THE SWEDISH ECONOMY

The opinions expressed are those of the authors and do not necessarily reflect the European Parliament's position

Luxembourg, 17 September 2003
Summary

The purpose of this briefing is to give a general view of the state of the Swedish economy and its perspectives over the medium term. The presentation is based on the criteria set out in the Stability and Growth Pact and on the fourth update of the Swedish Convergence Programme presented in November 2002. Subsequent major developments have been taken into account to the extent that new data have became available, including the negative result of referendum on the euro area membership.
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General Introduction

Under Article 99 of the Treaty, all EU Member States – whether they fully participate in the Single Currency or not – are required to regard their economic policies as a matter of common concern, and to co-ordinate them within the Council. Co-ordination is carried out within the framework of recommended "broad guidelines" for the economic policies of Member States.

In addition, under the pre-Single-Currency transitional provisions outlined in Treaty Article 116, Member States wishing to join the € area were asked to adopt multi-annual programmes intended to ensure the lasting convergence necessary for the achievement of economic and monetary union. These formed the basis of the May 1998 decisions on € area membership.

The requirement to submit such "convergence programmes" remains for those countries still outside the euro area. In the case of countries which have already adopted the €, the Stability and Growth Pact and Article 4 of the EU Council regulation 1466/97 on tighter surveillance of budgetary implementation calls for similar "stability programmes" to be submitted. These are three-year rolling programmes, and focus on progress in meeting the Pact’s two major objectives:

- a budget deficit below 3% of GDP in any one year; and
- an overall budgetary balance over the economic cycle.

The credibility of the Stability and Growth Pact has come under strain during the current economic downturn as doubts have arisen concerning the commitment of some Member States. As a response, the Commission proposed slight modifications to the interpretation of the Pact. It emphasised that budgetary objectives should be set and outcomes analysed in structural terms, i.e. after adjusting the nominal position to the economic cycle. A softer interpretation of the balanced budget requirement would apply to Member States with a relatively low debt burden (less than 60% of GDP) and sustainable public finances.

While adopting a common method of cyclical adjustment, the Council did not endorse this proposal but emphasised the need to assess the Programmes case by case, putting weight on the long-term sustainability of public finances and securing a sufficient safety margin, including an allowance for automatic stabilisers to operate fully, without breaching the 3% reference value. Further, the planned evolution and quality of public finances should be coherent with the close-to-balance requirement. Finally, a rule by which structural deficit should be reduced annually by 0.5% of GDP in Member States not having yet reached a structurally balanced position received backing from the Council.

Each Stability/Convergence programme is the subject of a Commission assessment and a Council opinion, and forms part of the input to the broad guidelines (BEPGs), together with the overall annual implementation report published by the Commission in January.

While the BEPGs indicate the medium-term orientation for the Member States' policies, the annual updates of the Stability/Convergence Programmes set out the measures decided by the national governments for the achievement of the medium-term goals. They should reflect the budget proposals for the following year. The annual updates should be submitted between mid-October and the beginning of December.

The initial Convergence and Stability programmes were published in late 1998. They have been updated four times. The fourth updates became available towards the end of 2002.

Background to the Swedish Convergence Programme

The fourth update of the Swedish Convergence Programme covering the period from 2002 to 2004 was published in November 2002\(^2\). It is based on the Government Budget Bill for 2003 presented to the Riksdag (Swedish Parliament) on 8 October 2002. The budgetary plans for 2005 are not included, due to prolonged negotiations prior to the formation of a new government in autumn 2002\(^3\).

