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Assessment of the 2014 national reform programme and convergence programme for SWEDEN

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION

on Sweden's 2014 national reform programme and delivering a Council opinion on Sweden's 2014 convergence programme

{COM(2014) 428 final}

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EXECUTIVE SUMMARY

Following stronger-than-expected economic growth of 1.5 % in 2013, Sweden's economy is expected to enjoy a gradually accelerating, broad-based recovery, backed by fiscal stimuli and loose monetary conditions. According to the Commission 2014 spring forecast, in 2014, GDP growth is expected to reach 2.8 % and unemployment is expected to drop slightly from 8.0 % in 2013 to 7.6 %. Inflation hovered around 0.4 % in 2013 and is expected to rise only moderately in 2014, remaining well below the central bank's 2 % target.

Overall, Sweden has made some progress in addressing the 2013 country-specific recommendations. Most progress has been made in addressing fiscal policy and labour market related issues. Even though the public budget balance is forecast to deteriorate temporarily in 2014, public finances remain sound overall, with low public debt. The Swedish government has also adopted promising measures to address the challenges of the labour market, notably by aiming to integrate the most excluded groups, such as young, low-educated people and migrants from outside the EU. Sweden's progress on recommendations concerning private sector indebtedness and the inefficiencies of its housing market, however, has been limited. Although some relevant measures have been announced and adopted in these fields, these measures appear insufficient to address the key drivers behind the growing indebtedness of Swedish households and the supply-side inefficiencies of the housing market. The Swedish national reform programme and the convergence programme, both submitted on 16 April 2014, provide detailed information on progress made since July 2013 and on the plans of the government.

To ensure that economic growth remains sustainable in the medium term, challenges pertaining to private-sector debt and related uncertainties in the housing market need to be addressed. Moreover, in order to promote value-added growth and employment, further efforts are needed to improve the participation of non-EU immigrants and less-educated young men and women in the labour market.

- **Financial sector and private sector indebtedness:** The high indebtedness of the private sector, and in particular of Swedish households, remains a matter of concern. Moreover, the financial sector's exposure to households, as opposed to the corporate sector, has been increasing in-line with household debt, which currently stands at 83% of GDP, or roughly 160% of disposable income. This indebtedness is spurred by continued rising house prices, credit growth, tax incentives, and a slow pace of mortgage amortisation. In case of sharp interest rate increases, house price drops and/or an adverse macroeconomic development, the high household sector indebtedness would be a risk factor. Such evolutions would affect households in their overall consumption patterns. Through second round effects, it could also have an adverse impact on the banking sector due to rising non-performing loans and higher market funding costs. Such effects could be particularly important for Sweden, given the large size of the banking sector and individual banks relative to GDP.
- **Housing market:** Swedish house prices have increased sharply over the last two decades and the housing market remains a potential source of instability. Inefficiencies still weigh on housing supply, particularly the cumbersome planning process, limited competition within the construction sector, and a high degree of rent control. Together with debt-inducing taxation, these inefficiencies tend to create an upward trend in house prices. Lack of housing implies important social and economic constraints on growth (e.g. by hampering labour mobility). House price developments are to be closely monitored, especially when in combination with favourable credit conditions, as imbalances in this sector can have important impacts on private indebtedness, consumption, economic growth and financial stability of the country.

- **Labour market and education:** The labour market situation of the young, the low-educated and non-EU immigrants remains weak. It appears that the Swedish education system fails to provide this group of young persons with the necessary education and skills for a successful integration into the labour market. While the Swedish government has taken steps to address these points, it appears that difficulties may be linked to structural shortcomings in the education sector.

1. INTRODUCTION

In May 2013, the Commission proposed a set of country-specific recommendations (CSRs) for economic and structural reform policies for Sweden. On the basis of these recommendations, the Council of the European Union adopted four CSRs in the form of a Council Recommendation in July 2013. These CSRs concerned public finances, private sector indebtedness, the housing market, and the labour market. This staff working document (SWD) assesses the state of implementation of these recommendations in Sweden.

The SWD assesses policy measures in light of the findings of the Commission's Annual Growth Survey 2014 (AGS)[1] and the third annual Alert Mechanism Report (AMR)[2], which were published in November 2013. The AGS sets out the Commission's proposals for building a common understanding about the priorities for action at national and EU level in 2014. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising public administration. The AMR serves as an initial screening device to ascertain whether macroeconomic imbalances exist or risk emerging in Member States. The AMR found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a complete and durable rebalancing is achieved, Sweden and 15 other Member States were selected for a review of developments in the accumulation and unwinding of imbalances. These in-depth reviews were published on 5 March 2014 along with a Commission Communication.[3]

Against the background of the 2013 Council Recommendations, the AGS, the AMR and the in-depth review, Sweden presented a national reform programme (NRP) and a convergence programme on 16 April 2014. These programmes provide detailed information on progress made since July 2013 and on the government's plans. The information contained in these programmes provides the basis for the assessment made in this staff working document. The reform priorities and policy measures described in the NRP rely largely on measures already announced by the government in the 2014 Budget Bill and the 2014 Spring Fiscal Policy Bill.

The national reform programme underwent an extensive consultation process, also at the local and regional level. Responding to requests from social partners, regular consultations were carried out with social partners through a reference group organised by the government. The reference group represents involved ministries of the Swedish government offices, as well as social partners and regular meetings on the implementation of the Europe 2020 strategy in Sweden are held. Since the presentation of the 2013 NRP, three consultations at the civil service level have also been organised. Civil society has also been consulted through a number of public consultations and Sweden's 2014 NRP was accompanied by examples of the implementation of the Europe 2020-strategy at the local and regional level provided by stakeholders. The convergence programme was presented to the Riksdag’s parliamentary Committee on Finance on 15 April 2014 and adopted by the government on 16 April 2014.

[1] COM(2013) 800 final

[2] COM(2013) 790 final

[3] Apart from the 16 Member States identified in the AMR, Ireland was also covered by an in-depth review, following the conclusion by the Council that it should be fully integrated into the normal surveillance framework as Ireland had successfully concluded its financial assistance programme after publication of the AMR.

2. ECONOMIC SITUATION AND OUTLOOK

Economic Situation

In 2013 and early 2014, growth and employment in Sweden continued to be adversely affected by sluggish European growth. Despite weak export markets, GDP rose from 0.9% in 2012 to 1.5% in 2013 driven by household and government consumption.

The labour market has proved to be rather resilient: employment continued to increase in 2013, although the unemployment rate stayed flat (at 8%) due to strong increase in population and labour force. Harmonised Consumer Price Index (HICP) inflation dropped significantly from 0.9% in 2012 to 0.4% in 2013. In light of the weakness of the main European trading partners and the appreciating krona, Swedish exports fell by 0.9% in 2013. Despite relatively strong household consumption, imports also fell by 1%.

To foster growth in the sluggish international environment, the Swedish government introduced fiscal stimuli. This led to a rise in government budget deficit in 2013 (deficit of 1.1% of GDP). The strong initial position of Sweden's public finances, with a budget surplus and a relatively low government debt ratio allows Sweden to use some of its available fiscal space for countercyclical measures (without breaching the medium term objective (MTO)). The declining trend in the general government debt was reversed in 2013 by a one-off measure: an additional SEK 100 billion (approximately 2.8% of GDP) was borrowed in order to strengthen the currency reserves of the Riksbank, raising debt to 40.6% of GDP in 2013. The general government debt is still at a relatively low level compared with other EU countries.

Economic Outlook

The Swedish economy is expected to pick up gradually and grow by 2.8% this year and 3.0% next year according to the Commission 2014 spring forecast. Strong consumption growth, rebounding investments and improving economic outlook of the main trading partners are projected to pave the way for stronger growth in 2014. By contrast, the contribution of net exports is expected to remain marginal. As a fall in unemployment follows GDP growth only with some time lag, a more substantial drop in the unemployment rate is expected from the second half of 2014. Taking the increasing labour force also into account, the unemployment rate is forecast to decrease to 7.6% in 2014 and to 7.2% in 2015. HICP inflation is expected to only slightly increase and reach 0.5% in 2014 and rise to 1.5% in 2015 on the back of healthier economic growth and improving labour market conditions.

Nevertheless, significant risks remain: correction in the high level of private debt, a fall in house prices or dynamically rising repo rates (i.e. the interest rate at which the Riksbank borrows money to commercial banks. The repo rate is the Riksbank's main tool to control inflation) could dampen household consumption; while a sharply appreciating krona could undermine exports performance and investments.

The macroeconomic scenario underpinning the budgetary projections in the Swedish programmes appear to be broadly realistic (the economic outlook contained in the NRP is in line with the main CP scenario). While the government forecast GDP growth of 2.7% in 2014 and 3.3% in 2015, the Commission forecasts 2.8% and 3.0%, respectively. The government has also estimated the macro impact of structural reform related to the labour market aiming to increase labour supply. The implemented structural measures could positively impact the long term growth potential of the Swedish economy. The methodology used for quantifying the expected impacts is available in a separate publication of the government[4].

3. CHALLENGES AND ASSESSMENT OF POLICY AGENDA

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

The main goal of the government's budgetary strategy, as expressed in the 2014 Convergence Programme (henceforth 'programme'), is to ensure long-term sustainability by respecting the rules of the Swedish fiscal framework, in particular to ensure a general government surplus of 1 % of GDP on average over the cycle**.** The programme confirms the previous MTO of a structural deficit of 1 % of GDP, which is in line with the objectives of the Stability and Growth Pact but should be seen as a minimum requirement for the structural balance to which Sweden is subject as an EU Member State. Indeed, the guiding principle for the government's fiscal policy strategy will continue to be the more demanding target of a 1 % surplus over the cycle.

In 2013, the Council recommended Sweden to preserve sound public finances (CSR 1). Public finances remain robust despite a widening of the general government deficit in 2013. After two years of fiscal surpluses (0.3% in 2010 and 0.2% in 2011), the general government balance turned into a deficit of 0.6% of GDP in 2012 further widening to 1.1% in 2013 reflecting lacklustre growth and some government measures to support the economy focusing on corporate taxation, active labour market policies and infrastructure investment. Nevertheless, the budgetary outcome in 2013 was better than the target of a deficit of 1.6% of GDP in the 2013 convergence programme.

The programme expects the 2014 deficit to be at 1.4% of GDP, which is above the target of a 0.9% deficit contained in the 2013 convergence programme. Indeed, the 2014 Budget Bill, which was adopted on 18 December 2013, focused on improving household disposable income in times of weak economic growth. The measures taken amounted to SEK 21 billion (EUR 2.4 billion) including notably income tax cuts and measures to strengthen the education system. Consequently, the Commission 2014 spring forecast projects that the general government deficit will reach 1.8% of GDP in 2014 and the structural balance will turn into a deficit of 0.9% of GDP reflecting the expansionary stance of the fiscal policy. The programme forecasts the structural balance to be at 0.0% of GDP in 2014. The difference with the Commission 2014 spring forecast mainly stems from the output gap calculations, the programme forecasts -2.4% of GDP and the Commission -1.4% of GDP. The programme forecasts the revenue ratio to be 50.2% of GDP and the expenditure ratio to be 51.6%, in line with the Commission spring forecast.

The medium-term budgetary strategy of the programme aims at achieving the government's target of a general government surplus of 1% of GDP over the cycle and a surplus of at least 1% of GDP by 2018. Therefore, any new expenditure increasing reform proposed in the Budget Bills for both 2015 and 2016 will have to be funded "krona for krona" by revenue increase and/or expenditure decrease as already exemplified in the proposed 2014 spring Budget Bill. Measures such as raising vehicle, alcohol and tobacco taxes, abolishing group registration for VAT and lowering pension savings deduction (before abolishing them in 2016) are proposed in order to fund reforms especially in the field of education but also to increase access and skills in healthcare and further improve the business and innovation

[4] '*How should the functioning of the labour market be assessed*?' Report 2011:1 from the Economic Affairs Department at the Ministry of Finance.

climate. On the back of the economic recovery and the government's commitment to fully fund all new reforms, the nominal deficit is expected to improve to 0.8% of GDP in 2015 with the structural balance improving to -0.4% of GDP whereas the programme foresees the structural balance, as recalculated by the Commission, to be in surplus at 0.3% in 2015 and 2016 and to reach 0.7% in 2017.

The decline in the government debt-to-GDP ratio over the previous years was reversed in 2013, on account of an additional borrowing of SEK 100 billion to strengthen the foreign currency reserves of the Riksbank. After increasing in 2013, gross debt is expected to slightly increase further in 2014 reaching 41.6% of GDP before falling back to 40.4% of GDP in 2015.

Over the programme horizon, Sweden is foreseen to be in compliance with the rules of the Stability and Growth Pact. The programme foresees the structural balance, as recalculated by the Commission, to tilt from 0.1% of GDP in 2013 to -0.4% in 2014 before improving to 0.3% in 2015 and 2016 and to 0.7% in 2017. According to the Commission spring 2014 forecast, the structural balance is projected to reach -0.9% in 2014 before improving to -0.4% in 2015 under the no policy change assumption. The difference between the programme and the Commission spring 2014 forecast results mainly from different expectations regarding the output gap. Furthermore, according to the information in the programme and to the Commission spring 2014 forecast, the growth rate of government expenditure, net of discretionary revenue measures, would be below the reference medium-term rate of potential GDP growth in 2015.

Box 1. Main budgetary measures

Revenue	Expenditure
2012	
• Lower VAT rate for restaurant and catering services (-0.2% of GDP)	• Higher spending on infrastructure (+0.1% of GDP)
2013	
• Lower corporate income tax (-0.2% of GDP)	• Labour market package (+0.1% of GDP)
2014	
• Lower household direct taxation (-0.4% of GDP)	• Education reforms (+0.05% of GDP)
2015	
• Lower pension savings deduction (+0.08% of GDP) • Higher taxes on vehicle, alcohol and tobacco (+0.08% of GDP)	• Education package (+0.1% of GDP)

Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.

Overall, Sweden has made substantial progress in implementing CSR 1. Sweden continues to meet its commitment under the Stability and Growth Pact ensuring compliance with the MTO over the programme horizon. Moreover, measures introduced in 2014 focusing on improving households' disposable income and the education system, and measures contained in the programme and the proposed 2014 spring Budget Bill for 2015 focusing on improving knowledge, increasing access and skills in healthcare and further improving the climate for business and innovation go in the directions of a growth-friendly fiscal policy. Nevertheless, a continued monitoring of the soundness of the public finances is needed, in particular as regards the long-term sustainability linked to expenditure for care services in an ageing society.

