scope, the mere fact that the measure is presented as compensation for the adverse effect of the balancing mechanism of the pension system (see footnote 5) risks casting doubts on the sustainability calculation behind the pension reform of the late 1990s. If it indicates a wish not to let pensions lag behind income developments among the employed, this might have negative fiscal implications in the future. Apart from this, tax relief for pensioners would seem to contradict the government policy of making work pay by cancelling out some of the incentives to remain longer in the workforce brought in by the so called in-work tax credit and targeted reductions in social contributions to elderly workers.

called budget margin (i.e. the difference between the expenditure ceiling and the planned size of expenditures subject to the ceiling) is relatively large at the moment (deemed to be about 1% of GDP in 2010 and around 2% of GDP in 2011 and 2012 according to the government), this could lead to some erosion of expenditure discipline. However, the good track record in respecting the expenditure ceilings means that the risk of a government spending spree is limited.

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




Source: *Commission services' autumn 2009 forecast (COM) and successive convergence programmes*

Overall, as a result of the macroeconomic forecasts in the reference scenario being considered cautious in the near-term and somewhat favourable in the outer years of the programme period, there is a risk that the budgetary outcomes will be better than foreseen in the updated programme in the years 2009-10 and worse than foreseen in 2011-12.

## 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.

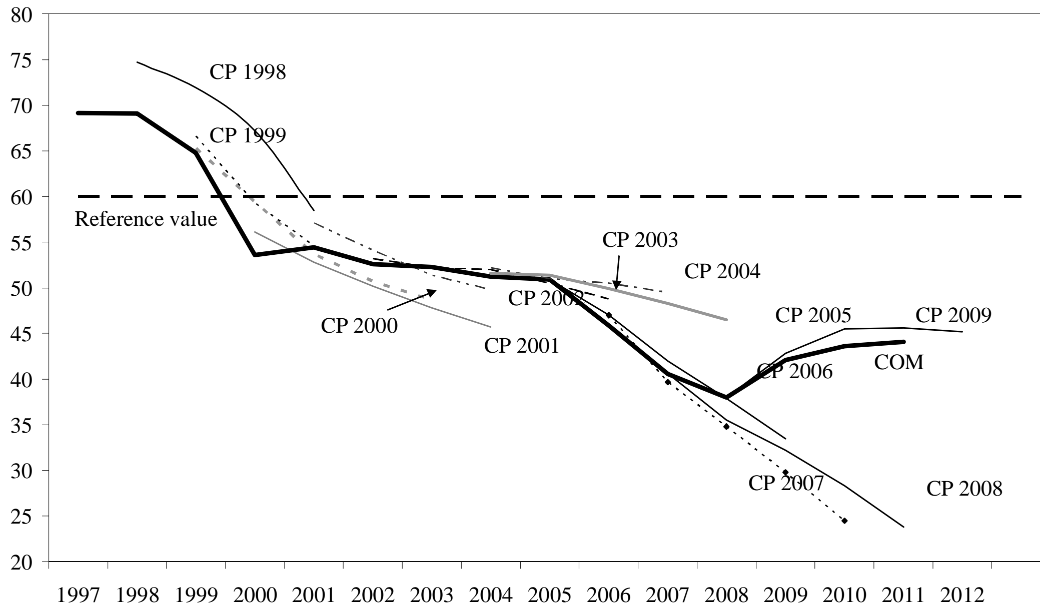
### 5.1. Recent debt developments and medium-term prospects

#### *5.1.1. Debt projections in the programme*

After a long period of falling debt because of primary surpluses, privatisation receipts and falling interest payments, the gross debt ratio rose by almost 5 percentage points to 42.8% of GDP in 2009 according to the updated programme. The increase is to some

extent explained by a worsening primary balance because of the recession but mainly by the so called snow-ball effect, i.e. the effect of interest payments on accumulated debt and the denominator effect of falling GDP. In the previous programme, the gross debt ratio was expected to fall from 35.5% of GDP in 2008 to 32.2% of GDP in 2009. In the period 2010-12, the debt ratio is expected to stabilise at a level slightly above 45% of GDP.

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




*Source: Commission services' autumn 2009 forecast (COM) and successive convergence programmes*

**Table 6: Debt dynamics**

| (% of GDP) | average 2003-07 | 2008 | 2009 | | 2010 | | 2011 | | 2012 |
|---|---|---|---|---|---|---|---|---|---|
| | | | COM | CP | COM | CP | COM | CP | CP |
| **Gross debt ratio**[1] | **48.2** | **38.0** | **42.1** | **42.8** | **43.6** | **45.5** | **44.1** | **45.6** | **45.2** |
| Change in the ratio | -2.4 | -2.5 | 4.1 | 4.8 | 1.5 | 2.7 | 0.5 | 0.1 | -0.4 |
| *Contributions* [2] *:* | | | | | | | | | |
| **1. Primary balance** | **-3.4** | **-4.2** | **0.8** | **0.9** | **2.1** | **2.2** | **1.4** | **0.8** | **-0.4** |
| **2. "Snow-ball" effect** | **-0.6** | **0.5** | **1.8** | **2.4** | **-0.3** | **0.7** | **-0.5** | **-0.2** | **-0.5** |
| *Of which:* | | | | | | | | | |
| Interest expenditure | 1.7 | 1.7 | 1.3 | 1.3 | 1.2 | 1.2 | 1.2 | 1.3 | 1.5 |
| Growth effect | -1.6 | 0.1 | 1.8 | 2.0 | -0.6 | -0.3 | -0.9 | -1.4 | -1.7 |
| Inflation effect | -0.7 | -1.3 | -1.3 | -0.9 | -0.9 | -0.3 | -0.9 | -0.2 | -0.4 |
| **3. Stock-flow adjustment** | **1.6** | **1.2** | **1.4** | **1.5** | **-0.3** | **-0.2** | **-0.4** | **-0.5** | **0.5** |
| *Of which:* | | | | | | | | | |
| Cash/accruals diff. | 0.2 | 1.1 | | 0.2 | | -0.1 | | -0.1 | 0.4 |
| Acc. financial assets | 1.2 | -1.0 | | 0.0 | | 0.0 | | 0.0 | 0.0 |
| *Privatisation* | 0.0 | -2.3 | | n.a. | | n.a. | | n.a. | n.a. |
| Val. effect & residual | 0.2 | 1.1 | | 1.2 | | -0.1 | | -0.4 | 0.2 |

