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Sweden: Staff Report for the 2000 Article IV Consultation

As required under Article IV of its Articles of Agreement, the International Monetary Fund conducts periodic consultations with its member countries. In the context of the 2000 Article IV consultation with *Sweden*, the following documents have been released and are included in this package:

- the staff report for the 2000 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **June 21, 2000,** with the officials of *Sweden* on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 25, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board in concluding the Article IV consultation on August 22, 2000.**

Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of Article IV staff reports and PINS allows for the deletion of market-sensitive information.

The Article IV staff report is published—both in hard copy and on the IMF's website (http://www.imf.org)—as part of a pilot project. To assist the IMF in evaluating the pilot project for release of Article IV staff reports, reader comments are invited prior to October 5, 2000, and may be sent by e-mail to Pilotproject@imf.org.

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SWEDEN

Staff Report for the 2000 Article IV Consultation

Prepared by the Staff Representatives for
the 2000 Consultation with Sweden

Approved by Michael Deppler and Jesús Seade

July 25, 2000

- The consultation discussions were held in Stockholm during June 13–21, 2000. The staff team comprised Messrs. Artus (Head), Thomas, Escolano, and Ms. Cerra (all EU1). Mr. Tornqvist, the Alternate Executive Director for Sweden, participated in most of the discussions.

- The staff representatives met with Minister of Finance Ringholm, Riksbank Governor Bäckström, officials of the Riksbank, the Ministry of Finance, the Ministry of Industry, the Office for Labor Market Programs, the Financial Supervisory Authority, the National Institute of Economic Research, and Statistics Sweden; as well as representatives of unions, employers, private financial institutions, and academics.

- At the conclusion of the last Article IV consultation on August 25, 1999 (EBM/99/92), Executive Directors noted that adherence to an inflation target had enhanced transparency and credibility and that the fiscal consolidation program pursued since the mid-1990s had strengthened public finances. Directors noted that the present favorable economic situation provided a good opportunity to foster structural changes inter alia tax and unemployment insurance reform and increased wage differentiation. Directors welcomed Sweden's decision to keep open the possibility of joining the European Monetary Union.

- Sweden accepted the obligations of Article VIII, sections 2, 3, and 4, on March 15, 1961, and subscribes to the Special Data Dissemination Standard. Sweden's provision of high-quality core data on a timely basis facilitates the conduct of effective surveillance, with extensive supplementary monetary data published on the internet.

- The authorities released the staff team's concluding statement to the public and intend to participate in the pilot project for publication of Staff Reports. They also intend to publish a fiscal policy transparency report, written by IMF staff members, in conjunction with this report. In light of favorable economic conditions and broadly unchanged policy choices facing Sweden, this brief staff report is circulated to the Executive Board on a lapse-of-time basis.

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I. ECONOMIC BACKGROUND

1. ***Sweden is currently enjoying a robust economic recovery with low inflation.*** Real GDP growth accelerated to 3.8 percent in 1999, as a result of a strengthening of private consumption and a firming in net exports (Figure 1 and Table 1). Since early 1999, employment has increased by over 4 percent with the open unemployment rate (which excludes labor market programs) falling to 4.1 percent in May 2000. Consumer price inflation has been exceptionally low in Sweden since early 1996, invariably below the EU average and within the lower part of the Riksbank's inflation target of 2 percent plus or minus 1 percent (Figure 2). The core rate of inflation (which excludes the effects of interest rates, indirect taxes, and petroleum prices) has fallen in recent months to 0.4 percent year-on-year in June. Stock prices have risen rapidly over the past year by over 50 percent, but house price inflation remains moderate at 7 percent.

2. ***While output growth is strong, the economy is not particularly advanced in the cycle.*** The recent period of growth still reflects the rebound from the severe recession of the early 1990s when output fell by 5 percent. Moreover, one of the main drivers of economic growth is the high-tech sector, which has contributed about ½ percentage point to output growth over the past five years. This sector is not an intensive user of labor resources; growth in labor productivity has contributed most of the output increase of this sector over this period, averaging over 30 percent per annum. Thus some economic slack remains. In particular, while the ratio of employment to the working age population (aged between 16 and 64) has increased over the past few years it is still 10 percentage points below its previous cyclical peak. Moreover, although the open unemployment rate is low, a broader measure of unutilized labor including those on labor market programs and education initiatives totals over 8 percent of the labor force compared to 3 percent prior to the recession of the early 1990s. Unfilled vacancies are only slightly above half of their previous cyclical peak and labor shortages are only visible in specific areas such as high-tech engineers and construction workers in the main urban centers. Wage pressures are largely absent.

3. ***In 2000 and 2001, the rate of economic growth is expected to remain firm with subdued inflationary pressures.*** The staff project that the economy will grow by about 4½ percent this year, and 3½ percent in 2001, with contributions from all demand components (Table 1). Employment growth should sustain its recent momentum, with the open unemployment rate dropping below 4 percent. The core inflation rate should rise only gradually to 1½ percent in 2001 with real wages remaining at or below productivity growth. This forecast, comparable to the Riksbank's projection, is more optimistic than the Ministry of Finance's forecast which estimates growth at 3¾ percent this year, falling to 3 percent in 2001. The main risks to the forecast would include a sizeable wage increase during the new wage round next year, a large drop in equity prices, and a hard landing in the United States. While a drop in equity prices would have macroeconomic effects through the wealth channel, simulations of such a scenario undertaken by the major banks indicate that they would not be seriously affected because of their current strong capital position.

II. REPORT ON THE DISCUSSIONS

4. **Against the backdrop of strong economic growth, the mission focused on medium-term structural issues–including tax policy, the wage formation process, and the unemployment insurance system–where changes were needed to expand the supply side of the economy and prevent the current economic expansion from ending prematurely.**

A. Fiscal Policy

5. ***The authorities indicated that their medium-term fiscal strategy was based on restraining expenditures through nominal ceilings and maintaining a fiscal surplus target of 2 percent of GDP, measured as an average over the cycle.*** These policies, adopted in 1997 followed an ambitious fiscal consolidation program containing both deficit reducing expenditure and revenue measures. As a result of adopting these policies Sweden achieved a sizeable structural fiscal surplus of 3¾ percent of GDP in 1999 which set the stage for tax cuts over the medium term (Table 2). The authorities took a first step in this direction in the 2000 budget by raising the threshold of the highest tax brackets and offsetting ¼ of the employee pension contribution through income tax credits. Based on the Spring Budget Bill and assuming no further tax cuts, the authorities estimate that the structural surplus would reach 3½ percent in 2001 and 4½ percent of GDP by 2003, implying room for tax cuts of about 2½ percent of GDP over the medium term.

6. ***The mission praised the authorities' medium term fiscal strategy but argued that, assuming that a structural surplus of 2 percent was maintained and that policy slippages on expenditures were avoided, the room for tax cuts was about 4 percent of GDP over the 2001–03 period, considerably more than envisaged by the authorities.*** The revenue forecasts of the authorities were considerably below those of the IMF staff on account of their lower growth forecast for this year and next and mainly, their lower level of potential growth (2 percent). The staff's growth forecasts for 2000 and 2001 were comparable to the consensus forecasts. Moreover, the staff considered that with the continued high growth rate of productivity in the high technology sector and with the gradual recovery of the ratio of employment to the working-age population, the growth rate of potential output was at least 2½ percent (within the range projected by the Riksbank).