Box 2. Sweden's status vis-à-vis the Stability and Growth Pact

Sweden is subject to the preventive arm of the Pact and is above its Medium Term Objective over the programme horizon. Therefore, it should preserve a sound fiscal position which ensures compliance with the Medium Term Objective.

Fiscal framework

The Swedish fiscal framework, which is characterised by a cautious approach, has been stable over time. In the past 20 years, Sweden's fiscal framework has put public finances on a strong footing at both the central and local level. The framework combines elements that are laid down by law with softer regulation through a series of practices and particular approaches to the budgetary process ensuring a tight process controlled by the Ministry of Finance. This process comprises three key components. First, a surplus target, encompassing the finances of both central and local governments and the pension system, stipulates that an overall budget surplus of 1% of GDP should be achieved over the business cycle. Second, a three-year nominal expenditure ceiling for central government and the pension system controls budget overruns and forces government departments to prioritise. Third, the balanced-budget rule for local authorities forbids municipalities and counties to approve ex ante deficit budgets and requires them to compensate for any ex-post deficits within three years. The 2013 Budget Bill included new rules allowing municipalities and countries to balance revenues counter-cyclically over time through ‘results-balancing reserves’.

At the end of 2012, the Swedish government mandated a parliamentary committee to review the budget process. In May 2013, the Committee presented its conclusions (SOU 2013:38)[5], as to whether the Swedish budgetary framework was in line with Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States. The inquiry concluded that the overall compliance was good but that Sweden lacked a regular evaluation of the government’s macroeconomic forecasts and budget forecasts, as required by the Directive. The inquiry therefore proposed to maintain the overall process and add a requirement for the government to regularly publish evaluations of the forecasts presented in the autumn and spring Budget Bill. The government acted upon these conclusions with a proposal in its 2014 autumn Budget Bill, which was adopted by the Riksdag on 18 December 2013. In March 2014, the government issued another legislative proposal[6] to increase the accountability of the surplus target, by yearly follow-up with the parliament and a requirement to demonstrate how the target is to be reached in the event of a deviation between the target and forecast development. However, the legislative proposal does not clarify the calculation method for the surplus target. The achievement of the target is assessed against seven different indicators, largely forward-looking. The multitude of indicators without clear weights allocated to each impairs the clarity of the assessment and could lead to an opportunistic interpretation. Finally, the legislative proposal is also to codify and extend the current practice on the expenditure side of the budget to the revenue side: bills affecting government revenues will have to be proposed as part of the legislative package during the autumn and spring Budget Bills. These packages would also include supplementary budgets detailing the impact of revenues or expenditures of these bills.

In addition to the budgetary rules, the Fiscal Policy Council (FPC) was established in 2007 with the task of providing an independent evaluation of the government’s fiscal policy and compliance with the fiscal rules. So far, the FPC’s access to information relies on a good working relationship with the Ministry of Finance. Two aspects of the functioning of the FPC could be improved. First, to avoid ‘opportunistic’ behaviour, the right to access information could be guaranteed in the legislation. Second, as legislators perform critical accountability functions in budgetary processes, mechanisms could be put in place to ensure an appropriate level of accountability of the FPC to the Riksdag. In its current set-up, the FPC is a government agency that reports directly to the government, which has the final say on appointing its members.

[5] The final report from the committee was presented in October 2013 (SOU 2013:73).
[6] 2013/14:173.

The well-established fiscal framework has played a specific role in preventing strong tax revenue in good times from translating into pro-cyclical expenditure increases. This has provided the necessary margin for automatic stabilisers to play their role in recessions, even making room for discretionary fiscal stimulus.

Medium and long-term sustainability

Government debt (40.6% of GDP in 2013 and expected to remain broadly unchanged until 2015) is currently below the 60% of GDP Treaty threshold, and projected to fall by 2030. The full implementation of the convergence programme would put debt on a decreasing path, remaining below the 60% of GDP reference value in 2030.

Sweden appears to face low fiscal sustainability risks in the medium-term. The medium-term sustainability gap[7], showing the adjustment effort up to 2020 required to bring debt ratios to 60% of GDP in 2030, is at -1.6% of GDP, primarily related to the low level of government debt (44.7% of GDP in 2015), and the structural primary surplus (0.9% of GDP in 2015). In the long term, Sweden appears to face medium fiscal sustainability risks, primarily related to the projected ageing costs contributing with 1.6 pp. of GDP over the very long run, in particular in the field of long-term care expenditure. The long-term sustainability gap[8] shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at 3.4% of GDP.

Risks would be lower in the event of the structural primary balance reverting to higher values observed in the past, such as the average for the period 2004-2013. It is therefore appropriate for Sweden to ensure sufficient primary surpluses and to further contain age-related expenditure[9] growth to contribute to the sustainability of public finances in the long term.

Tax system

Swedish taxation is the fourth highest in the EU with a tax-to-GDP ratio (including social contributions) of 44.2% in 2012 (latest available year).

In 2013, Sweden received a CSR recommending to reduce the debt bias in taxation by phasing out tax deductibility of interest payments on mortgages or/and increasing property

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7 See Table V. The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance to be introduced until 2020, and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year until 2020 after the last year covered by the autumn 2013 forecast (year 2015) is required(indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

8 See Table V. The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

9 Ageing costs comprise long-term projections of public age-related expenditure on pension, health care, long-term care, education and unemployment benefits. See the 2012 Ageing Report for details.

taxes and to further reduce the debt-bias in corporate taxation. The analysis in this SWD leads to the conclusion that Sweden has made limited overall progress to address this recommendation (for the full CSR assessment see the overview table in Section 4), and therefore the debt bias challenge persists.

Overall, there has been no progress in reducing the debt bias in housing related taxation. Private debt is high in Sweden: at 212% of GDP in 2012, it is the seventh highest in the EU. This constitutes a macroeconomic imbalance, as analysed in the 2014 in-depth review on Sweden.[10] The design of housing-related taxation, relatively low recurrent taxes and generous scope for deductions of interest on mortgages from income tax payments, is biased towards indebtedness. Two public inquiries have tabled proposals on tax reform.[11] However, the proposed reforms that would be relevant for reducing the debt bias are limited to redefining the calculation of the tax base and they would not result in the necessary move away from debt bias in income taxation. The decrease in the tax burden on labour could have been combined with a gradual reduction of mortgage interest deductions.

Despite some progress on tackling the debt bias in corporate taxation, this is still 38.9,[12] the eighth highest in the EU. In 2009, tax provisions were introduced which reduced the tax deductibility of interest payments for intra-group loans related to the acquisition of shares from an affiliate. Following a series of public inquiries, new legislation came into force in January 2013 which further extends the restrictions on interest deductibility to all types of loans, regardless of their purpose. Interest payments are tax deductible if the creditor is taxed on the interest at a rate of at least 10%, should the interest income be the only income for the creditor (10% tax test), or if the debt has been taken on for 'sound commercial reasons'. These measures, combined with the corporate income tax rate cut from 26.3 to 22% at the beginning of 2013, aim to eliminate a large proportion of corporate debt that is solely driven by tax avoidance motives, in particular intra-group loans from abroad. Furthermore, the 'investor's deductibility', introduced as from December 2013, allows individuals acquiring shares in a new or expanding SME to deduct half of the amount of the purchase up to SEK 650000 per person and year. Nonetheless, this measure is not expected to substantially shift the balance away from debt-financing on the aggregate level, but it can help start-ups and innovative SMEs. Lastly, the government has set up a corporate tax committee. The committee's mission is to propose tax incentives to stimulate the availability of risk capital, to propose increased tax incentives for research and development and to make proposals for a more comprehensive corporate tax system, if possible replacing the current interest deduction limitations and the debt bias against equity. Its report is due in June 2014.

Some progress has been made regarding the review of the effectiveness of the reduced VAT rate on restaurant and catering services introduced in 2012 to stimulate job creation. The government has commissioned a review of the effectiveness of this subsidy and complete results are expected for 2016. Preliminary results[13] were published in December 2013 and estimate that 4000 new jobs have been created. The costs of the measure in terms of foregone revenues have not been fully assessed yet, but it is estimated that each new job costs SEK 1-1.5 million (EUR 113,000 – 170,000).

As public finances have turned into deficit since 2012, the government has announced that all new reforms will have to be fully funded in the coming two years in view to ensure the Swedish one-percent surplus target. In this respect, the 2014 spring Budget Bill proposes

[10] European Commission (2014) *Macroeconomic Imbalances. Sweden.*

[11] SOU 2012:52, SOU 2014:1.

[12] The difference between the effective tax rates using equity and debt-financing. See European Commission (2013),Tax reforms in EU Member States: Tax policy challenges for economic growth and fiscal sustainability, Taxation Paper No. 38 (also published as European Economy paper No. 5), p. 62.

[13] *Effekter av sänkt restaurang och cateringmoms*, NIER, Specialstudier, December 2013

to raise vehicle, alcohol and tobacco taxes, to abolish group registration for VAT and to lower pension savings deduction (before abolishing them in 2016) to allow for additional measures mainly in the field of education.

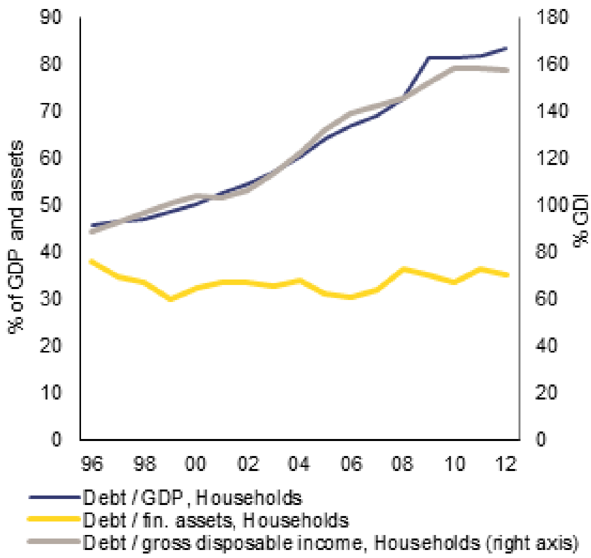
3.2. Financial sector

Sweden has a large banking sector whose total assets amount to about 400% of GDP. High and increasing exposure to households, mainly through mortgage loans, is the main credit risk of the Swedish banking sector, which is dominated by four large groups that together have about 70% market share in terms of loans or deposits. The banks are also exposed to funding risk as they finance their business predominantly on the international wholesale funding markets. Nevertheless, overall credit and funding risks in the Swedish banking sector remain stable at the current juncture, partly due to measures taken by Swedish authorities.

The foreign exposure of Swedish banks accounts for about half of their total lending, and mainly concerns the Nordic and Baltic region. Capital adequacy measured by standard regulatory ratios is high and the ratio of non-performing loans has stayed below 1% for a number of years. In 2013, the average return on equity (RoE) was at 11.3%, almost double the euro area average. Exposure to households has been increasing in line with private-sector indebtedness. Loans constitute about 55% of banking sector assets. In recent years, loans to households have been gaining share relative to loans to non-financial corporations on the back of higher credit growth. This change in balance is linked with the growing household indebtedness and increasing house prices, as well as to the inefficiencies on the housing supply side (the latter is described further in section 3.4). These issues were also analysed in detail in the 2014 in-depth review (Box 1). Household debt stood at more than 83% of GDP, or on average 158% of gross disposable income in Sweden in 2012. The lion's share of household debt is made up of mortgages (Graphs 1 and 2). At present, credit growth for mortgage loans still outpaces GDP growth, driving the household debt-to-GDP ratio further upward. In fact, the Riksbank has recently further highlighted the abovementioned risks by analysing household sector indebtedness by analysing credit information of a very large sample of borrowers,[14] i.e. by evaluating the situation while excluding those that are not indebted. The Riksbank analysis shows that the average debt ratio of indebted households (debt in relation to disposable income) was 263% in mid-2013, whereas for households with mortgages the corresponding ratio was 313% and over 400% in metropolitan municipalities. Regardless of income group the debt burden was consistently above 200% and highest among low- and middle-income earners, which translates into a higher vulnerability in the event of a loss of income and interest rate hikes. **In 2013, Sweden received a CSR concerning private-sector indebtedness.** This topic was also highlighted in the 2014 in-depth review carried out under the Macroeconomic Imbalance Procedure (see Box 1 below). The analysis in this SWD leads to the conclusion that Sweden has made limited progress on measures taken to address this recommendations (for the full CSR assessment see the overview table in Section 4).

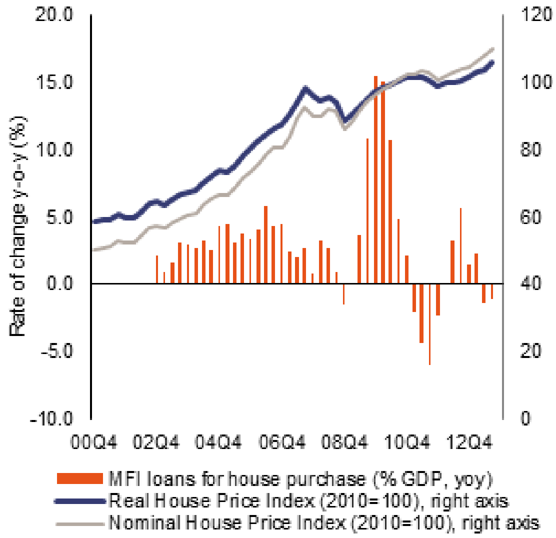
[14] *How indebted are Swedish households?*, Economic commentaries, No 1 2014, Sveriges Riksbank

Graph 1: Leverage of the Swedish households sector



Source: Commission services.

Graph 2: Evolution of house prices in Sweden



Source: Commission services.

Various initiatives have been launched to contain risks stemming from rising indebtedness. In 2010, an 85% loan-to-value (LTV) cap was placed on mortgage lending in Sweden in order to encourage more cautious credit risk assessment by banks and responsible borrowing by consumers. Since 2010, the Swedish Bankers' Association has recommended that loans with a LTV above 75% are amortised to this level, and in March 2014 this level was lowered to 70%. In 2013, the Financial Supervision Authority (FSA) recommended that banks prepare individual amortisation plans (IAP) for their customers' to promote the long-term benefits of amortisation. In March 2014, the Bankers' Association recommended to their members that IAPs should be prepared for all new borrowers as from mid-2014. The effectiveness of the FSA recommendation for individual amortisation plans remains to be verified through its impact on the actual amortisation levels.

