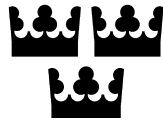


3

Economic and Budget Policy Guidelines



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3 Economic and Budget Policy Guidelines

Summary – Promoting jobs and welfare

The European sovereign debt crisis intensified in autumn 2011. There was an imminent risk of a disorderly default on the part of highly indebted countries. Intensive work in the EU to avert an acute crisis has stabilised the situation. However, there is still considerable uncertainty.

The deepening debt crisis in the euro area in autumn 2011 has lowered global growth prospects, particularly for 2012. Weaker global growth also lowers Sweden's growth prospects. As household and business confidence in the economy strengthens as the situation in the financial markets stabilises, a gradual increase in demand is expected.

Ensuring sound public finances, improving the functioning of the labour market and improving the business climate has made Sweden better able to manage the financial and debt crisis. Strong stabilisation policy measures have been taken without compromising confidence in the budget surplus target.

Stable public finances guarantee welfare

Stable public finances are the basic pre-conditions of the Government's economic policy. Sweden will remain stable when there is international economic turbulence. The public will be able to rest assured that schools, child-care and health care will also function in hard times. By following a responsible policy where the surplus target is maintained and the expenditure ceiling is not exceeded, we will ensure an orderly economy and a continued secure basis that will enable Sweden to meet future challenges. A number of debt-ridden

countries in the EU need to continue debt restructuring and implement important structural reforms. There is still considerable risk of new waves of economic and financial unrest. Sweden therefore needs adequate safety margins in its public finances in order to have sufficient resources to manage a possible intensified crisis.

A policy for full employment

The most important aim of the Government's economic policy is full employment. Since the current Government came to power in 2006, the design of the policy has been based on getting more people into work and reducing the number of people who are excluded from the labour market. The composition of measures has varied over the years due to sharp cyclical swings in the wake of the financial and debt crisis. But the aim has been clear – the Government has made jobs its top priority. Employment has increased by 96 000 people in 2011 and by 213 000 people since 2006. The employment rate is among the highest in the EU. At the same time, exclusion has declined by the equivalent of about 225 000 people since 2006.

Weaker cyclical conditions in the wake of the debt crisis have weakened the labour market. Measures to counter this will be taken. While other countries are forced to make cuts in welfare and raise taxes for households and businesses, Sweden can mitigate the downturn in the labour market and actively try to prevent unemployment from becoming persistent at a high level by taking active measures for jobs, adjustment and entrepreneurship. The number of unemployed has declined by

38 000 people in 2011 and since 2006, Sweden has climbed from 13th to 8th place in terms of having the lowest unemployment in the EU.

A policy that makes jobs a top priority involves giving everyone a chance in the labour market. Work is of greater value than a wage and output alone. With jobs come inclusion, security and a sense of being needed. Increasing employment and reducing exclusion reduce disparities and social cohesion increases.

Full employment is also a prerequisite for Sweden to remain a competitive country with long-term sustainable growth. Continuing to make jobs a priority in designing policy is of the utmost importance to the Government.

Facilitating establishment in the labour market and improving the functioning of the labour market

In addition to managing the direct effects of the debt crisis, Sweden needs to take on important challenges for higher sustainable employment and a lower rate of equilibrium unemployment, strengthened welfare, better business conditions, and a more sustainable climate.

The incentives to work need to be further strengthened by such means as regular reviews of taxes and marginal effects. The functioning of the labour market will also continue to be improved. There need to be more pathways to jobs, particularly for those who are most detached from the labour market. Everyone should be given an opportunity in the labour market. No one should be excluded in passive systems of support. Education is important in strengthening an individual's skills and improving his or her chances of getting work or starting a business. The high unemployment among young people, people born abroad, people with relatively limited education and people with disabilities necessitates further measures. Important actions are education initiatives, internships and other measures that equip people to get into work and build a strong and cohesive society.

The Swedish labour market model will be safeguarded and improved. The Government seeks to actively support initiatives by the social partners that lead to higher sustainable employment and lower equilibrium rate of unemployment. Initiatives for groups with a weak foothold in the labour market are

particularly important. Discussions between the social partners about how to make it easier for young people to enter the labour market are under way. Initiatives have already been taken together with the social partners to create a system for short-term employment which can be activated the next time an exceptionally sharp downturn of the kind experienced in 2009 affects Sweden.

More housing and improved access to rental apartments

A policy for full employment and a cohesive society requires a well-functioning housing market. It should be possible for people to move to places where the demand for labour is high, where there are good opportunities to earn a living, and where the risk of exclusion and unemployment is low. There must also be good opportunities to choose among different types of accommodation. This is important, not least for young people wanting to enter the housing market and for families with children whose needs often change over time. In this bill, the Government therefore announces proposals to make the letting of privately owned housing easier and to increase the incentives for building new housing.

Growth slows due to the debt crisis but stabilises in 2012

As a result of the fiscal problems in several euro countries, the Swedish economy slowed down sharply towards the end of 2011. Because of the slowdown, growth will be weak throughout 2012. The Government has lowered its GDP forecast for 2012 to 0.4 per cent, from 1.3 per cent in the 2012 Budget Bill. In 2012 a gradual return of household and business confidence is expected as the uncertainty surrounding the sovereign debt crisis in Europe subsides.

Weaker labour market growth

There has been a rapid recovery in the labour market as a whole in 2010 and 2011, both in terms of employment and the number of hours worked.

The global economic problems have a strong impact on Sweden's open and export-oriented economy. The contraction in GDP growth in 2012 will also lead to weak growth in the labour

market. Unemployment is expected to rise from 7.5 per cent in 2011 to 7.8 per cent in 2012, and then gradually decline again.

There is considerable uncertainty about future economic developments. Overall, the downside risks are expected to be considerable even though they are estimated to have declined somewhat since the 2012 Budget Bill was passed in September 2011.

Table 3.1 Summary table

Percentage change unless otherwise stated
Outcome 2011, forecast 2012–2016

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|------|------|------|------|------|------|
| GDP | 3.9 | 0.4 | 3.3 | 3.7 | 3.6 | 3.2 |
| Hours worked ¹ | 2.3 | -0.3 | 0.5 | 1.6 | 1.5 | 0.9 |
| Employed, aged 15-74 | 2.1 | -0.1 | 0.3 | 1.4 | 1.7 | 0.8 |
| Unemployment ² | 7.5 | 7.8 | 7.7 | 6.9 | 5.7 | 5.2 |
| Unemployment, older definition. ³ | 5.3 | 5.5 | 5.5 | 4.5 | 3.5 | 3.0 |
| GDP gap ⁴ | -1.0 | -2.7 | -2.1 | -0.9 | -0.4 | 0.0 |
| Wages ⁵ | 2.4 | 3.2 | 3.1 | 3.3 | 3.7 | 3.7 |
| CPI | 3.0 | 1.2 | 1.3 | 1.6 | 2.5 | 2.8 |
| Net lending ⁶ | 0.1 | -0.3 | 0.3 | 1.6 | 3.0 | 3.7 |
| Consolidated gross debt ⁷ | 38.4 | 37.7 | 35.4 | 31.8 | 27.5 | 22.5 |

¹ Calendar adjusted.

² Per cent of labour force.

³ The number of unemployed excluding unemployed full-time students as a percentage of the labour force excluding full-time students, i.e. open unemployment. This refers to those aged 15–74; originally it referred to those aged 16–64. The difference between age groups is marginal in terms of the number of unemployed.

⁴ Per cent of potential GDP.

⁵ According to short-term wage statistics.

⁶ General government net lending as a per cent of GDP.

⁷ As a percentage of GDP.

Sources: Statistics Sweden, National Mediation Office and own calculations.

Limited scope for reform and a need for adequate safety margins

The economic slowdown will contribute to a somewhat less rapid improvement in government net lending than estimated in the 2012 Budget Bill. Government net lending for 2012–2015 has been revised downwards by between 0.2 and 0.5 per cent of GDP per year. A surplus in the general government finances will be achieved in 2013 and then rise to 3.7 per cent of GDP in 2016.

Given the risk situation, there continues to be a need for adequate safety margins in the public finances, even though the need has lessened somewhat since the 2012 Budget Bill was passed in September 2011. In the event of sharply worsening economic development than in the base scenario, where there is a risk

that employment will be seriously weakened, there must be scope for taking further measures to support employment and economic growth. There must also be scope for managing a significantly more difficult financial market situation. This strategy ensures that the public finances will not become a source of uncertainty.

At the same time, capacity utilisation is low and unemployment is high. In the 2013 Budget Bill, the Government will thus need to propose measures to try to prevent unemployment from becoming persistent at a high level. But the economic situation is at present not expected to necessitate broad crisis measures now.

The Government's assessment is that there will be a limited scope for reform in the 2013 Budget Bill.

Policy direction

The limited scope for reform should be used, as noted above, both for measures to prevent unemployment from becoming persistent and for measures that strengthen the functioning of the economy, improve the financial position of vulnerable groups and strengthen welfare. The policy direction in the short run is to manage the effects of the debt crisis. In particular, the focus will be on strengthening the conditions for groups with a weak foothold in the labour market, such as young people, people with a foreign background and other groups with high long-term unemployment, to get work.

In its work on the 2013 Budget Bill, the Government will therefore focus on the following areas:

More people in work in an inclusive labour market

The Government's foremost objective is full employment. Reforms implemented thus far to get more people in work have had significant positive effects but further measures are needed to guide Sweden towards full employment. A good business climate nationwide is important for employment.

The Government's policy of an earned income tax credit in several steps has strengthened the incentives to work for low and

middle income earners in particular. The design of both the tax system and the social insurance systems affects the incentives to work and therefore the Government's policy will also in the future focus on strengthening the work-first principle. The reforms of the social security systems will be followed up and the need for adjustments examined so that no one will be overlooked and the way back into work will be made easier.

Reduced unemployment among young people and people with a foreign background is given a high priority. In 2011 these people represented about 5 percentage points, i.e. two thirds, of total unemployment of about 7.5 per cent. It is important that those who have difficulty getting established in the labour market get the help and support they need. It is therefore crucial that the transition from school to working life be as effective as possible and that young people's labour market entry be made easier.

The Government intends to improve the opportunities for employment and entrepreneurship among young people. The chances of getting a job can be improved by measures that strengthen demand and reduce the thresholds for labour market entry for groups with a weak foothold in the labour market, for example, a reduction in employers' social security contributions, new start jobs or forms of subsidised employment. Education initiatives such as Swedish language training, occupational training and basic education can strengthen individuals' skills and thus their chances of getting a job.

It is the Government's ambition to, in a dialogue with the social partners, improve flexibility in the labour market and facilitate entry by such means as expanding the opportunities for internships and apprenticeships.

When the labour market functions well, jobseekers and companies that want to hire can find each other easily and rapidly. Work on improving the functioning of the labour market continues, for example, by looking for ways to further improve matching between the unemployed and job vacancies and with measures to improve the employment services' effectiveness.

Improved welfare

Our jointly financed welfare should maintain a high quality and benefit everyone.

Education is essential both for an individual and for society in general. A good school makes up for differences in students' living conditions and opportunities and constitutes an important basis for people's future prospects. Education creates opportunities for everyone to actively participate in society and make active choices about their lives. The Government's work to improve the quality in the education chain continues. A matter of high priority is facilitating solutions that support the transition between school and working life.

The Government's policy aims at high quality, diversity and freedom of choice in schools, health care and social services. Equally high standards will apply to both private and public activities and be combined with follow-up, evaluation and review.

Swedish health and medical care achieves good medical results in international comparisons. The Government wants to continue to improve access to health care and strengthen patient safety. An ageing population and an increased need for health care and social services will bring additional challenges for health and medical services and elderly care.

The Government's work to ensure an effective legal system continues. Its aim is to carry out reforms that prevent crime and lead to rapid, clear and consistent responses to crime.

Enhanced competitiveness

The conditions for entrepreneurship are good in Sweden in many respects. Swedes are well educated and they have also been quick to adopt new technology. High quality higher education and research are essential in order to have internationally competitive firms. The business sector is innovative with extensive research and development activity and good financial capacity. The Government's improvement of the business climate has strengthened Swedish competitiveness. In recent times, the business climate in Sweden has been ranked highly in international comparisons. Retaining this ranking in the future will require an active policy for innovation and entrepreneurship.

The Government will continue to take measures to promote entrepreneurship and improve the business climate. The Corporate Tax Committee's (Företagsskattekommittén) proposal for an R&D credit (SOU 2012:03) is under consideration in the Government Offices. The Committee has a broad remit and will by the end of 2013 have submitted three reports, one on tax incentives for venture capital, one on tax incentives for research and development and a main report discussing the possibilities of reducing the taxation of venture capital in the corporate sector and levelling the playing field between equity and debt financing. Also part of the Government's efforts are the measures presented recently against tax planning through interest deductions. These measures will counter unacceptable tax schemes and increase the opportunities for balanced taxation in the welfare sector and elsewhere. The measures will create space in the budget for lowering the corporate sector's tax burden, which can be done by lowering the corporate tax.

Strengthening competitiveness and safeguarding welfare in the coming period requires world-class research and a capacity for innovation. In the forthcoming bill on research and innovation, the Government will present a clear commitment in these areas.

More efficient passenger and freight transport is essential for economic growth and increases people's chances of finding work within commuting distance. For businesses, a well-functioning transportation system makes it possible to employ staff with the right skills and to operate nationwide. Efficient transportation is thus of great importance for business competitiveness and for the investment climate. Preserving the existing infrastructure is of the utmost importance in ensuring robust road and railway systems.

The Government intends to present an infrastructure bill to the Riksdag in autumn 2012. This bill is an important part of the work to meet the need for measures in the transportation system in future.

A stable financial system

A stable and well-functioning financial system is of key importance to the economy. A number of measures have been taken to strengthen financial stability, but the fact that the Swedish banking sector is large in relation to GDP poses significant risks. The Swedish taxpayer should not be made to pay for irresponsible risk-taking by banks. Based on how the Swedish banking sector is structured, it is the opinion of the Government, the Riksbank and the Swedish Financial Supervisory Authority that the four largest Swedish banks are to meet a higher capital adequacy requirement than the Basel III's minimum requirement of at least a 7 per cent core tier 1 capital ratio in relation to the bank's risk-weighted assets. As a first step, the Government's ambition is to raise the requirement to 10 per cent of risk-weighted assets effective 1 January 2013. As a second step, the requirement will then rise to 12 per cent in 2015. However, implementation will be affected both by ongoing negotiations at the EU level and the stability in the Swedish financial system.

Concurrent with the work to strengthen the regulatory framework and improve financial market supervision, the Government will work actively to strengthen the position of consumers vis-à-vis financial institutions. Consumers find themselves at a knowledge disadvantage that in the long run risks undermining their confidence in financial institutions. With more transparent information, particularly about fees, consumers will have a better opportunity to differentiate between good and bad financial products. The demarcation between financial advice and the marketing of complex financial products is under review. Fees, risks and yield need to be reported more transparently.

Improved access to housing

The Government wants to improve labour market mobility and give everyone, regardless of economic status, access to job and study opportunities. Therefore access to housing and variety in the supply of housing need to be improved. A housing shortage hinders opportunities for individuals, not least young people, to move to where jobs exist or to study in another place.

A number of reforms to improve the housing market have been implemented since 2006. The previous property tax, which was felt to be unjust and illegitimate, has been abolished. A new planning and development act has simplified the planning and building permits processes. Ineffective subsidies have been abolished and the parties in the housing market have reached sustainable agreements.

This reform work continues. In this bill, the Government announces proposals that make it simpler and increase the incentives for private persons to rent out housing and in this way rapidly increase the supply of housing. Measures are also being announced to stimulate more housing construction.

The proposals are part of the continuing work to reform the housing market in order to make housing available for everyone, within the framework for the current model for the rental market.

Effective climate policy

Climate change is the Government's top environmental priority, alongside the preservation of biodiversity, the marine environment and a non-toxic environment. This requires an ambitious environmental policy in Sweden, in the EU and in other international contexts. As climate change is global, international agreements are an important part of an effective climate strategy. Sweden has and will continue to take the lead and has also undertaken to do more and act more quickly than many other EU countries. Through cost effective and long-term measures, the Government is working to continue to achieve Sweden's ambitious targets for its climate and energy policy. The Government's ambition is that by 2050, Sweden will have a sustainable and resource effective energy supply with no net emissions of greenhouse gases.

The Government's continued reform ambitions

The Government's reform ambitions for its current term of office, presented in the 2011 Budget Bill, will be implemented when there is scope for reform and the economic situation permits, and provided that important reforms in high priority welfare areas can be safeguarded.

To reduce exclusion, increase sustainable employment and make it more attractive to get an education and to start and run a business, the

Government wants to further strengthen the earned income tax credit and raise the lower state income tax threshold. When individuals and families get to keep more of their income, their independence and their opportunities to shape their own lives also increase. It is the Government's ambition to continue improving the business climate and the conditions for entrepreneurial activity, investment and employment, for example by reviewing corporate taxation. The Government also intends to come back in 2013 or 2014 with proposals for tax cuts for pensioners, provided that public finances are in balance.

3.1 Outlook for the Swedish economy

In the wake of the fiscal problems in several euro countries, there was a sharp slowdown in the Swedish economy towards the end of 2011. As a result of the slowdown, growth in 2012 is expected to be weak and unemployment will rise. The uncertainty surrounding the sovereign debt crisis in Europe has declined and the financial markets have begun to stabilise. In 2012, household and business confidence is gradually returning. A gradual increase in demand in Sweden is therefore expected towards the end of 2012 and onwards. Employment is expected to begin to increase in 2013 and in 2014–2016, the labour market will grow strongly. Unemployment will approach 5 per cent in 2016 and capacity utilisation in the economy as a whole is then expected to be normal.

Future economic developments are highly uncertain. Even though the risk situation has shifted in a positive direction compared with the estimate in the 2012 Budget Bill, the risks of slower growth are still expected to predominate.

3.1.1 Stabilisation in the financial markets

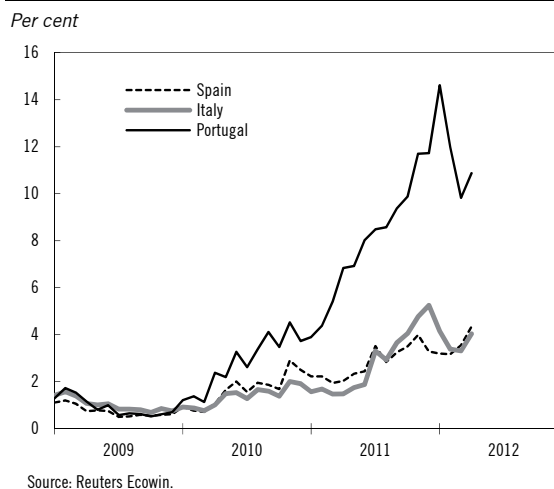
Financial stability was an obvious concern in autumn 2011, but this concern has since lessened following measures taken by the European Central Bank (ECB), the EU and

countries with acute fiscal problems. Support measures from the ECB aimed at facilitating banks' funding have reduced the financial stress in the banking sector. The risk of a credit crunch has thus decreased significantly. Increased fiscal policy cooperation in the EU and extensive austerity and reform programmes in several euro area countries have helped stabilise the financial markets (see Figure 3.1). The financial turmoil is expected to continue to decline in 2012.

Even though the financial market turmoil has abated and measures have been taken to counter the fiscal crisis, the international economic prospects are still highly uncertain.

In the euro area the consolidation of public finances, weak domestic demand and reduced global demand are expected to lead to a mild recession in 2012. The consolidation of public finances and the implementation of structural reforms will take time and only bear fruit in the long run. The recovery in the euro area in 2013–2016 will thus be protracted.

Figure 3.1 Interest rate spreads for 10-year government bonds compared with Germany



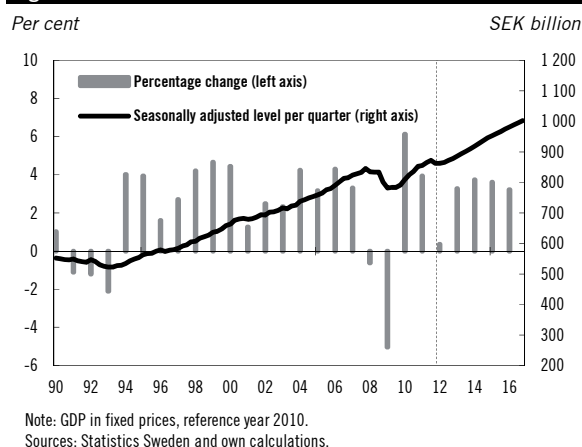
The sovereign debt crisis in the euro area has so far had relatively little impact on the American economy. There are clear signs of a stronger economy in the United States, for example, falling unemployment. But capacity utilisation is currently low and the recovery is expected to be protracted, even though an expansive monetary policy has stimulated growth. This is because a strong consolidation of public finances is also needed in the United States. But the political polarisation in Congress creates considerable uncertainty about the design of future fiscal policy.