7. ***Given the extremely high tax burden in Sweden, the highest in the OECD, the IMF staff urged the authorities to seize the opportunity to strengthen the incentives to work, save, and invest, through launching an ambitious tax reform program encompassing labor and capital taxes.*** The staff endorsed the authorities' strategy of offsetting the pension fees paid by employees through income tax credits (which would stimulate work incentives at the lower end of the income scale) and suggested supplementing it with lower marginal income taxes, in particular, through replacing the two state income tax rates of 20 and 25 percent with a single rate of 15 percent. On capital incomes, the staff suggested lowering the capital income tax rate (currently at 30 percent) and raising the threshold on wealth taxation to stimulate

entrepreneurship, saving, and investment. The staff tried to dissuade the authorities from maintaining the freeze on the tax valuation of housing, especially since this sector was already heavily favored from a fiscal standpoint.

8. ***Beyond the difference in views on the medium-term prospects for the structural budget surplus, the authorities indicated that they were not inclined to adopt a comprehensive program of tax cuts because this could lead to overheating.*** The staff believed that the stimulative effects of a large tax cut would be partially mitigated by the simultaneous reduction in expenditure which had a stronger demand impact—the staff projected a decline in cyclically adjusted primary expenditure of 2 percentage points of GDP during the period 2001–2003. Moreover, the automatic stabilizers were much more powerful in Sweden than in other countries and therefore these would also provide some restraint on aggregate demand. The nature of the tax cuts recommended by the staff would also expand the supply of resources in the economy because of their incentive effects. All combined, the staff did not think that the tax cuts would be a source of inflationary risk. Nonetheless, the mission recommended a cautious approach of smoothing tax cuts over time, dividing the available resources evenly over the 2001–03 period. Moreover, if next year's wage round resulted in a sharp increase in wages, tax cuts for 2002–03 that could be expansionary (mainly, the increase in income tax credits to offset the pension fees) should be put on hold.

9. ***On this matter, however, it should also be noted that the government depends on the support of its coalition partners in Parliament—the Green and the Left parties—that are opposed to lowering state income tax rates and taxes on wealth and capital.*** These parties consider that cutting taxes could ultimately endanger the development of the welfare state. Against the backdrop of a strong budgetary position, the Left party is putting pressure on the government to raise the expenditure ceilings and reestablish some of the expenditures that were cut during the crisis. Raising the expenditure ceiling is also motivated by the fact that sickness and disability expenditures are running far ahead of projections—related to the recent strong upturn but still largely unexplained—so that cuts are being made elsewhere to satisfy the target. The staff stressed that the existing expenditure ceilings, set through 2003, should be maintained and that any overruns in individual categories should be offset elsewhere in the budget. Moreover, savings resulting from lower than expected unemployment benefits should not be spent on other expenditure items.

B. Monetary Policy

10. ***The mission welcomed the Riksbank's cautious interest rate increases since last autumn.*** The Riksbank raised the repo rate by 85 basis points between November and February as it continued to implement monetary policy in a forward-looking inflation targeting framework (Figure 3). Riksbank officials indicated that they had kept the repo rate at 3.75 percent in recent months in light of a moderate inflation forecast and lower than expected inflation outcomes (core inflation dropped below 1 percent). The mission agreed that there was not a pressing need for further rate hikes in the absence of resource pressures or signs of an upward trend to inflation.

11. ***There was agreement between the monetary authorities and the staff that a less accommodative stance was likely to be needed later this year.*** Although two-year ahead inflation prospects are on target at current interest rates, both the staff and the Riksbank saw an increased likelihood that as the business cycle continues to mature, a return to a cyclically neutral level of interest rates would be required. Indeed, the authorities did not rule out rate hikes later this year, especially if they saw some wage momentum ahead of the major wage negotiation round next spring.

12. ***The monetary authorities broadly concurred with the mission's view that the combination of tax cuts and somewhat higher interest rates would not threaten the economic expansion.*** If tax cuts were to inject a slightly expansionary impulse to the economy that caused the inflation forecast to rise above 2 percent, the monetary authorities acknowledged that an increase in interest rates could be used to offset the stimulus. They agreed with the mission that Sweden's external sector has been competitive at current exchange rates with room for some moderate appreciation over the medium-term (Figure 4 and Table 3). Nonetheless, the staff argued that it would be important to keep in mind the need to avoid an excessive appreciation of the exchange rate vis-à-vis the euro to facilitate a smooth entry into the euro area if Sweden chooses to adopt the single currency.

C. Structural Policies

13. ***Since the mid-1970s Sweden's wage formation system has been criticized for its lack of wage differentiation and periodic excessive wage demands which required large exchange rate adjustments to maintain competitiveness.*** While in recent years aggregate wage agreements have been quite modest, concerns remain that as the effects of the crisis of the early 1990s wane, the wage formation process could once again become a source of inflation and low productivity growth. To avoid this outcome a government commission presented concrete guidelines for improving the wage formation process.[1] Even though the recommendations of the commission were not fully implemented and some sectors (industry and government) contracted out of the government's new mediation process through setting their own procedures, the need for wage agreement guidelines was now generally recognized. Moreover, increasing emphasis was being placed on individual wage agreements at the local level at the expense of the centrally negotiated minimum increases, which could help to contain wage pressures through avoiding the cumulation of the wage hikes at the central and local levels. The test of course would come in the new wage round set to commence next Spring against the backdrop of a lower unemployment rate.

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[1] The Öberg commission proposed the establishment of a new Mediation Authority with the right to intervene to coordinate wage agreements, delay industrial action, send disputes to compulsory arbitration, make unions pay the cost of industrial action, and prohibit industrial action against self-employed and family enterprises. After facing stiff resistance from unions, the last two proposals were dropped.

14. ***On wage differentiation, the authorities indicated that much greater attention was being placed on properly rewarding differences in work effort.*** However, differentiating wages based on varying profit developments within industrial sectors or investments in education was much less evident. Historically, wage equality had been an explicit policy choice of successive Swedish governments with the lack of wage differentiation among industrial groups forcing the least productive firms out of business. In the current environment, where productivity enhancements depended on the availability of a highly skilled mobile workforce, the authorities acknowledged that a lack of wage differentiation could delay the speed of economic adjustment and hamper growth prospects.

15. ***The authorities argued that their strategy of improving training and education, implemented during the past decade, was beginning to bear fruit.*** This was evidenced by the achievement of a sharp increase in employment over the past two years without noticeable wage pressures. Individuals were finding it easier to switch from active labor market programs into regular employment—this development was partly responsible for the sharp decline in active labor market programs since last summer. While recent evaluations of these programs during the early 1990s were critical (the majority of those on wage subsidies had returned to unemployment soon after the subsidies expired and those on youth programs had a lower probability of becoming unemployed relative to a control group with similar characteristics), the authorities argued that these evaluations had been conducted over a period when economic activity was low in Sweden. It was not clear whether similar results would hold true in the current strong upswing.

16. ***A committee set up to review the functioning of the unemployment insurance (UI) system had presented proposals to enhance job search through lowering the unemployment benefit over time.*** While the proposals implied that those not actively searching for jobs would receive lower benefits, the staff argued that the suggested changes were unlikely to achieve the desired results: the current system already contained a fairly strict search clause; the problem with the clause was that it was not being implemented properly. The authorities acknowledged that in many tightly-knit communities the close ties between the unemployment benefit recipient and the official of the employment agency had led to the weak implementation of rules. To address this problem, the UI proposals suggested transferring the authority for deciding on benefit eligibility to a central agency to release the local employment official from taking the decision.

17. ***The reform of the pension system was now being completed and was expected to be fully implemented in 2001.*** The rationale for the reform was to link benefits more closely to contributions, allow a portion of funds to be privately invested, ensure the long-run solvency of the system, and introduce additional flexibility into retirement options. While future pension benefits could be adversely affected by upward revisions to demographic projections and downward revisions to the projected rate of income growth or the return on investment, the solvency of the system was secure because a trigger mechanism (lowering the rate of indexation) would be adopted under such circumstances. However, to limit the likelihood that such a trigger mechanism would need to be introduced, the staff recommended that the

authorities enhance their efforts in raising the effective retirement age. Raising or eliminating the statutory retirement age, currently at 65, would be a possibility.