For the Swedish banking sector, the trend of shrinking risk weighted asset (RWA) density[15] is also a specific concern. The proportion of RWA in total assets is relatively low, raising questions about the actual solvency of the banks.[16] To address this problem, Sweden has advanced the full implementation of Basel III capital requirements, requiring a minimum 10% Core Equity Tier 1 ratio (CET1) as of 2013 and 12% CET1 as of 2015.[17] Furthermore, the 15%-floor on risk weights on mortgages introduced in early 2013 translates into increased individual capital requirements for banks. [18] The FSA has announced its intention to further increase the risk-weight floor to 25% and the increase is likely to start to apply as from the autumn of 2014.[19] Moreover, the four major Swedish banks are to hold a systemic risk buffer of 3% in common equity Tier 1 capital as of 1 January 2015 and a further 2% in a common

[15] RWA density is defined as the ratio of risk-weighted assets to total assets.

[16] See European Commission (2014) *Macroeconomic Imbalances. Sweden 2014* for more detailed analysis.

[17] A capital requirement is the amount of capital a bank has to hold as required by its financial regulator. This is usually expressed as a capital adequacy ratio of equity that must be held as a percentage of risk-weighted assets.

[18] In order to calculate the capital requirement for credit risk, the nominal amount for each credit exposure is multiplied by a risk weight. This results in a risk-weighted amount, and it is this amount that is subject to capital requirements.

[19] *Capital requirements for Swedish banks*, Memorandum FI ref: 14-6258, 08/05/2014

equity Tier 1 capital requirement within the framework of Pillar 2. The FSA also intends to activate the countercyclical capital buffer (which is a capital requirement that varies over time and which is to be used to support credit supply during recessions). The details are to be discussed within the framework of the Financial Stability Council, but the Director General of the FSA indicated in May 2014 that a level of roughly 1% as from the summer of 2015 could be appropriate.[20] Finance Minister Borg has also stressed that capital requirements for banks are to be further discussed in that forum. The impact of the new risk-weight floors on RWA density and banks' capital adequacy ratios should be immediate but the long-term effect of limiting mortgage credit growth remains to be seen.

Nevertheless, these measures are not expected to solve the fundamental structural problems on the housing market that also influence household debt. The sharply rising house prices have fuelled private indebtedness over the past decade, and could have a major impact on consumption, economic performance and financial stability in the event of an adverse development. Taxation conditions create incentives for households to purchase their own houses. The Swedish tax system continues to offer generous tax deductibility of mortgage interest payments, which, together with low recurrent property taxes sustains the debt bias as explained in the previous section. In 2013, foregone tax revenue linked to mortgage interest rate deductions was SEK 33 billion (roughly EUR 3.5 billion). With rising interest rates, the effects on the budget will be even more pronounced. Therefore, taking the opportunity to reform the deductibility rules whilst interest rates are low could help to finance reforms in other areas. Such reforms could target deductible rates or limit the maximum deductible amounts. Reducing the scope of tax deductibility could be also considered. In its 2014 report, the Fiscal Policy Council recently also stressed the need to review tax incentives, among other measures, to address the serious problems it has identified linked to the housing market.[21]

The banking sector has a high share of foreign market funding in addition to local deposits, which constitute about 40% of total funding excluding equity and derivatives. Consequently, Sweden has one of the highest loan-to-deposit ratios in the EU (202%). Funding on the international wholesale market is linked with currency risks: about 60% of debt is denominated in foreign currencies, mainly in dollar and euro. Sweden decided to frontload the CRD IV liquidity requirements, making the Liquidity Coverage Ratio binding since 2013. In 2012 the Riksbank also decided to increase by 30% its foreign exchange reserves to address the foreign currency liquidity risks. The average maturity of funding instruments held by Swedish banks has been increasing in recent years. This is likely to be a result of both the authorities' actions and the favourable market conditions for issuing long-term debt in the Nordic countries, which were regarded by international investors as a safe haven during the sovereign debt crisis.

Concerning SME access to finance, the situation in Sweden compared with the EU average is good. A high proportion of Swedish SMEs (70%) had access to the financing they sought (EU: 65%) in 2013 and only 8% of applicants were rejected (EU: 13%). Access to finance is the most pressing problem for 9% of Swedish SMEs (EU: 15%), finding customers being the main concern.[22] Risk capital in Sweden continues to be accessible, especially for high-tech investments. It is more challenging, though to obtain funding for other investments, such as clean-tech and life science.

Summing up, the recently adopted and announced measures appear to be both relevant and credible in addressing some of the challenges linked to the high level of indebtedness

[20] *Kontracyklisk kapitalbuffert för storbanker bör ligga på 1 procent,* FSA press release of 21 May 2014
[21] *2014 Report of the Fiscal Policy Council*, 12 May 2014.
[22] 2013 SMEs' Access to Finance Survey, Analytical Report, European Commission, 14/11/2013

of Swedish households. Nevertheless, they seem to lack ambition and scope. More comprehensive reforms would be merited, in particular in the area of taxation. The effects of the recent initiatives also have to be monitored.

Box 3. Conclusions from the March 2014 in-depth review on Sweden

The third in-depth review (IDR) on Sweden under the Macroeconomic Imbalances Procedure was published on 5 March 2014.[23] Based on this review, the Commission concluded that Sweden continues to experience macroeconomic imbalances, that require monitoring and policy action. The main observations and findings from the analysis are:

- The indebtedness of the private sector, and in particular that of households, continues to constitute a macroeconomic risk. Against the backdrop of rising house prices, household debt, in particular in the form of mortgages, remains high. At present, credit growth for mortgage loans is less expansive but still outpaces GDP growth. Corporate debt is still high but decreasing in a low growth and investment context.
- Although house prices are not growing extensively since 2010, inefficiencies in the Swedish housing market continue to pose potential risks to macroeconomic stability, in particular in the event of house price corrections. The rental market remains subject to rigidities through the utility-value based system, while relatively high transaction taxes reduce homeowners' incentives for selling houses. The planning and zoning processes for new construction remain lengthy and opaque; limited competition among construction and property development companies also push house prices up. Generous deductions of mortgage interest payments from income tax together with low recurrent property taxes keep fuelling house prices.
- Current account surpluses, though large, continue to fall as domestic savings level off. Despite continuously losing export market shares, Sweden remains one of the most competitive economies in the EU. Results in basic education have, however, deteriorated.

The IDR also discusses the policy challenges stemming from these developments and what could be possible avenues for the way forward. A number of options can be considered:

- Consideration could be given to a comprehensive reform that gradually limits the scope of the tax deductibility of interest payments and/or at the same time increasing recurrent property taxation. In addition, it could also be useful to encourage more of an amortisation culture among borrowers.
- Focusing on the housing market, additional steps could be taken. These could include a gradual modification of the rent setting system and increasing the freedom of contract. As regards new construction, a more strategic, overarching approach to solve the inefficiencies weighing on the housing market would be useful. Further streamlining the planning and zoning processes and increasing competition in the construction sector could be considered. Identifying clear mechanisms to incentivise developers to construct on land which has already been subject to detailed planning could also be considered, as could re-assessing the incentives for municipalities to support new constructions.

The suggested measures are linked and mutually reinforcing: gradual implementation, well considered timing, broad political and public support and continuous evaluation of the impact of the measures would be necessary.

[23] http://ec.europa.eu/economy_finance/economic_governance/macroeconomic_imbalance_procedure/index_en.htm

3.3. Labour market[24], education and social policies

The Swedish labour market, characterised by constructive cooperation between social partners, produces relatively positive labour market outcomes and is adequately flexible. The employment rate was 79.8% in 2013 for those aged 20-64, the highest in the EU. Although the unemployment rate has not recovered fully since the onset of the crisis, it stabilised around 8%, well below the euro area average. The proportion of long-term unemployed among the unemployed is one of the lowest in the EU at only 19%, which limits the risk of hysteresis.[25] Moreover, the wage-setting system is quite flexible and accommodates cyclical developments; dialogue between the social partners is consensus-oriented and efficient in preventing strikes. In recent years the unemployment benefits system as well as the sickness and disability benefit schemes have become more supportive of labour integration and employment and some progress has been made in reducing labour taxes.

Despite Sweden's good performance in relation to the Europe 2020 strategy, several labour market challenges remain: the labour market situation of young people is still weak, notably for those without upper secondary education. The employment rate of non-EU nationals remains far below the EU average; persons with disabilities also have comparatively low employment rates (58.7% in 2011) and there is an above-EU-average unemployment gap between persons with and without disabilities.[26] Moreover, basic skills attainments, as shown by international surveys, including OECD’s PISA tests, have continuously fallen since 2000. The at-risk-of-poverty rate for older women increased by more than 10 percentage points between 2007 and 2012 and is above the EU average.

The delivery of a Youth Guarantee in Sweden[27]

Important challenges to deliver a Youth Guarantee (YG)[28] in Sweden are:

- Insufficient outreach to non-registered NEETs and need to develop adapted quality offers for young people far from the labour market;

- Scope to strengthen avenues for work-based learning in vocational training, in particular apprenticeships;

- Lack of partnership strategy for implementation and review;

- Insufficient arrangements for the evaluation of the overall scheme.

In 2013, Sweden received a CSR concerning the need to improve the labour market participation of young people and people with a migrant background, to complete the Youth Guarantee and to review the effectiveness of the VAT cut on restaurants and catering services in supporting job creation. Overall Sweden has made some progress in facilitating the transition from school to work, including via work-based learning. However, no progress has been made on completing the youth guarantee for those not in employment,

[24] For further details, see the 2014 Joint Employment Report, COM(2013)801, which includes a scoreboard of key employment and social indicators.

[25] The risk that unemployment becomes entrenched.

[26] European Union Statistics on Income and Living Conditions, 2011

[27] Sweden presented a Youth Guarantee Implementation Plan, entitled "Measures for youth in Sweden", in December 2013.

[28] Pursuant to the Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (2013/C 120/01): "ensure that all young people under the age of 25 years receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within a period of four months of becoming unemployed or leaving formal education".

education or training (NEETs). Some progress has been made towards fully unlocking the labour market potential of people with a migrant background, especially new arrivals. Lastly, Sweden has made some progress in addressing the VAT review.

Labour market and education

The integration of low-educated young people into the labour market remains one of the main challenges for Sweden. An important factor driving the high youth unemployment rate, at 23.4 % in 2013, is that half of unemployed young people are students looking for jobs, who typically report short unemployment periods. However, even when students are excluded, youth unemployment still appears high (13.7 % in 2013) if compared to Member States[29] with a similarly good labour market performance, where it is between 2.5 % and 8.1 %). Furthermore, recent data[30] show that the labour market is particularly difficult for low-skilled young people, whose unemployment rate has increased by 6.4pp. since 2005 to reach 39.6% in 2013. Nevertheless, it is notable that with 7.5% in 2013, Sweden has one of the lowest NEET rates in the EU.[31]

Wage agreements between the social partners over the last decade have resulted in a rather narrow wage structure, with high entry wages and little wage progression. Substantial rigidity in the lower part of the wage structure prevents wages from reflecting the productivity differentials between individual workers or sectors. Whereas differences in pay between people with and without upper-secondary education are very small, the former enjoy markedly higher employment rates. This suggests that a possible adaptation of wages for inexperienced or less-productive workers could improve their employment rate. Moreover, entry wages in some sectors, such as retail, appear to be above the market-clearing level and lead to a sub-optimal level of employment.[32] The strong duality in employment protection legislation is detrimental to low-skilled people, who face difficulties in obtaining a permanent contract.

Improving the transition from school to work remains an important objective. While the early school leaving (ESL) rate of 7.1% has been below the national target and EU benchmark of 10%, many young people in Sweden take longer than the standard three years to complete upper secondary school. Almost 25% of young people registered with the public employment services (PES) lack an upper secondary school completion certificate. Furthermore, outreach to NEETs, in particular those who are not registered (almost two thirds of NEETs), is a challenge for the PES, making the job guarantee for young people less effective for this group. Municipalities are required to monitor young people up to the age of 20 who are not in upper secondary school and in line with a new government proposal, as from 1 January 2015, they will also be obliged to provide appropriate individual measures. Implementation differs widely among municipalities, as it is up to the local municipality to decide how to tackle ESL and approach NEETs and also to what degree to collaborate with the local PES and other municipalities or other relevant actors.

In the past year, the Swedish government has taken a number of measures to provide new and broader paths from school to work, presented in the 2014 Budget and the NRP.

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[29] The Netherlands, Denmark, Finland, Germany and Austria.

[30] Žáková (2013), Sun spots on the Swedish labour market? ECFIN Country Focus. 1. May 2013

[31] EU Labour Force Survey, 2012.

[32] See also OECD, *Economic Surveys – Sweden*, 2011 and 2013; Per Skedinger, *Minimum Wages and Employment in Swedish Hotels and Restaurants*, Labour Economics, 13, 2006; Minimilöners effekter på löner och sysselsättning - en översikt, Arbetsmarknad & Arbetsliv 13(2), 2007; Effects of Increasing Minimum Wages on Employment and Hours: Evidence from Sweden's Retail Sector, IFN Working Paper No.869, 2011; Malin Sahlen, *Ungdomsarbetslöshet – när ska muren rivas*, Ekerlids Förlag, 2012.

The 2011 reform of vocational education and training (VET) has been improved and the government has proposed a new 'apprenticeship reform', providing financial compensation to apprentices, further financial incentives for companies to take on apprentices, and grants to municipalities and employers' organisations to further develop work-based learning and apprenticeships in local vocational programmes. A new employment law is to enter into force on 1 July 2014, introducing salaries for secondary school apprentices. Vocational introduction employment (VIE), rolled out in 2013 following a pilot scheme in 2012, provides a wage subsidy for employment and financial support for training (15-25% of working time) for up to 12 months. VIE is based on sectorial collective agreements and is available mainly for people who have completed upper secondary education, therefore it might not be an alternative for the weakest groups. A first review of VIE is expected to be carried out by 2016.