The weak global economy will reduce Swedish growth, primarily in 2012. As the financial markets continue to stabilise and measures are taken to solve the fiscal problems in Europe, Swedish households and companies' concerns will abate.

3.1.2 The impact of the debt crisis on the Swedish economy in 2012

The Swedish economy has grown very rapidly in 2010 and for large parts of 2011 (see Figure 3.2). Both domestic demand and exports have been important in driving the recovery forward after the financial crisis. Towards the end of 2011, however, growth in the Swedish economy slowed markedly and the economy is expected to become distinctly weaker in 2012. This is due to the interaction of a number of factors. The fiscal problems, particularly in the euro area, have resulted in a sharp slowdown in global demand and thus in the demand for Swedish export products. Exports declined towards the end of 2011 and indicators point to a weak increase in exports in the first part of 2012. Household consumption slowed down already in the first half of 2011 as a result of increased uncertainty about economic developments and weak growth in net worth. The uncertain economic situation, weak export demand and weak domestic demand make companies delay investing.

Figure 3.2 Swedish GDP 1990–2016



The weaker growth in the Swedish economy will lead to a decline in capacity utilisation in 2012. Measured by the GDP gap, capacity utilisation will decrease from -1.0 per cent in 2011 to -2.7 per cent in 2012 (see Table 3.2).

Over the next few years, output and employment may thus increase rapidly without the emergence of tendencies to overheat. This is due to a combination of low capacity utilisation in the economy in 2012 and strong potential growth as a result of the Government's reforms for a better functioning labour market and a better business climate.

Table 3.2 Key indicators

Outcome for 2011, forecast for 2012-2016
Percentage change, unless otherwise stated

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|------|------|------|------|------|------|
| GDP | 3.9 | 0.4 | 3.3 | 3.7 | 3.6 | 3.2 |
| GDP gap ¹ | -1.0 | -2.7 | -2.1 | -0.9 | -0.4 | 0.0 |
| Employed | 2.1 | -0.1 | 0.3 | 1.4 | 1.7 | 0.8 |
| Employment rate ² | 80.0 | 79.7 | 79.6 | 80.5 | 81.6 | 82.4 |
| Hours worked ³ | 2.3 | -0.3 | 0.5 | 1.6 | 1.5 | 0.9 |
| Productivity ^{3,4} | 2.4 | 1.3 | 3.2 | 2.3 | 1.9 | 2.0 |
| Unemployment ⁵ | 7.5 | 7.8 | 7.7 | 6.9 | 5.7 | 5.2 |
| Unemployment, older definition ⁶ | 5.3 | 5.5 | 5.5 | 4.5 | 3.5 | 3.0 |
| Wages ⁷ | 2.4 | 3.2 | 3.1 | 3.3 | 3.7 | 3.7 |
| CPI ⁸ | 3.0 | 1.2 | 1.3 | 1.6 | 2.5 | 2.8 |

¹ Difference between actual and potential GDP, as a percentage of potential GDP.

² Under the EU2020 target, i.e. employed persons as a percentage of the population aged 20–64.

³ Calendar adjusted.

⁴ Productivity in the business sector.

⁵ Per cent of labour force.

⁶ The number of unemployed excluding unemployed full-time students as a percentage of the labour force excluding full-time students, i.e. open unemployment. This refers to those aged 15–74; originally it referred to those aged 16–64. The difference between age groups is marginal in terms of the number of unemployed.

⁷ According to short-term wage statistics.

⁸ Annual average.

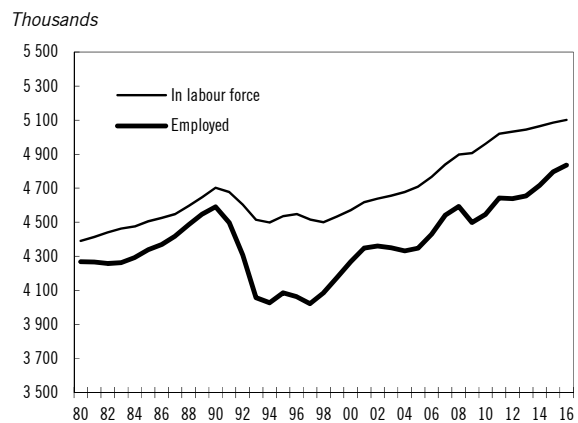
Sources: Statistics Sweden, National Mediation Office and own calculations.

As the financial markets continue to stabilise and households' concerns lessen, household consumption is expected to increase more rapidly from the second half of 2012 and onwards. An expansive monetary policy and gradually brighter labour market prospects will help household consumption to increase at a good pace in 2013–2016. The economy in other countries is also expected to strengthen and thus help increase export growth. As demand and output accelerate, the need for investment will be relatively large, resulting in strong investment growth. GDP will increase by an average of about 3.5 per cent a year in 2013–2016 and the strong growth will lead to a gradual rise in capacity utilisation. The economic downturn will however be protracted and capacity utilisation is not expected to be normal in the economy as a whole before the end of the forecast period.

3.1.3 The labour market slows down

The Government's reforms have laid the foundation for a resilient labour market

The labour market recovery has been swift in the past two years. There has been a substantial increase in the number of people employed (see Figure 3.3). The strong upturn in employment has also resulted in a decline in unemployment, even though labour force participation has increased markedly (see Figures 3.3 and 3.4). The strong labour market growth in the past two years is due to both a stronger economy and reforms that have strengthened the work-first principle and the business climate. One indication that the Government's reforms have improved labour market functioning is that labour force participation and the employment rate have increased in most age groups. But the debt crisis has caused growth to slow down and unemployment will first begin to fall in 2013; see Figure 3.4. In the fourth quarter of 2011, seasonally adjusted unemployment was 7.5 per cent.

Figure 3.3 Labour force and employment

Sources: Statistics Sweden, National Institute of Economic Research (NIER) and own calculations.

Figure 3.4 Unemployment

Slowdown in the labour market

The economic slowdown in Sweden towards the end of 2011 has already led to a rapid decline in companies' need to increase the number of people they employ. The increase in employment slowed towards the end of 2011 and it is in principle expected to remain unchanged throughout 2012. The slowdown is primarily due to companies not renewing fixed-term contracts and not replacing natural attrition to the same extent as they have done in recent years. But a wave of notices at 2008 and 2009 levels is not expected. At the same time, the labour supply is expected to continue to increase because of the growth in the working-age population. Unemployment is therefore expected to rise to 7.8 per cent in 2012.

As demand in the economy again picks up, the situation in the labour market will improve and employment is therefore expected to increase rapidly, particularly in 2014 and 2015. Unemployment is expected to decline to 5.2 per cent in 2016, which is in line with the Government's estimate of equilibrium unemployment in 2016.

The weak growth in 2012 will make it particularly difficult for people who have been unemployed a long time. The proportion of long-term unemployed is expected to increase in 2012. At the same time, long-term unemployment differs sharply from group to group. People born outside Europe, older workers and people with no more than a pre-upper secondary education are, for example,

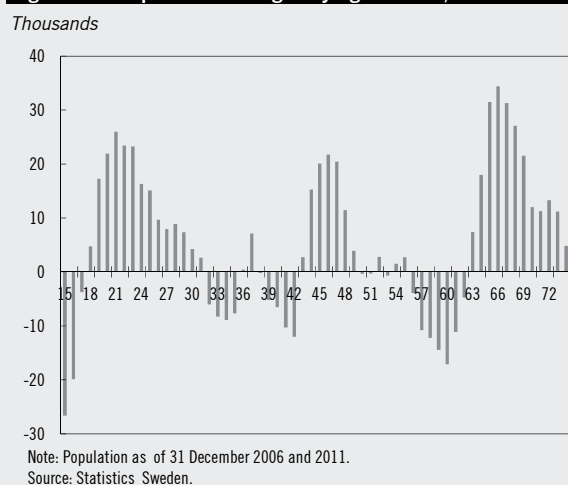
more apt to be long-term unemployed compared with other groups. For these groups, it will be even more difficult to get jobs when the economy again weakens, both because an individual's employability tends to decline as the time spent unemployed grows and because long-term unemployment may in itself be stigmatising. The low capacity utilisation in the labour market and the contraction in the economy in 2012 contribute to the expectation that the current wage negotiations will result in moderate wage increases, even though they are expected to be higher than in the 2010 round of negotiations. As the labour market situation improves, wages are expected to rise somewhat more rapidly in 2014–2016.

The low capacity utilisation combined with relatively low unit labour costs will lead to an underlying inflation that is expected to be less than 2 per cent for most of the forecast period. The Riksbank is expected to lower the repo rate to 1 per cent in summer 2012 and then keep it at this level for about one year. The repo rate will then be raised in the second half of 2013 as capacity utilisation and inflationary pressure increase.

Demographic changes have a negative impact on the employment rate

Between 2006 and 2011, the number of people employed increased by 213 000. In the same period, the employment rate in the population (aged 15–74) has declined from 65.8 per cent to 65.6 per cent. The slight decline in the employment rate at the same time that the number of jobs has increased occurs because the population has increased, and in particular, because of an unfavourable change in the composition of the population (see Figure 3.5).

Figure 3.5 Population changes by age 15–74, 2006–2011

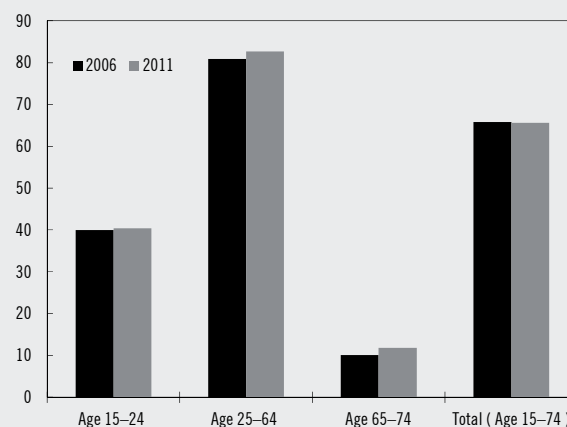


One important reason why the overall employment rate has declined slightly is that the group aged 25–64, the group with the highest employment rate, has declined as a percentage of the population since 2006. This is mostly because many in the large cohorts born in the 1940s are now retiring.

The change in the age structure of the population hides the fact that the employment rate has increased in various age groups. The increase in the employment rate has been particularly large among those between the ages of 25 and 69. But among the very young (aged 15–19) and the oldest (aged 70–74), the employment rate has declined (see Figure 3.6).

Diagram 3.6 The employment rate in 2006 and 2011 by age group

Per cent of the population



Source: Statistics Sweden.

People born abroad have sharply increased as a percentage of the population between 2006 and 2011, from 14.9 per cent to 17.3 per cent. People born abroad have for a long time had a lower employment rate than people born in Sweden, which is problematic (see Section 5). The employment rate among those born abroad remained stable between 2006 and 2011.

The significance of demographic changes can be illustrated with an estimate where the employment rate in various groups is held constant at the 2006 level while the population structure is allowed to change. An estimate like this shows that the employment rate, solely because of the demographic changes, would have declined by over 2 percentage points between 2006 and 2011. In fact, the employment rate for those in the group aged 15–74 declined by only 0.2 percentage points. This shows that the Government's policy has contributed to maintaining employment levels well, particularly when the unfavourable demographic developments are taken into account.

3.1.4 The downside risks predominate

There is considerable uncertainty about future economic developments. Overall, the downside risks are expected to be considerable, even though they are estimated to have declined somewhat since the 2012 Budget Bill was approved in September 2011.

A risk that has clearly diminished in early 2012 is the risk that European banks would in practice become unable to fund themselves in the financial markets. The ECB issuance of three-year loans at low interest rates have markedly reduced the risk of fiscal problems spreading to the banking sector.

In the majority of euro area countries, however, the underlying problems of high debt levels and low potential growth remain. There is a risk that the fiscal consolidation will not sustainably reduce budget deficits. There is also a risk that the negative effects of the necessary fiscal contractions will be larger than assumed in the forecast. As to the United States, there is also considerable uncertainty about the timing and extent of future fiscal consolidation. Weaker growth in both the euro area and the United States than that assumed in the forecast would result in a considerably more protracted global recovery and thus also a more protracted recovery in Sweden.

In Sweden there is a risk that the slowdown under way in the Swedish economy will have larger negative permanent effects on the labour market. If so, this would occur because the groups that are currently most detached from the labour market do not enter it. More people would in that case leave the labour force permanently. There are also indications that matching in the labour market has worsened recently. If this is due to structural factors, equilibrium unemployment may be higher than that assumed in the forecast.

At the same time, it is possible that the Government's policy will have larger positive effects than expected in the forecast. The employment rate has risen in most age groups and the labour force has increased more robustly than demographic growth, despite the weak economic situation. This indicates that the Government's reforms have improved the functioning of the labour market. If labour force participation continues to increase more

than assumed in the forecast, employment and GDP may increase more than expected without the economy showing any tendency to overheat. Another uncertain factor is productivity growth. Productivity has grown weakly since the financial crisis. There is a risk that productivity will continue to grow weakly, even more weakly than assumed in the forecast. At the same time, businesses may have a pent-up need to invest. If so, it would lead them to begin to invest earlier and to a greater extent than assumed in the forecast, resulting in higher productivity. This would result in higher GDP growth in the coming years and a higher GDP level in the long run.

EU measures and policy in managing the fiscal crisis

The global financial crisis that broke out in autumn 2008 clearly demonstrated that there were weaknesses in the EU's common rules for economic governance. What started as a financial market crisis grew in 2009 and 2010 into a fiscal crisis with far-reaching consequences for the economies of EU Member States. The fiscal crisis led the EU to take a number of measures not only to manage the acute crisis, but also to prevent the emergence of future crises.

Underlying causes of the crisis

When the euro area was established, there was broad agreement on the need for new economic policy requirements for participating Member States. To promote stable public finances and counteract macroeconomic imbalances, EU Member States decided to introduce the Stability and Growth Pact. Under the Pact, a member's government deficit may not exceed 3 per cent of GDP and its general government gross debt may not exceed 60 per cent of GDP. If a country exceeds these limits an Excessive Deficit Procedure will be launched, except if there are special circumstances. The procedure may result in stiff fines or non-interest-bearing deposits for euro area Member States, but not for other Member States.

However, the Stability and Growth Pact did not prevent the emergence of large budget deficits and major increases in government debt in several Member States. Furthermore, the regulatory framework was not designed to prevent the accumulation of significant macroeconomic imbalances. There was also inadequate regulation and supervision of the financial markets.

Before the global economic downturn in 2008, imbalances had accumulated in a number of euro area countries in the form of structural current account deficits, a deterioration in public finances, a lack of competitiveness and an unsustainable rise in property prices. A large majority of European countries experienced significant drops in demand as a result of the global financial crisis. To avoid systemically important financial institutions from going bankrupt, a number of countries

also carried out a series of rescue operations, which were very costly to taxpayers. There was a substantial risk of the crisis spreading to other, basically stable financial institutions. If that had happened, increased liquidity problems and a more severe credit crunch might have occurred, which could have led to an even worse economic slowdown. The rescue operations resulted in a sharp increase in government debts in Spain, Ireland and other countries.

The financial market turmoil grew due to increased uncertainty about several euro area countries' ability to pay their debts. The crisis in individual Member States developed into a crisis of confidence in the entire euro cooperation. In order to counter the sovereign debt crisis, work has been initiated along three parallel tracks at the EU level:

1. the introduction of new financial stability mechanisms,
2. a strengthening of the European banking system, and
3. a deepening of economic policy cooperation, primarily within the euro area.

Financial stability mechanisms

If a country is unable to finance its activities on terms that are sustainable in the long run, nationally or internationally, it may apply for financial support. Countries in this situation usually first turn to the International Monetary Fund (IMF). As a rule, loans from the IMF are associated with multi-year consolidation and reform programmes designed in cooperation with the government of the country concerned. The disbursements of these loans are strictly conditional on the implementation of consolidation measures and structural reforms by the borrowers. Without such loans, those countries would have to consolidate their budgets even more rapidly, or they would have to default on their obligations.

In 2010, the euro area countries, in cooperation with the IMF, decided to give bilateral loans to Greece. This decision made it clear that there was a need for stability mechanisms for the euro area Member States as a supplement to the IMF. Initially, two temporary loan facilities were established, the European Financial Stability Facility (EFSF), and the European Financial Stabilisation

Mechanism (EFSM). The aim is to establish a permanent stability mechanism, the European Stability Mechanism (ESM), in summer 2012, which will in the long run replace the temporary loan facilities.

Loans to euro area countries in acute crisis give these countries a breathing space, enabling them to rebuild confidence in their economies by way of budget consolidation and structural reforms, so as to regain access to the capital market. The new mechanisms also help strengthen the financial markets' confidence in the euro cooperation. But it is not certain that the volume of the new mechanisms is sufficient to support the larger euro area countries' need for financial assistance.

A strengthened banking system

The EU Member States have taken measures aimed at strengthening the banking system. Three measures can be singled out as particularly important:

1. recapitalisation of banks,
2. higher capital adequacy requirements, and
3. extraordinary measures by the European Central Bank (ECB).

1. The European Banking Authority (EBA) has been made responsible for improving the capital situation and mitigating the funding problems of European banks. After marking to market some thirty banks' portfolios of government securities, the European banks' Core Tier 1 capital ratios are to reach 9 per cent by 30 June 2012. Banks with large holdings of highly indebted countries' government securities, which have fallen sharply in value, will have to obtain major capital injections to meet the capital adequacy requirement.

2. As a result of the financial crisis, the current capital regulations for banks, Basel II, are no longer considered to take the risks in the banking system sufficiently into account. For this reason, a new framework, Basel III, has been developed in order to make the banks more stable and reduce the risk of future financial crises. New liquidity requirements for banks have also been introduced. Work is currently under way in the EU to develop capital regulations based on Basel III (for further details see Section 3.6).

3. The ECB has in several steps taken temporary extraordinary measures to safeguard the functioning of the financial system. On two occasions, the ECB has offered euro-area financial institutions three-year secured loans at a low interest rate. Through this loan programme (getting access to cheap loans from the ECB), the banks are able to cover their funding needs for a relatively long time ahead at a low cost and improve their interest margins and financial result. The banks' adjustment to the stricter capital adequacy requirements of Basel III is thus facilitated while supporting the flow of credit to households and businesses.

Deeper economic-policy cooperation

In parallel with new stability mechanisms and reforms and consolidation measures in individual countries, negotiations have been conducted on strengthening and deepening economic policy cooperation in the EU.

In September 2010, the EU Commission presented a proposal consisting of six Community legal instruments. The proposed instruments entered into force in December 2011 and aim at strengthening the fiscal framework of the EU and detecting macro-economic imbalances at an early stage. The main implications of the proposals are that the preventive and dissuasive arms of the Stability and Growth Pact are strengthened, a Directive with minimum requirements for national fiscal frameworks is introduced, a new process for preventing and correcting macroeconomic imbalances is introduced and new sanctions for euro area countries are inserted into the Stability and Growth Pact and the Excessive Deficit Procedure.

As a supplement to the six legal instruments, the Commission in November 2011 proposed two Regulations on strengthened economic governance in the euro area. The first proposal aims at strengthening economic and monetary surveillance of euro area countries experiencing financial problems and establishing clear conditions for countries receiving financial assistance. The second proposal entails expanded reporting requirements for euro area countries concerning their national budget policy.

A further measure for strengthening economic policy coordination in the EU is the Treaty on Stability, Coordination and

Governance in the Economic and Monetary Union (the Fiscal Compact). The main contents of the Treaty are requirements for the introduction of rules on balance or surplus in government finances, a correction mechanism in national legislation and more automaticity when the deficit criterion in the Stability and Growth Pact is exceeded. The rules in the Treaty are not binding on Member States outside the euro area until their possible introduction of the euro, unless they voluntarily undertake to be bound by all or parts of the Treaty (for further details see Section 4).

