

Opinion of the Economic and Social Committee on 'Sweden: economic situation and implementation of the structural reforms envisaged by the Cardiff process and the Council recommendation on economic policy'

(2002/C 48/30)

On 28 February 2001, the Economic and Social Committee, acting under Rule 23(3) of its Rules of Procedure, decided to draw up an opinion on 'Sweden: Economic situation and implementation of the structural reforms envisaged by the Cardiff process and the Council recommendation on economic policy'.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on this subject, adopted its opinion on 13 November 2001. The rapporteur was Mr Kenneth Walker.

At its 386th plenary session (meeting of 29 November 2001) the Economic and Social Committee unanimously adopted the following opinion.

1. Introduction

1.1. On 13 February 1998, the Section for Economic, Financial and Monetary Questions of the ESC published a report on the Economic and Social Situation in Sweden. In its report the section listed a number of advantages and disadvantages which Sweden could have encountered as a result of not joining EMU, such as:

- it did not have to rely on employment and wages as the only variables which could be used for regulating Swedish economic competitiveness;
- unstable exchange rates leading to high real interest rates;
- a decline in foreign investment, with investors preferring the security offered by monetary stability in euroland and the resulting trade outlets.

The analysis set out in the present opinion would appear to point to the fact that Sweden's decision not to join EMU did not have a major impact on its economy.

1.1.1. This present opinion is intended as a follow-up to that report, with specific reference to the progress which has been made in the implementation of the structural reforms envisaged by the Cardiff process and the objectives set out in the Presidency Conclusions of the Lisbon European Council. This assessment has to be made against the background of the EU's Broad Economic Policy Guidelines, the general economic situation in the country and the macro-economic developments that have taken place during the period under review.

1.2. The Presidency Conclusions of the Lisbon European Council recognised that the European Union is confronted with a quantum shift resulting from globalisation and the challenges of a new knowledge-driven economy. In response to these challenges it set a new strategic goal for the next decade: to become the most competitive and dynamic

knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.

1.2.1. Achieving this goal requires an overall strategy aimed at:

- preparing the transition to a knowledge-based economy and society by better policies for the information society and R & D, as well as stepping-up the process of structural reform for competitiveness and innovation and by completing the internal market;
- modernising the European social model, investing in people and combating social exclusion;
- sustaining the healthy economic outlook and favourable growth prospects by applying an appropriate macro-economic mix.

1.2.2. Implementing this strategy would be achieved by improving the existing processes, introducing a new open method of coordination at all levels, coupled with a stronger guiding and coordinating role for the European Council to ensure more coherent strategic direction and effective monitoring of progress.

1.2.3. Since that date, some of the momentum generated by the Lisbon Council has been lost; other priorities have supervened and economic growth in the EU has fallen significantly below the average rate of 3 % which the Lisbon

Presidency Conclusions envisaged as a 'realistic prospect for the coming years'. There is a danger that the objective could be lost sight of unless firm measures are taken to ensure that it remains the focus of attention.

1.3. It is in this context that the Committee has taken the initiative to monitor and report on the progress made in individual Member States towards achieving this new strategic goal. This opinion on the state of affairs in Sweden is the first to be drafted under this new approach

2. Overview of the Swedish economy

2.1. In 1970, Sweden had the fourth-highest per capita GDP in the world; a decade later, it had fallen to eighth position and by 1998 it had dropped to seventeenth (Table 1). This progressive decline in relative terms has been mirrored by the Swedish Krona, which has lost 50 % of its value against a basket of the currencies of 11 leading competitor countries over the same period (Table 2).

2.2. In the 1960s and the early part of the 1970s, economic growth in Sweden was the highest in the world except for the USA and Japan. In the 1980s, economic growth began to decline but employment levels remained high, largely because the public sector expanded to absorb the surplus labour (Table 3). At the beginning of the 1990s, the economic downturn dipped into recession and the public-sector expansion was no longer able to keep pace with the contraction of private-sector employment, resulting in a sharp but relatively short-lived rise in unemployment (Table 4).

2.2.1. Over the period 1970-2000, public-sector employment increased by 800 000 and private-sector employment decreased by 200,000. At the end of last year, 32 % of all employed persons were engaged in the public sector, compared to an EU average of 20 %. The total workforce is of the order of 4 000 000.

2.2.2. This ratio is reflected in the level of public-sector expenditure in Sweden which, in 1999, accounted for 56.4 % of national GDP compared with an average of 46.7 % in the EU and 38.1 % in the OECD countries (Table 5), although a decline in this figure took place at the end of the 1990s.

