Sweden's convergence programme

2015

REGERINGSKANSLIET
Government Offices of Sweden

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Introduction

In accordance with Council Regulation (EC) No 1466/97, Sweden submitted its Convergence Programme in December 1998.[1] The programme was evaluated and approved by the Council in spring 1999. The Council Regulation stipulates that an update of the Convergence Programme is to be submitted annually; accordingly, this took place from 1999 to 2009.

Effective from 2010, the reporting as part of the Stability and Growth Pact has been adapted to the European Semester; the aim is to strengthen the surveillance of economic policies. Consequently, the Convergence Programme and the National Reform Programme are delivered each spring. This allows budgetary and structural policy to be assessed consistently and recommendations to be made to the Member States while their budget proposals are still in the preparatory phase.

Sweden's Convergence Programme for 2015 is based on the Spring Fiscal Policy Bill of 2015 (Govt. Bill 2014/15:100), which the Government delivered to the Riksdag on 15 April 2015. The Parliamentary Committee on Finance was informed about the Convergence Programme on 21 April 2015. The Government approved the Convergence Programme on 23 April 2015.

The Parliamentary Committee on European Union Affairs studied the European Commission's proposals for country-specific recommendations concerning the Convergence Programme for 2014 on 13 June 2014.

[1] Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

1 Economic policy framework and targets

1.1 Budgetary policy goals

Budgetary policy goals encompass a general government net lending target, an expenditure ceiling for central government primary expenditure and old-age pension system expenditure, as well as a local government balanced budget requirement, according to which individual municipalities and county councils must adopt a budget in which revenues exceed costs.

General government net lending target

The argument in favour of having a governing target for general government net lending is that it strengthens control over the long-term development of general government finances and clarifies the need for tax funding of general government expenditure. The net lending target also delineates the need to set priorities among expenditure areas. In addition, the fiscal policy should facilitate economic stimulus in contractionary periods and help rein in the economy in expansionary periods. Accordingly, net lending when the economy is good must provide space for lower net lending when the economy is worse. This is accomplished by formulating the net lending target as an average over the course of an economic cycle. According to the Swedish Budget Act (2011:203), the Government is obliged to propose a target for general government net lending. As proposed in the Spring Fiscal Policy Bill for 1997, a decision was taken to introduce a surplus target for general government finances of 2 per cent of GDP on average across an economic cycle. The target was phased in over a three-year period and full application began from 2000. In line with a proposal in the Spring Fiscal Policy Bill for 2007, the Riksdag decided to lower the net lending target from 2 per cent to 1 per cent of GDP on average over the course of an economic cycle. The reason for the proposal was that Eurostat had decided that net lending in the premium pension system would no longer be posted to the general government sector in the National Accounts, which reduced general government net lending by around 1 per cent of GDP.

The Government's monitoring of the government net lending target

As the general government net lending target primarily constitutes a prospective fiscal policy objective, it is primarily monitored prospectively. However, a retrospective analysis is also carried out to determine whether there have been any systematic failures of fiscal policy that may have impact on achieving the target in the future. The Government considers it important that clear principles for monitoring general government net lending exist and that monitoring is transparent. The Government employs a number of indicators in the monitoring process (see also

section 3.4 *Reconciliation against the general government net lending target*). In this context, it is important to point out the drawbacks to an excessively mechanical application of these indicators. Above all, there is a danger that fiscal policy will amplify rather than moderate fluctuations in economic activity. The Government's starting point is thus that assessment of fiscal policy direction must take a broad approach in which a number of individual targets and restrictions are compared to one another.

When a deviation from the net lending target has been determined, the Swedish Budget Act requires the Government to report how a return to the target will be accomplished. This obligation was imposed on the Government through an amendment to the Budget Act in 2014. The preparatory work to the provision emphasised the following: an analysis should indicate that a deviation exists because the Government should have a duty to provide such an account; if net lending deviates from the target, the Government should present a plan for how a return to the target will be accomplished that incorporates the forecast years included in the Budget Bill; and that this plan should refer to a medium-term perspective (Govt. Bill 2013/14:173). When there is a deviation from the target, net lending must return to the target level, but no compensation for historical deviations from the target is required by means of corresponding austerity measures at a later date. A deviation from the target level cannot, however, be corrected mechanically. An overall assessment of how a deviation should be corrected must be conducted based on stabilisation, redistribution and structural policy premises.[2]

Ceiling for central government primary expenditure, pension system expenditure and a strict budgetary process

According to the Swedish Budget Act, the Government is obliged to propose an expenditure ceiling for the third additional year in the future in the Budget Bill. The expenditure ceiling is then adopted by the Riksdag. The expenditure ceiling serves the important purpose of creating the conditions necessary to attain the net lending target. The level of the expenditure ceiling should also encourage the desired long-term development of central government expenditure. Together with the general government net lending target, the expenditure ceiling governs the level of total taxes and helps prevent a situation in which taxes must successively be raised as a result of a lack of control over expenditure or in which temporary increases in revenue are used for permanent increases in expenditure.

The expenditure ceiling should not be circumvented by reporting benefits that normally are funded by appropriations against revenue

[2] The contents of the underlying bill, *An Improved Budgetary Process* (Govt. Bill 2013/14:173) were described in greater detail in Sweden's Convergence Programme 2014.

headings. The main principle is that expenses must be accounted for in the year in which they are intended to be used. Any departures from these principles must be justified.

According to standard practice, there should be a budgeting margin of a certain size under the expenditure ceiling. This is mainly intended to act as a buffer should the ceiling-limited expenditure increase in a way other than estimated because of changes in economic activity, for example.

A well-organised, strict budgetary process has central significance to attaining budgetary policy goals. The expenditure ceiling is the overarching restriction for the budgetary process in terms of total expenditure. The budgetary process compares various expenditures to one another and expenditure increases are examined based on a predetermined total fiscal space demarcated by the expenditure ceiling and the net lending target. The main principle is that the cost of proposed expenditure increases in any one expenditure area must be covered by proposed expenditure reductions in the same area.

It is also vital that the central government budget is transparent and comprehensive. The Government's proposed budget shall include all revenue and expenditure as well as other payments that have an impact on the central government borrowing requirement. Furthermore, the main principle is that central government revenue and expenditure are budgeted and reported gross on revenue headings and appropriations. Accordingly, costs are reported on the expenditure side of the budget and revenues on the revenue side.

The Ministry of Finance has a unifying role and is responsible for the timetable, guidelines for the work to draw up the budget and the process of budget negotiations. Nevertheless, every ministry is responsible for ensuring there is significant data to enable overall prioritisations among different sectors of the general government and among different expenditure areas included in the central government budget, as well as to facilitate examination of the general government commitment.

Local government balanced budget requirement

To reinforce the budgetary process at the local and regional levels, a statutory requirement for balanced budgets in the local government sector has been in force since 2000. This stipulates that each individual municipality and county council must budget for a balanced outcome, provided there are no special circumstances. If a deficit arises in a particular financial year, this must be corrected within three years. Municipalities and county councils are also required to maintain sound financial management of their operations.[3]

[3] Effective from 2005, municipalities and county councils set the financial targets that are significant to sound financial management. A commonly applied measure is that a

1.2 Sweden's medium-term budgetary objective

As a member of the EU, Sweden must adhere to the regulations concerning general government finances in the Stability and Growth Pact. In addition to the deficit limit of 3 per cent of GDP, which refers to net lending, all EU Member States are required to set a medium-term budgetary objective (MTO) defined in structural terms. The Government has decided that Sweden shall have an MTO of minus 1 percent of GDP, which is on par with the lowest MTO Sweden should have according to the EU Commission's calculations.[4]

The MTO specified by Sweden in the Convergence Programme will be regarded as a minimum requirement for net lending applicable to Sweden as a member of the EU. The general government net lending target adopted by the Riksdag of 1 per cent of potential GDP on average over the course of an economic cycle (see also *General government net lending target*, page 5) is compatible with a structural balance of minus 1 per cent of GDP. Accordingly, providing the national target is attained, the requirement pursuant to the Stability and Growth Pact is also attained (see also *The Government's assessment of medium-term budgetary objective MTO)*, page 38).[5] If the general government net lending target were changed to a target of 0 per cent of GDP on average over the course of an economic cycle, this would still comply with the rules of the Stability and Growth Pact (see also *The NIER is analysing the effects of lowering the net lending target to 0 per cent* , page 39).

1.3 Stabilisation policy

The most important fiscal policy contribution to economic stabilisation is that of maintaining confidence in the long-term sustainability of the general government finances. If the financial markets, households and businesses lose confidence in the general government finances, the automatic stabilisation mechanisms and the active fiscal policy measures in the stabilisation policy may have a weaker impact. In addition, if the finances are not sustainable in the long term, the Riksbank's efforts to maintain price stability will be impeded.

During disruptions that have an impact on demand in the economy, there is not normally an antagonistic relationship between stabilising the employment rate and inflation. This normally means that monetary policy will be used to stimulate the economy during contractionary phases

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financial result corresponding to 2 per cent of revenue from taxation and general central government grants meets the requirement for sound financial management.

[4] See Public Finances in EMU, European Commission, 2007.

[5] It should be noted, however, that the Government's calculations of net lending and the structural balance diverge somewhat from those of the European Commission. Looking solely at the national target and the MTO according to the rules of the Stability and Growth Pact however, the national surplus target of 1 per cent of GDP means that the Stability and Growth Pact rule requiring a structural deficit that does not exceed 1 per cent of potential GDP is highly likely to be attained.

and moderate the economy in expansive phases. During such disruptions, the fiscal policy contribution to economic stabilisation primarily takes place through the automatic and semi-automatic stabilisation mechanisms.[6] In addition, fiscal policy, as opposed to monetary policy, has a role to play in dealing with problems that may arise in the economy in conjunction with an economic downturn. For example, this may involve reinforcing labour market policy measures of various kinds and managing the various consequences for redistribution policy. During major supply and demand disruptions, fiscal policy may need to support monetary policy more actively. However, lessons learnt from the management of previous crises show that it is not entirely possible to combat a sharp downturn in the economy without endangering the general government finances. On the other hand, these measures may contribute to limiting the rise in unemployment, decreasing the risk that unemployment will become entrenched and alleviating the consequences for especially vulnerable groups.

1.4 Central government interventions in the event of crisis in the financial system

Well-functioning financial markets are also vital to stable economic development and an effective stabilisation policy. To ensure the effectiveness of central government intervention in the financial markets, it is important that the roles of different governmental agencies are clearly defined and that there are clear principles for how the general government finances will be protected in such interventions.

A financial crisis affects the entire economy. When there is a crisis in the financial system, the Government may therefore need to take special measures to promote stability in the financial system. If the Government needs to take such steps, the starting point is the limitation of consequences for the general government finances. According to the Government Support to Credit Institutions Act (2008:814), commonly known as the Support Act, conditions should be attached to the support that require the credit institution receiving support, and its owners, to primarily bear any losses that arise. If the central government provides an injection of capital to a credit institution that has serious financial problems, the Support Act also permits the central government to temporar-

[6] The automatic stabilisation mechanisms help mitigate fluctuations in the economy through automatic decreases (increases) in tax revenue and through automatic increases (decreases) in expenditure on unemployment insurance and certain income support benefits in an economic downturn (upturn). The 'semi-automatic stabilisers' are a hybrid between active decisions and automatic stabilisation mechanisms. It is primarily different types of labour market policy measures that are generally referred to as semi-automatic stabilisation mechanisms; that is, active decisions are made regarding a large proportion of these although it is more the rule than the exception that such measures are adjusted to prevailing economic conditions. The system of working short hours that has been established may also come to be seen as a semi-automatic stabilisation mechanism.

ily take over ownership of the institution, if its financial position is very weak or the institution fails to agree to reasonable conditions attached to the support. When the owners of the institution are aware that the central government has the possibility to take over ownership and replace the management and that they themselves must bear the losses, they have greater incentive to build buffers and disincentive to take excessive risks.

1.5 Openness and clarity

The Spring Fiscal Policy Bill normally indicates the direction of economic policy and budgetary policy for upcoming years. The bill contains the Government's view of the current economic situation; the structural, stabilisation and redistribution policy challenges currently faced; an assessment of an appropriate level of the expenditure ceiling for at least three years ahead; a follow-up of budgetary policy targets and an assessment of the current fiscal space. The Spring Fiscal Policy Bill also usually contains a separate report on redistribution policy, an assessment of local government sector finances, employment and indebtedness, an assessment of the long-term sustainability of the general government finances and a report on investments and capital volume in the Swedish economy.

The Budget Bill contains the Government's concrete policy proposals for, above all, the forthcoming financial year and the proposed expenditure ceiling for the third additional year. There is also a report on economic gender equality.

The Central Government Annual Report follows up on both the budget and the fiscal policy targets for the past financial year.

The Spring Fiscal Policy Bill and the Budget Bill both contain forecasts for the four forthcoming years. Forecasts must be calculated using the best available methods and the largest amount of information possible. Forecasts must be based on data of the highest possible quality and, where possible, on current research.

Assessments of the long-term sustainability of the general government finances will be complemented with generational analyses at regular intervals. Long-term investigations will also be carried out at regular intervals. These represent an important basis from which to analyse future challenges facing fiscal policy.[7]

[7] Long-term investigations are directed by the Ministry of Finance on the basis of extensive study data produced by governmental agencies, organisations and individual experts. Publication of the final report from the ongoing long-term investigation has been preliminarily planned for autumn 2015. The 2015 long-term investigation report discusses the long-term prerequisites for productivity and economic growth based on scenarios describing how the Swedish economy may develop for a few decades ahead.

1.6 Swedish Fiscal Policy Council

The Government established a Fiscal Policy Council in 2007. The general remit of the Fiscal Policy Council is to monitor and assess whether fiscal policy targets and economic policy targets proposed by the Government and adopted by the Riksdag are attained and thus contribute to greater openness and clarity concerning the aims and effectiveness of economic policy (2011:446). The Council's mandate is the following:

- In particular, based on the Spring Fiscal Policy Bill and the Budget Bill, the Council shall assess whether the fiscal policy is compatible with sustainable general government finances over the long term and budgetary policy targets, especially the surplus target and the expenditure ceiling.
- Also based on the Spring Fiscal Policy Bill and the Budget Bill, the Council shall assess whether the fiscal policy is in line with long-term sustainable growth and long-term sustainable high employment and to examine the clarity of these bills, particularly in relation to the stated bases for economic policy and the reasoning behind proposed measures and to review the effects of fiscal policy on distribution of welfare over the long and short terms.
- The Council may also review and assess the quality of the forecasts submitted and the models on which those forecasts are based.
- The Council shall further promote greater public debate on economic policy.

A non-partisan agreement was reached in 2011 among the former government, the Social Democratic Party, the Green Party and the Left Party on a new instruction for the Fiscal Policy Council. This included the strengthening of the Council's independence vis-à-vis the Government by means including separating the roles of chairman and head of agency. As a consequence of the agreement, the role of the Fiscal Policy Council was augmented with the task of reviewing attainment of fiscal and economic policy targets when the National Institute of Economic Research (NIER) was assigned the corresponding task of evaluating the long-term and short-term impacts of economic policy on the environmental quality objectives adopted by the Riksdag.

1.7 The objective of monetary policy

The Riksbank is responsible for monetary policy in Sweden. In accordance with the Sveriges Riksbank Act (1988:1385), the objective of monetary policy is to maintain price stability. Amendments to the Sveriges Riksbank Act adopted in 1999 gave the Riksbank greater autonomy. The Constitution states that no public authority may determine how the Riksbank shall decide in matters of monetary policy. The independence

of the governing Executive Board is also underlined by the Sveriges Riksbank Act, which states that the members of the Board must not seek or accept instructions when performing their monetary policy tasks.

According to the Sveriges Riksbank Act, the objective of monetary policy is to maintain price stability. The Riksbank has defined this as an inflation target of an annual change in the Consumer Price Index (CPI) of 2 per cent.

At the same time as monetary policy is focused on achieving the inflation target, it must support the objectives of general economic policy with the aim of achieving sustainable growth and a high level of employment. This is achieved by the Riksbank, in addition to stabilising inflation around the inflation target, also striving to stabilise production and employment around long-term sustainable development paths. Consequently, the Riksbank pursues what is termed a flexible inflation target policy. This does not mean that the Riksbank renounces the primacy of the inflation target.

It takes time for monetary policy to achieve its full impact on inflation and the real economy. Monetary policy is therefore guided by economic trend forecasts. Among other forecasts, the Riksbank publishes an assessment of how the repo rate will develop in the future. The course of interest rates is a forecast, not a promise.

When each monetary policy decision is made, the Executive Board evaluates which course the repo rate needs to take for the monetary policy to be well balanced. This normally entails finding a suitable equilibrium between stabilising inflation near the inflation target and stabilising the real economy.

There is no general answer as to how quickly the Riksbank aims to return inflation to 2 per cent if it deviates from this target. In certain situations, a rapid return may have undesirable effects on production and employment, while a slow return may weaken the credibility of the inflation target. In general, the ambition has been to adjust interest and the interest path such that inflation is expected to be relatively close to the target in two years' time.

In September 2003, Sweden held a referendum on the introduction of the euro. The result of the referendum, which was 'no', did not lead to any changes in monetary or exchange rate policy. The Government is responsible for overall exchange rate policy matters and decides on the exchange rate system, while the Riksbank is responsible for the application of the exchange rate system. The current monetary and exchange rate policy regime stands firm. Sweden's experience of an inflation target and a floating exchange rate is very favourable. Pegging the Swedish krona to ERM2 is not under consideration.

1.8 The Government's economic policy

The Government anticipates a gradual recovery of the Swedish economy in 2015 and 2016. However, unemployment remains high and the per-

sistent recession presents a risk that unemployment will become entrenched at high levels. From this perspective, a fiscal policy that supports economic recovery through, for example, intensified general government initiatives that push down unemployment, is to be desired. Reducing unemployment and increasing the employment rate is one of the Government's most important tasks during the mandate period. The Government is taking several measures to strengthen competitiveness and the long-term sustainability of the general government finances through, for example, reducing unemployment, reversing the academic performance trend in Swedish schools, accelerating the transition to a more sustainable society and strengthening welfare. The Government's areas of focus in the Spring Fiscal Policy Bill for 2015 are discussed below. Reform proposals have been presented to the Riksdag, which is expected to decide 16 June on the proposals for the current year within the framework of the Spring Adjustment Budget Bill for 2015.

Gender equality action is a priority

The Government's gender equality policy is based on the overarching objective that women and men must have equal power to shape society and their own lives. Gender equality promotes economic development by taking advantage of the potential of both women and men. Consequently, Swedish economic policy will proceed from a feminist philosophy. Vigorous action is required to attain gender equality policy objectives.

Partly in the light of this, the Government has commenced a project to integrate the budget process in terms of gender equality based on a gender analysis, termed 'gender budgeting', in the Statement of Government Policy. This clarifies how the budget is analysed from the gender perspective in order to identify patterns and take action that promotes gender equality. The Spring Adjustment Budget Bill for 2014 proposes several measures to counteract gender inequality and which affect household incomes. Single parents, who are most often women, typically have a more precarious financial position than partnered parents. In response, the Government is proposing measures including an increase of maintenance support by SEK 300 per child and month. As a whole, the proposals contribute to strengthening economic equality between women and men.

More jobs and strengthened competitiveness

Permanently reducing unemployment and increasing the employment rate is one of the Government's most vital tasks during the mandate period. The objective of the Government's employment policy is for unemployment to decrease and become the lowest in the EU by 2020. Economic policy must contribute to achieving the Government's objective of reducing high unemployment. More people in work and more hours worked will also create better conditions for improving Swedish welfare, reducing income disparities and securing continued higher pros-

perity. This requires action in several areas. The Government's policy for more jobs is three-pronged: an active business policy, knowledge-related reforms for improved matching in the labour market and investments for the future that also contribute to sustainable transformation.

An active business policy, higher exports and proactive investments in the future will increase demand for labour and secure economic growth. Creativity, entrepreneurship and innovation are required to build a strong Sweden and effectively respond to greater international competition. The Government has established a National Innovation Council under the leadership of the Prime Minister to bolster the Swedish innovation system. The Spring Adjustment Budget Bill for 2015 proposes the allocation of funds for initiatives to promote innovation within the framework of the Innovation Council.

A business policy that helps give businesses – especially small and medium-sized enterprises – the opportunity to grow sets the conditions for high demand and continued economic growth. Almi Företagspartner AB assists businesses all over Sweden with advice, loans and venture capital. Aimed at strengthening early phase seed-funding programmes, the Government proposes a reinforcement of Almi Företagspartner AB. In order to strengthen economic growth potential, it is also vital to increase housing construction, which has been far too low for a long time. The Government's goal is for at least 250,000 new homes to be built by 2020.

Longer global production chains and shrinking lead-times are imposing demands for an efficient and modern transport system for both goods and the labour force. Additional resources are also needed for operation, maintenance and reconstruction of the Swedish rail infrastructure to increase the robustness of Swedish infrastructure overall. The Spring Adjustment Budget Bill for 2015 proposes a temporary increase of SEK 620 million in funding for operations and maintenance in the rail infrastructure. Funding is estimated to rise temporarily for 2016–2018 by SEK 1.24 billion per year. The Government also aims to reduce environmental impact from the transport sector and to encourage a shift of long-haul transports, including goods transports, from road to rail and maritime shipping. The Government has therefore commenced the process to introduce a distance-based road wear tax that will also be applicable to foreign hauliers.

Plentiful and secure energy supply is also critically important to many Swedish businesses so that they can maintain and expand their operations. Investments in the energy system are often long-term by nature and have long lead-times. Consequently, longevity in the energy policy is a worthy objective and the Government intends to propose in the Budget Bill for 2016 strengthening support for solar cells and increasing existing support for methane gas reduction.

Knowledge-related reforms are also needed to improve labour market matching. The Government believes that more young people must begin and complete secondary education and upper secondary schools must

give young people the skills in demand in the labour market. It is particularly important that young people who leave school early and are not in work or training are given support to resume their studies. Adults must have opportunities for retraining and further education in the adult education system, higher education and folk high schools. The Spring Adjustment Budget Bill for 2015 therefore includes a proposal to allocate funding for around 2 800 additional study places in adult education and vocational adult education in 2015. Including earlier initiatives, the Government expects to allocate funding corresponding to 10 000 study places per year for 2016–2019. The Government is also proposing allocation of funding to expand general courses in the folk high schools by 750 study places in 2015. The Government expects to allocate further funding thereafter corresponding to 2 000 study places from 2016. To meet labour market demand and provide study places for higher numbers of eligible applicants, the Government intends to invest in the expansion of higher education. The initiative is expected to encompass around 14 000 study places in 2018. The Government is also proposing the allocation of funds to improve the quality of higher education.

