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BASIC STATISTICS OF SWEDEN, 2011
(The numbers in parentheses refer to the OECD average)

LAND, PEOPLE AND ELECTORAL CYCLE

| | | | | |
|----------------------------------|------|--------|--|-------------|
| Population (1 000 000): | 9.4 | | Population density per km ² | 21.0 (34.3) |
| Under 15 (%) | 16.1 | (18.4) | Life expectancy (years, 2010): | 81.5 (79.7) |
| Over 65 (%) | 19.3 | (14.9) | Males | 79.5 (76.9) |
| Foreign-born (% , 2010) | 14.8 | | Females | 83.5 (82.5) |
| Latest 5-year average growth (%) | 0.8 | (0.5) | Last general election: September 2010 | |

ECONOMY

| | | | | |
|---|---------|-------|-----------------------------|------|
| GDP, current prices (billion USD) | 538.6 | | Value added shares (%): | |
| GDP, current prices (billion, local currency) | 3 492.5 | | Primary | 1.7 |
| Latest 5-year average real growth (%) | 1.5 | (0.8) | Industry incl. construction | 26.3 |
| GDP per capita, PPP (thousand USD) | 41.3 | | Services | 72.0 |

GENERAL GOVERNMENT

| | | | | |
|------------------------|------|--------|---------------------------------|--------------|
| Expenditure (% of GDP) | 51.1 | (45.0) | Gross financial debt (% of GDP) | 49.2 (99.2) |
| Revenue (% of GDP) | 51.3 | (36.8) | Net financial assets (% of GDP) | 20.7 (-59.8) |

EXTERNAL ACCOUNTS

| | | | | |
|--|-------|--------|--|------|
| Exchange rate (per \$) | 6.485 | | Main exports (% of total merchandise exports, 2010): | |
| PPP exchange rate (USA = 1) | 8.946 | | Machinery and transport equipment | 39.8 |
| Exports of goods and services (% of GDP) | 50.1 | | Mineral fuels | 7.4 |
| Imports of goods and services (% of GDP) | 43.9 | | Miscellaneous manufactured goods | 33.8 |
| Current account balance (% of GDP) | 7.0 | (-0.6) | Main imports (% of total merchandise imports, 2010): | |
| Net international investment position (% of GDP) | -7.4 | | Machinery and transport equipment | 36.0 |
| | | | Mineral fuels | 13.4 |
| | | | Manufactured goods | 36.0 |

LABOUR MARKET, SKILLS AND INNOVATION

| | | | | |
|--|---------|-----------|---------------------------------|-------------|
| Employment rate (%) for 15-64 year olds: | 74.1 | (64.8) | Unemployment rate (%): | 7.5 (7.9) |
| Males | 76.3 | (73.0) | Youth (%) | 22.9 (16.2) |
| Females | 71.8 | (56.8) | Long-term unemployed (%) | 1.2 (2.6) |
| Average worked hours per year | 1 644.0 | (1 776.0) | Tertiary educational attainment | |
| Gross domestic expenditure on R&D | | | 25-64 year-olds (% , 2009) | 33.0 (30.0) |
| (% of GDP, 2009) | 3.6 | (2.4) | | |

ENVIRONMENT

| | | | | |
|--|------|--------|--|-----------|
| Total primary energy supply per capita (toe) | 5.2 | (4.3) | CO ₂ emissions from fuel combustion | |
| Renewables (%) | 33.5 | (8.2) | per capita (tonnes, 2009) | 4.5 (9.8) |
| Fine particulate matter concentration | | | Water abstractions per capita | |
| (urban, PM10, µg/m ³ , 2008) | 10.5 | (22.0) | (dam ³ , 2009) | 0.0 |
| | | | Municipal waste per capita | |
| | | | (tonnes, 2010) | 0.5 |

SOCIETY

| | | | | |
|---|------|--------|---|-------------|
| Income inequality (Gini coefficient, %) | 25.9 | (31.4) | Education outcomes (PISA score, 2009) : | |
| Relative poverty rate at 60% of the current median income | 16.4 | (17.7) | Reading | 497 (493) |
| Public and private spending (% of GDP, 2009): | | | Mathematics | 494 (496) |
| Health care | 10.0 | | Science | 495 (501) |
| Pensions | 8.4 | | Share of women in parliament, % | 44.7 (24.4) |
| Education | 5.3 | (3.7) | Net official development assistance | |
| | | | (% of GNI) | 1.0 (0.4) |

Executive summary

The Swedish economy has exhibited resilience in the face of international turbulence, thanks to sound macroeconomic policies and substantial structural reforms carried out since the early 1990s. The main challenge going forward is to maintain robust trend growth and make it more inclusive and stable against the backdrop of a weak and uncertain external environment. Maintaining a high level of welfare will help in pushing ahead with reforms.

The macroeconomic policy stance is broadly appropriate given recent developments and risks. However, there is scope to ease monetary policy further, if needed. Longstanding fiscal prudence also gives Sweden room for discretionary stimulus to support the economy if the outlook turns out to be weaker than expected by the authorities.

Sweden's large banking system entails risks and potential costs. Although matched by substantial assets, high household debt makes households vulnerable to a fall in house prices, an increase in real interest rates or rising unemployment. Disorderly household deleveraging would affect the banking sector. A more effective financial supervisory framework with a well developed macroprudential toolkit would help address these risks. The stricter liquidity requirements that are to come into effect shortly and plans to increase risk weights on mortgages are welcome. A leverage ratio for banks will be important as well.

Addressing the structural problems in the housing market would ensure adequate housing supply, reducing the risks associated with house prices, which have increased substantially in recent years and are high by historical standards. This would require continuing with reforms to raise the supply of rental apartments, to simplify and shorten the building process and to intensify competition in the construction sector. These reforms would have co-benefits as they may enhance welfare and encourage labour mobility.

Making the tax system more conducive to an optimal allocation of wealth would raise potential growth. Low property taxes have contributed to the increase in house prices. Though politically difficult, taxes on owner-occupied housing should be raised to better align the taxation of this type of asset with that of other assets. The taxation of financial assets should be made simpler and more neutral.

There is a need for better labour market integration. Recent labour market performance has been better in Sweden than in many other countries. Nevertheless, some groups such as youth with limited education, some immigrants, and those on sickness and disability benefits are not well integrated. Lower minimum wages relative to the average wage for groups at risk of becoming unemployed, a more efficient vocational and education system, active labour market policies better targeted to individual needs, combined with the existing earned-income tax credit would help these groups find a job and escape the risk of poverty. To the extent that these groups might be trapped in temporary contracts, it will be important to reduce the gap in job protection between temporary and permanent contracts. Health problems can impede labour market integration and lead to exclusion.

The effects of recent reforms of the health system need to be closely monitored to ensure that access to and the quality of health care do not become more unequal.

While most non-employed receive some type of financial assistance, there is variation in terms of benefits, incentives, efficiency of job-search support and job-search monitoring. The unemployed furthest from the labour market are less likely to receive effective support. The coverage of unemployment insurance could be extended, and contributions to unemployment insurance could be made mandatory. In parallel, the unemployed's job-search obligations and the Public Employment Service's power of sanction will have to be strengthened further.

Raising the cost-efficiency of climate change policies would help achieve Sweden's ambitious targets. This would require continuing to gradually phase out exemptions to the carbon tax and to clarify the role and the expected costs and benefits of the long-term priority to have a fossil-fuel independent vehicle fleet by 2030.

Key policy recommendations

Macroeconomic and financial stability policies

- The broadly neutral fiscal stance for 2013 is appropriate under the government's projections. If the economic outlook turns out to be weaker, the government should let the automatic stabilisers work in full. In the event of a sharp or prolonged downturn, discretionary stimulus would be warranted.
- The Riksbank should use the room it has to lower the interest rate further if weak inflationary pressures and the slowdown in activity persist longer or are more pronounced than expected.
- Address gaps in the macroprudential toolkit to supervise and influence financial institutions. Clarify the role of and relationship between the Riksbank, the Financial Supervisory Authority, the National Debt Office and the Ministry of Finance.
- Consider introducing a leverage ratio as a backstop to the risk-weighted capital measures. Continue to closely monitor banks' progress in reducing their wholesale funding dependence and further improve their liquidity reporting framework.

Labour market and social policies for higher inclusion

- Reduce the gap between the labour cost and the productivity of workers at risk. The government should continue talks with social partners to develop employment contracts that improve employment opportunities for such workers. Studies on the impact of minimum wages on employment should be commissioned and published regularly.
- Consider extending the coverage of unemployment insurance by easing the entitlement conditions in terms of duration of past work, and moving to a system with mandatory contributions to unemployment insurance.
- Develop further apprenticeship programmes and work placement in vocational education.

Policies to enhance the efficiency of capital taxation and the housing market

- Move towards more neutral taxation across types of assets. In particular, to tax owner-occupied housing like other assets, a tax on imputed-rent would be first-best. A property tax based on market value could proxy imputed-rent taxation. Alternatively, abolish mortgage interest deductibility.
- Phase out the restrictions on apartment rentals, including on buying an apartment to rent it out. Continue to phase out rent controls so as to more closely align rents with market values.

Climate change mitigation policies

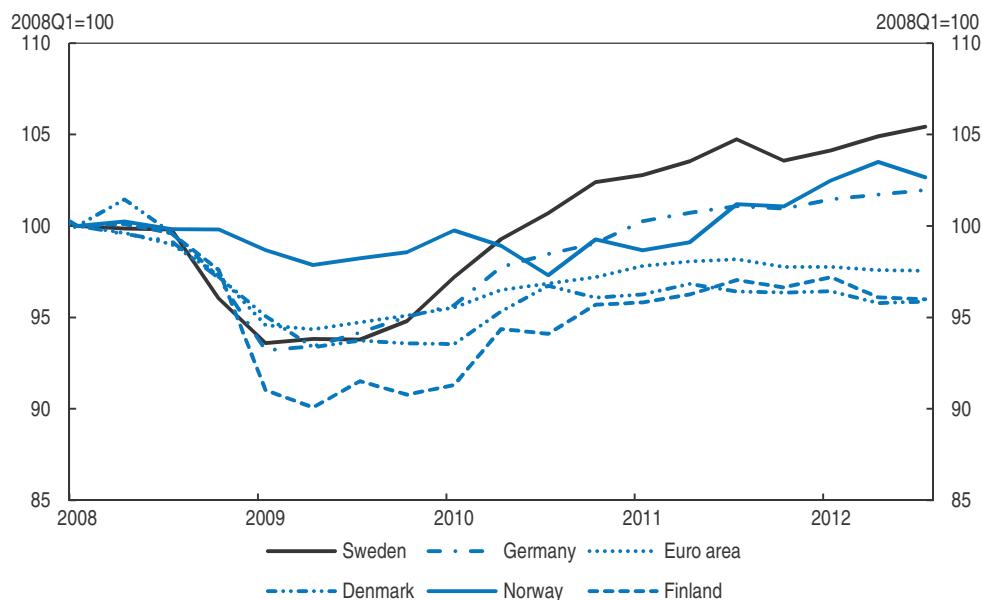
- Continue to gradually phase out exemptions to the carbon tax. Clarify the role and the expected costs and benefits of the long-term priority to have a fossil-fuel independent vehicle fleet by 2030.

Assessment and recommendations


Key challenges

In many areas, Sweden is at or close to the frontier, with high per capita income, low inequality and poverty rates, good health status and environmental quality, a sound balance between work and life and high trust in institutions. Moreover, GDP growth has been strong in recent years (Figure 1). These good outcomes are the fruit of sound macroeconomic policies and substantial structural reforms that have also helped to cope with economic, demographic and other shocks.

Figure 1. **Sweden's growth performance has been strong**



Source: OECD, Analytical Database.

StatLink  <http://dx.doi.org/10.1787/888932756459>

The country withstood the global economic and financial crisis well so far but continues to face risks. The main external risk is an intensification of the euro area crisis, since spillovers would aggravate internal vulnerabilities. Labour market outcomes are better than in many countries but some groups are not well integrated. Inequality and poverty are low but have increased over the past two decades. House prices have risen considerably and, notwithstanding some recent declines, remain high. High indebtedness makes households vulnerable to labour market, housing market and interest rate shocks.

The banking sector is large and concentrated, implying that the economic, fiscal and social costs of adverse shocks could be large.

Hence, Sweden faces both short-term and long-term challenges. In the near term, the challenges are to reduce the likelihood of an abrupt and disorderly deleveraging and limit the rise in unemployment. Over the longer haul, the challenge is to achieve more stable, inclusive, and green growth. These challenges are linked and there are common policies to address them:

- Pursuing the right mix and stance of monetary and fiscal policies will help coping with shocks and achieving sustainable and stable growth.
- Enhancing financial stability is key to addressing the risks associated both with a potential abrupt reversal of house prices and with the large size of the banking system, and to underpinning more stable growth in the long term.
- Improving labour market and social policies will help limit the risk that unemployment becomes entrenched and combat the rise in relative poverty and inequalities.
- Improving the functioning of the housing market and making the tax system more conducive to an optimal allocation of wealth would help limit the risk of housing price bubbles and raise potential growth.
- Raising the cost-efficiency of climate change policies would help achieve Sweden's ambitious targets.

A broad range of structural reforms have been undertaken since the early 1990s. However, in some areas, further progress is called for. Sweden's good economic performance should be used as an opportunity to push ahead with reforms.

The economy is performing well but is facing risks

Growth is slowing down from high rates but should regain strength

The economy started to decelerate in early 2011 but has remained resilient so far, with fairly robust growth in the first half of 2012. Sound fundamentals (an enviably strong fiscal position, relatively high competitiveness and good labour market outcomes) have limited direct exposure to the euro area crisis while accommodative monetary policy and structural reforms have helped. Growth is expected to be weaker in the second half of 2012 and the first half of 2013, however, as weakening euro area demand and krona appreciation hold back exports, rising unemployment and decreasing house prices weigh on household confidence, and uncertainty surrounding the global environment persists (Table 1). Going forward, however, activity is expected to regain strength. Private consumption is expected to pick up in 2014 as household confidence strengthens on the back of improving labour and housing markets. With world trade and firms' confidence turning up, exports and private investment are set to accelerate. As ample spare capacity lingers, core inflation should remain subdued.

Labour market outcomes are good but some groups are at risk

While recent labour market performance has been better in Sweden than in many other countries, the unemployment rate has ceased to decline and remains above the pre-crisis trough (Figure 2, Panel A). Employment growth has been anaemic since mid-2011, and the unemployment rate stood at 7.6% in 2011. Long-term unemployment has increased, making its entrenchment more of a risk. Employment is expected to recover in

Table 1. **Short-term economic outlook**

| | Percentage change, volume 2010 prices ¹ | | | | | |
|--|--|------|------|------|------|------|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| Real GDP | -5.0 | 6.3 | 3.8 | 1.2 | 1.9 | 3.0 |
| Private consumption | -0.2 | 3.9 | 2.2 | 1.6 | 1.8 | 3.1 |
| Government consumption | 2.0 | 1.8 | 1.3 | 0.8 | 0.8 | 1.1 |
| Gross fixed capital formation | -15.5 | 6.7 | 6.7 | 3.9 | 1.7 | 5.5 |
| Stockbuilding ² | -1.6 | 2.2 | 0.4 | -0.5 | 0.1 | 0.0 |
| Exports of goods and services | -12.5 | 10.0 | 7.4 | 0.7 | 3.6 | 5.8 |
| Imports of goods and services | -14.1 | 11.5 | 6.3 | 0.3 | 2.8 | 6.2 |
| Net trade ² | -0.1 | 0.0 | 1.0 | 0.2 | 0.5 | 0.2 |
| <i>Memorandum Items:</i> | | | | | | |
| CPI (per cent change) | -0.5 | 1.2 | 3.0 | 1.0 | 0.9 | 1.7 |
| Unemployment rate (% of labour force) | 8.3 | 8.4 | 7.5 | 7.7 | 7.9 | 7.6 |
| Household saving ratio ³ | 11.0 | 8.3 | 10.0 | 10.5 | 10.8 | 9.7 |
| General government financial balance ⁴ | -1.0 | 0.0 | 0.2 | -0.3 | -0.8 | -0.2 |
| General government structural net lending ⁴ | 1.7 | 0.8 | 0.3 | 0.3 | 0.2 | 0.5 |
| Gross government debt ⁴ (Maastricht definition) | 42.6 | 39.5 | 38.4 | 37.7 | 37.1 | 36.4 |
| Current account balance ⁴ | 6.7 | 6.7 | 6.5 | 6.2 | 6.0 | 5.9 |

1. Projections from 2012 onwards.

2. Contribution to changes in real GDP (percentage of real GDP in previous year).

3. As a percentage of disposable income.

4. As a percentage of GDP.

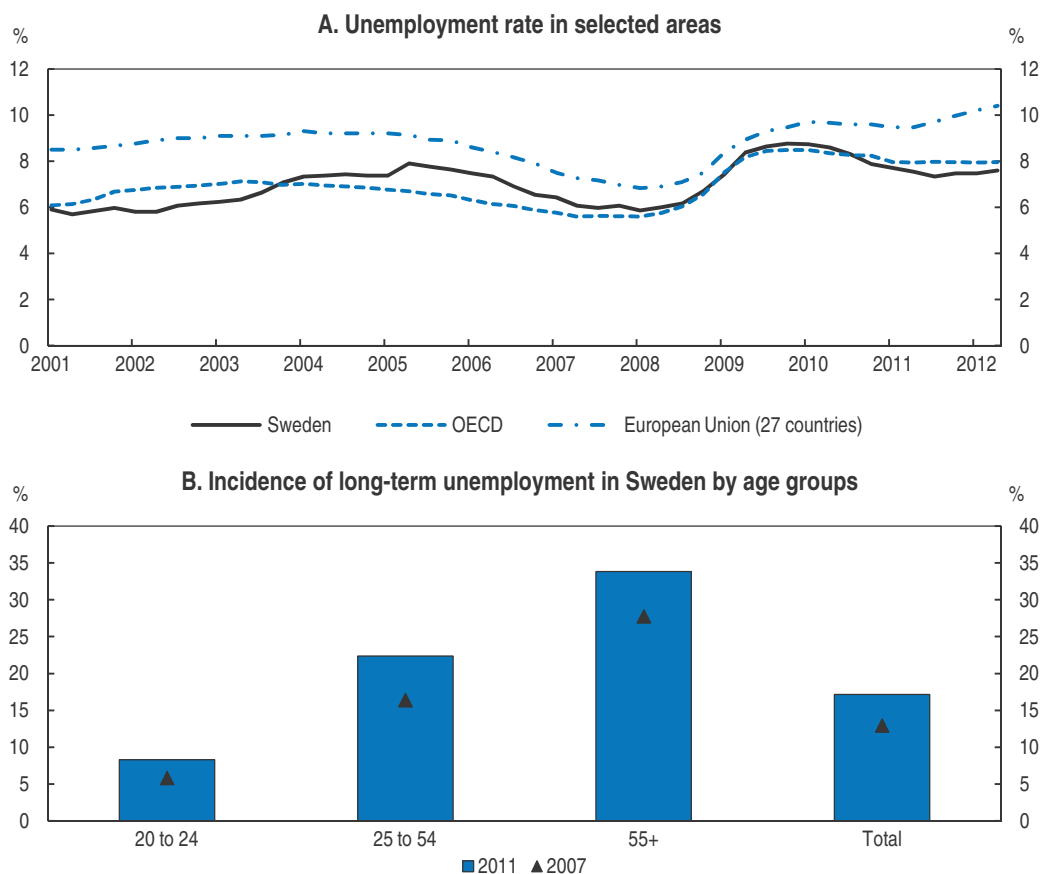
Source: Statistics Sweden and OECD, *Economic Outlook 92 Database*.

2013, but only slowly given persisting uncertainties and weak demand from European trade partners. Hence, it will take time for the unemployment rate to recede.

The employment rate, at 76% in 2011, is high but some groups are not well integrated. The risk of labour market exclusion existed before the crisis but has worsened for all age groups (Figure 2, Panel B). Immigrants are particularly at risk, especially those coming through the family and asylum channels, who are more likely to have a low level of education and account for a large share of immigrants in Sweden. The gap in labour market performance between the foreign and native born is large compared with other OECD countries (Figure 3). In 2008, Sweden reformed its labour immigration policy by allowing employers to recruit workers from abroad for any occupation, as long as wages and other working conditions comply with the ones prevailing in collective agreements. As a result, the number of non-EU immigrants coming through this “labour channel” has more than doubled since 2006 although labour migration flows are low compared with other OECD countries (with around five new labour immigrants per thousand employed in 2011). While migrants coming through this channel are less exposed to the risk of labour market exclusion than those who are coming through other channels, spouses and other family members are still vulnerable.

The youth unemployment rate is high and has increased during the crisis. However, this indicator over-estimates the extent of the problem since some of the young who are classified unemployed are full-time students. Relatively few young people were neither in education nor employed in 2010. Nevertheless, other indicators suggest that some youth, especially those with limited education and with an immigrant background, struggle to join the labour market. Older workers have a high employment rate compared to other OECD countries but they face a higher risk than other age groups of becoming long-term unemployed.

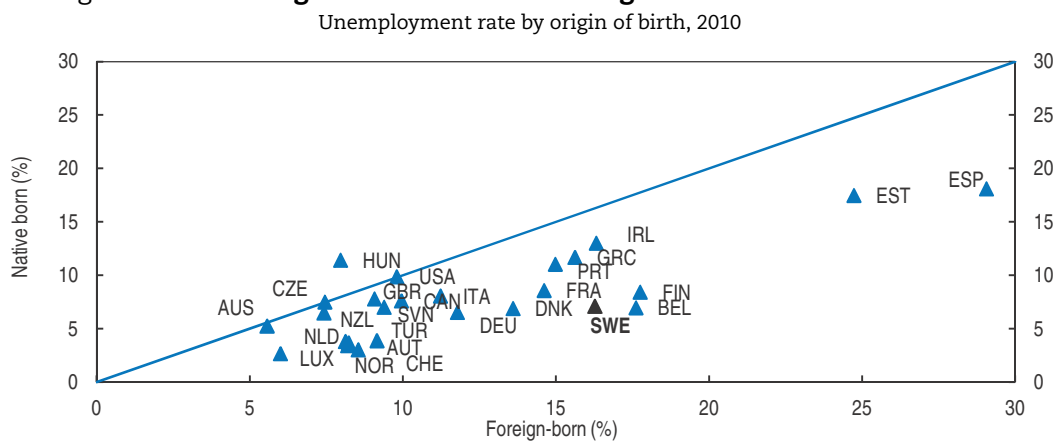
Figure 2. **Unemployment remains high**



Source: OECD, Labour Force Statistics.

StatLink <http://dx.doi.org/10.1787/888932756478>

Figure 3. **The foreign-born are not well integrated into the labour market**



Source: OECD, Migration Database.

StatLink <http://dx.doi.org/10.1787/888932756497>

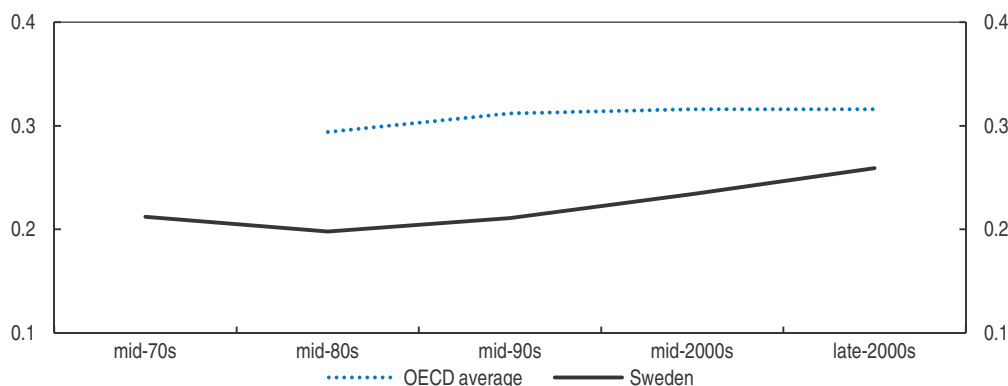
Income dispersion is low but has risen

Low income dispersion and low poverty have mitigated the need for extra social outlays in response to the crisis, thereby containing its fiscal cost. Nevertheless, income dispersion and relative poverty have risen over the past two decades, although they remain among the lowest in OECD countries (Figure 4), and are in fact the lowest when taking into account public services (OECD, 2011a). Capital income has been the main driver of the rise in inequalities but changes to the tax and transfer system have also contributed. Sweden's tax and transfer system reduces inequality considerably, although since the mid-1990s this equalising role has become less pronounced (Figure 5).

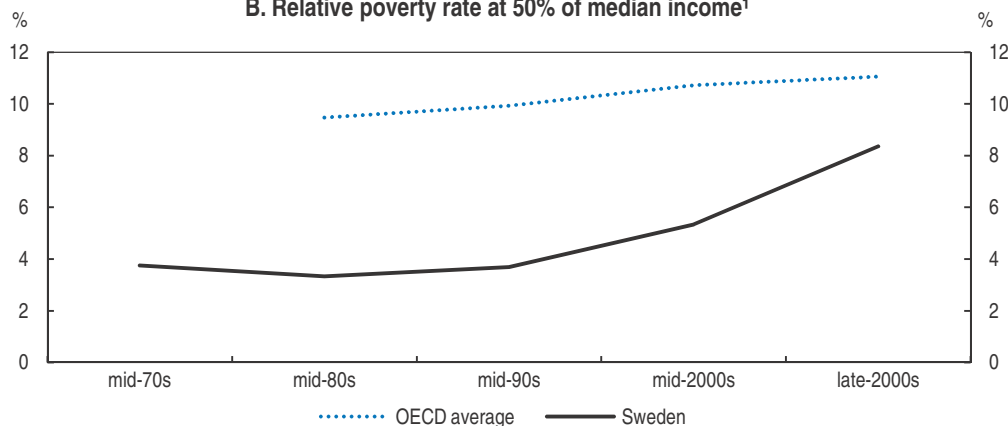
Over 1995-2010, wage growth has been weak for both the household head and spouse for the first three deciles of the income distribution and stronger for the upper ones. Structural changes, such as the reform of the sickness and disability benefit system and the introduction of an earned-income tax credit, have raised labour force participation but also, at least temporarily, the share of less productive workers, thereby contributing to relatively low wage growth for the lowest deciles. Large inflows of immigrants with limited education may also have contributed.

Figure 4. **Inequalities are low but rising**

A. Gini coefficient after taxes and transfers¹



B. Relative poverty rate at 50% of median income¹

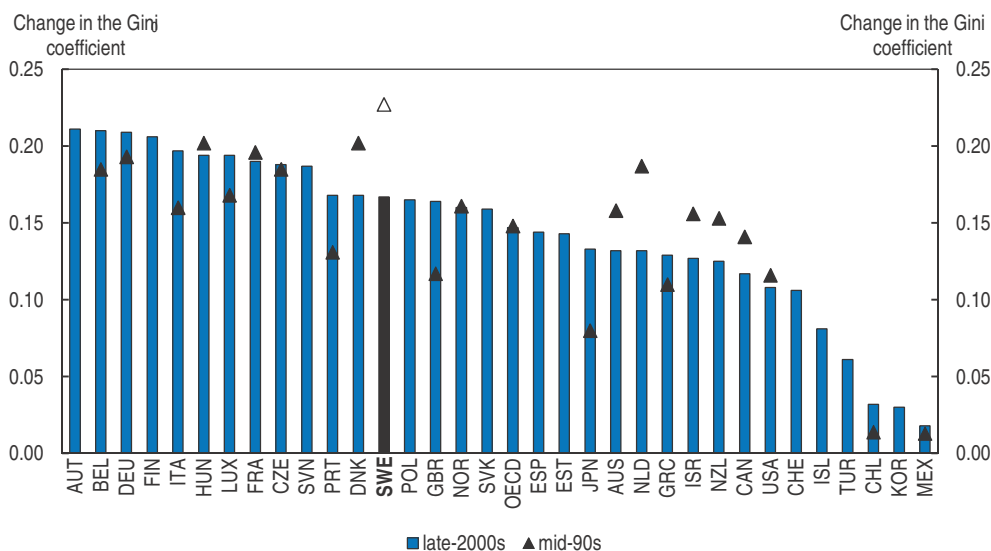


1. Based on equivalised household disposable income, after taxes and transfers, entire population.

Source: OECD, *Income Distribution and Poverty Database*.

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Figure 5. **The tax and transfer system reduces inequality considerably**
Reduction in the Gini coefficients coming from taxes and transfers¹



1. The redistributive impact of taxes and transfers is defined as the difference in the Gini coefficients for income before cash transfers and taxes (i.e. household market income) and after cash transfers and taxes (i.e. household disposable income). For instance in Sweden, the Gini coefficient was reduced through taxes and transfers from 0.44 to 0.21 (hence by 0.23) in the mid-1990s and from 0.43 to 0.26 (hence by 0.17) in the late 2000s. Entire population.

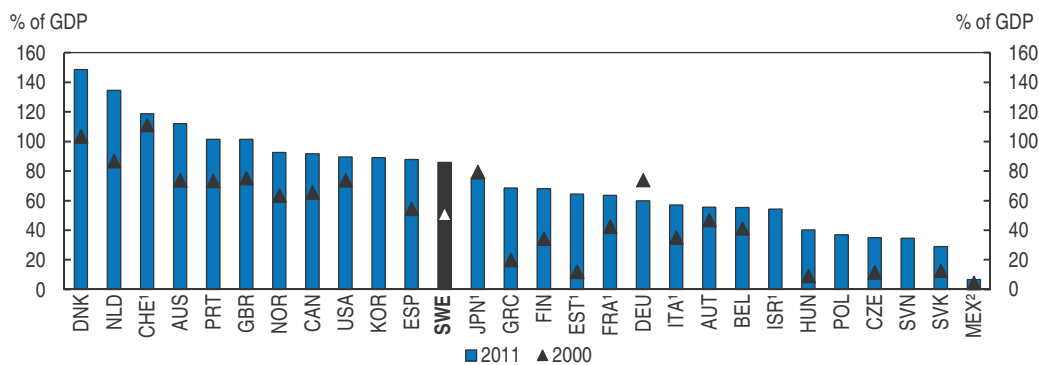
Source: OECD, *Income Distribution and Poverty Database*.