All the measures taken in the wake of the sovereign debt crisis are important steps in the long-term work to establish a stronger fiscal framework in the EU and reduce the risk of similar crises in future.

3.2 The public finances and the fiscal stance

3.2.1 Developments in the public finances

The public finances have strengthened in recent years in line with the economic recovery. General government net lending has increased from a deficit of 1 per cent of GDP in 2009 to a surplus of 0.2 per cent of GDP in 2011. Because of the weak economic growth, net lending is expected to show a small deficit of 0.3 per cent of GDP in 2012, which will turn into a small surplus already in 2013. Subsequently, net lending will gradually improve to 3.7 per cent of GDP in 2016 (see Table 3.3).

General government net lending came to 0.1 per cent of GDP in 2011, which was the same as in the forecast in the 2012 Budget Bill. For 2012–2015, net lending has been revised downwards by between 0.2 and 0.5 per cent of GDP a year, primarily on account of higher expenditure.

Tax revenue has been revised upwards by SEK 3 billion in both 2012 and 2013 compared with the forecast in the 2012 Budget Bill. It is revenue from the tax on labour that has been revised upwards, primarily because wages paid in 2011 were substantially higher than expected. Higher income and occupational pensions also contribute to the higher revenue. For 2014 and 2015, total tax revenue has been revised downwards by SEK 2–4 billion. The higher revenue from tax on labour in these years will be offset by a downward revision of revenue from the VAT. The revision is largely due to lower investment and a change in the composition of household consumption. On the revenue side, other revenue has also been revised upwards in 2012–2013 by SEK 4–7 billion, but it has been revised downwards in 2014–2015 by SEK 1 billion.

Expenditure has been revised upwards for 2012–2015 by SEK 9–21 billion annually compared with the forecast in the 2012 Budget Bill. A large part of the revision is local government consumption, which is now expected to be SEK 4–7 billion higher each year in 2012–2015. Other expenditure revised upwards includes transfers to households,

investment expenditure and interest expenditure.

It is the central government budget that accounts for the strengthening of the public finances from 2013. The old age pension system is expected to gain a small surplus in 2012 that changes to a deficit in 2013. After that, the old age pension system's finances are in principle expected to balance. During the forecast period, there will be a small deficit in the local government sector, but a positive outcome and can therefore achieve the balanced budget requirement for local governments.¹

Consolidated gross debt was 38.4 per cent of GDP at the end of 2011, which provides a comfortable margin to the reference value in the EU Stability and Growth Pact of 60 per cent of GDP. Smaller general government net lending surpluses contribute to a somewhat larger debt than estimated in the 2012 Budget Bill. In 2016, the consolidated gross debt is estimated at 22.5 per cent of GDP.

Table 3.3 Consolidated general government finances

| SEK billion | | | | | | |
|----------------------------------|-------|-------|-------|-------|-------|-------|
| Outcome 2011, forecast 2012–2016 | | | | | | |
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| Revenue | 1 735 | 1 773 | 1 837 | 1 922 | 2 024 | 2 116 |
| <i>Per cent of GDP</i> | 49.6 | 50.1 | 49.7 | 49.4 | 49.5 | 49.3 |
| Taxes and charges | 1 546 | 1 583 | 1 645 | 1 727 | 1 817 | 1 900 |
| <i>Per cent of GDP</i> | 44.2 | 44.7 | 44.5 | 44.4 | 44.4 | 44.3 |
| Other revenue | 190 | 190 | 192 | 194 | 206 | 216 |
| Expenditure | 1 731 | 1 783 | 1 824 | 1 861 | 1 902 | 1 959 |
| <i>Per cent of GDP</i> | 49.5 | 50.4 | 49.3 | 47.8 | 46.5 | 45.7 |
| Net lending | 4 | -10 | 13 | 60 | 122 | 157 |
| <i>Per cent of GDP</i> | 0.1 | -0.3 | 0.3 | 1.6 | 3.0 | 3.7 |
| Consolidated gross debt | 1 341 | 1 335 | 1 309 | 1 236 | 1 126 | 964 |
| <i>Per cent of GDP</i> | 38.4 | 37.7 | 35.4 | 31.8 | 27.5 | 22.5 |

Sources: Statistics Sweden and own calculations.

Owing to the great uncertainty about future economic developments, there is also considerable uncertainty in the forecasts for the public finances. Weaker economic growth

¹ Differences between local government accounts and the national accounts may amount to several billion kronor in some years. Local government accounts are based on the same accounting principles followed by the business sector. If, for example, investment expenditure increases sharply between two years, it has an immediate impact on net lending, while the result is only affected by depreciation.

is quick to affect public finances. Slower labour market growth has a particularly large impact because almost two thirds of total tax revenue comes from the taxation of earned income.

3.2.2 Limited scope for reform and the need for adequate safety margins

The scope for reform is estimated by monitoring the budget surplus target where a number of factors are considered in the estimate. The surplus target is estimated as a surplus of 1 per cent of GDP on average over the business cycle. Monitoring the surplus target is done using a number of different indicators, as there is no single indicator that can alone measure whether the target has been met.

The follow-up of the surplus target is both forward-looking and backward-looking. The forward-looking follow-up is made to establish the scope for reform or the need for consolidation measures. The indicators used for this evaluation are the seven-year indicator and structural net lending. The assessment of the seven-year indicator also takes into account the average cyclical situation during the period covered by the indicator. The backward-looking analysis is made to ascertain whether there have been any systematic errors in fiscal policy that could affect meeting the target in the coming period. Based on these indicators, an overall assessment of the scope for reform is then made that also takes into account the uncertainty in the estimate, the risk situation and the appropriateness of the fiscal policy based on the cyclical situation (fiscal policy should not contribute to overheating or to deepening an economic downturn). The risk that the business cycle may be asymmetric is also taken into account in the assessment.²

Estimating the scope for reform based on the indicators for following up the surplus target

The backward-looking ten-year average: In 2001–2011, general government net lending averaged 0.7 per cent of GDP (see Table 3.4). Net lending, in other words, was slightly lower than the target. Adjusted for the average cyclical situation, however, average net lending was 1.2 per cent of GDP, i.e. slightly higher than the target. This indicates that there are not any large systematic errors in the fiscal policy that can affect meeting the target in the coming period.

The seven-year indicator: The seven-year indicator will come to 0.5 per cent of GDP in 2012 and to 1.2 per cent of GDP in 2013. But the cyclically adjusted seven-year indicator for the same years indicates that net lending will be about 1 percentage point higher than the surplus target. The risk of an asymmetric business cycle (the GDP gap has been negative for a very long time) is an argument for attaching importance to both the unadjusted and cyclically adjusted indicators. The overall estimate is thus that average net lending will be slightly higher than the surplus target in the relevant period.

Structural net lending: Structural net lending is estimated to come to 1.2 per cent of GDP in 2012 and then gradually rise during the forecast period to 3.7 per cent of GDP in 2016. This indicator shows a net lending that is marginally higher than the surplus target in 2012 and 2013 and then gradually increases over the forecast period. Compared with the estimate in the 2012 Budget Bill, potential GDP and thus structural net lending have been revised substantially downwards for all the years after 2010.

² See Section 11 for a more detailed description of the analytical framework for the scope for reform and the various indicators. See also the Fiscal framework (Ramverk för finanspolitiken) (skr. 2010/11:79).

Table 3.4 Indicators for follow-up of the surplus target*Per cent of GDP and potential GDP*

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|-----------------------------------|-------------|-------------|-------------|-------------|-------------|------------|
| Net lending | 0.1 | -0.3 | 0.3 | 1.6 | 3.0 | 3.7 |
| Backward-looking ten-year average | 0.7 | | | | | |
| Cyclically adjusted ¹ | 1.2 | | | | | |
| Seven-year indicator | 0.4 | 0.5 | 1.2 | | | |
| Cyclically adjusted ¹ | 1.6 | 1.8 | 2.0 | | | |
| Structural net lending | 0.7 | 1.2 | 1.6 | 2.1 | 3.2 | 3.7 |
| GDP gap | -1.0 | -2.7 | -2.1 | -0.9 | -0.4 | 0.0 |
| Seven-year average | -2.2 | -2.3 | -1.4 | | | |
| Backward-looking ten-year average | -0.9 | | | | | |

¹The cyclical adjustment is made by decreasing the indicator's value by the GDP gap during the corresponding period multiplied by the elasticity 0.55. The cyclically adjusted seven-year indicator is not identical to a seven-year average for structural net lending, as structural net lending is also adjusted for extraordinary capital gains. Sources: Statistics Sweden and own calculations.

Estimating the scope for reform based on the indicators, taking into account the uncertainty in the estimate and the risk situation

All the indicators used for monitoring the surplus target indicate that net lending now is in line with or somewhat higher than the surplus target. The latter is valid for the later part of the forecast period in particular. But the assessment is uncertain and may be altered in the 2013 Budget Bill.

Estimates of the precision of the forecast for net lending made in the 2011 Fiscal Policy Council Report for the period 1998–2010 show that the uncertainty in the forecasts amounts to ± 2 percentage points already for the current year. Experience also shows that the estimate of structural net lending is very uncertain. It is not unusual for the estimate of structural net lending for an outcome year to be adjusted ex post by more than 1 per cent of GDP. The average difference between the lowest and the highest estimate of structural net lending for any one outcome year (i.e. in the absence of new policy) was as much as 2 per cent of GDP in 2000–2010.³ If the estimate of structural net lending were to be revised downwards by the

same amount, there would be no scope for reform at all in 2012. Instead, there would be a need for additional saving.

In the 2012 Budget Bill, the assessment was that the risks of a significantly more negative economic outcome in Sweden than forecast were substantial. At that time, the risks of a combined global financial and debt crisis made it particularly important to maintain relatively large safety margins in the public finances. The current assessment is that the risks for a more negative outcome still predominate, but that the risk situation is less negative than that reported in the 2012 Budget Bill. Thus, there is still a need for safety margins, but it has diminished somewhat.

The 2012 Budget Bill made the assessment that on the one hand, the forecasts for GDP and employment argued for allowing fiscal policy to be slightly more expansionary (or less contractionary). On the other hand, the clear downside risks associated with the debt problems in the euro area made it particularly important to maintain adequate safety margins in the public finances. In that situation, it was difficult to find the right balance between how much emphasis to place on maintaining adequate safety margins in public finances and how much emphasis to place on avoiding making fiscal policy too contractionary, given that capacity utilisation in the labour market was still weak. Given the very uncertain international situation, the assessment was then made that the right balance was to maintain adequate safety margins in the public finances. A marked deterioration of confidence in the public finances was expected to have a larger adverse impact on the labour market than a fiscal policy that was somewhat restrictive because of the need for extra safety margins.

As stated above, the risk situation is now slightly less negative than expected in the 2012 Budget Bill. This argues for less need for safety margins. Structural net lending, however, is expected to be smaller than the estimate in the 2012 Budget Bill.

³ This is illustrated in a box in the 2012 Budget Bill (Govt.Bill. 2011/12:1).

Overall assessment of the scope for reform

Overall, the indicators for monitoring the surplus target indicate that the scope for permanent reforms is relatively limited in the near future, but that it will increase gradually during the forecast period. Even though the situation in Southern Europe now seems to have stabilised, there is a continued need for adequate safety margins in public finances, even though the need has decreased somewhat since the 2012 Budget Bill. In case of a substantially worse economic development than foreseen in the main scenario, where there is a risk for a serious weakening of employment, there must be scope for taking additional measures to support employment and economic growth, even though the Riksbank can be expected to lower the repo rate in such a situation. There must also be scope for managing a significantly more difficult situation in the financial markets. This strategy ensures that the public finances will not be a source of uncertainty.

At the same time, capacity utilisation is low and unemployment high. Some measures therefore need to be taken to prevent unemployment from becoming persistent. But the economic situation is not expected to necessitate broad crisis measures now.

Against this background, the overall assessment is that there will be a limited scope for reform in the 2013 Budget Bill.

3.2.3 Average upward adjustment of the expenditure ceiling for 2016

The Riksdag has decided expenditure ceilings up to and including 2015. In this bill, the Government presents its estimate of the expenditure ceiling for 2016. The Government intends to propose the same expenditure ceiling for 2016 in the 2013 Budget Bill. It is the Government's view that the expenditure ceiling for 2016 should be SEK 1 153 billion. This is an increase of SEK 30 billion compared with 2015.

The expenditure ceiling is the Government's most important tool for meeting the surplus target, and it should be established at a level

that supports the surplus target and a long-term sustainable fiscal policy.

The estimate of the expenditure ceiling is based on the current forecast for the public finances. Economic developments in the next few years are highly uncertain, and it is important that an uncertain future scope for reform is not committed in advance but that it is always checked prior to each new budget year. The Government gives an estimate of the expenditure ceiling for 2016 which represents a fixed upper limit for expenditure.

For this reason, there should be a margin between between the expenditure ceiling and the estimated expenditure subject to the ceiling, a budget margin. The budget margin must be large enough to manage the uncertainties that exist, given the long time perspective, primarily about cyclical developments. According to the Government's guideline, the margin should for this reason be no less than 3 per cent of the expenditures subject to the ceiling for 2016. The budget margin can also be used for expenditure reforms, provided that this is compatible with the surplus target and the need for a safety margin. But the budget margin should not be larger than needed to allow the expenditure ceiling to function as a real limit on expenditure, given the surplus target and the Government's tax policy ambitions.

The annual increase in the expenditure ceiling for 2016 of SEK 30 billion is about as large as the historical average since 1997. In 2012–2015 the increase has been lower in order to adjust the ceiling because the expenditures subject to the ceiling increased very slowly in 2010 and 2011.

The buffer deemed necessary for 2016 is 6.2 per cent of the expenditures subject to the ceiling. This is more than the guideline for the minimum size of the margin. But it is the Government's opinion that the public finances will improve during the period and the expenditure ceiling for 2016 is expected to provide a stable support for the surplus target.

Table 3.5 Expenditure ceilings 2012–2016*SEK billion, unless otherwise stated*

| | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|-------|-------|-------|-------|-------|
| Government's proposed expenditure ceiling | 1 084 | 1 093 | 1 103 | 1 123 | 1 153 |
| Expenditure ceiling, percentage of potential GDP | 30.6 | 29.5 | 28.4 | 27.5 | 26.9 |
| Expenditures subject to the ceiling | 1 029 | 1 043 | 1 052 | 1 064 | 1 086 |
| Budget margin | 55 | 50 | 51 | 59 | 67 |
| Budget margin, percentage of expenditures subject to ceiling | 5.4 | 4.8 | 4.9 | 5.5 | 6.2 |
| Budget margin, percentage of GDP | 1.6 | 1.4 | 1.3 | 1.4 | 1.6 |
| General government structural net lending, percentage of GDP | 1.2 | 1.6 | 2.1 | 3.2 | 3.7 |

Source: Own calculations.

3.3 The challenges to job growth

The most important aim of the Government's economic policy is full employment. The most important task of employment policy is a sustainable increase in employment. This task has guided the Government in its design of the long-term employment policy and the stabilisation policy measures taken on account of the financial crisis in 2008.

The policy has focused on a combination of measures that stimulate both labour supply and demand. The emphasis has been on measures that increase the labour supply since experience shows that it is the labour supply that in the long run determines employment. The most important measure for increasing the labour supply is the earned income tax credit. The labour market and the education policy have also been reformed with the aim of increasing the employability of people with a weak foothold in the labour market.

So that the measures to stimulate supply lead swiftly to an increase in the number of people employed, they have been supplemented with measures that stimulate labour demand, targeting individuals most detached from the labour market in particular. Examples of such measures are new start jobs, the reduction in employers' social security contributions for young and older workers,

the HUS tax credit (credits for household work)⁴ and the lowering of the VAT for restaurant and catering services.

The reforms result in sustainably higher employment by increasing labour force participation and reducing unemployment and sickness absence among those who have a job.

3.3.1 The reforms have laid the foundation for strong labour market growth

In recent years, there has been good growth in the Swedish labour market, given the unfavourable global economic developments. The downturn that began with the financial crisis in 2008 contributed to the drop in employment. But since 2009, employment has again steadily increased, even though growth temporarily levelled off in the last part of 2011 in the wake of the fiscal problems in several European countries.

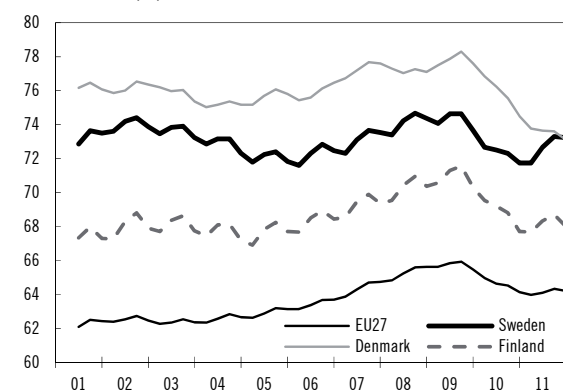
Today the number of employed is higher than before the 2008 crisis. The employment rate, i.e. the percentage of the population who work, has also recovered. Labour force participation fell in the early years of the crisis but has now returned to its pre-crisis levels. Labour force participation has been unexpectedly high compared with previous downturns.

Swedish labour market growth also appears strong in an international comparison (Figure 3.7). In many European countries, the employment rate has not yet begun to increase since the crisis was at its height.

⁴ The HUS tax credit includes the tax reduction for household work (the 'RUT-avdrag') and for repair, maintenance and improvement (the 'ROT-avdrag').

Figure 3.7 Employment rate, international comparison

Per cent of the population



Note: Seasonally adjusted data, three quarters' moving average. Refers to the age group 15-64.
Source: Eurostat.

From a longer perspective, labour market developments have also been positive. Even though the economic situation was significantly worse in 2011 compared with 2006, labour force participation, employment and the employment rate have increased for large age groups in the economy. The employment rate for the population as a whole (aged 15–74) has, however, declined by 0.2 percentage points, but this is because the age composition of the population has changed. Many in the large generation born in the 1940s, a group with a relatively high employment rate, are now retiring (see the box “Demographic changes have an adverse effect on the employment rate”). The percentage of the population who work has increased by 0.8 percentage points. The percentage of people in work has increased more than the employment rate because of the decrease in sickness absence and other factors.

The situation in the labour market is on the whole considerably stronger than might be expected, given the economy and the composition of the population. The Government estimates that since 2006, the number of people in the labour force has increased by over 100 000 more than can be explained by demographic and cyclical developments. Employment has also increased more than can be explained by demography and cyclical developments. The labour supply and the employment growth are indications that the

Government’s reforms have had the intended effect.⁵

3.3.2 Groups with a weak foothold in the labour market are hit by the downturn

Even with these positive developments, unemployment is still high and is expected to increase slightly in 2012. Not until 2014 will the decline in unemployment pick up speed and the economic situation is expected to normalise in 2016, close to 8 years after the downturn began in the wake of the 2008 financial crisis.

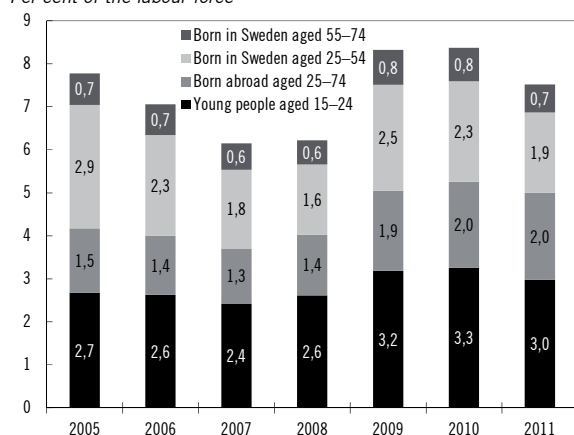
The high unemployment is to some extent the result of an increase in labour force participation but the downturn has also contributed. Temporary high unemployment due to increased labour force participation is less worrisome, as the chances of finding a job are considerably higher for jobseekers than for those people not in the labour force. Unemployment due to a weak economy is considerably more problematic.

Those affected in the downturn are primarily people who are already unemployed and people about to enter the labour market, for example, young people or people born abroad who have only resided in Sweden a short time. This is also confirmed by developments in the composition of unemployment. Unemployed young people and people born abroad make up more than half of unemployment. The proportion has increased between 2005 and 2011 (see Figure 3.8). This is a clear indication that groups entering the labour market bear a disproportionately large and growing share of the costs of unemployment, even though a significant part of youth unemployment consists of full-time students looking for part-time work.