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). 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 2009 forecasts (COM); Commission services' calculations*

As a result of the rebound in equity markets in 2009, the increase in public gross debt was more than compensated by an increase in financial assets. The net financial position thus improved in 2009, amounting to 15% of GDP. Over the remaining programme period, the net position is expected to deteriorate, falling to 8% of GDP in 2012.

#### *5.1.2. Assessment*

There are no large differences between the reference scenario and the Commission autumn forecast as regards debt developments. The fact that the latter contains stronger real GDP growth and assumes higher inflation in 2010 accounts for three fourths of the 1.6-percentage-point difference in gross debt ratio in 2011. Risks include the possibility that guarantees to the financial sector or the automotive industry may be called. Another risk is the need for further capital injections in financial corporations. In 2009, the government took part in the new issuance of stock by the bank Nordea, which is partly owned by the Swedish state. However, this should have a neutral effect on the net financial position, as government assets would increase accordingly.

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

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

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology.

Table 7 shows that age-related spending is projected to rise by 2.7 percentage points of GDP between 2010 and 2060, below the EU average (4.6 pps.). Sustainability indicators

for two scenarios are presented in Table 8. 'The 2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting year, while 'the programme scenario' takes into account the consolidation planned in the programme up to 2012 and is based on the projected 2012 structural primary balance as a starting position. Including the increase of age-related expenditure and assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2) would amount to 0.5% of GDP; about 1½ percentage points more than in last year's assessment. However, the starting budgetary position is more than sufficient to stabilize the debt ratio over the long-term before considering the long-term budgetary impact of ageing

The "programme scenario" projects the budgetary situation to deteriorate. Consequently, risks to long-term sustainability of public finances would increase slightly, as shown by the sustainability gap (S2) reaching 1.1% of GDP.

**Table 7: Long-term age-related expenditure: main projections**

| (% of GDP) | **2007** | **2010** | **2020** | **2030** | **2040** | **2060** | **Change** |
|---|---|---|---|---|---|---|---|
| **2010- 60** | | | | | | | |
| **Total age-related spending** | **27.2** | **27.1** | **26.9** | **28.2** | **28.8** | **29.7** | **2.7** |
| - Pensions | 9.5 | 9.6 | 9.4 | 9.5 | 9.4 | 9.4 | -0.2 |
| - Healthcare | 7.2 | 7.3 | 7.5 | 7.7 | 7.9 | 8.0 | 0.7 |
| - Long-term care | 3.5 | 3.5 | 3.7 | 4.4 | 5.0 | 5.8 | 2.2 |
| - Education and unemployment benefits | 7.0 | 6.6 | 6.3 | 6.5 | 6.6 | 6.6 | 0.0 |
| **Property income received** | 2.5 | 2.4 | 2.2 | 1.9 | 1.8 | 1.6 | -0.8 |

*Source: Economic Policy Committee and Commission services.*

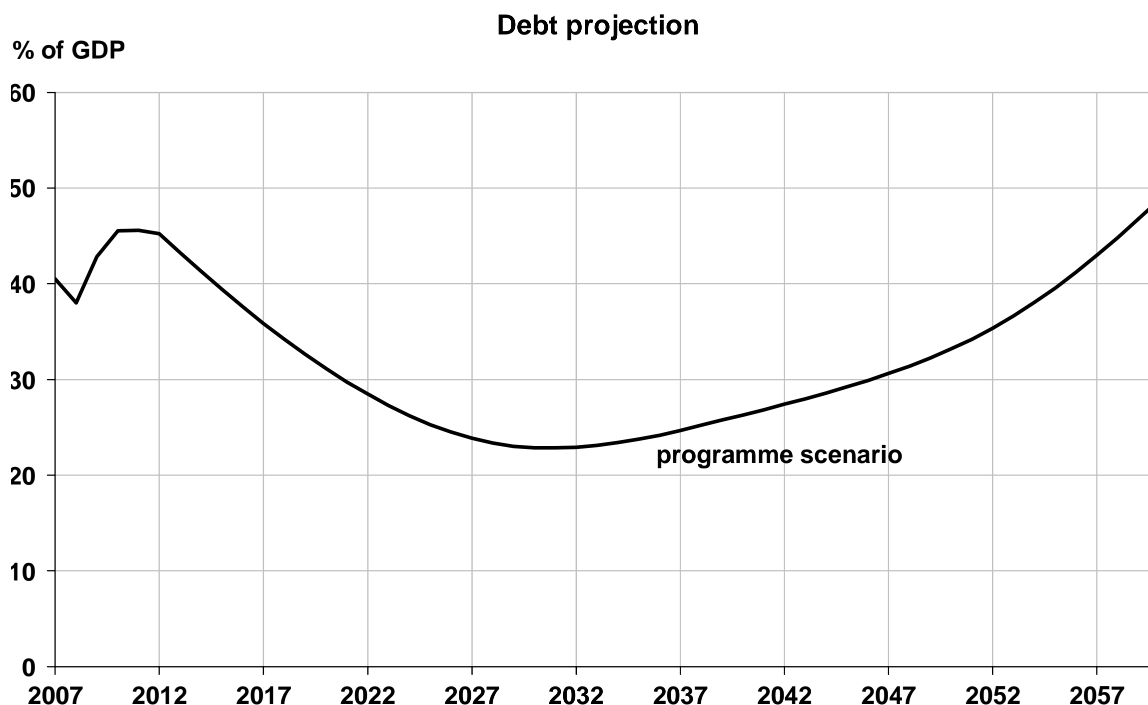
**Table 8: Sustainability indicators and the required primary balance**