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High household and corporate debt could lead to disruptive deleveraging

Household debt has risen to relatively high levels both historically and internationally, reaching 174% of household disposable income and 84% of GDP in 2011 (Figure 6). This has been driven by easier lending conditions, a greater sense of security due to improved macroeconomic stability and higher household financial wealth, the emergence of new financial instruments and, with most of the debt being mortgages, rising house prices. However, household assets are even larger, amounting to 510% of disposable income and the saving rate is high. Moreover, a large part of the debt has been incurred by high-income

Figure 6. **Household debt has increased**



1. 2010.
2. 2009.

Source: OECD, *Analytical Database*.

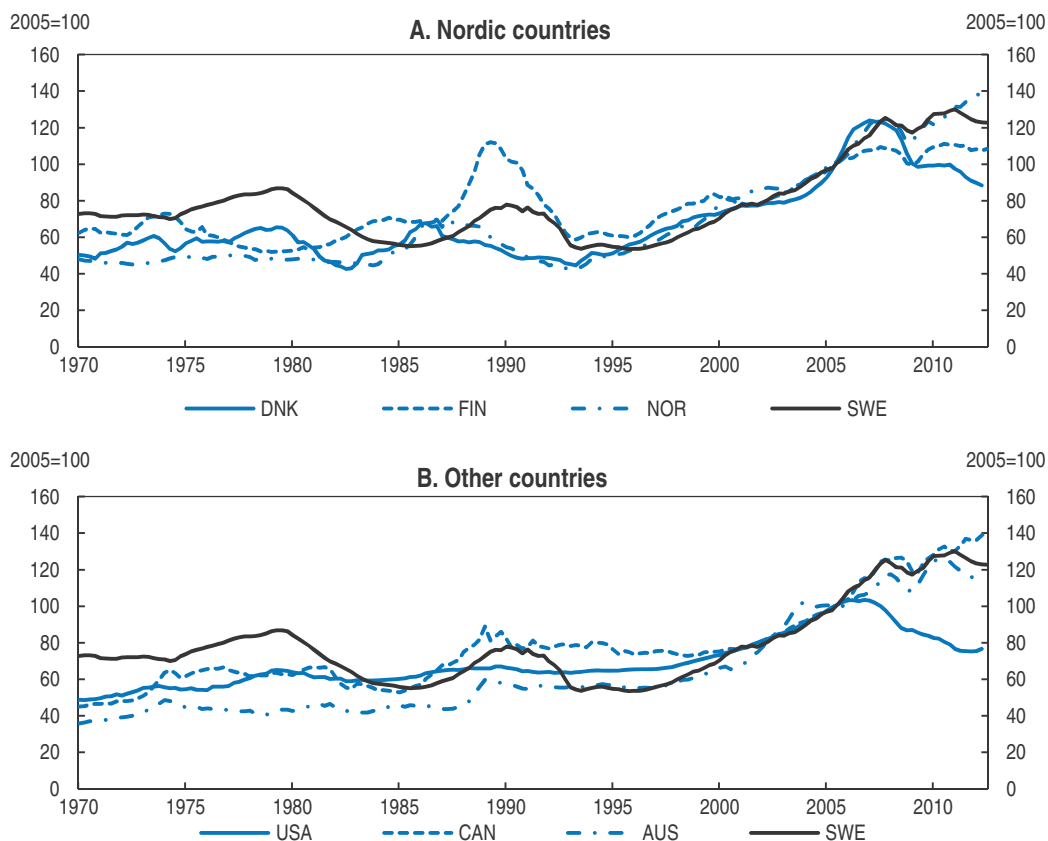
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households, with the 20% of top-income earners holding 57% of the total debt and 44% of the total assets.

Even so, a couple of factors increase the vulnerability of households to a fall in house prices, an increase in real interest rates or higher unemployment. A sizeable share of household wealth is held in illiquid assets, such as pensions and property. Furthermore, rapid credit growth has been accompanied by a shift towards riskier non-amortised and variable-rate mortgages. Although greater use of variable-rate mortgages could improve the effectiveness of monetary policy, it also exposes households to potentially dramatic increases in debt servicing costs if interest rates rise. High private sector debt in Sweden was flagged as a vulnerability in the European Commission's 2011 Alert Mechanism Report.

There has been no significant household deleveraging so far, even though credit growth has gradually slowed down, and is currently below 5% per year. Despite recent increases in the saving rate, household debt continues to rise. On the asset side, real house prices have risen substantially since 1995 and remain high in a historical perspective (Figure 7). It is far from clear that Sweden is experiencing a housing bubble as a large part of the house price increase can be explained by fundamentals such as higher real incomes and lower interest rates, but the sustained run-up in prices entails a risk that prices may decline substantially, as occurred in several other OECD countries. Sweden did not experience a residential investment boom, so the impact of declining house prices on

Figure 7. **Real house prices have increased substantially**¹



1. House prices are deflated by the private consumption deflator.

Source: OECD Economic Outlook 92 Database.

StatLink  <http://dx.doi.org/10.1787/888932756573>

activity would not come mainly through the construction sector. However, in the face of adverse shocks, including a potential fall in house prices, households may cut back consumption and increase savings, aggravating downturns. This may even lead to some loan impairment, with unfavourable consequences for the financial system.

Corporate debt on the basis of consolidated data, at 139% of GDP in 2010, is more than twice as high as in the rest of the European Union. To some extent, this can be attributed to the large number of multinational companies operating in Sweden but with a debt not directly linked to the Swedish economy (European Commission, 2012a; Blomberg *et al.*, 2012). Furthermore, the debt-to-asset and debt-to-equity ratios within the corporate sector are below the EU average and have been respectively stable and decreasing over the last ten years. Nevertheless, the high level of corporate debt relative to the size of the Swedish economy needs to be monitored closely.

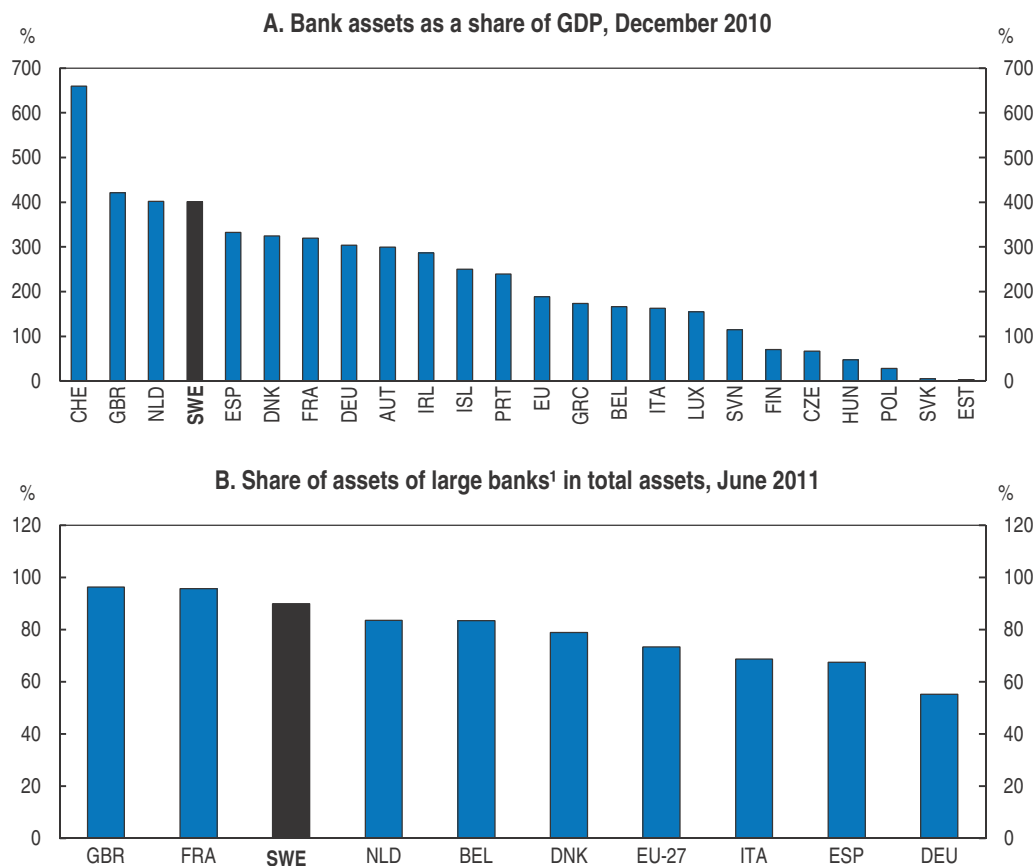
The banking system is large, concentrated and dependent on short-term wholesale funding

Banks are well capitalised both by international standards and compared to 2008. Core capital ratios in the four largest banks are well above the Basel III minimum standards. However, this is partly driven by low risk weights. Indeed, overall leverage ratios for some banks imply that capitalisation is less strong although by exactly how much depends on the definition of capital that is used (Riksbank, 2012a; Blundell-Wignall and Roulet, 2012; IMF, 2012). Furthermore, the banking system has total assets of four times Swedish GDP (Figure 8, Panel A).

Recent experience has shown that a large banking system relative to the size of the economy can entail heavy fiscal costs, in the event of a shock. These potential fiscal costs are compounded by the fact that the financial system is also very concentrated: the four major banks account for three fourths of deposits and domestic lending, and are therefore domestic systemically important institutions enjoying implicit state guarantees (Figure 8, Panel B). The implicit guarantees on bank debt reduce the funding costs for Swedish banks and might fuel excessive risk taking, magnifying contingent liabilities for the government (Schich and Lindh, 2012; IMF, 2012). The intimate links between certain banks and firms, and the associated connected lending, may also add to these risks, though action has been taken to limit such lending (IMF, 2011).

The geographical and currency composition of Swedish bank assets and liabilities also implies some vulnerabilities. Swedish banks operate as regional hubs, with foreign claims totalling 164% of GDP in March 2012, concentrated mainly in the other Nordic countries and the Baltics (BIS, 2012). The exposure to the Baltics has been reduced following the government's intervention during the crisis but risks remain (Riksbank, 2011). Spillover effects from EU countries are flagged as a risk by the Financial Supervisory Authority (FSA). The banks also face higher liquidity risk from foreign currency funding than other funding, as it is more short-term and can be volatile in times of crisis.

Dependence on short-term wholesale funding remains large and heightens the vulnerability of Swedish banks to international financial markets. In June 2012, 53% of banks' funding was wholesale, and half thereof short-term. Due to high investment in mutual and pension funds, the deposit base is narrow. As banking activity expanded during the past decade, the gap was filled by wholesale funding. Furthermore, the Swedish banks use more short-term funding than many other European banks. The gaps in

Figure 8. **The banking system is large and concentrated**

1. Banks with total assets greater than 0.5% of the total consolidated assets of EU banks are defined as large domestic banks. In Sweden, the large banks are Handelsbanken, Nordea, SEB and Swedbank.

Source: The Riksbank and European Central Bank, Consolidated Banking Data.

StatLink  <http://dx.doi.org/10.1787/888932756592>

maturity between their assets and liabilities have been reduced recently as the banks get ready for new liquidity requirements that will come into effect in January 2013, but vulnerabilities in the face of potential higher funding costs or drying-up of funding as in 2008 remain and should continue to be monitored.

Macroeconomic and financial policies

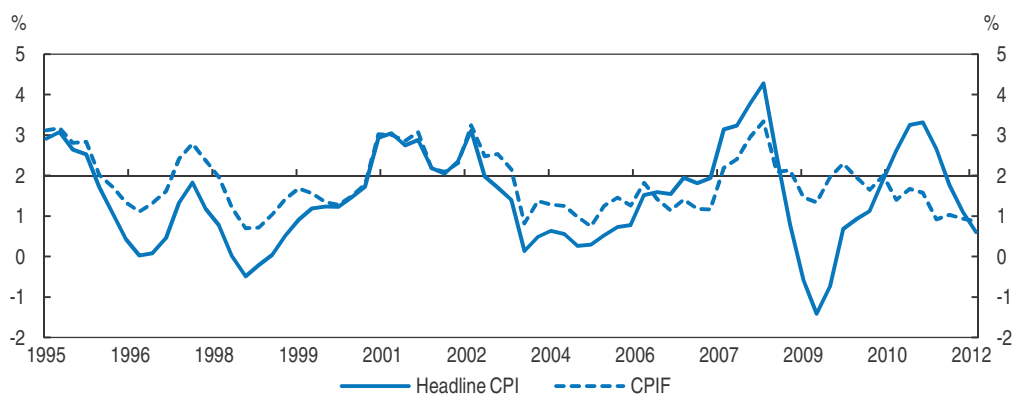
Monetary policy for stability and growth

In response to the 2008 economic and financial crisis, the central bank (Riksbank) slashed its main policy rate (repo rate) from 4½ per cent in August 2008 to ¼ per cent by mid-2009. In the context of the strong recovery that followed, the repo rate was gradually raised between spring 2010 and autumn 2011, when it reached 2%. However, faced with renewed weakening of the external environment and with limited foreseeable inflationary pressures, the Riksbank reversed course in late 2011. By September 2012, the repo rate was down to 1¼ per cent, against the backdrop of recent and projected inflation well below the 2% target, slowing activity and a relatively strong krona (which the Riksbank judged to be close to its equilibrium level, however). This stance is appropriately accommodative and with uncertainty related to external developments bound to stay high, monetary policy

ought to remain supportive. In the event of a worse-than-expected deterioration in the outlook, the Riksbank has room to further ease its monetary stance, more so than many other central banks.

Inflation has fluctuated around the 2% target, with a tendency to be slightly below it on average regardless of the time period or the data series used (Figure 9, Table 2). However, the deviation has been less marked for the inflation measure that excludes the effects of mortgage rates (CPIF), as the policy rate has been lowered, on average. Inflation expectations one and two years ahead have averaged 1.9% and 2.1%, respectively, pointing to high monetary policy credibility (Riksbank, 2012b). Two in-depth evaluation reviews of monetary policy in 1995-2005 and 2005-10 commended the Riksbank's overall performance in terms of achieving price stability (Giavazzi and Mishkin, 2006; Goodhart and Rochet, 2011). Furthermore, the response to the 2008 crisis was effective (see the chapter on monetary policy in the 2011 OECD Economic Survey).

Figure 9. **Inflation has fluctuated around the 2% target¹**



1. The series shown are not based on the official version that was revised backwards by Statistics Sweden in 2005, but the real-time data. CPIF excludes the effects of mortgage rates.

Source: Statistics Sweden.

StatLink  <http://dx.doi.org/10.1787/888932756611>

Table 2. **Inflation over the past 15 years in Sweden and the European Union^{1, 2}**

| Averages | 1995-2012 | 2000-12 | 2000-08 |
|--------------------------|-----------|---------|---------|
| CPI ¹ | 1.5 | 1.6 | 1.8 |
| CPIX | 1.7 | 1.6 | 1.7 |
| CPIF | 1.8 | 1.8 | 1.9 |
| HICP-Sweden ² | 1.6 | 1.8 | 1.7 |
| HICP-Euro area | 2.0 | 2.1 | 2.2 |
| HICP-European Union | 2.1 | 2.3 | 2.2 |
| <i>Memorandum items:</i> | | | |
| GDP growth | 2.7 | 2.5 | 2.8 |
| Unemployment rate | 7.9 | 7.0 | 6.6 |

1. CPI is the consumer price index, CPIX and CPIF measures of underlying inflation, based on real-time data. CPIX excludes mortgage interest expenditure and the effects of indirect taxes and subsidies. CPIF excludes the effects of mortgage rates. CPIX was introduced in 1993 and replaced by CPIF in 2008 by the Riksbank as the main measure of underlying inflation due to the higher-than-expected divergence between the CPI and the CPIX as a result of rising house prices.

2. HICP is the harmonised index of consumer prices developed by the European Union, based on a co-ordinated methodology and excludes the imputed prices for the services provided by owner-occupied housing. HICP averages are from 1996 to 2012.

Source: The Riksbank and Statistics Sweden.

The primary objective of the Riksbank is price stability, but stabilising production and employment around sustainable paths also features in its mandate. The rise in unemployment during the latest crisis and its persistence has prompted a debate on whether, and to what extent, the undershooting of the 2% target over the past 15 years has entailed avoidable costs in terms of higher unemployment (Svensson, 2012). Goodhart and Rochet (2011) argued that the potential tendency of monetary policy to be too tight in downturns was too small to warrant any change in behaviour. Nevertheless, further analysis of the implications of deviations from the target for the real economy is warranted. Moreover, the reasons underlying this small but persistent deviation of inflation from target merit further investigation, since existing studies are inconclusive (IMF, 2012; Andersson *et al.*, 2012).

Monetary and financial stability objectives interact, as illustrated during the recent crisis (Committee on International Economic and Policy Reform, 2011; Woodford, 2012). The extent to which monetary policy should be used to address asset price developments and financial imbalances remains disputed internationally and within the Riksbank's Executive Board (Riksbank, 2012c). On the one hand, low interest rates may result in excessive credit growth and higher house prices, with potential adverse implications (White, 2012). On the other hand, the difficulty of identifying bubbles, the costs of using one policy tool to address both monetary and financial stability objectives, and the uncertainty regarding the impact of the policy interest rate on asset prices all suggest that monetary policy cannot be solely relied on to "lean against the wind" (Claussen *et al.*, 2011). Financial regulation and supervision are crucial to contain financial imbalances, but at the same time the linkages between monetary policy and financial stability objectives need to be carefully accounted for, including in the Riksbank's modelling efforts. Concurrently, structural problems in the housing market ought to be addressed to reduce the financial stability risks arising from high indebtedness (see below).

Enhancing financial stability

The financial system authorities responded well during the recent crisis, but the crisis brought into focus some of the longstanding gaps in the financial stability framework and macroprudential toolkit. A Financial Crisis Committee was set up in February 2011 to clarify the responsibilities of the Riksbank, the FSA, the National Debt Office (NDO) and the Ministry of Finance. It is also looking at bank resolution schemes, the provision of liquidity support and the features of the Stabilisation Fund, which was created in 2008 to support financial institutions during crises. Following the conclusions of the Committee, expected in 2013, the division of responsibilities between the four institutions should be clarified, a clear mandate should be given for macroprudential regulation as soon as feasible, and gaps in the toolkit to supervise and influence financial institutions should be addressed. The establishment of a temporary council for co-operation on macroprudential policy in January 2012 is welcome.

The exact nature of the macroprudential tools, such as capital and liquidity requirements and risk weighting of different types of lending, will be subject to EU decisions. However, further interim measures could be taken in the meantime, in addition to for example the introduction of the liquidity coverage ratio (see below). Macroprudential policy should also pay attention to the risks that might arise from related-party lending and the non-separation of investment and commercial banking.

The authorities are waiting for the EU Directive on bank resolution. In the meantime, banking problems would be addressed via the provisions in the Government Support to Credit Institutions Act, which gives the government possibilities to support banks in distress and to take over a troubled bank under certain conditions. Application of general bankruptcy rules for companies to banks is not ideal and the financial supervisors' lack of power to initiate bankruptcy proceedings for financial institutions creates uncertainty and could cause delays. Hence, a bank resolution scheme, consistent with EU decisions, should be introduced as soon as is feasible.

The Stabilisation Fund has a target size of 2.5% of GDP on average by 2023. This was a useful step. However, setting the target size as a percentage of the total eligible liabilities of the contributing institutions would better address risks arising from the large size of the Swedish banking system. Fees should be based in part on the riskiness of the institutions, as judged by the supervisors. For example, the fees could rise to reflect the risks stemming from the size and composition of balance sheets and dependence on wholesale funding. Currently, there is an ongoing investigation of whether the Deposit Guarantee Fund and the Stabilisation Fund should be merged and use risk-based fees. Furthermore, increasing the banks' share of the Fund would better serve the purpose of lowering the contingent liabilities of the state.

The Swedish authorities have decided to implement higher capital requirements than stipulated by Basel III for the large banks, at 10% and 12% by 2013 and 2015 respectively. The authorities should also, as planned, impose countercyclical capital requirements. However, relying solely on capital ratios based on risk-weighted assets is not sufficient, as institutions can adjust their asset mix to comply and risk weights for mortgages in Sweden are below those in other European countries due to historically low residential loan losses. The FSA's plan to introduce higher risk weights for mortgages is welcome. As discussions on implementing a leverage ratio are on-going at the EU level, the authorities should consider introducing an overall leverage ratio (capital over total assets, non-risk-weighted) as a backstop to the risk-weighted capital measures.

To address Swedish banks' relatively large liquidity risks, the FSA will introduce a domestic liquidity requirement similar to the Basel III liquidity coverage ratio (which ensures that banks hold sufficient high-quality liquid assets) in January 2013. Large banks will also be required to meet these liquidity requirements in euros and US dollars. However, the banks are not ready to implement stricter rules in the form of the net stable funding ratio (which aims at ensuring a sustainable maturity structure of assets and liabilities). The financial supervisors should continue to monitor banks' progress in reducing their dependence on wholesale funding by further improving the liquidity reporting of banks.

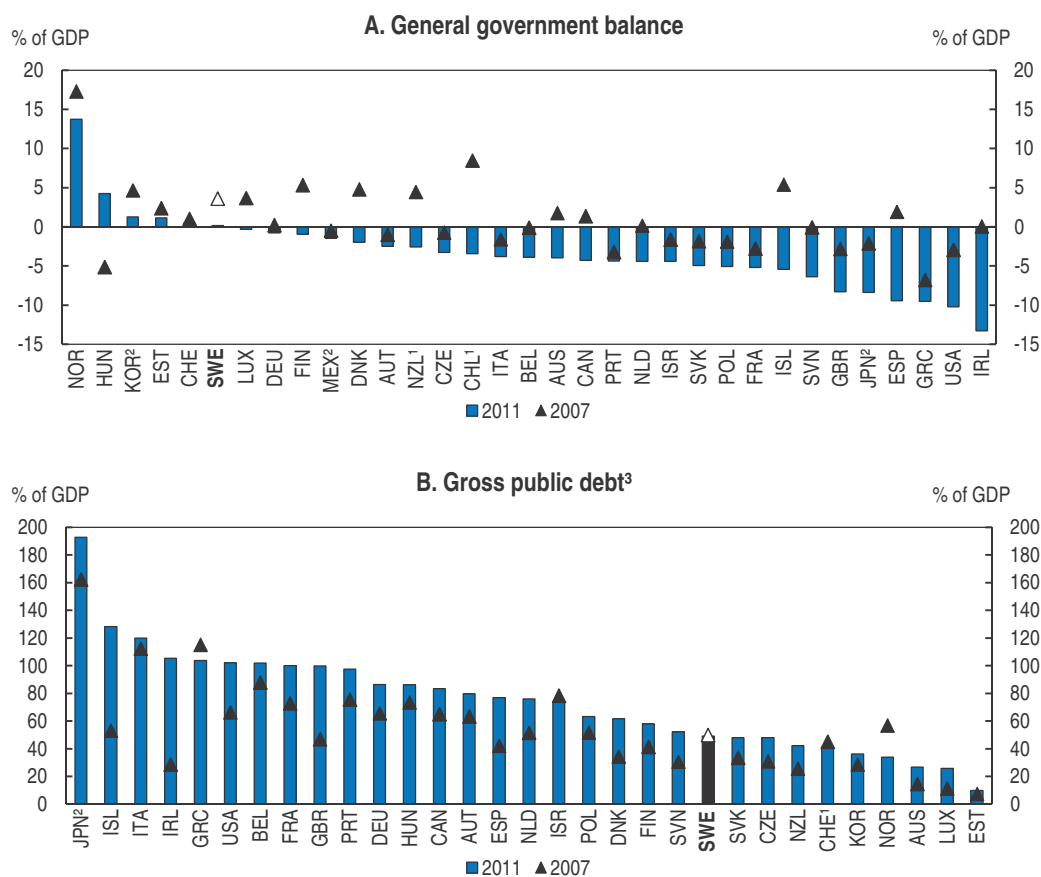
The use of variable-rate and non-amortised loans has increased in the past decade, raising households' vulnerability to shocks. Stress tests carried out by the FSA suggest that households are resilient to unemployment and interest rate shocks. However, non-amortised loans could be a source of weakness if they are granted to households who would face difficulties in servicing their debt if unemployment increased or interest rates rose sharply. In order to address risks arising from high household debt, the FSA introduced a guideline for a loan-to-value (LTV) cap of 85% in October 2010. According to the FSA, the cap helped limit LTVs for new loans in 2011 (Swedish FSA, 2012). However, as such caps are generally easy to circumvent, efforts to monitor the characteristics of

households and the types and size of loans that they use need to continue. The FSA is preparing a new survey focusing on the amortisation of loans, which is a welcome step. Swedish banks already apply strict lending conditions as part of their standard operating procedures, which are monitored by the FSA. However, the supervisors should consider more formal and binding measures to ensure sound underwriting practices for non-amortised and variable-rate loans. For example, a binding requirement could be imposed that in order to get such a loan the borrower should show they could afford the corresponding fixed-rate or amortised loan.

Upholding fiscal prudence while preserving the welfare system

Maintaining a strong fiscal position is key to addressing future shocks. Indeed, a large fiscal surplus at the onset of the crisis allowed Sweden to let automatic stabilisers play their role in full and to introduce discretionary stimulus without threatening fiscal sustainability (Figure 10). The general government balance recorded a small deficit in 2009 but was again in surplus by 2011, with only a tiny deficit projected for this year (Table 1). The structural balance remained in surplus all along, and is estimated to be 0.3% in 2012. In contrast to many other OECD countries, Sweden has no need for fiscal consolidation to

Figure 10. **Sweden's fiscal position is among the best OECD-wide**



1. 2009.
 2. 2010.
 3. Gross public debt according to ESA95 definition.
- Source: OECD, Economic Outlook 92 Database.

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meet EU requirements and should be able to achieve its more ambitious national targets (see below) in the next few years.

For 2013, the Budget Bill includes new measures, amounting to 0.6% of GDP, but the underlying fiscal stance is broadly neutral. This is appropriate but if GDP growth turns out to be less than the budget's 2.7% projection, the government should let the automatic stabilisers work unimpeded. And in the event of a sharp or prolonged downturn, the government should use its scope for discretionary stimulus.

In the Budget Bill for 2013, the government announced increased spending in a number of areas, and a cut in corporate tax rates from 26.3% to 22%. Various measures should improve the labour market (see below). Public investment in infrastructure will be extended, notably in roads and railways. Good ground transportation has many benefits but also some negative externalities. Recent OECD analysis shows that the efficiency of the road transport system is low in Sweden, partly related to an overextended network (Braconier *et al.*, forthcoming). The Swedish National Audit Office has been very critical of one of the biggest recent infrastructure projects (the Bothnia railway line). It is therefore important to decide new investments in this area on the basis of careful and comprehensive cost-benefit analysis taking into account the overall social efficiency of investments. The government also announced some permanent tax cuts for people older than 65, which may encourage some older workers to leave the labour market earlier.

Improving the medium-term fiscal framework

The fiscal framework has helped anchor fiscal policy following the economic crisis of the early 1990s and has increased transparency and accountability. It involves a surplus target of 1% of GDP for general government net lending over the cycle, a ceiling for central government expenditures, a stringent central budget government process and a balanced budget requirement for local governments. The surplus target has implications for the accumulation of gross debt and net assets. The 1% surplus target implies that net assets would stabilise at around 20% of GDP in the long run, based on a 5% nominal GDP growth assumption. This is in fact the level at which they currently stand, since gross financial assets amount to 60% of GDP and gross debt according to the Maastricht definition to about 40% of GDP. However, the absence of some indication by the government of targeted levels of gross debt or net wealth limits transparency. For instance, in 2010, the government introduced a 1% of GDP "safety margin" on top of the surplus target, invoking the risks surrounding the economic outlook. This margin was removed in the 2013 Budget Bill. While prudence is commendable against the backdrop of an uncertain international environment, such a safety margin has suggested, somewhat confusingly, that the accumulation of assets implied by the 1% surplus target was not enough to cope with adverse shocks (Swedish Fiscal Policy Council, 2012).

The government could better explain the implication of the surplus target for the accumulation of assets and the reasons for such an accumulation. The higher vulnerability of an open economy to shocks and the contingent liabilities implied by the large banking system could be part of the rationale. Moreover, in the current framework, the projected fiscal position for years following the budget year mainly reflects technical assumptions and does not include any of the new policies the government may envisage. It would be clearer to present such technical projections separately from the main economic forecasts.

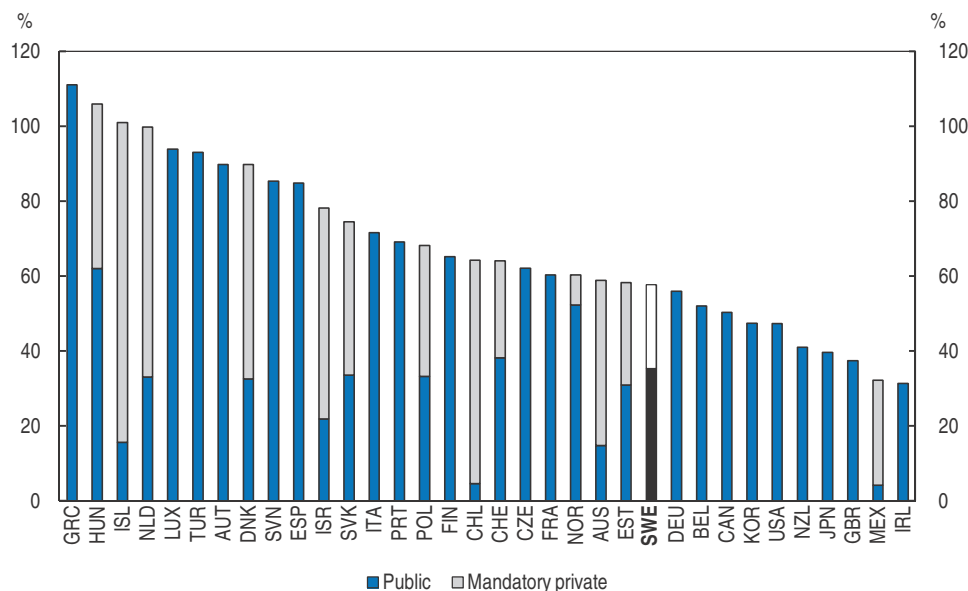
The balanced-budget requirement for local governments has led municipalities to cut spending in times of crisis (SOU, 2011). It is therefore welcome that the government plans to allow municipalities to build up savings in local funds, subject to some conditions. However, if local funds turn out to be insufficient to cope with adversity, other options should be considered, such as giving greater incentives to local governments to save in good times or formalising the adjustment of grants from the central government to make it more counter-cyclical.