The Commission gave its opinion on the fourth update of the programme on 8 January 2003\(^4\). It concluded that the updated programme was in line with the requirements of the Stability and Growth Pact and broadly in line with the Broad Economic Policy Guidelines (BEPGs). The Commission remarked on the missing information for 2005, as this was not in compliance with the "Code of conduct on the content and format of stability and convergence programmes"\(^5\). **Public finances** were expected to remain in surplus during the whole period, though calculations made by the Commission indicated that the surplus target of 2% of GDP might not be fulfilled. A reason for this was that the fiscal stimulus carried out in 2001 and 2002 would be only partially reversed in the following years. Consequently, it would still be necessary to persist with a tight control of expenditure. The dept-to-GDP ratio, which has been below 60% since 2000, would be further decreasing and expected to reach a level of 49.3% in 2004. Sweden had not yet joined ERM2 and the Swedish krona had fluctuated against the euro since the last update had been submitted. The Commission concluded in its 2002 Convergence Report that Sweden still did not fulfil the **exchange rate convergence criterion** and stated that the Swedish legislation was not in line with the statute of the ESCB. The GDP growth rate for 2003 and 2004 were expected to be 2.5% in both years. These outcomes were optimistic according to the Commission's calculations, which suggested a more moderate growth, 2.2% in 2003 and 2.4% in 2004. The sound public finances would be able to meet the increased budgetary cost of the **ageing population**. The third part of a tax reduction programme, at a cost of 1.1% of GDP, was implemented in compliance with the BEPGs. The Commission remarked that Sweden had a high tax level compared to other industrialised countries and the tax cut was important for enhancing the supply side of the economy. However, the challenge was to keep public finances on the sustainable path that had been achieved during the last couple of years.

The Council delivered its opinion on the programme on 21 January 2003\(^6\). It observed that Sweden maintained its medium term objective of a budget surplus of 2% of GDP on average over the business cycle, which resulted in continued government surpluses throughout the period. The expected economic growth appeared optimistic and the Council thought there were **downside risks to growth**. A more modest growth was to be expected, since there were


signs of some fragility both externally and domestically. The Programme fully respected the requirement "close to balance or in surplus" over the planning period. The Council noted that Sweden fulfilled the convergence criterion on **price stability** and was expected to continue do so in the years to 2004. The long-term interest rates had during the past years followed the trend in the international bond and equity markets. Sweden continued to fulfil the long-term **interest rate convergence criterion**. The **exchange rate** of the krona had been volatile since the last update of the Convergence Programme and Sweden did not fulfil this convergence criterion. The Council stated that while Sweden was not participating in the ERM2, it was expected to join the exchange rate mechanism in a near future.
Results for 2001 and 2002

The slowdown in the world economy, especially in the ICT sector, largely affected the Swedish economy in 2001. The ICT sector makes an important contribution to the Swedish economy, and its slowdown influenced the GDP growth, which remained at only 1.4% in 2001. In 2002 Swedish GDP growth improved slightly to 1.9%. This was higher than the EU average. However, the mobilisation against Iraq in autumn 2002 continued to restrain economic recovery in the international markets. This influenced Swedish exports, which continued to suffer from weak international demand. Domestic demand declined as well. Swedish nominal GDP was SEK 2340 billion (€ 257 billion) in 2002, which is 2.8% of total GDP in the 15 Member States of the EU.

Table 1: Main economic indicators for 2001 and 2002

<table>
<thead>
<tr>
<th></th>
<th>Sweden 2001</th>
<th>EU average 2001</th>
<th>Sweden 2002</th>
<th>EU average 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth (%)</td>
<td>1.1</td>
<td>1.6</td>
<td>1.9</td>
<td>1.0</td>
</tr>
<tr>
<td>Inflation rate - HICP (%)</td>
<td>2.7</td>
<td>2.2</td>
<td>2.0</td>
<td>2.1</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>5.1</td>
<td>7.7</td>
<td>4.9</td>
<td>7.6</td>
</tr>
<tr>
<td>General government deficit (-) / surplus (+) (% of GDP)</td>
<td>3.9</td>
<td>-0.5</td>
<td>1.3</td>
<td>-1.9</td>
</tr>
<tr>
<td>Government debt (% of GDP)</td>
<td>54.5</td>
<td>63.0</td>
<td>52.7</td>
<td>62.3</td>
</tr>
</tbody>
</table>

Source: Eurostat

Despite slower growth, the unemployment rate fell in 2002 to 4.9%, which is lower than the EU average. Employment grew less than in previous years, partly due to the recession but also due to the fact that net immigration doubled, increasing the workforce.