By providing more resources for individual needs assessment and active matching by the PES, the 2014 budget gave a boost to early activation measures from day one of unemployment for young people who are furthest away from the labour market and/or who risk long-term unemployment. Sweden also has several wage subsidies in place to stimulate demand for young labour. However, a recent study has shown that previous general reductions of social contributions have not benefited those who have not completed education and are furthest away from the labour market.[33] In this light, the 2014 budget attempts to better target potential beneficiaries by lowering the eligible age from 25 to 23 for reduced social contributions, but it does not specifically target disadvantaged young people. The government proposal was voted down in the Committee on Social Insurance on 6 May.

There is evidence that basic skills attainment is falling, which is a particular challenge for the long-term quality of education, and labour market supply. Despite high funding levels in education in EU comparison, 15-year-olds' performance in the PISA surveys carried out by the OECD continuously worsened between 2000 and 2012, with Sweden performing below both the EU and OECD averages in all three areas tested; reading, mathematics and science in 2012. To improve school outcomes, the government is focusing on improving the status and attractiveness of the teaching profession through initiatives for continuous professional development and a career development reform implemented in 2013, with salary increases for certain categories of teachers. At this juncture, funding of this reform is provided from the central budget. Furthermore, an inquiry will study the feasibility of raising compulsory schooling from 9 to 10 years for those starting school and extending school by a further year for pupils who lack the necessary grades to continue their studies at upper secondary level. Sweden is also trying to tackle early school leaving with preventive measures such as 'individual study plans' and special support to pupils at risk of dropping out. The study motivation courses introduced in 2011 as a compensatory measure have been reasonably effective with five in ten participants moving into regular education or work. Overall, it is too early to assess the results of these reforms. However, the potential impact is expected to be rather small, compared to the major reforms implemented in the 1990s, including decentralisation, school choice system and the independent school reform. Future actions could be based on the in-depth analysis of the Swedish PISA results and the school system in general, which is to be provided by the OECD in 2015.

Overall Sweden has made some progress in facilitating the transition from school to work, including via work-based learning. However, no progress has been made on completing the youth guarantee for NEETs as early measures included in the 'Job Guarantee for young people' are only available for those registered with the PES. Moreover, some government measures do not seem targeted enough.

[33] "Do payroll tax cuts raise youth employment?" by Egebark and Kaunitz, The Institute for Evaluation of Labour Market and Education Policies (IFAU), 2013.

The labour market leaves resources untapped with low employment rates among the 7% of the working age population (15-64) who are non-Swedish nationals and especially among the 4% who are non-EU nationals[34], in particular women. Sweden has a high share of asylum seekers among in particular recent migrants, who take long to integrate in the labour market due to associated problems with education, skills[35] and qualifications mismatches, lack of language skills and discrimination[36]. Sweden has larger differences in employment (50.2 vs. 81.3%), unemployment (29.6% vs. 7.2%) and activity rates (70.4 vs. 86.7%) between non-EU nationals and Swedish nationals[37] than other EU Member States, including those with a similarly large migrant population (AT, UK and NL) and there is a large gap in the employment rate between migrant women and men (41.3% vs. 59%).[38] The unemployment rate among young (15-24) third country nationals is very high, 46.8% compared to 33.9% for EU nationals and 22.6% for Swedish nationals. In addition, the rate of over-qualification for third country nationals in Sweden is 41.9% (around the EU rate of 44%), compared to 16.4% on average and 15.2% for Swedish nationals[39]. There are also differences in labour market outcomes of children of migrants[40], but they are smaller and also better aligned with the EU average, which indicates that certain labour market integration takes place.[41] Moreover, there are positive changes in employment rates between recently arrived and settled third country nationals with an increase of 25 percentage points.[42]

Some progress has been made towards fully unlocking the labour market potential of people with a migrant background, especially new arrivals. Sweden has amended the Introduction Act to enable earlier and more active involvement by the PES in the integration process. The 'work-first' principle has been strengthened so that newly arrived migrants cannot reject a suitable job offer without risking losing their introduction support. At the same time, individuals can retain their introduction and housing allowances for a limited period after taking up a job. Migrants are also beneficiaries of regular labour market programmes and wage subsidies (step-in jobs, new start jobs) and the Swedish Council for Higher Education has been tasked to develop effective methods to validate foreign qualifications in order to shorten the transition to the right job. As from 2014, the system of parental benefits has been amended to counter delays in the labour market entrance of migrant women due to long parental leave periods by placing a child age-limit on the uptake of the benefit. However, Sweden has not yet managed to narrow the employment gap between natives and immigrants.

[34] When using country of birth instead of nationality, the share is higher. Two thirds of the foreign-born population have been naturalised. Source: OECD, Settling In OECD Indicators of Immigrant Integration 2012.

[35] Foreign-language migrants have very low levels of literacy proficiency, as shown by the recent results from the OECD Programme for the International Assessment of Adult Competencies (PIAAC). While adults (aged 16-65) in Sweden perform above the EU average in all three domains: literacy, numeracy and problem solving in technology-rich (ICT) environments, the gap in literacy proficiency between the foreign and native-born is large in EU comparison. Source: http://www.oecd.org/site/piaac/Country%20note%20-%20Sweden.pdf.

[36] Eurobarometer, November 2012: http://ec.europa.eu/public_opinion/archives/eb_special_399_380_en.htm#393.

[37] Labour market situation for EU nationals is rather similar to that of Swedish nationals but there is still not negligible gap of a few percentage points.

[38] Data for age 20-64 except unemployment rate which is for age 15-64.

[39] Estimated as the share of highly educated (ISCED 5-6) working in medium and low-skilled occupations (ISCO 4-9).

[40] Direct descendants of non-EU nationals.

[41] 2008 data, Eurostat "Migrants in Europe" (2011).

[42] From 48 to 73%, 2008 data, Eurostat "Migrants in Europe" (2011).

Social policies

While Sweden has low levels of social exclusion and poverty in comparison to the EU average, relative poverty[43] among older women has doubled since 2007 and the gap between them and men of the same age group has widened. Between 2011 and 2012 relative poverty decreased somewhat (from 24.7 to 23.5%), mainly due to an increase of the housing allowance and tax cuts for pensioners. While Sweden has one of the highest female employment rates in the EU, the intensity of women's labour market participation is significantly lower than men's due to career breaks to care for family members and a high rate of part-time work.[44] Women also tend to earn less than men, partly due to the type of occupation chosen.[45] Since 1999, Sweden has a defined contributions pension system, linking pension entitlements beyond the guarantee pension with workers' contribution record, therefore gender differences in working hours, duration of working life and remuneration will be reflected in the pension outcomes for men and women. Moreover, the Swedish government's social policy is sharply focused on reducing social exclusion through labour market integration, which is not an effective approach for reducing the risk of poverty for those who are already retired. On the other hand, Swedish pensioners have access to subsidised social services and healthcare, which to some extent compensate for this group's lower income. Moreover, although the group has relatively low income levels, wealth aspects must also be considered when assessing the overall situation of individual households. Further analysis is needed to fully understand all underlying mechanisms that affect future generations of women, considering the imbalance in work intensity between men and women. A recently published public inquiry regarding the future pensionable age calls for a longer active working life of both women and men. According to the NRP, the proposals included in the inquiry report of April 2014 are currently being assessed by the government.

3.4. Structural measures promoting sustainable growth and competitiveness

Sweden continues to be one of the most competitive economies in the world, with a strong corporate sector. However, increasing competition from emerging, export-oriented economies has led to a structural decline in the export market shares of many advanced economies, including Sweden's. Notwithstanding the fact that Swedish exports have grown by 6% per year on average in the past 16 years, they have been outpaced by world exports rising by 8%. The weak economic performance of major EU markets in the wake of the international financial crisis has also curbed the rise of Swedish exports.

In 2013, Sweden received a CSR concerning the housing market. This issue was also highlighted in the 2014 in-depth review carried out under the Macroeconomic Imbalance Procedure (see Box 1 above). The analysis in this SWD leads to the conclusion that Sweden has made limited progress on measures taken to address this recommendation (for the full CSR assessment see the overview table in Section 4).

The housing market

During the previous two decades, the Swedish housing market has been characterised by a steady and strong rise in prices. In addition to demand-side factors affecting this development (as discussed in section 3.2), several supply-side factors also contributed to the

[43] The at-risk-of-poverty rate is the proportion of people with an equivalised disposable income (after social transfer) below the at-risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income after social transfers. This indicator does not measure wealth or poverty, but low income in comparison to other residents in that country, which does not necessarily imply a low standard of living.

[44] Employment and Social Development in Europe Review 2013, Chapter 3: The gender impact of the crisis and the gap in total hours worked and OECD, 2012, Closing the Gender Gap.

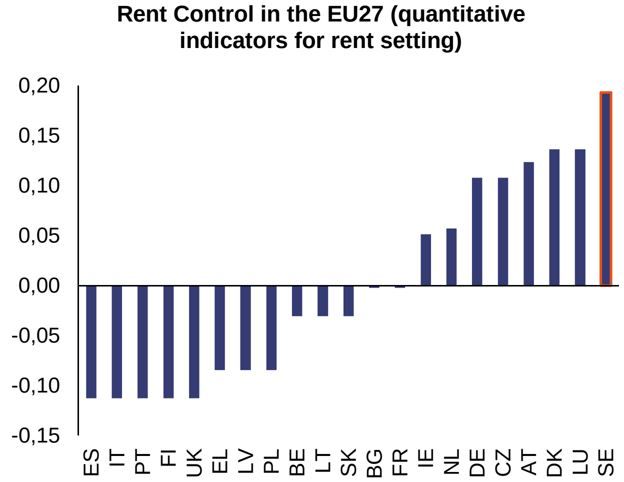
[45] EU Structural Earning Survey, 2010

steady rise in house prices. Despite the favourable fundamentals (strong economic growth, steadily rising population, growing house prices), new constructions remained at low levels for a prolonged period. From 2002 to 2013, housing investment amounted to 3.2% of GDP on average in Sweden, while the corresponding figure for the EU28 stood at 5.4% of GDP. Increasing demand in the housing sector has not been matched by an increased level of new construction activity. As a result, Sweden has built up a considerable investment gap in the housing sector and although it shows some signs of recovery since mid-2013, construction in Sweden remains subdued, causing increasing house shortages mainly in urban areas.[46] In order to stimulate an increased supply of housing, in the longer term larger infrastructure projects, as for example the metro extension planned in the Stockholm region, can also play a role.

However, currently the particularly long and complex planning and zoning process increases building time and uncertainty, as also recently highlighted by the World Bank in the context of barriers to firm and labour mobility.[47] This area has seen promising reform initiatives recently, and new measures affecting the Planning and Building Act were proposed by the government in mid-March 2014,[48] which should have the potential to ease and shorten the process. Nevertheless, the structure of the construction market remains characterised by weak competition, with a market dominated by four companies and with very limited participation of SMEs or foreign companies. In addition, sale of land for construction is not always conducted in a transparent manner, while local municipalities often do not have sufficient incentives to support new constructions in their areas holding back and/or postponing investments in this area.

The Swedish rental market is characterised by growing structural imbalances, in particular in dynamically growing urban areas. Market inefficiencies are primarily attributed to the high level of rigidity of the rental system (Graph 3).

Graph 3: Rental control in the EU



Source: Commission services

Distorted incentives on the rental market prevent an efficient use of the existing housing stock, which pushes up house prices. Due to rental market inefficiencies, rents and market prices differ substantially in some areas. This causes excessive demand on the rental market,

[46] Lack of sufficient housing implies social and economic constraints on growth. See for instance Macroeconomic Imbalances Sweden 2014, Economic and Financial Affairs, March 2014.

[47] *Sweden's Business Climate: Opportunities for Entrepreneurs through Improved Regulations*, World Bank, 2014.

[48] Legislative proposal 2013/14:126 of 18 March 2014.

fuelling house price increases in substitute segments (such as tenant-owned apartments). Moreover, the current taxation rules do not sufficiently encourage mobility. Although the Swedish government has taken several (albeit limited) steps on the rental market to tackle these shortcomings, it has so far not addressed the fundamental challenges linked to rent setting and the lack of freedom of contract between individual tenants and landlords. This is also reflected in the NRP, which discusses recent measures to promote construction, but does include additional measures to address the rental market dysfunction. In its 2014 report, the Fiscal Policy Council recently also stressed that further measures, among others a review of the utility value system, is needed to address the serious problems it has identified linked to the housing market.[49]

The lack of sufficient housing implies important social and economic constraints on growth.[50] The housing market has moreover had a role in previous financial crises and risks representing an important source of macroeconomic imbalances.[51] Distorted fundamentals and inefficiencies on the market thus have to be addressed to avoid imbalances building up, which could have important impact on private indebtedness, consumption, economic performance and financial stability of the country.

To sum up, the recently adopted and announced measures appear to be relevant and credible in addressing some of the challenges linked to the supply-side of the Swedish housing market. Nevertheless, they seem to lack ambition and scope. More comprehensive reforms addressing the complexity of the supply-side bottlenecks would be merited.

The business environment

The Swedish corporate sector has a high degree of international competitiveness, and Sweden ranks sixth in the World Economic Forum Global Competitiveness Report 2013-14. The structure of the Swedish export market has helped the Swedish economy to perform relatively well despite the euro-area downturn. However, Sweden's export market share is falling and companies are facing problems due to slacker demand from traditional export markets.

The export-oriented Swedish economy is highly dependent on its industry maintaining a competitive edge in a global marketplace, and market share losses in goods are also increasingly compensated by gains in services export. In general, the productivity of the Swedish services market is rising, with both employment and value added growth figures in market services being among the top in the EU over 2008-12 (Graph 4). Overall, Swedish firms benefit from a favourable regulatory framework in service sectors, but the electricity and telecom markets stand out as having a more challenging regulatory environment[52]. In the telecom sector, it will be important to monitor the impact of the recent initiatives by the regulator and the government[53] on the ease of comparing offers and switching providers. Consumers' overall assessment of the markets for internet services provision and mobile telephone services is second and fourth lowest in the EU respectively.[54] The difficulty to switch internet provider (due to reasons such as long contract duration, complex bundled

[49] *2014 Report of the Fiscal Policy Council*, 12 May 2014.

[50] Insufficient housing supply in particular affects vulnerable groups (new entrants to the labour market, immigrants, students) that do not get access to adequate housing thereby hampering labour mobility.

[51] European Commission (2012): Scoreboard for the surveillance of macroeconomic imbalances: technical explanations on the scoreboard.