Facing future pressures on spending

As elsewhere, Sweden is facing pressures stemming from population ageing and rising health care costs. It is important to address these pressures in ways that limit the risk of unsustainable increases in spending in the long term but preserve income and access to health care.


The increase in public expenditure on pensions is expected to be limited for Sweden, according to the government and European Commission projections (Government Offices of Sweden, 2012; European Commission, 2012b). This is because Sweden has introduced an automatic link between demographic and economic developments and the public retirement-income system (first pillar). This link ensures that public expenditure on pensions is contained, but may lead to a substantial fall in incomes. The mandatory private pension scheme (second pillar) covers all residents but the combined gross replacement rate from public and private schemes for a new entrant with an average wage is relatively low (Figure 11). By contrast, the replacement rate for a high-income earner will be high, because of revenues from occupational pensions (OECD, 2011c). Rising inequalities amongst pensioners may lead to pressures to raise guaranteed pensions of the first pillar

Figure 11. **The pension replacement ratio will be low for average income earners**¹



1. Gross replacement rate from public and private mandatory pension schemes for a new entrant with an average wage.

Source: OECD (2011), *Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries*, Paris.

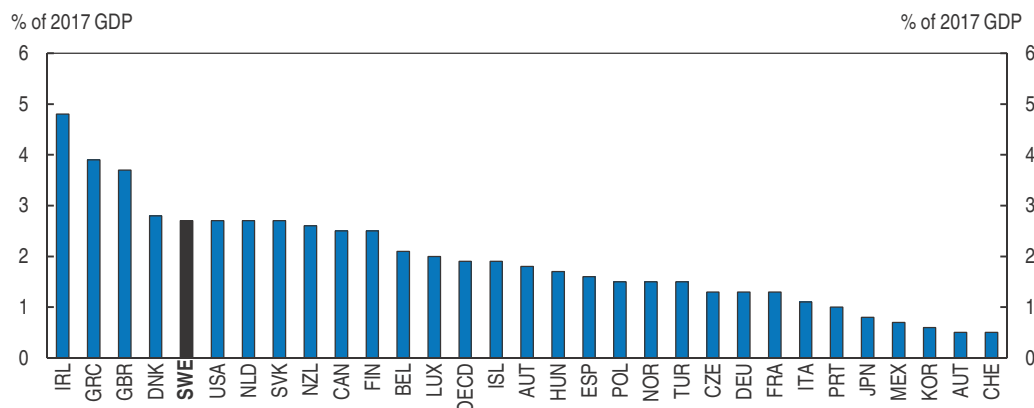
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or welfare benefits. This risk would be mitigated, however, by a rise in labour force participation, especially for women.

An efficient health care system is important to contain the pressures from rising costs and demand, while ensuring high service quality. Sweden's performance in terms of health status compares favourably to other OECD countries. Expenditure on health, however, is above the OECD average. OECD analysis shows that these outcomes could be achieved at a lower cost or that health outcomes could be even better with the same level of spending on health (Figure 12). Waiting times for treatment are relatively long. This partly stems from shortages of general practitioners in some geographical areas, and lack of incentives for doctors to see more patients or deal with them efficiently, which can generate inequalities in access to health care (see the chapter on health care in the 2005 *OECD Economic Survey*). Indeed, while average health outcomes are good, outcomes in terms of equality in access to medical care are mixed (van Doorslaer *et al.*, 2006; Anell *et al.*, 2012; OECD, 2011d).


Figure 12. **Efficiency gains could be achieved in health care**¹

Potential savings in public spending in OECD countries in 2017



1. Potential savings represent the difference between a no-reform scenario and a scenario where countries would become as efficient as the best performing countries.

Source: OECD (2010), *Health Care Systems: Efficiency and Policy Settings*, Paris.

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Since 2007, reforms have been launched that have led to the freedom of choice of primary care provider for the population and the freedom of establishment for providers accredited by the local county councils. The purpose was to develop primary care and improve its efficiency, notably in terms of access. Early evaluations suggest that the introduction of choice and competition in primary care have improved access to health care (Anell *et al.*, 2012). However, it is too early to fully assess the impact of the reforms in terms of cost and quality of health care. Therefore, it is crucial to closely monitor the impact of the reform on prices and quality of service, equality of access, and public finances.

Box 1. Main recommendations for macroeconomic and financial policies**Monetary and financial stability policies**

- The Riksbank should use the room it has to lower the interest rate further if weak inflationary pressures and the slowdown in activity persist longer or are more pronounced than expected.
- Address gaps in the macroprudential toolkit to supervise and influence financial institutions. Clarify the role of and relationship between the Riksbank, the Financial Supervisory Authority, the National Debt Office and the Ministry of Finance.
- Consider introducing a leverage ratio as a backstop to the risk-weighted capital measures. Continue to closely monitor banks' progress in reducing their wholesale funding dependence and further improve their liquidity reporting framework.
- Introduce a transparent bank resolution scheme as soon as is feasible, consistent with EU developments.
- Monitor closely the effects of the loan-to-value cap and the characteristics of households that use variable-rate and non-amortised loans. Introduce binding measures to ensure sound underwriting practices for non-amortised and variable-rate loans.

Fiscal policy

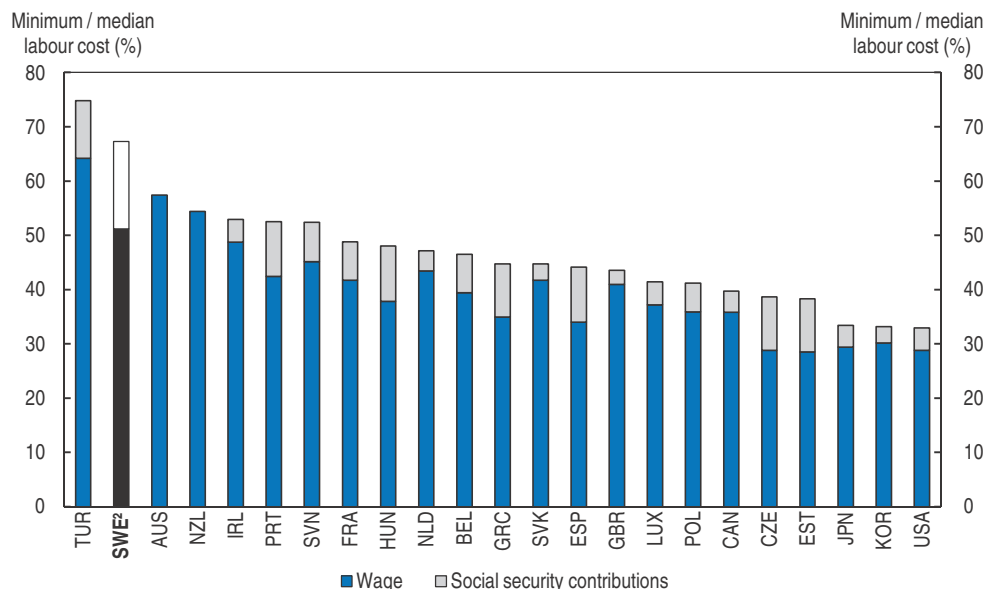
- The broadly neutral fiscal stance for 2013 is appropriate under the government's projections. If the economic outlook turns out to be weaker than it expects, the government should let the automatic stabilisers work in full. In the event of a sharp or prolonged downturn, discretionary stimulus would be warranted.
- Better explain the implications of the budget surplus target and the potential use of safety margins for gross debt and/or net wealth in the longer run. Clarify the status of the budget's medium-term fiscal projections.

Labour market and social policies for greater inclusion***Combining supply-side and demand-side labour market policies***

Various efforts have been made on the supply side of the labour market to raise participation incentives. Over the past decade, Sweden has undertaken a series of reforms to address the long-term structural problems with its sickness and disability policies. As a result, both inflows into and stocks of recipients of sickness and disability benefits have decreased substantially. The earned-income tax credit (EITC) that was introduced in 2007 and gradually made more generous strengthens incentives to take a job for various groups including former recipients of sickness and disability benefits. The EITC likely raised employment rates, although it is difficult to assess its impact, partly because there is no "control group" as all workers receive it (OECD, 2007).


However, the exclusion from the labour market of some groups of workers also stems from relatively high labour costs in the lower rungs of the wage distribution. While wage setting has become increasingly decentralised and individualised, relatively high minimum wages set through collective bargaining tend to push up labour costs (Figure 13). Many workers are covered by minimum wage agreements and studies suggest that these minima are binding in some sectors and may prevent the weakest groups from entering the labour market even if they are given strong incentives to do so (Skedinger, 2006).

Figure 13. **The minimum cost of labour is relatively high¹**
 Minimum cost of labour as a share of the labour cost for the median wage, 2010



1. The cost of labour is the sum of the wage and the corresponding social security contribution paid by employers.
2. Apart from Sweden, only countries with a legal minimum wage are shown. The minimum wage for Sweden is computed for a 20-year old worker, with no work experience, who has an unskilled job in a non-metropolitan region. Since the minimum wage for such a “prototype worker” varies between sectors, the figure shows the minimum wage in the sector where it is the lowest (the engineering sector).

Source: OECD, *Labour Force Statistics*; Skedinger, P. (2007), “The Design and Effects of Collectively Agreed Minimum Wages: Evidence from Sweden”, *IFN Working Paper*, No. 700; Statistic Sweden and OECD calculations.

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The wage setting system rests on negotiations between employee and employer confederations with very rare interventions from the government. Overall, it has delivered good results. However, when they negotiate wages, employer confederations and unions do not fully take into account the situation of the long-term unemployed or of those entering the labour market, because these groups receive some form of income support paid by the state. Regular studies on the impact of minimum wages on employment would help social partners in their negotiations. The government should continue talks with social partners to find ways to improve job prospects for groups at risk. For instance, the employment contracts initiated by social partners that combine 75% work time and 25% vocational education, with compensation at 75% of the monthly minimum wage, are welcome. Insofar as these measures result in lower wages at the bottom end for some groups, the EITC partly offsets the potentially negative short-term effects on income inequality. Another option to lower the labour cost at low wage levels would be to cut social contributions, instead of or in addition to existing rebates for youth, but this would not address the core of the problem and can be costly.

Job protection legislation is not stringent for temporary contracts but it is for permanent ones. This asymmetry raises the risk of duality in the labour market. While temporary jobs have been a stepping stone towards permanent jobs for some workers, it may be less the case in the future as over time these jobs have tended to become more concentrated on the most fragile groups of workers such as youth and non-EU immigrants. Collective agreements provide options to deviate from the legal framework but this is not enough to ensure efficient outcomes. They may penalise workers who are less integrated

or less represented by unions such as youth and immigrants, who bore much of the employment losses during the crisis. Hence, to address duality risks, job protection should be reformed by reducing the gap in regulations between temporary and permanent contracts to ease transitions from temporary to permanent contracts. There are several ways to achieve convergence depending on whether a new system is introduced (for instance with a single contract) or the main features of the current system, with two types of contract, are kept. In the latter case, options include the removal of the priority for dismissed workers to be re-hired and of the obligations related to the internal reassignment of employees, while having provisions that help to transform temporary jobs into permanent ones.

Improving the efficiency of support to the non-employed

To limit the risks of exclusion from the labour market and poverty, support to the non-employed has to provide strong incentives and help to find a job. While most non-employed receive some type of financial assistance, the share of the unemployed covered by UI has been shrinking over time, partly because the entitlement criteria concerning past work have become stricter. Those who are entitled to UI benefit, and therefore are in general not very far from the labour market, are more likely to receive the most effective support. Unemployed who are less close to the labour market – immigrants, youth and workers on temporary jobs – are more likely to depend on welfare benefits, with a lower incentive to find a job (Figure 14). They also receive less efficient support. For example, the unemployed receiving welfare benefits are also more likely to be enrolled in municipal active labour market policies (ALMP), which tend to be less efficient than those provided by the Public Employment Service (PES), although their efficiency may have increased recently, and their job-search efforts are less closely monitored than for those receiving UI benefits (Dahlberg *et al.*, 2009).

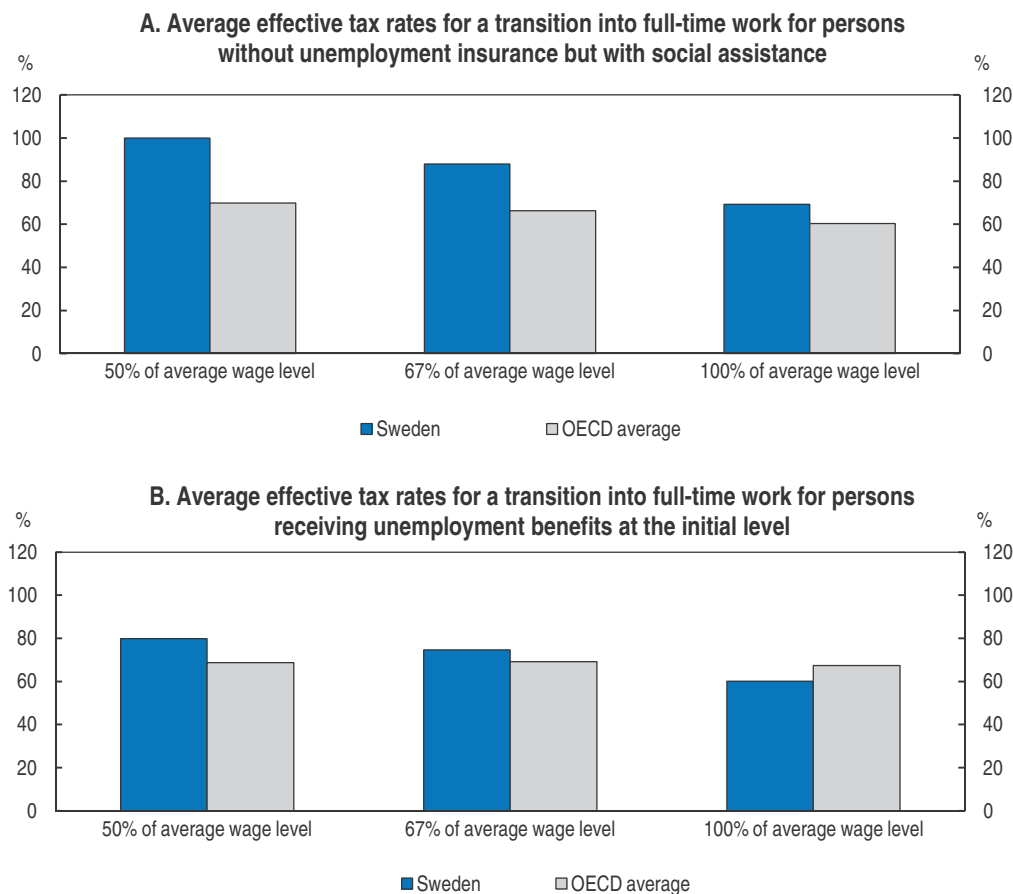
The government has started to address the issue of variations in the treatment and support provided to the unemployed by involving the PES more actively in job-search for immigrants and the sick and disabled with ability to work. It has increased PES resources and appointed a Parliamentary Commission to propose ways to improve the sickness and UI systems. In the Budget Bill for 2013, the government has increased the possibility to cumulate labour income and social assistance under a certain limit, thereby increasing the incentives to take a job for recipients of social assistance (Figure 14).

To enhance job search incentives and make them more uniform across the unemployed, most workers should be covered by UI, and the benefit should decline over time. In the current system, workers who are affiliated with a UI fund have a benefit initially equal to 80% of the previous wage up to a ceiling, but falling over time. Those who are not affiliated receive a constant basic allowance equal to 25% of the average wage. Those who are not entitled to UI benefits receive other types of support that are constant over time. One option to enhance and equalise job search incentives across the unemployed would be to have most unemployed receive an UI benefit and to finance this broader system through mandatory contributions to UI. This would require easing the entitlement conditions to UI in terms of duration of past work.

The enlargement in coverage of UI for some groups should be accompanied by stronger job search requirements and monitoring. The enlargement of the responsibilities of the PES has not been fully matched by capacities to monitor job search and sanction insufficient efforts. For instance, the PES has only limited means to sanction those who

Figure 14. **Unemployment and inactivity traps are relatively high**

2010



Source: OECD, Tax-Benefit Models.

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receive the “activity support” given to the long-term unemployed, or those on welfare benefits as eligibility does not depend only on work criteria. The PES should be in charge of job search help, monitoring and sanctions for all the unemployed. The measures in the Budget Bill for 2013 to harmonise sanctions across categories of unemployed and to introduce milder and more gradual, and hence, easier to implement, sanctions are welcome. The proposal to shift the burden of proof of job-search activity onto the unemployed is also welcome as Sweden is one of the rare countries where the unemployment benefit recipient does not need to provide evidence of job-search activity (Venn, 2012). However, it will be important to develop an efficient system of control of job-search activity that does not rely only on jobseekers’ declarations.

The record of ALMPs is mixed. Specific programmes tailored to individual needs have been developed and are promising. However, programmes that provide “work experience placement” for long-term unemployed with no payment from employers have not benefited individuals much. Furthermore, job subsidies for large groups of unemployed help some of them to find a job but have generated displacement effects as a significant share of these jobs would have been created anyway. The Budget Bill for 2013 increases the subsidy for youth having been unemployed for more than six months in the main

job-subsidy programme. For other programmes, the use of profiling can help identify individuals at risk of becoming long-term unemployed and limit displacement effects. In this respect, it will be important to closely monitor the impact of the statistical profiling tool that has been introduced in 2012 to identify unemployed who will need to receive job-search help at the beginning of the unemployment spell. Efforts to develop specific programmes tailored to individual needs should continue. Improving co-operation between the PES, the Social Insurance Agency and the education system would help those who are furthest from the labour market to durably enter it.

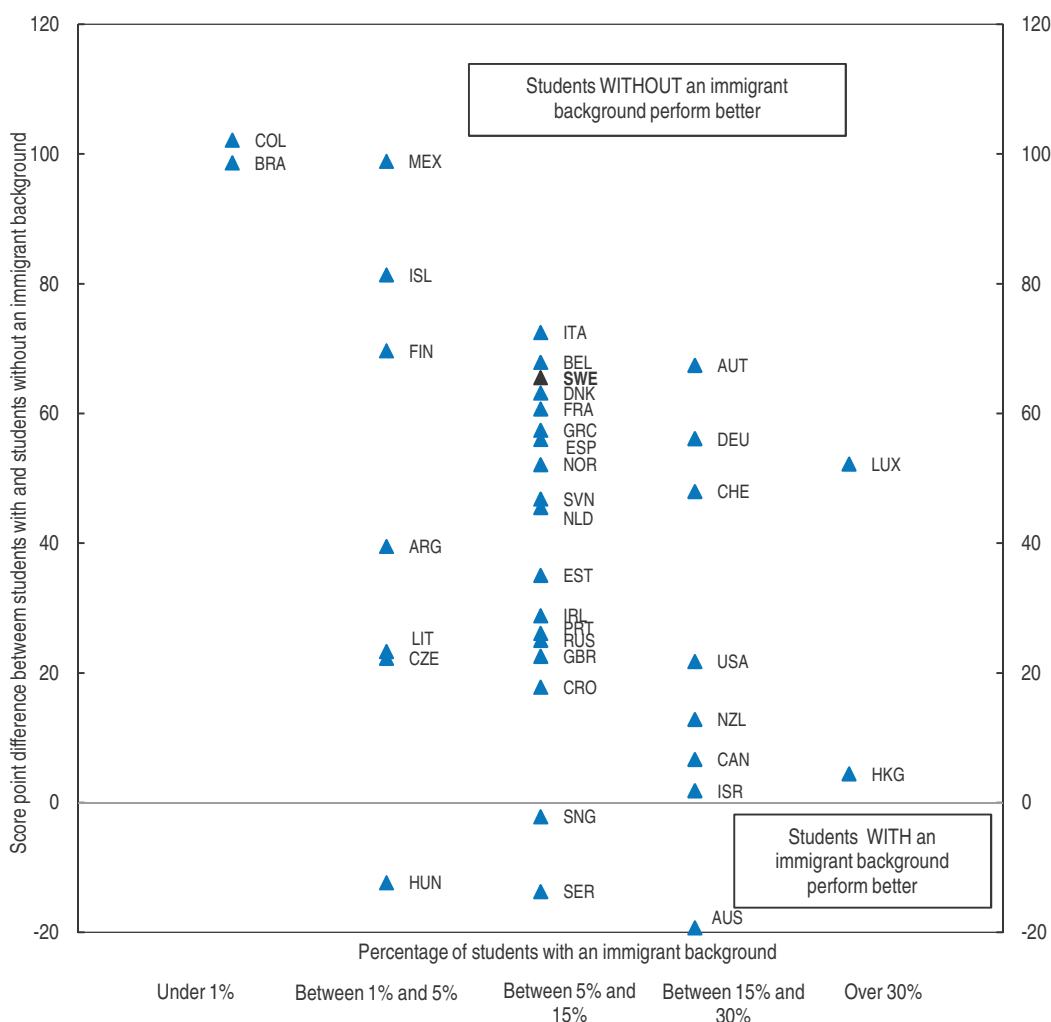
Education policies to promote integration and ease transition to the labour market

The education system has a key role to play in helping youth at risk of exclusion enter the labour market. Enrolment rates for early childhood and primary education are high in Sweden, but graduation rates for upper secondary education are below the OECD average. Furthermore, learning outcomes according to PISA results are slightly below the OECD average in mathematics and science, even though education spending per student exceeds the OECD average. PISA results also indicate that disadvantaged students, and in particular immigrants, are more at risk of doing poorly in Sweden than in a number of other countries (Figure 15).

Pre-school and compulsory education has a key role to play in enhancing the chances of disadvantaged students and closing the gap in educational outcomes. In 1992, Sweden implemented a major reform of compulsory education by introducing a system of school choice. More recently, a number of reforms have taken place with the aims of limiting drop-outs and better supporting disadvantaged students. The impact of these reforms, in particular on education outcomes of students with an immigrant background, needs to be monitored closely.

Encouraging the combination of study and work can ease the transition from school to work (OECD, 2010a). In this area, the Swedish system lacks flexibility and co-operation between schools on the one hand, and employer and labour market institutions on the other has been poor. In particular, the links between vocational education and training (VET) and the labour market are rather weak (Kuczera *et al.*, 2008). The government is well aware of this problem and several measures have been taken or proposed to strengthen VET. A pilot project aimed at developing apprenticeships started in 2008 and was made permanent in 2011. The Budget Bill for 2013 includes various measures to develop further apprenticeship programmes through higher subsidies for employers and training for apprentice supervisors. The number of places in regular education with vocational content will be temporarily increased and the government has proposed measures to reduce shortages in vocational teachers.

International experience with VET shows that several elements underpin successful apprenticeship systems (OECD, 2010b). There should be incentives to sustain the commitment of both students and firms, calling for subsidies or tax breaks and efforts to develop these programmes in various sectors, including rapidly expanding sectors. Close links between schools and local employers will contribute to efficient career guidance and to preparing apprentices' supervisors in companies. Strong institutions to engage employers, unions and students, and to carefully monitor these programmes are also important. The Swedish social partners have a major role to play in this area. The creation in 2011 of National Programme Councils with representatives from the social partners in charge of strengthening the relevance and the quality of VET is therefore welcome.

Figure 15. **PISA results are lower for students with an immigrant background**

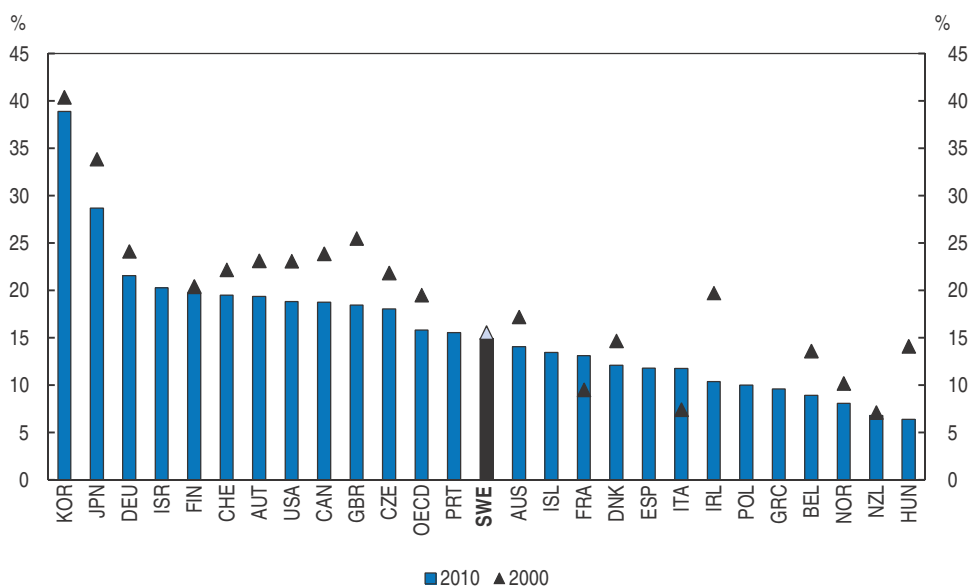
Note: Countries are classified on the horizontal axis according to the share of students with an immigrant background in all students. The vertical axis indicates differences in reading performance according to PISA results in 2009 between students with an immigrant background and native students. A positive gap shows lower performances for students with an immigrant background than for the natives and a negative gap, lower performances for the natives. Sweden, for instance, has a share of students with an immigrant background between 5% and 15% of overall students, who have learning outcomes around 70% of the natives' ones.

Source: OECD Programme for International Student Assessment (PISA).

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Further improving women's employment opportunities

Sweden has a strong focus on gender equality. Thanks to an easily accessible childcare system, labour force participation and employment rates for women are high and the share of part-time employment of women is below the OECD average. Furthermore, the share of women on boards and in parliament is high. The gender wage gap is lower in Sweden than in a number of other OECD countries, but Sweden's lead has diminished (Figure 16): the gender pay gap for median earners declined by 19% between 2000 and 2010 in an average of selected OECD economies, but only by 4% in Sweden. The breakdown of wage gaps according to earnings levels shows that for Sweden it is larger than the OECD average for the top decile.

Figure 16. **The gender pay gap has remained constant in Sweden¹**

1. Defined as the difference between male and female median wages divided by male median wages. Data refer to 2009 (instead of 2010) for Ireland, Denmark, Sweden, Czech Republic, Austria, Switzerland, Finland, Israel, Germany, Korea; to 2008 for Belgium, France, Greece, Iceland, Italy, Poland, Portugal, Spain. Data refer to 2004 (instead of 2005) for Italy and Switzerland. Data refers to 1999 (instead of 2000) for Czech Republic.

Source: OECD, *Employment Database*.

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According to the OECD's 2012 *Gender Report*, hours worked and job characteristics are major contributors to the gender pay gap. In Sweden, women are more likely to be employed in the public sector (OECD, 2012). In 2008, they made up 73% of the public sector workforce in Sweden, compared with 58% OECD-wide. More family-friendly policies in the public sector, such as more flexible working hours and part-time employment opportunities, may have helped achieve high employment rates for women in this sector (Gupta et al., 2008). General norms, cultural practices, and lack of role models are important barriers to women's leadership. The differences in the use of long parental leave between men and women might also contribute to divergences in their career profiles.

Family policies help female labour force participation, but may not be fully effective in ensuring career prospects (Hakim, 2000; Hallden, 2009). Child care mainly takes the form of centre-based care. The relatively high wages at the bottom of the wage distribution make it costly to hire professional household service providers. Social norms against buying household services may also play a role. In 2007, a tax deduction for up to 50% of expenses for domestic household-related services was introduced. Policies to improve wage flexibility at the lower end of the wage distribution, as proposed above, would lower the cost of in-house child-care further. Encouraging both parents to use parental leaves would improve gender equality. The government should continue to help address cultural barriers and stereotypes about the role of both women and men in society and business through collaboration with business, schools or the media.

Box 2. Main recommendations for labour market and social policies

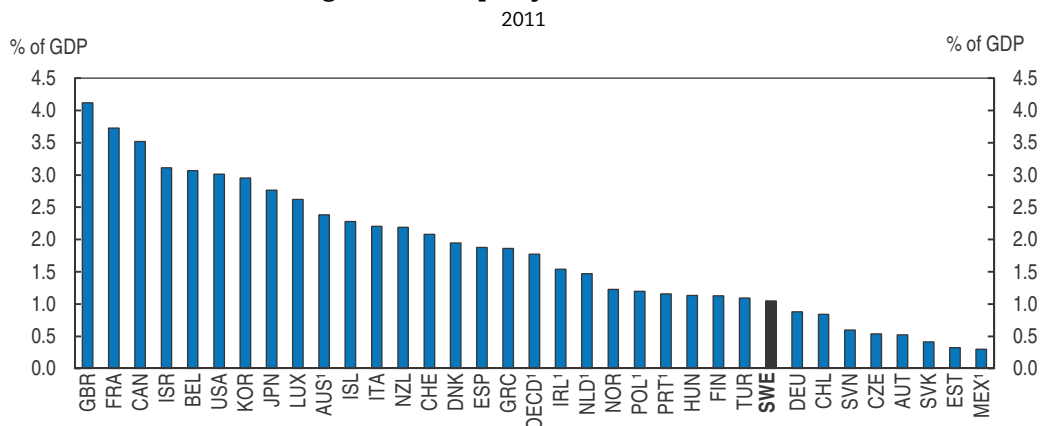
- Reduce the gap between the labour cost and productivity of workers at risk. The government should continue talks with social partners to develop employment contracts that improve employment opportunities for such workers. Studies on the impact of minimum wages on employment should be commissioned and published regularly.
- Reduce the gap in job protection legislation between temporary and permanent contracts. This can be achieved in various ways. Under the current system, job protection on permanent contracts needs to be eased.
- Consider extending the coverage of unemployment insurance by easing the entitlement conditions in terms of duration of past work and moving to a system with mandatory contribution to unemployment insurance.
- Continue to strengthen the obligations of the unemployed and the Public Employment Service's power of sanction. Make sure that all unemployed are actually covered by the Public Employment Service regardless of the type of support they receive. Implement plans to shift the burden of proof of job-search activity to the unemployed and develop an efficient control system of job-search.
- Develop further apprenticeship programmes and work placement in vocational education.
- Continue efforts to reduce the differences in the use of parental leave between men and women.