After exceeding both the Riksbank's (the Swedish Central Bank) target of 2% and the EU average in spring 2001, inflation sank and reached the target again in spring 2002, staying low for the rest of the year. High oil and food prices can partly explain the higher inflation, together with unexpected domestic price hikes. Inflation fell mainly thanks to the weaker international demand. The exchange rate of the krona has fluctuated widely in the past two to three years. The krona was strongest in January 2001 when one euro was traded for SEK 8.90. It was at its weakest in September 2001, when the exchange rate was 9.67 SEK/€. Long interest rate developments were very similar to those recorded in the euro area.

In 2001, public finances developed in accordance with the Government's target of an average surplus of 2% of GDP over the business cycle. In 2002, the surplus fell to 1.3%. Government debt declined in 2002 to 52.7% of GDP.

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Analysis and Future Prospects

The growth in the Swedish economy has declined as a consequence of the slow recovery in the world economy. However, the assessment presented in the 2002 Convergence Programme for 2003 involved improved growth, partly as a result of expansionary fiscal policy. Swedish exports have suffered from a weak international demand and the export order intake is weak despite a small improvement. Domestic demand has also been very low. Public finances are fundamentally sound and the target for the government surpluses of 2% is maintained. Employment is expected to be high, although the unemployment rate is likely to rise a little. Inflation is assumed to fall back to the Riksbank's target of 2%.

Economic growth

The economic recession in the beginning of the 1990s caused negative growth in Sweden. During 1990-1993 the volume of the GDP decreased by nearly 5%. From 1993 Sweden has experienced a strong growth with only a temporary slowdown in 1996. However, early in 2001 the world economy started to decline, due to the bursting of the high-tech bubble. The Swedish economy is very dependent on the ICT sector and was therefore hit hard by the recession.

Chart 1: Gross domestic product 1990-2004
(annual change in volume, %)

Swedish GDP grew by 1.9% in 2002, only slightly less than the 2.1% expected in the 2001 update of the Convergence Programme. The macro-economic projections presented in the updated Convergence Programme are based on the following assumptions: growth in the global economy strengthens in 2003, the average rate of GDP growth reaching 2.5%, slightly higher than in 2002. Growth rate in the EU is assumed to reach an average rate of 2.2%. The Swedish krona is expected to appreciate in a medium-term perspective.

In a recent survey on the Swedish economy\(^\text{11}\) the growth forecast was put at 1.3% for 2003, which is clearly less than assumed in the 2002 Convergence Programme.

\(^{11}\) Konjunkturläget Augusti 2003, Konjunkturinstitutet. (http://www.kunj.se/).
**External balance**

At the beginning of the 1990s Sweden suffered from a considerable external imbalance over several years. However, strong growth in exports between 1993 and 2000 and the fact that import fell more than exports in 2001 improved the current account. This is expected to remain in surplus during 2003 and 2004, at the same level as in the last few years.

**Chart 2: Swedish balances of trade and current account 1990–2002**

\[ \text{(% of GDP)} \]

- Source: Eurostat and Convergence Programme

**Inflation**

Sweden, like many other countries, experienced high inflation at the beginning of the 1990s, which led to a change in the politics to stem inflation. In the second half of the 1990s inflation in Sweden was modest, far below the EU-15 average. Although the pressures from world prices have been lower since the downturn began in the course of 2000, Sweden has experienced a upward pressure on its price level, among other factors due to increased nominal wages.

**Chart 3: Swedish inflation 1996-2004**

\[ \text{(HICP, annual change, %)} \]

- Source: Eurostat and Convergence Programme
In 2002 Swedish inflation fell gradually to below 2%. The low figures in the second half of 2002 can partly be explained by a stronger krona and a decline in the international price level.

The main reason for the sharp rise in the rate of inflation that took place in early 2003 were higher electricity prices due to the shortage of water in the reservoirs of the hydroelectric power companies\(^\text{12}\). In the February 2003 annual inflation reached 3.3%, but started to fall again in the subsequent months, reaching the Riksbank's target of 2% in May 2003, but hovering slightly above it during the summer. Declining oil prices and lower prices on electricity as well as lower demand overall contributed to lower inflation. An appreciation of the Swedish krona also tended to reduce inflation.