III. STAFF APPRAISAL

18. Sound macroeconomic management has made significant contributions to the rebound in the Swedish economy from the deep recession of the early 1990s. Although the economy is not yet particularly advanced in the cycle and economic growth is strong, more structural reform is needed to sustain the expansion. Notwithstanding the sharp reduction in the ratio of government expenditures to GDP in recent years, the role of government remains large in comparison with other industrial countries. This level of government is financed by numerous taxes which considerably weaken and distort the supply side. Other prominent rigidities include the limited amount of wage differentiation and weak job search incentives. These rigidities may partially explain Sweden's decline into the lower half of the income-per-capita league among industrial countries and why the benefits of new technologies in terms of higher productivity growth are yet to be evident outside the telecommunications industry.

19. On fiscal policy the authorities must resist mounting pressures to use the existing budgetary room for increased spending. Sustaining the expansion will require, at a minimum, maintaining the current expenditure ceilings to provide room for tax cuts. Indeed, the authorities should go further and take account of the rapid decline in unemployment compensation by staying below the expenditure ceilings by a corresponding amount. Measures should also be taken to correct policy slippages, including those currently taking place in sickness and disability benefits. Net budgeting (the practice of recording expenditures as negative revenues) masks the problems and should cease.

20. A broad-based reduction in the tax burden should be implemented to foster incentives to work, save, and invest. Provided that the existing expenditure ceilings are respected and the authorities maintain their 2 percent structural surplus target, the staff estimate that there should be room for tax cuts cumulating to 4 percent of GDP over the 2001–03 period to finance this reform. To err on the side of caution, the tax cuts should be spread uniformly over this period with updates for 2002 and 2003 made on the basis of economic and fiscal developments in 2001. A comprehensive tax reform package could include offsetting employee pension fees through income tax credits, lowering state income tax rates and the capital tax rate, and raising the wealth tax threshold. The tax cuts would coincide with a corresponding decline in cyclically adjusted expenditures and would expand the supply of resources because of their incentive effects. Taking these factors into account, the fiscal impulse would be quite limited and could easily be offset through a slight tightening in the monetary policy stance.

21. The Riksbank is to be congratulated for not having raised interest rates too aggressively early in the business cycle. However a less accommodative stance will likely be required by Fall 2000 to keep inflation on target through 2002. As long as moderation persists in the coming wage round, and even with the suggested tax cut, a gradual return to a

cyclically neutral level of interest rates in the first half of 2001 should probably be sufficient to keep inflation prospects for the next two years in line with the 2 percent target.

22. The wage formation process is changing through increased emphasis on mediation procedures and increased differentiation based on effort. The real test will come during the new wage round set against the backdrop of a lower unemployment rate. To avoid returning to the wage inflation of the 1970s and 1980s, the authorities will have to remain vigilant and, if necessary, implement more fully the recommendations of the Öberg commission. While wage differentiation is present in the high-tech sector, it needs to become more widespread. Increased wage flexibility could be accomplished through offering more wage variation with sectors and across skill levels while maintaining an aggregate ceiling for the wage bill.

23. The rationale for reforming the unemployment insurance system is commendable but tightening the relationship between the benefit level and the intensity of job search is unlikely to succeed because of the difficulty in assessing whether an individual is actively searching. Instead, the staff recommend offering a generous level of unemployment benefit for the first few months of unemployment but significant cuts later on, say after 6 and 12 months of unemployment. Sweden's new pension system is laudable but would benefit from an increase in the current statutory retirement age so that the enhanced retirement options embodied in the reform could be fully utilized.

24. It is proposed that the next Article IV consultation with Sweden be held on the standard twelve month cycle.

Table 1. Sweden: Selected Economic and Financial Indicators
(Percent change, unless otherwise noted)

	1995	1996	1997	1998	1999	Staff projections 2000	2001
Real domestic demand	2.0	0.7	0.9	3.8	3.6	3.6	3.5
Public consumption	-0.6	0.9	-1.0	2.2	1.8	-0.5	1.3
Private consumption	0.6	1.4	1.7	2.4	4.1	4.6	3.6
Gross fixed investment	9.4	5.0	-2.2	9.4	8.1	6.7	6.3
Stocks 1/	0.5	-1.1	0.6	0.3	0.0	0.0	0.0
External balance 1/	1.6	1.2	1.4	-0.6	0.6	0.8	0.2
Exports of goods and services	17.6	0.1	12.4	7.3	4.6	9.2	7.0
Imports of goods and services	14.4	-1.4	13.9	8.9	6.3	9.0	8.0
Real GDP	3.7	1.1	2.0	3.0	3.8	4.4	3.4
Inflation							
Consumer price index	2.5	0.5	0.5	-0.1	0.4	1.4	1.8
Employment and unemployment							
Employment	1.6	-0.6	-1.1	1.5	2.3	2.1	1.4
Open unemployment (as percent of labor force)	7.7	8.1	8.0	6.5	5.6	4.6	4.0
Labor market programs (as percent of labor force)	4.4	4.5	4.3	3.9	3.1	2.9	2.6
Business excluding agriculture							
Hourly wages	4.9	5.7	4.5	3.2	2.3	3.8	4.2
Productivity	4.2	2.0	4.5	2.5	0.4	2.7	2.0
Unit labor costs	0.7	3.6	-0.1	0.6	1.8	1.1	2.2
Manufacturing							
Hourly wages	5.4	6.6	4.5	3.5	1.8	3.7	4.0
Productivity	3.9	1.5	7.1	5.3	3.8	3.5	2.5
Unit labor costs	1.5	5.1	-2.7	-1.8	-2.0	0.2	1.5
Household sector							
Real disposable income	1.6	0.5	0.8	3.2	4.2	3.5	5.0
Saving ratio 2/	6.3	4.4	1.1	1.2	2.1	1.1	2.2
External current account balance (as percent of GDP)	2.4	2.8	3.2	3.0	2.7	2.6	2.5

Sources: Ministry of Finance; Statistics Sweden; the Riksbank; and staff estimates.

1/ Contribution to GDP growth.
2/ Percent of GDP.

Table 1. (Continued) Sweden: Selected Economic and Financial Indicators

	1995	1996	1997	1998	1999	Staff projections 2000	2001
(In percent of GDP)							
Fiscal Indicators (National accounts basis)							
General government financial balance	-7.7	-3.5	-1.7	1.9	1.9	3.4	4.1
Revenue	56.6	59.1	59.0	59.8	60.4	58.3	57.3
Expenditure	64.3	62.6	60.6	57.9	58.5	54.9	53.2
Local government balance	-0.1	0.2	-0.4	-0.1	-0.1	0.6	0.7
Consolidated gross debt	75.1	76.0	75.0	72.4	65.5	57.0	52.0
Monetary Indicators							
Money supply (percent change, end period)							
M0	-0.4	5.3	3.0	5.1	12.0	7.3 1/	...
M3	2.7	11.4	1.3	2.1	9.9	11.2 1/	...
Credit to non-bank public 2/ (percent change)	0.5	3.5	3.4	7.4	5.5	5.5 1/	...
Interest rates (period average)							
3-month interbank rate	8.8	6.0	4.4	4.4	3.1	4.0 1/	...
10-year bond yield	10.2	8.0	6.7	5.0	5.0	5.1 2/	...
Memorandum items:							
Interest rate differentials against Germany							
Short-term	4.3	2.5	0.8	0.8	0.2	-0.4 1/	...
Long-term	3.8	2.4	1.6	0.6	0.7	0.0 1/	...

Sources: Ministry of Finance; the Riksbank; and IFS.

1/ May 2000.
2/ June 2000.