The Government's objective is that no young person should have to be unemployed for more than 90 days. Young people who have not completed upper secondary school are the group that has the most difficulty securing employment. As an important component of the 90-day guarantee, the Government intends to introduce 'education contracts' to ensure that unemployed youth aged 20–24 begin or return to school with the goal of completing their upper secondary education. The Government also intends to introduce trainee jobs for youth aged 20–24 who have, in the normal case, completed upper secondary school. All told, this means that the Government is proposing initiatives in the Spring Adjustment Budget Bill for 2015 of around SEK 400 million to help young people acquire the right skills and competence necessary to gain a foothold in the labour market. The reforms are estimated to entail investments of around SEK 2 billion per year over the next few years.

Aimed at strengthening the opportunities of long-term unemployed people to secure jobs, the Government intends to introduce subsidised jobs in welfare services, termed 'extra jobs'. The first step towards discontinuing the employment phase (phase 3) will be taken in 2015, by means including implementation of extra jobs in welfare services. At a later date, the Government intends to present further initiatives on behalf of long-term unemployed people. The Spring Adjustment Budget Bill for 2015 proposes the allocation of funds to commence the introduction of extra jobs. The reform is expected to be successively expanded during 2016–2019 and reach SEK 2.6 billion in 2019.

The Government also intends to pursue a vigorous and integrated policy towards swifter introduction of newly arrived migrants to working life and society. This will be accomplished in a variety of ways, including making it possible to begin Swedish language instruction sooner, improving opportunities for validation and strengthening the

administrative budget allocation to the Public Employment Service for introduction of new arrivals. The Government intends to revisit the future orientation of initiatives towards better introduction in connection with the Budget Bill for 2016.

Equal, knowledge-based schools for every pupil

International studies show that learning outcomes in Swedish schools have declined faster than in any other OECD country. The Government's ambition is to elevate the knowledge level in Swedish schools and improve the quality of teaching. Teachers must be able to give pupils the support they need to develop, based on their personal circumstances. Aimed at reversing the trend of declining academic performance, the Government believes school reforms are required in four main directions: early intervention, greater attractiveness of the teaching profession, greater equality – all schools must be good schools – and that all pupils should complete upper secondary school.

Children in the early years of compulsory education who lack sufficient basic skills in reading, writing and arithmetic are at risk of falling behind and experiencing greater difficulties in later school years. The Government is therefore initiating several measures within the framework of an early years commitment aimed at improving early follow-up of learning outcomes and pupil support. The adopted budget includes in investment in an 'Early Years Boost' of around SEK 2 billion in 2015. The Government intends to use these funds to institute a central government grant aimed at increasing the attractiveness of the teaching profession and improving the quality of teaching by giving teachers more time to teach pupils in the early years, including the preschool class for six-year-olds.

Teachers are the key to raising learning outcomes in schools. Consequently, it is a serious matter that the status and attractiveness of the teaching profession have been declining for a long time. To make the teaching profession more attractive, it must offer higher pay, less administrative work and better career and professional development opportunities.

Towards this end, the Government has initiated a national rally on behalf of the teaching profession whose aims include better wage formation for teachers, linked to their skills and career development. The Government intends to allocate resources in the Budget Bill for 2016 aimed at increasing teacher pay.

All pupils must have equal opportunities for a good education, regardless of which school they attend and where in the country they live. There is no conflict between equality and high study outcomes - the reverse is instead true. Equality in the school system can be improved by means of targeted interventions to improve academic performance at schools facing the greatest challenges. The Government proposes several initiatives towards this end in the Spring Adjustment Budget Bill for 2015.

The Government's objective is that all young people should begin and complete upper secondary school. The Government has therefore appointed a special committee of inquiry to analyse the situation and, in dialogue with the reference group appointed by the Riksdag, to propose measures by 30 June 2016.

Sustainable future

Climate change is the defining question of our time and one of the Government's most highly prioritised issues. Sweden shall be on the leading edge of the crucial climate transition. The Government's objective is a resource-efficient economy in which environmental protection is a self-evident aspect of social development. Decisive steps towards attaining the environmental quality objectives should be taken.

The effort to reduce Swedish emissions of greenhouse gases is a high-priority issue for the Government. The interim climate goal adopted by the Riksdag is to reduce climate emissions by 40 per cent by 2020, compared with the baseline year of 1990. The Government's ambition is to work with national initiatives to a greater extent in order to attain the goal by 2020. The effort to reduce climate emissions will be strengthened through climate investment grants to municipalities and regions. In the Spring Adjustment Policy Bill for 2015, the Government proposes allocating funds for climate investments and announces that the initiative will be stepped up in 2016.

The Government believes that initiatives aimed at a fossil fuel-independent vehicle fleet by 2030 should be intensified and intends to study how a 'bonus-malus' system can be designed wherein eco-adapted vehicles with relatively low emissions of carbon dioxide are rewarded upon purchase with a bonus, while vehicles that produce relatively high emissions of carbon dioxide are taxed at a higher rate. The aim is for this system to take effect 1 January 2017.

The Government believes aviation should bear its own climate costs to a greater extent. Accordingly, the Government finds that a tax on air travel should be studied.

As for the climate policy, it is a fundamental principle of Swedish environmental policy that polluters should pay for their negative environmental impacts whenever possible and appropriate. Aimed at maintaining the impact of environmental taxes as a steering mechanism, the level of environmental taxes should appropriately be adjusted to changes in general price trends. Consequently, the Spring Adjustment Budget Bill for 2015 proposes an increase in the tax on pesticides, which has not changed since 1 January 2004, as well as the tax on natural gravel, which has not changed since 1 January 2006. The Government wishes to strengthen the implementation of Swedish environmental policy and take critical steps during the mandate period towards attaining the environmental quality objectives and the generation goal. Efforts to attain the environmental quality objectives of 'A Non-Toxic Environment', 'A Rich Diversity of Plant and Animal Life' and 'A Balanced Marine Envi-

ronment, Flourishing Coastal Areas and Archipelagos' will be awarded top priority. The Government therefore intends during this mandate period to substantially increase the budget appropriations that are most important to accomplishing this aim.

Increased welfare and security

Reduced income and health disparities, gender equality and action against racism and discrimination are necessary to create the necessary conditions for a fairer, more sustainable society. Economic policy should secure the prerequisites for efficient and effective welfare provision. Welfare is central to development, employment, sustainable growth and women's living conditions.

The Government has set a long-term goal to eliminate health disparities that are amenable to influence within one generation. The Government will appoint an Equal Health Committee in spring 2015, whose remit will be to draft a strategy for achieving the objective.

Older people must have access to equitable and gender-equal elderly care regardless of where they live. Women often take more responsibility for caring for family, children and older people and many women cut their working hours in order to do this. In the Spring Adjustment Budget Bill for 2015, the Government proposes that general funds, together with further reinforcements, should be used for an initiative focused on higher staffing in the elderly care system. The initiative has been proposed to amount to SEK 1 billion in 2015 and will amount to an estimated SEK 2 billion per year in 2016–2018.

The Government finds that an increase of the maximum daily benefit for income-related unemployment insurance is critically important to ensuring that the benefit functions as readjustment insurance and a safety net for the individual while unemployed. To counteract long-term unemployment and increase the incentives of jobseekers to look for work, the benefit level declines after a certain period of unemployment. Consequently, the Government proposes an increase in income-related unemployment benefits and the basic level of insurance in the Spring Adjustment Budget Bill for 2015. The Government also intends to eliminate the time limit for sickness insurance.

Public support for economically disadvantaged people also needs to be strengthened. The Government aims to improve the situations of people receiving sickness and activity compensation, whose incomes are relatively low, through an increase in income-related compensation and is also proposing an increase in housing supplement for people aged 65+ to improve the financial circumstances of pensioners.

Table 1.1 Reforms and financing

Effect on general government net lending, SEK billions

	2015	2016	2017	2018
More jobs and strengthened competitiveness				
Competitive business policy	0.63	0.66	0.68	0.70
Railway maintenance	0.62	1.24	1.24	1.24
Higher education, adult education and folk high schools	0.61	1.21	1.43	1.79
Education contracts	0.38	0.79	0.78	0.78
Trainee jobs	0.06	0.68	1.17	1.19
Extra jobs	0.01	0.56	1.66	2.43
Additional funding to the Swedish Public Employment Service	0.16	0.26	0.24	0.14
Modern working life	0.04	0.09	0.10	0.10
Knowledge-based education in equal schools with time for each pupil				
Early intervention	0.03	0.55	0.58	0.58
More attractive teaching profession	0.11	0.46	0.46	0.46
All schools must be good schools	0.33	1.55	1.62	1.62
Sustainable future				
Climate investments	0.13	0.60	0.60	0.60
Biodiversity and nature conservation	0.41	1.18	1.18	1.18
More resources to environmental authorities	0.02	0.11	0.11	0.11
Other environmental initiatives	0.01	0.12	0.12	0.12
Increased welfare and security				
Better maternity care	0.20	0.40	0.40	0.40
More staff in elderly care	1.00	2.00	2.00	2.00
Higher ceiling and minimum level of unemployment benefit (including coordination with sickness benefit)	0.88	2.83	2.78	2.71
Higher maintenance support	0.21	0.62	0.63	0.63
Higher housing supplement for pensioners	0.13	0.40	0.40	0.40
Higher sickness and activity compensation	0.06	0.24	0.24	0.24
Other reforms				
Swifter introduction of new arrivals	0.32	0.16	0.16	0.16
Increased support for women's shelters	0.03	0.10	0.10	0.10
Increased support for culture	0.04	0.09	0.10	0.09
Extra funds for municipalities	0.86	2.56	3.02	3.02
Other reforms	0.74	0.52	0.62	0.30
Total reforms	**8.00**	**19.97**	**22.41**	**23.07**
Revenue increases				
Decreased or abolished reduction of social security contributions for young people	5.49	15.76	18.34	18.10
Higher environmental taxes	0.01	0.03	0.03	0.03
Abolition of tax credit for help with homework and other schoolwork	0.02	0.05	0.05	0.05
Higher tax on thermal output of nuclear power reactors	0.10	0.25	0.25	0.25
Financing fee, unemployment insurance funds	0.12	0.40	0.41	0.42
Other budget top-ups	2.32	3.93	6.16	7.13
Financing, total	**8.06**	**20.41**	**25.24**	**25.97**
Impact on net lending	**0.06**	**0.44**	**2.83**	**2.90**
Technical transfers to households		0.44	2.83	2.90

Note: The amounts refer to reforms and financing proposed and announced in the Spring Adjustment Budget Bill for 2015 (Govt. Bill 2014/15:99) or announced in the Spring Fiscal Bill (Govt. Bill 2014/2015:100).

The Government's view of the Council's recommendations from 2014

The formal Council decision of 8 July 2014 recommended that Sweden:

1. Continue to pursue a growth-friendly fiscal policy and preserve a sound fiscal position, ensuring that the medium-term budgetary objective is adhered to throughout the period covered by the Convergence Programme, also with a view to the challenges posed on the long-term sustainability of public finances by an ageing population.

2. Moderate household sector credit growth and private indebtedness. To this end, reduce the effects of debt bias in personal income taxation by gradually limiting tax deductibility of interest payments on mortgages and/or by increasing recurrent property taxes. Take further measures to increase the pace of amortisation of mortgages.

3. Further improve the efficiency of the housing market through continued reforms of the rent-setting system. In particular, allow more market-oriented rent levels by moving away from the utility value system and further liberalising certain segments of the rental market, and greater freedom of contract between individual tenants and landlords. Decrease the length and complexity of the planning and appeal processes, by reducing and merging administrative requirements, harmonising building requirements and standards across municipalities and increasing transparency for land allotment procedures. Encourage municipalities to make their own land available for new housing developments.

4. Take appropriate measures to improve basic skills and facilitate the transition from education to the labour market, including through a wider use of work-based training and apprenticeships. Reinforce efforts to target labour market and education measures more effectively towards low-educated young people and people with a migrant background. Increase early intervention and outreach to young people who are unregistered with the public services.

The Government welcomes the country-specific recommendations. The Government largely concurs with the Council's view on the economic policy challenges Sweden is facing and has designed measures to meet these challenges. The first recommendation is addressed in Section 3. The second and third recommendations are addressed in Section 2.3 and the National Reform Programme. The fourth recommendation is addressed in the National Reform Programme.

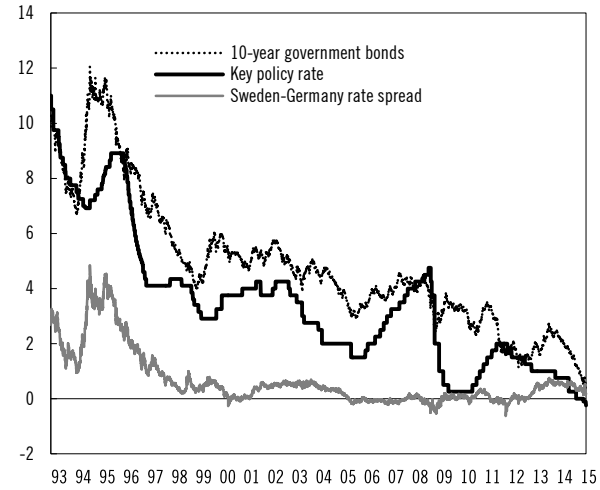
1.9 Monetary policy

Chart 1.1 shows the trend in a selection of interest rates in Sweden from 1993. Starting in October 2008, the Riksbank cut the repo rate in several

steps from 4.75 to 0.25 per cent to mitigate the effects of the financial crisis and check the decline of the real economy. As the Swedish economy recovered and inflationary pressure began to rise, the Riksbank gradually raised the repo rate in the second half of 2010 and the first half of 2011. In December 2011 and February 2012, the Riksbank again lowered the repo rate to 1.75 and 1.50 per cent respectively. In response to the slow economic growth, the Riksbank made two further cuts of the repo rate, of 0.25 per cent each in the autumn of 2012. The repo rate then remained at 1.0 per cent until December 2013 when, as a result of the continued weak economic situation, it was reduced by a further 25 points. Since the beginning of 2014, the Riksbank has further lowered the rate from 0.75 per cent to -0.25 per cent in March 2015. The measure was taken in response to diminishing inflation and concern about falling inflation expectations. In early 2015, the Riksbank also announced the purchase of government bonds on the secondary market to a total value of SEK 40 billion.

Chart 1.1 Interest rates in Sweden

Per cent



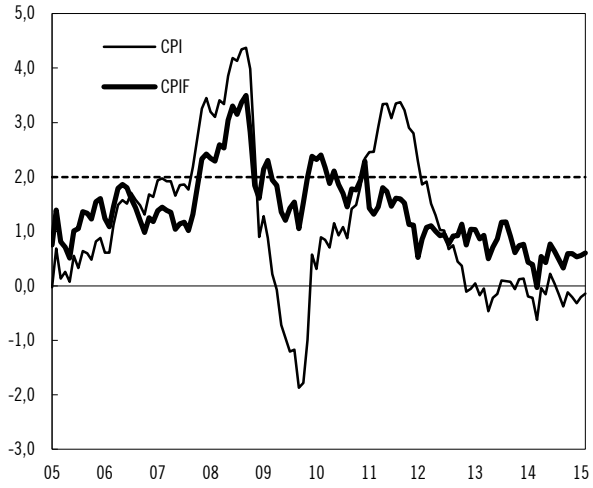
Source: Reuters.

The ten-year government bond rate also fell in autumn 2008, followed by a moderate rise in 2009 as the acute phase of the financial crisis abated. Long-term bond rates in Sweden rose as financial anxiety further eased in 2010 and investors began to seek higher-yield assets. However, risk aversion intensified in 2011 when the financial crisis evolved into a sovereign debt crisis and rates subsequently fell to record lows in the summer of 2012, as did German and US government bond rates. After strong pledges from the ECB to do whatever was necessary to protect the euro area from collapse, risk aversion decreased once more, contributing to Swedish, German and US bond premiums for riskier asset classes beginning to regress. Swedish and German government bond rates thereafter trended downwards in 2014, primarily due to investors having adjusted expectations to the understanding that the repo rate will remain low for a protracted period. This in turn depressed rates on securities

with longer maturity periods, such as government bonds. Swedish government bond rates rose slightly in early 2015, partly as a result of somewhat stronger cyclical indications in the Swedish economy. Rates ebbed again in March 2014 after the Riksbank cut interest rates and announced the bond purchase.

Chart 1.2 Inflation measured as CPI and CPIF

Annual percentage change



Note: The dashed line is the Riksbank's inflation target.
Source: Statistics Sweden.

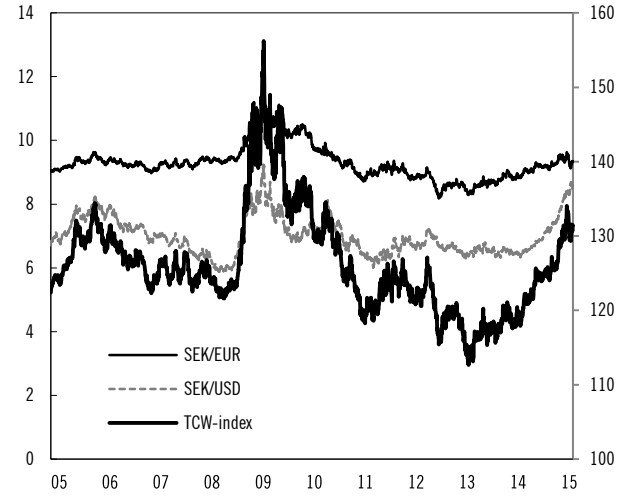
Inflation measured as the annual percentage change in the consumer price index (CPI) fell rapidly in autumn 2008 (see chart 1.2). The dramatic decline was mainly attributable to lower mortgage interest costs, but lower energy costs were another factor. From the end of 2010, CPI inflation rose and amounted to 3.0 per cent in 2011. This was largely due to the steep rise in interest rates in 2010 and 2011. Underlying inflation measured as CPIF (CPI at a fixed interest rate) was 1.4 per cent in 2011. In 2012, CPI inflation regressed as a result of lower interest rate costs and the subdued economic situation. CPI inflation remained around the same level throughout 2013, while CPIF inflation has decreased somewhat in recent months. Inflation declined further during most of 2014, mainly due to weak development in service prices in the domestic market. Service prices began to rise in late 2014, but the upturn in inflation was subdued by the steep decline in the oil price.

Sweden has had a floating exchange rate since November 1992. Chart 1.3 shows the development of the Swedish krona against the TCW index,[8] the euro and the US dollar in the period of 2005–2014. The uneasy situation in the financial markets caused the krona, like many other small currencies, to depreciate in 2008. The krona has since appreciated considerably. In TCW terms, the Swedish krona is as strong now as it was before the outbreak of the financial crisis.

[8] The TCW index (Total Competitiveness Weights) measures the value of the Swedish krona against a basket of other currencies.

Chart 1.3 Development of the Swedish krona against the TCW index, the euro and the US dollar

TCW index (right scale), EUR/SEK, USD/SEK (left scale)



Source: Reuters.

2 The macroeconomic development

2.1 International and financial economy

Recovery in the global economy was generally slow in 2014, but economic development varied among countries and regions. Economic development was relatively strong in the US and the UK, but growth in the euro area was comparatively weak. Growth decelerated in 2014 in many emerging economies, including China.

The lower oil price, lower interest rates and an otherwise more expansive monetary policy are expected to contribute to somewhat stronger economic development in the euro area in 2015. Business, households and the general government sector maintained high savings rates to reduce debt, which restrained economic activity. In addition, high unemployment is subduing demand growth in many economies.

Strong economic growth is expected in the US during the next few years. Continued high employment growth, low interest rates and a low oil price, combined, are creating scope for high growth in household consumption. High profits and high business confidence in the economic outlook are stimulating investment growth.

A transition is ongoing in the Chinese economy from growth largely dependent upon investments to growth driven by consumption to a higher extent. This development will lead to more balanced GDP growth in the next few years.

The overall assessment is that the world economy will strengthen in the next few years, although, as far as can be judged, the recovery will be slow in the euro area, which is Sweden's most important export market.

2.2 The Swedish economy

The sluggish recovery elsewhere in the world has resulted in subdued growth in Swedish exports – particularly export of goods. Growth has instead been driven primarily by household consumption and investments in housing. However, growth in investments in machinery was weaker due to weak export trends (see table 2.1).

Table 2.1 Key indicators

Annual percentage change, unless otherwise stated

	2014	2015	2016	2017	2018
GDP	2.1	2.6	2.7	2.5	2.4
Output gap[1]	-1.9	-1.4	-0.8	-0.1	0.1
Employment[2]	1.4	1.4	1.3	1.2	0.9
Employment rate[3]	66.2	66.6	66.7	66.8	66.9
Hours worked[4]	1.8	1.3	1.3	1.4	0.9
Productivity[4,5]	0.8	1.6	1.6	1.8	2.1
Unemployment rate[6]	7.9	7.5	7.1	6.7	6.4
Wages[7]	2.8	2.9	3.2	3.3	3.4
CPI[8]	-0.2	0.0	0.9	1.7	2.7

[1] The difference between actual and potential GDP as a percentage of potential GDP.
[2] Persons, 15–74 years.
[3] According to the EU2020 target, that is, those in employment as a percentage of the population in the age bracket 20–64 years.
[4] Calendar-adjusted.
[5] Business sector productivity.
[6] Per cent of the labour force, 15–74 years.
[7] Measured according to the short-term wage statistics.
[8] Annual average.
Sources: Statistics Sweden and own calculations.

Growth in Swedish exports is expected to increase in pace with continued economic recovery in the rest of the world. Growth in household consumption is also expected to accelerate in 2015 and 2016, supported by low interest rates and gradual improvement in the labour market situation. Housing investments and increasing investments in the service industries are also expected to provide a significant positive contribution to GDP growth in 2015 and 2016, which is estimated to be somewhat higher than in 2014.