The updated Convergence Programme expects both the CPI and HICP inflation to remain around 2% in 2003. The Commission spring forecast situates the rate of price increase, as measured by the HICP, slightly higher, at 2.4%.

**Unemployment**

After a period of a very low unemployment of 2% the Swedish unemployment rate rose to 9.3% in 1993, which was a consequence of the deep recession. However, the unemployment rate never exceeded the EU-average, although it remained at 9% until 1998. The subsequent decline was partly attributable to the buoyant state of the economy, but also to concrete measures taken by the Government to reduce unemployment.

The Swedish Government sees the reduction of unemployment as one of its main objectives. It has made extensive use of active labour market policies, providing training as well as sustaining activity in other ways. At 2% of GDP, Sweden is the number one in the OECD as regards expenditure on active labour market policies. The ratio of people participating in these policies to the number of the unemployed has remained high, at some 50%)\(^\text{13}\). Calculations made by the Swedish National Labour Market Administration (AMV) show that participation in labour market policies rose further in 2002\(^\text{14}\).

The unemployment rate reached 4.9% in 2002 due to weaker international growth, leading to lower demand for Swedish exports. However, in the updated Convergence Programme the unemployment rate is expected to remain lower than the Government target of 4% through

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\(^{12}\) European Economic Outlook June 2003, PriceWaterHouseCoopers.


2002 to 2004. It is worth noting that there is a discrepancy between the rates found in the Commission forecast and those given in the Swedish Convergence Programme because of different definitions used\textsuperscript{15}.

**Chart 5: Unemployment rate 1990–2004**

(%)

![Unemployment rate chart](chart)

*Source: Eurostat and Convergence Programme*

The Swedish **employment rate** is higher than that in most Member States of the European Union. In particular, the share of older workers (those between 55 and 64) is higher than in any other Member State. However, the Government aims to raise the employment rate further, targeting 80% of the labour force\textsuperscript{16}. This is what the Government means by achieving "full employment".

In the 2002 update of the Convergence Programme two alternative growth scenarios are presented, a low-growth and a high-growth one. The high-growth scenario assumes that growth, employment and labour supply are higher than in the base scenario, but wages and prices stay at the same level as in the base scenario. Should this happen, then the Swedish government expects to reach its aim of raising the employment rate to 80% in 2004.

Low actual growth rates observed in the first half of 2003 together with a higher share of older population due to immigration affect the labour market negatively. Therefore, the full employment aim is not likely to be reached in 2004. The employment rate is estimated to be 77.6% both in 2003 and 2004. During the first months of 2003 employment declined and unemployment rose. Unemployment is now forecast to rise above the Government's target of 4% to 4.8% and then decline to 4.5% in 2004, assuming that 2% of the labour force participate in labour market policies\textsuperscript{17}.

**The exchange rate of the Swedish krona**

By contrast with its southern neighbour Denmark, but in parallel with the United Kingdom, Sweden chose not to join the ERM2 at the start of the third stage of EMU in January 1999. Instead, it maintained the floating exchange rate introduced in 1992. It has remained outside the ERM2 ever since.

\textsuperscript{15} In Swedish texts, employment and unemployment rates usually refer to population aged 20–64 years, while the Commission uses the more common reference to population aged 15–64.

\textsuperscript{16} Labour force is defined as the population aged 20-64.

Although Sweden intended to join EMU, the 2002 update of the Convergence Programme does not refer to any intention of Sweden entering the ERM2. However, as the referendum on euro area participation was drawing close, the Prime Minister declared that such a move would take place in the end of 2003 should the outcome of the referendum be favourable to the Swedish entry. The result having been negative, joining the ERM2 is not likely to happen any time soon.

The exchange rate of the Swedish krona is currently determined by capital flows in addition to fundamental factors such as terms of trade and relative productivity growth. The krona depreciated by about 15% between autumn 2000 and autumn 2001. This was due to weak stock markets and increased diversification of institutional investors’ portfolios as well as the poor development in the ICT sector. The krona started to strengthen again in the autumn and stabilised then to a level of about 9.2 SEK/€. However, it is still believed to be undervalued in a medium-term perspective and is expected to appreciate from its present level during the next two years.