⁵ See Appendix 5 in this bill and Report 2011:1 from the Ministry of Finance’s Economic Affairs Department.

Figure 3.8 The composition of the unemployment

Per cent of the labour force



Source: Statistics Sweden.

Furthermore, the increasing long-term unemployment is a serious problem as the probability of finding a job declines as the duration of unemployment lengthens (see also Section 5 for a more detailed discussion of long-term unemployment). An increase in long-term unemployment risks reducing production potential in the economy and thus total prosperity for a long time to come. For the individual, long spells without work are also critical as they result in lower income and a risk of ill-health. Large differences in various groups' labour market opportunities may also lead to social tensions in society.

In view of this, it is necessary to continue the effort to get more people into work. The incentives to work and job opportunities need to be further strengthened and the functioning of the labour market improved. There must be a special focus on groups which have difficulty getting established in the labour market.

3.3.3 Job opportunities for groups with a weak foothold in the labour market will be strengthened

Some groups have a weak foothold in the labour market. Here are found young people, people born abroad, people with no more than a pre-upper secondary education, older workers and people with disabilities.⁶ One

challenge in particular is to make it easier for these groups to enter the labour market and/or get re-established.

Young people

Unemployment among young people is high, almost 23 per cent in 2011. This can be compared with about 5 per cent unemployment in the age group 25-54. Almost half of youth unemployment consists of full-time students looking for work. The group consisting of unemployed students includes mainly upper secondary school students looking for a summer or spare-time job. It also includes unemployed young people participating in labour market programmes or university students who have begun to look for a full-time job.

Relative to other groups, unemployed young people have a higher level of short unemployment spells. To some extent shorter periods of unemployment in the transition from school to work are a natural part of young people's establishment process. It is considerably more problematic that a group of young people has repeated periods of unemployment before they get a firm foothold in the labour market or that some young people get trapped in long-term unemployment. Young people who have not completed their education, were born abroad or have a disability resulting in reduced capacity to work are most at risk of having employment related problems.

Another explanation for the high youth unemployment is that there have been and are deficiencies in the education system that lead young people to leave upper secondary school without a school-leaving certificate. A further explanation is the compressed wage structure and the relatively high cost of employing young people in Sweden, where starting salaries play an important role. Young people may have problems in the labour market if employers suspect that their productivity is lower than that equated with the prevailing starting salary. Still another explanation is that employment protection is designed in a way that redistributes unemployment between various groups and creates lock-in effects that hamper labour market flexibility. Because of

⁶ For a more comprehensive account of various groups' labour market situation, see Section 5.

stricter employment protection for those with permanent jobs, a larger share of unemployment is borne by groups that have not entered the labour market, such as young people.

In view of this, the Government has taken a number of measures with the aim of combating unemployment among young people. The education system reforms are the most important measure. Their aims include reducing school drop-out rates and increasing the employability of those leaving school. To make the transition between school and working life easier, for example, the upper secondary school has been reformed and an upper secondary apprenticeship programme has been introduced. The Government has also lowered employers' social security contributions for young people with the aims of increasing labour demand and compensating for the relatively high starting salaries. The Government has also revised the labour market policy for young people and introduced the job guarantee for young people. Young people can also get new start jobs, i.e. employers who take on young people who have been unemployed at least six months get a deduction equivalent to the employers' social security contribution for one year. In the box "Reduced wage costs for employers hiring people with a weak foothold in the labour market" in Section 5, there is a more detailed account of various deductions and support measures for employing people with a weak foothold in the labour market. To increase labour market flexibility and thus increase employment, the Government has made it easier for employers to hire on temporary contracts. The Government has also appointed an inquiry to review the possibilities of introducing a new form of employment, trial apprenticeships for young people under the age of 23 (dir. 2011:87).

The Government is seriously concerned about the high youth unemployment. It may be necessary to supplement and strengthen some of the reforms already implemented by the Government. It is particularly important to increase the contacts between the school and working life in general and to strengthen the quality of on-the-job training in particular, so that labour market entry and establishment will function in the best possible way. The

business community, the public sector and the non-profit sector all have important roles to fill in this area, for example, by offering internships and apprenticeships. The Government intends to improve the opportunities for increased employment for young people. This will involve measures in both labour market and education policy, including vocational preparatory programmes and strengthened on-the-job training and entrepreneurship in education.

The foreign born are overrepresented in the group of unemployed young people. As shown below, these young people to a large extent have different problems in getting established in the labour market. Special solutions may therefore be justified for this group.

People born abroad

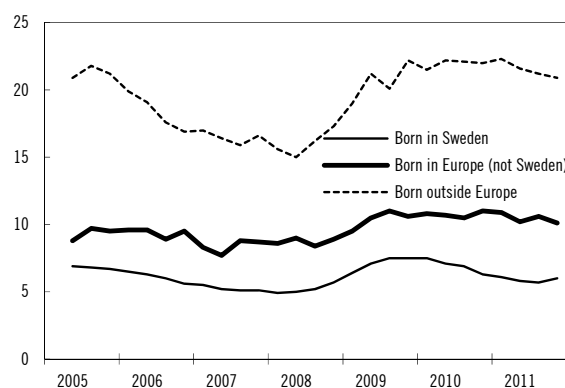
The labour market situation for people born abroad is generally speaking worrisome, even though there is considerable variation within the group. Unemployment among the foreign born averaged 15.8 per cent in 2011. Those born outside Europe had an unemployment rate of about 21.5 per cent and those born in Europe about 10.5 per cent, compared to an unemployment rate of 5.9 per cent for those born in Sweden (see Figure 3.9).

Among those who come to Sweden, there are groups who have difficulty getting established in the labour market. The situation is most difficult for those who have resided in Sweden for a short time and for those with a non-European background.

Having a job is an important part of integration. By working, individuals can also support themselves, contribute to growth and welfare and in this way be a part of society. Sweden should benefit from everyone's talents and contribution to total economic output.

Diagram 3.9 Unemployment by country of birth

Per cent of the labour force



Note: Seasonally adjusted data. Refers to age group 15-74.
Source: Statistics Sweden.

There are several reasons why those born abroad often have difficulty getting established in the labour market. Like young people, people born abroad who have been in Sweden a short time are in the process of getting established in the labour market. That being so, it may be difficult for employers to assess the person's skills. This, in combination with high starting salaries and strict employment protection, may reduce the propensity to hire people from this group. Many newly arrived also have a very limited education and a large percentage of those who have immigrated after reaching the school starting age have major problems getting through their schooling in Sweden. Insufficient knowledge in turn leads to a weak foothold in the labour market. Furthermore, there is also empirical evidence that there is discrimination in the labour market.

Measures to improve integration

The Government has taken a number of measures aimed at improving the labour market integration of people born abroad. A new system to enable newly arrived immigrants to become established in the labour market more rapidly has been introduced in the form of the establishment reform, which came into force on 1 December 2010. The Government has also announced its intention to strengthen the incentives to work by not letting establishment benefits decline to the same extent that incomes increase.

To provide for the skills needed in the business and public sectors, it is also the Government's opinion that it is important to

strive to create good conditions throughout the country that attract people with different backgrounds. Unexploited skills must be put to use. There are step-in jobs and new start jobs for the foreign born who have residence permits as refugees and close relatives of immigrants during their first few years in Sweden.⁷ The Government has also taken measures to improve the validation of foreign education and other vocational skills. Furthermore, the Government has introduced vocationally oriented mentoring. The Swedish for immigrants (SFI) initiative is an extensive measure to teach Swedish to immigrants. The aim of the measure is to improve the quality of the activity and achieve equal standards. The initiative includes skills enhancement for teachers, national final exams and clearer objectives in the curriculum. An inquiry is currently reviewing the scope for greater freedom of choice and individually tailored instruction in Swedish for immigrants by means of an SFI allowance. The inquiry will also analyse the possibilities of combining SFI studies with a job, an internship, vocational education and training and other adult education, and higher education (dir. 2011:81).

The Government is considering improvements to the establishment reform to further facilitate the establishment of newly arrived immigrants in the labour market, for example, by increasing opportunities for internships for individuals and strengthening the incentives for municipalities to shorten waiting times. To help newly arrived immigrants who have a foreign education, further validation initiatives are also possible. The Government also intends to take measures for young people born abroad who neither study nor work. Education is crucial in the long run to improve the labour market situation of people born abroad. The Government wants to improve the chances of pupils who come to Sweden after the school starting age and improve the learning environments in disadvantaged areas.

⁷ An employer who hires a person with a new start job does not pay any social security contribution and thus receives a subsidy equivalent to that contribution. This means that the wage cost of a new start job is practically halved. A step-in job is subsidised employment. All employers who hire newly arrived immigrants can get 80 per cent of the wage in subsidies for up to SEK 800/day.

Possible measures include support for better mapping of newly arrived pupils' knowledge, more teaching time and skills development for teachers. There will also be more initiatives for vocational training and internships.

The Government has appointed an inquiry that will review the possibilities of introducing a system with tax relief for companies in inner city areas with widespread exclusion, called 'new start zones' (dir. 2011:18). The Government has appointed an inquiry on increased labour force participation and more rapid establishment in the labour market among newly arrived women born abroad and relatives of immigrants (dir. 2011:88). The Government intends to examine the possibilities of taking measures to try to prevent women born abroad from being excluded from the labour force for a long time. The interim report, Benefit and trap – parental benefit claims by recently arrived immigrants (Förmån och fälla – nyanländas uttag av föräldrapenning, SOU 2012:9), is under consideration by the Government Offices.

People with no more than a pre-upper secondary education

People with only a pre-upper secondary education are another group that often has difficulties in the labour market. Unemployment is, for example, considerably higher in this group than for people with at least an upper secondary education. In the group, there are not only older workers who entered the labour market directly after compulsory school, but also many young people who have left upper secondary school without a school-leaving certificate.

One reason why people with no more than a pre-upper secondary education have problems is that they to some extent compete for the same jobs as those with more education. Structural change also causes the demand for labour with a limited education to decline over time. There are also indications that for people with low education, current starting salaries limit the possibilities of getting a job. The measures being taken by the Government to improve the education system will reduce the number of drop outs from upper secondary school and increase employability among

those with limited education. Against the background of the 2008 crisis, the Government expanded the number of study places in municipal vocational adult education, vocational colleges and universities and colleges, and in labour market training with the aim that more who are in need of education would get it. Expanding these activities would seem desirable.

Older workers

From an international perspective, older people in Sweden have a high employment rate but it declines rapidly with increasing age. Many older people quit working either with supplementary pension schemes or because of sick leave and sickness compensation. Most people claim the old age pension the year that they turn 65, even though there is no longer any formal retirement age. This probably reflects the extent to which norms govern labour market behaviour.

Unemployment among the elderly is low, but those affected risk long unemployment spells. The reasons for older workers' relatively weak position in the labour market include the employment costs for this group, employers' attitudes towards older workers, the design of agreed pension schemes and the retirement norms. According to the analyses and evaluations that have been made, the most important measure for increasing the labour supply of people over 65 years is the strengthened earned income tax credit for this group. To increase the demand for older workers in the labour force, the special employer's contribution on wages and the tax on income from active business activities have been abolished for people over 65. People aged 55–64 also qualify for new start jobs already after six months and can have a new start job for a maximum of ten years, which is twice as long as for people aged 26–54. The Government intends to return with proposals that further improve the conditions for working to a later age.

People with disabilities

Many people with disabilities are among those most detached from the labour market. It is important to improve the labour market situation for this group. Employers in the private, public and non-profit sectors can all help in this respect. Social enterprises can play an important role here. To increase demand for these people, the Government has increased the maximum subsidy for vocational assistive devices provided by the Public Employment Service and the subsidy for personal assistants. Furthermore, resources for wage subsidies and for Samhall AB have been increased. The Government intends to return with more proposals that will strengthen disabled people's chances of participating in the labour market.

The labour market must be more inclusive

Improving the labour market situation for groups with a relatively weak foothold in the labour market continues to be a major challenge. It is the Government's opinion that the large differences between different age groups as well as between those born in Sweden and those born abroad are unacceptable and reflect structural problems in the labour market.

The labour market needs to be more inclusive so that more people with a weak foothold have a chance of getting a job. Discrimination has to be combated. The labour market also needs to be more flexible in order to try to prevent sharp economic downturns from having sustainable adverse consequences for employment. It is primarily the groups with a weak foothold in the labour market that suffer in downturns. The Ministry of Finance has appointed an inquiry with a remit to review what is required to introduce a system of short-term employment that can be activated the next time a severe economic crisis hits Sweden. The aim is to create incentives for labour force retention in the event of such a downturn.

Labour market developments are greatly influenced by the design of the policy and it is the Government's responsibility to see that it is well designed. For example, taxes and

transfers affect how much it will pay to work. An active business policy is important for jobs and growth throughout the country. The labour market and education policies in turn affect the employability of those in the labour force.

Labour market developments are also affected by the agreements reached by employers and employee organisations. Wage formation is and should be the responsibility of the social partners. The Government takes a positive view of the discussions that have taken place between some of the social partners in recent years, including those about how to make it easier for young people to enter the labour market and how jobs can be retained in severe economic crises. The Government wants to promote further work by all the social partners to find broad agreements that provide places for more people in the labour market or generally improve the functioning of the labour market. The aim of the work is to reduce equilibrium unemployment and increase sustainable employment. It is in this context that the Government invited the social partners to discussions on how to make entry easier for groups with a weak foothold in the labour market.

Combating long-term unemployment

A major challenge is to ensure that the long-term unemployed get the support they need to find a job. Measures are also required to try to prevent more people from becoming long-term unemployed.

As a result of the Government's reforms, many people who were not in the labour market are now looking for work. This is positive as the chance of getting a job is considerably higher for people who are in the labour force than for those outside. But many people who have returned to the labour force have a reduced work capacity and risk long-term unemployment. The prospects of these people finding and keeping a job may therefore need to be further improved.

A well-functioning and effective employment service and unemployment insurance are required to address long-term unemployment. In the 2012 Budget Bill, the Government

estimated that more measures should be taken early in a period of unemployment in order to prevent more people from becoming long-term unemployed. These measures should mainly be in the form of employment services and improved monitoring of the jobseeking activities of the short-term unemployed, but should also include more places in labour market programmes for people who are at risk of long-term unemployment. Experience shows that there are positive effects on the individual's chances of finding a job when employment services are combined with monitoring unemployed individuals' job-seeking. An important task now is to follow up to see that the new way of working has been implemented and is functioning as intended. In addition to ensuring the implementation of these reforms, the Government intends to come back with proposals on how to ensure the Swedish Public Employment Service's effectiveness, governance and control. The Government has given the Swedish Agency for Public Management the remit to analyse the Public Employment Service's use of resources as a basis for making its activities more effective (dnr A2011/3920/A).

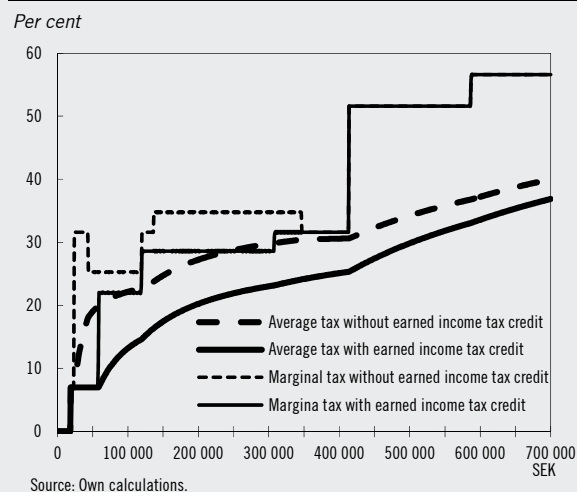
Wage-subsidised employment such as new start jobs is an important instrument in increasing the competitiveness of the long-term unemployed in a labour market with a compressed wage structure and relatively high starting salaries. The Government has taken a number of measures to reduce employment costs for people with a weak foothold in the labour market (see the box "Reduced wage costs for employers hiring people with a weak foothold in the labour market" in Section 5). Regarding subsidised employment, the Government intends to come back with proposals aimed at increasing the number of transitions to unsubsidised jobs and increasing employers' willingness to use subsidised employment. It also continues to be important that the design of the job and development guarantee is appropriate. For example, individuals must be offered suitable assistance and their willingness to work monitored regularly. The long-term unemployed with limited education may also be in need of further education in order to become competitive in the labour market.

What effects does the earned income tax credit have on employment?

To increase sustainable employment and reduce exclusion, there has been an earned income tax credit since 2007 that makes it more worthwhile to work. The earned income tax credit is the biggest tax change in the Swedish tax system in terms of the amount involved since the 1990–91 tax reform and in net terms, somewhat larger than the compensation for national pension contributions gradually introduced in the years 2000–2006⁸. Sweden is not alone in having reduced the tax on earned income. Tax rules more or less like those for the Swedish earned income tax credit can currently be found in 17 OECD countries.

The earned income tax credit has reduced the average tax the most for those with low incomes. Figure 3.10 shows how the earned income tax credit has lowered the marginal tax and the average tax on earned income for people under 65. For broad income groups, from about SEK 135 000 to about SEK 300 000 per year, the marginal tax has been reduced by about 6 percentage points and the average tax by about 7 percentage points.

Figure 3.10 Marginal tax and average tax with and without the earned income tax credit for people only earned income, indexed base rate for 2012



The Riksdag has made known to the Ministry of Finance its opinion that the earned income tax credit needs to be thoroughly evaluated and weighed against other reforms with a similar effect.⁹ For this reason, the Ministry of Finance has had an evaluation made of the earned income tax credit, which is reported in Appendix 5.

A summary of the principal conclusions of the evaluation follows.

Indications that employment has increased as a result of the earned income tax credit

An earned income tax credit helps increase both labour supply and demand. Household disposable income rises as a direct result of the earned income tax credit and leads to an increase in household demand for goods and services. At the same time, the earned income tax credit, which increases the return on work, contributes to more labour market participation and a greater propensity for the unemployed to look for work. All in all, the increase in the labour supply and labour demand leads to higher sustainable employment and lower equilibrium unemployment.

The evaluation notes that there are several indications that the earned income tax credit has already had positive effects on the labour market. For example, labour force participation in Sweden has increased strongly in recent years both from a historical perspective and in

⁸ The size of the compensation for the national pension contributions is estimated based on the net cost of the reform, taking into account that the compensation entailed the abolition of the tax deduction for the national pension contribution. It is also reasonable for reform costs to include the threshold adjustment that was made so that the number who pay state income tax would not change. With this taken into consideration, the value of the reform in 2012 is estimated at about SEK 70 billion, compared with the forecast for the earned income tax credit which is almost SEK 80 billion in 2012. As a percentage of public sector tax revenue, the corresponding figures are 4.4 per cent and 5.2 per cent respectively.

⁹ Bet. 2010/11:FiU20, rskr. 2010/11:319.

comparison with other countries. Since 2006, the number of people in the labour force has increased by over 100 000 more than can be explained by demographic and cyclical developments.

Employment has also increased strongly compared with other countries in 2006–2011. Like the labour force, both employment and average hours worked have increased more than can be explained by changes in demographic factors. A further indicator that points to the occurrence of a structural change in the Swedish labour market is that the historical relationship between GDP growth and unemployment has been temporarily changed. Unemployment is substantially lower than what would be expected based on the historical relationship between GDP growth and unemployment.

Furthermore, the evaluation points to the earned income tax credit's positive effects on employment among older workers. Estimates for 2004–2009 clearly show that employment has increased among those entitled to the higher earned income tax credit (individuals 65 and older) compared with those not entitled to the more generous earned income tax credit. The results should primarily be seen as evidence that the earned income tax credit, combined with the concurrent reduction of the social contributions for older workers, has increased employment among older people. But the results are also an indication of the positive effects on the labour supply in general.

Empirical studies indicate that the effects of the earned income tax credit can be substantial

There are a large number of empirical studies on how taxes on earned income affect the labour market. The overall assessment from these studies is that a tax reduction on earned income, such as the earned income tax credit, leads to an increase in labour force participation and lower equilibrium unemployment. Based on the studies reported in the evaluation, the earned income tax credit is expected to increase employment by 70 000 to 140 000 people in the long run, while the number of hours worked will in the long run increase by the equivalent of 93 000 to 186 000 annual work units. The evaluation also reported new estimates based on Swedish data for 1994–

2011, which indicate that lower income taxes lead to higher sustainable labour force participation and lower equilibrium unemployment. The estimated effects are in line with previous international empirical studies and thus reinforce the conclusion that the employment effects of the earned income tax credit should be substantial.