The unemployment rate has hovered around 8 per cent since 2011. The employment rate rose during the same period, but not sufficiently to reduce unemployment because the number of persons in the labour force also increased. The upturn in the employment rate in 2014 was driven primarily by the service-producing industries.

The unemployment rate is expected to decline as economic recovery strengthens demand for labour. The Government has also determined that active interventions are required to reduce unemployment. Swedish economic recovery will also bring about higher resource utilisation in the next few years. The overall estimate is that about 380 000 people will be unemployed in 2016, a large percentage of whom it is likely to be individuals with a tenuous position in the labour market.

2.3 Potential macroeconomic imbalances

Macroeconomic imbalances in general

The emergence of macroeconomic imbalances, for example, in the form of persistent differences in competitiveness, has created severe problems for many countries in the aftermath of the financial crisis. In the economically favourable years, good access to cheap capital caused consumption and investments to rise to levels that were unsustainable in the long-term and asset prices to soar. Initially high levels of debt and ineffective allocation of capital have, as a result of falling asset prices, made it hard for many businesses in many countries to make new investments in maintaining competitive production. Falling asset prices have also contributed to weak household demand in many countries.

In order to ensure favourable economic development in the long term, it is desirable to primarily implement measures that prevent the emergence of macroeconomic imbalances and, secondly, to identify and correct any imbalances that do emerge at an early stage. It is difficult to provide a precise definition of macroeconomic imbalance, but an imbalance reflects an underlying problem in a market that has the potential to lead to a rapid and significant correction and in turn affect the entire economy. Examples of areas in which imbalances can arise are international competitiveness and labour costs, asset prices and both private sector debt and general government debt.

The macroeconomic imbalance procedure

Within the framework of the EU Macroeconomic Imbalance Procedure (MIP), which was organised within the European Semester and is part of economic policy coordination in the EU, the European Commission published in-depth reviews of the macroeconomic situation in 16 Member States on 26 February 2015. All of these countries were identified on 28 November 2014 in the Alert Mechanism Report (AMR) as potentially having macroeconomic imbalances. For Sweden, the AMR indicated a high current account surplus, falling export market shares and a high private sector debt, which were each above their indicative thresholds.[9]

Because the European Commission found that macroeconomic imbalances existed in all Member States reviewed, including five in which the imbalances were excessive, the Commission will be submitting a proposal on country-specific recommendations for measures to address these imbalances. These proposals will form part of the package of country-specific recommendations to be presented in mid–May 2015 within the scope of the European Semester. The proposals on country-

[9] The countries that are currently involved in adjustment programmes – Cyprus and Greece - have not been subject to in-depth reviews within the scope of the MIP. Despite the ongoing programme, Romania was subject to an in-depth review due to delays in programme updates.

specific recommendation will take into account the information provided in the Member States' National Reform Programmes and Convergence or Stability Programmes.

The situation is particularly serious for two of the five countries the European Commission assessed as having excessive macroeconomic imbalances.[10] Based upon National Reform Programmes and other commitments by these Member States, the Commission will in May assess whether the measures taken by these countries are adequate to unwind the identified imbalances. If such is not the case, the Commission may recommend that the Council initiate the Excessive Imbalance Procedure (EIP), which is the corrective arm of the MIP.

In its 2015 in-depth review of Sweden, the European Commission's assessment found macroeconomic imbalances that require monitoring and policy action. The Commission notes in particular that these imbalances reside in the still very high level of household debt, whose continued expansion is fuelled by rising house prices, persistent low interest rates, continued tax incentives to home ownership via debt and housing supply constraints.

Household debt

A high level of debt, regardless of whether in the private or public sector, may present a risk to financial and macroeconomic stability. This is clearly illustrated by developments in Europe and in much of the rest of the world in recent years.

In the years from 1997 to 2010, Swedish household debt increased significantly (see chart 2.1). At the aggregated level, this development can be described in terms of debt-to-income ratio and interest-to-income ratio, where the debt and the interest payments after tax, respectively, are compared to households' disposable income. Despite the debt-to-income ratio being at a historically high level, the interest-to-income ratio is close to the average for the past 30 years. Lower interest rates have thus resulted in households being able to take on larger amounts of debt without higher interest payments suppressing the potential to consume, invest or save.

Following several years of upturns, the debt-to-income ratio currently amounts to around 170 per cent of households' disposable income. Swedish household indebtedness is high from a historical and an international perspective.

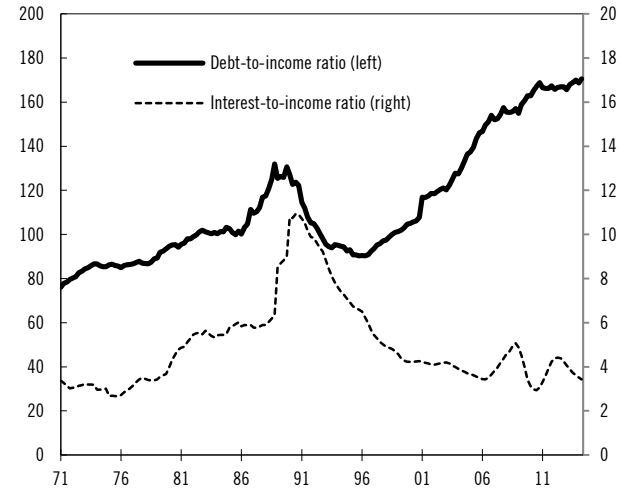
The increase in the household debt-to-income ratio over the past two decades can be explained to some extent by increased rates of home ownership and mortgage debt and by a greater proportion of these homes being in urban areas where prices are highest. In addition, the costs of mortgages and home ownership have decreased as a result of lower interest rates and reduced property tax. This means that house-

[10] Croatia and France.

holds can, in general, manage a higher individual debt-to-income ratio. The increase in the aggregate debt-to-income ratio is thus explained both by more households having loans and by households having larger loans on average.

Chart 2.1 Household debt-to-income and interest-to-income ratios

Percentage of disposable income



Source: The Riksbank.

Sweden's earlier Convergence Programmes demonstrated that very few households have high interest payments and that the interest payments on aggregated level will remain modest, even in a situation with normal interest rates. The Swedish Financial Supervisory Authority (*Finansinspektionen*) has conducted stress tests in its analyses of the Swedish mortgage market to look at households' sensitivity to interest rate increases, income decreases and falling housing prices. Based on these, Finansinspektionen concluded that the majority of households that have taken out new mortgages have good capacity to repay the loans and are resilient to changed economic conditions.

Even though the risk of financial instability has been assessed as low, vigilance concerning the macroeconomic consequences of high household indebtedness is justified. For example, higher interest payments for households may lead to reduced consumption and suppressed domestic demand, which in turn can stifle economic and GDP growth. Among other measures intended to moderate the trend of increasing household debt, Finansinspektionen has proposed an amortisation requirement on new mortgage loans (see also the Swedish National Reform Programme). These measures may inherently entail negative impact on the real economy. According to Finansinspektionen's calculations, an amortisation requirement will moderate household consumption by 0.5-1 per cent within a couple of years compared to a situation in which no requirement is introduced.

A number of measures have been taken the last years aimed at strengthening the banks' resilience to financial crises and curbing the rate at which household debt has grown in recent years. In June 2014,

the Riksdag enacted a law that increases the banks' required capital adequacy ratio and improves the banks capacity to withstand losses. Despite a somewhat more moderate trend, there is reason for continued vigilance and for the Government and responsible authorities to carefully monitor developments. It is now important to evaluate the measures that have already been implemented, the measures planned for implementation within the near future, and how the measures interact with each other.[11]

3 General government finances

3.1 Accounting principles

This section details the forecast for the general government finances provided in the 2015 Spring Fiscal Policy Bill (Govt. Bill 2014/15:100). Accounts of general government revenue and expenditure are, as in the Spring Fiscal Policy Bill, in accordance with European System of National and Regional Accounts (ESA 2010). The Government's accounts, which are also used by the National Institute of Economic Research (NIER), differ in certain respects from ESA 2010 (see table 3.1). The differences depend mainly upon that parts of sales revenues from public enterprises are recorded on the expenditure side in the national statistics as a debit item among general government consumption expenditure, while these revenues are recorded on the revenue side according to ESA 2010 (although net lending does not differ). A detailed account of the general government finances in accordance with ESA 2010 (and EDP) is provided in Annex C, Table C.2a.

Table 3.1 General government finances in accordance with the accounting standards in the Spring Fiscal Policy Bill and ESA 2010

Per cent of GDP

	2014	2015	2016	2017	2018
SFPB15					
Revenue	48.5	48.7	49.1	49.4	49.6
Expenditure	50.4	50.1	49.8	49.8	49.6
Net lending	-1.9	-1.4	-0.7	-0.4	0.0
ESA 2010					
Revenue	51.1	51.2	51.6	51.8	52.1
Expenditure	53.0	52.6	52.3	52.2	52.1
Net lending	-1.9	-1.4	-0.7	-0.4	0.0

Note: SFPB15 = 2015 Spring Fiscal Policy Bill.
Sources: Statistics Sweden and own calculations.

[11] The National Reform Programme contains a report on measures already implemented.

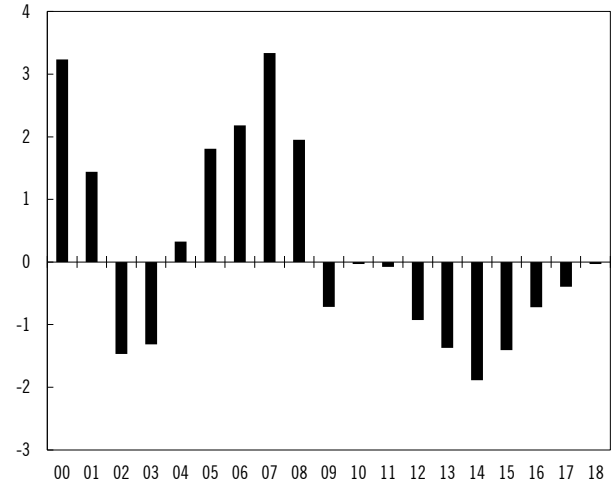
3.2 The development of the general government finances

General government net lending in 2014 amounted to a deficit of SEK 74 billion or -1.9 per cent of GDP. The deficit in the general government finances has thus doubled since 2012 (see chart 3.1). The deterioration is attributable partly to the weak economic recovery and partly to the measures implemented according to proposals made in the Budget Bills for 2013 and 2014. Higher expenditures due to changes in the number of persons receiving benefits from various transfer systems, primarily in the areas of ill-health and migration and integration, have also contributed to the deterioration in general government finances.

A consolidation of general government finances is anticipated in 2015 owing to stronger macroeconomic growth combined with full funding of implemented reforms. Estimated net lending in 2015 will be in deficit at -1.4 per cent of GDP (see table 3.2).

Chart 3.1 General government net lending 2000-2018

Per cent of GDP



Sources: Statistics Sweden and own calculations.

Based upon the anticipated continued economic recovery combined with a responsible fiscal policy, the general government finances are expected to be in balance from 2018. Net lending will be reinforced through rising revenue and falling expenditure in relation to GDP.

Table 3.2 General government finances

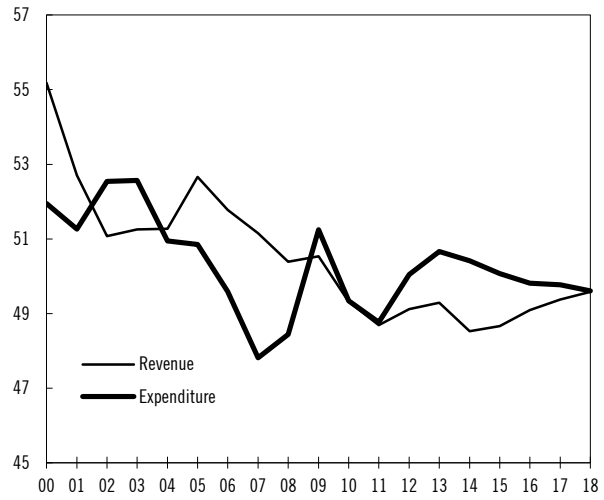
Per cent of GDP, unless otherwise stated

	SEK, billions					
	2014	**2014**	**2015**	**2016**	**2017**	**2018**
Revenue	**1 896**	**48.5**	**48.7**	**49.1**	**49.4**	**49.6**
Taxes and charges	1 664	42.6	42.8	43.3	43.6	43.8
Household direct taxes	592	15.2	15.2	15.5	15.8	16.0
Corporate direct taxes	101	2.6	2.7	2.6	2.7	2.8
Employers' contributions	110	2.8	2.8	2.8	2.8	2.8
Indirect taxes	862	22.0	22.1	22.3	22.3	22.2
Income from capital	62	1.6	1.6	1.5	1.6	1.6
Other revenue	170	4.4	4.3	4.2	4.2	4.1
Expenditure	**1 970**	**50.4**	**50.1**	**49.8**	**49.8**	**49.6**
Transfer payments	737	18.8	18.7	18.6	18.7	18.5
Final consumption expenditure	1 029	26.3	26.4	26.3	26.2	26.1
Gross fixed capital formation	177	4.5	4.3	4.3	4.2	4.2
Interest expenditure	35	0.9	0.9	0.8	0.8	0.9
Interest on pension liabilities	8	0.2	0.2	0.2	0.2	0.2
Net lending	**-74**	**-1.9**	**-1.4**	**-0.7**	**-0.4**	**0.0**
Primary net lending	-46	-1.2	-0.7	-0.1	0.3	0.7
Consolidated gross debt	**1 715**	**43.9**	**44.2**	**42.8**	**41.5**	**40.0**
Net debt	**-811**	**-20.8**	**-18.4**	**-16.9**	**-15.7**	**-14.9**

Sources: Statistics Sweden and own calculations.

Chart 3.2 General government revenue and expenditure 2000-2018

Per cent of GDP



Sources: Statistics Sweden and own calculations.

Revenue increasing as a proportion of GDP

Consequent upon the tax reductions implemented in 2014, general government tax revenue declined as a proportion of GDP (the tax ratio) by 0.1 per cent to 42.6 per cent of GDP compared with 2013. The tax changes proposed in the Spring Adjustment Budget Bill for 2015 will contribute to increasing the tax ratio by 1.3 percentage points by 2018. The tax ratio is estimated to be 44.0 per cent in 2018. Total revenue as a proportion of GDP is expected to develop in line with the tax ratio and

increase from 48.5 per cent of GDP in 2014 to 49.6 per cent of GDP in 2018 (see chart 3.2).

Expenditure decreasing as a proportion of GDP

The expenditure ratio (expenditure relative to GDP) amounted to 50.4 per cent in 2014. The expenditure ratio is expected to decline to 49.6 per cent in 2018, mainly attributable to stronger economic development and the expected decline in unemployment (see table 3.2).

GDP growth is expected to outstrip expenditure growth, especially in general government consumption and investments in the local government sector. Other transfer payments and subsidies to businesses and abroad are expected to decline as a proportion of GDP. Various transfer payments to households will develop largely in line with GDP. A higher interest rate at the end of the 2015–2018 forecast period will bring a moderate increase in interest expenditure as a proportion of GDP, despite the reduction in central government debt.

In relation to potential GDP, however, expenditures in 2015–2018 remain relatively constant as a proportion of GDP, at around 49.5 per cent.

Improvement in net lending occurring in central government

The improvement in the general government finances from 2015 occurs primarily at the central government level (see table 3.3), even though net lending in central government is only expected to become positive from 2018. The old-age pension system is expected to show positive net lending in 2014 and 2015 and balanced net lending in 2016. From 2017, the pension system is expected to show negative net lending. The local government sector reports negative net lending over the course of the forecast period, but a positive result according to the accounting principles that apply to the local government balanced budget requirement (see also Section 3.7).

Table 3.3 Net lending and the central government budget balance

Per cent of GDP

	2014	2015	2016	2017	2018
General government net lending	-1.9	-1.4	-0.7	-0.4	0.0
Central government	-1.4	-1.2	-0.5	-0.1	0.4
Old-age pensions system	0.1	0.2	0.0	-0.1	-0.2
Local government sector	-0.5	-0.4	-0.2	-0.1	-0.2
Central government budget balance	-1.8	-1.4	-0.1	0.0	0.4
Central government debt	34.5	34.3	32.7	31.1	29.4

Sources: Statistics Sweden, National Financial Management Authority and own calculations.

3.3 Net financial position and consolidated gross debt

General government consolidated gross debt decreases

Consolidated gross debt, known as Maastricht debt, is defined by EU regulations and is used to assess Member States' general government finances within the framework of the Stability and Growth Pact. In respect of conditions in Sweden, this definition means that the debt consists of the consolidated central government debt and local government sector debt in the capital markets, less the value of the Swedish National Pension Funds' holdings of government bonds.

Prior to Sweden's accession to the EU on 1 January 1995, the consolidated gross debt amounted to SEK 1 216 billion, corresponding to 70 per cent of GDP. Since then, the nominal value of the debt has fluctuated, amounting to SEK 1 715 billion at the close of 2014. The debt increased between 1994 and 2006 by around SEK 120 billion, even though the cumulative deficit in net lending between 1995 and 2006 was only about SEK 20 billion. This is mainly due to that surpluses in the National Swedish Pension Funds have been invested in equities and other assets, while the Funds have reduced their holdings of government bonds.

However, the debt has decreased considerably as a proportion of GDP, amounting to 43.9 per cent of GDP at the end of 2014, which can be compared with the reference value stated in the Stability and Growth Pact of a maximum of 60 per cent of GDP (see table 3.2).

Between 2012 and 2014, the debt increased by about SEK 370 billion, or about 7 percentage points as a proportion of GDP. Central government financing of loans to the Riksbank to reinforce currency reserves increased the debt by 2.8 percentage points, while sales of the central government's shareholdings reduced the debt ratio by 1.1 percentage points. According to regulatory changes effective 2014, central government units other than the National Debt Office may now hold outstanding repos over the turn of the year (the effect on assets and debt is of equal magnitude, but is recorded gross in the National Accounts). The Swedish Legal, Financial and Administrative Services Agency administers these repos, which primarily apply to the assets in the Nuclear Waste Fund and the Deposit Guarantee Board. From 2014, the Nuclear Waste Fund and the Deposit Guarantee Board have changed their investment policies with regard to the management of repos and reverse repos. In the past, repos were required to be closed before the end of the year; now that they are allowed to extend over the turn of the year, both gross debt and assets increase according to the National Accounts. The repos amounted to 1.8 per cent of GDP in 2014, which increases the debt and asset level by a corresponding amount. Because these repos are managed by the Legal, Financial and Administrative Services Agency, central government debt is not affected according to the budget.

The debt will increase in 2015 essentially in line with GDP growth. From 2016, debt will once again decline as a proportion of GDP. In 2018, the debt ratio is estimated to be 40.0 per cent of GDP.

General government net financial position is weakening

In 2014, general government financial wealth amounted to SEK 811 billion, corresponding to 20.8 per cent of GDP. In relation to last year's update, the financial position has been redefined in this year's update of the Convergence Programme. The changes are consequent upon the accounting changes made in the 2015 Spring Fiscal Policy Bill. Accounts are now consistent with the financial accounts provided by Statistics Sweden. As a result, total debt has been redefined and, as opposed to previous accounts, central government commitments and the majority of local government sector commitments for defined-benefit occupational pension plans are now included. As for the premium pension system, total debt for funded defined-benefit occupational pension plans is not included in the general government sector, but is instead reported in the insurance sector.

The net outstanding position at the end of the year with regard to taxes in arrears and prepaid taxes is also now reported in the financial accounts. Overall, the new definition of general government net worth entails a reduction of about 6 percent as a proportion of GDP in 2014, compared with the assessment according to the earlier definition applied in the Budget Bill for 2015.

General government net wealth resides mainly in the national pension funds, while the central government has a net debt. Since 2005, net wealth has been positive; that is, financial assets have exceeded liabilities. The general government's income from capital in the form of interest and dividends, which refers mainly to the old-age pension system, also exceeds its interest expenditure.

Net wealth increased in 2014 by the equivalent of 0.6 per cent of GDP compared with 2013. The contribution of net lending was negative while appreciation in value, etc., provided a strong positive contribution of 3.2 percentage points to the change in net worth. The increase in GDP reduced net worth in proportion of GDP by 0.7 percentage points.

In the absence of appreciation in value, the deficit in net lending will reduce net wealth in 2015. This forecast includes no changes in value other than the impact of predicted foreign exchange fluctuations on central government debt. Net wealth will decline by a further 0.8 percentage points as a proportion of GDP due to relatively strong GDP growth.

Net wealth will continue to decline as a proportion of GDP in 2017–2018. The improvement in net lending in 2016 does not compensate for the decrease in net wealth in relation to GDP resulting from the increase in GDP. Net wealth has been estimated at around SEK 690 billion in 2018, corresponding to 14.9 per cent of GDP.

From 2018, net wealth is expected to have declined in absolute numbers by around SEK 120 billion compared with 2014, primarily attributable to the change in cumulative net lending.

3.4 Reconciliation against the general government net lending target

The general government net lending target is 1 per cent of GDP on average over the course of an economic cycle. Formulating the target as an average instead of an annual requirement of 1 per cent of GDP is justified for reasons of stabilisation policy. If the target was 1 per cent for each individual year, fiscal policy would need to be contractionary in an economic downturn to ensure that the annual target is met. Fiscal policy would thus become pro-cyclical, meaning that it would amplify economic fluctuations instead of stabilising them. Consequently, there is good reason to formulate a net lending target as an average across an economic cycle even though this makes it more difficult to track whether fiscal policy is on target.

As the general government net lending target mainly constitutes a prospective guideline for fiscal policy, it is primarily monitored prospectively. However, a retrospective analysis is conducted in order to determine whether there have been any systematic failures of fiscal policy that may have impact on attaining the target in the future. The indicator used for the retrospective monitoring is average net lending over the course of the past ten years, currently 2005–2014. The structural balance and the 'seven-year indicator' are used in the prospective monitoring of the net lending target. The seven-year indicator is a seven-year moving average for general government net lending.

Retrospective ten-year average

Over the course of 2005–2014, general government net lending was equivalent to an average of 0.4 per cent of GDP (see table 3.4) and thus clearly below the target level. This is explained partly by the effects of the recession on the general government finances, but also by unfunded measures including tax reductions implemented by the former government, despite the improvement in the economy.