Long-term Interest Rates

Until the beginning of the 1990s Sweden experienced high inflation that caused high interest rates far above those of Germany. However, a change in the economic policy and macroeconomic stability led to lower inflation and stronger public finances that narrowed the gap. Swedish long-term interest rates, as measured by the yields on 10-year government bonds, have been approximately 50 basis points above the equivalent German rate during the past years.

Strong economic development in 1999 and early 2000 caused the Swedish interest rates to rise. As expectations of high growth began to weaken in late 2000, interest rates fell again. In the second half of 2001 the long-term interest rate differential between Sweden and Germany was rising, mainly because of higher inflation expectations in Sweden as well as increased nervousness on the financial markets. In the long-term, though, the interest rate differential continues to be low. In 2003 the difference between the German and Swedish long-term

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18 Mittkurser, genomsnitt månad och år från 1980, Sveriges Riksbank.
20 The Swedes rejected the idea of Sweden adopting the euro by 56.1% against on 14 September 2003. The interest in the referendum was fairly high, as 80% of those eligible to vote expressed their opinion.
interest rate has so far remained quite stable. Sweden fulfils the convergence criteria with regard to interest rates.

**Chart 7: Long-term interest rates in Sweden vs. € area and Germany**

Yield differential of long-term government bonds (% points)\(^{21}\)

Source: Eurostat

**Budget deficit**

There was a significant improvement in Sweden's budgetary position over the second half of the 1990s. During the years 1995 to 1998, Swedish fiscal policy focused on eliminating the large public sector deficit, which had emerged during the deep recession of the early 1990s. A consolidation programme, based on structural reforms, reversed the direction of general government borrowing, and general government finances improved from a deficit of about 12% of GDP in 1993 to a surplus of 1.5% of GDP in 1998. Since then Sweden has fulfilled the Maastricht criterion on government budgetary position.

**Chart 8: General government balance, 1993-2004**

(net borrowing -/net lending + as a % of GDP)

Source: Eurostat and Convergence Programme

\(^{21}\) Maastricht definition (average).
The Government has set a medium-term objective of attaining an average annual budget surplus of 2% of GDP over the business cycle. Central government expenditure is limited by nominal expenditure ceilings, which permit a nominal increase of 4% per year over 2003 and 2004. As from 2000, local governments are obliged to keep their budgets in balance.

The 2002 update of the Convergence Programme includes a sensitivity analysis with a low- and a high growth scenarios. The low-growth assessment describes a scenario with very slow growth in 2002 that cease entirely in 2003. In this scenario, the Swedish exports that consist to a large extent of investment goods are affected by the slow world recovery. However, the Swedish krona would fall, which would to some extent offset the reduction in exports. Unemployment would rise and consequently domestic demand decrease. Despite no GDP growth, a modest surplus would be maintained in public finances. The high-growth scenario assumes that growth, employment and labour supply are higher than in the base scenario, but wages and prices stay at the same level as in the base scenario. Public finances would improve as a consequence, and the 2% of GDP surplus aim would be reached.

**Public debt**

Gross government debt declined from a peak of 78% of GDP in 1994 to 52.8% in 2000, thus falling below the Maastricht limit of 60% for the first time since 1991. It has remained below 60% ever since, standing at 52.7% in 2002. Sweden consequently complies with the Maastricht convergence criterion on gross government debt. The decline in the general government debt has been a result of a determined consolidation effort together with the relatively strong GDP growth.

The gross debt-to-GDP ratio is expected to fall to 49.3% in 2004. Lower debt will contribute to the long-term sustainability of public finances. However, during the first quarter of 2003 the Swedish Government's net debt increased. Since 1996 savings have been positive during the first quarter of the year, whereby the negative figures may indicate a deterioration of the public finances.