| | **2009 scenario** | | | **Programme scenario** | | |
|---|---|---|---|---|---|---|
| | **S1** | **S2** | **RPB** | **S1** | **S2** | **RPB** |
| Value | -0.8 | 0.5 | 3.2 | -0.2 | 1.1 | 3.3 |
| *of which:* | | | | | | |
| Initial budgetary position (IBP) | -1.7 | -1.5 | - | -1.0 | -0.8 | - |
| Debt requirement in 2060 (DR) | -0.3 | - | - | -0.2 | - | - |
| Long-term change in the primary balance (LTC) | | 1.1 | 1.9 | - | 1.1 | 1.9- |

Source: Commission services.

Based on the assumptions used in the projection of age-related expenditure and the calculation of the sustainability indicators, Figure 3 displays the projected debt-to-GDP ratio over the long-term.

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

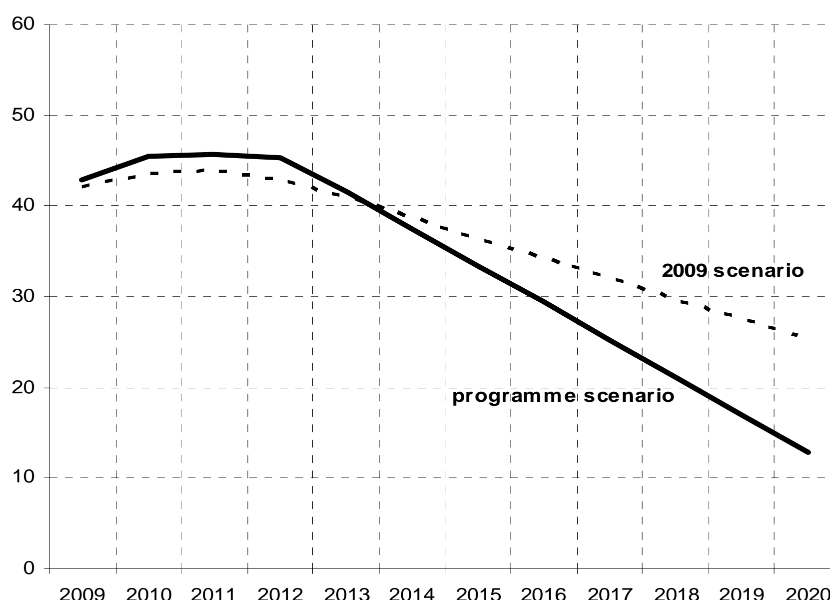



*Note:* Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.
*Source:* Commission services.

Based on the alternative assumptions of economic developments presented in the Commission services' autumn 2009 forecast publication[10], Figure 4 shows projected medium-term trajectory of the debt-to-GDP ratio. According to both sets of assumptions, in the programme scenarios the debt ratio will be on a declining path in the medium term; under the alternative assumptions of more recent economic developments the decline is even faster than in the baseline scenario.

[10] Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009. This economic scenario assumes that the output gap caused by the crisis will be closed by 2017.

**Figure 4: Medium-term projections for the government debt ratio**




*Source: Commission services' calculations*

### *5.2.2. Additional factors*

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account, as shown in Table 9. The large assets accumulated by the public pension funds will help finance the future increase in pension expenditure. On the other hand, the envisaged decline in the structural primary balance, the projected decline in the benefit ratio and the high tax burden weigh on the long-term sustainability risk. Moreover, the programme presents sustainability calculations based on national projections which broadly coincide with the sustainability gap presented above. Taken together, additional factors do not change the overall assessment of the long-term sustainability risk.