The seven-year indicator

The seven-year indicator is an average of net lending in the current year, three years prospectively and three years retrospectively, adjusted for one-off effects during the same period. The seven-year indicator shows that general government net lending is below the net lending target by around 2 percentage points (see table 3.4).

Table 3.4 General government net lending and indicators for reconciliation against the net lending target

Per cent of GDP, unless otherwise stated

	2014	2015	2016	2017	2018
Net lending	**-1.9**	**-1.4**	**-0.7**	**-0.4**	**0.0**
Retrospective ten-year average	0.4				
Seven-year indicator	-1.0	-1.0			
Structural balance	-0.9	-0.5	-0.4	-0.3	-0.1

Sources: Statistics Sweden and own calculations.

Structural balance

The structural balance aims to show how large net lending should be in a balanced economic situation. In the Government's calculation of the structural balance, net lending is adjusted to the current economic situation and for major one-off effects and extraordinary levels of household capital gains. The seven-year indicator is a seven-year moving average for general government net lending. The indicator for any given year includes net lending (adjusted for major one-off effects) for that year, the three previous years and the three subsequent years. Calculating the structural balance is associated with a high level of uncertainty, even if the certainty of the net lending forecast is disregarded. Firstly, the assessment of resource utilisation is uncertain. Secondly, the assessment of the sensitivity of general government net lending to the economic situation is uncertain. The assessment builds on an appraisal of an average relationship over a long period of time. All in all, this means that assessments of the structural balance are uncertain and that different assessments made at a single point in time can vary relatively widely, both historically and for the years ahead. The Government's starting point is thus that the assessment of the direction of fiscal policy must have a broad approach in which a number of individual targets and restrictions are compared to one another (see also The Government's monitoring of the government net lending target, Section 1.1). Consequently, the indicators used to monitor the net lending target only constitute one part of the overall assessment of the direction of fiscal policy.

In the Government's assessment, the structural balance has deteriorated significantly in recent years. In 2014, the structural balance, like the seven-year indicator, also fell short of the target level by almost 2 percentage points. Even if the structural balance is strengthened during the forecast period, it is expected to fall short of the target level by 1 per cent of GDP on average over an economic cycle for all years in 2015–2018 (see table 3.4).

The Government's overall assessment of attainment of the general government net lending target

The Government's overall assessment of target attainment is that net lending deviates clearly from the target level of net lending of 1 per cent of GDP on average over the course of an economic cycle. With respect to the Government's assessment of how a return to the target should be accomplished, the Government intends to pursue a responsible fiscal policy that leads to a gradual strengthening of the structural balance until net lending reaches the target level. The Government's overall assessment is that the reforms proposed in the Spring Adjustment Budget Bill for 2015 must be fully funded. The Government deems this fiscal policy direction reasonable with respect to creating margins that enable management of a deep recession while not endangering the ongoing economic recovery. Based on the current forecasts, the fundamental premise is that all reforms in the Budget Bill for 2016 should also be fully funded.

In the light of that general government indebtedness is relatively low, not least from an international perspective, the Government estimates that it will be possible to restore net lending to the target level at a rate that takes the stabilisation policy into account; that is, which takes into account the economic situation and that there are still available resources in the economy without jeopardising the sustainability of general government finances.

The Government anticipates a gradual recovery of the Swedish economy in 2015 and 2016. Nevertheless, unemployment remains high and the persistent recession presents a risk that unemployment will become entrenched at high levels. However, there is significant risk that development will be weaker than in this assessment. Despite the clear deviation from the target of 1 per cent of GDP, the Government therefore finds that it would be inappropriate to pursue a forcefully austere fiscal policy over the next few years. The Government estimates that it will not be possible to achieve net lending of 1 per cent of GDP until the next mandate period. If the economy is hit by a serious disruption, there is risk that the return to the target level for net lending will be further delayed. A stronger economic recovery, however, may create the conditions for a swifter return to the target level.

The Government's assessment of medium-term budgetary objective MTO) attainment as required by the preventive arm of the Stability and Growth Pact

The Government's assessment is that Sweden's MTO of a structural balance that does not fall below minus 1 per cent of potential GDP is attained throughout the entirety of the period reported. The Government notes, however, that the margins in Sweden's general government finances vis-à-vis the frameworks set by the preventive arm of the Stability and Growth Pact are small. The Government also notes that the Commission's assessments and forecasts of the structural balance are

slightly lower than the Government's and that the Commission's assessments indicate even smaller margins.[12] The Government notes that in February 2015, the Commission assessed Sweden's structural balance at -1.3 per cent of potential GDP, which is slightly below the MTO, but that in its overall assessment of the latest forecast, the Commission also takes into account factors including earlier forecasts and upon this basis deems Sweden to be in compliance with the rules of the Stability and Growth Pact in 2014 and expects Sweden to be in compliance in 2015 as well. However, the Commission noted the deterioration in the structural balance in 2014, which also means that Sweden will have a somewhat smaller margin for impaired net lending in 2015. In accordance with how the Government intends to attain the national target for general government net lending (see the section above, The Government's overall assessment of attainment of the general government net lending target), the Government estimates that the structural balance will be gradually strengthened during the programme period. According to its forecast of February 2015, the Commission seems to concur with this assessment.

The NIER is analysing the effects of lowering the net lending target to 0 per cent

Three main reasons were stated when the net lending target was originally established (see also Section 1.1 Budgetary policy goals). The first was to restore confidence in general government finances and reduce the need for foreign borrowing; the second was to provide scope for the stabilisation policy; the third was to contribute to the capacity of the general government sector to overcome demographic challenges in the future. The intention was not that the general government sector should maintain a surplus of 1 per cent indefinitely, but rather that it should be possible to re-examine the target level in the future.[13]

Confidence in the general government finances has risen significantly and the need for foreign borrowing has declined steeply since the target was introduced. The fiscal policy framework has made a strong contribution to the rapid restoration of confidence in the Swedish central government's capacity to meet its obligations to lenders and citizens alike. General government gross debt has declined from around 70 per cent of GDP when the surplus target was introduced to just over 40 per cent today. In parallel, the Swedish central government's borrowing costs have declined significantly since 1997 and the general government sector now has substantial net assets. A lower target level should also provide

[12] The European Commission uses its own assessment of structural balance as a basis for evaluating attainment of the MTO. According to the Commission's latest forecast (February 2015) Sweden attains its MTO in every year of the forecast period (2014-2016).

[13] The target was originally 2 per cent of GDP on average (across an economic cycle), but following a technical adjustment, the target amounted to 1 per cent of GDP (across an economic cycle). See also Section 1.1 Budgetary policy goals.

adequate margins for managing future recessions. Sweden's low central government debt and high net worth make the country highly resilient and well-equipped to manage future financial and economic crises without endangering confidence in general government finances.

The demographic pressure on the general government finances predicted when the surplus target was established is now upon us. The percentage of the retired population in relation to the working population has increased since the first decade of the 2000s. In a few years, the percentage of the population aged 80+ is also going to rise sharply, which will increase the need for elderly care and healthcare services. Demographic pressure affects the income of the general government sector when a smaller percentage of the population is employed.

In the light of this, the Government has tasked the NIER with analysing the consequences of changing the net lending target from 1 per cent of GDP on average over the course of an economic cycle to 0 per cent of GDP on average over the course of an economic cycle (ref no Fi2015/1488). The analysis must cover the short-term and long-term impacts on the general government finances, fiscal policy sustainability and capacity to respond to major economic disruptions in the future with fiscal policy measures. Furthermore, the NIER must assess any effects on employment, unemployment and productivity. A reference group composed of relevant academic experts will be attached to the remit. The remit must be reported to the Government by 14 August 2015.

It is important to note that a change of the target level would not create any fiscal space in the immediate future. Over the longer term, however, space will be freed up for urgent general government investments in welfare, infrastructure, housing, climate transition, research and education.

3.5 Impact of fiscal policy on demand

One often-used indicator of the impact of fiscal policy on demand is the change in the structural balance. This is a rough measure of the direction of fiscal policy, covering not only active fiscal policy in the central government budget, but also a number of other factors.

If the change in the structural balance is zero, this indicates that fiscal policy, disregarding the effect of automatic stabilisation mechanisms, has a neutral effect on resource utilisation in the economy. If the structural balance instead increases or decreases, this indicates that fiscal policy has a contractionary or expansionary effect, respectively, on resource utilisation. An analysis of the change in net lending 2015–2018 is provided below. The analysis is intended to provide a picture of how fiscal policy will affect demand in the future. It should, however, be emphasised that analyses of this kind are highly uncertain.

In 2015, resource utilisation is expected to increase and the negative output gap to decrease by the equivalent of 0.5 per cent of potential

GDP (see the last line in table 3.5). An increase in resource utilisation such as this is estimated to strengthen the general government finances by the equivalent of about 0.3 per cent of GDP (see the second line of table 3.5). This is the effect of the automatic stabilisation mechanisms. In parallel, there is a cyclical deterioration of the tax base composition that weakens net lending by 0.2 per cent of GDP (see line three of table 3.5). The difference between the change in net lending and the net effect of the automatic stabilisation mechanisms, tax base composition and one-off effects corresponds to the change in the structural balance. The one-off effects on the change in net lending reported for 2016 and 2017 arise from accruals of Sweden's fees to the European Union.

Tax revenue normally rises at about the same rate at GDP at current prices, while general government expenditure increases somewhat more slowly in the absence of policy change. The reason for this is that certain expenditures, such as child benefit, are determined nominally in SEK, while others are price-indexed. Furthermore, appropriations to central government authorities are not fully compensated for rising wages because a certain increase in productivity is assumed. Consequently, the general government finances are automatically strengthened in the absence of new active decisions, which largely explains the positive values in the 'Other' category in table 3.5.

Table 3.5 Indicators of impulse to demand

Annual change, per cent of GDP

	2015	2016	2017	2018
Net lending	**0.5**	**0.7**	**0.3**	**0.4**
Automatic stabilisation mechanisms	0.3	0.3	0.4	0.2
Tax base composition	-0.2	-0.1	0.1	0.1
One-off effects	0.0	0.3	-0.2	0.0
Structural balance	**0.4**	**0.1**	**0.1**	**0.1**
Discretionary fiscal policy[1]	0.3	0.1	0.0	-0.1
Capital income, net	-0.1	0.1	0.0	0.0
Local government finances	0.2	0.2	0.1	0.0
Old-age pensions system	0.1	-0.2	-0.1	-0.1
Other	-0.1	-0.1	0.1	0.3
Output gap, change in percentage points	0.5	0.6	0.6	0.3

[1] Refers to expenditure and revenue changes between 2014 and 2017 in relation to reforms adopted, proposed and announced in previous years.
Sources: Statistics Sweden and own calculations.

The active fiscal policy in the central government budget (line six of table 3.5) provides a near-zero contribution throughout the forecast period. The change in the structural balance is also affected by changes in net lending in the old-age pension system and the local government sector. While net lending is marginally strengthened in the local government sector, which has a mildly contractionary effect, it is weakened in the pension system for every year except 2015, which has an expansionary impact. The net effect of these changes in net lending have a virtually

neutral impact on demand in the economy except in 2015, when the effect is mildly contractionary.

3.6 Monitoring of the expenditure ceiling

The multi-year expenditure ceiling serves to foster the credibility of economic policy and is an important budgetary policy commitment for the Riksdag and the Government. All expenditure in the central government budget is subject to the expenditure ceiling, with the exception of interest payments on central government debt. In addition, expenditure on the old-age pension system is encompassed by the expenditure ceiling. Ceiling-restricted expenditure consists of actual rather than budgeted expenditure, meaning that the authorities' utilisation of appropriations savings and appropriations credit is included. The space between the expenditure ceiling and ceiling-restricted expenditure is termed the 'budgeting margin'. As a rule, if the budgeting margin is utilised, the general government finances deteriorate.

In the Spring Adjustment Budget Bill for 2015, the Government proposes increasing the already established levels of the expenditure ceiling for 2015–2017 for reasons justified by fiscal policy. There are no formal impediments to a Riksdag decision to amend a previously established expenditure ceiling. According to established practise, the Government has not proposed any changes to the real level of an expenditure ceiling previously proposed by the same government. It is, however, consistent with established practise and the fiscal policy framework for a new government to submit proposals on amended expenditure ceiling levels as part of a new direction in fiscal policy (see Comm. 2010/11:79). The Government proposed corresponding increases in the Budget Bill for 2015 (Govt. Bill 2014/15:1, Proposed Central Government Budget, Fiscal Plan, etc., sections 5.4.1 and 5.4.2). The Government's proposed expenditure ceiling levels for 2015–2017 were rejected when the Riksdag voted in favour of another budget proposal (Rep. 2014/15:FiU1, Riksdag Comm. 2014/15:29), but the Government maintains its position that expenditure ceilings for 2015–2017 should be increased as proposed in the Budget Bill for 2015.

For 2018, the Government's estimated expenditure ceiling level corresponds to the estimated level for 2018 in the Budget Bill for 2015. According to the Swedish Budget Act, the Government is obliged to propose an expenditure ceiling for the third future year. In accordance with the Budget Act, the Government will submit a proposed expenditure ceiling in the Budget Bill for 2016. An estimated level is not subject to decision by the Riksdag.

Table 3.6 Expenditure ceiling 2014–2018

SEK billions, unless otherwise stated

	2014	2015	2016	2017	2018
Expenditure ceiling[1]	1 107	1 158	1 204	1 262	1 319
Per cent of GDP	28.3	28.4	28.3	28.4	28.5
Ceiling-limited expenditure	1 096	1 117	1 166	1 213	1 249
Per cent of GDP	28.0	27.4	27.4	27.3	27.0
Budgeting margin	11	41	38	49	70
Per cent of GDP	0.3	1.0	0.9	1.1	1.5

[1] For 2015–2017, this refers to the Government's proposed expenditure ceiling levels in the Spring Adjustment Budget Bill for 2015. For 2018, this refers to the Government's estimation of the ceiling expenditure level in the Spring Fiscal Policy Bill for 2015.
Note: The budgeting margin is the difference between an expenditure ceiling and the ceiling-restricted expenditure.
Sources: Swedish National Financial Management Authority and own calculations.

The Government estimates that the budgeting margin will be SEK 70 billion for 2018. This is the maximum increase in expenditure for 2018 allowed by the expenditure ceiling. However, a corresponding amount of at least SEK 20 billion below the expenditure ceiling should be left unallocated as a buffer for unforeseen events when the Budget Bill for 2018 is submitted to the Riksdag.[14] Compared with the forecast for ceiling-restricted expenditure for 2018 in this bill, the expenditure ceiling thus allows ceiling-restricted expenditure to increase by around SEK 50 billion in the Budget Bill for 2018. This corresponds to around 1.2 per cent of GDP.

In the longer term, the level of the expenditure ceiling may be seen as an expression of the Government's view on how total central government expenditure and old-age pension system expenditure should develop and be constrained from the medium-term perspective. After the level of the expenditure ceiling has been established by the Riksdag, however, it should not be regarded as a target for the actual expenditure level, because this needs to be adjusted to factors including macroeconomic development. The existence of space below the expenditure ceiling does not necessarily mean there is scope for reforms that increase ceiling-restricted expenditure. Reforms on the expenditure side cannot be implemented until they have been reconciled against the net lending target and the increase in total taxes that may be required.

3.7 Monitoring sound financial management and the local government balanced budget requirement

The general government net lending target (see Section 1.1) also includes net lending in the local government sector: municipalities and county councils. However, no explicit target has been stipulated for local government net lending.

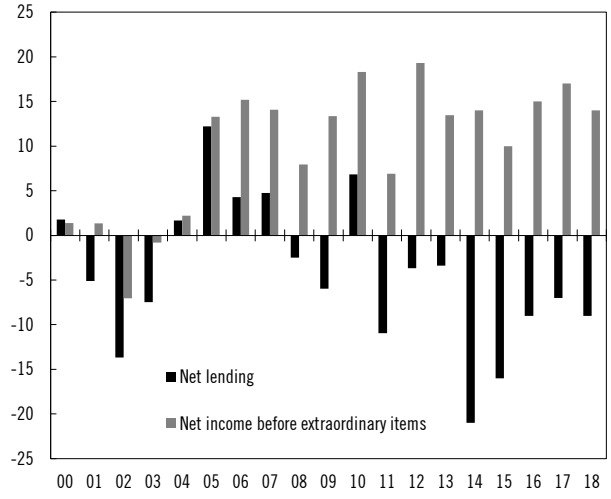
[14] According to the Government's guideline, the minimum budgeting margin should correspond to at least 1 per cent of ceiling-limited expenditure in the current year t (2014), at least 1.5 per cent in year t+1 (2015) and at least 2 per cent in year t+2 (2016). The necessary buffers for t+3 (2017) and for t+4 (2018) are estimated at a minimum of 3 per cent of ceiling-limited expenditure.

The general government surplus target is expressed in terms of net lending as defined in the National Accounts. However, it is net income, rather than net lending, that determines whether municipalities and county councils are in compliance with the balanced budget requirement of the Swedish Local Government Act (1991:900). According to this requirement, municipalities and county councils must draw up budgets in which income exceeds expenditure. Only in exceptional cases are deviations from the balanced budget requirement permitted. A negative net income in the closing accounts must be corrected within three years, unless there are exceptional grounds. This requirement represents the lowest acceptable short-term net income.

There are differences in accounting methods between the local government accounts and the National Accounts that may amount to several billion kronor for a particular year (see chart 3.3). These discrepancies are due to the fact that local government accounting is based on the same theoretical principles as those which apply to accounting in the business sector. If, for example, investment expenditure were to rise substantially between two years, this would have an immediate impact on net lending, while net income would only be affected by depreciation.

Chart 3.3 Local government net income and net lending

SEK billions



Sources: Statistics Sweden and own calculations.

According to the Swedish Local Government Act, municipalities and county councils must also maintain sound financial management in their operations. Effective from 2005, municipalities and county councils should to set the financial targets that are significant to sound financial management. A commonly used measure is that net income corresponding to 2 per cent of revenue from taxation and general central government grants meets the requirement for sound financial management. The annual reports of municipalities and county councils reports must contain an assessment of whether the balanced budget requirement has

been met. These reports must also include an evaluation of whether the requirement for sound financial management has been achieved.

As of 1 January 2013, municipalities and county councils are permitted to build up balancing funds within the scope of their equity. Surpluses can be set aside in good times to be utilised if deficits arise as a result of an economic downturn. The introduction of balancing funds can be seen as a clarification of the overall objective of sound financial management.

Development of net income in local government

The local government sector reported a preliminary net income before extraordinary items of SEK 14 billion in 2014 (see chart 3.3). The strong result is partially explained by increases in the average tax rate by a total of SEK 0.13 by municipalities and county councils.

3.8 Central government guarantees

A central government guarantee undertaking entails the central government providing a surety for another party's payment obligation, which incurs a financial risk for the central government. General rules for the management of central government guarantees are set out in laws and ordinances.

According to the Swedish Budget Act, the Government may issue credit guarantees and make other similar commitments for the purpose, which may not exceed the amount determined by the Riksdag. A guarantee charge must to be imposed corresponding to the central government's risk and other costs associated with the commitment, unless the Riksdag decides otherwise. The charge must cover expected costs associated with the guarantee, consisting of anticipated losses (or possible recoveries) should the beneficiary of the guarantee be unable to meet its obligations, as well as administrative costs. This model for central government guarantees was created to ensure that guarantees are self-financed in the long term. Examples of major guarantee commitments covered by this guarantee model are export credit guarantees and credit guarantees for infrastructure projects. Alongside the Swedish Budget Act, there are guarantees that are regulated by specific laws. The deposit insurance scheme, the investor compensation scheme and the bank guarantee programme are all examples of guarantees managed outside the guarantee model.

Composition of the guarantee portfolio

A summary of the guarantees and pledges issued by the Government and various public authorities is shown in table 3.7. The central government's guarantee portfolio amounted to SEK 1 727 billion at the close of 2014. The largest commitment was the deposit insurance scheme (SEK 1 389

billion as of 31 December 2013), followed by credit guarantees and guarantees for capital injections. Pension guarantees and other guarantees amounted to a total of SEK 10 billion.

Table 3.7 Central government guarantee commitments and pledges, 31 December 2014

SEK billions

	Guarantees	Pledges	Expenditure area
Deposit insurance scheme[1]	**1 388.9**		2 Economy and financial administration
Investor compensation[2]			2 Economy and financial administration
Credit guarantees	**206.4**	**126.3**	
of which			
Bank guarantee programme	0.9		2 Economy and financial administration
Export credit guarantees[3]	174.2	125.8	24 Industry and trade
Credit guarantees in foreign aid	1.0	0.1	7 International development cooperation
Independent guarantees	2.1	0.4	7 International development cooperation
Infrastructure	19.3		22 Transport and communications
Housing credits	2.1		18 Planning, housing provision, construction and consumer policy
International commitments	6.7		2 Economy and financial administration 7 International development cooperation 22 Transport and communications
Other	0.0		1 Governance 6 Defence and contingency measures 23 Land-based industries, rural areas and food
Guarantees for capital injections	**121.9**		
of which			
Capital cover guarantees[4]			22 Transport and communications
Subscription guarantees	0.4		24 Industry and trade
Guarantee capital	121.5		2 Economy and financial administration 7 International development cooperation
Pension guarantees[5]	**8.2**		2 Economy and financial administration 16 Education and university research 22 Transport and communications 24 Industry and trade
Other guarantees	**1.5**		16 Education and university research 22 Transport and communications
of which			
Guarantees for public enterprises etc.	1.5		
Total	**1 726.9**	**126.3**	

[1] The commitment for the deposit insurance scheme is as of 31 December 2013.
[2] For the investor compensation scheme there is a lack of data regarding the scope of the protected assets.
[3] Refers to both restricted and unrestricted pledges.
[4] There are two capital cover guarantees for which no values have been estimated since the guarantees are not limited in terms of time and amount.
[5] The commitment for pension guarantees is as of 31 December 2013.
Source: Swedish National Debt Office.

Expected costs in the central government guarantee portfolio

To measure the risk of the guarantee commitments that are managed according to the guarantee model, the authorities issuing these guaran-

tees continuously assess the anticipated losses. The authorities make provisions on the debt side of their balance sheets for the expected costs, which consist of anticipated losses and the administrative costs of managing the guarantees. The deposit insurance scheme, investor compensation scheme and the bank guarantee programme are not regulated by the Swedish Budget Act, but by specific legislation. Consequently no assessment is made of, or provision made for, anticipated losses.