Previous assessments remain valid – the earned income tax credit is expected to increase employment

Because of the relatively short time that has passed since the introduction of the earned income tax credit, the long-term effects still cannot be evaluated using outcome data. The Government's current assessment that the earned income tax credit in the long run leads to an increase in employment of 105 000 people and the number of hours worked increases by an equivalent 120 000 annual work units is therefore based on a simulation model. The results from the empirical studies reported in the evaluation are, however, also in line with simulation results, which support previous estimates.

The evaluation also shows that studies on international data of various effects of the earned income tax credit where both simulation studies and evaluations of outcome data have been used generally yield very similar results. This indicates that simulation studies are a good method for estimating the long-term effects of tax reforms.

Several external analysts have also employed simulation studies. The results of these studies are generally in line with the Government's analysis. Some of these studies are reported in Table 3.6 together with the results from the evaluation. The results from more external analysts are reported in Appendix 5.

Table 3.6 Estimated effects of the earned income tax credit

| | Annual full-time equivalents |
|---|------------------------------|
| <i>Results of the Government's evaluation</i> | |
| Ministry of Finance microsimulations | 120 000 |
| Estimate based on empirical studies | 93 000–186 000 |
| National Audit Office | 100 000 |
| SNS Economic Policy Group | 70 000 |
| National Institute of Economic Research | 90 000 |

Sources: Various analysts.

The earned income tax credit is an effective reform compared with other tax reforms

The evaluation also shows that the earned income tax credit can be expected to have a substantially greater employment effect per krona spent than other potential changes in the tax rules. This is primarily because the earned income tax credit is more effective compared with other tax changes in increasing the economic incentives to begin working for those excluded from the labour market. At the same time it is expected to lead to lower equilibrium unemployment. Based on Sweden's relatively high tax burden, low labour force participation in some groups and results from the simulation model, it is also the Government's view that further earned income tax credits can also provide significant employment effects.

Conclusion

The conclusion of the evaluation is that the earned income tax credit has significant positive effects on employment through the increase in labour force participation and lower equilibrium unemployment. This confirms the previous assessments of the earned income tax credit. It also confirms that a further step in the reform would provide significant positive employment effects.

In light of the evaluation made of the earned income tax credit, the opinion announced by the Riksdag has been addressed.

3.4 Challenges to welfare

The Government's aims of achieving ambitious distribution objectives and maintaining well-functioning welfare systems accessible to everyone make maintaining and enhancing the public welfare systems important. Minimising the risk of people becoming trapped in poverty without the possibility of earning a living should also be an aim. Nor should there need to be any doubt about the quality of publicly financed welfare services, regardless of who performs them.

3.4.1 Improving self-sufficiency for low-income groups

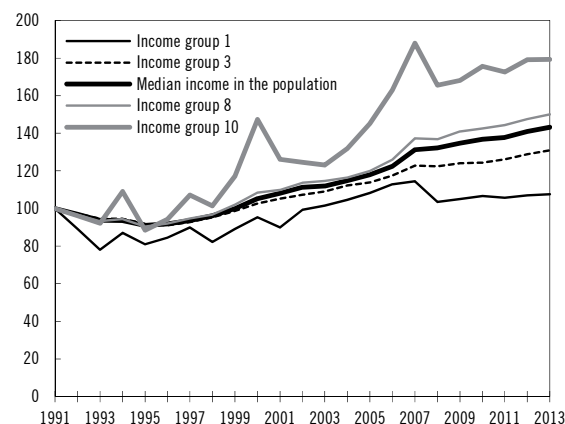
Sweden has one of the most even income distributions in the world. From an international perspective, intergenerational income mobility in Sweden is high, i.e. there is a relatively weak connection between parents' incomes and children's (long-term) incomes. But as in many other countries, income inequality has increased in the last 20 years (see Figure 3.11). One basis for the Government's economic policy is that growth will benefit everyone. Over time, the real income level has risen for all income groups.¹⁰ For groups with the lowest incomes, income groups 1–3, economic standards have, however, grown more slowly than the median income in the population.

There are probably several reasons for the relatively weak income growth in the lower part of the income distribution since 1991. One important contributing factor is that the principal means of support for many individuals in the lower income groups does not come from work. Transfer payments and allowances have grown more weakly than wages in the past 15 years. The trend increase in the percentage of foreign born in Sweden has also contributed to an increase in income inequality. As people born abroad find it particularly difficult to enter the

labour market, many have ended up in benefit dependence. This situation is reflected in the sharp increase in the number of foreign born in income group 1 between 2006 and 2010. Almost all the increase can be attributed to immigrants who have resided in Sweden a short time.

Figure 3.11 Real income growth for different income groups

Per cent, index 1991=100



Sources: Statistics Sweden and own calculations.

Income inequality in society declines when more people work and fewer are supported by social benefits. The best income distribution policy is therefore to get more people working. Since taking office in 2006, the Government has pursued a policy to make it more worthwhile to work. The earned income tax credit and the changes in the unemployment insurance and the sickness insurance reduce thresholds for labour market entry and stimulate the labour supply. These reforms are expected to lead to strong income growth, particularly for those with low incomes. The Government during its current term of office has also taken measures to improve standards for those groups who despite better opportunities to earn a living have a weak financial position. These measures include an increase in the housing allowance for young people without children and for families with children, an increase in study support, and a higher housing supplement and a higher basic tax allowance for pensioners. The direct effect of these reforms is expected primarily to benefit people in the lower part of the income distribution.

The aim of the Government's policy will continue to be to reduce exclusion and increase the degree of self-support in groups at the bottom of the income distribution. A remaining problem is that for recipients of

¹⁰ All individuals are ranked according to income and divided into ten income groups with an identical number of observations made in each group. Each income group thus comprises 10 per cent of the population. The first income group consists of the lowest income decile and the tenth income group consists of the highest income decile.

minimum income benefits, it is seldom worthwhile to work or to increase the number of hours worked when increases in incomes reduce the financial assistance by a corresponding amount. The Government therefore intends in 2013 to propose that the calculation of minimum income benefits be changed so that only part of the earned income affects the right to financial assistance. The aim is to reduce the marginal effects and strengthen the incentives to work and make it possible for more people to influence their financial situation. The Government is further considering strengthening local governments' possibilities of setting the same requirements for participation in skills enhancement measures for recipients of minimum income benefits for those aged 25 or over as they do for those under 25. In addition, measures directed at particularly vulnerable groups may be required.

3.4.2 Increase availability, safety and efficiency in health care and social services

The Government wants to create conditions for health and medical care of good quality, based on the needs and wishes of each patient. Health and medical care will be adapted to individual needs, accessible and effective and maintain high quality, irrespective of income and background.

Swedish health and medical care achieves good medical results in international comparisons. The Government wants to continue to improve access to health care and strengthen patient safety. An ageing population and an increased need for health care and social services will bring additional challenges for health and medical services and elderly care.

Having many different providers in the welfare sector increases the freedom of choice and supply for users of health care and social services. For personnel, this means a broader labour market and greater opportunities for personal development. In the next few years, the Government's policy will focus on measures that facilitate integrated health care and social services for older people with extensive needs, raise the competence of

elderly care workers and increase freedom of choice and diversity. State funds have been allocated for more local governments to introduce freedom of choice systems in elderly care and local dignity guarantees.

A number of measures have recently been implemented to increase the accessibility, effectiveness and quality of care. In 2011 SEK 500 million was spent aimed at achieving safer health care and more active work on patient safety through such measures as a performance-based remuneration model for work on patient safety. The 'waiting list billion', i.e. the performance-based benefit paid to county councils that meet targets and provide patients with a visit or a treatment within 60 days, will lead to reduced waiting times. Furthermore, the Government will continue its work to improve psychiatric services.

The pricing model for pharmaceuticals is currently being reviewed (dir. 2011:82). It is essential that Sweden not pay more for pharmaceuticals than other comparable countries. An agreement with the local government sector is being sought with the aim of transferring the targeted grants for pharmaceutical benefits to the general government grant. This reform would contribute to a more efficient use of public expenditure on pharmaceuticals.

The Health Care Fees Inquiry (Vårdavgiftsutredningen) has proposed indexing the cost ceiling for primary care visits and pharmaceuticals (SOU 2012:2). Raising the inpatient fee has also been proposed. The Government intends to come back to the Riksdag with proposals in this area.

A reform that improves the chances of good dental health for vulnerable groups will be implemented.

The Swedish Agency for Health and Care Services Analysis has been established with the remit to follow up and analyse activities and conditions in health care and social services from a patient, user and public perspective.

Elderly care

The Government's objective is for older people to be able to lead an active life and have influence in society and over their own daily lives, to be able to grow old in security while preserving their independence, to be treated

with respect, and to have access to health care and social services of a high standard. Older people should have the right to grow old with dignity. The 2012 agreement between the central government and the Swedish Association of Local Authorities and Regions concerning integrated health care and social services regarding the most infirm emphasises the need of integrated approaches in health care and social service activities. In 2012 the agreement contains over SEK 1.1 billion, including performance-based compensation to municipalities and county councils that reduce the occurrence of avoidable inpatient care and the use of inappropriate drugs or drug combinations.

To meet increased health care needs and maintain good quality in health care and social service activities, regular follow-up and evaluation of these activities are needed. Since 1 January 2010, the National Board of Health and Welfare has been responsible for all state supervision of social services and health and medical care. Responsibility was previously scattered over other actors, including the 21 county administrative boards. In conjunction with this reform, extra resources were also allocated to supervision. But an evaluation indicates that there are still shortcomings even in the new organisation. The Government intends to come back with proposals on how supervision can be further improved.

In December 2011 the Government gave the National Board of Health and Welfare a remit to look into whether there are systematic quality differences between public and private elderly care (dnr S2011/11253/FST). Thus far the state-run supervision has not been able to find any such differences. Its report is to be submitted to the Government no later than 31 May 2012.

The goal of achieving good quality in health care and social services requires the observance of strict requirements in the procurement process. When the local government sector procures these services, it is important that contracts ensure the maintenance of good quality in health care and social services. To strengthen procurement procedures, the Government has given the National Board of Health and Welfare the remit to draw up a basis that will serve as a guide in the procurement and follow-up of local

government health care and social services for older people (dnr S2011/11073/FST). The inquiry report is to be submitted to the Government no later than 31 January 2013. Another way of promoting good quality is to replace the procurement model with freedom of choice on the part of the individual recipient of health care and social services, which the Act on Free Choice Systems (2008:962) makes possible. The Government is also striving to improve opportunities for small market participants such as non-profit organisations.

The Government has also recently referred for consideration a proposal to come to grips with tax planning through interest deductions, which occurs in the tax-financed welfare sector, among others. The intention is to strengthen the requirements so that all companies operating in Sweden will be taxed on the same terms. The intention is for the proposals to enter into force on 1 January 2013.

3.4.3 An effective justice system for security

The Government wants to create a justice system that makes society more secure for everyone. Its objective is to improve crime prevention and solve more crimes and bring more criminals to justice. The public response to repeated offences will be stern. In 2010 the penalties for serious violent crimes were tightened as part of a general increase in punishments for gross assault and extortion, gross offence and for gross manslaughter. The general increase in penalties also covers sexual offences.

The justice system has received significant additional funding since the Government took office in 2006 and set about strengthening the entire justice system, from the police and prosecutors to the courts and the Prison and Probation Service. Given these initiatives, however, there must be further improvements in results.

The Government's work to ensure an effective justice system continues. It intends to carry out reforms that prevent crime and lead to rapid, explicit and consistent responses to crime. The Government intends to return in the 2013

Budget Bill with proposals for further measures in this area, which can be summarised under three themes: tougher penalties and measures, early and clear measures against young people who commit crimes and a more effective justice system. In this work, the Government is considering proposing the abolition of the automatic deferral of a prison sentence in connection with an application for a pardon and stricter rules on weapons possession. The Government also intends to present proposals for measures to shorten processing times for cases concerning young offenders, for work with young people aimed at preventing recidivist behaviour and with social intervention units where several agencies cooperate to help young people who are at risk of recruitment by criminal networks or want to drop out of a criminal network.

In addition, the Government will propose that there be changes in the police service's organisation, that those convicted of a crime be able to serve their prison sentence and other penalties in their home country to a greater extent than is currently the case and changes in the penalties system. The Government also intends to continue its work on the justice system's information provision.

3.5 Challenges to enhance competitiveness

3.5.1 Higher quality throughout the education chain

It is vital for economic growth and prosperity to maintain a high standard of education and research.

High quality higher education and research are essential in order for Sweden to have internationally competitive firms. A basic education will make it possible for everyone to actively participate in society and make decisions about their lives. By improving the individual's knowledge and abilities, the education system plays a crucial role in people's chances of getting a job or earning a living from entrepreneurial activities. A well-functioning education system contributes to increased productivity and employment in society as a whole and is thus a

prerequisite for economic growth and growing prosperity.

The Government has high ambitions for education

Sweden devotes large resources to education and the ambition is to have an education, innovation and research system which is among the best in the world.

The education system functions well in many respects. Most children take part in preschool activities and the preschools are of a consistently high quality internationally. Compulsory schools are relatively equal, with relatively small differences between schools compared with many other countries. A very large percentage of pupils begin upper secondary school and the percentage of young people who go on to university is high. Swedish adult education is extensive in an international perspective and has for a long time meant a second chance for many people to get an education. For many immigrants to Sweden, adult education has provided an important chance to get an education and thus a way to get a job. Post-secondary vocational education and training within the framework of the vocational college has been developed over a number of years and most often leads to a job once training has been completed. In recent years the focus has been on increasing the quality of higher education programmes. Study support has also been increased on two occasions. Swedish research is of consistently high quality with a large percentage of doctorates completed every year and a large number of articles published in international publications.

The opportunity to choose an independent school gives everyone regardless of their financial situation the possibility of choosing a school that suits their needs and rejecting a school that does not function well. There are many indications that the increased competition has had positive effects on education results, even in municipal schools. The freedom of school choice reform has increased the possibilities of drawing up special pedagogical profiles or teaching in the mother tongue for national minorities. For teachers and other school staff, the freedom of school choice

reform has led to more employers to choose from. The Government attaches great importance to follow-up and review of activities to ensure quality in education by both municipal and independent providers. The National Agency for Education and the Swedish Schools Inspectorate have played important roles in this work. At the same time, there are signs of problems in some parts of the education system.

Results have deteriorated

In international comparisons made in the mid-1990s, Swedish pupils in years 7–9 had good results. Since then, however, proficiency, particularly in mathematics and science, has deteriorated. At the same time, average grades have risen, which may indicate a certain amount of grade inflation. There are also indications that the grade spread has widened between schools.

The many drop-outs are another sign of shortcomings in the schools. More than one in ten compulsory school pupils do not qualify for upper secondary school, and of the pupils who do begin upper secondary school studies, only about two thirds complete their studies on time. This has, in turn, consequences in the form of increased youth unemployment (see Section 5). Children who immigrated to Sweden after they had passed the school starting age, particularly those who arrived when they were 13 or older, are at risk of having special problems coping with school. In 2010, the percentage of pupils eligible for upper secondary school after compulsory school came to 44 per cent for the group born outside the EU/EFTA and about 65 per cent for the group born in the EU/EFTA. For those born in Sweden, it was about 90 per cent.

Shortcomings in the schools have repercussions for higher education and in the labour market. For students who do not begin or break off upper secondary school vocational programmes, the step from school to working life may be too big. This can be explained both by the many who leave the vocational programmes without a school-leaving certificate and by the schools' failure to adequately prepare students for the labour

market. For those who go on to higher education from the academic preparatory programmes, an inadequate grounding, particularly in mathematics, is a problem.

In higher education, the school completion rate is a problem; Swedish students are comparatively old when they begin university studies and they remain at university longer. But as a result of changes in admissions rules, the age of those beginning university has fallen. Swedish research has for a long time had a strong international position. However, there are worrisome signs that Sweden's position in research has weakened relative to other comparable countries.

Students worse off to begin with are affected most

There is no one explanation as to why results in Swedish schools have worsened. Several different factors have probably contributed.

Under the reforms implemented in the 1990s, the intention was to replace the previous system, which had a high degree of micromanagement, with management by objectives. But this change was not implemented consistently, both because the objectives in the syllabus and curriculum were unclear with several different levels of objectives and because no system for following up students' results was established. Nor had an effective control system been introduced to enable the school authorities to use sanctions on schools that failed to achieve objectives. Together with a trend that had begun a few decades earlier, with less focus on grades and uniform national tests, this likely contributed to insufficient focus on knowledge and thus to worse results.

Also as a result of the economic crisis in the 1990s, there were fewer resources for schools. At the same time, the number of pupils in each year group increased, after a declining trend since the end of the 1970s. Research has not shown any obvious relationship between resources and results, but it is reasonable to believe that a relatively drastic reduction in resources per pupil would have adverse consequences.

One explanation put forward as crucial is that teaching has changed and students to a greater

extent work independently and without sufficient teacher support. Pupils receive less structured teaching. This development has probably mainly put pupils in particular need of support at a disadvantage.

Teachers and head teachers are critically important to students' results. Given this importance, the shortcomings in head teacher training and insufficient focus on the role of the head teacher as pedagogical leader have been pointed out as factors in the falling school results. Teachers' declining status and weak wage growth have also been pointed out as explanations. Recruitment to the teaching profession has thus become more difficult. Changes in teacher training may also have had an adverse effect on results by weakening the teaching profession's subject knowledge and knowledge of methodology. Not least, some studies show that teacher training has not provided the skills needed in reading and writing pedagogy. Training in special needs education has also been criticised for not providing the skills that the schools needed. The sharp increase in the percentage of teachers who either are unqualified or teach subjects that they are not qualified to teach may also have been a negative factor in the results.

Measures for those who need extra support are also inadequate in the sense that the support tends to be started too late. Whereas the special needs measures in Finland focus on younger children, the support in Sweden instead tends to increase with age.

A focus on strengthening education and research policy

Since the Government took office, it has taken a large number of reforms to come to grips with the problems in the education system (see the box "The Government's reforms to improve quality in education"). The universal preschool has been expanded and measures targeting children who need extra support have been implemented. Monitoring results in compulsory schools has been improved by introducing mandatory national tests in several subjects and several grades. Initiatives have also been taken to strengthen teaching in mathematics, science and technology. A major initiative in upper secondary school

apprenticeship programmes and adult education is also under way. Substantial resources have also been allocated to increase teachers' skills and status. The upper secondary school and teacher training have been reformed and measures taken to increase the quality of university and other higher education. Extensive resources have been allocated to research and companies' right to deduct research and development expenses has been broadened, while the expert tax has been simplified with the aim of attracting foreign expertise.

The Government is seriously concerned about the problems in the education system and will continue its extensive and long-term work begun during its previous term of office to improve various parts of the system. Its goal is to improve the quality throughout the education chain. The transition from school to working life needs to be further strengthened. This involves such matters as improving the quality of upper secondary school vocational training with a focus on on-the-job training. The status and the attractiveness of the teaching profession also need to be improved by such means as new career paths. Swedish research has long had a strong position internationally. But there are indications that Sweden's prominence has weakened. With the research and innovation bill presented by the Government in 2008, substantial new resources have been allocated to Swedish research. Systemic changes have also been implemented to increase the incentives for high quality in research. But in order for Sweden to retain its strong international standing, further measures are needed to strengthen the quality of Swedish research. A research and innovation bill will be presented to the Riksdag in autumn 2012. It will include a review of the mobility between various academic institutions and between academic institutions and the business community/society. Furthermore, the system for skills provision will be reviewed and the incentives for high quality research will be strengthened. These are also core issues in the innovation strategy that the Government will present in the autumn.

The Government's reforms to improve the quality of education

Education is essential both for an individual and for society in general. A good school makes up for differences in students' living conditions and opportunities and constitutes an important basis for students' future prospects. Society also has much to gain from education. Higher productivity and higher employment will improve the conditions for economic growth and increase common welfare. The availability of a skilled workforce and high quality research are also important prerequisites for ensuring competitiveness in the Swedish business sector.

Since the Government took office in 2006, it has worked intensively to remedy deficiencies and strengthen quality throughout the education chain. Initiatives taken have included facilitating the transition from school to working life and improving students' results. A number of measures have been taken to strengthen teachers' skills and teaching quality. For example, the follow-up of results has been improved. Special initiatives have been implemented to support students with special needs. There have also been initiatives in higher education and resources have been allocated to research. The following is a report of the principal measures.