2.3. The recession of the early 1990s precipitated an economic crisis; central government debt doubled in only a few years, interest rates rocketed, open unemployment rose to a peak of 8 %, the fixed exchange rate of the Swedish Krona to the ECU had to be abandoned and the negotiability of Swedish

government bonds was severely reduced. There were even rumours that the country might have to resort to assistance from the IMF. In response, the Swedish government introduced a budget consolidation programme in 1995.

2.3.1. This consolidation programme, amounting to some EUR 5 billion in the first year and a total of EUR 12 billion over the period 1995-1998, was predicated on significant cuts in public expenditure combined with substantial increases in taxation. The programme was deliberately front-loaded, with the bulk of measures being concentrated at the beginning of the period in order to demonstrate the determination of the Swedish government and restore the confidence of the financial markets in its ability to resolve the problems.

2.3.2. In order to secure acceptance of the consolidation programme by the electorate, the burden was balanced almost equally between expenditure reductions and tax increases. The distributional effect of this was that the top 20 % of income earners contributed some 40 % of the consolidation and the bottom 20 % contributed 10 %.

2.4. In order to maintain the stability of the economy and ensure that the effects of the consolidation programme were not dissipated, major institutional reforms in the budget process were initiated. The new budgeting model created a top-down process whose most important feature is an expenditure ceiling on central government spending. This takes the form of a three-year rolling ceiling in which the ceilings for the previous years two and three (now years one and two) are left untouched and only the ceiling for the new year three remains to be decided.

2.4.1. While the possibility exists of making subsequent substantive changes to the ceilings in the light of economic developments, this has not been utilised since the system was introduced. One reason for this is that the budgeting process incorporates a safety margin designed to permit minor adjustments for unpredicted events without exceeding the predetermined ceiling.

2.4.2. The precise level of the expenditure ceiling in each year is determined by the long-term objectives of the government's budgetary policy. In order to reduce the level of accumulated government debt and consolidate government finances in the face of adverse demographic trends, this is currently aimed at producing a surplus of 2 % per annum on average over the business cycle. To date, this target has been achieved or exceeded in every year. This fact could give the government room to manoeuvre by allowing the surplus to undershoot the 2 % target in the current year, if economic conditions require, provided that the moving average rate is maintained above the 2 % level.

2.5. This programme has been outstandingly successful. Table 6 demonstrates the extent of the recovery in terms of real GDP growth, private consumption, government borrowing, employment, labour factor productivity and inflation. The net improvement in public finances resulting from this programme has exceeded 12 % of GDP in the period 1995-2000. Following a budget deficit of 11 % of GDP in 1993, Sweden achieved a surplus of 2 % of GDP in 1998, a turn-round which is remarkable by any standards.

2.5.1. The Swedish economy expanded at a rate of 4 % per annum in 1999 and 2000, well above its estimated potential growth rate of 2.5 %. This rapid increase in total demand has been broadly based, with significant contributions from both domestic demand and exports. In addition, business investment has risen considerably, underpinned by the strength of other demand components and low interest rates. Against this background of robust and balanced growth, the fiscal balance has continued to improve while the current account has deteriorated only modestly. At some 2 %, economy-wide labour productivity gains over the most recent three years have been half a percentage point above the average of the last two decades. Likewise, the employment growth has been significantly above trend, leading to a sharp decline in open unemployment to around 4 % at the end of last year (5.9 % according to the harmonised Eurostat method of calculation), in line with the government's declared target.

2.5.2. The overall picture of a benign macro-economic situation is completed by the fact that inflation has remained remarkably subdued, with consumer prices having increased by a mere 0.75 % in 1999 and just 1.25 % in 2000. This is reflected in the level of business confidence; in a survey carried out by Eurochambres at the end of last year, prospects for 2001 were considered positive by 73 % of responding companies and almost no respondents expected 2001 to be less favourable than 2000.

2.5.3. The post-recession growth has been due in part to the fact that the recession eliminated the poorest-performing firms and stimulated the survivors to increase their efficiency.

2.6. All in all, the Swedish economy is probably stronger and better balanced than at any time since the heady days of the early 1970s. With savings/investment balances and international competitiveness both in reasonably good shape, there are no imminent risks to activity and a repetition of earlier sharp recessions is inherently unlikely. Growth has been strong and based on a solid foundation, although the labour market is becoming tighter.

2.6.1. Indeed, this last factor points to the one possible cloud on the horizon. Considerable uncertainty surrounds estimates of the current level of potential GDP and the output gap. Swedish analysts generally concur that there remains a certain amount of excess capacity and that the output gap will close only towards the end of this year or even into next year; other observers postulate that the output gap may already have closed last year.