To assess how well the guarantee scheme is expected to manage future redemptions, an analysis is made of the relationship between the provisions for expected costs and the assets (in the form of paid-in and future guarantee fees and administrative costs).

The debt and asset sides of the guarantee operations are shown in table 3.8. The comparison is made at authority level, but the deposit insurance scheme, investor compensation scheme, bank guarantee programme and guarantee capital to international financing institutions are not included in because the expected costs of these guarantees have not been estimated.

Table 3.8 Comparison between provisions for expected costs and assets in the guarantee operations as of 31 December 2014 (excluding the deposit insurance scheme, investor compensation scheme, bank guarantee programme and guarantee capital)

SEK billions

Authority	Guarantee commitment	Provisions for expected costs	Guarantee assets	Net present value of future fees
Swedish National Debt Office	34.7	0.9	1.6	0.0
The Swedish Export Credits Guarantee Board	166.8	5.6	29.6	1.6
Swedish International Development Cooperation Agency	3.5	0.3	2.0	0.0
BOVERKET - The Swedish National Board of Housing, Building and Planning	2.1	0.1	2.2	0.0
Total	**207.0**	**7.0**	**35.5**	**1.7**

Source: Swedish National Debt Office.

4 Alternative scenarios and comparison with Sweden's Convergence Programme 2013

4.1 Alternative scenarios

This section discusses possible risks in the forecast for economic development and the general government finances presented in Sections 2 and 3. In addition, two alternative scenarios for the development of the Swedish economy are presented.

Risk for weaker development is substantial

Inflation expectations have fallen recently, including in the euro area. At the beginning of 2015 they were at 1.2 per cent on a three-year horizon and thus below the ECB inflation target. This is a signal that households and businesses do not believe the inflation target will be met in three years, which in turn makes it more difficult for the ECB to reach the target. The low inflation reported in many economies presents a risk of even lower inflation expectations. This is of particular concern because monetary policy in the euro area is constrained by interest rates that are already low. There is risk that this will lead to a situation in which persistent low or negative inflation holds back the demand growth. Aimed at supporting an upturn in inflation, the European Central Bank has launched a programme of large-scale purchases of financial assets. Judging by appearances, the measures have had major impact on the financial markets: the euro has depreciated and stock market prices have been driven up. The effects are largely as expected, but unconventional monetary policy measures of this type are relatively untried and there is a risk they will contribute to destabilising segments of the financial markets. Such a scenario in the euro area would impair opportunities for recovery in the Swedish economy.

The Russian economy is expected to weaken in 2015 in the wake of lower oil prices and the conflict in Ukraine. There is risk that the trend will deteriorate further, especially if the oil price does not rise to any appreciable extent. The direct links between the Russian and Swedish economies are, however, not particularly strong, as trade between the countries is relatively insignificant. Nonetheless, there is risk that further weakening of the Russian economy will cause disruptions in the financial markets and that growth in neighbouring economies, such as Finland, will decline even further. In such a situation, there may be tangible negative impacts on the Swedish economy.

Political uncertainty in the euro area has increased since the end of 2014, primarily due to the strained negotiating position that has arisen between the new government in Greece and its lenders. In the baseline scenario, Greece reaches an agreement with its lenders in 2015 and is granted continued assistance after the current financial assistance programme expires in June of the same year. But the political situation is tense and the danger that negotiations will fail has increased. The consequences of such a development are very difficult to assess. Although the risk that a Greek crisis would spread to other euro countries seems less now than in 2012 when a similar situation occurred, a breakdown in negotiations may have severe adverse impact on the financial markets and the real economy in the euro area and globally. Such a development would also have significant consequences for the Swedish economy.

Floods, abnormal winter temperatures and droughts are three examples of extreme weather conditions that have affected macroeconomic development in recent years. There is risk that such events, related to climate change, will affect economic activity in forthcoming years to a

greater extent than assumed in the forecast. The macroeconomic effects of worsened weather conditions are hard to assess, but it has been shown that they can entail major costs for individuals and society.

In the light of house price trends, the high level of household debt in Sweden constitutes a risk in the forecast. The forecast presumes that house prices will continue to increase, albeit at a moderate rate, over the next few years. This assessment is uncertain, however, and it cannot be excluded that house prices will rise faster than predicted in the forecast. Rapidly rising house prices may increase the risk that the housing price bubble will burst. Such a development, with a combination of high levels of debt and falling house prices, entails a risk of negative consequences for macroeconomic development. In response, several measures, aimed at mitigating risk in the financial system and household debt, have been taken in recent years.

Stronger development possible

If business and consumer confidence in the rest of the world, especially the euro area, returns faster than expected, demand for Swedish exports may rise at a faster pace than assumed in the forecast. If this were to occur, Swedish economic recovery would be hastened. The effects of the lower oil price are also difficult to assess and it is possible that the positive effects have been underestimated, which would indicate stronger economic development.

Swedish household consumption is another factor that may strengthen the economic upturn. Households have a high level of savings as a proportion of income (a high savings ratio), which combined with gradual improvement of the labour market situation has favourable implications for high and stable consumption growth. The savings ratio is estimated at 7.7 per cent at the end of the forecast period, which is higher than the average of 1.5 per cent over the last 20 years. Given the relatively high savings ratio at the end of the forecast period, there is thus room for a higher rate of growth in consumption than in the forecast without the savings rate plunging to abnormally low levels.

Alternative Scenario 1: Weaker development in the rest of the world

Alternative Scenario 1 assumes that weaker recovery in the euro area causes lower demand for Swedish export products. This contributes to weaker GDP growth and slower growth in resource utilisation than in the baseline scenario. Lower resource utilisation leads to a lower rate of wage growth, which relieves inflation pressure. The Riksbank therefore does not raise the repo rate as rapidly as in the baseline scenario, which by reason of a weaker exchange rate partially counteracts the negative impact of reduced demand in the rest of the world for Swedish exports. A more expansive monetary policy also benefits investments and household consumption. Overall however, weaker export growth results in slower GDP growth in 2015–2017 than in the baseline scenario (see table 4.1) and the GDP gap remains negative for the entire forecast period.

Unemployment declines as resource utilisation on the labour market increases, but not to the same extent as in the baseline scenario.

General government net lending as a proportion of GDP is impaired by 0.1–0.3 percentage points compared with the baseline scenario. This is mainly due to slower wage growth as a result of fewer hours worked and lower wages.

Table 4.1 Alternative Scenario 1: Weaker international development.

Forecast according to the baseline scenario in parentheses, annual percentage change, unless otherwise stated

	2015	2016	2017	2018
GDP[1]	2.3	2.0	2.3	2.5
	(2.4)	(2.5)	(2.7)	(2.5)
Exports[1]	3.8	3.0	4.1	4.9
	(4.0)	(5.0)	(5.4)	(5.3)
Unemployment rate[2,3]	7.5	7.5	7.4	7.3
	(7.5)	(7.1)	(6.7)	(6.4)
Output gap[4]	-1.5	-1.3	-1.0	-0.8
	(-1.4)	(-0.8)	(-0.1)	(0.1)
Repo rate[5]	-0.1	-0.1	-0.1	0.2
	(-0.1)	(-0.1)	(0.2)	(1.1)
CPIF[5]	0.8	1.1	1.2	1.4
	(0.8)	(1.4)	(1.6)	(1.8)
Net lending[6]	-1.4	-0.9	-0.7	-0.3
	(-1.4)	(-0.7)	(-0.4)	(0.0)

[1] Calendar-adjusted.
[2] 15–74 years.
[3] Per cent of the labour force.
[4] The difference between actual and potential GDP as a percentage of potential GDP.
[5] Annual average.
[6] Per cent of GDP.
Source: Own calculations.

Alternative Scenario 2: Stronger growth in domestic consumption

Alternative Scenario 2 assumes a higher increase in household consumption than in the baseline scenario (see table 4.2). This may occur if, for example, households choose to reduce their savings, which are currently at historically high levels, in favour of higher consumption. Stronger consumption growth in 2015–2017 leads to higher GDP growth and a faster increase in resource utilisation. As a result of higher production growth, businesses increase hiring and unemployment is lower than in the baseline scenario. Higher resource utilisation on the labour market leads to stronger wage growth, which in turn increases inflation pressure. In response, the Riksbank raises the repo rate at a faster pace than in the baseline scenario. The higher interest rate constrains investments and exports somewhat, which moderates GDP growth. Taken as a whole, however, stronger consumption growth leads to the economy reaching balanced resource utilisation earlier. The inflation target of 2 per cent is reached by 2018.

General government net lending as a proportion of GDP is improved by 0.1-0.2 percentage points compared with the baseline scenario. Net

lending is strengthened primarily through revenue from taxes on labour and consumption.

Table 4.2 Alternative Scenario 2: Stronger household consumption

Forecast according to the baseline scenario in parentheses, annual percentage change, unless otherwise stated

	2015	2016	2017	2018
GDP[1]	2.5	2.7	2.7	2.0
	(2.4)	(2.5)	(2.7)	(2.5)
Final consumption expenditure of households (incl. NPISH)[1]	2.9	3.5	3.1	2.2
	(2.6)	(2.6)	(2.7)	(2.7)
Unemployment rate[2,3]	7.5	6.8	6.5	6.4
	(7.5)	(7.1)	(6.7)	(6.4)
Output gap[4]	-1.2	-0.4	0.2	0.0
	(-1.4)	(-0.8)	(-0.1)	(0.1)
Repo rate[5]	-0.1	-0.1	-0.1	0.2
	(-0.1)	(-0.1)	(0.2)	(1.1)
CPIF[5]	0.8	1.6	1.8	2.0
	(0.8)	(1.4)	(1.6)	(1.8)
Net lending[6]	-1.4	-0.5	-0.2	0.1
	(-1.4)	(-0.7)	(-0.4)	(0.0)

[1] Calendar-adjusted.
[2] 15–74 years.
[3] Per cent of the labour force.
[4] The difference between actual and potential GDP as a percentage of potential GDP.
[5] Annual average.
[6] Per cent of GDP.
Source: Own calculations.

4.2 Comparison with the 2014 Convergence Programme

Actual GDP growth has been revised down for 2014–2016 in relation to last year's programme, but is unchanged for 2017 (see table 4.3). The primary reason for the downwards adjustment in GDP growth, at least in the short term, is that the economic recovery in the rest of the world is more sluggish than assumed in last year's programme update. In the somewhat longer term, the downwards adjustments are explained primarily by the downwards adjustment of potential GDP, which is in turn partially explained by relatively restrained investments in the Swedish business sector due to the persistent recession.

General government net lending has been adjusted downwards in all years during the period of 2014–2017. The downwards adjustments are due in part to the amended regulations for the National Accounts (the transition from ESA 1995 to ESA 2010), but also in large part to the downwards adjusted macro-forecast. Upwards adjusted expenditure forecasts related to migration and ill-health also contribute to the downwards adjusted net lending. The lower net lending leads, in turn, to the consolidated gross debt now estimated to be higher in 2015 and 2016 than in the 2014 Convergence Programme. The upwards adjustment of the debt is also explained by the Legal, Financial and Administrative Ser-

vices Agency's revised management of transactions involving repurchase agreements ('repos' and 'reverse repos').

Table 4.3 Comparison with the 2014 convergence programme

Annual percentage change in volume and per cent of GDP

	2014	2015	2016	2017	2018
GDP, percentage change in volume					
Convergence programme 2014	2.7	3.3	3.5	2.5	--
Convergence programme 2015	2.1	2.6	2.7	2.5	2.4
Difference, percentage points	-0.6	-0.7	-0.8	0.0	--
General government net lending, per cent of GDP					
Convergence programme 2014	-1.6	-0.3	0.2	0.7	--
Convergence programme 2015	-1.9	-1.4	-0.7	-0.4	0.0
Difference, percentage points	-0.3	-1.1	-0.9	-1.1	--
Consolidated gross debt, per cent of GDP					
Convergence programme 2014	41.3	39.7	37.3	34.8	--
Convergence programme 2015	43.9	44.2	42.8	41.5	40.0
Difference, percentage points	2.6	4.5	5.5	6.7	--

Sources: Statistics Sweden and own calculations.

5 The long-term sustainability of the fiscal policy

Developments in Europe in recent years illustrate how unsustainable fiscal policy can lead to substantial interference with government-funded activities, resulting in societal costs. As a result of large and growing public debt, several crisis-hit countries have been forced to adopt emergency crisis measures instead of implementing reforms that promote stable, long-term growth. Enforced crisis management thus also often increases the strains in redistribution policy. Strong general government finances create the prerequisites for constructive crisis management. As needed, stabilisation policy interventions can be implemented without jeopardising confidence in the fiscal policy. It is therefore important that fiscal policy is sustainable and enjoys a high level of confidence, not only among households and businesses, but also in the international financial markets.

This section analyses and assesses whether fiscal policy is sustainable in the long term. The aim of the analysis is to identify, in good time, signs that fiscal policy is unsustainable so that measures to restore sustainability and maintain confidence in fiscal policy can be implemented at an early stage. If the necessary changes are postponed, the problems are usually exacerbated and the change process becomes more difficult, since more extensive measures need to be implemented at a later stage and often in more disorganised forms. An unsustainable fiscal policy that

is detected at an early stage provides more time for carefully considered reforms, while households and business are afforded ample time and opportunity to adjust to new conditions.

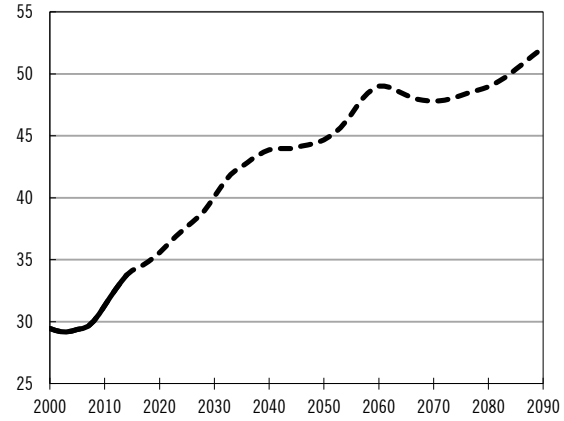
Sweden is facing several changes that may subject the economy to stresses and which therefore require careful monitoring. Not least, the ageing population has the potential to put pressure on fiscal policy, but higher costs and increased demand for tax-funded services may also entail fiscal policy stress. However, increased pressure on the general government finances does not necessarily have to be met with a reduction in the level of ambition or with higher taxes. Pressure on the general government finances can be moderated by extending the age of retirement, increasing employment in groups with lower employment rates, improving public health and increasing productivity in the production of tax-funded services.

5.1 Demographics and the general government finances

The average age of the Swedish population has increased in recent decades. This trend is expected to continue in the future. When average life expectancy increases, the proportion of older people in the population rises. This development is illustrated with a dependency ratio, which is defined as the number of persons aged 65+ per hundred persons in the 20–64 age bracket. After remaining essentially stable from the mid 1980s until around 2007, the number of older people has begun to increase more rapidly than the number of people of working age. This trend is expected to continue with brief interruptions for the rest of this century. In 2014, there were almost 34 persons age 65+ per 100 persons of working age. This number is expected to have increased to around 44 persons by 2040, around 48 persons by 2065 and around 54 persons by 2100.

Chart 5.1 Dependency ratios

Number of persons aged 65+ per hundred persons aged 20-64

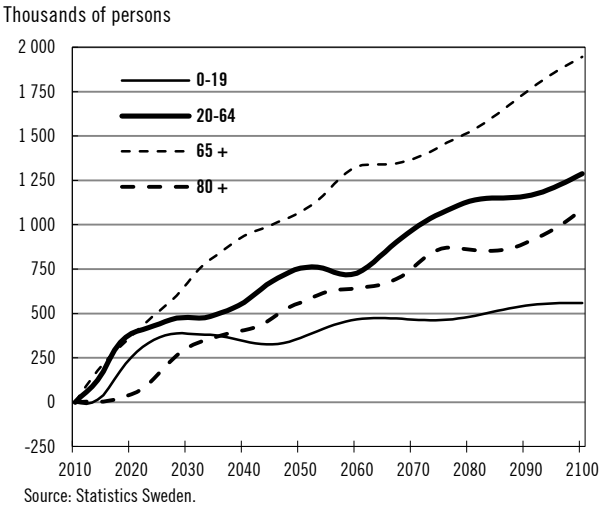


Sources: Statistics Sweden and own calculations.

The dependency ratio rises as a result of an increase in the older population, both in absolute terms and in relation to the number of people of

working age. This is shown in chart 5.2, which shows how the number of people in different age brackets changes from 2010 in the latest population forecast from Statistics Sweden. The number of people aged 65+ is expected to increase by around 1.1 million by 2050 and nearly 2 million by 2100, compared with 2010, while the working age population increases by barely 750,000 and 1.3 million, respectively. Over the course of the same period, the number of people aged 80+ increases by around 550,000 and 1.1 million respectively, that is, only slightly lower than working age population. Besides increased average life expectancy, the large generations born in the 1940s, 1960s and 1990s will contribute to the sizeable changes over time.

Chart 5.2 Change in population compared with 2010



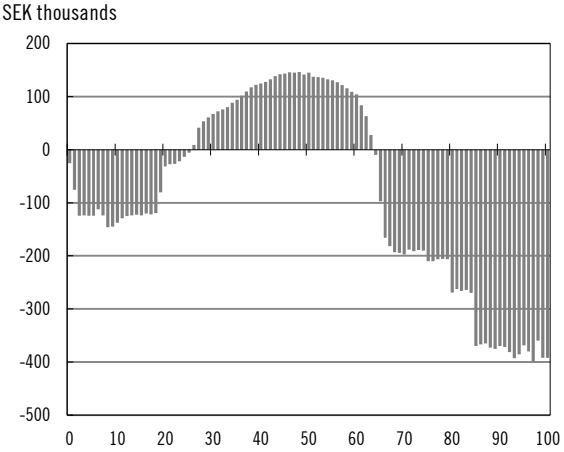
Source: Statistics Sweden.

The impact of changes in the age composition of the population on the general government finances is illustrated by the impact of an average individual on general government revenue and expenditure at various ages in 2012. Chart 5.3 shows that the net contribution of younger people, up to around 25 years of age, was negative. General government expenditure on people in this age bracket primarily consists of childcare and education. The net contribution of people in the 26–63 age bracket was positive because individuals' average payments of taxes and charges were higher than the cost of transfer payments and welfare services. At the age of 64, net contributions become negative once again when many choose to retire. Expenditure, above all on social care and healthcare, also rises with age. Towards the end of life, expenditure increases rapidly. For a 97-year-old, for example, the negative net contribution was around SEK 400 000 per person and year. Total age-distributed expenditure is, however, considerably higher among the 'younger elderly' since relatively few people live to be so old.

The general government's funding challenges presented by demographic changes become clear if the population change in chart 5.2 is combined with the general government net contribution shown in chart 5.3. The expected population increase largely corresponds to the age

brackets in which expenditure on services and transfer payments is substantially higher than tax payments. How the general government finances develop in future is, naturally, strongly dependent on how the financial exchange with the general government changes in various age brackets. For example, improved health can reduce the health and social care costs of elderly people.

Chart 5.3 General government net contribution per person and age in 2012



Note: A negative net contribution means that expenditure on services and transfer payments is greater than the taxes paid in for an average individual.
Sources: Statistics Sweden and own calculations.

Costs for tax-funded services tend to increase rapidly

Yet another challenge for the fiscal policy is the difficulty of improving the efficiency of services such as education, childcare and social care services for older people at the same rate as other production. Wages in these sectors generally follow the trend in sectors that have higher productivity growth, which tends to lead to a gradual rise in the relative unit cost for these types of services. This is termed 'Baumol's law' or the 'cost disease' for labour-intensive services. The consequence for the general government sector is that the costs of providing an unchanged scope of, for example, childcare and social care services for the elderly, tends to increase over time in relation to general price trends in society.

There is some disagreement as to the extent to which Baumol's law applies to all tax-funded activities. In the National Accounts, productivity growth was previously assumed to be zero in the entire general government sector. However, many believe that productivity has in fact increased in certain segments of tax-funded service production, such as within the healthcare system. Still, it is difficult to prove productivity changes in the general government sector.

For any productivity increase to result in lower general government expenditure, it must lead to lower resource usage. This means that the same number of teachers, healthcare workers, etc., should be able to produce a higher quantity of welfare services, or even that the number of teachers and healthcare workers should be able to decline in the future with no deterioration in the level of service.

Higher relative unit costs in general government production do not inevitably lead to higher expenditure, however. The size of general government expenditure is determined in a political process wherein the drawbacks of higher total taxes must be balanced against the gain of producing more services. Higher unit costs may lead to reduced production in this process. For this reason, it is impossible to determine in advance the extent to which higher production costs lead to increased expenditure or reduced production.

5.2 Calculations of fiscal sustainability

A scenario that illustrates the aforementioned challenges is outlined below, based on the demographic changes described above. The calculations also assume a difference in productivity growth in production of tax-funded services and average productivity growth in the business sector. It should be emphasised that the scenario does not illustrate the most likely development. Instead, the intent is to reflect a development involving no change to policy and no change in behaviour with regard to, for example, labour force participation. Calculations based on various assumptions make it possible to analyse in alternative scenarios which factors strengthen the long-term sustainability of the fiscal policy and which weaken it.

The calculation is based on a number of assumptions about future developments

The long-term projection is based on the assessment of Swedish economic development presented in Sections 2 and 3. The primary balance was -2.6 per cent of GDP in 2014. A gradual move towards balanced resource utilisation in the economy occurs in 2015–2019, with higher employment and lower unemployment while no further unfunded reforms are assumed to be implemented after 2015, which improves general government net lending. The primary balance is calculated to amount to -0.3 per cent of GDP in 2019, which is the starting position for general government finances in the projection of long-term development in subsequent years.

Productivity in the business sector is assumed to increase by 2.2 per cent in the long term. However, productivity in tax-funded services, regardless of whether delivered by public or private sector providers, is assumed to be constant. This difference in the productivity trend, along with an assumption that wage growth is identical across the entire economy, leads to an increase in the costs of producing one unit of tax-funded production relative to one unit in the business sector. This is the previously mentioned 'Baumol effect.'