School reforms

- A new education act came into effect on 1 July 2011 and applies to large parts of the education system. The act contains a number of changes to put more focus on knowledge, freedom of choice and security. The preschool will be a distinct form of school.
- The Swedish Schools Inspectorate has been allocated resources and a new sanctions system has been introduced to increase and improve state supervision and ensure that the conditions stipulated for running a school are observed.

Initiatives to improve teachers' skills

- New teacher training has been introduced.
- To improve the attractiveness of the teaching profession, a certification system for teachers and preschool teachers will be introduced. The Government also plans to introduce a system starting in 2013 with new career paths for teachers.
- The teaching skills of preschool staff have been strengthened by continuing education measures in the "Boost for Preschool Teachers," which was introduced in 2009–2011. An additional initiative has been decided that will extend from 2012–2014 and which includes skills development for preschool teachers and preschool directors.
- The skills enhancement initiative for teachers, which is the Government's continuing education initiative for teachers with a teaching degree, continues. The teachers who have had the opportunity to participate in the measure indicate that the continuing education has deepened their knowledge and that in many cases it has also led them to make changes in their teaching.
- The skills enhancement initiative for teachers II is a continuation of the original skills enhancement initiative for teachers, but its aim is for teachers to become qualified in all school forms, subjects and grades that they teach. The measure will also cover education in one or two practical or aesthetic subjects for recreation instructors so that they can become qualified teachers.

Preschool initiatives and pedagogical childcare

- The pedagogical tasks of the preschool have been strengthened by making the curriculum clearer with new goals for developing children's language and mathematical skills and for science and technology. Preschool teachers' pedagogical responsibility has also been clarified and new sections on the preschool director's responsibility and on follow-up, evaluation and development have been added.

- A childcare voucher system was introduced in 2009 with the aim of increasing the possibilities of starting independently run pedagogical childcare. The childcare voucher provides scope for both the family day care home and other alternative providers in forms as yet untried.
- Municipalities' obligation to set up public preschools was expanded on 1 July 2010 to apply to all children beginning in the autumn term of the year that the child turns three.

Compulsory school initiatives

- New curricula have been introduced in all subjects in order to clarify objectives and knowledge requirements.
- A new grading scale with more levels for more accurate grades was introduced in the autumn 2011 term. Grades have also been introduced starting in grade 6, beginning in autumn 2012.
- In May 2011, the Government approved the introduction of additional national tests. Beginning with the academic year 2013/14, tests in the natural sciences (chemistry, physics and biology) will also be introduced in grade 6 and national tests in the social sciences in grades 6 and 9.
- All students, including those with disabilities, will have the opportunity to choose the school that best suits them. The Government has re-established state-run special schools for students with impaired vision and other disabilities and for students with serious speech impediments.
- The Government has introduced a special initiative for the basic skills of reading, writing and arithmetic.
- An initiative on mathematics teachers skills and increased teaching time in mathematics, the Maths Boost, will be implemented.

Initiatives in the upper secondary school

- From autumn 2011, all educational content in the upper secondary school has been modernised and quality assured

nationally. Eligibility requirements for the national programmes have been tightened so that students will be better prepared for requirements in upper secondary school. The content in the national programmes has been streamlined and in the preparatory programmes for post-secondary education, the requirements are higher than before, such as studying more Swedish. The knowledge requirements have also been clarified.

- In the upper secondary school vocational programmes, the time spent to go deeper into vocational subjects has been increased and the programmes have been adapted to meet the needs of the labour market and to better prepare students for running their own business.
- Apprenticeship training has been introduced in the upper secondary school and requirements for on-the-job training have been clarified.
- An upper secondary school certificate has been introduced, which can serve either as a vocational qualification or as a preparatory qualification for higher education.
- The same provisions for the governing bodies of municipal and independent schools have been introduced.
- The evaluation of university applicants' qualifications has been changed. This has made in-depth studies in mathematics and languages more common in upper secondary school.

Adult education initiatives

- To ensure the quality of non-academic post-secondary vocational education and training programmes outside universities, the National Agency for Higher Vocational Education was established on 1 July 2009.
- In the light of the financial crisis, large temporary initiatives have been carried out since 2009 to create more study places in adult vocational education and training (adult vocational education and training at the municipal level and vocational colleges).

- An initiative for adult apprentices under way in municipal adult education has about 5 900 full-time equivalent places in 2011–2014.

Folk high school and other education initiatives

- In 2007 the appropriation for folk high school education was raised with the aim of strengthening the activities of study associations and folk high schools.
- Unemployed young people will be given the opportunity to study motivational courses in the folk high schools.

Higher education and research initiatives

- Higher compensation amounts have been introduced for the humanities, the social sciences, law and theology with the aim of increasing teacher-led instruction.
- Tuition fees for students from outside the EU have been introduced.

- Under proposals in the bill A Boost to Research and Innovation (Ett lyft för forskning och innovation) (Govt. Bill 2008/09:50, bet. 2008/09:UbU4, rskr. 2008/09:160):

1. SEK 5 billion, the highest funding increase ever, was allocated to research.
2. there was a special initiative in strategic research, medicine and life sciences, technology and climate.
3. a new resource distribution model based on allocation according to quality was introduced.

Study support reforms

- Beginning 1 January 2010, the amount of study support was increased by SEK 431 per month of studies and by a further SEK 498 from 1 July 2011. As a result of the reforms, study support now comes to SEK 9 400 per month of study for full-time studies.
- The exempt amount has been raised from about SEK 107 000 to SEK 136 400.
- A temporary measure is under way whereby unemployed young people aged 20–24 who have not completed their compulsory or upper secondary education can under certain conditions get the higher study support benefit level if they resume regular studies.

3.5.2 Entrepreneurship and the business climate

Sweden is to be one of the best countries in the world in which to start, run and grow a business. Sweden needs more women and men who see entrepreneurship and enterprise as an obvious choice.

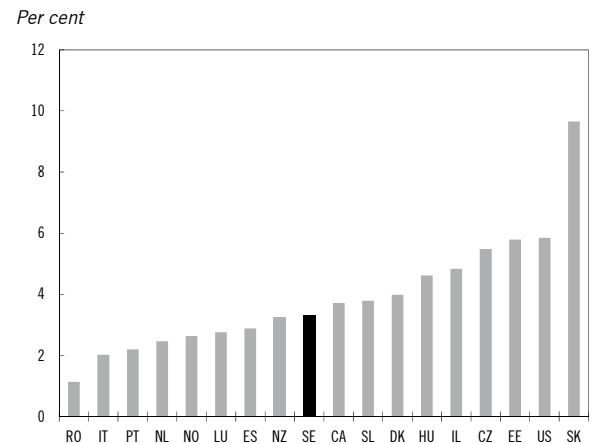
A good ability to adapt on the part of both business and the workforce is essential for economic recovery, competitiveness and long-term economic growth. Businesses and individuals must have the opportunity and the ability to keep adapting to new circumstances. This in turn requires a good business climate that promotes entrepreneurship, innovation and investment. A dynamic business sector where new companies are developed and expand is an important part of structural change and contributes to higher productivity and enhanced competitiveness.

Barriers to starting and developing businesses should be as low as possible as this contributes to competition and renewal in the business sector. According to OECD measurements of barriers to entrepreneurship in 2008, Sweden is very well positioned among OECD countries, in third place after the United Kingdom and the Netherlands.¹¹

Business starts and growth are an important part of a dynamic business environment. In a comparison of OECD countries, Sweden comes somewhere about the middle with respect to the percentage of rapidly growing companies (see Figure 3.12).¹²

The structure of the business sector can to some extent explain why Sweden is not among those countries with a large percentage of growth companies. Swedish base industry requires very extensive and long-term investment in production facilities and technology in order to create competitive companies. At the same time a positive trend can be seen in young people becoming entrepreneurs, women entrepreneurs and the number of start-up companies.

Diagram 3.12 The share of growth companies in some OECD countries 2007



Note: Refers to manufacturing companies with at least 10 employees at year of start-up. The share as a percentage of all manufacturing companies with 10 employees. Data for Norway refer to 2006 and data for Israel to 2008. Data available for 18 OECD countries.
Source: OECD (2011), Entrepreneurship at a glance.

The Government's efforts to create better conditions for entrepreneurship and innovation continue. The Government's tax policy, initiatives in education, research, innovation, technology, administrative simplification and infrastructure, and improvements to make the labour market function better mean better conditions for entrepreneurship, thus enhancing competitiveness and productivity in the business sector. In 2012 the Government will submit a research and innovation bill to the Riksdag and present an innovation strategy aimed at further improving the conditions for innovation and modernisation in the business sector, the public sector and civil society.

The Government intends to reform the state venture capital system. This will include clarifying its role as a supplement to the market and strengthening the conditions for the commercialisation of knowledge-intensive ideas at an early stage. In its 2012 Spring Budget Amendment Bill (Vårändringsbudget) (Govt. Bill 2011/12:99), there is a proposal for procedures for the establishment of a common organisation covering the activities of Almi Företagspartner AB and Innovationsbron AB as announced in the 2012 Budget Bill. The Government will also review the possibility of coordinating state initiatives on venture capital for companies in growth phases and come back with proposals in the 2013 Budget Bill.

¹¹ OECD (2008), Indicators of Product Market Regulation (barriers to entrepreneurship).

¹² Refers to employment growth of at least 20 per cent a year among companies with at least 10 employees at year of start up. The percentage of companies with at least 10 employees.

Good tax conditions for entrepreneurship, investment and employment

The Government has worked for a long time to improve the tax environment for existing companies and facilitate the establishment of more and growing companies. The wealth tax has been abolished and the corporate tax, employers' social security contributions and individual contributions have been lowered. The tax for qualified owners of close companies and for the self-employed has also been lowered. The earned income tax credit, the introduction of the tax reduction for household work (RUT) and for repair, maintenance and improvement (ROT) and the reduced VAT on restaurant and catering services have improved the conditions for entrepreneurship.

The Government will continue this work and its ambition is to further improve the business climate and the conditions for entrepreneurship, investment and employment in Sweden. A strategic part of the work will be done by the Corporate Tax Committee (Företagsskattekommittén) (dir. 2011:01). The Committee has a broad remit and by the end of 2013 will have submitted three reports.

As a first step, the Committee has recently submitted an interim report on tax incentives for venture capital (SOU 2012:3). The report contains two proposals, a venture capital deduction at the ownership level and an emissions credit at the corporate level. Both proposals aim at addressing the difficulties new start-ups and smaller, growing companies may experience in finding external financing of their activities. The proposal has been referred for consideration and the Government will come back to this matter in the 2013 Budget Bill.

As a second step, the Committee is to consider the possibilities of introducing tax incentives for research and development. A report on this matter will be submitted no later than October 2012.

The Committee's main task concerns the possibilities of reducing the taxation of equity capital in the corporate sector and levelling the playing field for equity financing and borrowed capital. Underlying this remit is the growing tax competition in the corporate sector evident by the number of countries that

have lowered their corporate tax rate, or plan to do so. Because of the global tax competition, tax planning increases when companies with international operations and other institutions exploit the lack of uniformity that exists between the tax systems in different countries.

Also included in the Committee's remit is to propose measures that broaden the tax base to make lowering the taxes paid by the corporate sector possible. Changes will be made in a way that will mean good tax conditions for entrepreneurship. Investment and employment will be encouraged and firms' financial resilience will be strengthened. The Swedish corporate tax will remain competitive and generate stable tax revenue. The Committee will also review the rules on group contributions and underprice transfers and analyse whether a withholding tax on interest payments should be introduced. Its final report will be presented no later than 1 November 2013.

Within the framework of good tax conditions for entrepreneurship and investment, it is essential to limit tax planning that erodes Swedish tax bases. In recent years, it has become apparent that companies have been able to use interest payments to limit their total tax payments in Sweden. In view of this, the Ministry of Finance has recently presented a memorandum with proposals that supplement and expand the rules introduced in 2009 to limit the deductibility of interest.¹³ Creating stable and fair market rules requires companies to pay taxes on equal terms. The proposal in the memorandum levels the terms for groups operating internationally and other companies. The terms for all-Swedish concerns where any of the taxable entities are subject to special tax rules (for example, municipalities) and other companies will be put on an equal basis. Thus the basis for balanced taxation in the welfare sector and elsewhere will be strengthened.

The consequent budget improvement, seen in isolation, would lead to a higher tax burden for the corporate sector, which would be at

¹³ The memorandum More effective interest deductibility limitations (Effektivare räntebegränsningar, dnr Fi2012/1349).

odds with what international developments call for. The budget improvement should therefore benefit the corporate sector, which can, for example, be achieved by a reduction in the corporate tax. Pending proposals by the Corporate Tax Committee, this should be accomplished as part of the long-term strategy to enhance competitiveness. At the same time, the proposals for more effective interest deductibility limitations will come into effect on 1 January 2013.

The Government wants to improve the conditions for sustainable growth everywhere in Sweden by creating attractive business and living environments. Helping all of Sweden to grow involves the potential for jobs, entrepreneurship, business and housing in all parts of the country.

The Government's reforms to strengthen the business climate

A favourable business climate promotes entrepreneurship and investment. Improving the basic conditions for business enables companies to better manage global challenges. More and growing companies help to create more jobs.

Since the Government took office in 2006, it has taken a number of measures to strengthen the business climate. Some are reported below:

More profitable to run and start companies

The Government has carried out a number of tax measures aimed at creating more jobs in more and growing companies:

- lower income tax due to the earned income tax credit to increase the incentives to work,
- lower corporate tax makes it more profitable to start and run companies,
- employers' social security contributions have been lowered to improve the conditions for new recruitment and employment,
- the 3:12 rules have been changed in order to reduce the tax burden for closely held companies,
- tax relief for home-related services (RUT and ROT) has created new jobs and a larger market for entrepreneurs, and
- the VAT on restaurant and catering services has been lowered.

Simplification of companies' day-to-day practice

The Government has carried out a number of reforms aimed at reducing the regulatory burden for business.¹⁴ Examples of simplifications are:

- share capital requirements have been lowered to make the limited company form more accessible,

- the reporting period for the value-added tax has been lengthened from monthly to quarterly, and
- for some smaller limited companies, an audit is now voluntary.

Access to capital and advisory services

A well-functioning system for accessing capital and advisory services is essential for starting a company and for a company's growth.

- To better exploit the potential for innovation and growth nationwide, the Government intends to reform state measures on access to capital in order to better meet a variety of needs for venture capital supplementary to the market.
- The Government, by increasing resources to Almi Företagspartner AB, has contributed to an increase in the volume of mentor programmes with the aim of stimulating new enterprises and growth.
- The wealth tax was abolished, with one of the aims being to improve the supply of venture capital to small companies.

Stimulating entrepreneurship

- Several measures to promote entrepreneurship have been implemented with the aim of reducing the thresholds to entrepreneurship, including the establishment of a special programme to promote women's entrepreneurship.
- Security for entrepreneurs has been improved by changes in the rules for unemployment insurance, sickness insurance and parental insurance, making the rules clearer and more predictable and leading to more equal treatment of entrepreneurs and the employed.

¹⁴ Total administrative costs are estimated to have decreased by SEK 7 billion during the period 2006–2010 as a result of the Government's measures (rskr. 2009/10:226).

3.5.3 Effective transport services are essential for growth

Infrastructure investments that benefit the economy leading to more efficient transport of freight and passengers are important to create economic growth. More efficient passenger transport increases people's chances of finding attractive workplaces within commuting distance. For businesses, more efficient transport increases the chances of employing staff with the right skills and operating nationwide. Well-functioning passenger and freight transport is of great importance for business competitiveness and for the investment climate. Public transport represents an important means to meet transport policy objectives and thereby achieve long-term sustainable growth.

The Government decided in 2010 on an intermodal national plan containing investments of nearly SEK 500 billion for 2010–2021. The appropriations for railway and road maintenance were increased by about SEK 3.9 billion a year. Substantial additional resources will come from user financing and co-financing. In the 2012 Budget Bill, further measures totalling SEK 5 billion in 2012 and 2013 were proposed (Govt. Bill 2011/12:1, expenditure area 22). These concerned primarily operation and maintenance, reinvestment and fine-tuning measures in the road and rail network. Preserving the existing infrastructure is, according to the Government, of the utmost importance in ensuring robust road and rail systems.

During its term of office, the Government will come back with proposals for a new infrastructure decision intended to meet future needs in the transport system. An important part of this is the infrastructure bill that the Government intends to present to the Riksdag in autumn 2012. Important starting points for the Government in this decision will be creating capacity and robustness in the transport system. It is essential for there to be a solid basis for these decisions. The Government has therefore given the Swedish Transport Administration a broad remit to analyse deficiencies in the transport system and propose measures for rectifying them. It is to present a final report no later than 30 April

2012 (dnr N2011/1933/TE and N2011/5221/TE).

The Government also intends to come back with proposals for creating more opportunities for municipalities to help finance state transport infrastructure.

3.6 Challenges to financial stability

A well-functioning financial system is essential for the economy. If serious problems emerge in the financial system, particularly in the banking system, the conditions for growth, jobs and welfare deteriorate dramatically. Problems in the banking sector affect citizens primarily in two ways. First, they are affected via the real economy, as reduced lending by banks risks lowering economic growth. An economic slowdown with lower demand may force companies to reduce their activities. This will eventually result in higher unemployment and probably downward pressure on wages. Second, households will be adversely affected if problems in the banks make it necessary to use tax revenue, for example because the deposit guarantee is activated or systemically important banks become unviable and have to be taken over by the state and recapitalised. Such events would make it more difficult to maintain core public functions such as education, health care, social services and the justice system. There are thus several reasons for Swedish households and businesses to want robust banks and a well-functioning financial system.

3.6.1 A large and concentrated banking sector

By international standards, Sweden has a large banking system relative to the size of the economy. A failure in the banking sector may therefore be very costly for the Government and the taxpayers to handle. The four largest Swedish banking groups' assets in Sweden and abroad are almost four times larger than Sweden's GDP (see Table 3.7).

Table 3.7 The four largest banks' assets and capital at the turn of the year 2011/12

| | Assets as a per cent of GDP | Basel II ¹ , per cent | Basel III ² , per cent |
|---------------|-----------------------------|----------------------------------|-----------------------------------|
| Handelsbanken | 70 | 8.0 | 12.9 |
| Nordea | 184 | 9.2 | 9.7 |
| SEB | 68 | 11.3 | 10.9 |
| Swedbank | 53 | 9.9 | 14.2 |

¹ Capital including transition rules.

² Estimated capital.

Note: When converting Nordea's figures from euros into kronor, an exchange rate of SEK 8.90 per euro has been used. Core Tier 1 Capital as a percentage of risk-weighted assets. GDP in current prices.

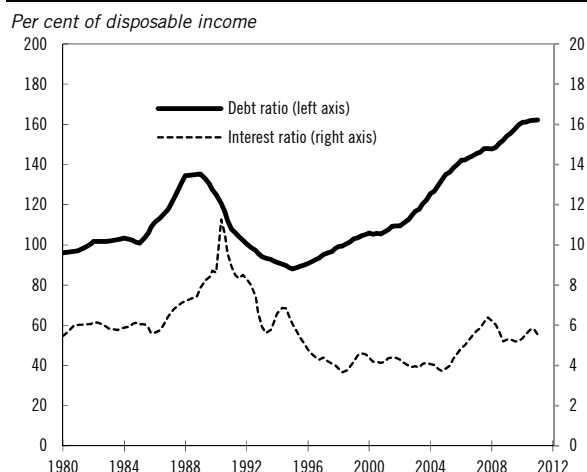
Source: The Riksbank.

Another risk factor is the banks' increased international operations. Possible problems in the banks' foreign operations risk becoming a burden for Swedish taxpayers. The banks also increasingly fund themselves in foreign currencies. In the fourth quarter of 2011, 56 per cent of the banks' total market funding of SEK 3 127 billion consisted of foreign currency debt. If the international financial markets were to stop functioning, it would become difficult for the banks to maintain their funding. Furthermore, the large Swedish banks are so interlinked by their extensive mutual transactions that problems in one bank easily spread to the others.

3.6.2 Household debt

Alongside the two above-mentioned risks in the banking system, the relatively high household debt also poses some risk. Total household debt in December 2011 came to SEK 2 649 billion, of which 2 124 billion was mortgage debt. These amounts correspond to about 75 per cent and over 60 per cent of GDP, respectively. The average household had debts of more than 160 per cent of its annual disposable income in 2011.