2.6.2. This raises the question of the sustainability of low inflation at the current set of interest rates. While inflation expectations have been solidly anchored to the inflation target of 2 %, this must be weighed against indicators of increasing labour shortages and the fact that nominal wage increases in Sweden have remained slightly higher than in its trading partners, even if they have been low by historical standards. Suppression of rent increases, due to what amount to de facto rent controls, has contributed to low inflation; in addition, real wage gains have exceeded productivity increases and profit margins have been squeezed in recent years, which contrasts with developments in most other countries. Against this background, inflationary pressures could gradually build up in the medium term if the economy continues to expand at rates above potential. The unexpected surge in both headline and underlying inflation in April and May of this year emphasises this danger. In addition, the persistent weakness of the Krona poses an increasing risk of medium-term inflation. There can be little doubt that, in recent months, the balance of inflation risk has shifted to the upside.

2.7. In this context, the current global economic downturn could assist in containing demand within the level of long-term equilibrium. Looking ahead, if weaker global demand were to ease medium-term inflation concerns, this would permit a more relaxed monetary stance than would otherwise be appropriate. The adverse impact of the global slowdown could be larger in Sweden than in other Member States because of the relatively high dependence of the Swedish economy on the technology sector, which has been the hardest hit world-wide.

2.8. The most worrying scenario is that of rising inflation despite continuing sluggish economic growth. This could force the monetary authorities to raise interest rates in order to keep inflation under control, thereby prolonging the economic retrenchment and possibly resulting in recession, the macro-economic phenomenon known as stagflation. However, the deft economic management displayed by the Swedish government in recent years and the Riksbank's consistent monetary framework, widely regarded as an example of best practice in monetary policy management, should be sufficient to ensure that this danger is averted.

3. Social policy

3.1. Sweden has one of the most comprehensive and generous welfare systems in the world. It is a system based on the principles of solidarity and social cohesion, where social benefits are regarded as a fundamental right of citizenship and not as a form of charitable dispensation; they are treated as part of the essential fabric of society and not as a burden on the State. There is a wide measure of consensus in Sweden on this issue; even employer representatives largely accept that high levels of taxation are an ineluctable concomitant of the social model to which they subscribe. Taxes in Sweden are amongst the highest in the EU (Table 7).

3.2. The economic crisis of 1994 administered a severe shock to this system. Although the government took care to ensure that the necessary economies were achieved approximately equally from reductions in expenditure and increases in taxation, the resulting cuts in benefits hit many people hard and were hard for many people to accept. In any welfare system there is a natural tendency for the contributors to feel that they are contributing too much and for the recipients to feel that they are receiving too little. These feelings are enhanced when increases in the contributions occur simultaneously with reductions in the benefits; both sides are inclined to protest that they are not getting value for money.

3.3. It is a measure of the extent of social cohesion in Sweden that the principles of solidarity were able to survive this experience. There is still a broad consensus that the welfare state lies at the heart of a stable society but there is now an equally wide acceptance of the fact that sound public finances are an essential prerequisite for the existence of such a system. It is now recognised that deficit financing leads to a loss of sovereignty because government policy becomes increasingly dictated by the demands of the lenders and the servicing of the debt absorbs such a large proportion of government revenue that the amount available for spending on social welfare measures is significantly reduced.

3.3.1. Therefore, if a government is to preserve its independence of action it must balance its expenditure with its income over the long term. Governments need to retain the confidence of their electorates and of the financial markets; in order to do both, they must, *inter alia*, observe the principle of transparency. In the final analysis, solvency is the key to independence.

3.3.2. The improved state of the Swedish economy has led to pressures from some quarters for a relaxation or even the abandonment of expenditure ceilings; it is argued that such measures are only appropriate to a crisis situation and cannot be justified as a permanent feature of macro-economic policy. The government has rejected these arguments; it points out that each year's ceilings are determined by an estimate of the long-term sustainable level of expenditure and not by

predictions of the revenues in any single year. This enables it to formulate a welfare policy that is capable of being sustained in the long term and does not leave the welfare state dependent on the evolution of the business cycle. The government is determined to avoid a return to the situation where downturns in the business cycle force it to choose between retrenchments in welfare-state provision or deficit financing which leaves it at the mercy of external influences.

3.3.3. In this, it has effectively elected to follow the fundamental macro-economic strategy which has been employed in the United States since 1990. Prior to that, the strategy was that the US federal government budget would be brought into balance by setting statutory targets for the deficit; although this had the effect of restricting the annual deficits, it never succeeded in balancing the budget for the simple reason that government spending was allowed to rise in expansionary phases of the business cycle and could not then be curtailed sufficiently in the downswing.