**Table 9: Additional factors for the assessment of long-term sustainability risks.**

| | **Impact on risk** |
|---|---|
| Debt and pension assets | + |
| Decline in structural balance until 2011 in COM Autumn 2009 forecast | - |
| Alternative projection of cost of ageing | na |
| Strong decline in benefit ratio | - |
| High tax burden | - |
| Difference between S1 and S2 | na |

*Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability.*
*'na': not applicable.*

*Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unoffic*

*An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.*

*Source: Commission services.*

### *5.2.3. Assessment*

The long-term budgetary impact of ageing is lower than the EU average and the large assets accumulated by the public pension schemes will help finance part of the future increase in pension expenditure. The budgetary position in 2009, as estimated in the programme, which is worse than the starting position of the previous programme, still contributes to the reduction of gross debt. Ensuring primary surpluses over the medium term would contribute to limiting the already low risks to the sustainability of public finances. Medium-term debt projections until 2020 that are based on more recent economic developments and projections on the potential growth show that the budgetary development envisaged in the programme is sufficient to turn the debt ratio on a declining path. According to the programme scenario, when the policy measures will be taken, the debt ratio would reduce to about 15% of GDP by 2020.

## 6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

This section is subdivided into two elements: the fiscal framework and the quality of public finances in a broader sense.

### 6.1. Fiscal framework

The Swedish budgetary framework, which evolved in the second half of the 1990s in reaction to the significant worsening of public finances during the deep recession of the early 1990s, is strong and is generally perceived to have contributed to the significant debt reduction observed since its introduction. The framework benefits from broad political support across the political spectrum, which has raised its credibility. The rules of the framework are also fairly simple (a surplus target of 1% of GDP for the general government to be achieved over the business cycle, a multi-year nominal expenditure ceiling for central government and a balanced-budget rule for local governments). To increase transparency, the government has in recent years taken a number of steps to refine the framework. It has more clearly defined the length of the business cycle by introducing a rolling 7-year average indicator for the general government fiscal balance, stated its intention to discontinue the use of tax expenditures, reintroduced a three-year horizon for the expenditure ceilings (after several years of only a two-year horizon) and created a Fiscal Council with the task of evaluating how well the government has implemented its stated fiscal policy objectives. The latter has to date presented two annual reports.

The government is continuing its work on reviewing the fiscal policy framework in order to strengthen it. Regarding expenditure ceilings, this work has resulted in an amendment to the budget law making it compulsory for the government, as from 1 January 2010, to propose an expenditure ceiling in the Budget Bill. The law now also requires that an expenditure ceiling is specified for a three-year period. Regarding the surplus target, the government published a report in February 2010, setting out to clarify the rationale behind the surplus target, how it should be designed and followed up and whether the status of the surplus target needs to be strengthened. Among its conclusions, the following stand out: i) The current 1% of GDP surplus target strikes a balance between

intergenerational and stabilisation objectives and should remain unchanged over the coming 10 years; ii) The requirement to specify a surplus target should be made compulsory by law. The government may also review the balanced-budget requirement regarding the municipalities. In that case, it would be useful if the review could address the issue of allowing the municipalities to balance their books over a longer period than one year in order to avoid the risk of pro-cyclical policies embedded in the current rule. Alternatively, consideration could be given to making state transfers automatically dependent on the economic cycle in order to increase the predictability of municipal revenues. The current regime with ad hoc decisions, as demonstrated by the increased state transfers to the municipalities announced in 2009 on two occasions, risks unnecessarily complicating financial planning and could lead to pro-cyclical policies.

### 6.2. Quality of public finances

As achieving a high rate of employment is a prerequisite for achieving sustainable public finances, in particular in view of the ageing of the population, the government has taken a number of measures on both the supply and demand side to improve the incentives to work and reduce the cost of employment, in particular for groups with a relatively low employment rate, such as young people and immigrants. Labour income taxes have been reduced, in the form of a so called in-work tax credit and an increase in the threshold for paying state tax. These tax cuts have been coupled with general and targeted reductions in social contributions to lower the cost of hiring. Reforms have also been undertaken with regard to the unemployment and sickness insurance systems, where both the level and the length of time a person can receive benefits have been scaled back. Calculations by both the government and independent research institutes[11] points to important long-term effects of these reforms. The government estimates that the employment level will increase by 2.8% (or 125 000 persons) and the number of hours worked by 4.8% as a result of the reforms. GDP is estimated to be 3.7% higher in the long run. While the number of people receiving sickness insurance benefits has already fallen, the effects of the income tax reforms are mainly to be expected in the medium to long term. The reforms have also contributed to a gradual decline in total expenditures and revenues as a share of GDP. Excluding the effects of lower interest payments on public debt, total public expenditures have fallen by 3 percentage points between 1998 and 2008 and revenues have fallen by 5.6 percentage points between 2000 and 2008.

While the tax reform of the early 1990s implied a significant simplification of the tax system by lowering tax rates and closing loopholes, over the years a large number of changes to the tax system have made it less transparent. This could pose a medium-term problem if it were to undermine popular understanding of and support for the tax system and could lead to less efficient resource allocation.

## 7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the budgetary objectives of the Stability and Growth Pact, against the background of the current economic

[11] See for instance to Lundgren, S. (red.); "Vägar till full sysselsättning", SNS Konjunkturråd; January 2008) for an assessment of the first two steps of the in-work tax credit.

situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

According to the information in the updated programme, the recalculated structural surplus is about 1½% of GDP smaller in 2010 than in 2009, implying that fiscal policy is expansionary. While the headline deficit falls by 1.2 percentage points to 3.4% of GDP, the upside risk to the macroeconomic scenario for 2010 implies that there is a significant probability that the reference value will be respected.