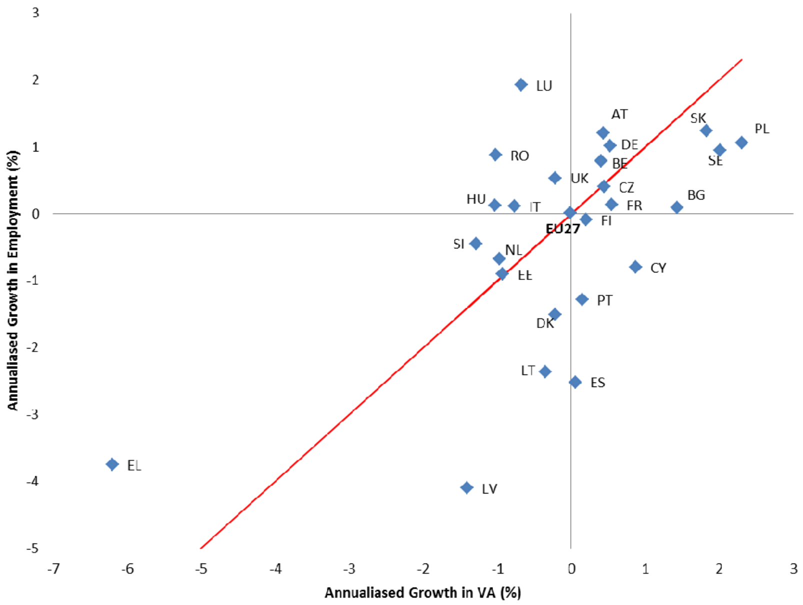
[52] European Commission, DG Economic and Financial Affairs, *Thematic fiche on market services*.

[53] Legislative initiative to shorten the notice periods for telecom contracts to one month (as of May 2014).

[54] 10th Consumer Markets Scoreboard (to be published in mid-June 2014).

products and high termination fees) was also confirmed by a 2012 Commission study on internet services provision.[55]

Graph 4: Employment and value added growth in market services (2008-12)



Source: Commission services.

The Swedish government has come forward with a number of proposals that aim to improve competitiveness further. SEK 23 billion (EUR 2.56 billion) were allocated to reform measures to improve conditions for growth and competitiveness in the 2013 budget. The previous corporate tax rate of 26.3% (above the EU average) was also reduced to 22% in January 2013 (slightly below the EU average). The 'investor's deductibility' introduced as from December 2013 allows individuals acquiring shares in a new or expanding SME to deduct half of the amount of the purchase up to SEK 650 000 per person and year, and as such the measure could facilitate the development of start-ups and innovative SMEs. In addition, the government proposes to cap companies' cost linked to employees' illness by introducing a ceiling beyond which these costs will be borne by the state at an expected cost of SEK 360 million (or roughly EUR 40 million) per year. To strengthen entrepreneurship policies and optimise the corporate tax system, the government appointed an Entrepreneurship Committee in spring 2014, with a view to boosting the business climate in Sweden. Proposals by the Committee are to be neutral in terms of their effect on public finances.

Starting a business remains time-consuming in Sweden with the current lead time being approximately two weeks,[56] substantially longer than the agreed Small Business Act target of three days. E-submission speeds up the process with two days on average, but the main cause of delays is due to the checking of company names. An IT tool is being developed for applicants to check company names before submission. As regards the procedures and costs linked to starting a business, and to export across borders, only limited changes have been introduced over the previous five years.[57]

[55] The functioning of the market for internet access and provision from a consumer perspective, Study on behalf of the European Commission, DG SANCO, 2013.

[56] http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/sweden_en.pdf

[57] European Commission, DG Economics and Financial Affairs, *Business dynamics and business costs in EU Member States.*

To sum up, the recently adopted and announced measures appear to be credible and appropriate to address the challenges linked to the Swedish business environment. They also address the 2014 AGS priority of promoting growth and competitiveness for today and tomorrow.

Research and innovation

Although no CSR relating to research and innovation was addressed to Sweden in 2013, due to the adoption of the Research and Innovation Bill in late 2012, the Commission undertook to continue to monitor its implementation and practical effects going forward. Swift and efficient implementation remains a key challenge for Sweden, in an environment where the R&D intensity of Swedish business enterprises has been falling since 2001. This process is largely linked to the internationalisation of research and innovation in larger firms, tapping into available knowledge and expanding markets mainly in Asia. This trend is also visible in employment, with larger Swedish corporations growing globally while at the same time reducing employment in Sweden.

Swedish research and innovation policy is addressing the structural challenges linked to internationalisation and commercialisation through a place-based,[58] regional approach focusing mainly on innovation in SMEs. Institutes for knowledge circulation and cluster creation are used to foster open innovation. Challenge-driven innovation is targeted by taking a lead markets approach aimed at commercialising solutions that merge products and services. This policy allows Sweden to make some progress in addressing this challenge.

With a strong increase in public R&D investments since 2008, in line with the principle of growth-friendly fiscal consolidation, Swedish research and innovation policy is building on Sweden's excellence in science and technology. The OECD Review on Innovation Policy bears witness to this as Sweden's innovation performance is ranked as one of the best in the world. According to the 2014 Innovation Union Scoreboard Sweden remains the EU innovation leader. Efforts have also been made to better link the focus areas of Swedish research and innovation (R&I) policy to the Horizon 2020 programme, in areas such as sustainable cities, innovative health care solutions or waste management, clean-tech incubators and innovative food supply chain solutions. The NRP also addresses a measure implemented in January 2014 aiming to stimulate research activities by reducing social fees of employers by 10% for persons working with R&D. The total reduction may not, however, surpass SEK 230 000 (roughly EUR 25 500) per month and concern.

All in all, although the implementation of the R&I Bill seems to be on track, and measures taken appear relevant, the pursuit of an active innovation policy and investments in R&D need to remain a top priority for the Swedish government.

Environment, energy and transport

Sweden maintains a good mix of different types of energy-saving measures, supported at various governance levels, and tackling all sectors of the economy.

As regards energy infrastructure, Sweden has a very extensive electricity transmission network. However, there is significant congestion between the north, where the hydroelectric power plants are predominantly located, and the demand centres in southern Sweden. This led the authorities to divide Sweden into four distinct pricing areas, which will improve market incentives for creating new generation capacity and interconnectors. Hydropower dependency makes Sweden vulnerable to the hydrological situation, leading to price volatility, especially

[58] Place-based approaches can be most simply defined as stakeholders engaging in a collaborative process to address issues as they are experienced within a geographic space, with the aim of strengthening ownership and accountability.

when a low reservoir level coincides with unplanned/temporary closures of a nuclear plant.[59] In the building sector, new European legal obligations have been introduced. However, there are limited incentives to put the ambitious building efficiency requirements in operation, especially for the existing building stock.

Sweden has been successful in reaching its targets as regards renewable energy, which is mainly promoted through a quota system based on a certificate trading system. Tax regulation mechanisms and a subsidy scheme have also been introduced. The carbon tax creates an incentive for renewable heating, but exemptions from the energy tax are also major motivators. The main incentive for renewable energy use in transport is currently a tax exemption for biofuels but a new law providing for an incorporation quota for biofuels is set to enter into force on 1 May 2014.

The Swedish electricity market functions fairly well. Market concentration is moderate, with the three largest retail suppliers controlling around half of the market and approximately 80% of power generation in Sweden. The proportion of network fees and taxes in final electricity prices has increased in recent years. The government announced in February 2014 its intention to revisit the applicable legislation, which should ensure that the regulator is fully competent to set appropriate fees in line with applicable EU legislation (Directive 2009/72/EC).

Sweden's energy and climate policies are overall successful. Between 1990 and 2012, Sweden's total greenhouse gas (GHG) emissions fell by 13 % while GDP per capita increased by around 42 %. According to the latest national projections, Sweden is expected to reach its emissions reduction target in 2020. Sweden is also making good progress towards achieving its other climate and energy-related EU targets. Nevertheless, emissions from transportation, which make up 25% of national emissions, remain high. The Swedish car fleet is still relatively inefficient compared to the EU average. In order to stimulate further emission reductions in the transport sector, the government is promoting tax measures and pilot programmes promoting low-carbon vehicles and technologies, including for biofuels. A government inquiry on measures to reduce the transport sector's emissions and dependency on fossil fuels was published in December 2013, with a view to framing a long-term strategy. Sweden has adopted a voluntary national target to reduce non-ETS emissions by 2020 by 40% compared to 1990 and by 33% compared to 2005, of which two thirds should be achieved domestically.

The overall situation of the transport infrastructure network is quite satisfactory, with rising investment levels. The new infrastructure projects and additional funding in 2012 should start having an impact. However, the level of investment in the maintenance and upgrading of the Swedish rail system continues to be an area with limited progress. Investments are needed to reduce delays and eliminate remaining bottlenecks, particularly on cross-border rail traffic with continental Europe. Sweden is in line with the EU average (2.2% of total national transport) in terms of the cabotage[60] penetration rate. While all transport modes are important for future Swedish export traffic, potential capacity bottlenecks need careful consideration. In this context, maritime transport continues to offer a strong alternative and could offer support for the Swedish climate improvement ambitions. Some further considerations, resulting from several evaluations, aiming at strengthening this mode further were taken: In 2013 the government adopted an action plan for improved competitiveness of the Swedish shipping industry and a maritime strategy is due to follow in the autumn of 2014.

[59] Natural gas plays a relatively small role in the energy system and the gas infrastructure is not extensive.

[60] Cabotage refers to road transport companies carrying out international freight transport activities abroad with both the origin and the destination of the transport being outside their country of registration. The proportion of cabotage can be seen as an indicator of the degree of openness of the transport market of that country.

The strategy aims to address the whole maritime cluster, including maritime transport, and should bring forward concrete measures to boost its competitiveness, including new rules meant to counteract the flagging out of Swedish vessels. In this context, it is noted that the government notified the European Commission of its intention to introduce a new measure aimed at vessels such as research and supply vessels, to enter into force in June 2014.

Box 4: Potential impact of structural reforms on growth – a benchmarking exercise

Structural reforms are crucial for boosting growth. It is therefore important to know the potential benefits of these reforms. Benefits of structural reforms can be assessed with the help of economic models. The Commission uses its QUEST model to determine how structural reforms in a given Member State would affect growth if the Member State narrowed its gap vis-à-vis the average of the three best EU performers on key indicators such as the degree of market competition in the economy and various aspects pertaining to the labour market. Improvements on these indicators could raise Sweden's GDP by about 3% in a 10-year period. This result corroborates the analysis of Section 3.4 according to which the largest gains could be reaped by improving market competition, in particular in the construction sector. As discussed in Section 3.3, measures related to labour market integration and education could also have an impact on GDP. For instance, a higher female employment rate could yield benefits already in the short run to medium term.

Table: Structural indicators, targets, and potential GDP effects[61]

Reform areas		SE	Average 3 best EU performers	GDP % relative to baseline	
				5 years	10 years
Market competition	Final goods sector markups (price-cost margin)	0.20	0.13	1.9	2.3
Market regulation	Entry costs	0.60	0.13	0.0	0.0
Tax reform	Implicit consumption tax rate	27.3	28.6	0.0	0.0
Skill enhancing reforms*	Share of high-skilled	8.5	10.7	0.0	0.0
	Share of low-skilled	17.6	7.5	0.0	0.0
Labour market reforms	Female non-participation rate (25-54ys):			0.2	0.2
	- low-skilled	31.1	26.4		
	- medium-skilled	11.6	10.5		
	- high-skilled	7.2	4.3		
	Low-skilled male non-participation rate (25-54ys)	12.2	7.7	0.0	0.1
	Elderly non-participation rate (55-64ys):			-0.1	-0.1
	- low-skilled	12.5	13.4		
	- medium-skilled	5.0	4.8		
	- high-skilled	2.7	3.3		
	ALMP (% of GDP over unemployment share)	19.3	37.4	0.1	0.1
	Benefit replacement rate**	64.4	52.6	0.3	0.4
Total				2.5	3.1

Source: Commission services. Note: In these simulations it is assumed that all Member States undertake reforms which close their structural gaps by half. The table shows the contribution of each reform to total GDP after five and ten years. Sweden is among the best performers for a number of indicators. In these cases, we do not simulate the impact of reform measures. Although Sweden can still benefit from measures taken by other Member States, this can have a negative statistical effect, e.g. in the case of the elderly non-participation rate.[62] * The simulation model foresees also a long run, 50-year-scenario under which the effect of increasing the share of high-skilled population would be 1.1% of GDP and of decreasing the share of low-skilled would be 1.9%. ** EU average is set as the benchmark.

[61] Final goods sector mark-ups is the difference between the selling price of a good/service and its cost. Entry cost refers to the cost of starting a business in the intermediate sector. The implicit consumption tax rate is a proxy for shifting taxation away from labour to indirect taxes. The benefit replacement rate is the % of a worker's pre-unemployment income that is paid out by the unemployment scheme.. For a detailed explanation of indicators see Annex.

[62] For a detailed explanation of the transmission mechanisms of the reform scenarios see: European Commission (2013), "The growth impact of structural reforms", Chapter 2 in QREA No. 4. December 2013. Brussels; http://ec.europa.eu/economy_finance/publications/qr_euro_area/2013/pdf/qrea4_section_2_en.pdf

As regards environmental challenges, the 2014 AGS highlights the reduction of environmentally harmful subsidies as a key area. In Sweden a guide for identifying, assessing and phasing out non-tax environmentally harmful subsidies was developed in 2013. It gives guidance but still lacks proposals with clear timelines based on these assessments. Efforts continue to reduce environmentally harmful tax reductions and exemptions for fossil fuels.

To sum up, the structural measures announced by the Swedish government in relation to the fields of energy, environment and transport in general appear both appropriate and credible.