In this scenario, the population's labour market behaviour is assumed to remain unchanged from 2020. This means that labour force participation, unemployment and average working hours for people of various

ages and countries of origin of both genders remains constant. On average, a 50-year-old woman or a 35-year-old man, for example, is assumed to work just as much in the future as she or he does today.

The scenario is also based on the assumption that fiscal policy remains unchanged from 2020. This means that tax rates are kept at the same level as in 2019; that is, their proportion of the tax bases is constant. It is assumed that the standard per service user for tax-funded activities is the same, expressed as unchanged resource input. For example, it is assumed that a 90-year-old in the future will receive the same number of hours of geriatric care as a 90-year-old does today. Because no change is assumed in productivity in the production of tax-funded services, general government consumption will develop at the same rate as the number of hours worked. The compensation rate in the transfer payment system is also unchanged, so that transfer payments per individual develop in parity with the hourly wages of those in employment. This means that transfer payments that are, in accordance with the regulations, nominally fixed or only track the price trend are assumed to increase in line with average wages from 2020.

The demographic trend primarily has an impact on expenditure on those welfare services that are currently the responsibility of municipalities and county councils. However, the projection focuses on the general government commitment in its entirety; in this context the general government sector is regarded as a combined whole. One key assumption is that the central government has the overall responsibility for financing tax-funded welfare. Consequently, central government grants are adjusted in the calculations so that the requirement for sound financial management established in the Swedish Local Government Act (1991:900) is met.

Fiscal policy is sustainable in the long term based on the stated assumptions

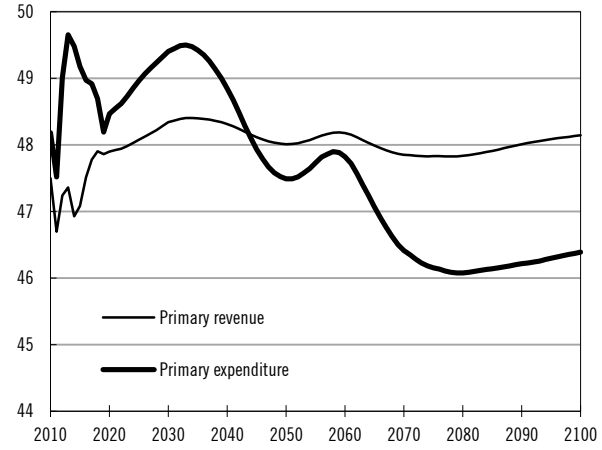
The period of 2020–2035 is characterised by demographic changes that increase general government primary expenditure; that is, expenditure excluding interest expenditure (see chart 5.4). An upturn will begin in 2020, culminate around 2033 and then fall back. Expenditure increases by around 1 per cent of GDP as a result of the large cohort born in the 1940s reaching the costly age of over 80 years, at the same time as the generation born in the 1960s begins to retire. The primary balance is negative until around 2045 (see chart 5.5).

The demographic cost pressure abates with time and primary expenditure decreases to just over 46 per cent of GDP in 2100. The long-term trend of falling expenditure is mainly attributable to a decline in general government consumption as a proportion of GDP. One cause of this reduction is the assumption, according to this calculation model, that there is no improvement of standards in tax-funded welfare services when GDP, and thus incomes, increase. General government transfer

payments and investments also fall as a proportion of GDP over time, albeit to a lesser extent.

Chart 5.4 General government revenue and expenditure if there is no change in behaviour

Per cent of GDP



Sources: Statistics Sweden and own calculations.

Table 5.1 shows the development of the primary general government expenditure distributed by different purposes. It should be noted that the primary expenditure ratio decreases rapidly up to 2019 if the policy is unchanged and thereafter increases somewhat up to 2030 and then declines again. One explanation for this trend is that expenditure on transfer payments decreases by 0.4 per cent of GDP between 2014 and 2019. After 2019, transfer payments remain relatively stable as a proportion of GDP until 2030, after which there is a moderate decline. The downturn is mainly attributable to that payments from the old-age pension system do not increase as quickly as GDP. One cause of this is that pensions will be paid to a greater extent from the premium pension system (PPM) instead of the old-age pension system. Pension payments from PPM are not accounted for as transfer payments from general government because PPM is part of the household sector in the National Accounts.

General government consumption expenditure declines by around 0.4 per cent of GDP to 2019 and then rises again to 2030 when expenditure expressed as a proportion of GDP is four-tenths higher than in 2014. Expenditure thereafter declines by around 2.3 per cent of GDP until 2100. Expenditure on social care, which includes care services to elderly and disabled people, is the only expenditure item that demonstrates increasing proportions of GDP in all years, while healthcare expenditure remains relatively stable as a proportion of GDP until 2050. Expenditure on education increases at virtually the same rate as GDP to 2030 and then declines by around 0.7 per cent of GDP to 2050 and by an additional 0.7 per cent of GDP to 2100 if utilisation per service user does not change. There is only a slight decline in expenditure for other purposes

as a proportion of GDP 2019–2030, but declines thereafter by around 1.7 per cent of GDP until 2100.

Table 5.1 Primary general government expenditure if there is no change in behaviour

Per cent of GDP

	2014	2019	2030	2050	2100
Primary expenditure	**49.5**	**48.2**	**49.4**	**47.5**	**46.4**
General government consumption	26.3	25.9	26.7	25.5	24.4
Education	5.0	4.9	5.0	4.3	3.6
Social care	6.3	6.2	6.8	7.3	8.1
Healthcare	6.1	6.0	6.2	6.0	5.6
Other	9.0	8.8	8.7	8.0	7.0
Investments	4.5	4.1	4.4	4.4	4.4
Transfer payments	18.6	18.2	18.3	17.6	17.6

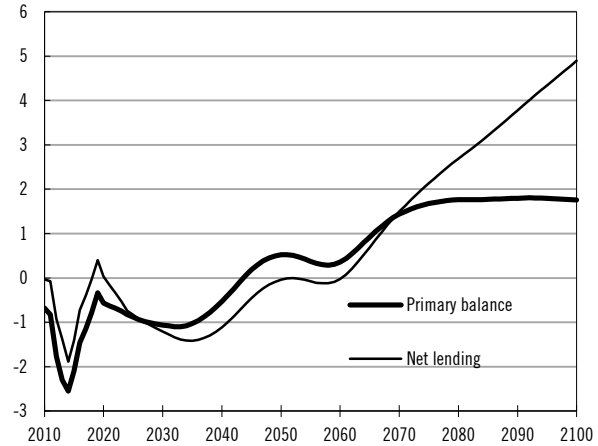
Sources: Statistics Sweden and own calculations.

The most important tax base, and thus tax revenue, is controlled largely by the development of the labour market. Primary revenue amounts to around 48 per cent of GDP for most of the projection period (see chart 5.4).

As a consequence of increased general government expenditure, the primary balance decreases from -0.3 per cent of GDP in 2019 to -1.1 per cent in 2033 (see chart 5.5 There is a subsequent gradual strengthening of the primary balance until it reaches 1.8 per cent of GDP in 2100. The cause of this gradually increasing difference between net lending and the primary balance shown in chart 5.5 is the increasingly large yield from net financial assets illustrated in chart 5.6.

Chart 5.5 Net lending if there is no change in behaviour

Per cent of GDP



Sources: Statistics Sweden and own calculations.

In the long run, the high level of the primary balance contributes to a sharp reduction in consolidated gross debt (see chart 5.6). This debt is estimated to amount to around 34 per cent of GDP in 2019. It increases as a proportion of GDP until around 2040, but thereafter declines gradu-

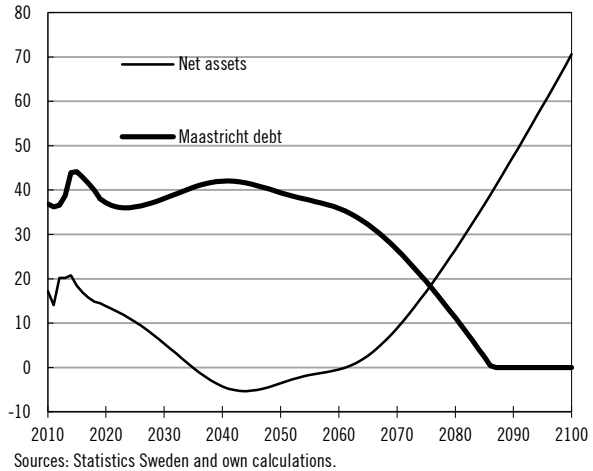
ally and has been fully repaid by around 2085. Financial assets are built up gradually from around 2040 and capital income rises sharply as a result. Consequently, net lending, which includes income from capital, will also increase sharply and amount to nearly 5 per cent of GDP in 2100.

It is important not to interpret the trend described as a forecast of an expected actual development. It is virtually impossible that the current rules for general government revenue and expenditure would not be amended if a surplus of the size indicated in Chart 5 actually arose.

The S2 sustainability indicator is a measure of how large an immediate and permanent budgetary weakening or strengthening would be required to ensure the long-term stability of the general government's net position. In this scenario, the indicator is -1.1 per cent of GDP (calculated from 2016), which theoretically means that net lending can be weakened permanently by 1.1 per cent of GDP this year while still stabilising net debt over the very long term. The projection is not a forecast, but rather simply an impact analysis of the reported assumptions, which means that the S2 value cannot be interpreted to mean there is actually fiscal space for a one-off reform. Instead, the indicator's value forms the basis of a more general assessment of under which conditions the current fiscal policy is sustainable in the long term and must be interpreted with caution. In general, it can be said that the higher the value of S2 in absolute terms, and the earlier in the projection an imbalance arises, the higher is the probability that fiscal policy will need to be revised.

Chart 5.6 General government financial net assets and consolidated gross debt if behaviour does not change

Per cent of GDP



Sources: Statistics Sweden and own calculations.

In the light of this, it is important to supplement the S2 measure with an indicator of the impact of fiscal policy in the shorter term, what is known as the S1 indicator. This indicator indicates, in the same way as S2, the size of the immediate and permanent budgetary weakening or budgetary strengthening required for general government gross debt to achieve a given objective over a certain time period. In this section, S1 is

calculated on the basis that general government consolidated gross debt – Maastricht debt – will be equivalent to 60 per cent of GDP in 2030. Because Maastricht debt was only equivalent to around 44 per cent of GDP in 2014, this normally means that there are relatively large safety margins in the debt level stipulated by the Stability and Growth Pact.

The S1 indicator amounts to -1.5 per cent of GDP (calculated from 2016), which means that, if consolidated gross debt must be 60 per cent of GDP in 2030, this can be accomplished through an immediate, permanent weakening of net lending of 1.5 per cent that year.

Accordingly, based on the criteria and indicators used above, fiscal policy in this scenario is deemed sustainable in the long-term. However, it should be underlined that this assessment is based on relatively strict assumptions. A number of alternative scenarios based on other assumptions are described below to provide a more exhaustive picture of the long-term sustainability of the fiscal policy.

Alternative scenario: Higher demand for leisure and welfare services impairs general government net lending

The aim of this scenario is to illustrate the consequences of changes in demand that may occur as a result of increased prosperity. In this scenario, the average number of hours worked per employee is assumed to decrease by 0.1 per cent per year compared with the main scenario in which there is no change in behaviour, while the volume of general government consumption grows 0.2 per cent faster than demographically justified. This involves a certain increase in the standard of welfare services offered by general government. Consequently, there is also a gradual change in fiscal policy over time.

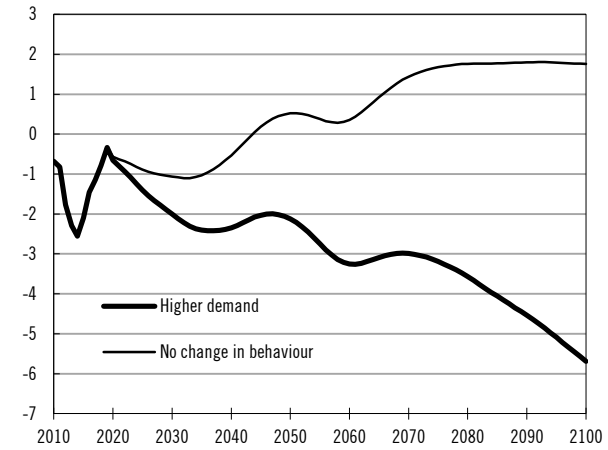
In this alternative scenario, future generations choose to work less than we do today. The average number of hours worked in 2100 is assumed to be around 120 hours less per person and year compared with the main scenario (equivalent to around three working weeks per year or around a half hour per working day). As a result, tax revenue declines, as do opportunities to finance tax-funded welfare. The funding problems are further exacerbated by the gradually increasing standards of general government services. For example, it is assumed that staffing density increases in healthcare, schools and social care. All in all, the number of hours worked in the general government sector is around 17 per cent higher in 2100 compared with the main scenario in which behaviour does not change. In turn, the number of working hours available for production in the business sector declines to a corresponding extent. As leisure time increases, the number of hours worked decreases and standards are raised, the general government finances are subjected to an increasingly intense pressure to change in order to maintain a sustainable fiscal policy.

The primary balance is dramatically undermined in this scenario compared with the main scenario, weakening sustainability considerably (see

chart 5.7). The S1 indicator amounts to -1.1, which is a weakening of 0.4 per cent of GDP compared with the main scenario and the S2 indicator is 3.8, which is a weakening of 4.9 per cent of GDP. According to the S2 indicator, the trend is therefore unsustainable over the long term. One third of the change is attributable to the decreased labour supply due to higher leisure hours, while two thirds can be attributed to increased demand for publicly funded welfare.

Chart 5.7 Primary balance with higher demand

Per cent of GDP



Sources: Statistics Sweden and own calculations.

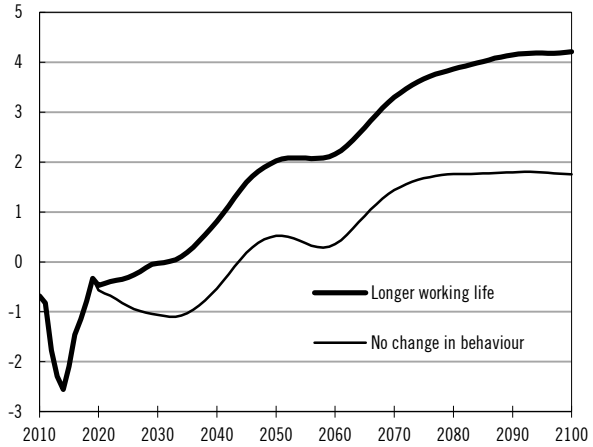
Alternative scenario: A longer working life strengthens the general government finances

In a scenario that analyses the impact of a longer working life, the average age of entry into the labour market decreases gradually by one year between 2020 and 2029. At the same time, the retirement age is assumed to rise by half of the increase in remaining average life expectancy at the age of 65. This means that the retirement age has increased by just over one year by 2050 and just over three years in 2100. The calculation assumes that young people entering the labour market will use unemployment and sickness insurance to the same extent as employed young people do today, while older active people will be ill, unemployed and receiving disability pensions to the same extent as active older people do today. The calculation does not take into account any further general government expenditure on measures to extend working life.

Compared with the main scenario, this reinforces the primary balance and thus tangibly strengthens fiscal policy sustainability (see chart 5.8). The S1 indicator improves by 0.4 per cent of GDP to -1.9 and the S2 indicator improves by 1.9 per cent of GDP to -3.0. This scenario shows that a longer working life is very important to the long-term funding of welfare.

Chart 5.8 Primary balance with a longer working life

Per cent of GDP



Sources: Statistics Sweden and own calculations.

Sensitivity in the calculations

The S1 and S2 sustainability indicators show that fiscal policy is sustainable in the long term in a scenario based on no change in behaviour. However, this result should be interpreted with caution for several reasons. The fiscal challenges addressed in this section have an effect over the very long term and calculations thus often extend far into the future. The long calculation horizon involves a sizeable level of uncertainty. It should also be added that the calculations strongly depend on the assumptions made. As has already been noted, the calculations should not to be interpreted as forecasts of a probable development, but rather as impact analyses of the effect of changes in the different assumptions on fiscal sustainability. Table 5.2 summarises the impact of the alternative assumptions on S1 and S2. A number of sensitivity analyses are also reported. In general, it may be said that fiscal policy is sustainable in the majority of the different calculations. The S1 indicator is negative in all reported scenarios except in connection with a poorer starting position, while S2 is only positive in the last scenario and when there is constantly increasing demand for higher standards in tax-funded production.

In the calculation of Non-Accelerating Inflation Rate of Unemployment (NAIRU), it is assumed that NAIRU is 1 percentage point higher for all years subsequent to 2019, weakening S2 by around 0.4 per cent of GDP.

In the assessment of the trend up to and including 2019, it is assumed that there is no change to fiscal policy and that no reforms are implemented other than those that have already been approved or announced in this bill. In order to describe the significance of a poorer starting position, it is assumed in an alternative assessment that ceiling-limited expenditures increase each year in the period of 2016–2019 so that the budgetary margin is equivalent to 1.5 per cent of ceiling-limited expenditure. According to the Government's guideline, this is the mini-

mum allowable budgetary margin at the start of the financial year. This deterioration in net lending, equivalent to around 1.8 per cent of GDP in 2019, is assumed to take place without any corresponding funding on the budget's revenue side; that is, the primary balance deteriorates to the same extent that expenditure increases. This means that the primary balance is equivalent to around 2.1 per cent of GDP in 2019, compared with around -0.3 per cent in the other scenarios. In the long-term calculations, the primary balance is thus brought down by around 1.8 per cent of GDP over the course of the entire projection period. In a trend such as this, S1 and S2 deteriorate to 0.2 and 0.6 per cent of GDP, respectively. The risk that fiscal policy will become unsustainable thus increases if net lending is substantially lower in the year the projections begin than it is today.

Table 5.2 S1 and S2 in the different scenarios

Per cent of GDP

	S1	S2
No change in behaviour	-1.5	-1.1
Impairs sustainability		
Higher demand for leisure and welfare services	-1.1	3.8
More leisure	-1.3	0.4
Higher standards	-1.2	2.0
Higher non-accelerating-inflation rate of unemployment	-1.3	-0.7
Poorer starting position	0.2	0.6
Improves sustainability		
Longer working life	-1.9	-3.0
Earlier start to working life	-1.8	-1.7
Higher retirement age	-1.6	-2.4
Improved integration	-1.7	-1.6
Higher labour supply among women	-1.9	-2.5
Improved health	-1.8	-4.2
Higher productivity in the general government sector	-1.6	-2.2

Note: Positive values indicate that net lending must be strengthened permanently in order for fiscal policy to be sustainable in the long term and negative values that a permanent weakening is possible.
Source: Own calculations.

5.3 Overall assessment of the long-term sustainability of the fiscal policy

Fiscal policy is adjudged sustainable in the long term in a scenario involving no change in the behaviour of various parties and in which no unfunded reforms are implemented, other than those already adopted or announced in this bill. In this case, S1 amounts to -1.5 per cent of GDP and S2 to -1.1 per cent of GDP. Net lending and consolidated gross debt are also within the limits set by the Stability and Growth Pact in most of the reported scenarios. Accordingly, an important requirement that forms the basis of market evaluations of sustainability is met.

The new pension system is creating strong incentives to work longer when average life expectancy increases because pensioners' incomes decrease in relation to those in work if the retirement age is not postponed.

The period of 2020–2035 is characterised by growing demographic pressure on expenditure. Primary general government expenditure is calculated to increase by just over 1 per cent of GDP in these years due to higher demand for tax-funded welfare services arising from demographic changes. A poorer starting position for the general government finances as demographic pressure increases around 2020 may result in a long period of impaired net lending.

The aforementioned problems also illustrate the importance of policy that remains focused on increasing the number of hours worked. A long and productive working life is a prerequisite if pensioners are to enjoy a good economic standard and general government-funded services are to be of good quality. Increased average life expectancy provides the opportunity to increase both leisure time and time in work. As average life expectancy increases, it is therefore important to have high labour-force participation among both women and men, far into their later years.

Other assessments of financial sustainability

Assessments of the long-term sustainability of Swedish fiscal policy are made by several different analysts. Swedish fiscal policy is marginally unsustainable in the financial sense according to the majority of assessments included in this synthesis.

The S1 sustainability indicator is based on assessments by the Government and the Commission that Maastricht debt should equal 60 per cent of GDP in 2030. Because Sweden's Maastricht debt is currently well below this level, the Government and the Commission have assessed fiscal policy as financially sustainable according to this indicator (see table 5.3). The S1 values according to the OECD and the IMF are marginally positive however, but not comparable to the assessments of the Government and the Commission because they are based on the stricter requirement that the debt ratio in 2030 must be unchanged at the baseline year level.

According to the Swedish National Institute of Economic Research (NIER), S2 for Sweden amounts to between 3.5 and 0.6 per cent of GDP. The NIER assesses the fiscal policy as less sustainable partly because its assessment of the medium-term outlook is more pessimistic and partly because, according to the NIER definition of 'unchanged policy', general government consumption grows at a significantly faster rate than in the Government's calculation. In its assessment, the NIER assumes that the standard of tax-funded services increases by 0.6 per cent per year, while the Government assumes an unchanged standard. The Fiscal Policy Council also reports an S2 value that indicates a minor need for consolidation to make the fiscal policy strictly sustainable.

However, in the Council's judgement, the fiscal policy may be considered sustainable in the long term. According to the European Commission, Sweden's S2 indicator lies somewhat above the level considered to constitute the threshold for low sustainability risk in the long term.

The main reason that the calculations differ is the different definitions of 'unchanged policy'. In its calculations, the Government assumes that the standard of welfare services provided by the general government is maintained at a constant level, while other analysts assume that the real standard for a given service will increase, calculated per service user within the age bracket. The projections are thus conditional to a certain extent upon the making of political decisions with such an orientation. A similar assumption is made in the sensitivity calculation *Higher standards*. In this scenario, S2 amounts to 2.0 per cent of GDP, which is closer to the calculations of other analysts.

Table 5.3 Sustainability indicators for Sweden

Per cent of GDP

	S1 (or equivalent)	S2
Government	-1.5	-1.1
Swedish National Institute of Economic Research (Mar 2015)		0.4 – 3.3
Fiscal Policy Council (May 2012)		1.0
European Commission (Dec 2012)	-2.7	2.4
OECD (Jun 2013)	0.5	
IMF (Oct 2014)	1.4	

Note: The values of the indicators are not directly comparable as they are calculated based on different assumptions. S1 indicates the permanent budgetary change needed for the gross debt to amount to either 60 per cent of GDP in 2030 (European Commission and the Government) or the current level in 2030 (OECD and IMF).
Sources: Swedish National Institute of Economic Research, Fiscal Policy Council, European Commission, OECD, IMF and own calculations.