Table 2. Sweden: General Government Fiscal Operations 1/

	1998	1999	2000	2001		2002		2003	
	Act.	Prel.	Staff proj.	Staff proj.	Auth. Proj.	Staff proj.	Auth. Proj.	Staff proj.	Auth. Proj.
				(In percent of GDP)					
Total revenue	60.6	60.2	58.3	57.3	56.7	...	...	...	...
Primary revenue	57.6	57.8	56.2	55.6	55.0	...	...	...	...
Tax revenue	52.7	52.9	51.4	51.0	50.4	...	...	...	...
Other	4.8	4.9	4.8	4.6	4.6	...	...	...	...
Interest receipts	3.0	2.4	2.1	1.6	1.6	...	...	...	...
Total expenditure	58.7	58.4	54.9	53.2	53.4	...	...	...	...
Primary expenditure	52.5	53.0	50.8	49.7	49.9	...	...	...	...
Current	50.9	50.5	48.3	47.2	47.4	...	...	...	...
Capital	1.7	2.5	2.5	2.5	2.5	...	...	...	...
Interest payments	6.2	5.3	4.1	3.5	1.6	...	...	...	...
Primary balance	5.0	4.8	5.4	6.0	5.1	...	...	...	...
Overall balance	1.8	1.9	3.4	4.1	3.2	...	...	...	...
General government gross debt	72.4	65.5	56.7	52.4	52.5	...	...	...	...
Cyclically adjusted fiscal operations									
				(In percent of potential GDP)					
Total revenue	60.3	60.1	58.2	57.3	56.7	57.3	56.6	57.4	56.6
Primary revenue	57.4	57.8	56.2	55.6	55.0	55.8	55.1	55.9	55.1
Tax revenue	52.8	52.9	51.4	51.0	50.4	51.3	50.6	51.4	50.6
Other	4.7	4.8	4.7	4.6	4.6	4.5	4.5	4.4	4.5
Interest receipts	2.9	2.3	2.1	1.6	1.6	1.5	1.5	1.5	1.6
Total expenditure	55.6	56.4	54.5	53.3	53.3	52.7	53.1	51.5	52.2
Primary expenditure	49.7	51.1	50.4	49.8	49.8	49.3	49.7	48.5	49.1
Current	48.1	48.7	47.9	47.3	47.3	46.8	47.1	46.0	46.6
Capital	1.6	2.4	2.5	2.5	2.5	2.5	2.5	2.5	2.6
Interest payments	5.9	5.2	4.1	3.5	3.5	3.4	3.4	3.0	3.0
Primary balance	7.8	6.6	5.8	5.8	5.3	6.5	5.4	7.3	5.9
Overall balance	4.7	3.7	3.8	3.9	3.4	4.6	3.6	5.9	4.5
General government gross debt	69.7	64.0	56.4	52.5	52.5	49.3	49.5	46.6	47.4
Memorandum items:									
Real GDP growth (percent)	3.0	3.8	4.4	3.4	2.9	...	...	...	...
Potential real GDP growth (percent)	2.3	2.4	2.5	2.6	2.0	2.6	2.0	2.6	2.00
GDP Gap (percent of potential GDP)	-3.7	-2.4	-0.6	0.2	-0.2	...	...	...	...

Sources: Ministry of Finance; and Staff estimates.

1/ Projections for 2001-2003 are before tax cuts.

Table 3. Sweden: Balance of Payments
(In billions of US Dollars)

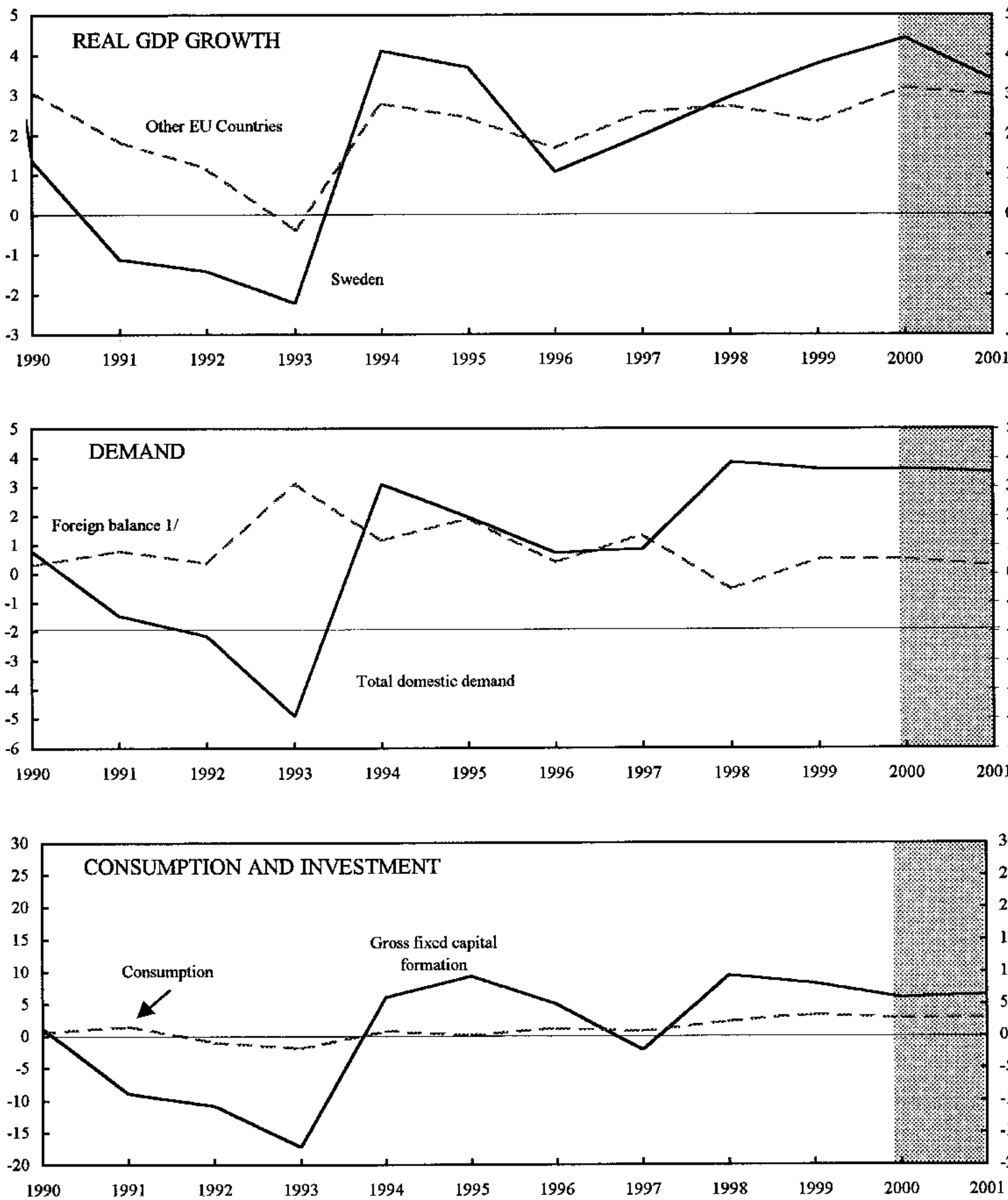
	1994	1995	1996	1997	1998	1999	2000 2/	2001 2/
Current account balance	2.4	7.1	7.2	7.5	7.0	6.1	6.8	7.0
(in percent of GDP)	1.1	3.0	2.7	3.2	2.9	2.6	2.6	2.5
Trade Balance	9.4	15.0	18.0	17.2	16.5	16.7	18.5	19.1
Services	0.2	-0.5	-1.2	-1.8	-2.0	-2.9	-2.7	-2.7
Transportation	0.6	0.1	0.1	0.4	1.0	0.9	...	...
Travel	-2.0	-2.2	-2.8	-3.2	-3.5	-4.0	...	...
Other services	1.7	1.5	1.4	1.0	0.4	0.3	...	...
Compensation of employees	-0.2	1.7	0.5	1.0	-0.3	-0.3	-0.3	-0.3
Investment income	-5.8	-6.3	-7.3	-5.6	-3.8	-3.9	-4.9	-5.2
Direct investment	2.2	2.9	3.2	3.3	5.1	3.7	...	...
Portfolio investment excl. fin. Derivatives	-0.7	-0.8	-2.5	-3.4	-6.4	-5.2	...	...
Income on equity	-0.1	-0.4	-1.0	-0.8	-0.7	0.1	...	...
Income on debt (interest)	-0.6	-0.5	-1.5	-2.6	-5.6	-5.3	...	...
Other investment	-7.3	-8.4	-7.9	-5.6	-2.8	-1.6	...	...
Current transfers	-1.2	-2.7	-2.8	-3.2	-3.5	-3.7	-3.7	-3.9
CAPITAL ACCOUNT	-1.0	-0.5	-0.7	0.0	0.8	-2.2	...	...
FINANCIAL ACCOUNT	3.4	-3.4	-4.0	1.7	-0.5	-3.2	...	...
Direct investment	-0.3	3.2	0.4	-1.7	-4.8	39.6	...	...
Abroad	-6.7	-11.2	-4.7	-12.7	-24.4	-20.0	...	...
In Sweden	6.4	14.5	5.1	11.0	19.6	59.6	...	...
Portfolio investment excl. fin. Derivatives	-13.5	-2.3	-12.4	-11.7	-14.9	-35.5	...	...
Assets	-2.6	-10.6	-13.2	-9.2	-17.7	-37.4	...	...
Equity securities	-2.5	-9.1	-7.5	-5.6	-7.4	-30.4	...	...
Debt securities	-0.1	-1.5	-5.7	-3.6	-10.3	-7.0	...	...
Liabilities	-10.9	8.2	0.7	-2.5	2.9	1.9	...	...
Equity securities	6.8	2.0	4.1	-1.7	-0.4	-4.0	...	...
Debt securities	-17.7	6.2	-3.3	-0.8	3.2	5.9	...	...
Financial derivatives	0.0	-0.8	1.5	2.1	-1.3	0.1	...	...
Other investment	19.6	-4.9	0.3	6.5	23.8	-5.3	...	...
Reserve assets	-2.3	1.4	6.2	6.5	-3.3	-2.0	...	...
Net errors and omissions	-4.8	-3.2	-2.5	-9.2	-7.3	-0.7	...	...
Memorandum Items:								
Net foreign assets 1/	-86.6	-80.2	-102.6	-100.7	-92.3	-79.5	...	...
(in percent of GDP)	42.1	33.5	39.3	42.6	39.2	33.9	...	...
Official reserves								
In weeks of imports	22.9	18.3	15.4	9.0	11.2	9.7	...	...