3.3.3.1. After 1990, the focus was put on strict control of expenditure without setting specific deficit targets. In a cyclical down-turn, the budget deficit is allowed to increase to the extent that the increase results from the effects of built-in stabilisers; during an economic boom, on the other hand, the deficit must narrow, as the favourable situation on the revenue side may not be used to finance additional spending but may only be used for consolidation. Consequently, this strategy implies a deficit that 'breathes' in rhythm with the business cycle and one that, moreover, owing to its anti-cyclical orientation, has the effect of stabilising the business cycle.

3.3.3.2. This contra-cyclical strategy is similar to that upon which the Swedish government has now embarked. This policy has been singularly successful in the United States; as Table 6 shows, there is no reason why it should not be equally successful in Sweden. Such a policy is, of course, conditional on other policy areas, especially monetary policy, providing consistent support to economic expansion. Sweden, which is not currently a member of EMU, retains independent control over its monetary policy within the constraints of the Stability and Growth Pact.

3.3.3.3. In the short to medium-term, the Swedish government will probably have to take a rather more restrictive attitude to expenditure limits than the US government has adopted because of the need to combat the negative demographic trends. Hence the decision to aim for an average annual surplus of 2% rather than a balanced budget.

4. Employment

4.1. Sweden has one of the lowest open unemployment rates in the EU; in 2000, the actual rate of unemployment, at 4 %, was below the non-accelerating inflation rate of unemployment (NAIRU), as shown in Table 8. However, as with most countries, there are marked regional discrepancies; unemployment in the north of Sweden is three times higher than in Stockholm and there are pockets of relatively high urban unemployment.

4.1.1. Sweden's employment and participation rates are amongst the highest in the world. In 2000, the employment rate was 75 % and the participation rate was 78 % of the working-age population. Although this represents a decline from the position in 1990, when both rates stood at 85 %, Sweden's current employment rate is considerably higher than the EU average and higher than the USA, Japan and most of the Member States. Nevertheless, the government has set an objective of raising the employment rate for persons in unsubsidised jobs to 80 % by 2004; this implies the creation of some 110 000 new jobs. It will, in fact, be necessary to increase the participation rate if output growth is to be maintained, since an increasing number of companies are reporting labour shortages across a wide spectrum of industrial sectors. In a Eurochambres survey conducted at the end of last year, 35 % of responding companies expected to have to increase their workforce in 2001. Sweden is one of the four Member States which have announced that they will grant free and open access to their labour markets to the nationals of new Member States from the date of their accession.

4.1.1.1. One unexplained factor of the Swedish labour market is the high level of absenteeism through sickness, which now averages some 10 % of the nominal working capacity. This figure has tended to rise in line with falling unemployment and has led to a rapid increase in sickness benefit payments, thereby putting additional constraints on other areas of government spending in the context of the expenditure ceilings. The figures are higher in the public sector than the private sector and lowest of all amongst workers in SMEs.

4.2. The Swedish government favours the use of active labour-market policies (ALMP) to deal with unemployment. Its strategy is to keep people in the labour market on the grounds that if early retirement is used as a tool to reduce unemployment in times of economic slow-down it is difficult to persuade those people to re-enter the labour market in times of labour shortages. It is also considered dangerous, as well as socially divisive, to allow large groups of people to remain outside the labour market for long periods of time. ALMP policies are aimed primarily at improving the employability of people; they do not have the objective of creating jobs.

4.3. As part of this strategy, an activity guarantee came into force on 1 August 2000. It applies to persons registered at the public employment service (PES) who receive either unemployment or other social benefits and who have not had ordinary (i.e. unsubsidised) work for 27 months. This group comprised 50 000 persons (1.25 % of the workforce) at the end of last year, despite the relatively low level of unemployment.

4.4. There is a requirement that job-seekers participate in an ALMP or some other education in order to build their human capital. Each activation within the framework of the activity guarantee must be planned for a maximum period of six months but there is no fixed time limit to the total duration of the activity guarantee period; in principle, it may be open-ended.

4.4.1. Criticisms which are sometimes levelled at the ALMP by employers and others include:

- that the training provided is not always relevant to the current requirements of employers;
- that training without job creation merely creates better-qualified unemployed persons;
- that ALMP have tried to do too much and set themselves too many objectives;
- that there are too many strata of labour-market activity and too many layers of management;
- that the process is too slow and focused on the wrong areas;
- that when people are the subject of ALMP programmes they cease to look for active employment;
- that the system discourages labour mobility by subsidising commuting costs;
- that employers prefer people with 'real' job experience.