**Chart 9: General government consolidated gross debt 1993–2004**

(% of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Sweden</th>
<th>Convergence Programme 2002</th>
<th>Convergence Programme 2001</th>
<th>EU-15</th>
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<tbody>
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<td>1993</td>
<td>3.5</td>
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<td>1994</td>
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<td>73.1</td>
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<td>1998</td>
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<td>2001</td>
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<td>2002</td>
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<tr>
<td>2004</td>
<td>49.3</td>
<td>49.3</td>
<td>49.3</td>
<td>49.3</td>
</tr>
</tbody>
</table>

*Source: Eurostat and Convergence Programme*

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Structural Reforms

Sweden is a small open industrial economy. Its structural development has been shaped by a unique blend of capitalism and socialist interventionist policies aimed at relative wage equality, full employment and a universal social welfare system. However, this model has displayed serious weaknesses, producing a decline in relative incomes since the early 1970s. Faced with a severe recession and the need for rigorous fiscal consolidation in the 1990s, the Swedish Government has taken measures to improve the functioning of the markets and efficiency of the welfare system. While admitting that marginally lowering the tax burden will generate benefits, the Government is firm in defending the traditional Swedish welfare system.

Supporting the use of modern technology and ensuring the necessary human capital are Swedish priorities, which have been put into practice by generous public funding. With its spending on research and development as a share of GDP, Sweden is number one in the EU. With its investment on knowledge activities representing 6.5% of GDP in 1998, it was at the top of the list of knowledge-based economies in a study carried out by OECD\textsuperscript{23}.

The 2003 BEPGs note that the Swedish fiscal policy of maintaining high surpluses in a long-term perspective and keeping a tight expenditure control will result in a fiscal position of "close to balance or in surplus" in the next years. Sweden would, however, need to raise productivity, the labour supply in the medium term and the level of competition in certain sectors as well as the efficiency of the public sector, given that the ageing of the population is likely to cause shortage of labour supply and a further upward pressure on expenditure\textsuperscript{24}. According to the BEPGs, both growth and employment would benefit from a reduction of the most distortionary elements of the tax and benefit systems.

The Labour Market

Swedish labour market policies are anchored in two pillars. In the short term, active labour-market policies, including a strong emphasis on training, aim at ensuring that the unemployed remain active and use their time to improve their chances in the labour market. In the longer term, providing a high-quality education to everyone at the secondary level and favouring adult education (lifelong learning) should make it possible for citizens to acquire and adapt their skills in accordance with changing needs in the labour market, even where the threat of unemployment is not imminent. A better skills base should ensure adequate labour supply for continued economic growth and help face the problem of ageing population by making sure that older workers continue to have appropriate skills. Other measures to increase flexibility include tax incentives and making employment protection legislation less restrictive.

In 2002 the labour market continued to be fairly tight. Unemployment reached 5%, although employment rose by almost 2%. This means that in the medium term, the remaining labour reserve is limited. Sweden also has a high percentage of employment among older workers (55-64 years old). In 2000 65% of the older workers were employed, which is higher than in other Member States.


Sweden emphasises life-long learning and the various **active labour-market programmes** (ALMPs) together with the special, temporary education programme occupy almost 5% of the labour force. However, the efficiency of ALMPs is debatable, recent surveys indicating a somewhat mixed outcome.

The tax reduction programme that started in 2000 has benefited **low and medium wage earners**, but the tax burden on labour is still among the highest in the EU. A maximum charge for day-care services was introduced in 2002 to improve job opportunities for small children's parents and to reduce marginal effects, thus stimulating labour supply. However, a survey made by Tidningarnas Telegrambyrå (TT) concludes that high-income earners benefit the most from the maximum charge\(^\text{25}\).

The Swedish Government aims to reach an **employment target** of 80% in 2004. Due to the current situation in the world economy this is not likely to happen. However, the labour market policy focusses on mitigating bottlenecks and intensifying efforts to help those with most difficulty in finding work. Unemployment benefit levels were raised in 2001 and 2002.

Remarks in the country-specific recommendations in the 2002 BEPGs concerned the tax and benefit systems to promote work incentives and the improvement of the active labour-market programmes. The former is "in progress", while the latter has been completed. The new labour market programmes are fewer in number and focus rather on "quality than quantity"\(^\text{26}\).