Source: Riksbank

1/ Capital and financial accounts are defined as in IFS except that reserve assets here are included in the financial account instead of being a separate item.

2/ Staff projections

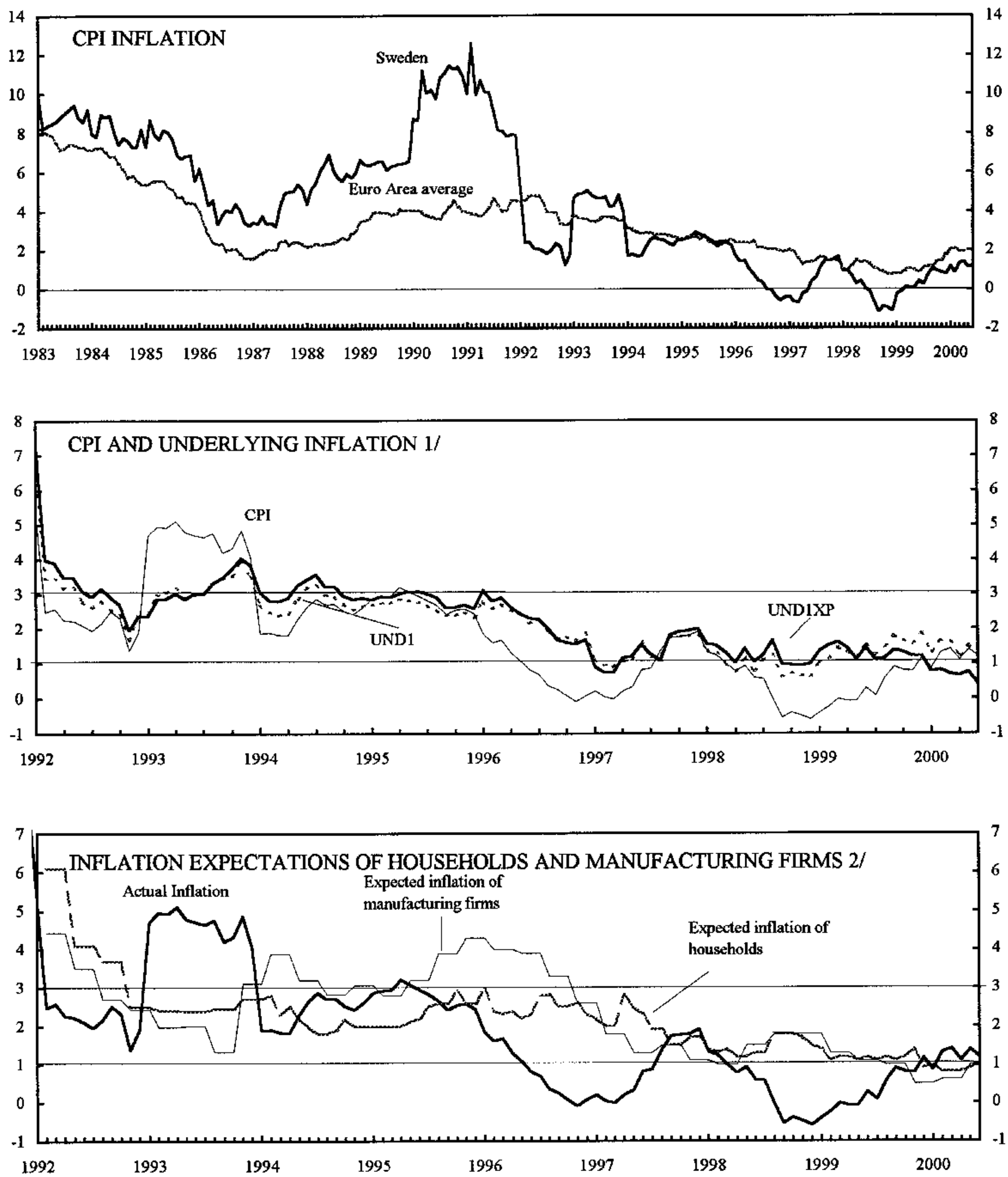
Figure 1. Sweden: Output Developments and Prospects
(Annual percentage change)



Source: Statistics Sweden and National Institute of Economic Research.

1/ Contribution to GDP growth.