Enhancing the efficiency of capital taxation and the housing market***Improving the design of capital taxation***

The tax system favours investment in owner-occupied housing which, given constrained supply in the short run, has fuelled increases in house prices and has inflated household debt. In 2008, a reform of capital taxation replaced the central government tax on property by a fee payable to municipalities, further decreasing the already relatively low taxes on property (Figure 17). The deductibility of interest payments, which encourages debt-financed investment in housing, was not altered. The reform was driven by a lack of public support for property taxation and it remains politically difficult to increase property taxes. The 2008 reform has reinforced the investment bias in favour of housing. Furthermore, by making housing tax revenues independent from the land value, the reform has weakened incentives to provide more land for construction (see below).


The first-best solution to align the tax on owner-occupied housing with that on other types of assets is to tax imputed rent, but this regime is difficult to implement. A property tax based on the market values of property could be considered a proxy for a tax on imputed rent, if it is assumed that the flow of rent is proportional to the property value. Alternatively, the mortgage interest relief should be abolished as a second-best solution. Given lack of public support, any change to property taxation would best be made gradually. Furthermore, a higher rate of recurrent taxation of the market value of residential property would also be easier to introduce if used to reduce taxes on real estate transactions, thereby improving labour mobility.

Capital taxation also tends to favour institutional savings. The main distortion arises because imputed returns on institutional financial savings (pension funds, life insurance companies) are taxed at 15%, as against 30% for other financial savings of households.

Figure 17. **Property taxation is low**

1. 2010.

Source: OECD, Revenue Statistics.

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Furthermore, the contributions to pension schemes mandated by collective bargaining agreements are exempt from ordinary social security tax and are subject to a lower wage income tax, lowering the effective tax rate on pension savings for high-income earners. Finally, pensions are taxable, while contributions to pension schemes are deductible, lowering the effective tax rate on the return to pension savings to the extent that the marginal income tax at the time of contribution is higher than the marginal tax rate when the pensions are received.

The taxation of assets should be revised to make taxation of financial savings more neutral and uniform. One option would be to reduce the gap between the tax rate on pension savings and that on other financial assets. Evidence that better-off households benefit more from the design of the pension system suggests that tax incentives for institutional savings may have led to distortions. A more extensive investigation of which people participate in the tax-favoured pension scheme and the impact of the taxation of institutional savings on their total saving would be useful. There is some empirical analysis that tax subsidies to institutional savings boost these types of savings but not the overall savings level (Bergström *et al.*, 2010). Hence savings are reallocated from other types of savings. It could be argued that favourable taxation of private pension saving helps to address the expected fall in the replacement ratio coming from lower public pensions for above-average wage earners. However, the mandatory nature of contributions to these private pensions is the best way to serve this objective and contribution rates could be changed if pension saving appears to be insufficient.

Favourable tax treatment of pensions and property may have implications for wealth inequality, as top incomes have risen steeply in Sweden in the past two decades, driven mainly by realised capital gains. Given the large role of capital gains in the rise in top incomes, it is important to monitor developments in wealth distribution. The abolition of the wealth tax in 2007 has eliminated an important source of data. Hence, getting other sources of wealth information, including that on pension wealth, which constitutes a large part of household wealth in Sweden, should be a priority.

Addressing the structural problems in the housing market

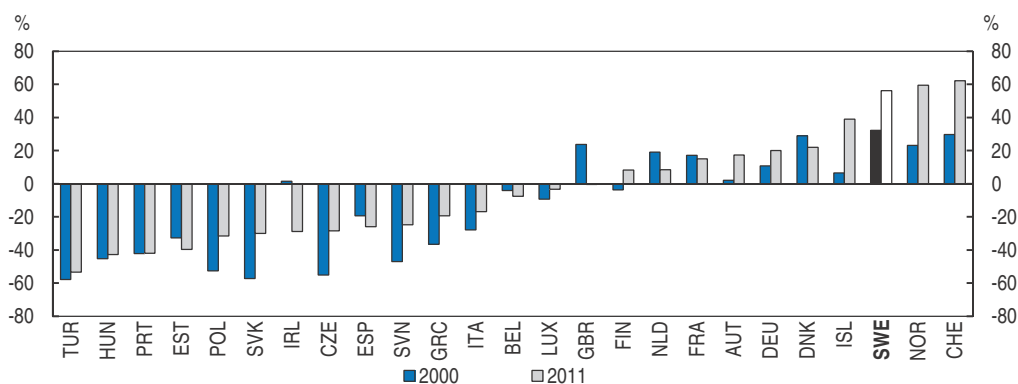
Although house price increases have been partly driven by fundamentals such as rising disposable incomes, falling mortgage rates and property taxes, structural factors

have also contributed. Rapidly rising demand has not been matched with sufficient supply, especially in urban areas, potentially dampening labour mobility. Measures to ensure adequate housing supply should be complemented with changes in taxation (see above) in order to avoid house price bubbles that would threaten financial stability.

Construction costs are high in international perspective and have risen fast, driven by large increases in land costs (Figure 18). Land shortages, driven by complex and lengthy planning processes, delays due to appeals and the lack of incentives for municipalities to provide land for building discourage new housing development. Furthermore, the building permit requirements applied by municipalities to construction firms are not uniform, decreasing efficiency. Streamlining these requirements across municipalities would make the allocation of land to construction companies more transparent and open. The 2011 Building and Planning Act makes a step in that direction as it stipulates that decisions on building permits are to be taken in ten weeks.


Figure 18. **Price levels for housing investment are relatively high**

Difference with EU15¹



1. Housing investment refers to gross fixed capital formation in construction. Based on purchasing-power parity exchange rates.

Source: Eurostat.

StatLink  <http://dx.doi.org/10.1787/888932756782>

Construction costs are also pushed up by lack of competition in the construction sector. Past high subsidies led to an uncompetitive market structure, with a few dominant large firms and some vertically-integrated companies that have pushed up the cost of materials (see the chapter on housing in the 2007 *OECD Economic Survey* and Swedish Competition Authority, 2009). This market structure generates high entry barriers, cartel-like behaviour and bribery (see the chapter on competition in the 2004 *OECD Economic Survey* and Sjöblom, 2011). The prospects of small and foreign firms are further restricted by a land distribution process that tends to favour established large domestic companies and the nature of the tendering process where certain tenders are too large, not well-specified and take a long time between submission and results. Accordingly, the access of small and foreign firms to the public procurement process could be enhanced by improving its timeliness, predictability and clarity. It is also important to ensure that the high cost of building materials does not disadvantage smaller firms who rely on larger vertically-integrated companies for the provision of building materials.

In recent years, much of the new construction has been through housing co-operatives for tenant-owner apartments (*bostadsrätter*), which is a specificity of the Swedish housing

market. Under this arrangement, there are tight restrictions on an owner who wishes to sublet or rent an apartment, as the tenant co-operatives have a veto right. In 2009, the possibility to build owner-occupied apartments was introduced as an alternative, but their effect on the long-standing problem of insufficient supply of rental apartments is limited. Furthermore, so far there have been strong restrictions on purchasing an apartment with the purpose to rent it out, curtailing the supply of rentals.

Rent controls prevent rents from responding to market values, hold back construction activity, create inefficiencies in the use of existing housing stock, lead to black market activity and might even increase segregation (Lind, 2003). Despite some reforms, historic cost-based rents, dependent on management and maintenance costs, mainly reflect the age of the apartment rather than its location, creating a mismatch between supply and demand across regions. The resulting long queues limit labour mobility and force young households to buy rather than rent. With rents out of line with fundamentals, the return on construction of new rental dwellings is low or uncertain, even in high-growth areas where land prices are high, impeding the supply response to demand changes, and resulting in too low levels of construction.

The Budget Bill for 2013 proposes the relaxation of the rules concerning tenant co-operatives' right to veto subletting, a reduction in the municipal property tax for rental units, an extension of the reduction of the municipal property tax on new residential housing construction, an increase in the standard deduction for a person letting their own home and the relaxation of the restrictions on renting out one's own apartment. These measures will contribute to increasing the supply of rentals and are a welcome move towards easing the rental market. However, the remaining restrictions, such as those on an owner to rent an apartment and on a person to buy an apartment to rent it out, should be phased out completely. Efforts to phase out rent controls and align rents with market values should also continue.

Box 3. **Main recommendations for enhancing the efficiency of capital taxation and the housing market**

- Move towards more neutral taxation across types of assets. In particular, to tax owner-occupied housing like other assets, a tax on imputed-rent would be first best. A property tax based on market value could proxy imputed-rent taxation. Alternatively, abolish mortgage interest deductibility.
- Evaluate further which people benefit most from the lower tax rate on institutional savings and how the taxation of institutional savings affects their total saving. Consider reducing the gap between the tax rate on pension savings and that on other financial assets.
- To reduce supply rigidities in the housing market, streamline building requirements across municipalities and ease the process of setting up co-operatives. Enhance the access of small and foreign firms to the public procurement process by improving its timeliness, predictability and clarity.
- Phase out the restrictions on apartment rentals, including on buying an apartment to rent it out. Continue to phase out rent controls so as to more closely align rents with market values.

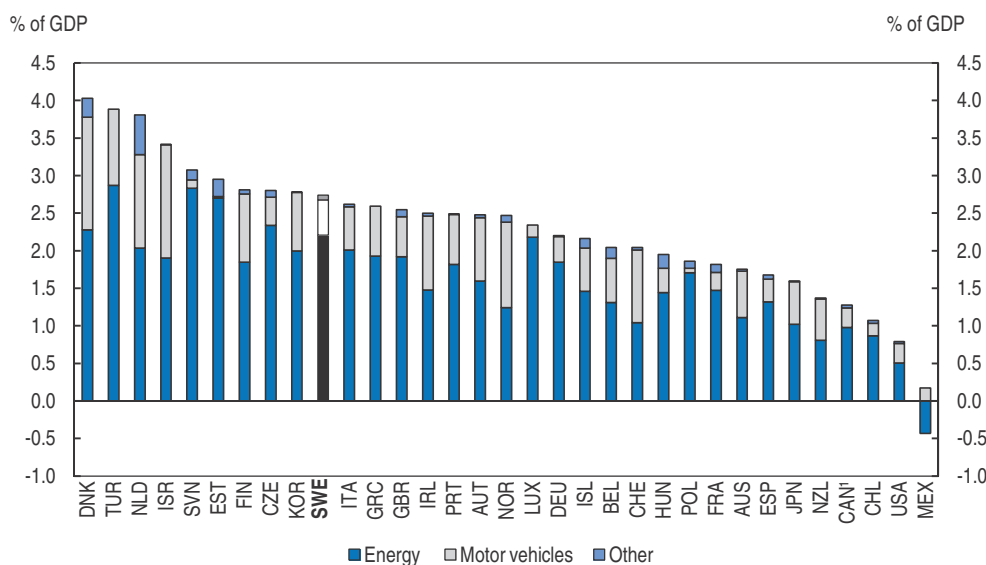
Raising the efficiency of climate change mitigation policies

Sweden has managed to decouple GDP growth from greenhouse gas (GHG) emissions. This has been achieved through a sound policy framework to mitigate GHG emissions that combines market-based instruments, performance and technology standards, and various forms of support to “green technologies”. Some of these policies nevertheless impose relatively large costs (see the chapter on climate change mitigation in the 2011 *OECD Economic Survey*). Going forward, Sweden has adopted ambitious targets to lower GHG emissions. Improving the cost-efficiency of climate change mitigation policies is important to achieve strong economic growth and high environmental ambitions. Actions taken in this area are detailed in Annex A1.

Most sectors are covered by market-based instruments, either the EU Emissions Trading System (EU ETS) or the Swedish carbon tax, which was introduced in 1991 and then gradually raised. Other taxes, such as the energy tax, also put an implicit price on carbon and local air pollutants. Indeed, Sweden has high energy taxation (Figure 19). However, the carbon price varies between sectors, which implies that GHG emission reductions are not achieved where they are the cheapest. Parliament’s decision to gradually decrease carbon tax exemptions for energy-intensive industries and other cases between 2011 and 2015 is therefore welcome.


Figure 19. Taxes on energy in Sweden are high

2010



1. 2009 data.

Source: OECD/EEA Database.

StatLink  <http://dx.doi.org/10.1787/888932756801>

In the transport sector, the main policy to contain growth in GHG emissions has been to develop the use of biofuels through an exemption from the energy tax (and the carbon tax). However, the cost of reducing CO₂ emissions through the development of biofuels can be high (Steenblik, 2007). The use of biofuels is estimated to have brought a reduction in emissions of about 1% of Sweden’s total GHG emissions at an average cost close to 360 per tonne of CO₂ equivalent (Swedish National Audit Office, 2011). The government has

recently strengthened the criteria on the share of biofuels in blends of biofuels and petrol or diesel to qualify for tax reliefs. While low-blend biofuels are more likely to lead to GHG emission reductions, they are a costly way to do so and may not be sustainable in the long run, especially if the global demand for them continues to increase (OECD, 2008). Despite new research, the development of new and advanced biofuels that would be efficient in reducing GHG emissions and could be used by all cars has been difficult. Hence, the government should introduce an energy tax on biofuels, as proposed in the Budget Bill for 2013. It should also closely monitor the impact of the biofuel quota obligation for petrol and diesel that it is planning to introduce on the share of renewable energy in the transport sector to ensure that the renewables EU target is not overshoot.

The government has set out a long-term priority to have a fossil-fuel independent vehicle fleet by 2030. To this end, a “super-green car” rebate was introduced in 2012 amounting to SEK 40 000 (around € 4 600). While encouraging the development of “green” cars could help limit pollutant emissions and foster green innovation, this strategy entails costs and risks. Taxing fuels is likely to be a more cost-efficient way to reduce GHG emissions in the transport sector as, unlike vehicle subsidies, it creates incentives to drive less and to consider alternative means of transportation. The government should therefore carry out a cost-benefit analysis of the fossil-fuel independent vehicle fleet priority and examine whether road fuel taxes are sufficient to internalise the social costs of vehicle use.

Box 4. Main recommendations for climate change mitigation policies

- Continue to gradually phase out exemptions to the carbon tax.
- Clarify the role and the expected costs and benefits of the long-term priority to have a fossil-fuel independent vehicle fleet by 2030.

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ANNEX A1

Progress in structural reforms

This annex summarises recommendations made in previous *Surveys* and actions taken since the *OECD Economic Survey on Sweden* published in January 2011.

| Recommendations | Action taken since January 2011 |
|--|---|
| Fiscal framework | |
| Set fiscal targets with reference to the existing stock of assets and liabilities, and the future path of spending and revenues. | The government has performed this type of analysis but has concluded that the uncertainty surrounding this methodology was too large to base fiscal targets on it. |
| Reduce the pro-cyclicality of the balanced-budget requirement for local governments by basing it on average taxable income over a number of years. Alternatively, central government grants could be adjusted counter-cyclically. | The government plans to allow municipalities to build up savings in local funds, subject to some conditions. |
| To better appreciate the implications of fiscal policy for intergenerational distribution, produce and publish generational accounts using the same data and assumptions as the fiscal sustainability calculations that are already produced. | The Swedish Fiscal Policy Council has produced this type of analysis in its 2012 report. |
| Consider introducing periodic reviews to assess how new spending pressures arising from greater service demands or technological change could be financed either via private spending or via savings on existing programmes. | The government reassesses the level of the surplus target at regular intervals. |
| Increase the resources of the Swedish Fiscal Policy Council, if it is a barrier to its mandate. | The resources of the Swedish Fiscal Policy Council were raised in 2011 and its mandate has been clarified. |
| Financial system | |
| The increased government support, via the capital injection and the guarantee programmes should be unwound as conditions normalise. Aspects of the government support programmes need to be reviewed to examine whether they are inappropriate or poorly designed. | The Bank Guarantee Programme was terminated in June 2011. |
| There is scope to improve FSA funding and correct any anomalies, such as not having all deposit-taking institutions fully regulated by the FSA. | Resources of the FSA are being raised over the next few years, while legislative amendments have been made to clarify its autonomy. |
| The responsibilities of and relationship between the Riksbank, the FSA and the NDO need to be reviewed and clarified. Gaps in the toolkit to supervise and influence financial institutions need to be addressed. An evaluation of the resolution framework for banks is needed. If the FSA remains the supervisor, its toolkit may need to be strengthened. If the Riksbank retains financial stability responsibilities, it could be given more effective instruments to influence banks' behaviour. | A Financial Crisis Committee was set up in February 2011 and will report in May 2013 on how to clarify the responsibilities of the Riksbank, the FSA, the NDO and the Ministry of Finance and how to improve bank resolution schemes, the provision of liquidity support and the features of the Stabilisation Fund. A council for co-operation on macroprudential policy was set up in January 2012. New capital and liquidity requirements are to come into effect in 2013. |
| Cross-border financial supervision co-ordination and co-operation need to be further nurtured. Memorandums of Understanding between cross-border institutions generally could be more specific. | The authorities are involved in the development of international supervision at the EU level. |

| Recommendations | Action taken since January 2011 |
|---|--|
| Labour market | |
| Progressively move the ALMP mix away from work experience placement schemes towards training and job search. Improve the targeting of ALMP by increasing the use of profiling to identify individuals at risk of becoming long-term unemployed and revisiting the eligibility criteria for the employment incentive scheme (Nystart jobs). | ALMPs are still tilted towards work experience placements and job subsidies, and the eligibility criteria for the employment incentive scheme have been eased for young unemployed. A statistical profiling tool has been introduced in 2012 to identify unemployed who will need to receive job-search help at the beginning of the unemployment spell. |
| Consider moving gradually towards a system of tuition fees for tertiary education while extending the government loans available for students to finance tuition costs. Repayment of these loans could be made contingent on future income provided marginal income taxes are reduced. | No action taken. |
| Further develop information on and indicators of the performance of vocational education and make them publically available. Assess the impact of using education programmes for unemployed workers' probability of moving into employment and on the quality of the education system. | In 2011, a National Programme Council with representatives from the social partners in charge was created with the objective to strengthen the relevance and the quality of VET. An investigation on the performance of the current VET system (especially, on-the-job education) was launched in 2012. |
| To lower marginal tax rates for workers with above-average earnings, reduce the state income tax and offset the fall in government revenues by, for instance, raising property taxes. | No action taken. |
| Continue to improve the job-search incentives of the unemployed by reducing the tax wedge and reforming social benefits. In particular a cut in housing benefits could be combined with a targeted increase in family benefits. | No action taken. |
| Extend the coverage of unemployment insurance by making unemployment insurance contributions mandatory. | A parliamentary commission (appointed in 2011) is looking at possible reforms of the unemployment insurance system. |
| Strengthen the implementation of sanctions when job-search requirements are not met while making sanctions more gradual. Strongly improve co-ordination between the job-placement service and the administration of unemployment benefits. Implement performance indicators for the PES. | The Budget Bill for 2013 has increased the number of sanctions for not complying with obligations but has decreased their severity. Unemployed will have to provide evidence of their job-search activities. An "activity report" is introduced for this purpose. |
| Reduce the protection of workers on regular contracts by easing procedures for individual and collective dismissals. Consider legislation to facilitate the use of severance payments in lieu of the notice period. | No action taken. |
| Promote the use of transparent opt-out clauses allowing for local wage agreements at levels below the minima or consider moving towards a system where an independent commission plays a role and advises on the impact of minimum wages on employment. | The government is supporting an employment contract for youth developed by social partners in 2012. The contract combines 75% of the time on the job and 25% in education with compensation at 75% of the minimum wage. |
| Continue the reforms to improve the gate-keeping to sickness and disability benefits. If the ongoing reforms of the sickness and disability benefit scheme fail to reduce substantially the number of recipients of these benefits, lower the replacement ratio further. | Reforms have continued to deliver a fall in the number of recipients of these benefits although the declining trend has marked a pause in late 2012. |
| Taxation | |
| Continue with reductions of the corporate income tax rate. | The Budget Bill for 2013 includes a reduction of the corporate income tax rate from 26.3% to 22%, starting in January 2013. |
| Continue to cut income taxes in ways that maximise the effect on employment rates and hours worked. Raise the threshold for where the state income tax applies or cut its rate. | Income taxes have continued to be cut. No action taken concerning the state income tax. |
| Reinstate a housing tax levied in proportion to home value. | No action taken. |
| Climate change | |
| Continue to gradually phase out exemptions to the carbon tax and avoid introducing measures that would increase the heterogeneity of effective CO ₂ tax rates. Consider freezing or lowering the general level of the CO ₂ tax while enlarging the tax base if it is consistent with national GHG emission reduction targets. | The parliament has approved a stepwise decrease and abolishment of exemptions to the carbon dioxide tax between 2011 and 2015, including CO ₂ tax rates outside the EU ETS. For sectors and plants covered by the EU ETS, carbon taxes are being gradually phased out. |

| Recommendations | Action taken since January 2011 |
|---|--|
| Limit the interactions between the carbon tax and the energy tax by reforming the two. As far as possible, address the carbon dioxide externality only through the carbon tax. Use the energy tax and perhaps other taxes to address other externalities. | The energy tax for diesel is increased gradually (by SEK 0.20 per litre in 2011 and in 2013), which implies a reduction in the difference in energy taxation on diesel and petrol. The energy tax on fuels used for heating purposes has been made proportional to the energy content from 2011. |
| Tax biofuels over and above VAT to account for GHG emissions, partly outside Sweden, generated by the production and imports of biofuels. This can be done, as is planned by the government, by assessing tax exemptions against environmental sustainability criteria. Moreover, an energy tax should be applied to biofuels. | The Budget Bill for 2013 includes a proposal to tax biofuels used for low blend purposes from 2013. An evaluation of the introduction of a quota system for low-blend biofuels (7% in diesel and 10% in petrol) has been commissioned for 2014. If a quota system goes ahead, the government plans to introduce an energy tax for all biofuels included in the quota, possibly with a higher tax rate for biofuels not fulfilling the sustainability criteria. |
| Limit the use of other instruments that implicitly generate a carbon price to situations where there is a distinct market failure or a clear other reason for having them. As the electricity certificate system is in place, phase out other forms of support to renewables in the electricity sector. Phase out most subsidies to local public investments in green technologies that have delivered limited GHG emission reductions. | The local cross-sectoral investment programme (LIP) and climate investment programme (KLIMP) have been phased out. |
| In future negotiations on the allocation of permits within the EU ETS, take a larger share of the effort by negotiating lower permit allocations conditional on a downward adjustment of the EU level quota or by buying EU ETS permits with a strong commitment not to sell them in the future. | The allocation of permits is set at the EU level and individual countries do not negotiate their own allocations. Sweden has continued to buy international carbon credits through the Clean Development Mechanism to fulfil part of its target for the non-trading sector. |
| Work at the international level to reform existing flexible mechanisms so as to limit their additionality and bottleneck problems. | The Swedish government is working on these issues with other EU member states and the European Commission. |
| Assess the costs and gains of having developed renewable energy and of developing it even further. If renewables targets are renegotiated at the EU level, consider negotiating less binding national targets. | No action taken. |
| Restrict access to the electricity certificate system to technologies that require support in addition to that provided by the EU ETS carbon price. Introduce some provisions to avoid the certificate price reaching levels that generate excessively large costs to consumers. One possibility is to relax the quotas, another to introduce a price ceiling. | No action taken. |
| In the transport sector, avoid measures that target the development of one specific technology. | No action taken. |
| Reconsider the fossil-fuel-independent vehicle fleet long-term priority. | In 2012, the government appointed a commission to investigate this long-term priority with a report due by October 2013. The Budget Bill for 2013 proposes to make the criteria to benefit from the vehicle tax relief for "green cars" stricter. Generous rules for cars that can be driven by alternative fuels would be phased out in the future. |
| Develop <i>ex ante</i> and <i>ex post</i> evaluations by both governmental and independent institutions of the global effects of climate change policies. | No action taken. |
| Clarify the responsibilities between governmental institutions that are involved in climate change policies and put one of them in charge of the overall assessment of policies. | Responsibilities have been clarified. A number of indicators to follow progress towards the climate change targets have been defined and some institutions are in charge of the follow-up of these indicators. |
| Assess more carefully the interactions between Sweden's climate change policies and those decided at an international level. | The government has asked the Swedish Environment Protection Agency to provide inputs to long-term climate policy planning. |

Chapter 1

Labour market and social policies to foster more inclusive growth

Sweden is a very egalitarian country but inequalities have risen and some groups are poorly integrated into the labour market. To make growth more inclusive, the gap between the cost of labour and productivity for some groups will have to be reduced, transitions from education to work should be facilitated, incentives to take a job ought to be strengthened and the non-employed need to be protected against the risk of falling into unemployment or inactivity traps. This calls for lowering minimum wages relative to the average wage for groups at risk of becoming unemployed, improving vocational education and training, and extending the coverage of the unemployment insurance while strengthening obligations for the unemployed. To address labour market duality risks, the gap in job protection between temporary and permanent contracts needs to be reduced. Women's employment is high but the gender wage gap could be narrowed further by enhancing women's employment opportunities.

Inequalities are low but have increased

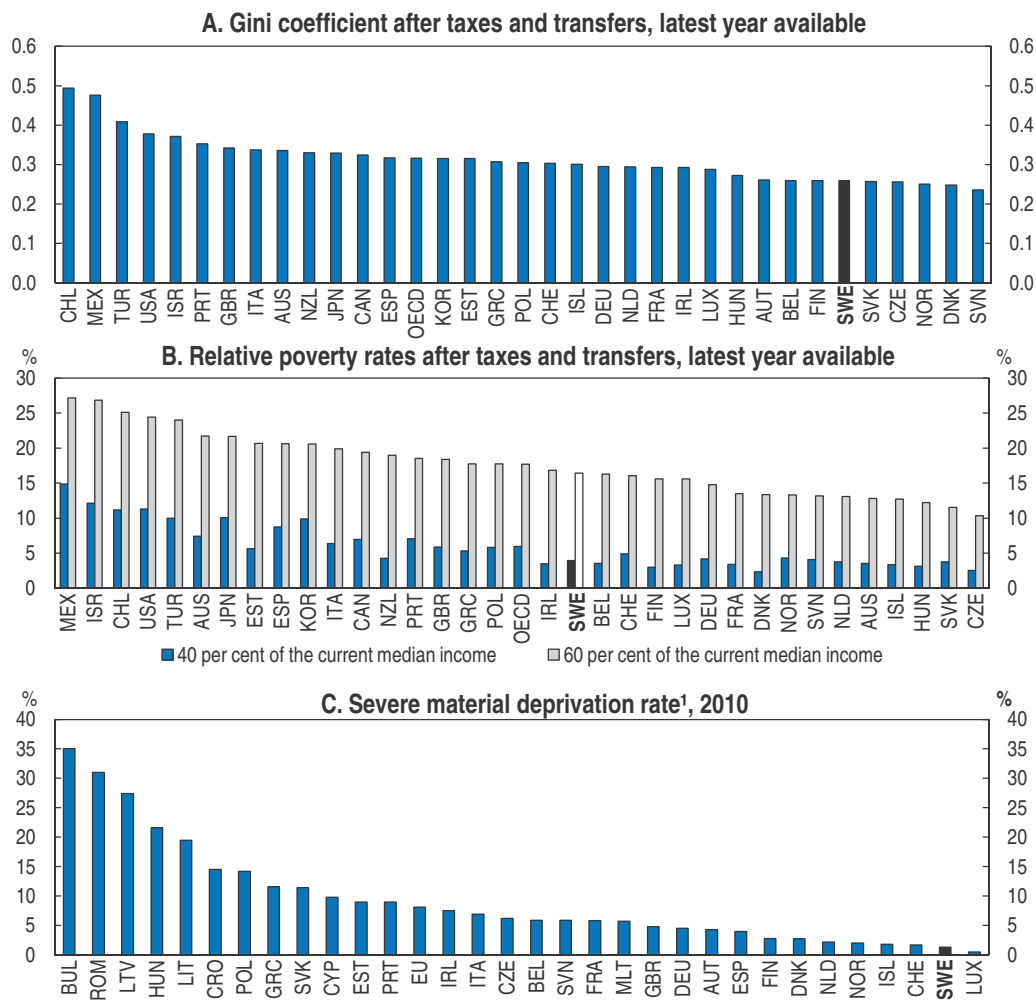
Sweden stands out among OECD members as a country with a low level of inequalities. This holds for income distribution as captured by the Gini coefficient (Figure 1.1). It also holds for poverty: relative poverty is well below the OECD average and material deprivation is low (Nolan and Whelan, 2010). The OECD has recently mapped inequalities across a large number of dimensions and virtually all indicators point in the same direction (Box 1.1).

However, inequalities have been rising since the early 1990s (Figure 1.3). While this has been true in most OECD countries, the increase in Sweden has been among the steepest (OECD, 2011a). As in most countries, household incomes increased faster at the top of the distribution, but the contrast was particularly stark in Sweden (Table 1.1). Furthermore, while in many EU countries, income growth has been fairly uniform across deciles between the second and the ninth, in Sweden, growth has been faster the higher the income decile, pointing to some polarisation of the income distribution (Figure 1.3, Panel B). Relative poverty has increased with those without a job and children now facing a higher risk of poverty (Figure 1.3, Panel C).