Even though the debt ratio is historically high, the interest ratio is below the historical average. Falling interest rates have thus enabled households to carry a larger debt without crowding out consumption or savings. More developed financial markets and improved access to credit have probably also affected the debt ratio. But the sharp increase in household debt in the last 15 years requires vigilance.

Figure 3.13 Household debt- and interest ratio

Note: Interest ratio is calculated based on the benchmark for Swedish five-year housing bonds, plus an interest margin of two percentage points and with a tax deduction for interest. The increase in 1991 is primarily explained by the reduced interest deduction from an assumed average of 50 per cent to 30 per cent.

Sources: Reuters, Statistics Sweden and own calculations.

3.6.3 A more stable financial system

Largely thanks to rapid decisions by the Riksdag and the Government on forceful support measures, the Swedish banks weathered the crisis better than the banks in many other countries. The banks are currently profitable and well capitalised by international standards. But the financial crisis showed how swiftly uncertainty and instability can emerge in the financial system and thus how fragile the system can be. The financial crisis made clear that both crisis prevention and the ability to handle financial crises must be strengthened. Even though the situation in the financial markets has improved, there are still clear risks in the financial system which could contribute to instability in the Swedish economy.

The work to improve stability in the financial system continues. In order to create even better conditions for a well-functioning financial system, the 2012 appropriation to the Swedish Financial Supervisory Authority has been raised by SEK 38 million for increased and improved supervision of financial institutions. In total, the appropriation to the Financial Supervisory Authority is estimated to be SEK 103 million higher in 2014 than in 2011.

As part of the work to strengthen financial stability, the Financial Supervisory Authority

has decided to issue a general advice on home mortgages, the 'mortgage ceiling'. According to this advice, new loans should not exceed 85 per cent of the home's market value. The general advice came into force on 1 October 2010, and aims to prevent banks and other credit institutions from using higher mortgage ratios as a competitive instrument. Too much debt makes borrowers less equipped to handle swings in housing prices and in the economy. According to the Financial Supervisory Authority, the general advice has been effective and has changed the banks' lending to some extent.

Raising the deposit guarantee from SEK 500 000 to about SEK 900 000¹⁵ makes bank savings secure. It may also help safeguard bank deposits in turbulent times. Banks and other credit institutions should bear the costs of their own risk-taking to a greater extent. By paying stability fees to the Stability Fund, banks and other credit institutions partly finance the support measures which may have to be taken in future financial crises. The Financial Crisis Committee (dir. 2011:6) will further examine how the fee paid to the Stability Fund could be set based on the risks taken by each individual bank.

A number of measures have been taken to strengthen financial stability, but the fact that the Swedish banking sector is both large and concentrated poses risks. It is therefore important that the systematically important banks are highly resilient so they will be able to weather financial crises. The higher the banks' capital ratios are, the more resilient they are. Therefore, the Government will increase the capital requirement on the four largest banks in a first step effective 1 January 2013 (see the box "Capital Requirements – the Swedish Proposal for Stricter Rules").

3.6.4 Strengthening consumers' position in the financial market

The financial sector is undergoing a crisis of confidence. It was caused by irresponsible risk-taking, which has damaged jobs and welfare. Concurrent with the work to strengthen financial market rules and supervision, the Government is working actively to strengthen consumers' position vis-à-vis financial institutions. Financial institutions must regain consumer confidence.

A fundamental problem in this regard is that the playing field where households and financial institutions meet is not level. Financial services are often complicated, and the companies in the industry have a knowledge advantage over consumers. The weak position of consumers contributes to large profits in the financial industry. In the long run, the companies' behaviour risks jeopardising confidence in the whole industry and reduced households' willingness to use financial services. Consumers should be able to feel confident in their contacts with financial institutions, be they about saving for a buffer, borrowing for a home or planning for retirement. The work to strengthen consumers' position in the financial market is a priority for the Government and covers many areas.

As a consumer, it may be difficult to differentiate between financial advice, where the focus is on the consumers' interests, and pure marketing and selling of a service. The Financial Supervisory Authority is currently reviewing the dividing line between advice and marketing or the sale of complex financial products. The Government will follow up the result and take measures as they are needed. At the EU level, the Government is working for a prohibition stopping independent investment advisers from receiving compensation for recommending a particular investment.

The information to consumers about financial services and products is often complicated. With clearer and more transparent information, consumers will have a better opportunity to differentiate between good and bad financial products. The Government is therefore working to make the information about fees, risks and the costs of different services more transparent

¹⁵ According to EU rules, the maximum compensation amount is to be expressed in multiples of 100 000 euro. It is the Government's ambition to make it possible to denominate it in kronor.

in the long run. A new regulation of concise fact sheets about funds has been introduced at the EU level. It is the Government's view that the industry must take responsibility for making the information about yield, risks and fees even more transparent. The Government will also work for more transparency in the fact sheets.

The conditions for saving should be improved. Households' savings are important to create necessary buffers in everyday life. It should be simple and inexpensive to save. That being so, it should also be easy to change banks and managers and to decide against expensive funds and insurance products.

Competition and low thresholds to changing from one actor to another give the consumer freedom of choice and force prices down. Better mobility exerts pressure on the industry to offer all customers better terms. At the turn of the year 2011/2012 an advantageous form of savings, the investment savings account, was introduced. To increase mobility, the Government has also appointed an inquiry to review the right to move insurance savings (dir.2010:43).

Financial stability and consumers who feel confident when dealing with banks and other financial institutions are fundamental in order for the financial market to contribute to growth and prosperity. Therefore, the Government continues its efforts to create good order in the financial market and re-establish confidence in financial institutions.

Capital requirements – the Swedish proposal for stricter rules

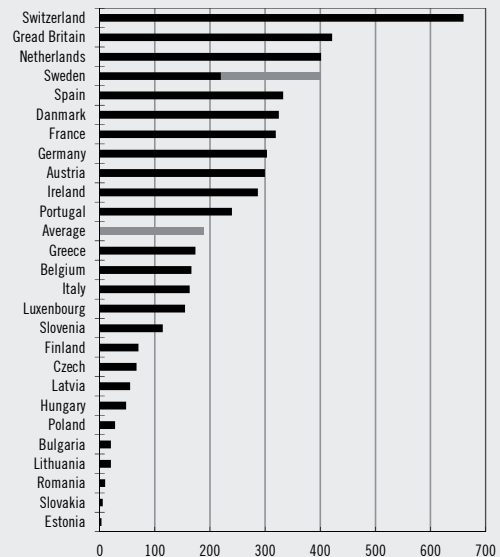
Financial crises are a serious threat to jobs, growth and welfare. To reduce this threat, and thus make Sweden less vulnerable to financial crises, increasing the large banks' capital ratios is a key measure.¹⁶ Higher capital requirements for large banks are a central part of the framework created by the Government to improve financial stability.

An important explanation of why the consequences of the financial crisis in 2007–2009 were so serious is that banks in general had too little capital and that the quality of the capital was too low. The banks simply did not have enough high quality capital to protect them from the (unexpected) credit losses they suffered in the wake of the financial crisis. In many countries, this led to financial turbulence with falling output and employment. In some countries, the governments had to take measures to rescue all or parts of the banking sector, resulting in rapidly rising government debts. Increasing the banks' capital ratios is a key measure to maintain stability in the banking system and reduce the risks to taxpayers. Higher capital ratios reduce the banks' risks and provide a larger buffer in case a bank gets into trouble and suffers losses.

In the EU, the implementation of the global regulatory framework Basel III is under way, which means that banks and other credit institutions must have more and better capital. The implementation in the EU will be through the capital adequacy framework CRD IV.¹⁷ But Basel III does not take into account the size of the banking sector relative to a

country's GDP. Banking activities tend to cluster in certain countries. This concentration of activities is particularly pronounced in Switzerland and the United Kingdom (see Figure 3.14).

Figure 3.14 Bank assets in relation to GDP, December 2010



Note: The lighter part of Sweden's bar shows the four largest banks' foreign assets relative to Sweden's GDP. For other countries in the figure, the banks' foreign assets are included in the black bar.
Source: The Riksbank.

But the banking sector is also large in Sweden. Alongside the Netherlands, Sweden has the third largest banking sector in Europe in terms of the banks' total assets relative to GDP. There are many advantages for a country in having a large banking sector. For example, it provides businesses and households with a large array of financial services. At the same time, a large banking sector makes a country vulnerable to shocks to the financial system. In particular, this is the case if, as in Sweden, the banking activities are concentrated to a few large interconnected banks. Sweden has a very large banking sector dominated by the four large banks: Nordea, Swedbank, SEB and Handelsbanken. The assets of the four large banks have grown in the last 15 years from the equivalent of 109 per cent of GDP in 1996 to the equivalent of 375 per cent of GDP in 2011.

Countries with large banking sectors, such as the United Kingdom and Switzerland, are taking measures parallel with Basel III to further increase their resilience against financial crises and reduce the risks to the

¹⁶ The capital requirements specify how much capital banks and other credit institutions must have to cover their risks. The main are risks of loss associated with lending (credit risk), market risks and operational risks. The rules specify what kind of capital is required. The capital requirements are risk-weighted, meaning that different assets (for example, loans to different borrowers) are assigned risk weights linked to the risk that the borrower may not be able to meet its credit obligations. The capital requirements also vary depending on how advanced the risk and capital management of a credit institution is. Institutions with less complex risks use standardised, simple rules, whereas more advanced banks may use internal methods for risk and capital assessments.

¹⁷ CDR IV includes rules in the form of both directives and regulations.

public finances and taxpayers. Among the measures proposed are higher capital requirements for systematically important banks in the form of capital surcharges for systemic risk.

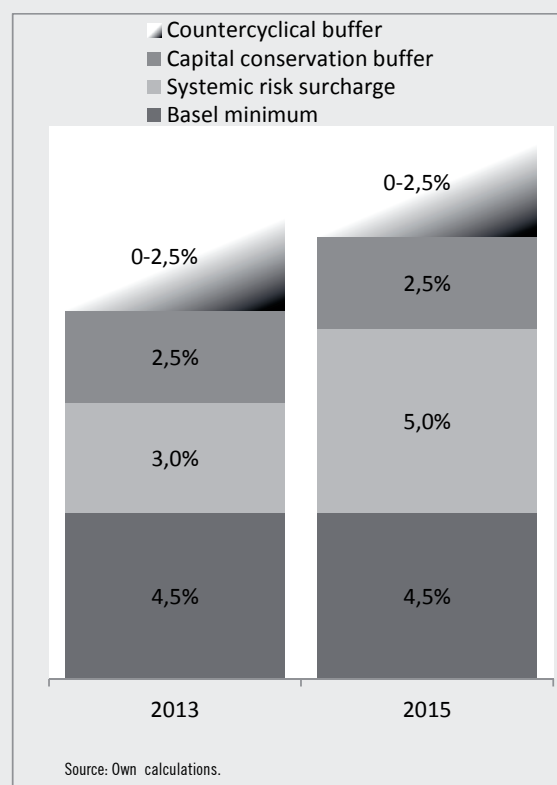
As the banking sector is so large relative to Sweden's economy, the Swedish banks' resilience to financial crises must increase. The increased capital requirements in Basel III are necessary, but are not deemed high enough to achieve sufficient resilience and reduce the risk facing Swedish taxpayers if one or more of the large, systemically important banks were to experience serious problems. Consequently, the four large Swedish banks need to be subject to higher capital requirements than the minimum levels in Basel III.

Based on how the Swedish banking sector is structured, it is the opinion of the Government, the Riksbank and the Financial Supervisory Authority that the four largest Swedish banks should meet a higher capital requirement than Basel III's minimum requirement of at least 7 per cent Core Tier 1 Capital in relation to the banks' risk-weighted assets.¹⁸ The requirement for Core Tier 1 Capital in the four systemically important banks should as of 1 January 2013 be raised to 10 per cent of risk-weighted assets. The requirement will be raised to 12 per cent in 2015 (see Figure 3.15). When the second step in the capital surcharge for systemic risk is complete, the large banks will have a capital ratio that is 5 percentage points higher than the minimum level in CRD IV. Their implementation will however be affected both by ongoing negotiations at the EU level and stability in the Swedish financial system.

Currently, the four large banks have capital ratios of approximately the level proposed to come into effect on 1 January 2013 (see Table 3.7 in Basle III terms). From a financial stability perspective, it is welcome that the banks have made the adjustments necessary to meet the future higher requirements. It is, however, important to raise the legal requirement in order

to ensure that the necessary capital ratios are also maintained in the future.

Figure 3.15 Capital ratios



It would not be reasonable for the banks to charge their customers the increased costs associated with the higher capital requirements. Banks with a higher capital ratio are safer and pose less risk to their investors and financiers. The banks' required return should thus be lower than it currently is. It should therefore be possible to make the adjustment to the new capital requirements without significantly affecting households and businesses' terms for banking services. In order to monitor developments, the Financial Supervisory Authority has been instructed to supervise how the banks adjust to the new rules, including housing loan margins and commercial lending.

¹⁸ The minimum level includes a capital conservation buffer of 2.5 per cent of Core Tier 1 Capital. In addition to the minimum requirement in Basel III, there is a countercyclical buffer of 0-2.5 per cent, which means that the capital requirement can be raised further in good times.

3.7 Challenges to a secure housing market

A well-functioning housing market is an essential precondition for good economic growth and a competitive economy. The housing market is important to the labour market and mobility. A good supply of housing also increases people's options. It should be possible to accept a job or a study place at a location other than where one lives, regardless of one's economic status. A well-functioning housing market also contributes to financial and economic stability. The housing market should be diverse in order to meet people's need for a secure place to live in different phases of their lives and also offer pathways into the housing market to people with limited resources. Rented housing and the letting of private residential properties fill an important function in this respect. Ownership gives people more influence over their housing situation. Of all year-round homes in Sweden, 41 per cent are owner-occupied housing, 22 per cent are tenant-owned apartments and 37 per cent are rented apartments.

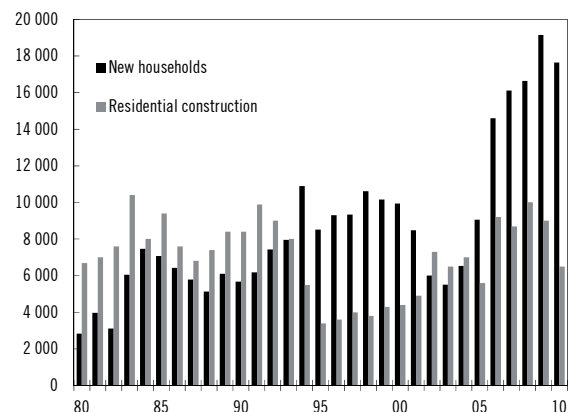
3.7.1 A shortage of housing in some parts of the country

The housing market is currently out of balance in many municipalities. There is a shortage of housing in the metropolitan areas and around university and college towns and other growth areas. At the same time, there are empty apartments in some locations and residential buildings have had to be demolished in other locations. Young people, refugees, older people and households with a weak financial position in particular are in a difficult situation in municipalities with a housing shortage. Young people move primarily to growth areas, but it is becoming more and more difficult for them to get established in the regular housing market. Establishment has become particularly difficult for people aged 21–25 in the major growth areas. The number of rent contracts on offer is very small. Furthermore, it is difficult for young adults to compete for the contracts on offer because they have fewer contacts, have been in line for a shorter time at the

housing exchange and often have poorer finances. A high percentage of young workers have a temporary position and property owners may easily perceive them as risky tenants.

There are problems in the production of new housing, particularly in the metropolitan areas. In Stockholm, for example, the production of new housing in the last five years has been markedly less than the increase in the number of households (see Figure 3.16).

Figure 3.16 The number of new housing units and the increase in the number of households in Stockholm County



Note: The number of new households has been calculated as the population growth in Stockholm adjusted for the national trend in household size.

Source: Regional Planning Office, Statistics Sweden and own calculations.

A limited supply of land, a complicated and protracted planning and construction process, high costs for new production, weak incentives for developers, low profitability in managing residential property and not least a distorted demand for housing with respect to forms of tenure are among the factors thought to restrain housing production. A well-functioning housing market requires efficient planning processes and effective competition in the construction and housing markets.

3.7.2 A shortage of housing is an obstacle to jobs and growth

A shortage of housing hampers the functioning of both the labour market and higher education and thus limits growth in the short and the long run. It is essential that people be able to move to places with a shortage of labour. In knowledge intensive sectors, it is crucial to be able to recruit both new graduates and skilled labour. Consequently, a certain degree of mobility is

required to maintain a dynamic economy. Furthermore, a well-functioning housing market also helps give people more equal opportunities in life as individuals with limited financial resources also have the opportunity to move to where the jobs and study opportunities are. Research shows that mobility in the housing market is affected by the housing supply, moving costs and the supply of different forms of tenure.

Demographic developments mean that more people live longer, which poses particular demands for flexible housing markets. Different stages in life involve different needs and wishes for the quality and standard of housing and the services that can be provided in close connection with the housing. If it is easy to change dwellings, it will help make it easier to meet needs and also make more effective use of the housing stock.

There is a risk that a poorly-functioning housing market may create large fluctuations in housing prices, with adverse affects on the real economy, and problems in the financial system owing to high mortgage debt combined with rapidly falling housing prices. Well calibrated reforms in this area may mitigate these risks.

3.7.3 Housing policy reforms

The Government has begun long-term work to increase the housing supply. The property tax, which was which was felt to be unjust and illegitimate, has been abolished. The system for rent setting has been reformed. Under the new rules in force as of 1 January 2011, the municipal housing companies are to operate under business principles and collectively negotiated rents, no matter who the owner is, are to act as guidelines in deciding what is a correct rent when assessing the utility value. This creates neutrality in the sector. The introduction of the RMI tax credit has strengthened the incentives for the renovation and expansion of owner-occupied housing, which can also be expected to strengthen the housing stock.

In spring 2011 the new Planning and Development Act and a new appeals system entered into force. Their aims are transparency and more rapid processes, which enable

building projects to get started earlier. The Government is currently reviewing the rules for the implementation of plans – the process from the approved detailed plan to the finished home. Furthermore, the Government intends to instruct the National Board of Housing, Building and Planning and the Swedish Environmental Protection Agency to review the outcome and the implementation of the new rules for shoreline protection and propose changes if needed. A reference group composed of local government and environmental protection representatives will be associated with this work. The Government has also appointed an inquiry to review the technical requirements set by many local governments, which often vary from one to the other, aimed at improving the rules in order to increase predictability for builders.

The Government will continue to take measures which both stimulate the production of new housing and facilitate and open up the market for the letting of private dwellings.

No return to building subsidies

In the 1970s and 1980s, general building subsidies were an important part of Sweden's housing policy. The result was a distorted production where supply did not match demand and where the production of housing was largely detached from costs and responsibility for risks. The share of rented housing grew strongly, but the growth was almost entirely concentrated in municipalities outside the metropolitan areas, i.e. not where the need was greatest. In metropolitan Stockholm, housing construction hardly increased at all, in spite of the favourable financial conditions. Given this experience, a return to subsidised building is not the right way to solve the current problems in the Swedish housing market.

Access to rented housing is crucial

The housing market consists of a number of different forms of tenure: rented housing, tenant-owned housing and owner-occupied housing. There are also cooperative rentals and condominiums. A diversified supply of

different forms of tenure and rental possibilities for various contracted times contributes to flexibility in the housing market.

Rented housing and tenant-owned housing are two important parts of the housing market, complementing each other. Tenant-owned housing and owner-occupied housing provide the opportunity to own a home, which strengthens people's control over their housing situation and makes savings in the form of home ownership possible. Rented housing ensures good housing conditions without financial risk or any capital requirement for an individual. Subletting privately owned housing, in whole or in part, is also an important part of the housing market. Traditionally, rented housing has been the more flexible form of living. Rented housing is easy to move to or from it as the moving costs are usually lower than in the case of owner-occupied housing. Most international studies indicate that people living in rented housing tend to be more mobile.

Rented housing fills an important function not only by facilitating mobility for young and newly established people, but also as an alternative for those who are not able or do not want to buy their own home.

The current rules with strong tenant protection and an established mode for rent negotiations are basically sound. The housing market cannot be compared with other markets, as it is a market for people's homes. The current system creates predictability for both the tenant and the landlord and provides secure housing arrangements.