3.5. Modernisation of public administration

Overall, Sweden's public administration is efficient and performs well with regard to government and judicial system effectiveness as well as digital technology utilisation. Sweden is ranked in the top percentile by the World Bank's Worldwide Governance Index (WGI). Overall, tax compliance is high and tax administration cost-effective.[63] The implementation of new technology for modernising public administration remains highly advanced but public e-procurement could be extended further and procedures could be simplified and shortened to optimise tendering opportunities for SMEs and foreign companies. The Swedish Competition Authority has also recently identified risks linked to unsound competition practices in public procurement[64] and to public providers competing on unequal terms with the private sector. Linked to public procurement, the NRP reports that the government has tasked the Competition Authority with providing support for authorities engaged in public procurement as well as for participating companies, irrespective of whether these companies are Swedish or based in other EU Member States. There is room for improvement in terms of reducing the administrative burden (including a return to the principles of tax uniformity and neutrality) and simplifying procedures. The efficiency of the national judicial system seems high, with disposition time (measuring the average trial length) being significantly shorter than the EU average and markedly lower backlog ratios of unresolved cases.[65] Sweden is a frontrunner in digital technology utilisation, having an ambitious broadband plan and making significant progress in broadband roll-out including rural areas. Sweden remains a net contributor to the EU budget, and the absorption rate of EU funds is almost 70% of allocated resources, slightly below the EU average. Together with the Netherlands and Denmark, Sweden does not show strong regional disparities in GDP or employment, but GDP per capita is still significantly higher in the capital area than in other parts of the country.[66]

In 2013, Sweden did not receive a CSR as regards modernisation of the public administration. Nevertheless, Sweden implemented measures to further strengthen the responsiveness of its administration.

The 2014 Budget Bill included a number of measures aiming to facilitate administrative procedures for businesses. SEK 52 billion were earmarked to develop a one-stop-shop register where businesses can submit necessary data once only. The government also proposed to render the Regulatory Council's activities permanent, and to further strengthen its role linked to impact assessment of legislative proposals. The Swedish Companies Registration Office has also been tasked by the government with evaluating how rules

[63] European Commission, DG Enterprise and Industry, *Excellence in public administration for competitiveness in EU Member States*, 2012.

[64] Swedish Competition Authority, *Osund konkurrens i offentlig upphandling* (Report 2013:6).

[65] European Commission, DG Economic and Financial Affairs, *Thematic fiche on civil justice performance*.

[66] European Commission, DG Economic and Financial Affairs, *Cohesion Policy Funds and the 2014 European Semester: a framework to identify possible synergies*.

regarding auditing and annual report preparation could be facilitated for businesses. However, the objectives of the government presented in the 2013 Budget Bill remain to be quantified and operationalised.

Summing up, Swedish citizens and enterprises overall benefit from a modern public administration and the objectives of the government in this area are in line with those of the 2014 AGS. Nevertheless, progress has been slower in recent years and it is not clear whether substantial improvements will be made in the course of 2014. While there is no doubt about the relevance of the announced measures, their effectiveness is uncertain, at least in the short term.

4. CONCLUSIONS

Overall, the Swedish economy shows strong international competitiveness, a sound performance in research, development and innovation and reliable and transparent institutions. In other respects, however, it performs less well. Unlike many other EU Member States, Sweden has experienced a continuous rise in household indebtedness in the course of the previous decade. The rise in household debt, mainly linked to mortgages, has taken place on the back of sharply rising house prices and favourable tax incentives coupled with unprecedentedly low-interest-rates. The Swedish housing market also has inefficiencies on the supply side, with a low degree of competition in the construction sector, inefficient zoning and planning processes and a high degree of rigidity in the rental system. In general, contrary to their EU peers, Swedish households do not regard mortgage amortisation as a preferred mode of saving. The significant private-sector debt makes household budgets very sensitive vis-à-vis potential interest rate increases, as it is characterised by sustained credit growth and a very slow amortisation pace. Moreover, most mortgages are taken up at variable interest rates. Potential house price corrections could also dampen consumption patterns, thereby challenging macroeconomic development also through the risks that would be imposed on the banking sector. By continuing to address private sector debt, Sweden could reduce the vulnerability for household balance sheets and reduce the risks of triggering an economic slowdown as a consequence of withheld consumption. While Sweden has a well-functioning labour market overall, with a high labour market participation rate, labour market entry has proved difficult for certain vulnerable groups, in particular low-educated young people and non-EU immigrants, for whom labour demand remains slack despite the measures that have already been taken. Failure to ensure a well-functioning labour market for all segments of society may have long-term effects on its functioning. All of the above-mentioned issues were addressed in the 2013 country-specific recommendations.

The analysis in this staff working document leads to the conclusion that Sweden has made some progress in addressing the 2013 country-specific recommendations. Sweden's public finances remain sound, its budget deficit remains relatively low and public debt is comparatively modest, although deficit figures worsened in the course of 2013 compared to previous years. Private-sector debt remains pronounced, and although measures have been taken to address this challenge, they appear insufficient. As regards the housing market, while some measures have been taken to facilitate and shorten the time required to construct new dwellings in Sweden, competition in the sector remains restricted and the rent-setting system would need substantial reform. Hence, overall only limited progress has been made to address this challenge. Finally, as regards the labour market, the government has actively promoted a better integration of vulnerable groups and measures have been taken to facilitate the transition from school to work. The education system has also been the target of recent measures. Nevertheless, the bulk of these will be implemented in 2014 and it is too early to say whether they will have any significant effects on the target groups.

The national reform programme confirms Sweden's commitment to address shortcomings in the areas of the private-sector indebtedness, the housing market, the labour market and the education system and in general addresses the above-mentioned areas in a pertinent and credible way. The policy plans submitted by Sweden address most of the challenges identified. Nevertheless, the national reform programme does not include measures aimed at further addressing the debt bias in taxation that affects housing, or remaining rigidities linked to the rental market. The convergence programme demonstrates Sweden's commitment to keep a sound budgetary position in view of the medium-term objective.

OVERVIEW TABLE

2013 commitments	Summary assessment[67]
Country-specific recommendations (CSRs)	
CSR 1: Implement the measures necessary to pursue a growth-friendly fiscal policy and preserve a sound fiscal position ensuring compliance with the medium-term objective over the programme horizon.	Sweden has made **substantial progress** in addressing CSR 1. • The general government budget had a deficit of 1.1% in 2013. Nevertheless, taking into account the downward revision of the medium-term objective in the 2012 convergence programme (from a surplus of 1 % of GDP to a deficit of 1 % of GDP), Sweden is still likely to continue to meet its commitment under the Stability and Growth Pact and the CSR. • A continued monitoring of the soundness of public finances is needed, in particular as regards the long-term sustainability linked to expenditure for care services in an ageing society.
CSR 2: Continue addressing risks related to private debt by reducing the debt bias in housing taxation by phasing out tax deductibility of interest payments on mortgages or/and increasing property taxes. Take further measures to foster prudent lending by measures promoting amortisation of mortgages. Further reduce the debt-bias in corporate taxation.	Overall, Sweden has made **limited progress** in addressing CSR 2. Sweden has made **no progress** in addressing the taxation part of CSR 2: • Sweden has neither announced nor adopted any measures to address the tax deductibility of interest payments on mortgages or to reduce the recurrent property tax.. Sweden has made **limited progress** in addressing the prudent lending/mortgage amortisation part of CSR 2: • Sweden has taken some action to foster prudent lending by introducing the 15% risk weight floor for mortgage exposures in May 2013, and by announcing a further increase to 25%. Nevertheless, amortisation practices remain relaxed with very long amortisation periods below 75% LTV rates and strong measures in this regard have not been taken. Sweden has made **some progress** in addressing the corporate taxation debt bias part of CSR 2:

[67] The following categories are used to assess progress in implementing the 2013 country-specific recommendations: No progress: The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures. Limited progress: The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk. Some progress: The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. Substantial progress: The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR. Fully addressed: The Member State has adopted and implemented measures that address the CSR appropriately.

	• Sweden has extended the restrictions on interest deductibility to all types of intra-group loans as of January 2013 and also introduced an investors' deductibility that could alleviate the debt bias in taxation. Nevertheless, it is too early to fully evaluate the effect of these measures.
CSR 3: Improve the efficiency of the housing market by continued reforms of the rent setting system and strengthening the freedom of contract between individual tenants and landlords. Promote increased competition in the construction sector and review the planning, zoning and approval processes with the aim of increasing transparency, shortening lead times and reducing entry barriers for construction companies.	Overall, Sweden has made **limited progress** in addressing CSR 3. Sweden has made **limited progress** in addressing the rental market part of CSR 3: • Sweden has taken some measures to address the rental market, but these measures appear insufficient to address the underlying structural problem linked to the high degree of rigidity of the rent system. Sweden has made **some progress** in addressing the construction sector part of CSR 3: • Sweden has adopted measures to address the inefficiencies of the zoning and planning process, as well as municipalities' planning monopoly by requiring them to take a regional perspective when defining housing needs. These measures are promising, but not all of them have been implemented yet and it will remain vital to assess the implementation in practice, as no penalties are foreseen for failing municipalities. Further opening up municipalities' planning monopoly to other stakeholders, allowing for planning and zoning proposals from the private sector, could be a powerful way to shorten the process
CSR 4: Reinforce efforts to improve the labour-market integration of low-skilled young people and people with a migrant background by stronger and better targeted measures to improve their employability and the labour demand for these groups. Step up efforts to facilitate the transition from school to work, including via a wider use of work-based learning, apprenticeships and other forms of contracts combining employment and education. Complete the Youth Guarantee to better cover young people not in education or training. Complete and draw conclusions from the review of the effectiveness of the current reduced VAT rate for restaurants and catering services in support of job creation.	Sweden has made **some progress** in addressing CSR 4. Sweden has made **some progress** in addressing the labour market integration and education and training part of CSR 4: • Measures have been adopted to facilitate the transition from school to work (apprenticeships reform, including an 'apprentice salary') and help young people get work experience (vocational introduction employment). • There has been a *de facto* strengthening of the job guarantee through the introduction of early measures for those assessed to be most in need, but the guarantee is still weak on coverage and on outreach towards non-registered NEETs • Sweden is also working to speed up the integration of migrants (work first principle, validation). • Since reforms came into effect in 2013 or will be implemented in 2014, it is too early to say whether they will have any significant effects on the target groups.

	Sweden has made **some progress** in addressing the VAT review part of CSR 4: • A first, preliminary evaluation made by the National Institute of Economic Research suggests that 4 000 jobs may be attributed to the reduced VAT rate. Nevertheless, the cost-effectiveness of the measure still remains to be fully evaluated. A final evaluation is due in January 2016.
Europe 2020 (national targets and progress)	
Policy field target	**Progress achieved**
Employment rate target set in the National Reform Programme: well over 80 %.	Employment rate 2011: 79.4%, 2012: 79.4%, 2013: 79.8%. The EU wide target has already been met. It was also attained before the crisis in 2007-08. Achievement of a more ambitious national target was hindered by the 2008-09 crisis. Since then progress has picked up and the Swedish labour market performance remains solid.
R&D target: 4 % of GDP by 2020	Gross domestic expenditure on R&D (in % of GDP) in 2010: 3.39 %, 2011: 3.39 %., 2012: 3.41% Although public expenditure on R&D as a percentage of GDP grew yearly by 3.3 % in 2007-12, a determined counter-cyclical effort, private R&D intensity decreased by 1.6 % per year over the same period. Against this background, the Swedish R&D target for 2020 is realistic and strikes the right level of ambition, providing the new policy of challenge-based innovation succeeds in spurring the development of high-growth innovative enterprises. However, given the negative trend in private R&D, achievement of this target will be challenging and will require full and swift implementation of the National Innovation Strategy.
Greenhouse gas emissions target: -17 % (compared to 2005 emissions; emissions under the EU Emissions Trading Scheme (ETS) are not covered by this national target).	Change in non-ETS greenhouse gas emissions between 2005 and 2012: -14%. According to the latest national projections and taking into account existing measures, the target is expected to be achieved: -19% in 2020 compared to 2005 (with a margin of 2 pp).
Renewable energy target: 49 % Share of renewable energy in the transport sector: 10 %	According to provisional Eurostat data, Sweden has already reached its 2020 target. The proportion of renewable energy in gross final energy consumption reached 51% (preliminary) in 2012 and stood at 46.8% in 2011. The corresponding figure (preliminary) was 12.6% in the transport sector (2011).
Energy efficiency target: 20% reduction in energy intensity (vs. 2008)	Sweden's methodology for developing the target for energy efficiency is based on analysing energy

By 2020: level of 43.4 Mtoe primary consumption and 30.3 Mtoe final energy consumption	intensity in 2008 and setting a target of reducing the energy intensity of Sweden's economy by 20% in 2020. Sweden notified the policy measures it plans to adopt to implement Article 7 of the Energy Efficiency Directive.
Early school leaving target: 10 %	Early leavers from education and training (percentage of the population aged 18-24 with at most lower secondary education and not in further education or training): 2010: 6.5 %, 2011: 6.6 %, 2012: 7.5 %, 2013: 6.9% (provisional data) The target has been achieved.
Tertiary education target: 40-45 %	Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education): 2010: 45.3 %, 2011: 46.8 %, 2012: 47.9 %, 2013: 48.2 % (provisional data) The target has been achieved.
Risk of poverty or social exclusion target: Reducing to well under 14 % the number of people aged 20-64 who are not in the labour force (except full-time students), long-term unemployed or on long-term sick leave	People at-risk-of-poverty or social exclusion in 2011: 13.4%, 2012: 13.1%, 2013:12.7% According to the 2014 national reform programme the proportion of the population covered by the target is estimated to be about 12.7% of the age group in 2013, which would suggest that the target has been reached.