Overall, taking into account the risks to the budgetary targets mentioned above, the strategy to maintain supportive fiscal policies also in 2010 can be considered in line with the EERP. Nevertheless, in structural terms no progress towards meeting the MTO is expected even during the 2011-12 period, during which growth assumptions are deemed favourable. Therefore, the budgetary strategy would need to be reinforced in the outer years of the programme period to be in line with the requirements of the Pact. This is particularly so, since the composition of growth during the programme period, with its reliance on buoyant household consumption, is assumed to be relatively tax-rich. Given the concerns about the rapid accumulation of household debt in combination with the ongoing rise in house prices and the risks this poses for consumption once the monetary policy stance is normalising, relying solely on an automatic improvement in the budget balance carries some risks. However, there may be lags in the cyclical development of the budget balance that understate the structural balance at the trough of the cycle and overstates it at the peak, because the turning-point in the labour market lags the turning-point of the output gap.

* * *

## ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

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 only partly adheres to the code of conduct as far as data requirements are concerned. Not all required and 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 required data pertain to:

- Compensation per employee (Table 1c)
- Statistical discrepancy 2008 (Table 1d)
- GDP growth (world excluding EU, EU, relevant foreign markets) and world import volumes, excluding EU (Table 8)

Gaps in optional data pertain to:

- Labour productivity, hours worked (Table 1c)
- Breakdown on sub-components of net lending/borrowing vis-à-vis the rest of the world
- Net lending of the private sector (Table 1d)
- General government expenditure by function % of GDP 2012 (Table 3)
- Privatisation proceeds, liquid financial assets and net financial debt % of GDP (Table 4)
- Potential GDP growth and contributions from labour, capital and TFP (Table 5)
- Cyclical budgetary component, cyclically-adjusted balance and cyclically-adjusted primary balance (Table 5)
- Participation rate males (aged 20-64), participation rate females (aged 20-64), total participation rate (aged 20-64)

The tables on the following pages show the data presented in the January 2010 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 |
|---|---|---|---|
| *a. Involvement of parliament* | | | |
| … mentions status vis-à-vis national parliament. | X | | |
| … indicates whether Council opinion on previous programme has been presented to national parliament. | X | | |
| *b. Economic outlook* | | | |

| The SCP… | Yes | No | Comments |
|---|---|---|---|
| … (for euro area and ERM II Member States) uses "common external assumptions" on main extra-EU variables. | | X | |
| … explains significant divergences with Commission services' forecasts[1]. | | 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 | | |
| *c. Monetary/exchange rate policy* | | | |
| … (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability. | | X | Independent central bank |
| *d. Budgetary strategy* | | | |
| … 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). | X | | |
| … backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance. | X | | |
| … specifies state of implementation of measures. | | X | |
| *e. "Major structural reforms"* | | | |
| … (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. | X | | |
| … includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms. | X | | |
| *f. Sensitivity analysis* | | | |
| … includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of:<br>a) changes in main economic assumptions<br>b) different interest rate assumptions<br>c) (for CP only) different exchange rate assumptions<br>d) if common external assumptions are not used, changes in assumptions for main extra-EU variables. | X | | |
| … (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth. | | X | |
| *g. Broad economic policy guidelines* | | | |
| … provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them. | | X | |
| *h. Quality of public finances* | | | |
| … describes measures to improve quality of public finances, both revenue and expenditure sides. | X | | |
| *i. Long-term sustainability* | | | |
| … outlines strategies to ensure sustainability. | X | | |
| … includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information). | | X | |
| *j. Other information (optional)* | | | |
| … includes information on implementation of existing national budgetary rules and on other institutional features of public finances. | X | | |

Notes: SCP = stability/convergence programme; CP = convergence programme
[1]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.

*Source:*
*Commission services*

## Tables from Annex 2 of the code of conduct

**Table 1a. Macroeconomic prospects**

| | ESA Code | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|
| | | Level | rate of change | rate of change | rate of change | rate of change | rate of change |
| **1. Real GDP** | B1*g | *3157* | -0.2 | -5.2 | 0.6 | 3.1 | 3.8 |
| **2. Nominal GDP** | B1*g | *3157* | 3.0 | -2.9 | 1.2 | 3.5 | 4.7 |
| **Components of real GDP** | | | | | | | |
| **3. Private consumption expenditure** | P.3 | *1467* | -0.2 | -1.8 | 1.2 | 3.0 | 3.4 |
| **4. Government consumption expenditure** | P.3 | *834* | 1.5 | 1.2 | 1.1 | -0.3 | -0.5 |
| **5. Gross fixed capital formation** | P.51 | *615* | 2.7 | -16.6 | -6.6 | 4.0 | 8.4 |
| **6. Changes in inventories and net acquisition of valuables (% of GDP)** | P.52 + P.53 | *5.0* | -0.6 | -0.7 | 0.4 | 0.4 | 0.2 |
| **7. Exports of goods and services** | P.6 | *1711* | 1.8 | -15.3 | 2.2 | 6.7 | 7.9 |
| **8. Imports of goods and services** | P.7 | *1477* | 3.0 | -16.1 | 1.3 | 6.2 | 7.8 |
| **Contributions to real GDP growth** | | | | | | | |
| **9. Final domestic demand** | | - | 0.8 | -3.7 | -0.3 | 2.0 | 2.9 |
| **10. Changes in inventories and net acquisition of valuables** | P.52 + P.53 | - | -0.6 | -0.7 | 0.4 | 0.4 | 0.2 |
| **11. External balance of goods and services** | B.11 | - | -0.4 | -0.8 | 0.5 | 0.7 | 0.7 |