4.4.2. Financial support is available to persons who are unemployed or in danger of becoming unemployed to enable them to start up in business on their own account, provided that they are judged to be capable of running a business.

4.4.3. Special introductory and follow-up support is available for job-seekers with occupational disabilities. This support is given both to the job-seeker and the employing organisation by a consultant with special knowledge of introductory methodology.

4.4.4. Including participants in the Adult Education Initiative, 220,000 persons (full-time equivalents) took part in ALMP programmes in 2000, corresponding to some 5 % of the workforce. Total ALMP expenditure amounted to over 2 % of GDP (Table 9), which, despite the relatively low unemployment rate, is more than in any other OECD country.

4.5. In addition to ALMP, the government pays subsidies to employers who take on long-term unemployed workers. Both private and public-sector employers can receive General Employment Subsidies of 50% of wages up to a limit of SEK 350 per diem in respect of workers who have been unemployed and actively seeking work for more than twelve months; Reinforced Employment Subsidies are available on a sliding scale of higher rates for workers who have been unemployed for twenty-four months; for workers aged over 57 who have been unemployed for twenty-four months, Special Employment Subsidies are available, equating to 75 % of wages up to SEK 525 per diem, with a limit of two years. Active Labour Market Policies are twice as expensive as subsidised employment but there are concerns that employers may exploit the subsidy system to obtain subsidised labour.

4.6. As Table 9 shows, the level of maximum gross unemployment benefits is amongst the highest in Europe; the formal stringency of eligibility criteria for unemployment benefits is relatively high but these are not always strictly applied. The theoretical duration of the unemployment benefit period is 300 days but this can effectively be extended by a further 600 days if the recipient enters a training scheme. Supplementary benefits permit an individual to work part-time and receive unemployment benefits for the remaining hours of a standard work-week; the generosity of these arrangements means that the marginal benefits of working longer hours are minimal.

4.6.1. The unemployment benefit replacement rate is fixed at 80 % of preceding wage income, up to a certain income level, but there is a strong political commitment to increase this, as the application of the limit means that a large proportion of the workforce receives less than 80 %.

4.7. A World Competitiveness Report, prepared by the International Institute for Management Development (IMD) in 2000, indicated that labour market regulations in Sweden were still relatively restrictive compared to other EU Member States and other leading world economies (Table 10).

5. Pensions and the demographic challenge

5.1. In common with most other developed countries, Sweden faces severe demographic problems in the next half-century. The current situation is set to get dramatically worse in the near future as the post-war 'baby-boom' generation comes to retirement age. Demographic concerns in Sweden have been heightened by the low birth-rate which, at 1.4, represents a sharp fall from the level of over 1.7 in 1995. This drop is considerably more pronounced than that experienced by any other Member State and gives Sweden one of the fastest-ageing populations in the EU. By 2030, the ratios of people under working age, those of working age and those above normal retirement age will be 21.6: 54.4: 24. Even with a participation rate as high as 80 %, this would mean that every active person would have to support 1.3 inactive persons. On present projections, the situation will have worsened still further by 2050. The current level of unfunded pension commitments as a proportion of GDP is 26 %.

5.1.1. The demographic situation in Sweden is exacerbated by a national tendency to retire well in advance of the statutory retirement age and by the high average standard of health enjoyed by the Swedish population, which increases life expectancy there well beyond the levels found in some other Member States. The trend towards longevity in the population is increasing in nearly all developed countries. Failure to adjust regularly for these increases in life expectancy has contributed to the cost crises faced by many national social security systems today.

5.2. The old pension system was conceived in the 1950s in an economic environment of consistent 4 % real growth and life expectancies much below their current levels. As the rate of per-capita wage growth slowed to an average of about 2 % and labour-force growth stagnated, experts became concerned that the contribution base would not increase sufficiently rapidly in future to support the anticipated increase in old-age pensioners. Actuarial calculations showed that it would be necessary to raise the contribution rate considerably in order to meet future commitments, although the extent of the problem depended, as usual, on the actuarial assumptions made about the future. The fact that it was not possible to say today what the likely outcome would be tomorrow was itself seen to be a problem. There is general agreement that it is important to be clear about the content of the inter-generational commitment of the pay-as-you-go (PAYG) system.

5.2.1. The concerns felt by the experts were shared by the general populace. In the early 1980s, there emerged an increasingly widespread belief among the public in general that the system could not meet its "promises" for the future. Younger workers, in particular, were becoming more and more sceptical about their prospects as pensioners; in short, trust in the system was eroding. The deep economic recession of the early 1990s, and the accompanying fall in the contribution base by around 10%, finally brought home the acute need for reform to a broad spectrum of political interests.