ANNEX

Standard Tables

Table I. Macro-economic indicators

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015
Core indicators								
GDP growth rate	3.5	2.7	1.7	2.9	0.9	1.5	2.8	3.0
Output gap [1]	-0.3	-0.3	-0.3	-0.4	-1.4	-2.0	-1.4	-0.7
HICP (annual % change)	1.1	1.8	2.1	1.4	0.9	0.4	0.5	1.5
Domestic demand (annual % change) [2]	3.0	1.8	2.1	3.2	0.3	1.5	3.1	3.1
Unemployment rate (% of labour force) [3]	8.0	6.7	7.3	7.8	8.0	8.0	7.6	7.2
Gross fixed capital formation (% of GDP)	16.8	17.4	18.9	18.7	19.0	18.3	18.8	19.3
Gross national saving (% of GDP)	21.8	23.7	26.7	26.1	25.3	25.0	25.1	25.5
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**0.1**	**0.4**	**1.5**	**0.2**	**-0.6**	**-1.1**	**-1.8**	**-0.8**
Gross debt	**66.5**	**51.9**	**41.2**	**38.6**	**38.3**	**40.6**	**41.6**	**40.4**
Net financial assets	**-18.2**	**1.4**	**20.4**	**20.7**	**23.7**	**n.a**	**n.a**	**n.a**
Total revenue	59.2	55.0	53.9	51.5	51.2	51.5	50.5	50.5
Total expenditure	59.1	54.6	52.4	51.3	51.8	52.6	52.2	51.3
of which: Interest	4.5	2.2	1.4	1.0	0.7	0.6	0.7	0.6
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**2.9**	**3.8**	**3.5**	**1.9**	**1.5**	**2.1**	**2.1**	**1.7**
Net financial assets; non-financial corporations	**-122.1**	**-125.0**	**-172.9**	**-167.3**	**-180.2**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**13.2**	**-11.8**	**-2.5**	**-4.1**	**0.7**	**n.a**	**n.a**	**n.a**
Gross capital formation	12.4	11.9	12.4	13.4	12.5	12.2	12.7	13.2
Gross operating surplus	22.3	20.7	21.7	21.7	20.8	20.6	20.6	20.8
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**0.8**	**1.7**	**2.6**	**4.0**	**5.4**	**5.5**	**5.5**	**5.2**
Net financial assets	**93.9**	**111.5**	**141.7**	**138.7**	**147.3**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	40.3	40.5	40.4	40.8	41.6	41.7	41.7	41.5
Net property income	3.3	2.2	3.3	3.5	3.9	4.0	3.8	3.6
Current transfers received	24.8	23.7	22.0	20.8	21.4	21.9	21.8	21.6
Gross saving	2.8	4.5	5.9	7.2	8.4	8.4	8.6	8.3
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**4.0**	**6.2**	**7.6**	**6.1**	**6.3**	**6.4**	**5.7**	**5.9**
Net financial assets	**34.0**	**24.7**	**14.6**	**13.9**	**10.3**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	6.7	7.3	7.0	5.6	5.8	5.6	5.3	5.3
Net primary income from the rest of the world	-1.5	0.2	2.2	2.2	2.5	2.8	2.4	2.3
Net capital transactions	-0.5	0.0	-0.2	-0.1	-0.1	-0.2	-0.4	-0.1
Tradable sector	42.6	41.8	40.7	40.1	39.1	38.0	n.a	n.a
Non tradable sector	45.0	45.8	46.8	47.5	48.7	49.8	n.a	n.a
of which: Building and construction sector	3.8	4.1	4.5	4.5	4.6	4.7	n.a	n.a
Real effective exchange rate (index, 2000=100)	106.7	100.6	97.1	99.9	101.7	104.3	102.3	101.5
Terms of trade goods and services (index, 2000=100)	109.5	102.5	100.6	100.1	99.6	99.7	99.8	100.0
Market performance of exports (index, 2000=100)	97.4	98.9	99.4	100.4	100.2	98.4	98.8	99.3

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :

Commission 2014 spring forecast (COM); Convergence programme (CP).

Table II. Comparison of macroeconomic developments and forecasts

	2013		2014		2015		2016	2017
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	1.5	1.5	2.8	2.7	3.0	3.3	3.5	2.5
Private consumption (% change)	2.0	2.0	2.9	2.6	2.8	3.7	3.4	2.8
Gross fixed capital formation (% change)	-1.3	-1.3	5.5	4.7	6.5	7.4	6.5	4.5
Exports of goods and services (% change)	-0.9	-0.9	3.7	3.5	5.4	5.5	6.5	5.7
Imports of goods and services (% change)	-1.2	-1.2	4.7	3.4	5.9	6.3	6.7	6.0
Contributions to real GDP growth:								
- Final domestic demand	1.2	1.2	2.8	2.4	2.9	3.4	3.2	2.3
- Change in inventories	0.2	0.2	0.2	0.1	0.0	-0.1	0.0	0.0
- Net exports	0.1	0.1	-0.2	0.2	0.1	0.0	0.3	0.2
Output gap[1]	-2.0	-2.1	-1.4	-1.7	-0.7	-0.9	0.0	0.0
Employment (% change)	1.0	1.0	1.2	1.2	1.1	1.2	1.2	1.0
Unemployment rate (%)	8.0	8.0	7.6	7.7	7.2	7.3	6.7	6.3
Labour productivity (% change)	0.5	0.5	1.6	1.6	1.9	2.1	2.3	1.5
HICP inflation (%)	0.4	0.4	0.5	0.6	1.5	1.3	1.5	1.6
GDP deflator (% change)	0.8	0.8	1.2	1.3	1.8	1.7	1.6	1.9
Comp. of employees (per head, % change)	1.2	1.3	2.7	2.9	3.0	3.0	3.4	3.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.4	3.8	5.7	6.0	5.9	5.8	5.8	5.6

Note:

[1] In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2014 spring forecast (COM); Convergence programme (CP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2013	2014		2015		2016	2017	Change: 2013-2017
	COM	COM	CP	COM[1]	CP	CP	CP	CP
Revenue	**51.5**	**50.5**	**50.2**	**50.5**	**50.3**	**50.1**	**50.2**	**-1.3**
of which:								
- Taxes on production and imports	18.8	19.0	18.3	19.0	18.4	18.6	18.8	0.0
- Current taxes on income, wealth, etc.	18.5	18.2	18.6	18.1	18.5	18.4	18.3	-0.2
- Social contributions	7.5	7.4	7.4	7.4	7.3	7.3	7.3	-0.2
- Other (residual)	6.8	5.9	5.9	6.0	6.1	5.8	5.8	-1.0
Expenditure	**52.6**	**52.2**	**51.6**	**51.3**	**50.4**	**49.8**	**49.4**	**-3.2**
of which:								
- Primary expenditure	52.0	51.5	50.9	50.7	49.6	49.0	48.6	-3.4
of which:								
Compensation of employees	14.4	14.4	14.4	14.2	14.1	13.8	13.7	-0.7
Intermediate consumption	9.2	8.9	9.0	8.6	8.7	8.5	8.3	-0.9
Social payments	18.6	18.6	18.1	18.3	17.8	17.7	17.8	-0.8
Subsidies	1.6	1.5	1.5	1.5	1.5	1.5	1.5	-0.1
Gross fixed capital formation	3.3	3.4	3.3	3.3	3.2	3.2	3.3	0.0
Other (residual)	4.9	4.9	4.5	4.8	4.3	4.2	4.1	-0.8
- Interest expenditure	0.6	0.7	0.7	0.6	0.8	0.8	0.8	0.2
General government balance (GGB)	**-1.1**	**-1.8**	**-1.4**	**-0.8**	**-0.2**	**0.3**	**0.7**	**1.8**
Primary balance	**-0.5**	**-1.1**	**-0.6**	**-0.2**	**0.6**	**1.1**	**1.6**	**2.1**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-1.1**	**-1.8**	**-1.4**	**-0.8**	**-0.2**	**0.3**	**0.7**	**1.8**
Output gap[2]	-2.0	-1.4	-1.7	-0.7	-0.9	0.0	0.0	2.0
Cyclically-adjusted balance[2]	0.1	-0.9	-0.4	-0.4	0.3	0.3	0.7	0.7
Structural balance (SB)[3]	**0.1**	**-0.9**	**-0.4**	**-0.4**	**0.3**	**0.3**	**0.7**	**0.6**
Change in SB	*-0.2*	*-1.0*	*-0.5*	*0.6*	*0.8*	*-0.1*	*0.4*	-
Two year average change in SB	*-0.2*	*-0.6*	*-0.3*	*-0.2*	*0.1*	*0.4*	*0.2*	-
Structural primary balance[3]	0.7	-0.3	0.3	0.3	1.1	1.1	1.5	0.8
Change in structural primary balance		*-0.9*	*-0.4*	*0.5*	*0.9*	*-0.1*	*0.4*	-
Expenditure benchmark								
Applicable reference rate[4]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Deviation[5] (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Two-year average deviation (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-

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 programme scenario using the commonly agreed methodology.

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

[4] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[5] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source:
Convergence programme (CP); Commission 2014 spring forecast (COM); Commission calculations.

Table IV. Debt dynamics

(% of GDP)	Average 2008-2012	2013	2014		2015		2016	2017
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**39.6**	**40.6**	**41.6**	**41.3**	**40.4**	**39.7**	**37.3**	**34.8**
Change in the ratio	-0.4	2.3	1.0	0.7	-1.2	-1.6	-2.4	-2.5
Contributions[2] *:*								
1. Primary balance	**-1.3**	**0.5**	**1.1**	**0.6**	**0.2**	**-0.6**	**-1.1**	**-1.6**
2. "Snow-ball" effect	**0.0**	**-0.3**	**-0.9**	**-0.8**	**-1.3**	**-1.1**	**-1.1**	**-0.7**
Of which:								
Interest expenditure	1.0	0.6	0.7	0.8	0.6	0.8	0.8	0.9
Growth effect	-0.4	-0.6	-1.1	-1.1	-1.2	-1.3	-1.3	-0.9
Inflation effect	-0.7	-0.3	-0.5	-0.5	-0.7	-0.6	-0.6	-0.7
3. Stock-flow adjustment	**0.9**	**2.0**	**0.8**	**0.9**	**0.0**	**0.2**	**-0.2**	**-0.2**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

	2013	2014		2015		2016	2017
		COM	CP	COM	CP	CP	CP
Gap to the debt benchmark[3,4]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Structural adjustment[5]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
To be compared to:							
Required adjustment[6]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

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.

[3]Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[4]Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[5]Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[6]Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP/CP) budgetary projections for the previous years are achieved.

Source :

Convergence programme (CP); Commission 2014 spring forecast (COM); Commission calculations.

Table V. Sustainability indicators

	Sweden			European Union		
	2013 scenario	**No-policy-change scenario**	**Convergence programme scenario**	**2013 scenario**	**No-policy-change scenario**	**Convergence programme scenario**
S2*	3.0	3.4	2.2	2.4	2.4	0.7
of which:						
Initial budgetary position (IBP)	0.3	0.8	-0.5	0.5	0.4	-1.3
Long-term cost of ageing (CoA)	2.7	2.6	2.7	1.9	2.0	2.0
of which:						
pensions	0.0	0.0	0.1	0.7	0.8	0.9
healthcare	0.5	0.5	0.5	0.9	0.9	0.8
long-term care	2.0	2.0	2.0	0.6	0.6	0.6
others	0.2	0.2	0.2	-0.4	-0.4	-0.3
S1**	-1.9	-1.6	-3.0	1.5	1.7	-0.2
of which:						
Initial budgetary position (IBP)	-1.3	-0.8	-1.7	-0.2	-0.4	-2.0
Debt requirement (DR)	-1.2	-1.3	-1.9	1.5	1.8	1.5
Long-term cost of ageing (CoA)	0.6	0.6	0.6	0.2	0.3	0.3
S0 (risk for fiscal stress)***	0.19	:		:		
Debt as % of GDP (2013)	40.6			88.9		
Age-related expenditure as % of GDP (2013)	27.6			25.8		

Source *: Commission; 2014 convergence programme.*

Note : The 2013 scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2013 in line with the Commission's 2014 spring forecast. The 'no-policy-change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2015 in line with the Commission's 2014 spring forecast. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented. Age-related expenditure as given in the 2012 Ageing Report.

* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: (i) the initial budgetary position (IBP), which gives the gap vis-à-vis the debt-stabilising primary balance and (ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that, in an infinite horizon, the growth in the debt ratio is bound by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60 % debt threshold. The following thresholds were used for the S2 indicator: (i) if the value of S2 is lower than 2, the country is classed as low risk; (ii) if it is between 2 and 6, it is classed as medium risk; and (iii) if it is greater than 6, it is classed as high risk.

** The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance in the period to 2020 and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure by the target date, arising from population ageing. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is classed as low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 pp of GDP per year until 2020 after the last year covered by the 2014 spring forecast (2015) is required (indicating a cumulated adjustment of 2.5 pp), it is classed as medium risk; and (iii) if the S1 value is greater than 2.5 (i.e. a structural adjustment of more than 0.5 pp of GDP per year is necessary), it is classed as high risk.

*** The S0 indicator reflects up-to-date evidence on the role played by fiscal and financial competitiveness variables in creating potential fiscal risks. The methodology for the S0 indicator differs fundamentally from that for the S1 and S2 indicators. Unlike S1 and S2, S0 is not a quantification of the required fiscal adjustment effort, but a composite indicator which estimates the extent to which there might be a risk of fiscal stress in the short term. The critical threshold for the S0 indicator is 0.43.

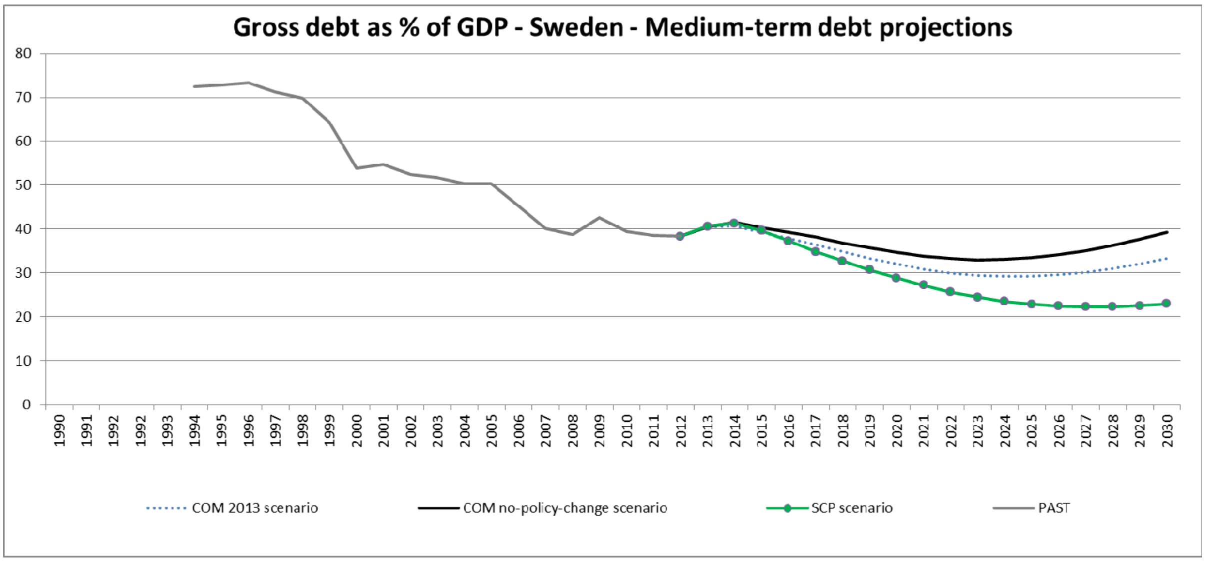


Table VI. Taxation indicators

	2002	2006	2008	2010	2011	2012
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	47.5	48.3	46.4	45.4	44.4	44.2
Breakdown by economic function (% of GDP)[1]						
Consumption	12.7	12.5	12.7	13.2	12.8	12.6
of which:						
- VAT	8.8	8.9	9.3	9.7	9.5	9.3
- excise duties on tobacco and alcohol	0.8	0.7	0.7	0.7	0.7	0.7
- energy	2.4	2.3	2.2	2.2	2.0	2.0
- other (residual)	0.6	0.6	0.6	0.6	0.6	0.6
Labour employed	25.7	24.1	24.0	22.3	22.4	22.7
Labour non-employed	4.0	4.3	3.7	3.4	3.1	3.2
Capital and business income	3.4	5.8	4.7	5.1	4.7	4.4
Stocks of capital/wealth	1.7	1.7	1.3	1.4	1.3	1.4
p.m. Environmental taxes[2]	2.9	2.7	2.7	2.7	2.5	2.5
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	52.7	55.7	58.3	59.1	58.4	56.2

Note:

1. Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.