The number of working days lost due to **sick leave** has escalated during the last couple of years, leading among other things to higher costs for the public sector. In four years, the cost has doubled from SEK 50 billion (€ 5.5 billion) to SEK 100 billion (€ 11 billion). Some factors contributing to this change are an ageing population, a change in attitudes towards being on sick leave, as well as insufficient incentive for employers to re-employ people coming back from long sick leaves. The target of the Swedish Government is to cut by one half the number of days of sick leave between 2002 and 2008 and to reduce the number of people receiving sickness benefits. During the last years the Government has provided SEK 70 million (€ 7.7 million) to the public sector for preventive health care\(^\text{27}\).

**Taxation**

A recurring recommendation included in the BEPGs for Sweden has been to reduce the tax burden. The level of taxation is very high in Sweden compared with other EU and OECD member states. Public revenue is some 60% of GDP at present. However, while reducing taxes, the Swedish Government has in recent years opted to use some of the leeway available to increase discretionary spending, taking into account the commitment to maintain a 2% surplus in general government finances. This is the case also in 2003.

In the near future, taxes are to be cut in accordance with the multi-year tax reduction programme announced in 1999. Three stages of the reform have been implemented. The final step will be implemented later in the mandate period 2003-2006 if the financial situation permits. The Government refers to the target of a surplus of 2% of GDP as a reason not to


implement the last step in 2003\textsuperscript{28}. A reduction in personal income tax rates is, in terms of reduced government revenue, the largest part of this reform. Its impact was SEK 14.6 billion (€ 1.6 billion) in 2001 and SEK 20.3 billion (€ 2.2 billion) in 2002. The lower threshold of the tax scale will be raised, with the effect of limiting to 15% the share of taxpayers liable to pay central government tax. The reform has so far resulted in a reduction in marginal tax of almost 4 percentage points for wage earners not paying central government income tax. Corporate income taxes and payroll taxes were already cut in 2001. During 2003 a "green" tax change is taking place at a cost of SEK 3 billion (€ 0.33 billion). It implies raising energy taxes and lowering income taxes correspondingly by raising the basic allowance.

In the country-specific recommendations of the 2002 BEPGs Sweden was asked to lower the tax burden for low- and medium-wage earners, without renouncing to the medium-term surplus target. Sweden cut taxes corresponding to 1.1% of GDP in 2003 and the surplus target was maintained in the 2002 update of the Convergence Programme.

\textit{The Pensions System}

A major pension reform was adopted by the Swedish Parliament in 1998, and applies from January 2003\textsuperscript{29}. The purpose of the reform was to cope with varying business cycles and demographic changes by creating a better match between contributions to and payments from the system. In contrast to the earlier system, benefits will be based on earnings during the whole working career. Changes in life expectancy can be taken into account in determining the age at which full benefits are to be paid. The new system will be funded to a greater extent than the former. Part of contributions will be invested in securities, which the future beneficiary may choose himself. The first pensions based completely on the new system will be paid out in 2014.


\textsuperscript{29} The Swedish National Pension System, \textit{Ministry of Health and Social Affairs and National Social Insurance Board}, June 2003.
Political Background

The Political System

Sweden is a constitutional monarchy. The reigning monarch, King Carl Gustaf XVI, acceded to the throne in 1973. His functions and duties, which are mainly of a ceremonial nature, are defined in the 1975 Constitution Act. The Constitution defines working procedures for the Parliament and Government too.

The Swedish Government consists of the Prime Minister and 21 other ministers. Sweden is currently governed by a Social Democrat-led coalition (in alliance with the Left and Green Parties) under the leadership of the Prime Minister, Mr Göran Persson.

Legislative powers are vested in the unicameral parliament (the Riksdag). It has 349 members, elected every four years by proportional representation in multi-seat constituencies. The last general election was held in September 2002. The next election is due in 2006.