Better utilisation of the existing housing stock is important

In the long run, new production is necessary, particularly with a growing population. But as the time from planning to a completed house is long and most of the need is covered by the existing stock, it is important that this stock is well utilised. An open and well-functioning market for letting private housing is thus desirable. The existing stock of housing can be used by more people if private individuals, who wish to rent out all or part of a residential property they own actually do so to a larger

extent. Currently, such rentals only represent a small part of the housing stock. An international comparison shows that Sweden is among the countries with the lowest share of privately rented housing.

There are also problems in the market for temporary rentals of tenant-owned housing. For example, there are indications that many apartments are empty because the rules on letting are unclear or because letting them is not profitable. In addition, this market is not transparent and some activities are not registered.

More incentives for new production and letting of private dwellings

In the 2013 Budget Bill, the Government intends to come back with proposals to make it more attractive to invest in and manage residential property and to facilitate letting of private dwellings. Letting private dwellings offers the opportunity of a home without debt or financial risk. It therefore plays a key role both in providing young people with an opportunity to get their own home and in increasing mobility in the labour market.

Increased letting of private dwellings provides access to more housing already in the short run. The aim of the measures to facilitate the letting of private dwellings is to rapidly increase the supply of housing within the existing stock. Simplifications and changes to the rules for pricing will make apartments which otherwise would not be used available in the housing market. The measure also aims to make the market for letting private residential property more transparent and increase security for both landlord and tenant.

To facilitate the letting of private dwellings, a number of rule changes are being considered, which aim to enable owners to set a rent that will allow them to cover their costs and give tenant-owners the right to rent out their dwelling unless there are special reasons. The new rules will also enable the owners of private dwellings to cover their capital costs for the dwelling. Other changes considered aim to simplify and clarify rules for fixed-term contracts, security of tenure, conditions for termination notices, etc. Furthermore, retro-active rent assessment should be abolished in

order to reduce contract uncertainty. The reach of these rules will be clearly limited to the temporary letting of private dwellings.

In connection with the new rules, there is a proposal to increase the standard deduction for letting private dwellings from SEK 21 000 to SEK 40 000. The increase in the standard deduction aims to further stimulate the letting of private dwellings.

To strengthen the incentives to build new housing and thus in the long run also counteract housing shortages in the metropolitan areas and places of study, it is proposed that the real estate charge for multi-dwelling buildings (rented housing and tenant-owned housing) be lowered from 0.4 to 0.3 per cent. At the same time, the ceiling for the real estate charge for multi-dwelling buildings will be lowered from about SEK 1 400 to SEK 1 200. It will continue to be indexed. Also, more favourable conditions for building new housing will be proposed by extending the grace period for the real estate charge to 15 years. The proposal is intended to apply to housing completed in 2012 or later. In connection with this extension, the Government intends to come back with a proposal for a corresponding extension of the period when more market based rents for newly produced housing, the 'presumption rates', may apply, from the current 10 years to 15 years. In addition to improving the incentives for new production, these measures should help dampen rent increases.

Along with these measures, the Government is reviewing other ways of improving the housing market. An inquiry chair is analysing the possibilities of further developing the rental market and improving the conditions for renters and identifying the differences in the conditions between the different forms of tenure that pose obstacles to well-functioning housing markets (dir. 2011:108). The inquiry chair has recently presented an interim report with proposals for facilitating letting of private dwellings which are in line with what the Government is now announcing (SOU 2012:25). Furthermore, the Government will appoint an inquiry chair with a remit to analyse how the taxation of rented housing can be changed to increase the supply of rented housing.

In order to clarify local government responsibility for the provision of housing and the regional perspective in the planning, the National Board of Housing, Building and Planning has been instructed to review the Housing Provision Act (dnr S2012/2989).

The purpose of the Government's housing market reforms is to secure access to housing for everyone. The ambition is to create strong economic incentives and stable planning conditions for existing and future businesses in the rented housing market to act and thereby to increase the supply of rented housing so that it will meet demand in all parts of the country. At the same time, it is important to maintain good order in the housing market. The Swedish Union of Tenants and the Swedish Property Federation have a shared view on many housing issues, which the policy will respect. A completely free rent setting in the existing stock reduces tenants' security and risks contributing to more speculation in the housing market. The rules for rent setting are to promote tenants' security, long-term property ownership and a stable housing market.

3.8 Challenges to energy, climate and environmental policy

The overall goal of environmental policy is to hand on to the next generation a society in which the major environmental problems have been solved. By 2050, Sweden is to have a sustainable and resource effective energy supply and no net emissions of greenhouse gases in the atmosphere. Realising these visions requires an ambitious and cost-effective energy, climate and environmental policy. Many of the challenges are also global and thus success in handling them requires international cooperation.

3.8.1 Energy and climate policy are interlinked

Swedish energy policy is based on three pillars: security of supply, competitiveness and ecological sustainability. Under the 2009 energy agreement between the Alliance

parties, climate policy cannot be separated from energy policy and has formed the basis for the Riksdag's approval of energy and climate policy targets to 2020 (Govt. Bill 2008/09:162, bet. 2008/09: MJU28, rskr. 2008/09:300 and Govt. Bill 2008/09:163, bet. 2008/09: NU25, rskr. 2008/09:301). Guiding climate and energy policy are the targets to 2020 approved by the Riksdag: the percentage of renewable energy is to be at least 50 per cent, energy use is to be 20 per cent more efficient, the percentage of renewable energy in the transport sector should be at least 10 per cent and emissions should be 40 per cent lower than in 1990.

Energy and climate development is to take place using general economic policy instruments to the extent possible. For example, there is a gradual decline in the reduction in the carbon dioxide tax between 2011 and 2015 for industries not covered by the EU Emissions Trading System, and there is a reduction in the refund of the carbon dioxide tax for forestry, aquaculture and agriculture in 2011, 2013 and 2015. There is also a need for policy instruments such as information and education as well as research and the demonstration of new technology.

How much progress there is towards these targets will be examined at a checkpoint in 2015. At that time, actual energy balance and cost developments and the climate impact compared with the target will be analysed. The checkpoint does not affect the basic policy direction, but may lead to adjustments in the policy instruments.

The structural change in the transport sector to make it sustainable is one of Sweden's biggest challenges. The Government plans to introduce a new green car definition in 2013. It will more explicitly reward vehicles with low carbon dioxide emissions relative to the vehicle's weight. With its introduction, there will be stricter requirements for exemption from the vehicle tax. There was an increase of SEK 0.20 per litre in the energy tax on diesel in 2011 and it will be raised another SEK 0.20 in 2013.

3.8.2 International efforts – climate financing in focus

The climate issue is the Government's highest priority among environmental issues. Broad and technology-neutral economic policy instruments with a polluter pays focus are vital in meeting the climate target in a fair way and at the lowest possible cost to society. The Government has given the Swedish Environmental Protection Agency a remit to produce a basis for a roadmap for a Sweden with no net emissions of greenhouse gases by 2050 (dnr M2011/2426/KI).

Climate change is global, and affects conditions for life everywhere. The basis for a successful climate effort is laid in broad international agreements on reductions in emissions of greenhouse gases. To make a high level of ambition possible, it is important that the measures taken are cost effective and long term. In international efforts, Sweden is working in the EU to change the current Energy Tax Directive. An important part of the proposal is an obligatory introduction of a carbon dioxide tax in all EU Member States.

At the COP17 meeting in Durban, a decision was taken to initiate a process that is to lead to a new climate agreement with binding legal effect. The agreement will be entered into in 2015 and come into effect in 2020. The focus in the next few years will be on how the two-degree target will be met. This in turn means a greater focus on the commitment made in 2009 to mobilise USD 100 billion until 2020 for climate-related measures in developing countries.

The Government, together with other parties, is analysing what sources of financing should and can be given priority and what role public and private financing will play. Climate financing will to a large extent be channelled via the green fund. There are high expectations in the developing countries that the fund will rapidly be established and will in the long run channel large financial flows. A priority for the Government is that the fund be designed so that it constitutes a value added to other climate funds.

3.8.3 The climate and energy package

Increased use of biofuels will help meet targets up to 2020, but it is also important for the energy and climate policy's long-term ambitions and for the realisation of the Government's priority of a fossil-free vehicle fleet by 2030.

It is important to create stable conditions for the actors in biofuel production and trade. To improve long-termism and stability, taxation will therefore be determined by law and not as it was previously by exemption decisions by the Government.

Under EU state aid rules, an exemption for biofuels must not result in overcompensation. If companies producing biofuels receive tax relief exceeding the extra cost of producing it compared to the cost of producing fossil fuels, they risk having to repay the amount corresponding to the tax relief. The risk of overcompensation has been highest for low-level biofuel blends in recent years and thus some tax on these biofuels is considered necessary. The Government also is of the opinion that biofuels cannot be self-supporting. For this reason, an energy efficiency obligation scheme will be introduced in 2014 with the aim that the blend should be made of 10 volume per cent ethanol in low biofuel petrol and 7 volume per cent FAME in diesel in order to achieve a permanent increase of low-level biofuels in the market.¹⁹ A blend with a higher level of biofuel than currently available would result in reduced carbon dioxide emissions of about 0.6 million tons, which would lower dependence on fossil energy and be on course for the energy and climate policy targets decided. It is important to encourage the introduction of the second generation biofuels of the future. In line with the exemption decisions taken, hydrogenated vegetable and animal oils, known as HVO, and fats will be granted tax relief on blends of up to 15 per cent HVO in diesel. E85 and other high biofuel petrol should continue to receive tax relief in 2013. If high biofuel petrol and biofuels without fossil content are not covered by an energy

efficiency obligation, they should continue to receive favourable treatment and thus contribute to long-term priorities.

All in all the Government's ambitions will result in more stable conditions for the actors in the biofuels market.

The Government will also present proposals leading to a more level playing field for cogeneration (combined heat and power) in the EU Emissions Trading System and deliveries of heat to some customers in industry. The proposals will involve abolishing the carbon dioxide tax for cogeneration in the trading system, thus increasing the effectiveness of controls in climate policy. As a carbon dioxide tax does not reduce total emissions in the trading system, but only affects where in the system the emissions occur, the existing situation results in a distortion of competition.

Current climate and energy policy measures are briefly described in the box Some tax measures prior to the 2013 Budget Bill. In total, the measures are expected to make an important contribution to achieving Sweden's energy and climate targets. EU state aid rules are deemed to make it impossible to combine an energy efficiency obligation for low biofuel petrol with a tax that is designed in a way that involves state support. A future tax on biofuels should therefore be designed in a way that follows the nature and logic of the taxation system and thus is compatible with EU law as it is not considered state support. Such a tax would involve abolishing the customs condition.

3.8.4 A multifaceted environmental policy

To meet the environmental policy's generation target and the 16 environmental quality targets, it is important to ensure the ecosystems' resilience and the long-term production of ecosystem services. The Government's ambition is to raise the visibility of the ecosystem services' value to society. As part of this ambition, the Government has given a remit to the Swedish Environmental Protection Agency and the Swedish Agency for Marine and Water Management to compile information on Sweden's ecosystem and ecosystem services.

¹⁹ FAME is Fatty Acid Methyl Esters (biodiesel).

The work of the All Party Committee on Environmental Objectives is to draw up a strategy for a non-toxic environment and a strategy for long-term sustainable land use (dir. 2011:50). The strategies will result in proposals for policy instruments and measures needed to meet the environmental quality targets effectively. Based on the All Party Committee on Environmental Objectives' earlier proposals, the Government also intends to establish new intermediate objectives along the path to the environmental quality objectives.

The marine policy is also a priority in the Government's work on the environment. Sweden until June 2012 chairs the regional marine convention Helcom and is working to facilitate the implementation of the Marine Strategy Directive in the Baltic Sea region. In a first phase, decisions would be taken on environmental quality norms that will be used in the work to achieve a good marine environment.

3.9 Long-term challenges to society

There are several challenges facing the Swedish economy in the long run. International developments affect Sweden's economy and continue to make heavy demands on the economy's flexibility and adaptability. The demand for welfare services increases as incomes grow and the population ages. It is important to design the publicly funded welfare systems so that they are stable in the long run and legitimacy and confidence in the systems are maintained. Environmental challenges, not least climate change, are global, and affect conditions of life throughout the world. There are also challenges with respect to how we can foster social cohesion, fairness and common values in a changing society with increasing competition.

A policy focused on promoting long-term growth and employment strengthens our ability to meet future challenges. A high labour supply and high employment are also of fundamental importance in safeguarding public financing of the welfare services in the long run. To achieve high long-term economic growth, it is also important to promote productivity growth. Measures to promote

entrepreneurship and competition, to strengthen skills, research and innovation, and to build a well-functioning infrastructure are important in this regard.

3.9.1 The Commission on the Future analyses long-term challenges

The work of the Commission on the Future aims to identify the important long-term social challenges facing Sweden (dnr SB2011/8276).²⁰ Identifying Sweden's long-term challenges enables the Government to take decisions so that Sweden can meet these challenges. The years 2020 and 2050 are used as perspectives in this work. The Commission's conclusions will provide a basis for the Government's day-to-day work. A report is to be presented no later than 1 March 2013, in which the social challenges Sweden faces and strategies to meet them are described.

Four inquiries have been appointed within the framework of the Commission: Our demographic developments; Integration, gender equality, democracy and inclusion; Sustainable growth in an era of globalisation and Fairness and social cohesion. The inquiry remits include stimulating a public debate on these issues in order to gather views from all parts of Swedish society.

Our demographic developments

Up to 2060, Sweden's population is expected to grow from 9.4 to almost 10.9 million. At the same time, the age distribution will change, resulting in a decrease in the working age population from about 75 per cent in 2010 to about 70 per cent in 2060. Furthermore, the share of older people will grow and in twenty years, every fourth Swede is expected to be over 65.

²⁰The Commission on the Future is appointed by the Government. Members of the Commission are Prime Minister Fredrik Reinfeldt, and the Ministers Jan Björklund, Göran Hägglund and Annie Lööf. The Prime Minister leads the Commission's work. A number of additional members have been appointed to the Commission and it has a special Secretariat.

These demographic developments challenge the Sweden of the future and make more and new demands on our society. The number of hours worked have to increase. More people thus need to work and those who work need to work longer hours. The Inquiry is to draw up a scenario of what Sweden's demographic developments and people's different phases of life may look like in the short run towards 2020 and in the long run towards 2050. Both regional differences in Sweden and a global perspective are to be included. The Inquiry is also to review skills provision in a number of critical sectors and the impact of various factors such as medical and technological developments on demographic developments. It is to identify potential obstacles to a sustainable social development.

Integration, gender equality, democracy and inclusion

One of Sweden's major challenges is how to identify and exploit the skills of everyone living in Sweden. This applies both to men and women and to people born in Sweden and those born in another country.

The Inquiry is to study the factors that are crucial for Sweden to be a country which gets people with an immigrant background rapidly into work and can attract labour and make best use of the skills of both women and men in the labour market. The Inquiry is also to analyse differences in the participation in elections and democratic assemblies among people born outside Sweden and other under-represented groups, survey how these groups participate in society and how their participation could be increased. The Inquiry is also to review existing and future threats to democracy.

Sustainable growth in an era of globalisation

Globalisation and economic growth create major opportunities with more mobility and trade. This has enabled countries to lift themselves out of poverty. At the same time, these developments have resulted in more emissions and increased use of natural resources, with serious consequences for

ecosystems, biological diversity and the climate.

Sweden has set ambitious goals for environmental management and for climate change measures and energy conversion. To be able to take effective climate and environmental measures, we need to better understand and appreciate our common green capital.

The Inquiry is to draw up a scenario on how Sweden can progress towards a green economy with sustainable growth. The Inquiry will also consider how Sweden can better follow up the results of its measures and compare them with those of other countries and how the value of ecosystems can be demonstrated. It will survey new methods for measuring sustainability and the environment. The Inquiry is also to analyse those indicators that can provide supplementary and accurate measurements of societal development and serve as a basis for decision-making. It is also part of the Inquiry's remit to analyse how participation can be engendered for climate and environmental policy objectives and measures and to consider the threats to society inherent in the environmental and climate challenges.

Fairness and social cohesion

In a society with higher prosperity and more urbanisation, individualisation and fragmentation, challenges exist with respect to society's capacity for cohesion and relations between people: the capacity and possibility for community in our future society. Income distribution policy and the analysis of living standards need to be supplemented with measures and instruments for analysing policy effects and other factors affecting relationships, social cohesion and well-being, for example.

Future challenges include fostering an inclusive society, strengthening the capacity and possibilities for interpersonal relationships and community in our future society and continuing to build on our fundamental trust, tolerance and solidarity among people.

The Inquiry is to study the factors that could help maintain or strengthen society's fundamental values and common identity. The remit includes examining the significance of

both material and non-material factors for fairness and social cohesion and applying international perspectives. Particular attention is to be paid to the role of the civil society in a cohesive society. The inquiry is also to examine new methods for monitoring and measuring the dimensions of social developments such as well-being and the indicators that may provide such a picture and can be used as a basis for decision-making.

3.9.2 The long-term financing of welfare

The demographic changes in the next few decades will affect both the labour supply and the growth of the public welfare systems. Statistics Sweden's population projections show that the share of the population over 65 will increase from 19 per cent at present to 23 per cent in 2030, while the share of the working age population will decrease.

Even though it is gratifying that people live longer, an ageing population represents a growing structural challenge in many parts of the country, entailing vulnerability with respect to both the economy and skills provision. This demographic development means that in the future there will be more young and old people relative to the number of people of working age. The changing demographic structure will bring about an increase in the demand for welfare services. Furthermore, in the last few decades, expenditure on these services has increased more in real terms than justified by demographic trends. This increase is due both to increasing prosperity in society, which has resulted in more demand for welfare services, and to technological developments in health care, which have resulted in higher productivity and increased treatment possibilities. Meeting people's future needs and demand for health care and social services within the framework of a long-term sustainable fiscal policy will be a challenge (see also Section 13).

One of the major policy challenges will be to decide how to meet the growing demand for welfare. This includes issues about higher employment, the size of the public commitment and funding by taxes and contributions. But the most important measures are those that increase employment. The objective is to find a method of funding which maintains

sustainability and is desirable from both an efficiency and a welfare perspective.

The Government also continues its efforts to improve the conditions for ensuring a welfare system that embraces everyone in the long run. Sustainable long-term employment is crucial in this regard. If more people enter the labour force and working life is extended, the number of hours worked, and thus tax revenue, will increase. A gradual increase in the number of hours worked, for example by an increase in the average labour market exit age, will also be crucial to ensure good pensions and secure the future viability of the pension system.

By continually developing welfare services, their quality can be maintained, while greater efficiency and productivity can contribute to long-term sustainability. The Government's work promoting greater competition and entrepreneurship in health care and social services is an important part of its work to encourage innovation and thereby increase productivity and efficiency in the welfare sector. Measures to reduce overuse of the social security systems and ensure high quality and efficiency in the management of these systems by the authorities are also important for the welfare systems' long-term sustainability.

Some tax issues prior to the 2013 Budget Bill

In connection with the 2011 Spring Fiscal Policy Bill, a special memorandum with a number of tax proposals was referred for consideration. This was done so that an overall assessment of different tax proposals and their budget effects could be made in the 2012 Budget Bill. Sufficient time had to be provided for the Council of Legislation to review the proposals where this was considered necessary. It is the Government's intention to prepare current tax proposals in a similar way prior to the 2013 Budget Bill. For this reason, a memorandum has also been produced by the Government Offices this year, which will be presented at the same time that the Spring Fiscal Policy Bill is submitted to the Riksdag.

The memorandum has the following proposals:

- lower corporate tax,
- lower expansion fund tax,
- simplified reduction of individual social security contributions,
- changes in the taxation of biofuels,
- reduced carbon dioxide tax for particular types of district heat production,
- higher vehicle tax for vehicles in the carbon dioxide-based system,
- higher vehicle tax for vehicles in the weight-based system, and
- a change in the definition of a green car.

Whether or not the above-mentioned proposals will be put forward in the 2013 Budget Bill depends on the assessment of the economic situation, the scope for reform and the financing needs and on the priorities the Government will set in the final preparations for the Budget Bill after summer 2012.

Furthermore, the Government intends to propose measures in the 2013 Budget Bill – also referred for consideration in the special memorandum – to increase the supply of housing and the use of existing housing:

- lower real estate charge for rental housing units
- a bigger reduction in the real estate charge for new construction
- higher standard deduction for residential sub-letting

In addition to the proposals in the special memorandum, the Government will continue its work preparing a number of other tax proposals. They include limitations on interest deductions in the corporate sector and an R&D tax credit.