Figure 2. Sweden: Inflation Developments
(Percent change from a year ago)

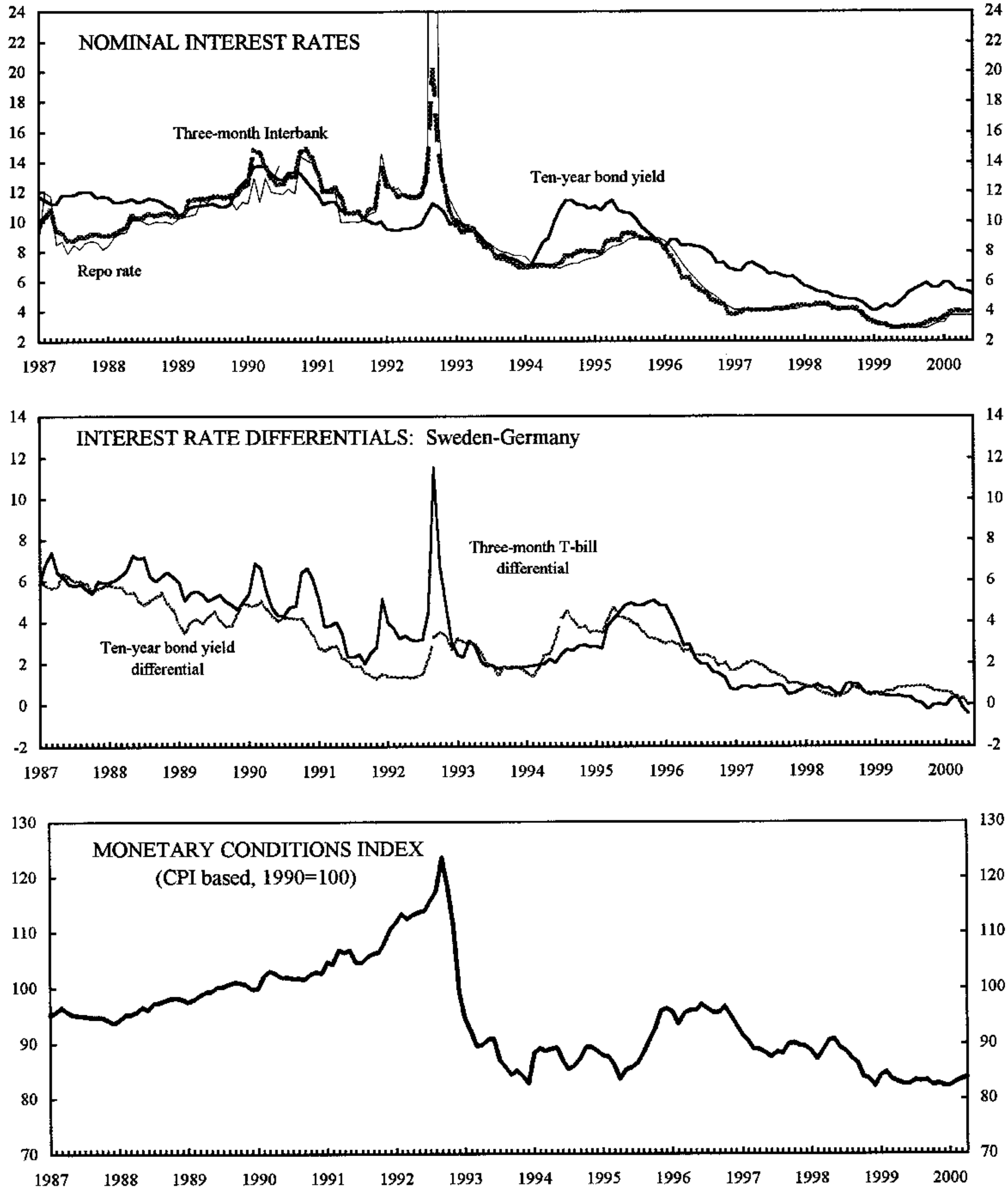


Sources: Statistics Sweden and the Riksbank.

1/ UND1 = CPI excluding changes in indirect taxes and subsidies and interest costs for owner-occupied housing; UND1XP also excludes changes in petroleum prices; the horizontal lines indicate the inflation target range, centered at 2%.

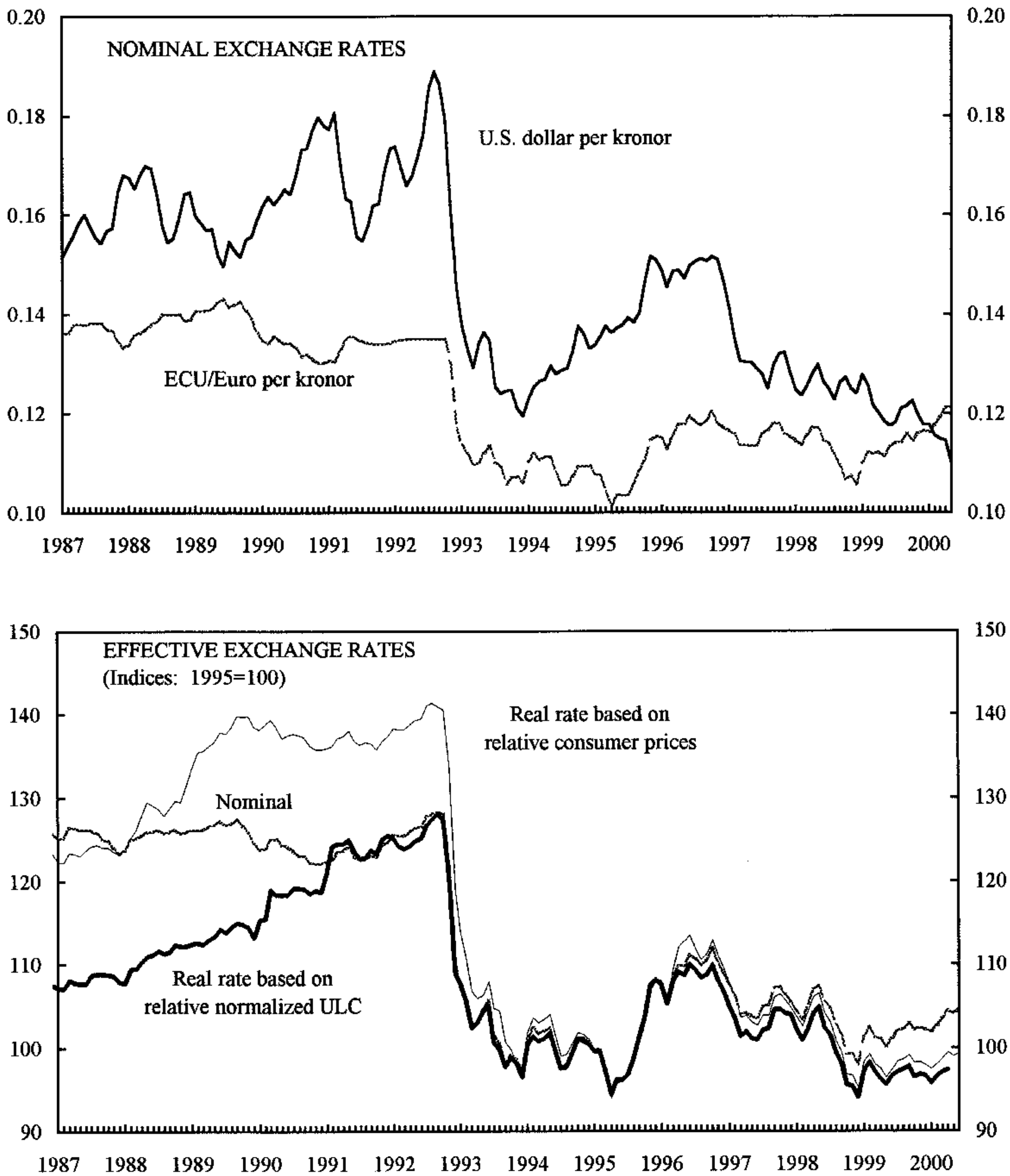
2/ Inflation expected one year ahead.