The cross-country literature on the drivers of household income inequalities shows that changes in the distribution of wages and salaries play a major role (Kierzenkowski and Koske, 2012). Changes in the structure of households due to factors such as population ageing and the trend towards smaller household sizes have also been important in several countries. In Sweden for instance, 25% of the increase in household earnings inequalities over 1991-2005 came from changes in the household structure (OECD, 2011a). Finally, in half of the OECD countries, income taxes and cash transfers have become less effective in reducing market income inequalities during the late 1990s and early 2000s. The underlying causes of the recent changes in inequality remain subject to debate. Globalisation and technological change are the leading contenders (OECD, 2011a). Structural reforms also affect inequality but their impact depends on the type of reform (Fournier and Koske, 2012).

In Sweden, the decomposition of household disposable income by component shows that across much of the distribution, income growth over 1995-2010 has mainly been driven by labour income, with wage growth weak for the three bottom deciles and stronger for the upper ones (Table 1.2). Social transfers and taxes have redistributed income from the upper deciles to the bottom ones, but their equalising role has become less pronounced (Figure 1.4). Over 2000-10, wage growth has been modest for the first three deciles but also for the top decile. The relatively weak growth of wages for the top decile likely reflects a substitution from labour to capital that has been encouraged by the tax system (Chapter 2). Changes in transfers have positively contributed to income growth for the lowest deciles while changes in taxes have mostly benefited to middle and upper deciles.


Figure 1.1. Inequality and relative poverty indicators in OECD countries



Note: Panels A and B are based on equivalised household disposable income, after taxes and transfers, entire population.

1. Severe material deprivation is defined as the inability for people to afford at least four of the following items: 1) to pay their rent, mortgage or utility bills; 2) to keep their home adequately warm; 3) to face unexpected expenses; 4) to eat meat or proteins regularly; 5) to go on holiday; 6) a television set; 7) a washing machine; 8) a car; 9) a telephone.

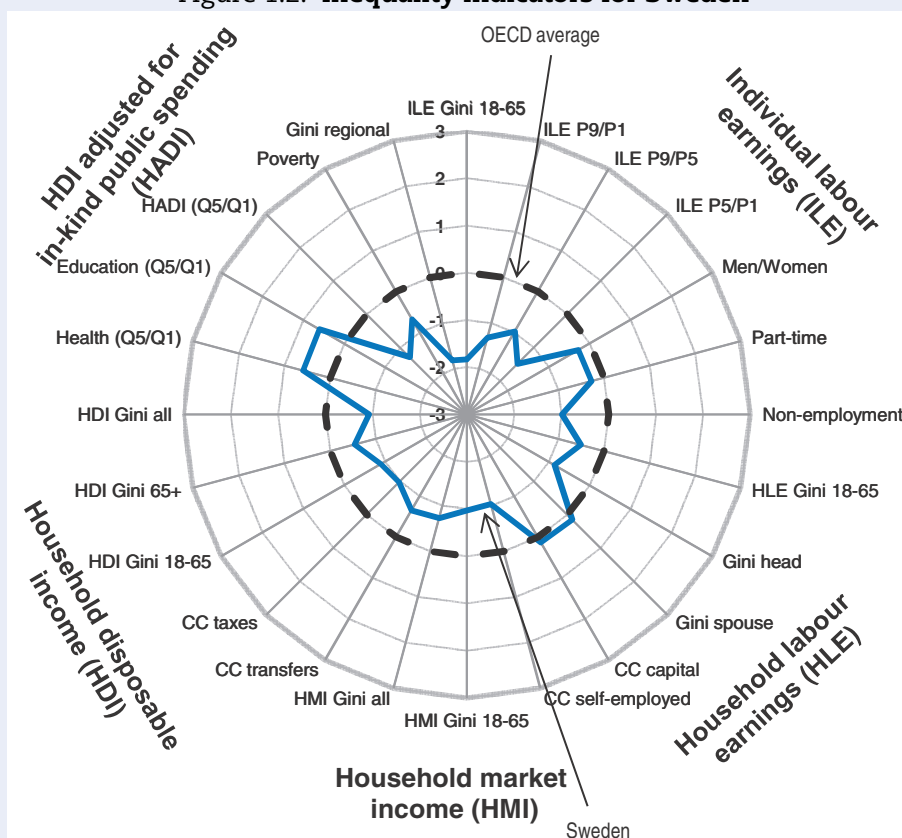
Source: A and B: OECD, *Income Distribution and Poverty Database*. C: Eurostat.

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Box 1.1. Inequalities in Sweden along various dimensions

For Sweden, the indicator set developed in Hoeller *et al.* (2012) reveals that inequality in household disposable income, whether adjusted or not for in-kind public services, is low in international comparison (Figure 1.2). Inequality in individual labour earnings for the working age population is low, reflecting both a narrow wage dispersion and a non-employment rate below the OECD average. Capital income is slightly more concentrated than in the OECD on average but overall the Gini index of household market income for the entire population remains well below the OECD average. Taxes and cash transfers bring inequality in household disposable income significantly below the OECD average, and in-kind transfers work in the same direction. Health and education services tend to have a slightly less redistributive impact than on average in the OECD mainly because of their universal nature in Sweden. However, other services, such as child care, public transport and social housing are more redistributive than in other countries and on the whole, the inequality indicator adjusted for in-kind public spending is the lowest among all OECD countries (OECD, 2011a).

Figure 1.2. Inequality indicators for Sweden



Note: Data refer to 2008 for Sweden and to the late 2000s for the OECD average. The dotted line represents the OECD average and the solid line Sweden. Where the solid line falls inside the OECD average, this implies less inequality than the OECD average, and vice versa. The indicators are presented in units of standard deviation.

OLE: OLE Gini 18-65 = for working age population, including wage earners, self-employed, unemployed and non-employed; OLE P9/P1 = ninth to first decile, wage earnings for full-time employees; OLE P9/P5 = ninth to fifth decile, wage earnings for full-time employees; OLE P5/P1 = fifth to first decile, wage earnings for full-time employees. Men/Women = median wage earnings of men to women. Part-time = ratio of part-time workers to total employment. Non-employment rate = as a share of the working age population.

HLE: HLE Gini 18-65 = for working age population. Gini head = for heads of household. Gini spouse = for spouses.

HMI: CC capital = concentration coefficient for capital income. CC self-employed = concentration coefficient for self-employment income. HMI Gini 18-65 = for working age population, HMI Gini all = for total population.

Box 1.1. Inequalities in Sweden along various dimensions (cont.)

HDI: CC transfers = concentration coefficient for cash transfers. CC taxes = Concentration coefficient for household taxes. HDI Gini 18-65 = for working age population. HDI Gini 65+ = for population aged 66 and over HDI. Gini all = for total population.

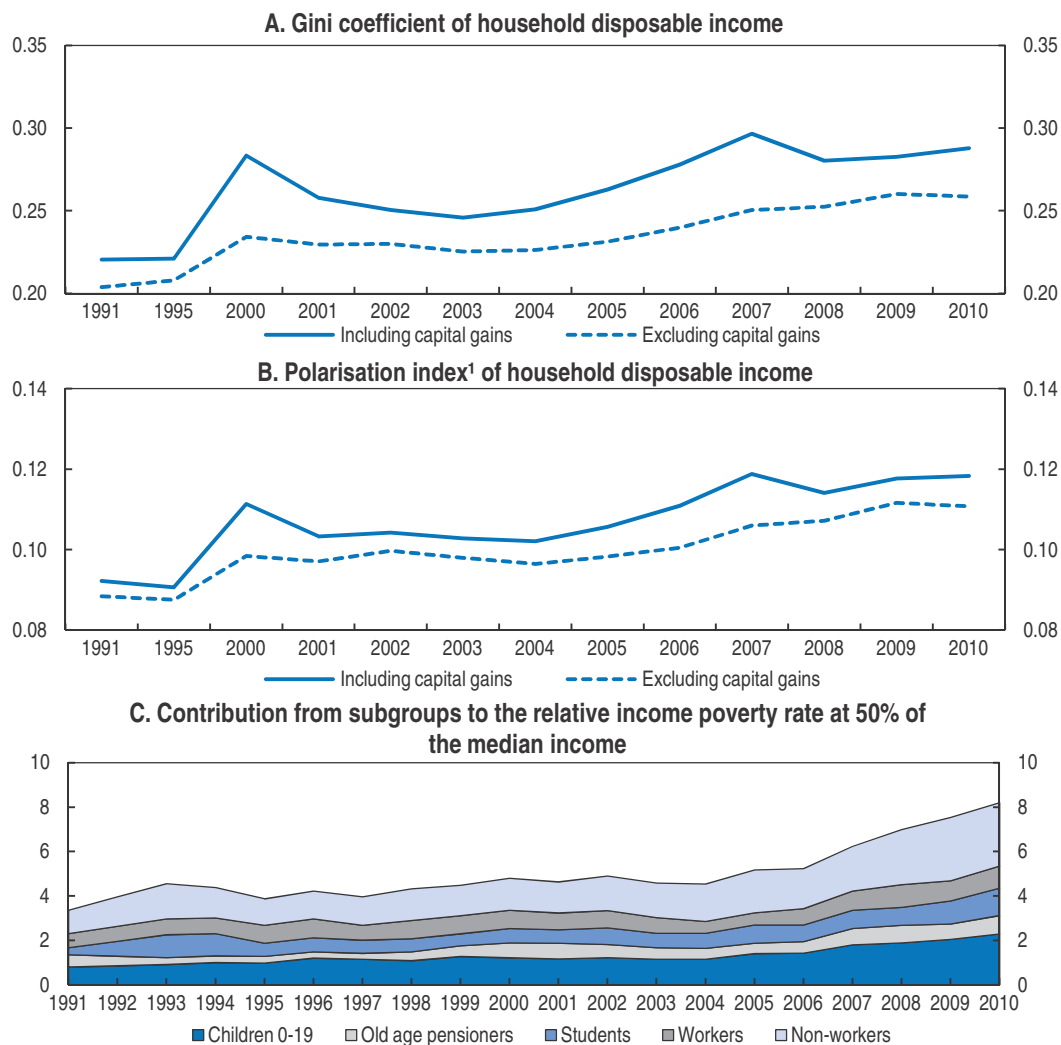
HADI: Health Q5/Q1 = public spending on health, fifth to first quintile; Education Q5/Q1 = public spending on education and early childhood education and care, fifth to first quintile; HADI Q5/Q1 = HDI adjusted for in-kind health and education public spending, fifth to first quintile.

Poverty = relative poverty rate; Gini regional = for regional GDP.

Source: Hoeller, P., I. Joumard, M. Pisu and D. Bloch (2012), "Less Income Inequality and More Growth – Are They Compatible? Part 1. Mapping Income Inequality Across the OECD", *OECD Economics Department Working Papers*, No. 924.

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Figure 1.3. The evolution of inequality and relative poverty in Sweden



Note: Panels A and B are based on equivalised household disposable income, after taxes and transfers, entire population.

1. The Foster and Wolfson polarisation index measures the extent to which the distribution is spread out from the middle. More precisely it is the area delineated by the vertical distance between the Lorenz curve and the tangent to that curve at the median.

Source: OECD estimates, Statistics Sweden and Swedish Ministry of Finance.

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Table 1.1. Average annual real disposable income growth per decile, by country¹
Between the mid-1990s and 2008, percentage change

| Decile | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|----------------------------------|------|------|-----|-----|-----|-----|-----|-----|-----|-----|
| Denmark | 0.3 | 0.8 | 0.8 | 0.9 | 1.0 | 1.1 | 1.1 | 1.2 | 1.2 | 2.7 |
| Finland | 1.4 | 1.4 | 1.7 | 2.1 | 2.3 | 2.4 | 2.5 | 2.5 | 2.6 | 4.8 |
| France | 1.2 | 1.4 | 1.4 | 1.4 | 1.3 | 1.2 | 1.2 | 1.2 | 1.2 | 2.4 |
| Germany | -0.1 | -0.2 | 0.0 | 0.0 | 0.2 | 0.2 | 0.2 | 0.3 | 0.4 | 1.3 |
| Greece | 6.1 | 4.7 | 4.4 | 4.0 | 3.7 | 3.5 | 3.4 | 3.3 | 3.3 | 3.0 |
| Italy | 2.6 | 1.6 | 1.1 | 1.1 | 0.9 | 0.9 | 0.8 | 0.8 | 0.9 | 0.9 |
| Luxemburg | 1.3 | 1.7 | 1.9 | 2.0 | 2.2 | 2.3 | 2.3 | 2.2 | 2.4 | 3.7 |
| Netherlands | -0.3 | 0.4 | 0.5 | 0.4 | 0.4 | 0.3 | 0.3 | 0.4 | 0.6 | 2.4 |
| Sweden | 0.7 | 1.2 | 1.8 | 2.2 | 2.4 | 2.6 | 2.7 | 2.8 | 2.9 | 3.5 |
| United Kingdom | 0.5 | 2.6 | 2.6 | 2.5 | 2.4 | 2.4 | 2.5 | 2.5 | 2.6 | 4.0 |
| Weighted EU average ¹ | 1.2 | 1.4 | 1.4 | 1.4 | 1.3 | 1.3 | 1.3 | 1.3 | 1.4 | 2.3 |
| United States | -0.4 | 0.5 | 0.5 | 0.5 | 0.6 | 0.7 | 0.8 | 0.9 | 0.9 | 1.2 |

1. Average household income per decile deflated by the consumer price index. Entire population. EU average weighted with population size and including Hungary.

Source: Bonesmo Fredriksen, K. (2012), "Income Inequality in the European Union", *OECD Economics Department Working Papers*, No. 952; *OECD Income Distribution and Poverty Database*.

Table 1.2. Contributions of various income components to income growth per decile¹

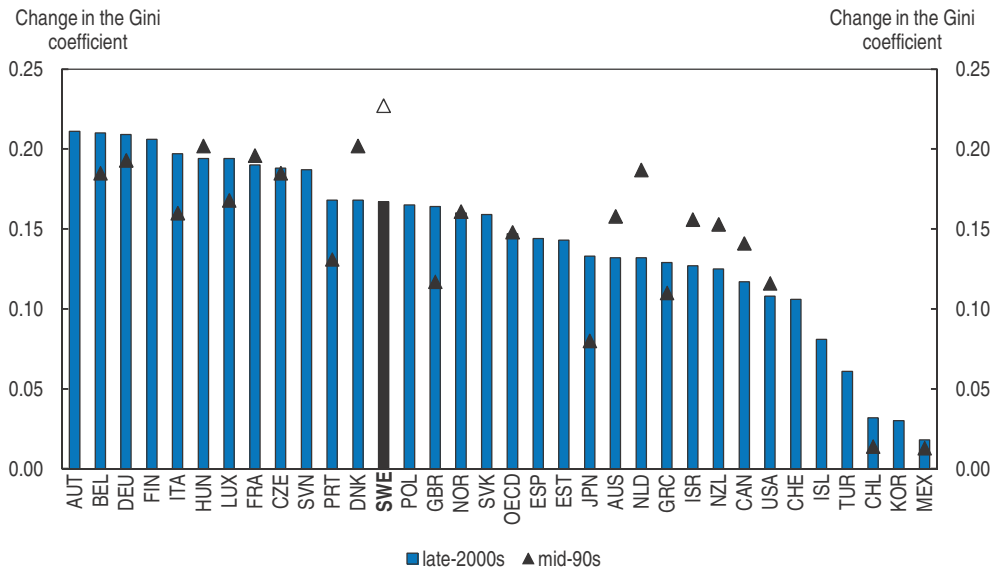
Sweden, contribution to average annual percentage change

| Decile | 1995-2010 | | | | | | | | | |
|--|-----------|------|------|------|------|------|------|------|------|------|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Wage of the household head | -0.1 | 0.1 | 0.9 | 1.6 | 1.9 | 1.9 | 2.2 | 2.2 | 2.0 | 2.4 |
| Wage of the household spouse and other members | -0.1 | 0.0 | 0.3 | 0.5 | 0.6 | 1.0 | 1.3 | 1.4 | 1.5 | 1.5 |
| Capital income | -0.1 | 0.1 | 0.3 | 0.3 | 0.2 | 0.2 | 0.1 | 0.2 | 0.3 | 1.4 |
| Self-employment income | -0.2 | 0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.4 |
| Social security transfers | 0.9 | 1.3 | 0.8 | 0.2 | 0.1 | -0.1 | -0.2 | -0.2 | -0.3 | 0.0 |
| Direct taxes and social security contributions | 0.3 | -0.1 | -0.2 | -0.2 | -0.1 | -0.2 | -0.2 | -0.3 | -0.3 | -1.1 |
| Other | 0.0 | -0.1 | -0.2 | -0.4 | -0.5 | -0.5 | -0.6 | -0.6 | -0.7 | -1.0 |
| Total income growth | 0.8 | 1.3 | 1.7 | 2.1 | 2.4 | 2.6 | 2.7 | 2.8 | 2.9 | 3.6 |
| Decile | 2000-10 | | | | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Wage of the household head | -0.1 | -0.1 | 0.3 | 0.9 | 1.2 | 1.2 | 1.4 | 1.3 | 1.1 | 0.3 |
| Wage of the household spouse and other members | 0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 0.4 | 0.7 | 0.7 | 0.7 | 1.0 |
| Capital income | -0.2 | 0.0 | 0.4 | 0.4 | 0.2 | 0.3 | 0.1 | 0.2 | 0.3 | 1.0 |
| Self-employment income | -0.1 | -0.1 | -0.1 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 |
| Social security transfers | 0.7 | 1.1 | 0.6 | 0.3 | 0.2 | 0.1 | -0.1 | 0.1 | 0.0 | 0.1 |
| Direct taxes and social security contributions | 0.4 | 0.3 | 0.4 | 0.5 | 0.7 | 0.7 | 0.7 | 0.6 | 0.7 | 0.6 |
| Other | 0.0 | -0.1 | -0.1 | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.4 |
| Total income growth | 0.6 | 1.2 | 1.6 | 2.1 | 2.4 | 2.5 | 2.6 | 2.6 | 2.6 | 2.8 |

1. Average household income per decile deflated by the consumer price index. Entire population, excluding capital gains.


Source: *OECD, Income Distribution and Poverty Database*; Swedish Ministry of Finance; OECD calculations.

Figure 1.4. **The impact of taxes and transfers on income inequalities**
Reduction in the Gini coefficients coming from taxes and transfers¹



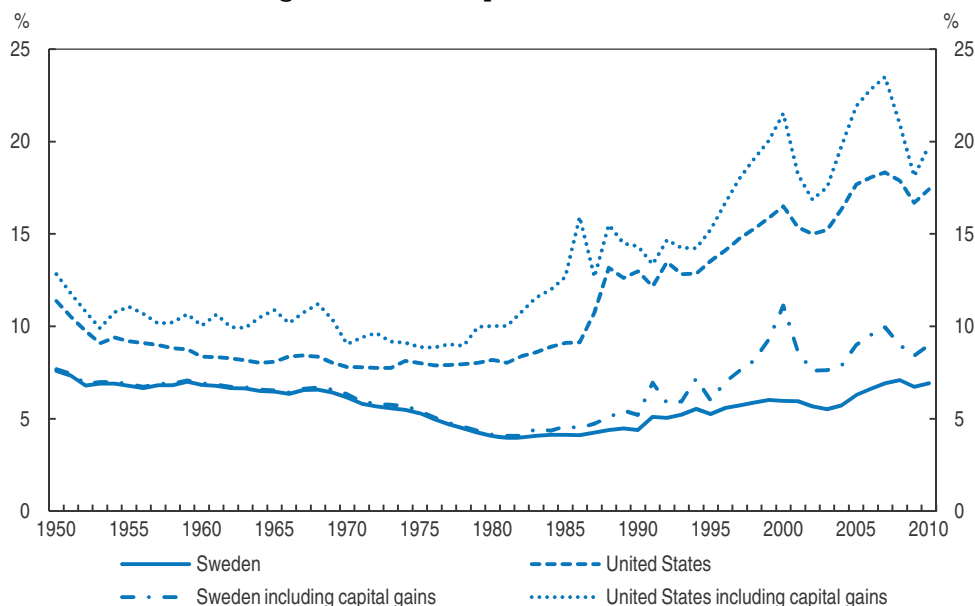
1. The redistributive impact of taxes and transfers is defined as the difference in the Gini coefficients for income before cash transfers and taxes (i.e. household market income) and after cash transfers and taxes (i.e. household disposable income). For instance in Sweden, the Gini coefficient was reduced through taxes and transfers from 0.44 to 0.21 (hence by 0.23) in the mid-1990s and from 0.43 to 0.26 (hence by 0.17) in the late 2000s. Entire population.

Source: OECD, *Income Distribution and Poverty Database*.


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Capital income has largely driven the rise in inequalities since the early 1990s as it went increasingly to richer households even if the share of capital income in total income remained stable (OECD, 2011a). In addition, capital gains have contributed to the increase in inequalities. When this source of income is excluded, the increase in inequalities since the early 1990s is smaller (Figure 1.3). The top decile, and more precisely the top percentile, has mainly benefited from this source of revenues, especially in recent years, at least partly reflecting high compensation for chief executives and other high-income individuals (Waldenström, 2009; Björklund *et al.*, 2012). When capital gains are included, Sweden exhibits a sharp increase in the pre-tax income share of the top percentile, although less marked than in the United States (Figure 1.5).

Whether this rise in inequality was unavoidable for Sweden to achieve an average rate of growth of 3% per annum over 1995-2008 is an open question. The cross-country empirical evidence on the links between inequality and growth has been inconclusive so far (De Dominicis *et al.*, 2008). On the one hand, inequalities may push up growth insofar as work incentives are stronger in more unequal societies, as higher-income individuals save a higher share of their earnings, and as wealth concentration favours the creation of new activities when there are sunk costs to investment (Aghion *et al.*, 1999). On the other hand, insofar as more unequal countries tend to redistribute more, this entails distortions that act as a drag on growth; large inequalities foster political and social instability which deters investment; and in the presence of credit market imperfections, inequality leads to under-investment in human capital. Another question is whether the increase in inequalities in Sweden should be a source of concern given that inequalities remain very low from an international perspective.

Figure 1.5. **The top 1% income share**

Source: The World Top Incomes Database, <http://g-mond.parisschoolofeconomics.eu/topincomes>.

StatLink  <http://dx.doi.org/10.1787/888932756896>

Sweden undertook many structural reforms to consolidate its public finances in the wake of the banking crisis of the early 1990s. They included reforms of the unemployment insurance and pension systems, and, more recently, a reform of the sickness and disability benefit system. The overall purpose of these reforms was to make the welfare and tax systems more conducive to labour market participation. It is therefore not surprising that inequalities increased after the mid-1990s, especially because positive effects on employment take time to materialise and the share of less productive workers may have increased.

Some groups perform less well on the labour market

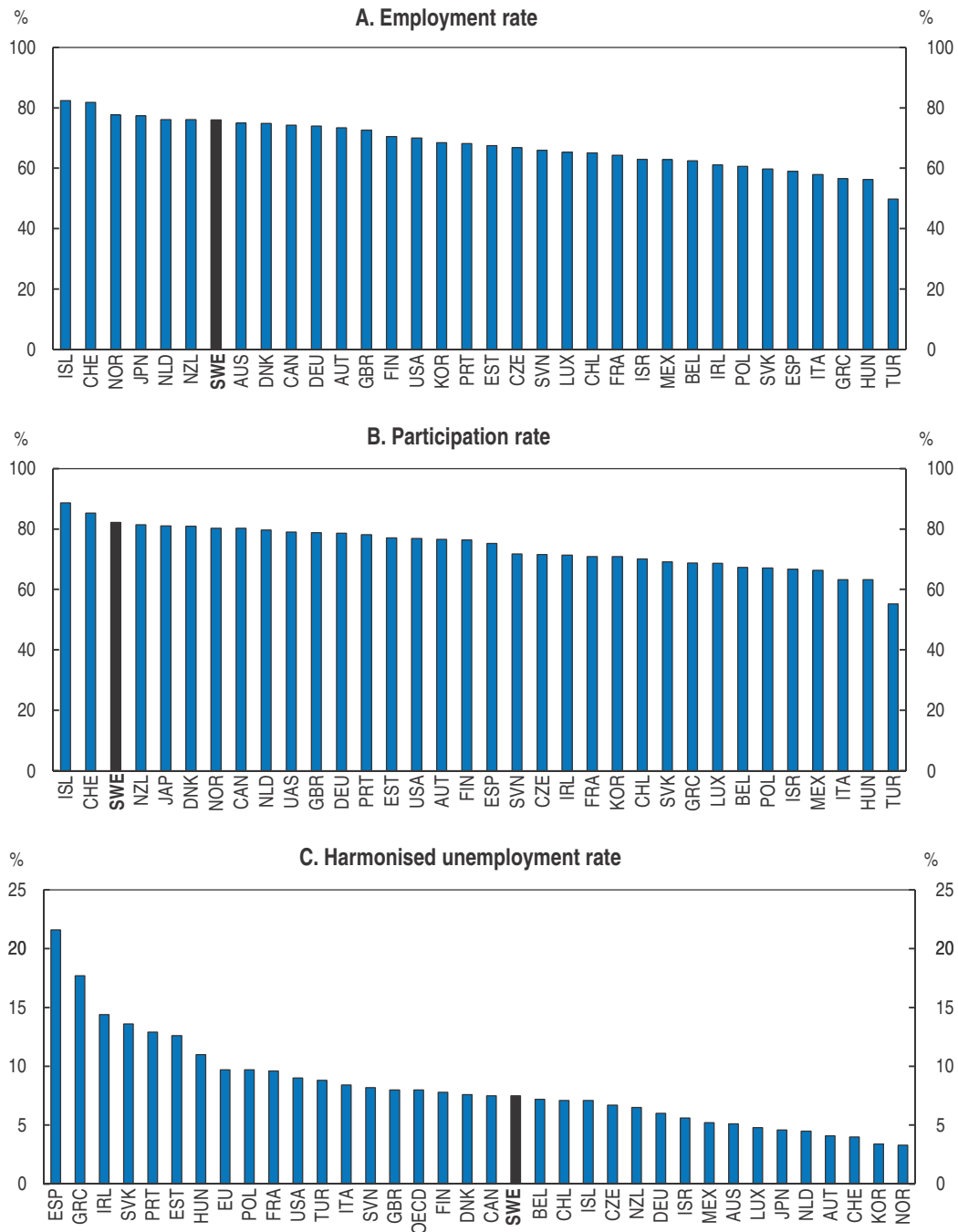
Good labour market outcomes are key to containing the rise in inequalities. Sweden performs very well in terms of most labour market indicators (Figure 1.6). Structural reforms have helped to raise employment rates to high levels and to lower the unemployment rate, although it never returned to its pre-1990s crisis level, partly because participation rates have also increased (Figure 1.7). However, groups who are given incentives to join the labour force but fail to find a job risk becoming long-term unemployed and discouraged. This in turn raises demands for inactivity benefits, which can undermine the success of Sweden's structural reforms agenda. Furthermore, higher risks of exclusion for some groups can worsen inequalities in opportunities, in a context where geographical segregation and the evolution of the structure of couples (with both members more often having a similar socio-economic background) make children more likely to inherit their parents' labour market situation.

Youth


Youth with a low level of education are one of the main groups at risk. They are more likely to be non-employed or to go back and forth between temporary employment and inactivity (OECD 2010a). Youth have less access to welfare benefits (see below) and are

Figure 1.6. Labour market performance indicators in OECD countries

2011

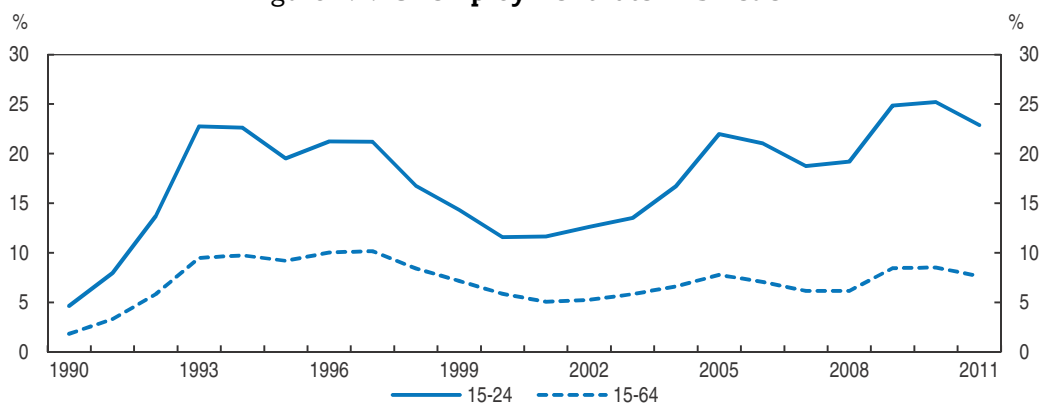


Source: OECD, Labour Force Statistics.

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therefore potentially more exposed to the risk of poverty. Overall, the situation is better in Sweden than in many other OECD countries (Table 1.3). The NEET rate, the share of youth who are neither employed, nor in education or training, is among the lowest in OECD countries (OECD, 2012a). The youth unemployment rate is high in Sweden but to some extent this reflects statistical issues (Box 1.2). Unemployment spells are very short for most

Figure 1.7. Unemployment rate in Sweden



Source: OECD, Labour Force Statistics.