5.3. Faced with this situation, the government set up a Pensions Working Group in 1992 with a mandate to reform the then existing pension system in order to make it more sustainable. The first legislation for the reform came in June 1994. Social security reforms are inherently political and, in the end, inevitably represent compromises between various interests. One of the strengths of the Swedish reform process is that the reform emerged out of a political consensus among five of the seven parliamentary parties in 1994, representing over 80 % of the voters. This broad political support has continued.

5.3.1. The over-riding principle of the reform is that which has guided Swedish social policy since the 1950s. This is to provide an adequate earnings-related retirement benefit with universal coverage for all persons working and residing in Sweden, backed up by a safety net that guarantees a reasonable standard of living for the elderly. The Swedish reform has four main goals, viz:

- fair treatment of persons with different contribution histories; two persons who have paid the same amount in contributions and who retire at the same time and the same age should be entitled to the same benefit;
- transparent redistribution; this goal is achieved by a redistribution policy financed by general budget resources earmarked specifically for this purpose;
- financial stability in the face of changes in demography and the economy;
- the creation of financial saving managed by private financial institutions.

5.3.2. Thus, during the period during which the large birth cohorts of the 1940s will drain the reserves of the present PAYG pension fund, the public financial saving will be maintained through the creation and growth of new second-pillar saving from younger workers. A result of the reform is that older workers will be able to combine earnings from work and retirement income in any way, with the same tax rules applying for both earnings and benefits.

5.4. The total contribution rate on earnings for the new system will be 18.5 %, financed equally by employer and employee contributions, of which 2.5 % will be allocated to a premium pension element. This can be invested in private market funds chosen by the employee. This has had the effect of introducing a funded element into what was previously an exclusively PAYG system. For those who do not reach a minimum level, there is a guaranteed supplementary pension funded by the state.

5.5. The second pillar in the pensions system comprises an occupational pension funded by the employer and the employee. This also now includes a premium pension element. Moreover, many people supplement their pensions with a private pension.

5.6. In view of the demographic situation outlined above, it seems inevitable that there will have to be further moves in the direction of funded rather than PAYG schemes over the next thirty years. This does not necessarily involve privatisation of the system; it is perfectly possible, and indeed desirable, for governments to operate funded schemes.

6. Research and Development

6.1. Expenditure by companies and governments on R & D is the single most important source for the development of new ideas. Whilst expenditure on R & D is considerably higher in the USA than in Europe, Sweden has the highest level of research and development expenditure per capita in the EU. As Table 11 shows, Swedish expenditure exceeds Japan's, is approaching American levels and is nearly double the average for the EU-14 (excluding Luxembourg).

6.2. Research expenditure in Sweden accounts for some 3.8 % of GDP but 85 % of this is carried out by companies and therefore tends more towards applied research than basic research. A cause of concern in this area is the number of leading Swedish companies which have been taken over by foreign-owned multi-national corporations, a process which is likely to continue. One consequence of this is that research might be concentrated by these companies in global research centres, which could have the effect of down-grading their Swedish research operations.

6.3. Universities have traditionally been seen as the home of pure research but they are becoming increasingly involved in the field of commercial exploitation. The principal source of revenue for university research departments is now the spinning-off of companies rather than the patenting of inventions. In this context, the fact that Swedish law gives all patent rights to the inventor, no matter how the research has been

funded, acts as a constraint on basic research activity by reducing the income available to the university to fund further research projects.

7. The New Economy

7.1. The last decade has seen the emergence of a 'new economy' based on the exploitation of Information Technology (IT). One of the main reasons for this is that the Internet has created and imposed a global standard. This is possibly the most significant standard that has ever been created. Before the creation of this standard, computers used different technical platforms, which were incompatible; customers were therefore locked in to a given system. The effect of the standard has been to empower IT users as never before and, in the process, bring about a widespread and fundamental restructuring of all types of commercial, industrial, governmental and private activity. The process of globalisation stems from the capability for the free exchange of information.

7.2. Traditionally, technology has been regarded as the application of scientific discoveries; today's IT has changed this — the discoveries are now being made at the technological level. IT differs from previous leading-edge technologies in that it rationalises and accelerates information flows rather than moving objects. The New Economy involves new conditions for the entire economy; IT is not merely a question of successful IT companies but also the effects of the use of IT in all types of enterprises and organisations, including the public sector. The new technology involves a fundamental restructuring of the flows of corporate information. The old boundaries are disappearing:

- between nations;
- between industries;
- between goods and services;
- between and within companies;
- between employers and employees;
- between blue and white collar workers;
- between work and leisure;
- between work and home.