**Table 1b. Price developments**

| | ESA Code | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|
| | | Level | rate of change | rate of change | rate of change | rate of change | rate of change |
| **1. GDP deflator** | | *n.a.* | 3.2 | 20.4 | 0.6 | 0.4 | 0.9 |
| **2. Private consumption deflator** | | *n.a.* | 2.8 | 2.2 | 0.5 | 0.4 | 0.8 |
| **3. HICP[1]** | | *n.a.* | 2.1 | 2.0 | 0.4 | 0.6 | 0.9 |
| 4. Public consumption deflator | | *n.a.* | 3.7 | 2.3 | 1.7 | 0.6 | 2.6 |
| 5. Investment deflator | | *n.a.* | 3.0 | 2.1 | 1.8 | 1.6 | 1.9 |
| **6. Export price deflator (goods and services)** | | *n.a.* | 4.2 | 1.2 | -2.2 | -1.0 | 0.1 |
| **7. Import price deflator (goods and services)** | | *n.a.* | 4.3 | 0.4 | -1.5 | -0.8 | 1.3 |

[1] Optional for stability programmes.

**Table 1c. Labour market developments**

| | ESA Code | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|
| | | Level | rate of change | rate of change | rate of change | rate of change | rate of change |
| **1. Employment, persons[1]** | | *4593* | 1.2 | -2.6 | -3.5 | -0.5 | 0.9 |
| 2. Employment, hours worked[2] | | *740406* | 1.0 | -3.7 | -2.1 | 0.4 | 1.0 |
| **3. Unemployment rate (%)[3]** | | *305* | 6.2 | 8.8 | 11.4 | 11.6 | 10.9 |
| **4. Labour productivity, persons[4]** | | *n.a.* | -1.6 | -2.6 | 4.0 | 3.7 | 3.2 |
| 5. Labour productivity, hours worked[5] | | *n.a.* | n.a. | n.a. | n.a. | n.a. | n.a. |
| **6. Compensation of employees** | D.1 | *1719* | 2.7 | -0.8 | 0.7 | 2.5 | 3.6 |
| **7. Compensation per employee** | | *n.a.* | n.a. | n.a. | n.a. | n.a. | n.a. |

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

**Table 1d. Sectoral balances**

| % of GDP | ESA Code | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| **1. Net lending/borrowing vis-à-vis the rest of the world** | B.9 | 7.8 | 7.2 | 7.1 | 7.4 | 7.4 |
| *of which* : | | | | | | |
| - Balance on goods and services | | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Balance of primary incomes and transfers | | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Capital account | | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2. Net lending/borrowing of the private sector | B.9 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 3. Net lending/borrowing of general government | EDP B.9 | 2.5 | -2.2 | -3.4 | -2.1 | -1.1 |
| **4. Statistical discrepancy** | | n.a. | optional | optional | optional | optional |