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Table 1.3. Scoreboard for youth aged 15-24

| | 2001 | | | 2011 | | |
|--|--------|-----------------|-------------------|--------|-----------------|-------------------|
| | Sweden | EU ² | OECD ² | Sweden | EU ² | OECD ² |
| Employment rate (% of the age group) | 48.7 | 40.2 | 43.3 | 40.4 | 33.4 | 37.8 |
| Unemployment rate (UR) (% of the labour force) | 11.6 | 16.5 | 14.5 | 22.9 | 22.8 | 19.0 |
| Difference in UR between youth ¹ and adult (15-24)-(25-54) | 7.5 | 9.4 | 7.0 | 17.4 | 12.1 | 9.0 |
| Unemployment to population ratio (% of the age group) | 6.4 | 7.3 | 6.7 | 12.0 | 9.0 | 8.1 |
| Incidence of long-term unemployment (% of unemployment) | 7.0 | 25.4 | 18.7 | 5.4 | 28.0 | 22.1 |
| Incidence of temporary work (% of employment) | 47.8 | 33.1 | 30.0 | 57.5 | 40.6 | 38.2 |
| Incidence of part-time work (% of employment) | 32.7 | 16.8 | 20.6 | 36.6 | 25.4 | 27.9 |
| NEET rate ³ (% of the age group) | 7.4 | 13.6 | 13.2 | 10.8 | 11.2 | 12.8 |
| School drop-outs ⁴ (% of the age group) | 8.2 | 19.9 | 22.7 | 7.4 | 15.1 | 19.6 |
| Difference in UR between low skills and high skills ^c (ISCED<3-ISCED>5) | n.a. | 10.1 | 8.8 | 19.6 | 14.3 | 11.5 |

UR: unemployment rate; NEET: neither in education nor in employment or training; ISCED 3 and 5: International standard of education referring to, respectively, upper secondary education and first phase of tertiary education.

1. Youth aged 16-24 for Iceland, Spain, Sweden, the United Kingdom and the United States; youth aged 15-24 for all other countries; youth aged 20-24 for school drop-outs.

2. Unweighted average of the 21 EU and 34 OECD countries.

3. 2000 and 2010.

4. Share of youth not in education and without an ISCED 3 educational attainment; 1999 and 2009.

Source: OECD Project on Jobs for Youth (www.oecd.org/employment/youth) from OECD Employment Database and OECD Education Database.

Box 1.2. Measuring the share of youth at risk of being left behind and poorly integrated

The OECD *Jobs for Youth* review identified two groups of youth that face particular difficulties in getting a stable job after leaving school: the so-called “youth left behind” and “poorly-integrated new entrants” (Figure 1.8). The size of these two groups is, however, difficult to estimate.

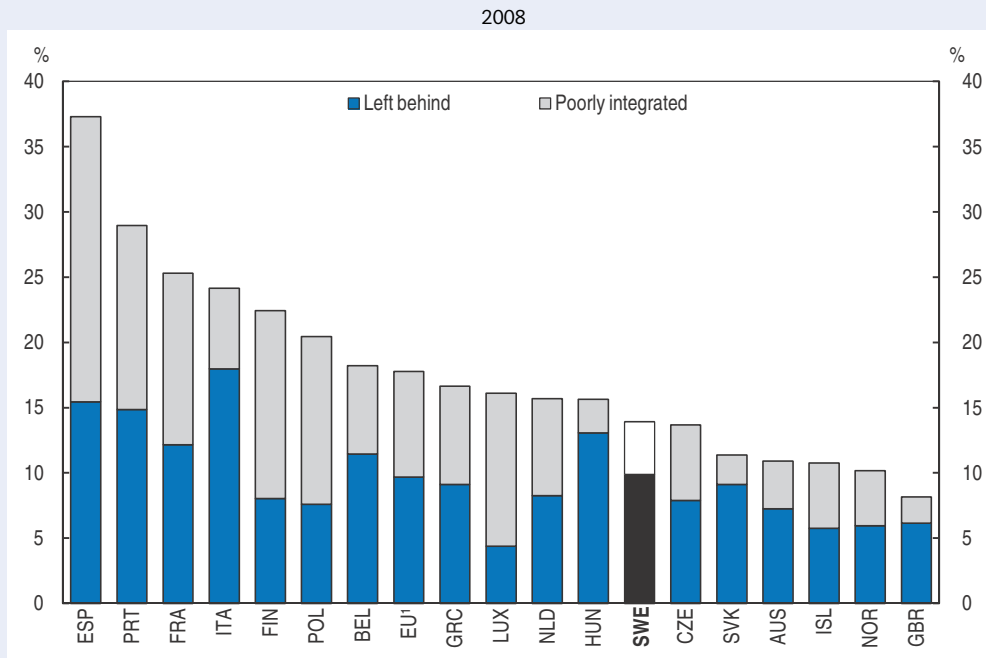
The “youth left behind” include those who lack qualifications, those coming from an immigrant or minority background and/or those living in disadvantaged, rural or remote neighbourhoods. The size of this group is proxied by the number of young people aged 15-29 who are neither in employment, nor in education or training (NEET) and who lack an upper secondary education, which was around 10% in 2011.

Box 1.2. Measuring the share of youth at risk of being left behind and poorly integrated (cont.)

The “poorly-integrated new entrants” include youth who often have diplomas but find it difficult to obtain stable employment, even during periods of strong economic growth. They frequently go back and forth between temporary jobs, unemployment or inactivity. The size of this group is proxied by the proportion of youth-out-of-school employed on a temporary basis in 2005 who were still in temporary employment, unemployed or inactive two years afterwards.


The youth unemployment rate can be a misleading indicator. Indeed, it depends on the country characteristics of youth labour force participation. In Sweden for instance, it is often argued that a large share of the young unemployed are full time students who mainly define themselves as students (Government Offices of Sweden, 2012). Indeed, in 2010, 6.5% of the young aged 15 to 29 were in education and also unemployed – well above the 1.9% OECD average. By contrast, 5.5% of them were not in education and unemployed, against 6.7% on average in the OECD (OECD, 2012a). Therefore it is more informative to look at NEET indicators (Table 1.3).

Figure 1.8. **Estimated size of the group at risk: Left behind and poorly integrated after a temporary job¹**



1. Estimates for youth aged 15-29 as a percent of the youth aged 15-29 having left education.

Source: OECD (2010), *Off to a Good Start? Jobs for Youth*, Paris.

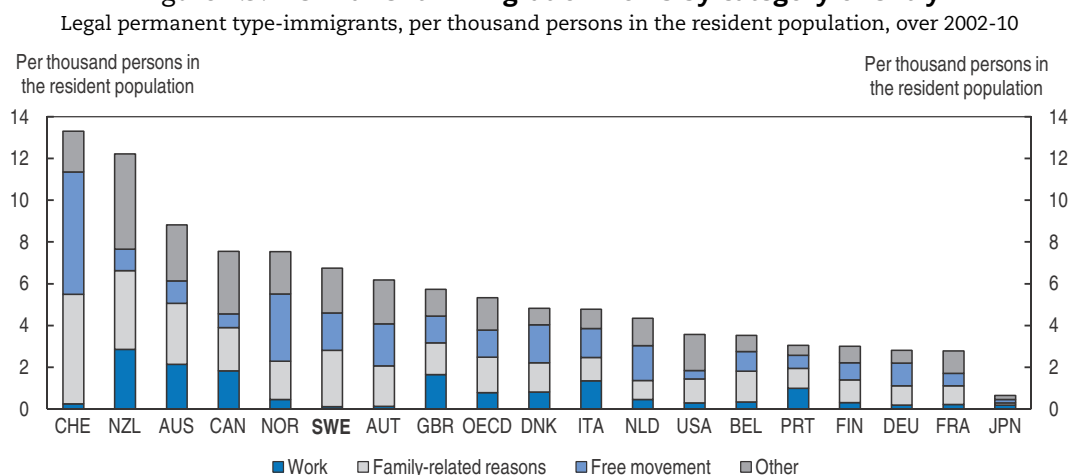
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young people: in 2011, 68% of the unemployed aged 15 to 24 were in unemployment for less than three months. However, youth have been hit particularly hard by the crisis, with their unemployment rate rising more than for the working age population as a whole (Figure 1.7) and the NEET rate also increasing. Also, their likelihood of being on a temporary job has increased with the crisis.


Immigrants

Some immigrants also face a high risk of being excluded from the labour market and more generally from society. Compared with other OECD countries and relative to its population, migration to Sweden has been high over the past decade (Figure 1.9). Sweden has encountered limited success with the integration of these migrants. The gap in unemployment rates between the foreign-born and the natives is high (Figure 1.10). Foreign-born women show a particularly weak attachment to the labour market as they are more often inactive than native women. The foreign-born have also less income than the natives and, thus, are more exposed to poverty risk.

Figure 1.9. **Permanent immigration flows by category of entry**



Source: OECD, *International Migration Database*.

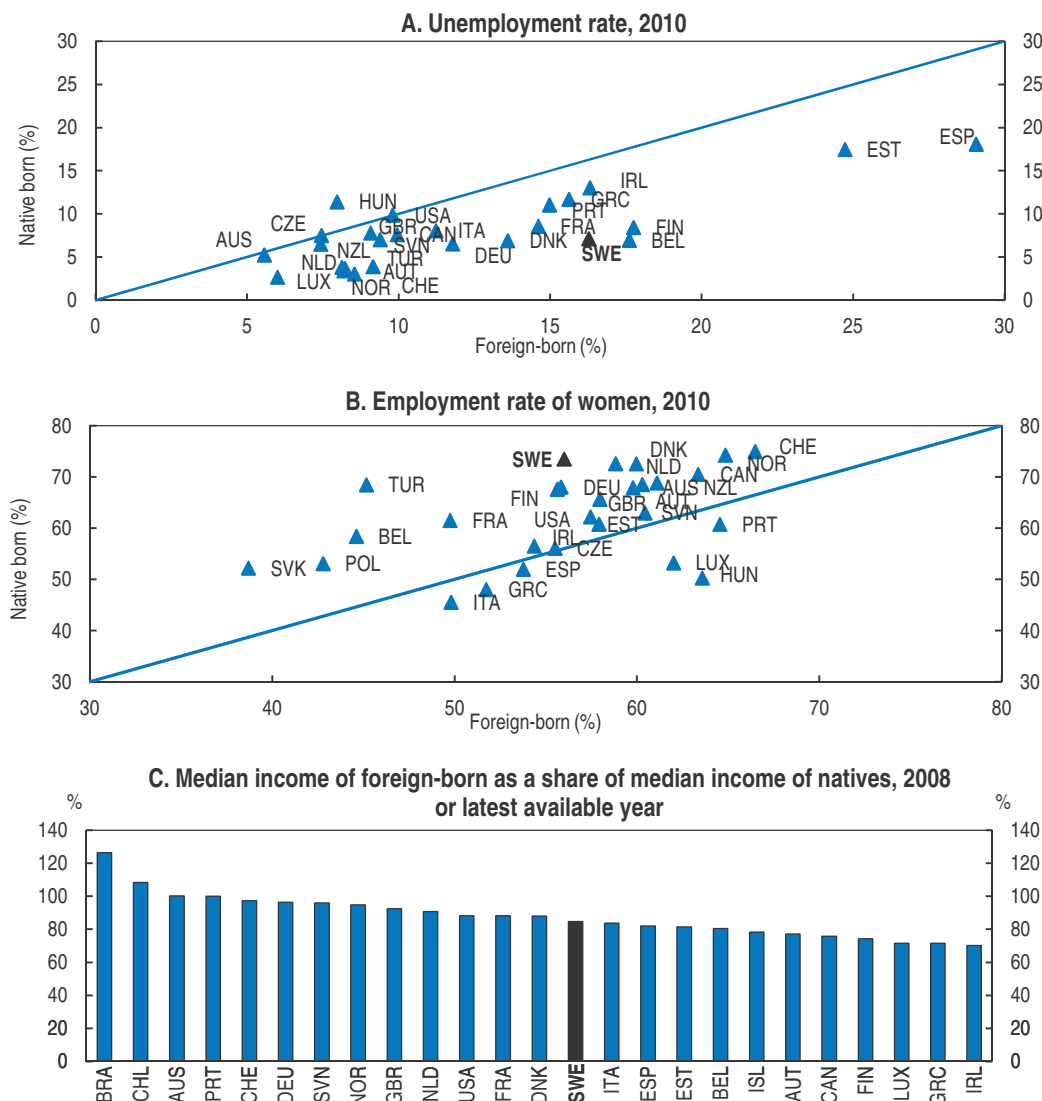
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Labour market outcomes vary greatly between different types of immigrants. Those coming from outside the European Union and through the family and asylum channels, who made up of more than 70% of immigrant flows between 2006 and 2008, have a lower level of education and are younger than the natives, which make them more likely to suffer from labour market exclusion (OECD, 2011b, Table 1.4). By contrast, non-EU migrants who come through the labour channel are more educated than the natives, have a higher income and a very low unemployment rate. In 2008, Sweden reverted to a more open labour migration policy by allowing employers to recruit workers from abroad for any occupation as long as wages and other working conditions fulfil the ones prevailing in collective agreements. This boosted the number of non-EU migrants coming in through the labour channel.


The disabled and sick

In all countries, people with a disability are exposed to the risk of being excluded from the labour market. In Sweden, the share of the working age population receiving sickness and disability has remained among the highest in the OECD for decades. Nevertheless, the employment rate of people with disability was the highest in the OECD in the late 2000s and the gap in employment rates between people with and without disability was relatively small (Figure 1.11). The labour market outcomes for workers with mental health problems are less favourable, particularly for those with severe disorders (OECD, 2011c).

Figure 1.10. **Gaps in labour market performance between natives and foreign-born in OECD countries**



Source: OECD, *International Migration Database*.

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While the relatively generous welfare system prevents recipients of disability benefits from falling into relative poverty, it may also act as a trap and foster feelings of exclusion.

Since 2006, Sweden has undertaken a series of reforms to address the long-term structural problems with its sickness and disability policies. A new sick-leave process was introduced with stricter time limits for work-capacity assessment at different stages (with referral to other jobs in the same company after three months and referral to all jobs in the labour market after six months) to facilitate early return to work. Moreover, sickness benefits can now be paid for a maximum of 2.5 years while there was no limit in the previous system. Entitlement criteria for a disability pension have also been made more stringent. These reforms have reduced the inflows into the sickness and disability benefit schemes and the stock of benefit recipients (Figure 1.12), although sickness benefit claims were on the rise in late 2012, but entail new challenges: social and labour market

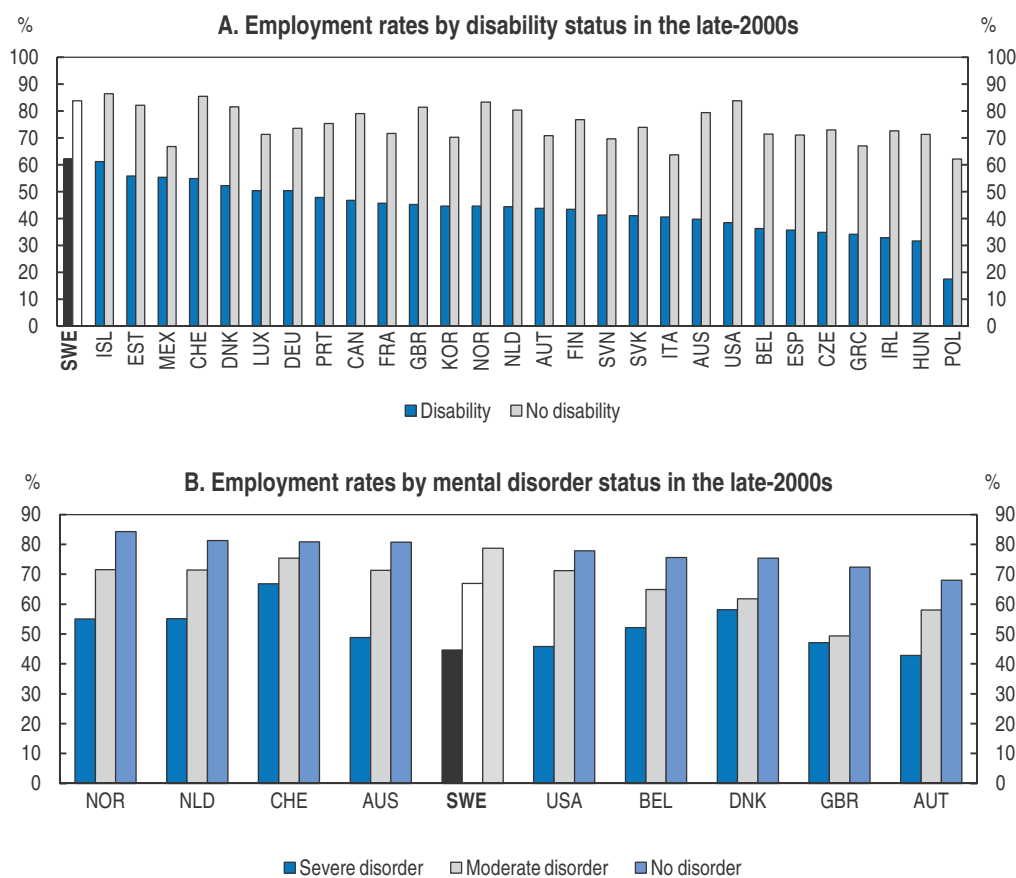
Table 1.4. **Characteristics of permanent residents by migration channel**
2009

| | Country of birth | | Migrant type (non-EU) | | | | |
|--|------------------|--------------|-----------------------|--------|--------|--------|---------|
| | Native-born | Foreign-born | Labour | Family | Asylum | Study | Other |
| Age | 40.5 | 40.7 | 35.7 | 33.7 | 35.2 | 28.9 | 38.1 |
| Women | 49% | 51% | 24% | 59% | 37% | 30% | 39% |
| Low education | 20% | 25% | 4% | 33% | 43% | 0% | 24% |
| High education | 26% | 30% | 80% | 33% | 24% | 67% | 41% |
| Total annual income (SEK) | 254 535 | 180 455 | 327 174 | 84 236 | 67 670 | 34 062 | 130 843 |
| Registered employment | 73% | 53% | 65% | 33% | 25% | 14% | 44% |
| Registered unemployment | 4% | 13% | 1% | 22% | 47% | 4% | 12% |
| <i>Memorandum item:</i> | | | | | | | |
| Population type as a share of total population | 83.6% | 16.4% | 0.1% | 1.7% | 1.0% | 0.2% | 0.0% |

Note: Permanent residents in Sweden aged 16 to 65. Migrants include only those arrived prior to 2009.

Source: OECD (2011), *Recruiting Immigrant Workers: Sweden*, Paris.

Figure 1.11. **Employment rates of people with disability and mental health problems**



Note: In Panel B, data for the United Kingdom refer to England only.

Source: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers – A Synthesis of Findings across OECD Countries*, Paris; OECD (2011), *Sick on the Job? Myths and Realities about Mental Health and Work*, Paris.


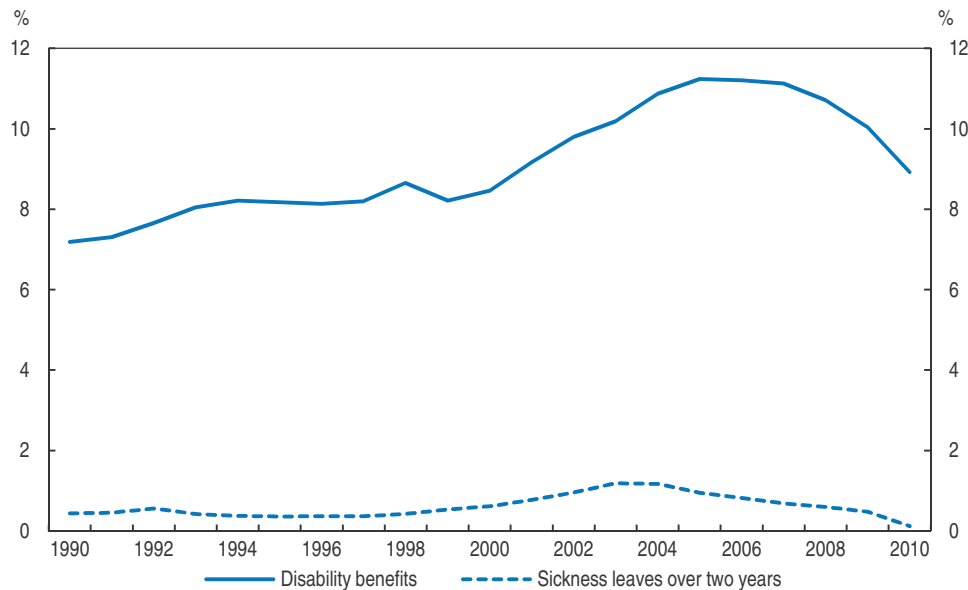

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Figure 1.12. **Evolution of the stock of recipients of sickness and disability benefits**
As a percentage of the working-age population



Source: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers – A Synthesis of Findings across OECD Countries*, Paris.

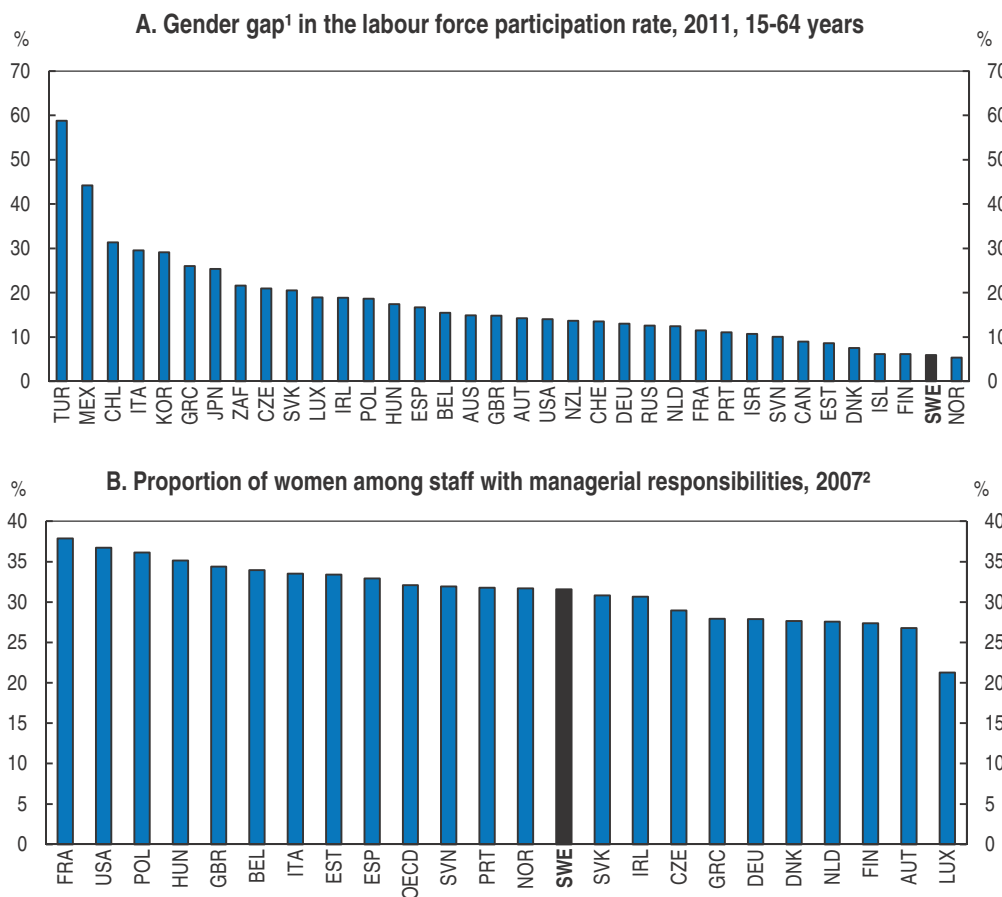
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institutions have to adapt to help people with a disability find a job and durably escape exclusion.

Women

Sweden performs well in terms of gender equality. Educational attainment of women, labour force participation and employment rates for women are high in Sweden (Figure 1.13). The widespread availability of affordable childcare enables women to work full-time, and the share of part-time employment for women is below the OECD average. However, despite higher labour force participation and employment rates the share of female managers is slightly below the OECD average. The contrast between the public and the private sector is striking, with the share of women in management positions in the public sector at 58% in 2006, compared to 23% in the private sector (Statistics Sweden, 2008).

Although slightly less than the OECD average, the gender wage gap for median earners only declined by 4% in Sweden between 2000 and 2010, while it declined more in some countries with a similar gender wage gap in 2000. The compressed wage structure and relatively high minimum wage tend to contain wage inequality and the gender wage gap (Blau and Kahn, 2003; Magnusson, 2010). For the top decile of the earnings distribution, this gap stands at 25%, exceeding the 21% OECD average. For the bottom decile, the gap is 9% and 13% for Sweden and the OECD, respectively (Figure 1.14). Even when differences in occupation and sectors are controlled for, a “glass ceiling” is observed (Albrecht *et al.*, 2003; Arulampalam *et al.*, 2007). OECD estimates show that in Sweden as in most other OECD countries, hours worked and job characteristics are the main contributors to this gap, apart from unexplained factors (Figure 1.15).

Figure 1.13. **Female labour market outcomes**

1. Difference between male and female labour force participation rate.

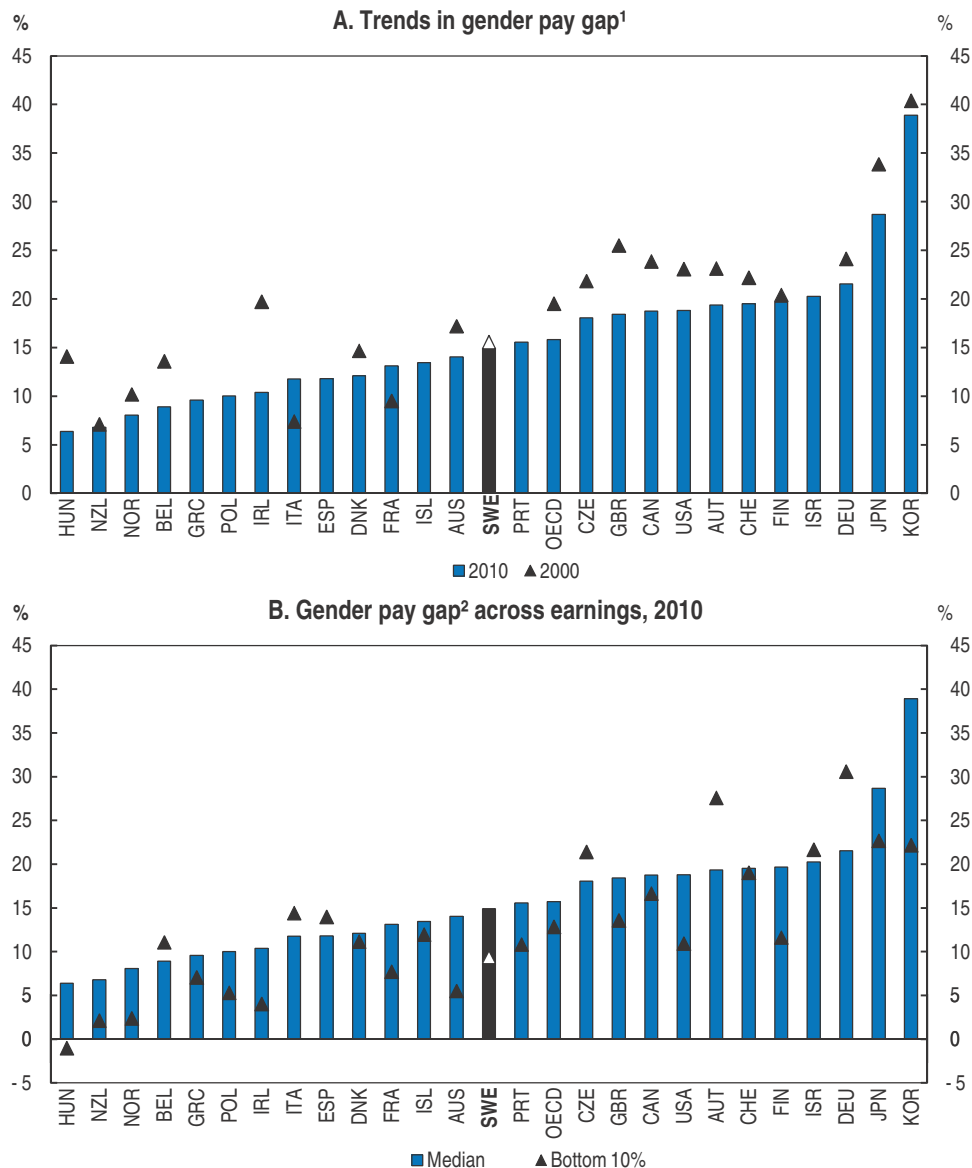
2. March 2009 for the United States.

Source: OECD, *Employment Database*; European Labour Force Survey, 2007, and Current Population Survey, March 2009, for the United States.

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Women are over-represented in some occupations. In the 1990s, the development of new technologies and changes in work organisation were expected to contribute to widening women's occupational choices, but female employment is concentrated in fewer occupations, and this "horizontal segregation" has not improved over time (Kumlin, 2007). A comparison of the number of occupations that account for half of the employed men and women shows that Sweden is one of the countries with the widest gap in occupational concentration according to the OECD's *Gender Report* (OECD, 2012b; Figure 1.16, Panel A). Women are also more represented in the public sector. In 2008, the share of women in the public sector was 73% in Sweden, compared to 58% in an average of selected OECD countries (Figure 1.16, Panel B).


The concentration of female employment in the public sector and therefore in a small number of activities has contributed to maintaining the gender wage gap. Although part of the difference can be explained by preferences, concentration in fewer occupations may curtail women's employment opportunities and prevent them from making the most of their skills. More flexible working hours and part-time employment opportunities in the

Figure 1.14. **The glass ceiling**

1. Defined as the difference between male and female median wages divided by male median wages. Data refer to 2009 (instead of 2010) for Ireland, Denmark, Sweden, the Czech Republic, Austria, Switzerland, Finland, Israel, Germany, Korea and to 2008 for Belgium, France, Greece, Iceland, Italy, Poland, Portugal, Spain. Data refers to 1999 (instead of 2000) for the Czech Republic.