7.3. Individuals experience the impact of the New Economy in many ways. As consumers, they can benefit from better information, from a greater choice of goods and services and from lower prices through access to a global marketplace; as employees, they can benefit from more independent work, both individually and in teams, from greater responsibility and authority, from the scope for higher earnings and the opportunity to learn new skills throughout their working lives; as citizens, they can be better informed, more influential and able to maintain closer contacts with government.

7.4. Sweden was one of the pioneers of the use of IT. Swedish companies and government authorities were quick to invest, and invested heavily, in the new technology. This process was facilitated by the following factors:

- a high level of management skills in Swedish companies;
- a generally high level of education in the population;
- an absence of trade union resistance to the introduction of new technologies.

7.4.1. On the domestic front, the government made a major contribution to the spread of computer literacy by introducing a tax-break scheme for the purchase of personal computers for home use. As a result, Sweden's total IT expenditure as a percentage of GDP is not only higher than that of any other country in Europe but higher than the USA and considerably higher than Japan (Table 12). In terms of the Information Society Infrastructure Index compiled by IDC (part of the International Data Group) in 2000, Sweden leads the world (Table 13).

7.5. This New Economy is characterised by high total factor productivity growth and low inflation. Table 14 shows that the Nordic countries (Sweden, Denmark, Finland and Norway) have shown a sharp drop in inflation combined with a strong increase in total factor productivity over the reference period; the USA has exhibited the same trends but not to the same extent. Conversely, the EU (excluding the Nordic countries, the UK, the Netherlands and Luxembourg) has shown reduced inflation but a dramatic decline in total factor productivity; Japan has shown a similar pattern but to a less marked degree. This is reflected in the positions of the leading and lagging countries in the New Economy according to the European Commission's benchmarking study in 1998 (Table 15).

7.6. One of the Lisbon objectives was for Member States to ensure generalised electronic access to main basic public services by 2003. This is the only indicator in which Sweden does not feature amongst the leading IT countries; in this respect, Sweden falls marginally below the EU average (Table 16). This is a benchmark of the progress which national governments have made in exploiting the potential of the Internet. It measures the capacity of governments and companies to use the Internet to complete mandatory administrative processes (B2A); more effort is needed in this area in Sweden.

7.7. In order to maintain Sweden's lead in the New Economy and exploit the benefits it offers, certain measures will have to be taken. Swedish companies, employees and households have been quick to adopt the new technologies but there is a need to increase the acceptance of change. Trade unions will need to maintain the flexibility of their approach to new technologies, new working methods, new organisational techniques and new forms of remuneration. Exploiting the potential of the New Economy requires capital; improvements need to be made in the availability of equity-based risk capital, particularly venture capital and particularly for SMEs. Another beneficial measure would be the creation of shared commercial facilities to enable SMEs to develop their business-to-business (B2B) and business-to-consumer (B2C) capabilities.

8. Privatisation and deregulation

8.1. Deregulation and exposure to competition of publicly-financed activities began on a large scale in Sweden in the 1990s. At the same time, competition laws have been strengthened and aligned more closely with EU norms. However, a substantial part of the Swedish economy is still protected from competition. Public-sector activity in Sweden still amounts to SEK 650 billion, of which around SEK 150 billion is open to competition. Some sectors both under public and private ownership, continue to be under-exposed to competition, notably in retail distribution, while others, such as housing, remain heavily regulated. In some areas, notably telecommunications, more needs to be done to regulate the position of the incumbent supplier and remove barriers to entry.

8.2. As in other countries, the results have been mixed. Trade in electricity and the production of electricity has been opened to competition and there are now approximately 160 firms engaged in these activities. As a result, Sweden has the lowest prices for electricity supplies to domestic consumers

in the EU, although a very sharp general price rise in 2001 has prompted the government to review the competitive situation in this sector. The average family can save a substantial amount each quarter by choosing the appropriate service provider. The deregulation of taxis has led to a reduction in prices and a 25 % increase in the number of taxis available. Deregulation of the service markets has led to strong growth.

8.2.1. On the other hand, the privatisation of commuter trains in the Stockholm area initially led to a year of chaos because the process had been badly prepared and there have been some instances of a deteriorating standard of care for the elderly where these services have been privatised.

8.3. In general, consumers have been the principal beneficiaries of the process but employees have also benefited from a wider choice of employers and the positive effects which privatisation has had in most cases on job creation. A recent public survey showed that 46 % of those surveyed thought that, overall, the results had been positive, while 27 % thought they had been negative; 65 % were in favour of the principle of being able to choose between public and private service providers and only 15 % were opposed to it.