Figure 3. Sweden: Interest Rate Developments
(In percent)



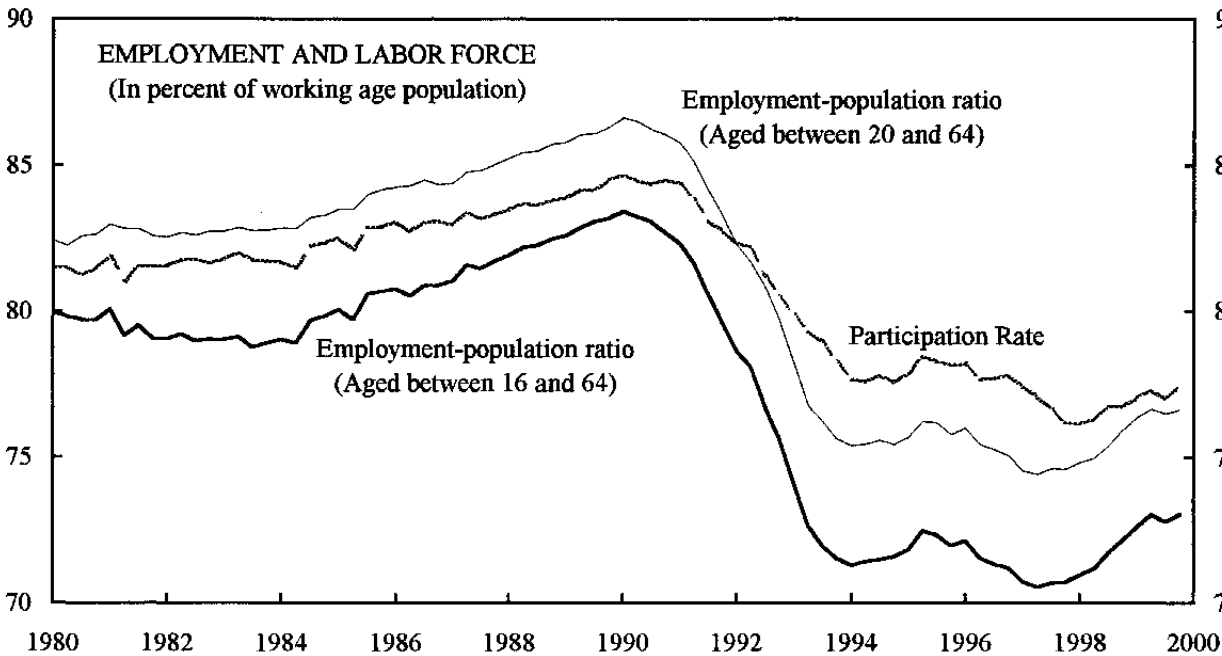
Sources: IMF, International Financial Statistics, and INS.

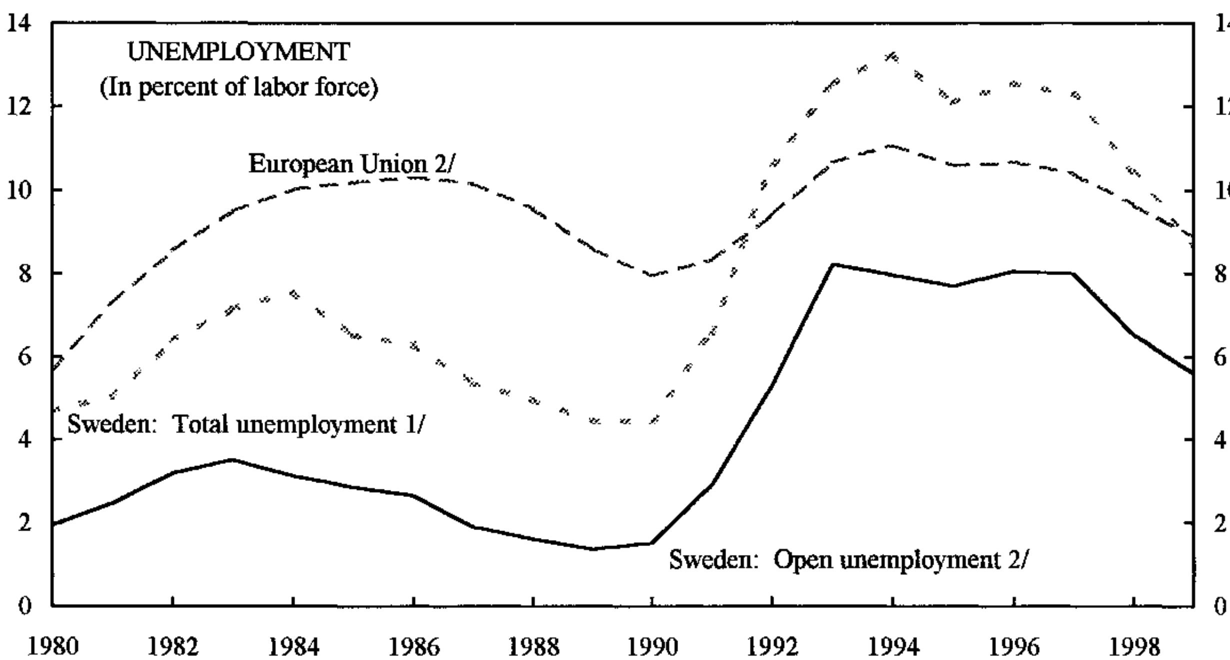
Figure 4. Sweden: Exchange Rate Developments



Source: IMF, International Financial Statistics

Figure 5. Sweden: Labor Market Developments





Sources: Statistics Sweden and OECD.
1/ Open unemployment plus labor market measures.
2/ Source is OECD.

Sweden: Core Statistical Indicators

as of July 14, 2000

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt
Date of Latest Observation	July 14, 2000	June 28, 2000	June 28 2000	May 2000	May 2000	July 14, 2000	May 2000	March 2000	May 2000	End-1999	1st Quarter 2000	End-1999
Date Received	July 14, 2000	July 5, 2000	July 5, 2000	June 29, 2000	June 29, 2000	July 14, 2000	June 15, 2000	June 22, 2000	July 12, 1999	April 13, 1999	June 15, 2000	April 10, 2000
Frequency of Data	Daily	Weekly	Weekly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annually	Quarterly	Annually
Frequency of Reporting	Daily	Weekly	Weekly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Bi-annual	Quarterly	Annually
Source of Update	Commercial	Riksbank	Riksbank	Riksbank	Riksbank	Commercial	Commercial	Statistics Sweden	Riksbank	Ministry of Finance	Statistics Sweden	Riksbank
Mode of Reporting	On Line	Publication	Publication	On-line	On-line	On Line	On Line	On-line	On-line	Publication	On-line	On-line
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Daily	Weekly	Weekly	Weekly	Monthly	Daily	Monthly	Monthly	Monthly	Bi-annual	Quarterly	Annually

Sweden: Fund Relations
As of June 30, 2000

I. **Membership Status:** Joined: 08/31/1951; Article VIII

II. **General Resources Account:**	**SDR Million**	**%Quota**
Quota	2,395.50	100.0
Fund holdings of currency	1,664.65	69.5
Reserve position in Fund	730.85	30.5
Operational budget transfers (net)	-4.00	

III. **SDR Department:**	**SDR Million**	**%Allocation**
Net cumulative allocation	246.53	100.0
Holdings	243.22	98.7

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to Fund:** None

VII. **Exchange Rate Arrangements:** The Krona has been floating since November 19, 1992.

Under Decision 144-(52/51), Sweden has notified the Fund that it has lifted exchange restrictions vis-à-vis: the Socialist People's Libyan Arab Jamahiriya and areas of the Republic of Bosnia and Herzegovina under the control of the Bosnian Serb forces. Sweden has amended restrictions vis-à-vis the Federal Republic of Yugoslavia (Serbia and Montenegro) and maintains restrictions vis-à-vis Angola (EBD/96/91, 7/12/96) and Iraq (EBD/90/286, 9/10/90).