2. This category comprises taxes on energy, transport and pollution, and resources included in taxes on consumption and capital.

3. The VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative size of cross-border shopping compared to domestic consumption also influences the value of the ratio, notably for smaller economies. See European Commission (2012), Tax Reforms in EU Member States and OECD (2012), Consumption tax trends for a more detailed discussion.

Source: Commission caluclations

Table VII. Financial market indicators

	2009	2010	2011	2012	2013
Total assets of the banking sector (% of GDP)	320.1	305.2	295.9	297.5	289.1
Share of assets of the five largest banks (% of total assets)	60.7	57.8	57.8	57.4	-
Foreign ownership of banking system (% of total assets)	7.1	8.6	8.4	8.6	-
Financial soundness indicators:					
- non-performing loans (% of total loans)[1), 2)]	0.8	0.8	0.7	0.7	0.6
- capital adequacy ratio (%) [1), 2)]	12.7	12.0	11.5	11.7	11.9
- return on equity (%) [1), 2)]	8.0	14.1	14.9	15.3	12.5
Bank loans to the private sector (year-on-year % change)	3.3	7.3	5.5	3.6	3.0
Lending for house purchase (year-on-year % change)	10.4	8.7	5.6	4.7	5.4
Loan to deposit ratio	221.9	217.4	215.3	207.8	201.9
CB liquidity as % of liabilities	3.9	0.0	0.0	0.0	0.0
Banks' exposure to countries receiving official financial assistance (% of GDP)[3)]	7.8	5.4	4.2	3.9	3.6
Private debt (% of GDP)	225.3	212.0	210.6	209.9	209.5
Gross external debt (% of GDP)					
- Public	16.4	17.3	18.2	18.6	19.4
- Private	83.2	73.5	67.0	63.3	57.9
Long term interest rates spread versus Bund (basis points)*	2.8	15.0	-0.3	9.7	55.1
Credit default swap spreads for sovereign securities (5-year)*	70.2	31.2	35.7	36.2	14.3

Notes:

1) Latest data 2013Q3.

2) Four large banking groups.

3) Covered countries are CY, EL, ES, LV, HU, IE, PT and RO.

* Measured in basis points.

Source :

Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).

Table VIII. Labour market and social indicators

Labour market indicators	2008	2009	2010	2011	2012	2013
Employment rate (% of population aged 20-64)	80.4	78.3	78.1	79.4	79.4	79.8
Employment growth (% change from previous year)	0.9	-2.4	1.0	2.1	0.7	1.0
Employment rate of women (% of female population aged 20-64)	77.2	75.7	75.0	76.5	76.8	77.2
Employment rate of men (% of male population aged 20-64)	83.5	80.9	81.1	82.1	81.9	82.2
Employment rate of older workers (% of population aged 55-64)	70.1	70.0	70.4	72.0	73.0	73.6
Part-time employment (% of total employment, 15 years and more)	26.6	27.0	27.0	26.5	26.5	26.2
Part-time employment of women (% of women employment, 15 years and more)	41.4	41.2	41.0	40.1	39.6	38.8
Part-time employment of men (% of men employment, 15 years and more)	13.3	14.2	14.5	14.2	14.6	14.9
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	16.1	15.3	16.4	17.0	16.4	16.9
Transitions from temporary to permanent employment	45.9	34.5	43.9	41.6	:	:
Unemployment rate[1] (% of labour force, age group 15-74)	6.2	8.3	8.6	7.8	8.0	8.0
Long-term unemployment rate[2] (% of labour force)	0.8	1.1	1.6	1.5	1.5	1.5
Youth unemployment rate (% of youth labour force aged 15-24)	20.2	25.0	24.8	22.8	23.7	23.4
Youth NEET rate (% of population aged 15-24)	7.8	9.6	7.7	7.5	7.8	7.5
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	7.9	7.0	6.5	6.6	7.5	7.1
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	42.0	43.9	45.3	46.8	47.9	48.3
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	18.0	26.0	18.0	19.0	17.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	31.0	37.0	33.0	32.0	35.0	:
Labour productivity per person employed (annual % change)	-1.5	-2.7	5.5	0.8	0.2	0.5
Hours worked per person employed (annual % change)	0.3	-0.5	1.6	-0.2	-0.9	-0.6
Labour productivity per hour worked (annual % change; constant prices)	-1.8	-2.2	3.9	0.9	1.1	1.2
Compensation per employee (annual % change; constant prices)	-1.6	-0.4	2.3	-0.4	2.0	0.3
Nominal unit labour cost growth (annual % change)	3.1	4.4	-2.3	0.1	2.9	0.7
Real unit labour cost growth (annual % change)	-0.1	2.3	-3.1	-1.2	1.9	-0.2

Notes:

[1] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.

[2] Long-term unemployed are unemployed persons for at least 12 months.

Sources:
Commission (EU Labour Force Survey and European National Accounts)

Expenditure on social protection benefits (% of GDP)	2007	2008	2009	2010	2011
Sickness/Health care	7.5	7.5	7.9	7.4	7.5
Invalidity	4.4	4.4	4.6	4.1	3.8
Old age and survivors	11.6	12.0	13.2	12.7	12.4
Family/Children	2.9	3.0	3.2	3.1	3.1
Unemployment	1.1	0.9	1.3	1.4	1.2
Housing and Social exclusion n.e.c.	0.5	0.5	0.5	0.5	0.4
Total	28.6	28.9	31.4	29.8	29.0
of which: means tested benefits	0.8	0.8	0.9	0.8	0.8

Social inclusion indicators	2008	2009	2010	2011	2012
At-risk-of-poverty or social exclusion[1] (% of total population)	14.9	15.9	15.0	16.1	15.6
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	14.6	15.1	14.5	15.9	15.4
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	15.5	18.0	15.9	18.6	17.9
At-Risk-of-Poverty rate[2] (% of total population)	12.2	13.3	12.9	14.0	14.1
Severe Material Deprivation[3] (% of total population)	1.4	1.6	1.3	1.2	1.3
Share of people living in low work intensity households[4] (% of people aged 0-59)	5.5	6.4	6.0	6.9	5.7
In-work at-risk-of poverty rate (% of persons employed)	6.8	6.9	6.5	6.8	6.7
Impact of social transfers (excluding pensions) on reducing poverty	57.2	50.0	51.7	49.8	48.5
Poverty thresholds, expressed in national currency at constant prices[5]	112 302	116 661	117 236	117 980	121 035
Gross disponsable income (households)	1 595 302	1 661 482	1 713 289	1 796 919	1 879 388
Relative median poverty risk gap (60% of median equivalised income, age: total)	18.0	20.3	19.7	18.5	18.9

Notes:

[1] People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).

[2] At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.

[3] Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone.

[4] People living in households with very low work intensity: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.

[5] For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)

Sources:
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table IX. Product market performance and policy indicators

Performance indicators	**2004-2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Labour productivity[1] total economy (annual growth in %)	1.2	-3.1	5.7	1.1	0.2	0.5
Labour productivity[1] in manufacturing (annual growth in %)	2.4	-12.6	29.5	3.4	-1.6	1.4
Labour productivity[1] in electricity, gas, water (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	-3.8	-6.1	1.4	-5.8	0.1	3.0
Patent intensity in manufacturing[2] (patents of the EPO divided by gross value added of the sector)	533.8	518.9	510.6	487.9	n.a.	n.a.
Policy indicators	**2004-2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Enforcing contracts[3] (days)	508.0	314	314	314	314	314
Time to start a business[3] (days)	16.0	16	16	16	16	16
R&D expenditure (% of GDP)	3.6	3.6	3.4	3.4	3.4	n.a.
Tertiary educational attainment (% of 30-34 years old population)	38.8	43.9	45.3	46.8	47.9	48.3
Total public expenditure on education (% of GDP)	6.8	7.3	7.0	n.a.	n.a.	n.a.
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	1.6	n.a.	n.a.	n.a.	n.a.	1.6
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	0.6	n.a.	n.a.	n.a.	n.a.	0.6
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	2.2	n.a.	n.a.	n.a.	n.a.	1.9

Notes:

[1] Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

[2] Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.

[3] The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology.

[4] The methodologies of the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html.

[5] Aggregate ETCR.

Source :

Commission, World Bank - *Doing Business* (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).

Table X. Green Growth

		2003-2007	2008	2009	2010	2011	2012
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.16	0.15	0.15	0.15	0.15	0.14
Carbon intensity	kg / €	0.22	0.19	0.19	0.20	0.18	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	0.62	0.63	0.57	0.60	0.62	n.a.
Waste intensity	kg / €	n.a.	0.26	n.a.	0.35	n.a.	n.a.
Energy balance of trade	% GDP	-1.5%	-2.0%	-1.2%	-1.6%	-1.9%	-2%
Energy weight in HICP	%	12	11	11	11	12	12
Difference between change energy price and inflation	%	4.68	6.5	-0.4	2	0.7	-3.9
Environmental taxes over labour taxes	ratio	9.7%	9.8%	10.4%	10.6%	9.8%	n.a.
Environmental taxes over total taxes	ratio	5.8%	5.8%	6.1%	6.0%	5.7%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.21	0.19	0.21	0.20	n.a.	n.a.
Share of energy-intensive industries in the economy	% GDP	11.5	11.6	10.7	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.07	0.07	0.08	0.09	0.08
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.05	0.04	0.04	0.04	0.04
Public R&D for energy	% GDP	n.a.	0.03%	0.04%	0.04%	0.04%	0.04%
Public R&D for the environment	% GDP	n.a.	0.01%	0.02%	0.02%	0.02%	0.02%
Recycling rate of municipal waste	ratio	93.3%	96.1%	97.6%	97.9%	99.1%	99.2%
Share of GHG emissions covered by ETS*	%	n.a.	31.9%	29.6%	34.8%	32.7%	31.5%
Transport energy intensity	kgoe / €	0.43	0.40	0.42	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	1.08	0.96	0.99	n.a.	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	37.6%	37.1%	36.7%	36.6%	36.2%	28.7%
Diversification of oil import sources	HHI	n.a.	0.22	0.22	0.25	0.24	n.a.
Diversification of energy mix	HHI	0.29	0.29	0.28	0.28	0.29	0.32
Share renewable energy in energy mix	%	27.8%	31.7%	34.8%	33.5%	33.3%	37.2%

Country-specific notes:
The year 2012 is not included in the table due to lack of data.

General explanation of the table items:
Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below
All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)
Waste intensity: waste (in kg) divided by GDP (in EUR)
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)
Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste
Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP
Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)
Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers
Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin
Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents
* Commission and EEA.
** For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.
*** For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.

List of indicators used in Box 4 on the potential impact on growth of structural reforms.

Final goods sector mark-ups: Price-cost margin, i.e. the difference between the selling price of a good or service and its cost. Final goods mark-ups are proxied by the mark-ups in selected services sectors (transport and storage, post and telecommunications, electricity, gas and water supply, hotels and restaurants and financial intermediation but excluding real estate and renting of machinery and equipment and other business activities[68]).
Source: Commission services estimation using the methodology of Roeger, W. (1995). "Can imperfect Competition explain the Difference between primal and dual Productivity?" *Journal of Political Economy* Vol. 103(2) pp. 316-30, based on EUKLEMS 1996-2007 data.

Entry costs: Cost of starting a business in the intermediate sector as a share of income per capita. The intermediate sector is proxied by the manufacturing sector in the model.
Source: World Bank, Doing Business Database. www.doingbusiness.org. 2012 data.

Implicit consumption tax rate: Defined as total taxes on consumption over the value of private consumption. In the simulations it is used as a proxy for shifting taxation away from labour to indirect taxes. The implicit consumption tax-rates are increased (halving the gap vis-à-vis the best performers) while labour tax-rates are reduced so that the combined impact is ex-ante budgetary neutral.
Source: European Commission, Taxation trends in the European Union, 2013 edition, Luxembourg, 2013. 2011 data.

Shares of high-skilled and low-skilled: The share of high skilled workers is increased, the share of low-skilled workers is reduced (halving the gap vis-à-vis the best performers). Low-skilled correspond to ISCED 0-2 categories; high-skilled correspond to scientists (in mathematics and computing, engineering, manufacturing and construction). The remainder is medium-skilled.
Source: EUROSTAT. 2012 data or latest available.

Female non-participation rate: Share of women of working age not in paid work and not looking for paid work in total female working-age population
Source: EUROSTAT. 2012 data or latest available.

Low-skilled male non-participation rates: Share of low-skilled men of working age not in paid work and not looking for paid work in total male working-age population
Source: EUROSTAT. 2012 data or latest available.

Elderly non-participation rates (55-64 years): Share of the population aged 55-64 years not in paid work and not looking for paid work in total population aged 55-64 years.
Source: EUROSTAT. 2012 data or latest available.

ALMP: Active Labour Market Policy expenditures as a share of GDP over the share of unemployed in the population.
Source: EUROSTAT. 2011 data or latest available.

Benefit replacement rate: Share of a worker's pre-unemployment income that is paid out by the unemployment insurance scheme. Average of net replacement rates over 60 months of unemployment.
Source: OECD, Benefits and Wages Statistics.
www.oecd.org/els/benefitsandwagesstatistics.htm. 2012 data.

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[68] The real estate sector is excluded because of statistical difficulties of estimating a mark-up in this sector. The sector renting of machinery and equipment and other business activities is conceptually part of intermediate goods sector.