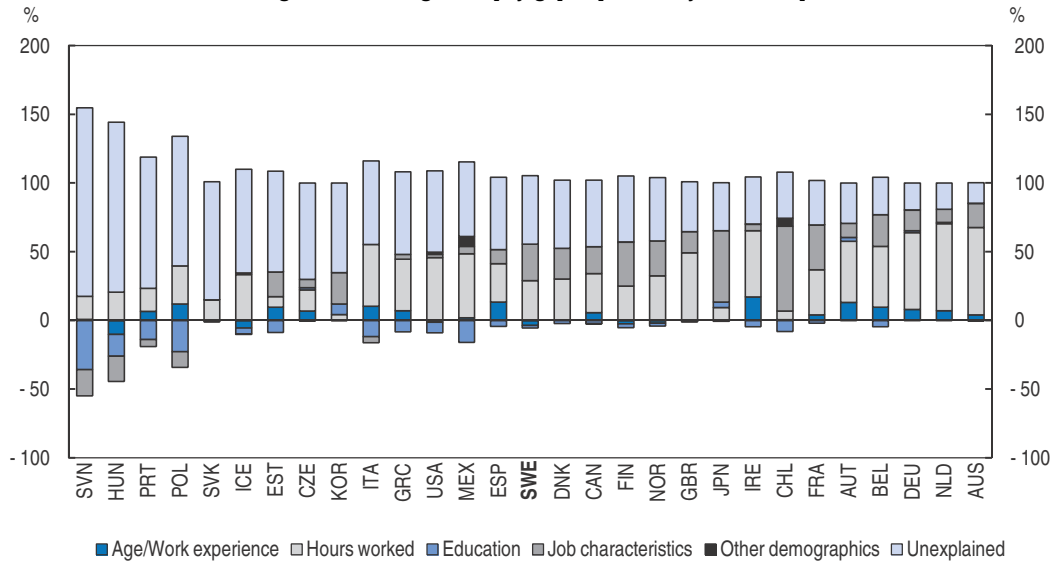
2. Defined as the difference between male and female wages divided by male wages.

Source: OECD, *Employment Database*.

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public sector help to achieve a balance between work and family lives. However, they may also explain why fewer women attain high-paying positions in the private sector (Mandel and Semyonov, 2005).

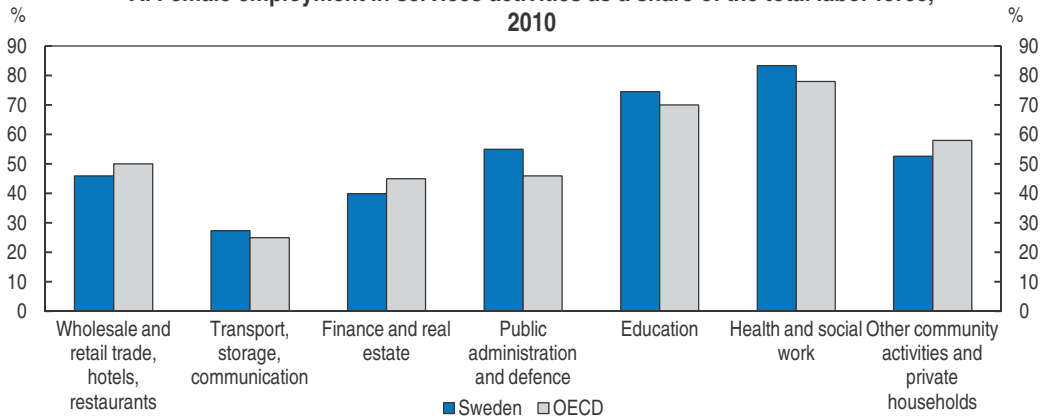
Figure 1.15. Main determinants of the gender pay gap in OECD countries
Percentage of the total gender pay gap explained by each component



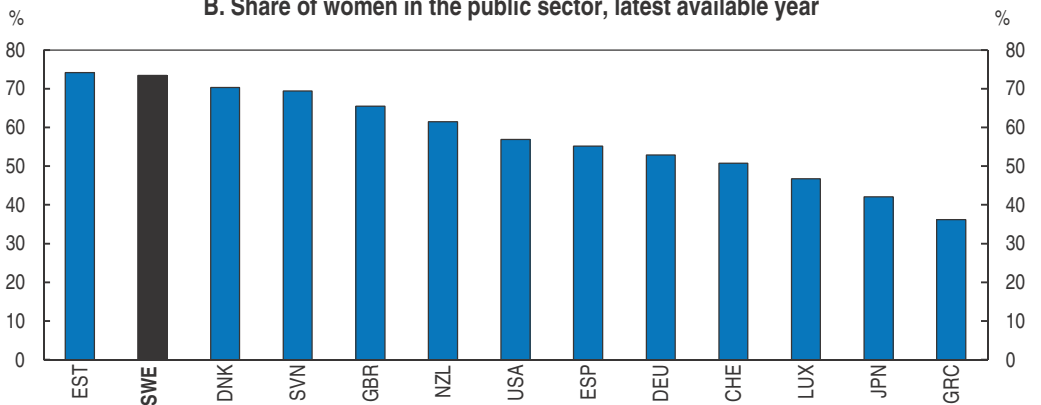
Note: The wage gap is computed on annual earnings of both part-time and full-time employees (excluding self-employed individuals). Countries are ordered by decreasing proportion of unexplained gender pay gap.
Source: OECD (2012), *Closing the Gender Gap: Act Now*, Paris.

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Figure 1.16. Concentration of female employment in certain sectors
A. Female employment in services activities as a share of the total labor force, 2010



B. Share of women in the public sector, latest available year



Source: OECD (2012), *Gender Equality in Education, Employment and Entrepreneurship*, Final Report to the MCM, Paris; ILO.

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Older workers

In many OECD countries, older workers are at greater risk of labour market exclusion and poverty. These risks are relatively low in Sweden as their labour force participation and employment rates are well above the OECD average. The employment rate of 60 to 64-year olds was 63% in 2011, as against 43% OECD-wide. The unemployment rate of this group, at 4.8%, was also below the OECD 5.6% average. However, the risk of becoming long-term unemployed is higher for this group. Furthermore, compared to the OECD average, the hiring rates of workers over 55 were below the OECD average in 2011, suggesting low labour mobility for this age group of workers (OECD, 2012c).

The earned-income tax credit provides stronger incentives to participate in the labour market

The earned-income tax credit (EITC) has been a key pillar of Sweden's labour market policies in recent years. It provides strong incentives to take a job and thereby reinforces the positive impact of structural reforms (such as the reform of the sickness and disability benefit schemes) on employment, while limiting the increase in income inequalities. The Swedish EITC was introduced in 2007 and enlarged in 2008, 2009 and 2010. Individuals aged below 65 all face the same tax credit formula and those older than 65 a more generous one. There is no need to apply for the scheme; taxes are automatically reduced. The formula is independent of marital status or number of children and cannot lead to a reduction of tax liability below zero. The Swedish EITC is not phased out, which avoids increasing marginal tax rates that are already high for higher incomes. However, the tax credit is capped, which implies that, as a share of income, it tends to zero for high incomes. The system is costly, at 2.3% of GDP in 2011.

There is a vast literature on the impact of in-work tax policies. Making-work-pay policies have two main goals: raising employment and limiting in-work poverty. However, these policies have been mainly assessed in terms of job creation while a more comprehensive assessment would have to take into account their impact on inequalities. Empirical evidence tends to show that the positive effects on headcount employment outweigh the costs associated with reduced incentives to work more hours (Immervoll and Pearson, 2009). Evaluations have mainly concerned periods of buoyant labour demand, which raises the question of how effective these policies are in an economic downturn, when wages need to adjust downwards if additional jobs are to be forthcoming. Even so, an EITC can still be effective as a tool to reduce in-work poverty in times of crisis.

Several factors determine the size of the potential positive impact of the EITC on employment:

- The shape of the income distribution prior to its introduction: with a narrow income distribution, as in Sweden, it is difficult to target and finance the EITC.
- When the existing tax burden is high, redistribution policies such as the EITC are more expensive as the additional taxes needed to finance transfers are likely to exacerbate disincentive problems.
- The potential to increase work incentives and in-work incomes is larger where wages of potential recipients are low.

Compared with some other countries, the size of the effect is expected to be smaller in Sweden because of the country's wage formation and distribution characteristics (Bassanini *et al.*, 1999). Studies that have assessed the impact of the Swedish EITC on

employment have yielded mixed results. On the one hand, *ex-ante* studies tend to find a positive impact on employment with the size of the effects depending on the model and underlying assumptions (Swedish Ministry of Finance, 2012a). Ministry of Finance estimates suggest that the EITC could increase employment by 2.3%. However, the absence of a “control” group – since all individuals with a job receive the EITC – makes it very difficult to evaluate its effect on employment through quasi-experimental or *ex-ante* methods. One study assesses the impact of the EITC up to 2008 by using the differences in the EITC received by similar individuals in different municipalities, stemming from the fact the EITC amount depends on the local tax rate, which varies across municipalities (Edmark *et al.*, 2012). However, this source of variation is too small to robustly establish the impact of the EITC. Two other studies use the fact that the EITC is higher for workers older than 65 and find a positive impact on employment for this age group (Swedish Ministry of Finance, 2012b; Laun, 2012).

While it may be too early to fully assess the impact of the Swedish EITC, existing studies point to a number of policy-relevant conclusions:

- The EITC has likely helped to contain the risk of poverty by raising the income of workers. However, it may have only partly delivered its effect on employment as labour demand has been subdued lately. Nevertheless, it may have contributed to the fall in unemployment between mid-2009 and mid-2011. It may also have helped reduce the number of recipients of sickness and disability benefits.
- More flexibility in wage setting, especially at the lower end of the wage spectrum, would enable the EITC to fully deliver its benefits in terms of both employment and reduction of inequalities (see below).
- The absence of the phasing out of the EITC when incomes increase raises the cost of the system.

Entry thresholds in the labour market are high for some groups of workers

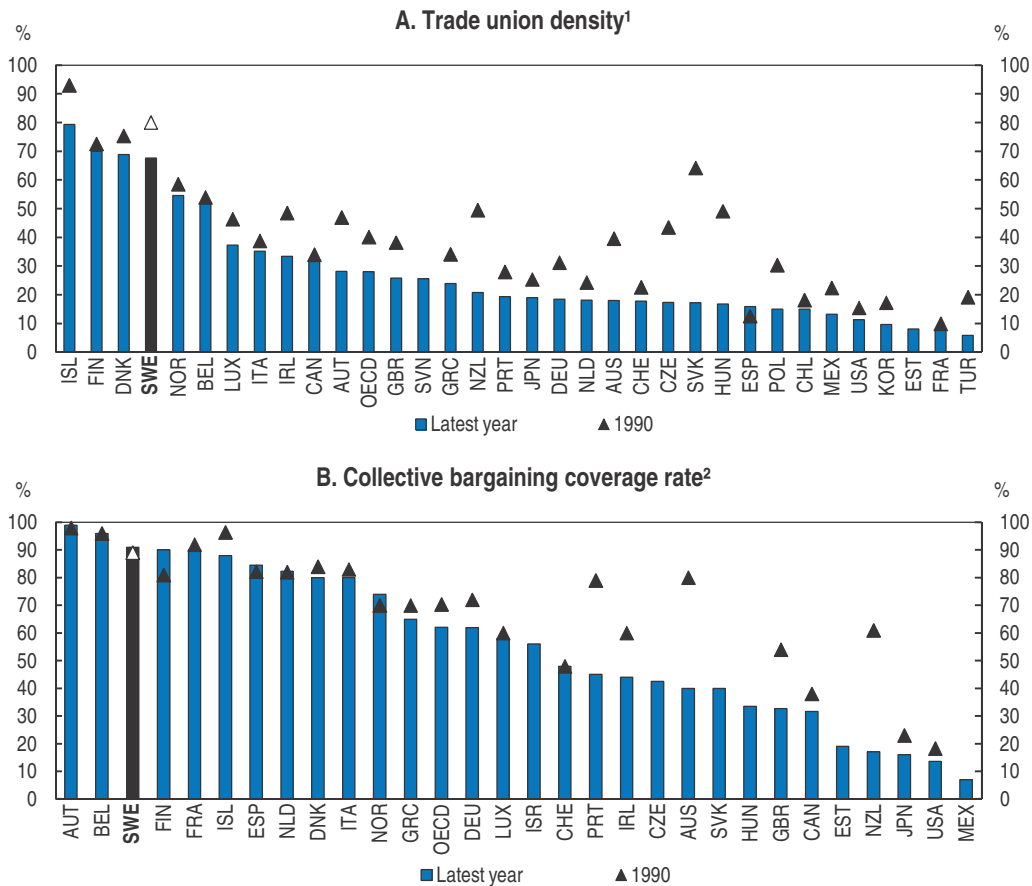
Minimum wages and job protection legislation protect workers against the risks of in-work poverty and abusive dismissals. However, they can also hinder the entry of low-educated and inexperienced workers into the labour market and limit their access to jobs where they would be able to accumulate human capital. Therefore, minimum wages and job protection legislation need to find the right balance between protecting workers and easing the entry of new workers into the labour market.

The minimum wage

Wage setting has become increasingly decentralised, allowing wages to better adjust to productivity (Ahlberg and Bruun, 2005; OECD, 2012d). In several cases, the determination of average wage increases still takes place at the sectoral level and most workers are still covered by collective agreements (Figure 1.17), but the decision on how to distribute wage increases among employees is left to firm-level bargaining. As a result, wages have become much more individualised, though still within a collective framework.

Nevertheless, minimum wages are still set at the sector level through collective agreements although they are differentiated by age, experience, and occupation. Employer contributions also add to the minimum cost of labour. As a result, the relative minimum labour cost for a prototype worker is largely above the average in OECD countries with a legal minimum wage, although in Sweden, not all workers are covered by a minimum wage (Figure 1.18). The minimum wage was 76% and 85% of the average wage in the retail sector


Figure 1.17. **Trade union density and collective bargaining coverage**
1990 and latest year



Note: Trade union density refers to the number of trade union members as a percentage of wage and salary earners; the collective bargaining coverage rate refers to the number of workers covered by wage bargaining agreements as a proportion of all wage and salary earners (employees excluded from bargaining rights have been removed from the numerator and the denominator).

1. Data for the latest year refer to 2011 for: Australia, Canada, Ireland, Japan, Mexico, the Netherlands, New Zealand, Norway, Sweden, the United Kingdom and the United States; 2010 for Austria, Chile, Estonia, Finland, Germany, Italy, Korea, Poland, Portugal and Turkey; 2009 for Belgium, the Czech Republic, Denmark, Slovenia and Switzerland; and 2008 for France, Greece, Hungary, Iceland, Luxembourg and the Slovak Republic. Data refer to 1995 instead of 1990 for Czech Republic and Hungary; 1992 for Mexico, and 1994 for the Slovak Republic.
2. Data for the latest year refer to 2009 for Austria, Canada, the Czech Republic, Estonia, Germany, Italy, Portugal, the Slovak Republic, the United Kingdom and the United States; 2008 for Belgium, France, Greece, Iceland, Ireland, Japan, Luxembourg, Mexico, the Netherlands, Norway, Spain, Sweden and Switzerland; and 2007 for Australia, Denmark, Finland and New Zealand. Data refer to 1991 instead of 1990 for Sweden and Switzerland; 1989 for Iceland. As data for the Czech Republic, Hungary, Israel, Mexico and the Slovak Republic are available for the latest year only, these countries are not included in the OECD average.

Source: OECD Database on Trade Unions; Visser, J. (2011), "Database on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts", 1960-2010(ICTWSS), Version 3.0, May, www.uva-aias.net/208.

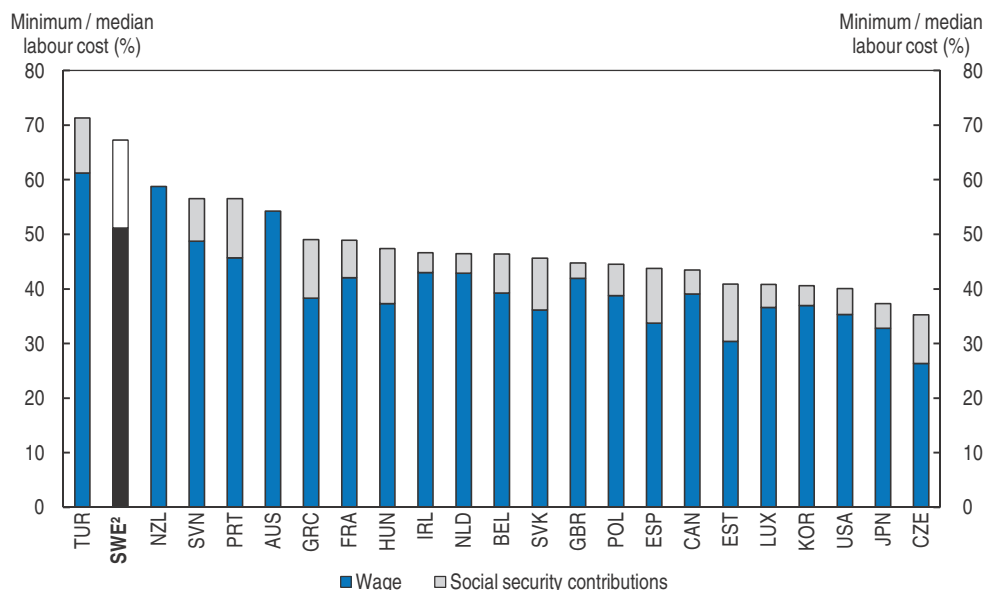
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and in the hotel and restaurant sectors, respectively, in 2010, suggesting that a large share of the workers are paid at the minimum wage in these sectors, with the minimum wage being binding.

For some groups of workers, the minimum cost of labour has been lowered by cuts in social contributions and by public subsidies. Social contributions for younger workers have been lowered from 31.4% to 15.5%. For immigrants benefiting from special programmes,


Figure 1.18. **Relative minimum cost of labour¹ in OECD countries**

Minimum cost of labour as a share of the labour cost for the median wage, 2010



1. The cost of labour is the sum of the wage level and the corresponding social security contribution paid by employers.
2. Apart from Sweden, only countries with a legal minimum wage are shown. The minimum wage for Sweden is computed for a 20-year old worker, with no work experience, who has an unskilled job in a non-metropolitan region. Since the minimum wage for such a “prototype worker” varies between sectors, the figure shows the minimum wage in the sector where it is the lowest (the engineering sector).

Source: OECD, *Labour Force Statistics*; Skedinger, P. (2007), “The Design and Effects of Collectively Agreed Minimum Wages: Evidence from Sweden”, *IFN Working Paper*, No. 700; Statistic Sweden and OECD calculations.

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public subsidies can amount from 70% to 85% of the labour cost. Nevertheless, the minimum cost of labour can hamper access to the labour market for young workers with a low level of education and low-productivity workers who are not eligible to subsidised jobs. Increases in the minimum wage, which have been substantial in the hotel and restaurant and retail sectors since 1995, tend to spill over to other low wages. Empirical evidence is limited but one study suggests that the minimum wage has had negative effects on employment in the service sector (Skedinger, 2006).

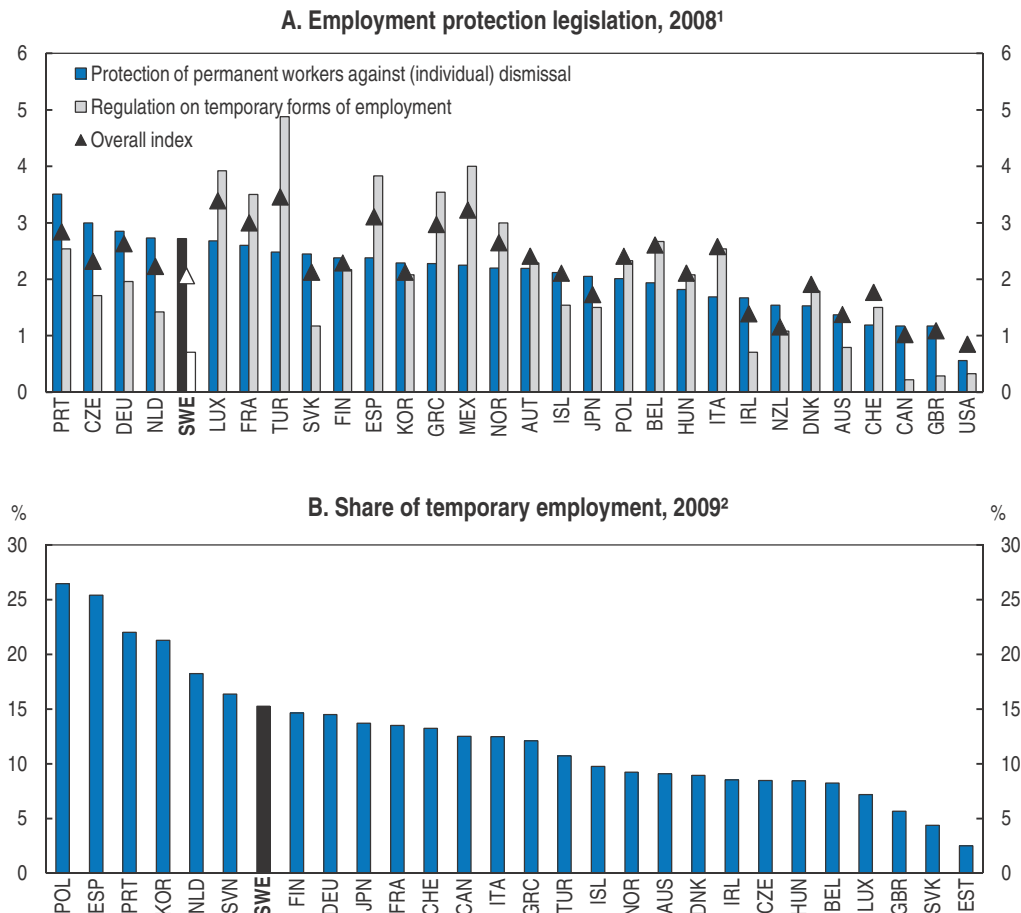
The wage setting system rests on negotiations between employee and employer confederations and the government’s interventions are very rare. It has delivered some good results by, for instance, allowing wages and hours to fall in the manufacturing sector during the crisis, which has limited the impact of the crisis on unemployment. More recently, the government has presented a proposal for a “Job Pact” with unions and employers to tackle youth unemployment (EIRO, 2012, Annex 1.A1). The “Job Pact” is inspired by agreements reached in 2010 in the metal industry to employ young workers and consists in contracts that include 75% of the time on the job and 25% of the time in education with compensation equal to 75% of the minimum wage. These initiatives are welcome and the government should continue working with social partners to develop and expand these types of contracts. In parallel, the government should commission and publish regularly studies on the impact of minimum wages on employment. Over the longer term, there should be broader possibilities to hire less productive workers at a lower relative minimum wage. The EITC would tackle the potential adverse impact of a lower

relative minimum wage on inequalities. Another option would be to lower social contributions, thereby further lowering the labour cost of groups at risk. However, this would not address the core of the problem and could be costly.

Job protection legislation

The flexibility of the Swedish labour market mainly comes from temporary contracts, which employers can use with few constraints. By contrast, the legislation on permanent contracts, which mainly protects insiders, is stricter, with heavy notification procedures in case of dismissal, stringent regulation of the order of layoffs in case of redundancy, a relatively broad definition of unfair dismissals and sizeable compensation following unfair dismissal (OECD, 2011d). When cases go to court, the procedures are long (one to two years), which may explain why the number of cases is relatively low (Skedinger, 2010). Accordingly, the gap in the strictness of employment protection legislation (EPL) between permanent and temporary contracts, as measured by OECD EPL indicators, is among the highest in the OECD (Figure 1.19).

Figure 1.19. **Job protection legislation and temporary contracts**



1. Latest available OECD indicator for strictness of employment protection legislation. Index scale is 0 to 6, from least to most restrictive.

2. Incidence of temporary employment as a share of total dependent employment, latest available observation.

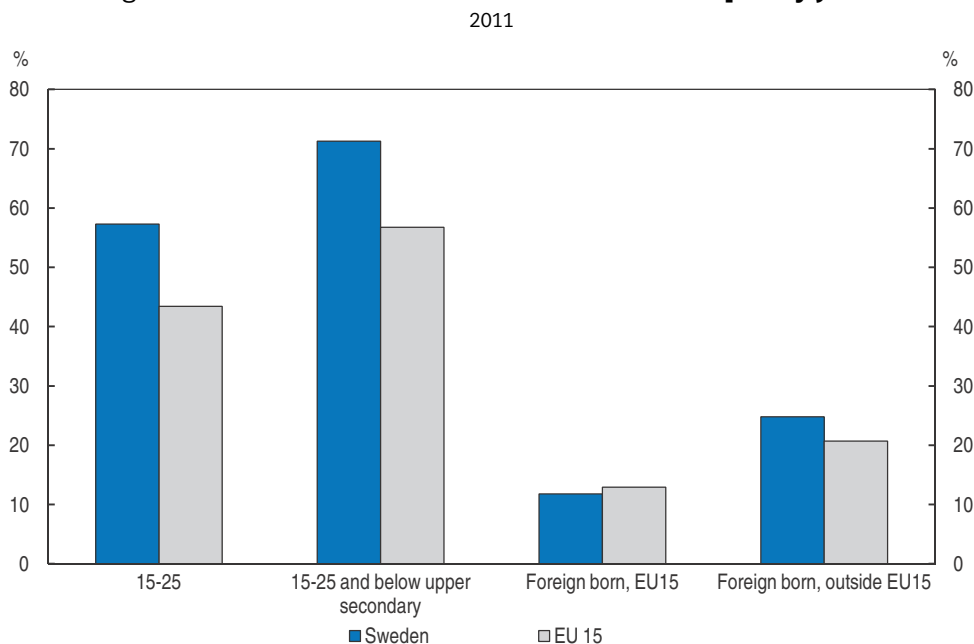
Source: OECD, *Employment Protection Database*; OECD, *Labour Force Statistics*.

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There is a rich literature on the effects of EPL (OECD, 2006; Skedinger, 2010). Different groups are not affected in the same way by EPL. Strict EPL for permanent jobs has negative employment effects for vulnerable groups (OECD, 2006). Vulnerable groups are more likely to be on temporary jobs, and, when there is an asymmetry in the legislation between temporary and permanent contracts, are more likely to be hit harder by job destructions in times of crisis. They are also less likely to get training (Walette, 2005) and earn less than workers with similar characteristics on permanent contracts (OECD, 2012e). These factors create some duality in the labour market, contributing to inequality.

Collective agreements provide options to deviate from the legal framework through both more and less restrictive regulations. In particular, it is possible to deviate from the “last-in-first-out” rule through collective agreement and to agree on which workers to dismiss when there are redundancies. However, this does not ensure that the agreement will be an efficient outcome. It may penalise workers who are less integrated or less represented by unions such as youth and immigrants. Moreover, while collective agreements introduce some flexibility in the use of permanent contracts, the share of temporary contracts is relatively large in Sweden, which suggests that collective agreements do not fully remove the asymmetry in EPL between temporary and permanent contracts. Youth and those with limited formal education are more likely to hold temporary jobs (Figure 1.20) and have endured greater job losses during the crisis.

Figure 1.20. **Characteristics of workers with temporary jobs¹**



1. Temporary employees as percentage of the total number of employees.

Source: Eurostat.

StatLink  <http://dx.doi.org/10.1787/888932757181>

Labour market duality is less marked than in several other EU countries. On average, after one year, 41% of temporary workers in Sweden find a permanent job (Table 1.5). However, the probability of moving from a temporary job to unemployment is higher in Sweden than in many other EU countries. Furthermore, temporary jobs have tended to

Table 1.5. **One-year mobility of temporary workers**

| | Temporary workers moving into: | | | |
|-----------------|--------------------------------|--------------|---------------|---------------------|
| | Permanent job | Unemployment | Temporary job | Others ¹ |
| Slovak Republic | 52.4 | 6.1 | 32.6 | 9.0 |
| Hungary | 46.9 | 11.0 | 25.0 | 17.0 |
| United Kingdom | 45.1 | 2.5 | 28.9 | 23.5 |
| Norway | 43.5 | 4.9 | 36.7 | 14.9 |
| Austria | 41.6 | 5.6 | 30.8 | 21.9 |
| Sweden | 41.2 | 10.4 | 36.3 | 12.0 |
| Luxembourg | 40.1 | 10.4 | 40.7 | 8.7 |
| Slovenia | 38.8 | 9.6 | 43.3 | 8.3 |
| Ireland | 38.1 | 7.4 | 35.3 | 19.2 |
| Czech Republic | 37.3 | 5.0 | 48.3 | 9.4 |
| Belgium | 35.8 | 8.4 | 42.8 | 12.9 |
| Italy | 29.7 | 8.1 | 47.0 | 15.2 |
| Poland | 26.9 | 8.9 | 54.7 | 9.5 |
| Iceland | 24.7 | 2.6 | 38.2 | 34.5 |
| Germany | 23.0 | 0.7 | 53.9 | 22.4 |
| Netherlands | 22.9 | 1.6 | 65.5 | 10.0 |
| Spain | 22.6 | 14.0 | 49.4 | 13.9 |
| Greece | 21.4 | 9.1 | 59.1 | 10.3 |
| Portugal | 21.0 | 11.4 | 57.0 | 10.7 |
| Finland | 20.3 | 9.9 | 48.0 | 21.8 |
| France | 13.8 | 9.2 | 71.6 | 5.4 |
| Average | 29.0 | 9.1 | 49.5 | 12.4 |

Note: Probabilities of transition within one year from a temporary job, over 2003-09. For instance, the probability of transition from a temporary to a permanent job is calculated as the number of persons who were in a temporary job in one year and in a permanent job the year after divided by all transitions.