8.4. Some concerns have been expressed that, following deregulation, state monopolies in other countries have entered the Swedish market, creating distortions of competition by taking advantage of their monopoly situation in their home market. It is felt that this is tantamount to the re-nationalisation of parts of the Swedish economy by other Member States.

8.5. The government has taken the initiative of reducing the burden of bureaucracy on small companies by exempting the smallest firms from some regulations. This should have the effect of encouraging company formation and improving the success rate.

9. Taxation

9.1. As has already been indicated, Sweden has very high levels of taxation. The strategy for the future must be to build on the achievements of recent years by enhancing the efficiency of the tax-benefit system and its effectiveness in delivering social support. In the medium to long-term there remains substantial scope for the continuing rationalisation of the tax benefit regime without compromising its social objectives.

9.2. The taxation system should be designed to maximise the incentivisation of the workforce. At the same time, it is necessary to mitigate the incentive to transform labour into capital income that is a central difficulty of the dual-income taxation regime. Structural reforms to the wealth tax, removing exemptions favouring the wealthiest and raising the threshold to exclude moderate property wealth, would also be beneficial.

10. Conclusions

10.1. The Swedish economy has made a successful recovery from the recession of the mid-1990s and is now in better shape than at any time over the past three decades.

10.2. Central to this recovery has been the imposition of three-year rolling ceilings on government expenditure. This has introduced a counter-cyclical measure into Swedish macro-economic management, which should have the effect of stabilising the business cycle and ensuring the sustainability of the recovery; it should also assist the government to achieve a sustainable level of welfare provision, independent of fluctuations in the business cycle. One negative factor is the possibility of resurgent inflation if output continues to rise above potential. Increasing labour shortages indicate that the output gap will close in the near future if it has not already done so.

10.3. Sweden subscribes to the Nordic social model, which is characterised by a highly-developed system of social protection and correspondingly high taxes. There is a general consensus that the social model must be retained but also that it must be sustainable and adaptable to the paradigms of the New Economy. As Leif Pagrotsky, the Swedish Minister for Trade, has said, 'The challenge is not to dismantle the European social model but to modernise it so as to provide Europe's citizens with security in support of change, rather than security against change'.

10.4. Sweden has both lower unemployment rates and higher participation rates than most other countries. The Swedish government's policy to combat the surge of unemployment in the mid 1990s combined active labour-market policies with subsidised employment. The former are more expensive but are deemed to be more appropriate in the long term; however, some criticisms have been levelled at the

way in which they operate. The OECD has stated that the functioning of the labour market would be improved by further easing of employment protection regulations, by enhancing regional mobility and by continuing the trend of reduced wage compression. The desirability and feasibility of these measures are currently the subject of heated debate in Sweden.

10.5. In common with most other countries, Sweden faces severe demographic problems. The government has recently introduced reforms to the pension system aimed at combating these. While the reforms have improved the sustainability of the pension provisions, more will have to be done if the current expectations of the working population are to be met when they come to retire.

10.6. Sweden spends a higher proportion of GDP on R & D than most other countries but this work is carried out mainly in companies and therefore relates to applied research and development rather than pure research. The internationalisation of Sweden's major companies could lead to these activities being relocated to other countries.

10.7. Sweden is one of the leading players in the New Economy but the pace at which this is advancing and the magnitude of the changes being generated means that it cannot afford to relax its efforts if it is to maintain this position. It is well positioned to take advantage of the opportunities presented but much will depend on the extent to which it is successful in bringing its ample expertise to market.

10.8. There has been a great amount of activity in the area of deregulation and privatisation of state monopolies but substantial portions of the Swedish economy are still protected from competition. Deregulation has not always been unequivocally successful and there are mixed views as to the extent of privatisation which is desirable and the form which it should take but, in general, there is majority support for the principle of enhanced competition. Further down-sizing of the state ownership of market activity appears inevitable. There is need for a wider recognition of the importance of re-training managers who have worked exclusively in a public-sector environment to enable them to adapt to the disciplines of a competitive market place.

10.9. The government has moved to assist small companies by exempting them from some regulations but the development of better systems for financing SMEs remains a priority.

10.10. In many ways, the economic, social and technical evolution of Sweden over the last decade has been a success story. The challenge for the future must be to build on this success by maintaining the technological lead, enhancing

productivity, modernising the labour market and refining the taxation system in order to create a sustainable and improved welfare system which will support the spirit of social cohesion which lies at the heart of Swedish society.

Brussels, 29 November 2001.

The President
of the Economic and Social Committee
Göke FRERICHS