Another reason that S2 may differ is that different analysts make explicit calculations for the primary balance over various time horizons. In calculating the S2 value, the values of future primary surpluses and deficits are discounted so that the significance of balances that arise far into the future gradually declines. The discount factor, which is the difference between the nominal growth rate and the nominal sovereign debt rate, is, however, so small that even primary balances several hundred years in the future become significant to the S2 value. Normally however, primary balances are calculated only for the time for which meaningful demographic information exists and the primary balance is assumed unchanged thereafter. The calculations of the Government and the NIER extend to 2100, but the European Commission instead sets the end year to 2060.

The fact that primary balances after the end year for the relevant calculations still have relatively great impact on the size of the S2 value reduces its relevance to policy conclusions. In the main scenario, the primary balance, for example, amounts to 1.8 per cent of GDP in 2100 but only 0.4 per cent of GDP in 2060. If 2060 is used as the end year for calculating S2, instead of 2100, the indicator value deteriorates in this

scenario by around 0.9 per cent of GDP, from -1.1 to -0.2 per cent of GDP. In the scenario where demand for welfare services and leisure both increase, S2 improves from 3.8 to 2.6 when the end year is changed to 2060, which is close to the Commission's assessment. The improvement in S2 occurs because the increasing trend for demand for leisure and welfare services affects general government revenue and expenditure for a shorter period when the number of projection years lessens.

Calculation results may also differ for other reasons, such as different assumptions concerning potential growth rate, price increases, interest rates, unemployment, demographics, etc.

6 Quality in the general government finances

6.1 Expenditure

Principles have been developed at the EU level for the production of uniform statistics on the Member States' distribution of general government finances. Uniform statistics facilitate comparison between different Member States' general government expenditure, as well as of how this develops over time. The ability to evaluate whether a change in the composition of general government expenditure has affected long-term growth is dependent on additional information and a higher level of detail. However, the distribution of general government expenditure between different purposes and the change in distribution over time do indicate how different types of expenditure and purposes have been prioritised and provide an indication of policy focus. Table 6.1 and table 6.2 show expenditure distributed by purpose in accordance with the COFOG classification.[15]

Expenditure measured as a proportion of GDP (the expenditure ratio) declined overall from around 54 per cent of GDP to around 50 per cent over the period of 2003–2008. Following a temporary increase in 2009 in the wake of the financial crisis, the expenditure ratio subsided again and amounted to around 51 per cent in 2011. Thereafter, expenditure has risen faster than GDP and the general government sector reported an expenditure ratio of around 53 per cent of GDP in 2013.

[15] COFOG (Classification of the Functions of Government) is a tool for reporting and analysing the purposes of the goods and services provided by general government entities. The classification is in accordance with international standards.

Table 6.1 General government expenditure by purpose, per cent of GDP

Per cent of GDP

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Change 2003–2013
General public services	8.0	7.6	7.8	7.7	7.7	7.8	7.4	7.4	7.6	7.7	7.8	-0.2
Interest payments	2.2	1.8	1.9	1.8	1.8	1.7	1.3	1.2	1.3	1.1	1.0	-1.3
Other	5.8	5.8	5.9	6.0	5.9	6.1	6.1	6.2	6.4	6.6	6.8	1.0
Defence	1.9	1.8	1.7	1.6	1.5	1.5	1.5	1.5	1.4	1.4	1.5	-0.4
Public order and safety	1.3	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.3	1.4	1.4	0.0
Economic affairs	4.1	4.0	4.2	4.0	3.9	4.2	4.5	4.4	4.3	4.5	4.3	0.2
Environmental protection	0.3	0.3	0.4	0.4	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.0
Housing and community amenities	0.8	0.8	0.8	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	-0.1
Health	6.7	6.5	6.5	6.4	6.4	6.6	7.1	6.8	6.8	6.9	7.0	0.3
Recreation, culture and religion	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	0.1
Education	6.9	6.7	6.7	6.6	6.3	6.5	6.8	6.5	6.5	6.5	6.6	-0.2
Social protection	23.3	22.8	22.5	21.6	20.5	20.4	22.1	21.9	21.3	22.1	22.6	-0.7
Total expenditure	**54.4**	**52.8**	**52.7**	**51.3**	**49.7**	**50.3**	**53.1**	**52.0**	**51.4**	**52.6**	**53.3**	**-1.1**
Excluding interest	52.1	50.9	50.8	49.6	47.9	48.6	51.8	50.8	50.2	51.5	52.3	0.2

Sources: Statistics Sweden and own calculations.

Expenditure on social protection in Sweden accounts for more than 20 per cent of GDP and more than 40 per cent of total general government expenditure. The proportion fell from the middle of the first decade of the new millennium, although it rose again in 2009 in connection with the financial crisis and the subsequent recession. Health expenditure also accounts for a major share of general government expenditure. Having amounted to 12 per cent of total expenditure in 2002, the proportion rose over a period of several years and in 2013 amounted to almost 13 per cent. There has been a steep drop in the proportion of expenditure taken up by interest payments. This is mainly the result of general government consolidated gross debt falling sharply as a proportion of GDP while interest rates have remained relatively low.

Table 6.2 General government expenditure by purpose, per cent of total expenditure

Per cent of total expenditure

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Change 2003–2013
General public services	14.8	14.5	14.7	15.1	15.5	15.4	14.0	14.2	14.9	14.6	14.6	-0.2
Interest payments	4.1	3.5	3.6	3.4	3.6	3.4	2.4	2.3	2.5	2.0	1.8	-2.3
Other	10.7	11.0	11.1	11.6	11.9	12.1	11.5	11.9	12.4	12.5	12.8	2.1
Defence	3.5	3.3	3.1	3.2	3.1	2.9	2.8	2.9	2.8	2.7	2.8	-0.7
Public order and safety	2.5	2.4	2.4	2.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6	0.1
Economic affairs	7.6	7.5	7.9	7.7	7.9	8.3	8.5	8.5	8.4	8.6	8.1	0.6
Environmental protection	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.1
Housing and community amenities	1.5	1.5	1.5	1.4	1.4	1.4	1.4	1.3	1.4	1.4	1.4	-0.2
Health	12.4	12.3	12.3	12.5	12.8	13.1	13.3	13.0	13.3	13.1	13.1	0.8
Recreation, culture and religion	1.8	1.8	1.9	2.0	2.0	2.1	2.1	2.1	2.1	2.0	2.0	0.2
Education	12.6	12.7	12.7	12.8	12.7	12.8	12.9	12.5	12.6	12.5	12.4	-0.2
Social protection	42.8	43.3	42.6	42.2	41.4	40.6	41.7	42.1	41.4	41.9	42.3	-0.5
Total expenditure	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	
Excluding interest	95.9	96.5	96.4	96.6	96.4	96.6	97.6	97.7	97.5	98.0	98.2	2.3

Sources: Statistics Sweden and own calculations.

6.2 Revenue

Between 2007 and 2014, the tax ratio, which is total tax revenue as a percentage of GDP, declined by 2.4 percentage points (see table 6.3). In 2018, the tax ratio is estimated to be 44 per cent of GDP. It is primarily revenue from tax on capital that has declined as a proportion of GDP in the period 2007–2014. The most significant change in recent years in terms of tax on capital is the reduction in the corporation tax rate, for which the latest reduction took effect in 2013. Revenue from tax on labour also declined as a proportion of GDP during the period of 2007–2014. The in-work tax credit accounts for the largest proportion of the tax reductions, but social security contributions have also been reduced and there are greater opportunities to receive tax deductions for work in and on the home. Revenue from taxes on consumption has remained largely stable as a proportion of GDP throughout the period 2007–2014. Revenue from value added tax has increased as a result of household consumption making a greater contribution to GDP. However, revenue from excise duties including taxes on energy and carbon dioxide are declining, despite increases in these taxes. Environmental tax revenues as a proportion of GDP have declined over the last ten years. This decline is explained by more efficient residential heating, the switch from electricity and oil to geothermal heating and district heating, as well as newer vehicles with more energy-efficient engines. In order to maintain the impact of environmental taxes as steering mechanisms in pace with the transition to a more sustainable society, environmental taxes should be regularly reviewed and adjusted. This has not occurred to an extent that

maintained the proportion of environmental taxes to GDP in the last ten years.

Table 6.3 Tax revenue, by tax types, per cent of GDP

Per cent of GDP

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Change 2007–2018
Tax on labour	26.6	26.9	26.5	25.0	25.0	25.6	25.8	25.4	25.8	26.4	26.8	26.8	0.3
Direct taxes	14.6	14.7	14.5	13.5	13.3	13.7	13.9	13.5	13.8	14.0	14.2	14.3	-0.3
Indirect taxes	11.9	12.2	12.0	11.5	11.6	11.9	11.9	11.9	12.0	12.4	12.5	12.5	0.6
Tax on capital	6.3	4.8	4.9	5.4	5.0	4.6	4.6	4.9	4.9	4.9	5.0	5.2	-1.2
Households	1.5	0.8	0.8	1.0	0.8	0.8	0.9	1.0	1.1	1.1	1.2	1.1	-0.4
Corporate incomce	3.2	2.5	2.6	3.0	2.8	2.4	2.4	2.4	2.5	2.5	2.5	2.5	-0.6
Tax on consumption	12.1	12.4	12.9	12.8	12.4	12.3	12.2	12.1	12.1	12.0	11.9	11.8	-0.3
VAT	8.6	8.9	9.2	9.2	9.1	9.0	9.0	9.1	9.0	9.0	9.0	9.0	0.4
Arrears and other taxes	0.0	-0.1	-0.1	0.0	0.1	0.1	0.3	0.2	0.1	0.1	0.1	0.1	0.1
Total tax revenue	**45.0**	**44.0**	**44.1**	**43.2**	**42.5**	**42.6**	**42.8**	**42.6**	**43.0**	**43.5**	**43.8**	**44.0**	**-1.0**

Sources: Statistics Sweden and own calculations.

Changes in the composition of tax revenue are relatively small during the period of 2007–2014 (see table 6.4). Tax on capital accounts for the largest change, as its proportion of total tax revenue declined by 2.6 percentage points during the period of 2007–2014. The proportion of total tax revenue derived from tax on consumption increased during the same period by 1.6 percentage points. The proportion of total tax revenue from tax on labour has also increased, by 0.3 percentage points, and is expected to amount to 59.5 per cent in 2014.

Table 6.4 Tax revenue, by tax types, per cent of total tax revenue

Per cent of total tax revenue

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Change 2007–2018
Tax on labour	59.1	61.2	60.1	57.8	58.7	60.3	60.1	59.5	60.0	60.9	61.1	61.1	2.0
Direct taxes	32.6	33.4	32.8	31.2	31.4	32.2	32.3	31.6	32.0	32.3	32.5	32.6	0.0
Indirect taxes	26.5	27.8	27.3	26.6	27.4	28.1	27.8	27.9	28.0	28.5	28.6	28.5	2.0
Tax on capital	14.1	11.0	11.1	12.6	11.8	10.7	10.7	11.5	11.4	11.2	11.4	11.7	-2.3
Households	3.4	1.8	1.7	2.3	1.9	1.8	2.0	2.4	2.5	2.6	2.7	2.6	-0.8
Corporate incomce	7.1	5.6	6.0	7.0	6.6	5.7	5.5	5.7	5.8	5.7	5.7	5.7	-1.3
Tax on consumption	26.9	28.1	29.2	29.5	29.3	28.9	28.5	28.5	28.3	27.7	27.2	26.9	0.0
VAT	19.2	20.1	20.8	21.3	21.4	21.1	21.0	21.2	21.0	20.7	20.5	20.5	1.3
Arrears and other taxes	-0.1	-0.2	-0.3	0.1	0.2	0.2	0.7	0.5	0.3	0.3	0.3	0.3	0.3
Total tax revenue	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Sources: Statistics Sweden and own calculations.

Annex A - Technical assumptions

The methods used in calculations concerning the general government finances in the period 2020–2100 are discussed in more detail below. The results reported in this appendix are for the scenario involving no change in behaviour.

Demographic assumptions

The calculation is based on Statistics Sweden's population forecast from February 2015 shown in Table A.1.

Table A.1 Demographic assumptions

Number of children born per woman, number of years and number of individuals

	2010	2020	2030	2040	2050	2060
Birth rate	1.98	1.95	1.91	1.91	1.91	1.91
Average life expectancy, women	83.5	84.7	85.8	86.9	87.9	88.8
Average life expectancy, men	79.5	81.5	83.1	84.6	85.7	86.7
Net migration, thousands	50 000	40 000	18 000	18 000	17 000	16 000

Source: Statistics Sweden.

The labour market

Labour market development is strongly linked to the demographic trend. Projections concerning the employment rate and the number of hours worked are distributed by age, gender and country of origin. The extent of participation in the labour market, the employment rate and average working hours are assumed to remain constant in each group. This can be interpreted as unchanged labour market behaviour as the absenteeism rate, sickness and activity compensation rate, average hours worked, employment rate and unemployment rate are constant within each group.

The number of hours worked in the general government sector is assumed to rise at the same rate as demographically dependent general government consumption. This implies an assumption that staffing density is constant in the general government sector. The number of hours worked in the business sector represents the difference between the total number of hours worked and the number of hours worked in the general government sector.

Productivity

The assumption regarding productivity growth in the business sector is based on an analysis of the historical trend. The underlying trend in productivity growth is assumed to be 2.2 per cent beginning in 2020. Based on an international comparison, productivity growth in Sweden has been strong over the last two decades, with the exception of the period 2007–2009. It is, however, reasonable to assume that, in the long term, it will adjust to international growth rates. The weak growth in

2007–2009 has not affected the view of the long-term trend in productivity. Productivity growth in the general government sector is assumed to be zero from 2020.

Components of GDP: Expenditure approach and production

GDP growth is the sum of productivity growth in the economy as a whole and the increase in the number of hours worked. GDP from the usage side is determined so that the development of household consumption expenditure is generated by a macroeconomic model called MIMER.[16] Household consumption expenditure as a proportion of GDP increases gradually over the period as people live longer and the population ages. Overall, household consumption increases from 46.5 per cent of GDP in 2020 to 49.5 per cent of GDP in 2100. In total, investments account for around 25 per cent of nominal GDP. General government consumption in terms of volume is projected in line with demographic changes, while price growth in general government consumption is determined by assumptions about hourly wage growth and CPI. The remaining components of GDP using the expenditure approach are net exports, which are calculated residually in the estimates as the difference between GDP and its domestic usage. Production of general government consumption is derived with an assumption of unchanged productivity and degree of privatisation. Production in the business sector is determined as the sum of productivity and hours worked in that sector.

Inflation and wages

It is assumed that the Riksbank will pursue a monetary policy that holds inflation at 2 per cent. The proportion of wage costs and gross profits in the business sector is assumed to be constant in the long term. Wages are thus determined by the price level and productivity. Higher productivity and a higher GDP deflator generate scope for increased wages. Wages in the general government sector rise in line with those in the private sector.

Assumptions regarding yields on capital

It is assumed that average interest rates on saving and borrowing are the same for all sectors in the economy in the long term. A nominal interest rate of 5 per cent is assumed. Given an inflation rate of 2 per cent, the real interest rate becomes 3 per cent. In addition to interest-bearing assets, the general government sector also has non-interest-bearing assets. The yield on these assets consists of share dividends and value adjustments. Dividends are assumed to be 3 per cent and value increases 2 per cent in the long term. The total return thus amounts to 5 per cent, which is the same as for interest-bearing assets. It is also likely in the

[16] MIMER is a model for intergenerational macroeconomic accounts: a macroeconomic simulation model of the Swedish economy. See *Promemoria, Teknisk beskrivning av modellen MIMER [Memorandum, Technical description of the MIMER model]* on the Government's website for a more detailed account of the model.

long term that differences will arise between the borrowing and lending rates and that there will be differences between sectors. It is also likely that the long-term return on non-interest-bearing assets will be higher than for interest-bearing assets. However, the assumption regarding the return on financial capital is used for the purpose of simplification and to avoid the focus of the analysis shifting from central issues to those surrounding the dynamics of debt.

Table A.2 Macroeconomic assumptions

Annual percentage change and per cent

	2010	2015	2020	2030	2040	2050	2060
Percentage change							
Population, 15–74 years	1.0	0.9	0.3	0.3	0.1	0.1	0.2
Labour force, 15–74 years	0.8	0.9	0.4	0.0	0.3	0.2	0.2
Number employed, 15–74 years	0.6	1.4	0.4	0.0	0.3	0.3	0.2
Hours worked	2.6	1.9	0.4	0.1	0.3	0.2	0.2
Business sector productivity	4.4	1.2	2.2	2.2	2.2	2.2	2.2
GDP, fixed prices	6.0	2.6	2.1	1.8	2.2	2.1	2.2
GDP per capita	5.1	1.5	1.2	1.5	1.9	1.8	1.9
GDP productivity	3.3	0.7	1.7	1.8	1.9	1.9	1.9
GDP deflator	1.0	1.5	2.3	2.3	2.2	2.2	2.1
CPI, annual average	1.2	0.0	2.0	2.0	2.0	2.0	2.0
Hourly wages	0.4	2.5	4.1	4.1	4.1	4.1	4.1
Per cent							
Real interest	1.7	1.9	1.0	3.3	3.3	3.3	3.3
Employment rate, 15–74 years	64.4	66.6	67.0	66.4	65.4	67.2	66.5
ILO unemployment rate, 15–74 years	8.6	7.5	6.4	6.8	6.8	6.3	6.0

Sources: Statistics Sweden and own calculations.

General government revenue

The calculations reported here are based on an assumption of constant tax rates relative to different tax bases. Consequently, the aggregate tax ratio will vary if the tax bases develop in a different way than GDP. This method reflects unchanged tax regulations. Stable tax rates over time are advantageous both in terms of their efficiency and for redistribution policy. Table A.3 shows, in detail, general government taxes and charges as a proportion of GDP and as a proportion of the respective tax base (implicit tax rate), as well as the tax base's proportion of GDP.

Table A.3 Taxes and charges

Per cent of GDP

	2010	2015	2020	2030	2040	2050	2060
Taxes and charges	43.1	42.8	43.8	43.8	43.8	43.6	43.7
Household direct taxes and charges							
Proportion of GDP	12.4	12.5	13.3	13.4	13.4	13.2	13.3
Implicit tax rate of direct taxes	23.7	22.9	24.2	24.2	24.2	24.2	24.2
Tax base for direct taxes as a proportion of GDP	52.6	54.7	55.0	55.3	55.3	54.7	55.2
Implicit tax rate of charges	6.6	6.7	6.7	6.7	6.7	6.7	6.7
Tax base for charges as a proportion of GDP	38.8	40.7	40.9	41.3	41.4	41.6	41.8
Corporate direct taxes							
Proportion of GDP	3.0	2.7	2.8	2.8	2.7	2.7	2.7
Implicit tax rate	9.8	9.4	10.1	10.1	10.1	10.1	10.1
Tax base as a proportion of GDP	30.9	28.4	27.8	27.3	27.1	27.1	26.8
Indirect taxes[1]							
Proportion of GDP	13.4	12.9	12.5	12.4	12.3	12.2	12.1
Implicit tax rate	28.9	27.9	27.0	26.6	26.1	25.6	25.3
Tax base as a proportion of GDP	46.4	46.3	46.1	46.5	47.2	47.4	47.8
Social security contributions from employers and the self-employed[2]							
Proportion of GDP	14.0	14.7	15.2	15.3	15.4	15.4	15.5
Implicit tax rate	36.1	36.0	37.1	37.1	37.1	37.1	37.1
Tax base as a proportion of GDP	38.8	40.7	40.9	41.3	41.4	41.6	41.8

[1] Excluding wage-dependent indirect taxes.
[2] Including wage-dependent indirect taxes.
Sources: Statistics Sweden and own calculations.

General government expenditure on consumption

The projection of general government consumption has two parts: a volume projection and a price projection. The calculation of general government consumption is based on costs for various purposes such as schools, healthcare and social care, distributed according to age and gender. All expenditure areas are projected in line with the demographic trend. This means, for example, that a 70-year-old woman is allocated the same amount of public services, in real terms, in 2100 as in 2019. This may be regarded as an expression of unchanged standards in general government services. The price of general government consumption develops in line with a total appraisal of the price of the component parts of gross production; that is, hourly wages, the price of consumption and the price of consumption of fixed capital (the investment price).

Table A.4 General government consumption

Per cent of GDP

	2010	2015	2020	2030	2040	2050	2060
Total consumption	25.2	26.4	26.0	26.7	26.3	25.5	25.6
Childcare	1.8	1.9	1.9	1.8	1.6	1.6	1.6
Education	5.0	5.0	5.0	5.0	4.7	4.4	4.4
Healthcare	6.0	6.4	6.3	6.5	6.5	6.3	6.3
Elderly care	3.9	4.2	4.1	4.8	5.2	5.6	5.9
Other activities	8.5	8.8	8.7	8.5	8.2	7.5	7.4

Sources: Statistics Sweden and own calculations.

Transfer payments

The calculations assume a certain guarantee of standards in the general government transfer payment systems. For some transfer payments, there are rules and regulations that automatically raise expenditure in line with wages. This applies to pensions, which are adjusted upward in line with the earnings index, and also partly to transfer payments compensating for loss of earnings, such as health and parental insurance. In the calculations, pensions are projected in accordance with the current rules. Other transfer payments are assumed to rise in line with wages. This also means there is an assumption that the 'ceilings' applied in the social insurance systems rise in line with wages. Such a guarantee of standards offsets the erosion of household transfer payments that would take place if the estimate were only based on a price projection.