VIII. **Article IV Consultation**: Discussions for the 1999 Article IV consultation were held in Stockholm, May 19-26, 1999, and concluded by the Executive Board on August 25, 1999.

IX. The Article IV consultations with Sweden are on the standard twelve-month cycle.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 00/74
FOR IMMEDIATE RELEASE
September 8, 2000

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Sweden

On August 22, 2000, the Executive Board concluded the Article IV consultation with Sweden.[1]

Background

Sweden is currently enjoying a robust economic recovery with low inflation. Real GDP growth accelerated to 3.8 percent in 1999, as a result of a strengthening of private consumption and a firming in net exports. Since early 1999, employment has increased by over 4 percent with the open unemployment rate (which excludes labor market programs) falling to 4.1 percent in May 2000. Consumer price inflation has been exceptionally low in Sweden since early 1996, invariably below the EU average and within the lower part of the Riksbank's inflation target of 2 percent plus or minus 1 percent. The core rate of inflation (which excludes the effects of interest rates, indirect taxes, and petroleum prices) has fallen in recent months to 0.4 percent year-on-year in May.

While output growth is strong, the economy is not particularly advanced in the cycle. The recent period of growth still reflects the rebound from the severe recession of the early 1990s when output fell by 5 percent. Moreover, one of the main drivers of economic growth is the high-tech sector, which has contributed about ½ percentage point to output growth over the past five years. This sector is not an intensive user of labor resources; growth in labor productivity has contributed most of the output increase of this sector over this period, averaging over 30 percent per annum. Thus some economic slack remains. In particular, while the ratio of employment to the working age population (aged between 16 and 64) has increased over the past few years it is still 10 percentage points below its previous cyclical peak. Moreover, although the open unemployment rate is low, a broader measure of those available for work including those on labor market programs and education initiatives totals over 8 percent of the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

labor force. Unfilled vacancies are only about half of their previous cyclical peak and labor shortages are only visible in specific areas such as high-tech engineers and construction workers in the main urban centers. Wage pressures are largely absent.

In 2000 and 2001, the rate of economic growth is expected to remain firm with subdued inflationary pressures. The staff project that the economy will grow by about 4½ percent this year, and 3½ percent in 2001, with contributions from all demand components (Table 1). Employment growth should sustain its recent momentum, with the open unemployment rate dropping below 4 percent. The core inflation rate should rise only gradually to 1½ percent in 2001 with real wages remaining at or below productivity growth.

Executive Board Assessment

Executive Directors agreed with the broad thrust of the staff appraisal, arguing that sound macroeconomic management had made significant contributions to the rebound in the Swedish economy from the deep recession of the early 1990s. Public finances were strong, inflation was low and the unemployment rate was on a declining trend. However, sustaining the expansion would require additional structural reforms—in tax policy and in the wage formation and unemployment insurance systems—to help expand the supply side of the economy.

On fiscal policy, Directors urged the authorities to stick to their nominal expenditure ceilings and resist using the existing budgetary room for increased spending especially since the tax burden in Sweden was the highest in the OECD area. The authorities should even go further and stay below the expenditure target in the event of savings in unemployment benefits during the current cyclical upswing. Overruns in sickness and disability benefits were a concern and needed to be analyzed; the authorities should ensure that these overruns were short lived and covered by savings elsewhere in the budgetary envelope.

Provided that the expenditure ceilings were respected, Directors felt that there was considerable room for lowering the tax burden over the next few years as the underlying fiscal position was already in very substantial surplus. To err on the side of caution, tax cuts should be spread evenly over the medium-term and measures planned for the period beyond 2001 should be reviewed on the basis of economic and fiscal developments in 2001. The tax cuts should encompass both labor and capital incomes and could include maintaining the government's current strategy of offsetting employee pension fees through income tax credits, lowering state income tax rates and capital tax rates, and raising the wealth tax threshold.

Directors considered that such a fiscal policy should be consistent with the need to avoid overheating. In particular, Sweden was not yet particularly advanced in the cycle, the tax cuts would coincide with a corresponding decline in cyclically adjusted expenditures and automatic stabilizers were stronger in Sweden than in other countries. The type of tax cuts envisaged would also expand the supply of resources in the economy because of their incentive effects. However, there would also be a need for supportive monetary and structural policies.

Directors noted that through its inflation targeting framework, the Riksbank had successfully managed to control inflation in recent years without raising interest rates too aggressively early in the business cycle. A less accommodative stance would likely be required by Fall 2000. However, as long as wage developments were moderate in the new wage round, a gradual return to a cyclically neutral level of interest rates in the first half of 2001 would probably be sufficient to keep inflation prospects in line with the inflation target over a 2 year horizon.

On structural issues, while changes were becoming evident, more needed to be done to prevent the current upswing from ending prematurely. Directors acknowledged that the wage formation process was placing increased emphasis on mediation procedures and differentiation based on effort, but pressed the authorities to remain vigilant to avoid returning to the wage inflation of the 1970s and 1980s. Wage differentiation needed to become more widespread on sectoral and skill levels while maintaining an aggregate ceiling for the wage bill.

Directors noted that the authorities were considering a reform of the unemployment insurance system with the laudable aim of tightening the relationship between the the benefit level and the intensity of job search. However, the current system was already fairly strict; the problem with the system was that the rules were not being implemented properly, associated with the difficulty in assessing whether an individual is actively searching. Directors were therefore supportive of the staff's suggestion to introduce a generous initial level of unemployment benefit that would then decline with the duration of unemployment. Directors commended the authorities for their pension reform, but recommended raising the current statutory retirement age to fully utilize the enhanced retirement age options embodied in the new reform.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. As part of a pilot project, the staff report for the 2000 Article IV consultation with Sweden is also available.

Sweden: Selected Economic Indicators

	1997	1998	1999	2000 1/	2001 1/
Real economy (change in percent)					
Real GDP	2.0	3.0	3.8	4.4	3.4
Domestic demand	0.9	3.8	3.6	3.6	3.5
CPI	0.5	-0.1	0.4	1.4	1.8
Total unemployment rate (in percent)	8.0	6.5	5.6	4.6	4.0
Of which: Labor market programs	4.3	3.9	3.1	2.9	2.6
Gross national saving 2/	18.6	19.6	19.5	19.8	20.2
Gross national investment 2/	15.0	15.8	16.6	16.8	17.3
Public finance (in percent of GDP)					
General government financial balance	-1.7	1.9	1.9	3.4	4.1
General government debt	75.0	72.4	65.5	56.7	52.4
Money and credit (end-year, percent change)					
M0	3.0	5.1	12.0	7.3 3/	...
M3	1.3	2.1	9.9	11.2 3/	...
Interest rates (year average)					
Three-month interbank rate	4.4	4.4	3.1	4.0 3/	...
Ten-year government bond yield	6.7	5.0	5.0	5.1 4/	...
Balance of payments (in percent of GDP)					
Trade balance	7.3	7.0	6.7	7.1	6.9
Current account	3.2	3.0	2.7	2.6	2.5
Reserves (gold valued at SDR 35 per ounce end of period, in billions of SDRs)	8.2	10.2	11.2	11.4 3/	...
Exchange rates					
Exchange rate regime			Floating exchange rate		
Present rate (July 21, 2000)			US$1 = SKr 8.946		
Nominal effective rate (1995=100)	105.5	103.2	101.8	103.6 4/	...
Real effective rate (1995=100) 5/	104.8	101.7	10.2	96.7 6/	...

Sources: IMF, *International Finance Statistics*; the Riksbank; and IMF staff projections.

1/ Staff projections, except where noted.
2/ In percent of GDP.
3/ May 2000.
4/ June 2000.
5/ Based on relative normalized unit labor costs in manufacturing.
6/ March 2000.