Table 2: Results of the September 2002 elections

<table>
<thead>
<tr>
<th>Political Party</th>
<th>Number of seats</th>
</tr>
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<tbody>
<tr>
<td>Social Democratic Worker's Party (S)</td>
<td>144</td>
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<tr>
<td>Moderate Party (M)</td>
<td>55</td>
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<tr>
<td>Left-wing Party (V)</td>
<td>30</td>
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<tr>
<td>Christian-Democrats (KD)</td>
<td>33</td>
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<tr>
<td>Centre Party (C)</td>
<td>22</td>
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<tr>
<td>Liberal Party (FP)</td>
<td>48</td>
</tr>
<tr>
<td>The Greens (MP)</td>
<td>17</td>
</tr>
</tbody>
</table>

Public opinion

The latest Eurobarometer survey analysing public opinion on various issues related to the European Union was carried out in all Member States in spring 2003. According to the survey, 41% of the Swedes regard their country's EU membership as a "good thing" while 27% see it as a "bad thing". Swedes are thus less likely to support membership than the European citizen on average (54% in favour, 11% against). However, support for the EU membership is more widely spread among the Swedes than the feeling that their country has benefited from the membership. Only 31% think that Sweden has drawn benefit from its membership of the EU.

Regarding the level of support for enlargement, the results show that public opinion varies considerably in the Member States. While in Greece 71% are in favour of enlargement, in France only 31% have a positive opinion. In Sweden, support for enlargement has decreased slightly during last year, from 65% to 56%.

In the Eurobarometer survey carried out in autumn 2002, Swedes were slightly more optimistic than most Europeans both as regards their personal economic situation and that of their country. A full 86% expected their own situation to remain stable or to improve, and only 12% feared a worsening of their personal economic situation in 2003. As regards the outlook for employment in their country, 29% of the Swedes surveyed feared that the situation would deteriorate in 2003, which is less than the year before.

31 The latest Eurobarometer survey in which this question was asked. (http://europa.eu.int/comm/public_opinion/archives/eb/eb58/eb58_en.pdf).
Appendix: Sweden and EMU

In 1998, Sweden fulfilled all convergence criteria except the requirement for central bank independence. New legislation concerning the status of the Riksbank came into force in 1999, making the Central Bank independent of the Government in the conduct of monetary policy. However, Sweden chose not to join the ERM2 at the start of the third stage of EMU and has remained outside ever since. Not having pegged the krona to the euro has allowed Sweden to use monetary policy for other targets.

In accordance with the present legislation concerning the status of the Riksbank, price stability is the overriding objective of monetary policy and the executive board of the Riksbank takes independent decisions to guarantee price stability. The Central Bank follows an inflation target, which is an annual increase in the consumer price index (CPI) of 2% +/-1 percentage point. The Riksbank may deviate from the signal given by the CPI if it believes that a change in the index has been caused by temporary factors not susceptible to have a permanent impact on inflation.

The Government decides on the exchange rate system to be followed. At present, Sweden has a floating exchange rate, but the Prime Minister had stated that Sweden would have joined the ERM2 at the end of 2003 if the outcome of the referendum held on 14 September 2003 had been favourable to Swedish entry. In this case, Sweden would have aimed at adopting the euro in 2006.

The proportion of Sweden in favour of the euro increased sharply in the months preceding the launch of the euro notes and coins. While only 29% supported the single currency in spring 2001, the share of those in favour had jumped to 51% in autumn 2002. Support for the euro, however, subsequently decreased and in the spring of 2003, only 41% of the Swedish population were in favour while 48% were against. Subsequent surveys released before the 14 September vote also indicated that a larger number of Swedes were against than in favour of the euro. The referendum corroborated these results, 56.1% of the voters rejecting the entry, while 41.8% voted in favour.

The factual debate before the vote centered around the question of how to compensate for the loss of an independent monetary policy in reacting to country-specific shocks if Sweden was to enter EMU. The Government had been following the experience of the single monetary policy for Member States in the euro area but whose economies make up part of the economic "periphery", such as Finland, Spain and Ireland. Among others, the need for specific tools for fiscal policy were analysed. A fiscal buffer consisting in a larger surplus target was planned as an option, together with a plan to make it easier to alter the rate of VAT, payroll taxes and income taxes, in order to stimulate economic activity in a recession and resist pressures for overheating in an strong upturn.

The Consequences of the 'No' Vote

The negative result of the referendum on euro area membership means that no further Swedish attempt to adopt the € is likely for several years.


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