**Table 2. General government budgetary prospects**

| | ESA Code | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|
| | | Level | % of GDP | % of GDP | % of GDP | % of GDP | % of GDP |
| **Net lending (EDP B.9) by sub-sector** | | | | | | | |
| **1. General government** | S.13 | *79* | 2.5 | -2.2 | -3.4 | -2.1 | -1.1 |
| **2. Central government** | S.1311 | *45* | 1.4 | -2.1 | -3.5 | -2.1 | -0.9 |
| **3. State government** | S.1312 | *n.a.* | n.a. | n.a. | n.a. | n.a. | n.a. |
| **4. Local government** | S.1313 | *2* | 0.1 | -0.3 | 0.0 | 0.0 | -0.1 |
| **5. Social security funds** | S.1314 | *31* | 1.0 | 0.2 | 0.1 | 0.0 | -0.1 |
| **General government (S13)** | | | | | | | |
| **6. Total revenue** | TR | *1754* | 55.6 | 54.9 | 54.6 | 54.3 | 53.9 |
| **7. Total expenditure** | TE[1] | *1675* | 53.1 | 57.1 | 58.0 | 56.3 | 54.9 |
| **8. Net lending/borrowing** | EDP B.9 | *79* | 2.5 | -2.2 | -3.4 | -2.1 | -1.1 |
| **9. Interest expenditure** | EDP D.41 | *53* | 1.7 | 1.3 | 1.2 | 1.2 | 1.5 |
| **10. Primary balance[2]** | | *132* | 4.2 | -0.9 | -2.2 | -0.8 | 0.4 |
| **11. One-off and other temporary measures[3]** | | *11* | 0.3 | -0.1 | 0.0 | 0.1 | 0.1 |
| **Selected components of revenue** | | | | | | | |
| **12. Total taxes** (12=12a+12b+12c) | | *1124* | 35.6 | 35.3 | 34.7 | 34.6 | 34.4 |
| **12a. Taxes on production and imports** | D.2 | *576* | 18.2 | 18.6 | 18.0 | 17.8 | 17.6 |
| **12b. Current taxes on income, wealth, etc** | D.5 | *548* | 17.4 | 16.6 | 16.7 | 16.8 | 16.9 |
| **12c. Capital taxes** | D.91 | *0* | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **13. Social contributions** | D.61 | *374* | 11.9 | 11.6 | 12.0 | 11.9 | 11.7 |
| **14. Property income** | D.4 | *77* | 2.4 | 2.2 | 2.0 | 2.0 | 2.1 |
| **15. Other[4]** | | *179* | 5.7 | 5.9 | 5.9 | 5.8 | 5.6 |
| **16=6. Total revenue** | TR | *1754* | 55.6 | 54.9 | 54.6 | 54.3 | 53.9 |
| **p.m.: Tax burden** (D.2+D.5+D.61+D.91-D.995)[5] | | 1485.0 | 47.1 | 46.4 | 46.2 | 46.1 | 45.8 |
| **Selected components of expenditure** | | | | | | | |
| **17. Compensation of employees + intermediate consumption** | D.1+P.2 | *771* | 24.4 | 26.0 | 26.2 | 25.3 | 24.6 |
| 17a. Compensation of employees | D.1 | *465* | 14.7 | 15.6 | 15.7 | 15.2 | 14.8 |
| 17b. Intermediate consumption | P.2 | *306* | 9.7 | 10.4 | 10.5 | 10.1 | 9.7 |
| **18. Social payments** (18=18a+18b) | | *575* | 18.2 | 20.2 | 20.7 | 20.1 | 19.5 |
| 18a. Social transfers in kind supplied via market producers | D.6311, D.63121, D.63131 | *100* | 3.2 | 3.5 | 3.6 | 3.5 | 3.4 |
| 18b. Social transfers other than in kind | D.62 | *476* | 15.1 | 16.7 | 17.1 | 16.6 | 16.1 |
| **19=9. Interest expenditure** | EDP D.41 | *53* | 1.7 | 1.3 | 1.2 | 1.2 | 1.5 |
| **20. Subsidies** | D.3 | *46* | 1.5 | 1.6 | 1.6 | 1.6 | 1.5 |
| **21. Gross fixed capital formation** | P.51 | *105* | 3.3 | 3.7 | 3.6 | 3.5 | 3.4 |
| **22. Other[6]** | | *125* | 4.0 | 4.4 | 4.7 | 4.6 | 4.5 |
| **23=7. Total expenditure** | TE[1] | *1675* | 53.1 | 57.1 | 58.0 | 56.3 | 54.9 |
| p.m.: Government consumption (nominal) | P.3 | *n.a.* | n.a. | n.a. | n.a. | n.a. | n.a. |

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

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

[6] 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 | 2007 | 2012 |
|---|---|---|---|
| 1. General public services | 1 | 7.5 | n.a. |
| 2. Defence | 2 | 1.6 | n.a. |
| 3. Public order and safety | 3 | 1.3 | n.a. |
| 4. Economic affairs | 4 | 4.7 | n.a. |
| 5. Environmental protection | 5 | 0.4 | n.a. |
| 6. Housing and community amenities | 6 | 0.7 | n.a. |
| 7. Health | 7 | 6.8 | n.a. |
| 8. Recreation, culture and religion | 8 | 1.0 | n.a. |
| 9. Education | 9 | 6.8 | n.a. |
| 10. Social protection | 10 | 21.6 | n.a. |
| 11. Total expenditure (=item 7=23 in Table 2) | TE[1] | 52.5 | 54.9 |

[1]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 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| **1. Gross debt[1]** | | 38.0 | 42.8 | 45.5 | 45.6 | 45.2 |
| **2. Change in gross debt ratio** | | -2.5 | 4.8 | 2.6 | 0.1 | -0.3 |
| **Contributions to changes in gross debt** | | | | | | |
| **3. Primary balance[2]** | | -4.2 | 0.9 | 2.2 | 0.8 | -0.4 |
| **4. Interest expenditure[3]** | EDP D.41 | 1.7 | 1.3 | 1.2 | 1.2 | 1.5 |
| **5. Stock-flow adjustment** | | 1.2 | 1.5 | -0.3 | -0.4 | 0.6 |
| *of which:* | | | | | | |
| - Differences between cash and accruals[4] | | -0.5 | 0.2 | -0.1 | -0.1 | 0.4 |
| - Net accumulation of financial assets[5] | | -2.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| *of which:* | | | | | | |
| *- privatisation proceeds* | | n.a. | n.a. | n.a. | n.a. | n.a. |
| - Valuation effects and other[6] | | 4.0 | 1.2 | -0.1 | -0.4 | 0.2 |
| **p.m.: Implicit interest rate on debt[7]** | | 4.3 | 3.2 | 2.9 | 2.8 | 3.4 |
| **Other relevant variables** | | | | | | |
| 6. Liquid financial assets[8] | | 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. |

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]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 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| **1. Real GDP growth (%)** | | -0.2 | -5.2 | 0.6 | 3.1 | 3.8 |
| **2. Net lending of general government** | EDP B.9 | 2.5 | -2.2 | -3.4 | -2.1 | -1.1 |
| **3. Interest expenditure** | EDP D.41 | 1.7 | 1.3 | 1.2 | 1.2 | 1.5 |
| **4. One-off and other temporary measures[1]** | | 0.3 | -0.1 | 0.0 | 0.1 | 0.1 |
| 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 | | 0.0 | -6.4 | -6.5 | -5.0 | -3.0 |
| 7. Cyclical budgetary component | | n.a. | n.a. | n.a. | n.a. | n.a. |
| 8. Cyclically-adjusted balance (2 - 7) | | 1.2 | 1.2 | 1.1 | 1.1 | 1.0 |
| 9. Cyclically-adjusted primary balance (8 + 3) | | n.a. | n.a. | n.a. | n.a. | n.a. |
| 10. Structural balance (8 - 4) | | 2.3 | 1.4 | 0.2 | 0.7 | 0.6 |

[1]A plus sign means deficit-reducing one-off measures.