Table A.5 General government transfer payments

Per cent of GDP

	2010	2015	2020	2030	2040	2050	2060
Total transfer payments	**18.6**	**18.5**	**18.2**	**18.3**	**18.1**	**17.6**	**17.8**
Transfer payments to households	15.3	15.0	14.9	15.0	14.8	14.3	14.4
Old age	8.0	8.0	8.2	8.1	7.9	7.4	7.7
Ill-health	2.9	2.9	2.8	2.9	2.9	2.9	2.9
Children/studies	2.1	2.0	2.0	1.9	1.9	1.9	1.9
Labour market	1.0	0.8	0.7	0.7	0.7	0.6	0.6
Other	1.4	1.3	1.3	1.3	1.3	1.3	1.3
Transfer payments to businesses and the rest of the world	3.3	3.5	3.3	3.3	3.3	3.3	3.3

Note: Old age = old-age pensions, survivor's pensions, central government and local government pensions and supplementary housing benefit to pensioners. Ill-health = health insurance, occupational injury insurance sickness compensation and assistance compensation. Children/studies = child benefit, parental insurance, maintenance support and student grants. Labour market = unemployment benefit, labour market training grants and wage guarantees.
Sources: Statistics Sweden and own calculations.

Old-age pension system

Table A.6 shows the old-age pension system's revenue and expenditure and its financial position. The calculation of pension expenditure is based on the demographic trend, economic conditions and applicable regulations. The average age of retirement is assumed to be 65 and to remain constant.

Table A.6 Old-age pensions system

Per cent of GDP

	2010	2015	2020	2030	2040	2050	2060
Revenue	**6.6**	**6.8**	**6.9**	**7.0**	**6.9**	**6.8**	**6.8**
Fees	6.0	6.1	6.2	6.2	6.2	6.2	6.3
Interest, dividends etc.	0.7	0.7	0.8	0.8	0.6	0.6	0.6
Expenditure	**6.4**	**6.6**	**7.2**	**7.0**	**6.8**	**6.4**	**6.6**
Pensions	6.2	6.4	6.9	6.7	6.5	6.1	6.4
Other	0.2	0.2	0.3	0.3	0.2	0.2	0.2
Net lending	**0.2**	**0.2**	**-0.2**	**0.1**	**0.1**	**0.5**	**0.3**
Net financial assets	**25.5**	**29.6**	**23.2**	**17.7**	**13.4**	**12.6**	**12.7**

Sources: Statistics Sweden and own calculations.

Table A.7 presents a number of key variables from the Swedish Convergence Programme in the format recommended by the European Commission.

Table A.7 Long-term sustainability of the general government finances

Per cent of GDP, unless otherwise stated

	2010	2015	2020	2030	2040	2050	2060
Total expenditure	49.3	50.0	49.6	51.6	51.2	49.8	49.9
Age-related[1]	26.3	27.1	26.8	27.7	27.4	26.7	27.1
Pensions[2]	8.0	8.0	8.2	8.1	7.9	7.4	7.7
Guarantee pensions	0.5	0.4	0.3	0.3	0.2	0.2	0.2
Old-age pensions	6.2	6.4	6.9	6.7	6.5	6.1	6.4
Other pensions (disability and survivors')	0.7	0.5	0.4	0.4	0.4	0.4	0.4
General government occupational pensions	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Healthcare	6.0	6.4	6.3	6.5	6.5	6.3	6.3
Elderly care and care services for disabled	3.9	4.2	4.1	4.8	5.2	5.6	5.9
Childcare	1.8	1.9	1.9	1.8	1.6	1.6	1.6
Education	5.0	5.0	5.0	5.0	4.7	4.4	4.4
Unemployment benefit	1.0	0.8	0.7	0.7	0.7	0.6	0.6
Other age-related expenditure	0.7	0.7	0.7	0.7	0.7	0.7	0.6
Interest expenditure	1.0	0.7	1.0	1.8	2.0	1.9	1.7
Total revenue	49.3	48.6	49.7	50.4	50.1	49.7	49.9
of which income from capital	1.8	1.5	1.8	2.0	1.8	1.7	1.7
of which is from the pensions system	0.7	0.7	0.8	0.8	0.6	0.6	0.6
Assumptions							
Labour productivity growth, GDP level	3.3	0.7	1.7	1.8	1.9	1.9	1.9
GDP growth	6.0	2.6	2.1	1.8	2.2	2.1	2.2
Unemployment rate	8.6	7.5	6.4	6.8	6.8	6.3	6.0
Population aged 65 + as a proportion of the total population	18.3	19.7	20.1	21.9	23.6	24.1	25.6

[1] Age-related expenditure includes childcare. This expenditure is not included in the age-dependent expenditure presented in Annex B as calculated by an EU working group.
[2] In addition to old-age pensions, pensions also include sickness and activity compensation.
Sources: Statistics Sweden and own calculations.

Annex B - Comparison with the European Commission's projections of demographically dependent expenditure

A working group (Ageing Working Group, AWG) under the Economic Policy Committee (EPC) has, together with the European Commission, calculated the development of demographically dependent expenditure up to and including 2060. These estimates were last reported in April 2015.[17] The calculations in the Convergence Programme are, however, based on the data presented to the Riksdag in the 2015 Spring Fiscal Policy Bill. This section compares the key demographic and macroeconomic indicators as well as demographically dependent expenditure from these two sources. The comparison is made for the period from 2013, the year EPC estimates commenced.

Table B.1 Macroeconomic assumptions in the EPC estimates and in the Swedish convergence programme

Index, unless otherwise stated

	2013	2020	2030	2040	2050	2060
Population, 15–74 years						
EPC	100.0	103.2	112.2	130.3	158.0	165.4
Convergence programme	100.0	105.3	107.7	111.1	112.2	114.8
Employed						
EPC, 15–74 years	100.0	104.0	110.3	117.8	122.3	126.2
Convergence programme, 15–74 years	100.0	107.3	108.8	110.4	114.6	116.1
Hours						
EPC	100.0	104.1	110.4	117.9	122.4	126.3
Convergence programme	100.0	107.8	109.0	111.1	114.8	116.0
Unemployment rate, percentage points						
EPC, 15–74 years	8.1	6.2	5.8	5.8	5.8	5.8
Convergence programme, 15–74 years	8.0	6.4	6.8	6.8	6.3	6.0
Labour productivity						
EPC	100.0	109.7	127.8	148.8	173.3	201.8
Convergence programme	100.0	109.1	129.4	154.9	186.8	224.7
GDP						
EPC	100.0	114.2	140.9	175.1	211.8	254.3
Convergence programme	100.0	117.6	141.1	172.1	214.4	260.6
GDP per capita						
EPC	100.0	107.5	123.5	144.2	165.4	190.3
Convergence programme	100.0	108.7	124.1	147.2	178.0	210.3

Sources: European Commission and own calculations.

[17] The 2015 Ageing Report: Economic and budgetary projections for the 28 EU Member States (2013-2060).

The population forecast used in the EPC was prepared by Eurostat in 2013. Calculations in the Convergence Programme are based on a population forecast issued by Statistics Sweden in February 2015. Over the long term, the population grows considerably faster than in the EPC calculation. The EPC thus also has a stronger increase both in hours worked and the number of employed persons. In 2060, the level of employment and the number of hours worked are approximately 10 percentage points stronger in the EPC calculations. In the Convergence Programme, the unemployment rate is assumed to be adapted to a structural level of around 6.8 per cent until around 2040, with a moderate decline thereafter. In the EPC, the structural level of unemployment is 5.8 per cent. Productivity growth is stronger in the Convergence Programme than in the EPC calculations. The higher level of productivity is one reason that the GDP level for 2060 is higher in the Convergence Programme. GDP per capita also reaches a higher level in the Convergence Programme. However, the calculations are not comparable with regard to GDP and productivity because the EPC uses a one-sector model and the Convergence Programme applies a two-sector model without a chain index.

Table B.2 Change in age-dependent general government expenditure in the EPC calculations and in the Swedish convergence programme

Proportion of GDP

	Change 2010–2020			Change 2010–2060		
	CP	EPC	CP-EPC	CP	EPC	CP-EPC
Pensions	-0.2	-0.7	0.5	-0.7	-1.4	0.7
Healthcare	0.0	0.2	-0.2	0.0	0.4	-0.4
Elderly care and care services for disabled	-0.1	0.3	-0.4	1.7	1.5	0.2
Education	0.0	0.0	0.0	-0.6	0.2	-0.9
Unemployment benefit	-0.3	-0.1	-0.2	-0.3	-0.1	-0.2
Total	**-0.6**	**-0.4**	**-0.2**	**0.1**	**0.6**	**-0.5**

Note: CP is the abbreviation of convergence programme. Childcare is not included in this synthesis.
Sources: European Commission and own calculations.

There are differences in age-dependent general government expenditure in all areas. This is largely due to the ECP assuming a minor improvement in the standards of general government services, but also because the ECP bases the age distribution of general government consumption on a different data set. The lower cost increase for unemployment benefit over the next few years in the Convergence Programme is due to a fixed ceiling for unemployment benefit funds in the calculations, up to and including 2019. Pensions are the item where the difference is greatest.

Annex C – Tables

Table C.1a Macroeconomic prospects

Annual percentage change

	Mdkr 2014	2014	2015	2016	2017	2018
Real GDP	3 856	2.1	2.6	2.7	2.5	2.4
Nominal GDP	3 908	3.5	4.2	4.4	4.4	4.3
Components of real GDP						
Private consumption expenditure	1 804	2.4	2.7	2.7	2.6	2.6
Government consumption expenditure	1 007	1.9	1.9	1.4	0.8	0.7
Gross fixed capital formation	888	6.5	2.9	4.5	3.6	3.5
Changes in inventories and net acquisition of valuables[1]	7	0.2	0.0	0.0	0.0	0.0
Exports of goods and services	1 716	3.3	4.4	5.3	5.0	5.1
Imports of goods and services	1 566	6.5	4.3	5.7	5.0	5.3
Contributions to real GDP growth						
Final domestic demand		3.0	2.4	2.7	2.3	2.2
Changes in inventories and net acquisition of valuables		0.2	0.0	0.0	0.0	0.0
External balance of goods and services		-1.1	0.2	0.1	0.2	0.1

[1] Contribution to real GDP growth.
Sources: Statistics Sweden and own calculations.

Table C.1b Price developments

Annual percentage change

	Level 2014	2014	2015	2016	2017	2018
GDP deflator	101.3	1.3	1.5	1.7	1.9	1.9
Private consumption deflator	100.7	0.7	0.9	1.3	1.6	1.8
HICP[1]	114.1	0.2	0.6	1.1	1.4	1.6
Public consumption deflator	102.2	2.2	2.3	2.7	3.4	3.3
Investment deflator	101.8	1.8	1.6	1.5	1.5	1.5
Export price deflator (goods and services)	101.7	1.7	1.3	1.1	0.9	0.9
Import price deflator (goods and services)	101.8	1.8	1.1	1.2	1.1	1.1

Note: All deflators are indices. 2013=100.
[1] Index, 2005=100.
Sources: Statistics Sweden and own calculations.

Table C.1c Labour market developments

Annual percentage change if not otherwise stated

	Level 2014	2014	2015	2016	2017	2018
Employment, persons[1]	4 737	1.4	1.4	1.3	1.2	0.9
Employment, hours worked[2]	762 198	1.5	1.9	1.9	0.8	0.7
Unemployment rate (%)[3]	411	7.9	7.5	7.1	6.7	6.4
Labour productivity, persons[4]	719	0.7	1.4	1.5	1.3	1.5
Labour productivity, hours worked[5]	447	0.6	0.9	0.9	1.7	1.8
Compensation of employees[6]	1 879	3.9	4.2	4.6	4.8	4.4
Compensation per employee[7]	416 971	2.3	2.8	3.3	3.5	3.4

1 Occupied population, national accounts definition. Level in thousands.
[2] National accounts definition. Level in ten thousands.
[3] Level in thousands. Per cent of labour force.
[4] Real GDP per person employed, SEK.
[5] Real GDP per hour worked, SEK.
[6] SEK billion.
[7] SEK.
Sources: Statistics Sweden and own calculations.

Table C.1d Sectoral balances

Per cent of GDP

	2014	2015	2016	2017	2018
Net lending/borrowing vis-á-vis the rest of the world	6.1	6.4	6.3	6.1	5.8
of which					
Balance on goods and services	4.7	4.8	4.7	4.7	4.6
Balance of primary incomes and transfers	1.6	1.7	1.7	1.5	1.3
Capital account	-0.1	-0.1	-0.1	-0.1	-0.2
Net lending/borrowing of the private sector	8.0	7.8	7.0	6.5	5.8
Net lending/borrowing of the general government	-1.9	-1.4	-0.7	-0.4	0.0
Statistical discrepancy	-3.3	--	--	--	--

Sources: Statistics Sweden and own calculations.

Table C.2a General government budgetary prospects

Per cent of GDP

	SEK bn 2014	2014	2015	2016	2017	2018
Net lending by sub-sector						
General government	-74	-1.9	-1.4	-0.7	-0.4	0.0
Central government	-56	-1.4	-1.2	-0.5	-0.1	0.4
Local government	-21	-0.5	-0.4	-0.2	-0.1	-0.2
Social security funds	3	0.1	0.2	0.0	-0.1	-0.2
General government						
Total revenue	1 996	51.1	51.2	51.6	51.8	52.1
Total expenditure	2 070	53.0	52.6	52.3	52.2	52.1
Net lending/borrowing	-74	-1.9	-1.4	-0.7	-0.4	0.0
Interest expenditure	28	0.7	0.7	0.7	0.7	0.7
Primary balance	-46	-1.2	-0.7	-0.1	0.3	0.7
One-off and other temporary measures	4	0.1	0.1	-0.2	0.0	0.0
Selected components of revenue						
Total taxes	1 555	39.8	40.0	40.5	40.8	41.0
Taxes on production and imports	862	22.0	22.1	22.3	22.3	22.2
Current taxes on income. wealth. etc.	693	17.7	17.9	18.2	18.5	18.8
Capital taxes	0	0.0	0.0	0.0	0.0	0.0
Social contributions	110	2.8	2.8	2.8	2.8	2.8
Property income	66	1.7	1.7	1.7	1.7	1.7
Other	266	6.8	6.7	6.6	6.5	6.5
Total revenue	1 996	51.1	51.2	51.6	51.8	52.1
Tax burden	1 670	42.7	43.0	43.5	43.8	44.0
Selected components of expenditure						
Compensation of employees + intermediate consumption	829	21.2	21.1	21.0	20.9	20.8
Compensation of employees	495	12.7	12.7	12.7	12.7	12.7
Intermediate consumption	334	8.6	8.4	8.3	8.2	8.1
Social payments	677	17.3	17.3	17.4	17.4	17.3
of which Unemployment benefits	32	0.8	0.8	0.8	0.8	0.7
Social transfers in kind supplied via market producers	137	3.5	3.5	3.5	3.5	3.6
Social transfers other than in kind	540	13.8	13.8	13.9	13.9	13.7
Interest expenditure	28	0.7	0.7	0.7	0.7	0.7
Subsidies	68	1.7	1.7	1.6	1.6	1.5
Gross fixed capital formation	176	4.5	4.4	4.3	4.3	4.3
Capital transfers	9	0.2	0.2	0.2	0.2	0.2
Other	282	7.2	7.1	7.1	7.2	7.2
Total expenditure	2 070	53.0	52.6	52.3	52.2	52.1
Government consumption (nominal)	1 029	26.3	26.4	26.3	26.2	26.1

Sources: Statistics Sweden and own calculations.

Table C.2b Revenue and expenditure forecasts

Per cent of GDP if not otherwise stated

	SEK bn 2014	2014	2015	2016	2017	2018
Total revenue	1 996	51.1	51.2	51.6	51.8	52.1
Total expenditure	2 070	53.0	52.6	52.3	52.2	52.1

Sources: Statistics Sweden and own calculations.

Table C.2c Amounts to be excluded from the expenditure benchmark

Procent av BNP

	SEK bn 2014	2014	2015	2016	2017	2018
Expenditure on EU programmes fully matched by EU funds revenue	3	0.1	0.1	0.1	0.1	0.1
Cyclical unemployment benefit expenditure	-3	-0.1	0.0	0.0	0.0	0.0
Effect of discretionary revenue measures	-13	-0.3	0.4	0.4	0.1	0.0
Revenue increases mandated by law	–	–	–	–	–	–

Source: Statistics Sweden and own calculations.

Table C.3 General government expenditure by function

Per cent of GDP

	COFOG code	2013
General public services	1	7.8
Defence	2	1.5
Public order and safety	3	1.4
Economic affairs	4	4.3
Environmental protection	5	0.3
Housing and community amenities	6	0.7
Health	7	7.0
Recreation, culture and religion	8	1.1
Education	9	6.6
Social protection	10	22.6
Total expenditure		53.3

Source: Statistics Sweden and own calculations.

Table C.4 General government debt developments

Per cent of GDP

	2014	2015	2016	2017	2018
Gross debt	43.9	44.2	42.8	41.5	40.0
Change in gross debt ratio	5.1	0.3	-1.3	-1.4	-1.5
Contribution to changes in gross debt					
Primary balance	1.4	0.7	0.1	-0.3	-0.7
Interest expenditure	0.7	0.7	0.7	0.7	0.7
Stock-flow adjustment	4.4	0.6	-0.2	0.0	0.2
of which					
Differences between cash and accruals	-0.1	0.2	-0.2	0.0	0.0
Privatisation proceeds	0.0	-0.1	-0.1	-0.1	-0.1
Valuation effects and others	4.5	0.6	0.2	0.2	0.3
Implicit interest rate on debt	1.9	1.7	1.5	1.6	1.8

Sources: Statistics Sweden and own calculations.

Table C.5 Cyclical developments

Per cent of GDP if not otherwise stated

	2014	2015	2016	2017	2018
Real GDP growth (%)	2.1	2.6	2.7	2.5	2.4
Net lending of general government	-1.9	-1.4	-0.7	-0.4	0.0
Interest expenditure	0.7	0.7	0.7	0.7	0.7
One-off and other temporary measures	-0.1	-0.1	0.2	0.0	0.0
Potential GDP growth (%)	1.5	1.8	1.9	2.0	2.2
Output gap	-1.9	-1.4	-0.8	-0.1	0.1
Cyclical budgetary component	-0.9	-0.8	-0.5	-0.1	0.1
Cyclically-adjusted balance	-1.0	-0.6	-0.2	-0.3	-0.1
Cyclically-adjusted primary balance	-0.3	0.1	0.4	0.4	0.6
Structural balance	-0.9	-0.5	-0.4	-0.3	-0.1

Sources: Statistics Sweden and own calculations.

Table C.6 Divergence from previous update

	2014	2015	2016	2017	2018
Real GDP growth (%)					
Previous update	2.7	3.3	3.5	2.5	--
Current update	2.1	2.6	2.7	2.5	2.4
Difference	-0.6	-0.7	-0.8	0.0	--
General government net lending (% of GDP)					
Previous update	-1.4	-0.2	0.3	0.7	--
Current update	-1.9	-1.4	-0.7	-0.4	0.0
Difference	-0.5	-1.2	-1.0	-1.1	--
General government gross debt (% of GDP)					
Previous update	41.3	39.7	37.3	34.8	--
Current update	43.9	44.2	42.8	41.5	40.0
Difference	2.6	4.5	5.5	6.7	--

Sources: Statistics Sweden and own calculations.

Table C.7 Long-term sustainability of public finances

Per cent of GDP

	2010	2015	2020	2030	2040	2050	2060
Total expenditure	**49.3**	**50.0**	**49.6**	**51.6**	**51.2**	**49.8**	**49.9**
of which							
Age-related expenditure	26.3	27.1	26.8	27.7	27.4	26.7	27.1
of which							
Pension expenditure	8.0	8.0	8.2	8.1	7.9	7.4	7.7
of which							
Social security pension	0.5	0.4	0.3	0.3	0.2	0.2	0.2
Old-age and early pensions	6.2	6.4	6.9	6.7	6.5	6.1	6.4
Other pensions (disability- and survivors-)	0.7	0.5	0.4	0.4	0.4	0.4	0.4
Occupational pensions (if in general government)	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Health care	6.0	6.4	6.3	6.5	6.5	6.3	6.3
Long-term care	3.9	4.2	4.1	4.8	5.2	5.6	5.9
Educational expenditure	5.0	5.0	5.0	5.0	4.7	4.4	4.4
Other age-related expenditures	0.7	0.7	0.7	0.7	0.7	0.7	0.6
Interest expenditure	1.0	0.7	1.0	1.8	2.0	1.9	1.7
Total revenue	**49.3**	**48.6**	**49.7**	**50.4**	**50.1**	**49.7**	**49.9**
of which							
Property income	1.8	1.5	1.8	2.0	1.8	1.7	1.7
of which							
From pensions contributions (or social contributions if appropriate)	0.7	0.7	0.8	0.8	0.6	0.6	0.6
Pension reserve fund assets	25.5	29.6	23.2	17.7	13.4	12.6	12.7
of which							
Consolidated public pension fund assets (assets other than government liabilities)	22.8	26.8	20.7	15.1	10.5	9.9	10.2
Assumptions							
Labour productivity	4.4	1.2	2.2	2.2	2.2	2.2	2.2
Real GDP growth	6.0	2.6	2.1	1.8	2.2	2.1	2.2
Unemployment rate	8.6	7.5	6.4	6.8	6.8	6.3	6.0
Population aged 65+ over total population	18.3	19.7	20.1	21.9	23.6	24.1	25.6

Sources: Statistics Sweden and own calculations.

Table C.7a Contingent liabilities

Per cent of GDP

	2014
Public guarantees	**44.2**

Sources: Statistics Sweden and own calculations.

Table C.8 Basic assumptions

Annual average if not otherwise stated

	2014	2015	2016	2017	2018
Short-term interest rate (annual average)[1]	0.4	0.0	0.1	0.4	1.5
Long-term interest rate (annual average)[2]	1.7	0.8	1.5	2.5	3.2
USD/ € exchange rate (annual average)	1.3	1.1	1.2	1.2	1.2
Nominal effective exchange rate vis-á-vis the €[3]	9.1	9.3	9.2	9.1	8.9
World. GDP growth[4]	3.3	3.6	3.8	3.9	4.0
EU GDP growth[4]	1.4	1.7	2.0	2.0	2.0
Growth of relevant foreign markets[4]	3.2	5.0	5.9	6.0	5.8
World import volumes, excluding EU					
Oil prices (Brent USD/barrel. annual average)	99	61	69	73	75

[1] 6-months interest rate.
[2] 10-year government bond yield.
[3] SEK/€. annual average.
[4] Annual percentage change.
Sources: Statistics Sweden and own calculations.

Government Offices of Sweden

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