**Table 6. Divergence from previous update**

| | ESA Code | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| **Real GDP growth (%)** | | | | | | |
| **Previous update** | | 1.5 | 1.3 | 3.1 | 3.5 | n.a. |
| **Current update** | | -0.2 | -5.2 | 0.6 | 3.1 | 3.8 |
| **Difference** | | -1.7 | -6.5 | -2.5 | -0.4 | n.a. |
| **General government net lending (% of GDP)** | EDP B.9 | | | | | |
| **Previous update** | | 2.8 | 1.1 | 1.6 | 2.5 | n.a. |
| **Current update** | | 2.5 | -2.2 | -3.4 | -2.1 | -1.1 |
| **Difference** | | -0.3 | -3.3 | -5.0 | -4.6 | n.a. |
| **General government gross debt (% of GDP)** | | | | | | |
| **Previous update** | | 35.5 | 32.2 | 28.3 | 23.8 | n.a. |
| **Current update** | | 38.0 | 42.8 | 45.5 | 45.6 | 45.2 |
| **Difference** | | -2.5 | -10.6 | -17.2 | -21.8 | n.a. |

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

| % of GDP | 2000 | 2005 | 2010 | 2020 | 2030 | 2050 |
|---|---|---|---|---|---|---|
| Total expenditure | 53.0 | n.a. | 55.1 | 49.9 | 50.0 | 48.1 |
| Of which: age-related expenditures | n.a. | n.a. | 30.2 | 27.5 | 28.5 | 28.1 |
| Pension expenditure | 10.0 | n.a. | 10.8 | 10.0 | 10.0 | 9.2 |
| Social security pension | 0.5 | n.a. | 0.6 | 0.5 | 0.5 | 0.4 |
| Old-age and early pensions | 6.2 | n.a. | 7.1 | 6.8 | 6.7 | 6.1 |
| Other pensions (disability, survivors) | 2.8 | n.a. | 2.5 | 2.2 | 2.2 | 2.1 |
| Occupational pensions (if in general government) | 0.6 | n.a. | 0.6 | 0.6 | 0.6 | 0.5 |
| Health care | n.a. | n.a. | 7.0 | 6.4 | 6.6 | 6.7 |
| Long-term care *(this was earlier included in the health care)* | n.a. | n.a. | 4.3 | 4.1 | 4.9 | 5.5 |
| Education expenditure | n.a. | n.a. | 5.3 | 4.7 | 4.7 | 4.5 |
| Other age-related expenditures | 0.0 | n.a. | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest expenditure | 3.5 | n.a. | 1.2 | 1.6 | 0.7 | -0.4 |
| Total revenue | 56.8 | n.a. | 51.7 | 51.5 | 51.4 | 50.7 |
| Of which: property income | 2.4 | n.a. | 2.0 | 1.9 | 1.7 | 1.5 |
| *Of which* : from pensions contributions (or social contributions if appropriate) | 1.4 | n.a. | 0.8 | 0.6 | 0.5 | 0.4 |
| Pension reserve fund assets | 32.5 | n.a. | 26.7 | 17.6 | 13.8 | 12.1 |
| *Of which* : consolidated public pension fund assets (assets other than government liabilities) | 20.0 | n.a. | 21.5 | 15.6 | 12.8 | 11.4 |
| **Assumptions** | | | | | | |
| Labour productivity growth | 3.8 | n.a. | 2.2 | 1.9 | 1.7 | 1.9 |
| Real GDP growth | 4.4 | n.a. | 0.6 | 2.1 | 1.8 | 1.9 |
| Participation rate males (aged 20-64) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Participation rates females (aged 20-64) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Total participation rates (aged 20-64) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Unemployment rate | 5.3 | n.a. | 8.4 | 4.6 | 4.4 | 4.3 |
| Population aged 65+ over total population | 17.2 | n.a. | 18.5 | 21.0 | 22.9 | 24.0 |

**Table 8. Basic assumptions**

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| **Short-term interest rate[1] (annual average)** | 3.81 | 0.39 | 0.42 | 0.82 | 1.81 |
| **Long-term interest rate (annual average)** | 3.90 | 3.33 | 3.71 | 3.96 | 4.32 |
| **USD/€ exchange rate (annual average) (euro area and ERM II countries)** | 1.35 | 1.38 | 1.35 | 1.28 | 1.28 |
| **Nominal effective exchange rate** | 141.9 | 141.0 | 138.0 | 132.0 | 132.0 |
| **(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)** | 10.8 | 10.6 | 10.2 | 9.6 | 9.6 |
| **World excluding EU, GDP growth** | n.a. | n.a. | n.a. | n.a. | n.a. |
| **EU GDP growth** | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Growth of relevant foreign markets** | n.a. | n.a. | n.a. | n.a. | n.a. |
| **World import volumes, excluding EU** | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Oil prices (Brent, USD/barrel)** | 43.1 | 70.0 | 80.0 | 95.0 | 100.0 |

[1]If necessary, purely technical assumptions.