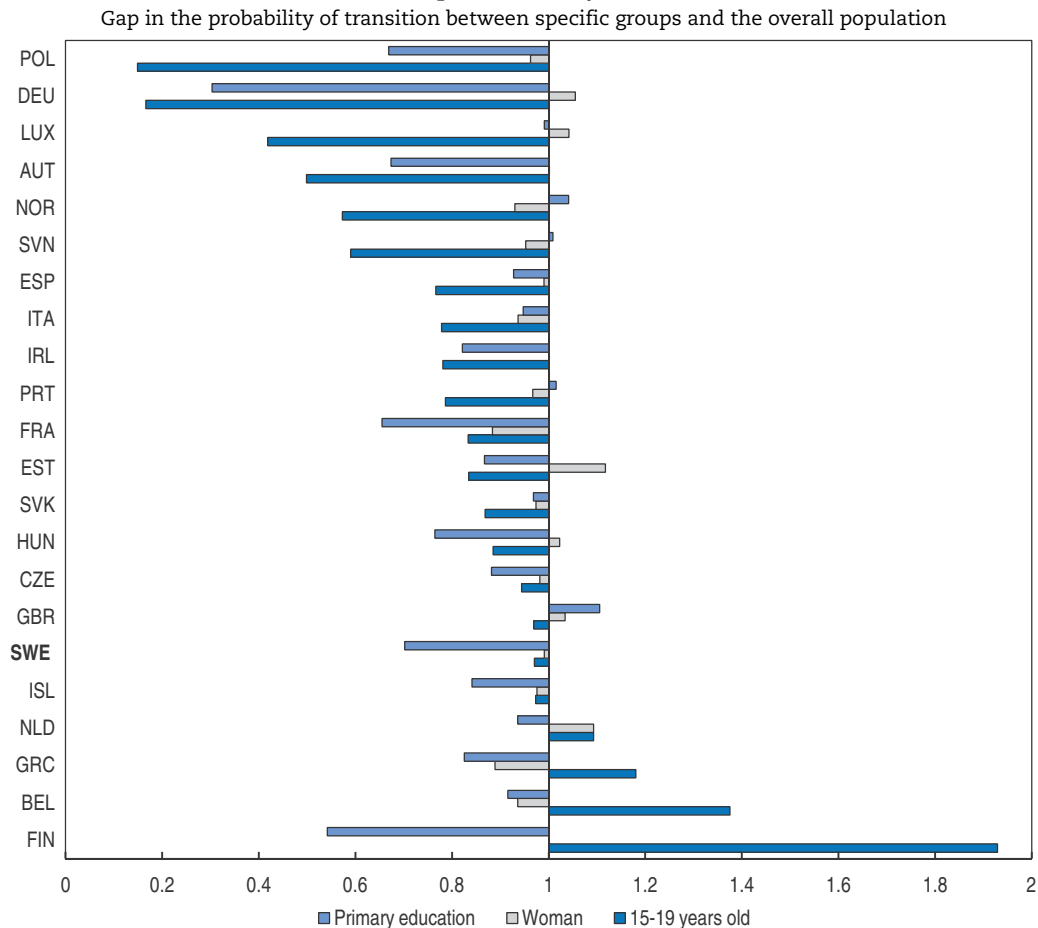
1. Includes self-employed, students or others inactive.

Source: SILC Longitudinal Database and OECD calculations.

become increasingly concentrated on the more fragile groups of workers, such as youth and non-EU immigrants, raising the risk that duality becomes a larger problem in the future. In 2011, 66% of non-EU immigrant workers aged 15 to 24 were on these contracts, up from 50% a decade earlier. In most EU countries, transitions from temporary to permanent jobs are more difficult for youth, the low educated and women (Figure 1.21). In the case of Sweden, education plays a major role, as confirmed by new empirical analysis showing how age, education and gender influence transitions (Box 1.3). According to these estimates, having a secondary degree would raise the probability of getting a permanent contract by almost 70%.


Options to reform EPL in Sweden have been proposed recently (Cahuc, 2011). The goal should be to achieve some convergence in EPL between temporary and permanent jobs to facilitate the integration of the most fragile groups. There are several ways to achieve convergence, depending on whether a new system is introduced (for instance with a single contract) or the main features of the current system, with two types of contract, are kept. In the latter case, options include the removal of the priority for dismissed workers to be re-hired and of the obligations related to the internal reassignment of employees while having provisions that help to transform temporary jobs into permanent ones.

Figure 1.21. **Characteristics influencing the mobility of temporary workers to permanent jobs**



Note: In Sweden for instance, the probability of moving from a temporary to a permanent job for workers who did not graduate from secondary education is 70% of that for all workers.

Source: SILC Longitudinal Database and OECD calculations.

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Box 1.3. Explaining the mobility of temporary workers in EU countries and in Sweden

The probability of moving from a temporary to a permanent job or to unemployment depends *inter alia* on workers' individual characteristics and on policy settings. A multinomial logit model is estimated to examine how one-year transitions from a temporary job are influenced by individual characteristics in the European Union and in Sweden (Table 1.6). Using country fixed effects rather than policy variables such as EPL indicators is advisable as many other factors specific to each country influence transition probabilities.

The cross-country results show that the probability to secure a permanent contract over one year is 33% higher for people who graduated from secondary education compared to those who did not; that men have 17% more chances to get a permanent contract; and that 15-19 year-olds and 55-64 year-old temporary workers are respectively 48% and 15% less likely to move on to a permanent contract. Probabilities to switch from a temporary to a permanent job are higher for members of households with a higher disposable income. Similar results are obtained for the probability of switching from a temporary job to unemployment, which is higher for the low-educated, youth and low-income household members.

Box 1.3. Explaining the mobility of temporary workers in EU countries and in Sweden (cont.)

In Sweden, gender and age do not seem to play an important role in explaining these transitions. The education level is the only significant factor, with a secondary degree raising the probability of getting a permanent contract by 69% (as against the 33% EU-wide average). While the coefficients for age and gender are not significant in Sweden, their sign and size are close to the EU-wide ones, which suggests that the small number of observations for the estimate on Sweden may partly explain why these factors fail to be significant.

Table 1.6. Explaining the transitions from temporary to permanent jobs or unemployment

Multinomial logit regressions, relative-risk ratios of independent variables¹
Reference labour market state = staying in a temporary contract

| | All EU countries | | Sweden | |
|------------------------------------|------------------|--------------|-----------|--------------|
| | Permanent | Unemployment | Permanent | Unemployment |
| Education | | | | |
| Primary education | Ref. | Ref. | Ref. | Ref. |
| Secondary education | 1.33*** | 0.86*** | 1.69* | 0.53* |
| Tertiary education | 1.22*** | 0.54*** | 1.07 | 0.30*** |
| Gender and age | | | | |
| Women | Ref. | Ref. | Ref. | Ref. |
| Men | 1.17*** | 0.95 | 1.06 | 1.02 |
| Age 15-19 | 0.52*** | 0.82** | 0.73 | 1.19 |
| Age 20-24 | 0.01 | 1.03 | 0.93 | 2.04** |
| Age 25-54 | Ref. | Ref. | Ref. | Ref. |
| Age 55-64 | 0.85*** | 1.08 | 0.79 | 1.67 |
| Household disposable income | | | | |
| 1st income quantile | 0.78*** | 2.14*** | 0.75 | 2.32** |
| 2nd income quantile | 0.86*** | 1.28*** | 0.72 | 0.86 |
| 3rd income quantile | Ref. | Ref. | Ref. | Ref. |
| 4th income quantile | 0.05 | 0.83** | 1.75** | 1.15 |
| 5th income quantile | 1.12*** | 0.65*** | 1.41 | 1.21 |
| Marital status | | | | |
| Married | Ref. | Ref. | Ref. | Ref. |
| Not married | 0.96* | 1.46*** | 0.99 | 0.96 |
| Country fixed effects ² | Yes | Yes | | |
| Time dummies ³ | Yes | Yes | Yes | Yes |
| Number of observations | 45 223 | 45 223 | 724 | 724 |

Note: ***, ** and * indicate that the coefficients are statistically significant at the 1%, 5% and 10% levels.

1. Change in the predicted probability of making the indicated transition which is associated with an increase from 0 to 1 of the indicated dummy variable, when all other variables are set at their sample means.
2. Countries: Austria, Belgium, the Czech Republic, Germany, Estonia, Spain, Finland, France, Greece, Hungary, Ireland, Iceland, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Sweden, Slovenia, the Slovak Republic and the United Kingdom.
3. All the available years (2003-09) from the SILC longitudinal database have been used.

Source: OECD estimates based on SILC data.

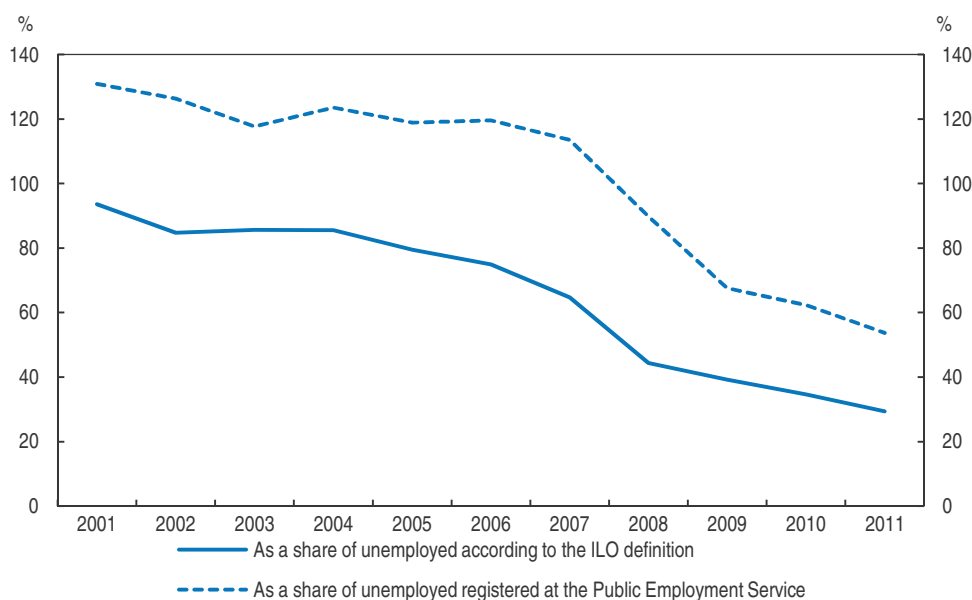
Support to the unemployed provides uneven social protection and incentives to take a job

The share of the unemployed covered by unemployment insurance (UI) has been shrinking over time, partly because the eligibility criteria concerning past work have become stricter (Figure 1.22; Box 1.4). Furthermore, part-time jobs that only give right to shorter UI benefits have become more widespread and the composition of unemployment has changed, with a larger share of the unemployed with no or limited labour market experience, such as youth, workers with a low level of education and some newly-arrived immigrants. As a result, an increasing share of the unemployed is covered by social assistance instead of UI.

The fact that a significant share of the unemployed does not receive UI benefits but municipal welfare benefits instead creates a number of problems:

- The unemployed on social assistance tend to receive less income than those on UI, although this depends on various parameters, and are therefore more exposed to the risk of poverty.
- Welfare benefits are means tested, implying a high average effective tax rate that discourages the unemployed from taking a job, and therefore, leads to inactivity and poverty traps (Figure 1.23). The measure included in the Budget Bill for 2013 (Annex 1.A1) to increase the possibility to cumulate labour income and social assistance will mitigate this problem. Nonetheless, social assistance being a last resort based on household income, it is not always possible to introduce some financial sanctions if the unemployed do not fulfil some of their obligations, which weakens their job-search incentives.

Figure 1.22. **Unemployed receiving unemployment insurance benefits**



Note: Yearly average. Before 2008, more unemployed were covered by receiving UI benefits than registered at the PES, explaining why the share was above 100%.

Source: Statistics Sweden, Swedish Public Employment Service.

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Box 1.4. Unemployment insurance in Sweden

Swedish public unemployment insurance (UI) is regulated and subsidised by the state, but administered by the UI funds. Some but not all UI funds are closely linked to labour unions. Since 2007, the state subsidy amounts to approximately 70% (Anxo and Ericson, 2011). The remaining part of the financing comes from worker fees paid to the UI funds. Fees are fixed by the government and differentiated according to the sectoral unemployment rate, in order to get unions to internalise the unemployment cost of overly high wages.

The UI has two components: a basic allowance and an income-related benefit. The basic allowance amounts to SEK 320 (around € 40) per day in 2012 and the income-related benefit to 80% of the past wage during the first 200 days of unemployment and 70% thereafter, with a ceiling at SEK 680. The basic allowance is available to those who are over 20 years old. To qualify for an income-related benefit, the unemployed person must have been a member of a UI fund for at least 12 months. For both types of UI benefit, the maximum entitlement period is 300 days and 450 days for parents with children. There is a seven-day waiting period for all the unemployed. In addition, workers may contribute to a private insurance.

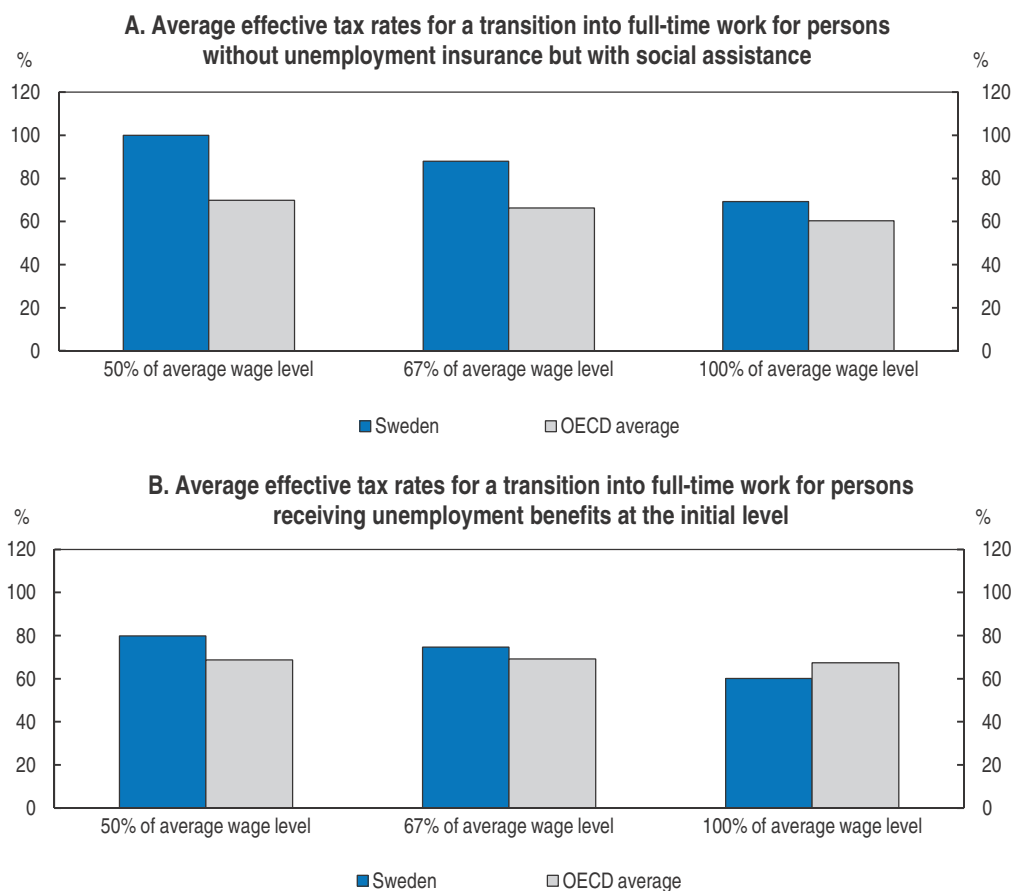
The eligibility criteria are the same for the two components. The unemployed need to have worked for a certain time, to look for a job and to be registered at the Public Employment Service (PES). Part-time workers are entitled to a shorter period of UI benefits. During the first 300 days, the unemployed may be oriented towards an active labour market policy (ALMP) programme. After 300 days, the unemployed is eligible for activity support corresponding to 65% of the income loss provided she or he participates in an ALMP programme (within the so called “Job and Development Guarantee”). Activity support is fully financed by the government.

Those aged less than 25 face a different benefit structure. Recipients of the income-related benefit see it decline faster. Those who are not entitled to the income-related benefit or to the basic allowance and who are over 20 and have completed upper secondary education receive an allowance of SEK 140 per day (corresponding to the study allowance paid to those who are in tertiary education). The 18-20 year-olds who have not completed upper secondary education receive SEK 48 per day, corresponding to the study allowance for students in upper secondary education. After 100 days, youth have to participate in the “job guarantee for youth” programme to receive these benefits.


The PES is in charge of monitoring job search efforts. Furthermore, all unemployed have the right to register at the PES.

Those who are not entitled to UI receive social assistance, which is provided by municipalities. Municipalities also run some ALMP programmes. Those who have received social assistance for 14 months and, during this time period, have been unemployed and registered at the PES are offered the option to participate in the Job and Development Guarantee and to receive activity support.

- Municipalities tend to be less efficient at monitoring job search and assisting the unemployed than the PES, although the efficiency varies between municipalities (Dahlberg *et al.*, 2009). Accordingly, those who are further away from the labour market tend to get less efficient support (see below).
- The unemployed receiving social assistance have to register both at the PES and with the municipal services, causing some efficiency losses.

Figure 1.23. **Inactivity and unemployment traps in 2010**

Source: OECD, Tax-Benefit Models.

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To ensure that a larger share of the unemployed get UI benefits instead of welfare benefits, work conditions should be eased. With enlarged UI coverage, social assistance could target those who are further away from the labour market.

Another issue concerns the optimal level and profile of unemployment benefits. According to theoretical models, the benefit should decline over time to provide optimal job-search incentives. Furthermore, similar models show that indexation of unemployment benefits on previous earnings tends to foster wage moderation and thus leads to higher employment (Heer and Morgenstern, 2005). This is because, when wages are bargained, firms take into consideration that the utility of the union, which depends on the utility of its workers employed and not employed, will be less affected by a lower wage when the indexation of unemployment benefits on previous earnings is larger. Against this backdrop, the current system suffers from several problems:

- Only the unemployed with an income-related benefit under the ceiling have their benefit decreasing with time and linked to previous wages. For those who are at the ceiling, or receive the basic allowance, or receive welfare benefits, the profile is flat and the level of benefit is not linked to previous income. In 2009, only 13% of the unemployed had a compensation that was declining with time (Swedish Fiscal Policy Council, 2011).

- Having some unemployed receiving an income-related benefit and others only the basic allowance creates inequalities between these two groups as the level of the benefit is different, all the more so as the UI system, including the income-related part, is mainly financed by the government, i.e. by taxpayers.
- The unemployed entitled to the basic allowance are more likely to receive other means-tested welfare benefits and therefore, to face higher average effective tax rates and lower incentives to take a job.

To enhance job-search incentives and make them more uniform across the unemployed, most workers should be covered by a benefit that declines with time. The benefit needs to be sufficiently generous at the beginning of the unemployment spell so that it can diminish over time without pushing recipients into poverty. One option would be to have all eligible unemployed receive an income-related benefit. In most OECD countries, the UI benefit is linked to previous income as a flat rate needs to be very low to provide job incentives to low-paid workers, which tends to increase the risk of poverty.

Extending the coverage of UI and changing the structure of the benefit would justify broadening its financing base. In the current set-up, UI fund member fees are linked to the unemployment rate in the sector and are partly state-financed. In theory, this should encourage UI funds to monitor their members' eligibility for UI benefits, and employer and employee confederations to internalise the impact of their wage negotiations on unemployment as they have close links with these funds. However, in practice, the system does not fully deliver these effects (Swedish Fiscal Policy Council, 2011). This is mainly because unions are in fact in charge of paying UI benefits for only a limited number of unemployed who are likely to be relatively close to the labour market. The fact that UI funds stop to pay benefits after 300 days of unemployment (at which point the state takes over) entails perverse incentives for wage formation. Furthermore, the link between UI funds and unions is actually not that tight. Therefore, it would make sense to broaden financing and to make contributions to UI mandatory. At a minimum, the distinction between the unemployment benefit and activity benefit should be removed and both benefits should be financed by the same institution. In that case, and if contributing to UI is not made mandatory, the system of differentiated fees could be kept as the extension in the coverage of UI would make it work better.

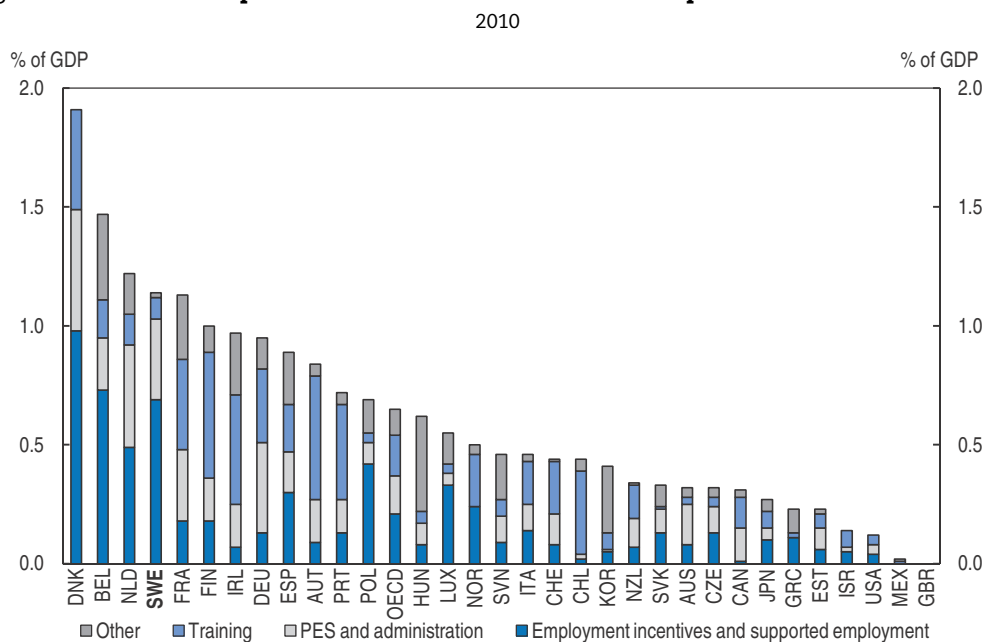
Changes to the financing of the UI system could have implications for the membership of trade unions as some UI funds and trade unions are closely linked (Box 1.4). While there is no assessment of the impact of such an arrangement on labour market performance, recent research has explained the strong involvement of labour unions in Scandinavian countries by the high trustworthiness and civicness of citizens, which has allowed labour relations to develop without the need for state regulation (Aghion *et al.*, 2011). The impact of making contributions to UI mandatory on union membership is unclear and would depend on the way this would be implemented. In any event, contributions to an UI fund and to a trade union do not have to be linked. Indeed, the option of remaining a union member without contributing to an UI fund has been used more and more since 2007 as fees were increased, somewhat mitigating the fall in trade union density (Kjellberg, 2009).

Job-search monitoring and the efficiency of ALMPs can be strengthened further

The increase in labour supply and in the heterogeneity of the unemployed has generated new challenges for the PES, which has tried to adapt. Its services are now more customised to specific individual needs. Its resources for placement and related services have been tripled since 2004 and its overall resources are high from an international perspective (Figure 1.24). In 2012, almost 80% of the PES staff was working directly with clients and more than 10% were specialists, including psychologists. The PES has introduced various specific programmes for targeted groups such as immigrant women, young unemployed with mental health problems and groups suffering from discrimination. One example is the “Youth in” project for youth belonging to the NEET group (Box 1.5). The PES website is translated into various languages and thus easily accessible to most newly arrived immigrants.

Since 2008, the PES has become more involved in the rehabilitation of people on sick-leave or with disabilities. However, that the payment of related benefits has remained under the Social Insurance Agency (SIA) while the PES is in charge of job-search support has created inefficiencies. For instance, not many actions are initiated in the earlier phase of sickness absence, even though this can be very important for unemployed with mental health problems (OECD, 2012f). Co-operation between the SIA and the PES will have to continue to be strengthened further. In addition, the rehabilitation chain has been less efficient for persons with mental disorders who stay on sickness benefit much longer than other recipients of these benefits. Efforts to improve the efficiency of the rehabilitation chain should continue.

Figure 1.24. **Public expenditure on active labour market policies in OECD countries**



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Box 1.5. Targeting youth risking long-lasting social exclusion

The PES and the Stockholm Youth Centre (Fryshuset) are piloting a project to reach and motivate youth who suffer from social exclusion. In itself, Fryshuset is in fact more than a youth centre as it has schools that combine basic education with sports and culture and various social projects (for youth from families with addiction problems, or to combat violence and vandalism, the formation of destructive subcultures, etc.). More precisely, the joint PES and Fryshuset programme (financed by the European Social Fund) targets 16-24 year-olds who are not studying, working nor involved in any other recognised occupation, and who are not in contact with the PES or with social services. The goals of the programme are that by the end of the project: 50% of the participants will have tried at least two to four short-term jobs, 30% will have started a job or studies and 80% will feel they have strengthened their position in the labour market and their self-esteem. The programme concerns Stockholm but will be implemented in other cities if successful.

The method is based on individual interviews to assess the participant's formal and informal knowledge as well as her/his situation in terms of health, accommodation, family, education, work and contacts with the government. Then, a series of activities is proposed to the participant including short-term jobs, mentoring, internships, and workplace visits. The team in charge of the programme includes staff from the PES, social services and the education system, social workers and psychologists.

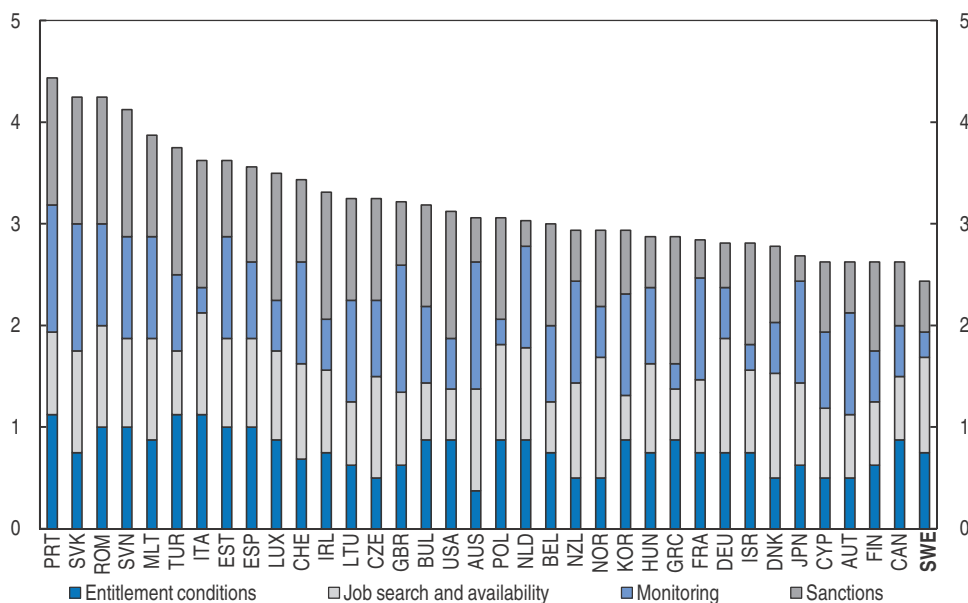
The first phase of the project included 60 participants, with 80% of them having disabilities and mental health problems. The outcomes are promising: 32% of the participants were employed at the end of the project, 8% had returned to education and 40% had held short-term jobs.

The PES has also been granted more responsibility concerning the integration of immigrants. A special labour market programme ("Step-In Jobs") was introduced in 2007 to promote the integration of newly arrived immigrants into the labour market. It includes a wage subsidy of 75% of the gross wage. In 2010, an Introduction Act entered into force with the aim of formalising the various forms of support proposed to newly-arrived immigrants through the family and asylum channels. It includes Swedish courses, civic orientation and employment preparation activities. The PES is in charge of co-ordinating activities and providing monitoring data that will be used for an assessment by researchers in 2015.

This enlargement of the responsibilities of the PES should continue and the PES should be in charge of job search help for all the unemployed. In parallel, the PES should have the full capacities to monitor job-search and sanction insufficient efforts. According to an OECD indicator, the overall strictness of eligibility criteria for the unemployment benefit is the lowest in the OECD (Figure 1.25). While this indicator only captures the strictness of rules as they are outlined in legislation rather than how they are enforced and is subject to other limitations, it does highlight some of the specificities of the Swedish system. According to the indicator, entitlement conditions tend to be relatively strict, consistent with the fall in the number of unemployed covered by UI. By contrast, monitoring is not stringent at all, Sweden being one of the rare OECD countries where the unemployment benefit recipient does not need to provide evidence of job-search activity.

Measures in the Budget Bill for 2013 (Annex 1.A1) aiming at harmonising sanctions across categories of unemployed and introducing milder and more gradual, and hence, easier to implement, sanctions are welcome. In particular, the PES should have the right to

Figure 1.25. Overall strictness of eligibility criteria for unemployment benefit



Note. The composite indicator of the strictness of eligibility criteria is based on information on entitlement conditions (employment and/or contribution requirements to gain access to benefits and sanctions for voluntary unemployment), job-search requirements (availability requirements during ALMPs and suitable work criteria), monitoring of job-search effort and sanctions for refusing a job offer or ALMP placement. Countries are allocated a score for each item from one (least strict) to five (most strict) and these data are used to compile the composite indicator. For most items, data reflect eligibility criteria in place in 2011.

Source: Venn, D. (2012), "Eligibility Criteria for Unemployment Benefits: Quantitative Indicators for OECD and EU Countries", OECD Social, Employment and Migration Working Papers, No. 131.

StatLink  <http://dx.doi.org/10.1787/888932757276>

sanction those who receive the activity support, which is given to the long-term unemployed once UI benefits have expired, as proposed in the Budget Bill. Welfare benefits are harder to sanction because they are last-resort benefits and tend to be very low. Furthermore, even if recipients of welfare benefits have to formally register with the PES, they may be monitored by municipalities with weaker job-search obligations. Extending the coverage of UI benefits as proposed in the previous section would allow the PES to be able to monitor and sanction a wider range of the unemployed. The proposal to shift the burden of proof of job-search activity onto the unemployed is also welcome. However, it will be important to develop an efficient system of control of job-search activity that does not rely solely on jobseekers' declarations.

Studies of the efficiency of Swedish ALMPs tend to deliver mixed results, suggesting that they can be improved further (Forslund *et al.*, 2011; SOU, 2010; Forslund and Nordström Skans, 2006). Specifically:

- Swedish ALMPs have indirect effects as the activity requirement to receive financial support raises the incentives to look for a job and accept it before having been placed in these programmes (pre-programme effect). Hence, enrolment in the PES should aim at helping jobseekers with good labour market prospects to increase job-search effort but these jobseekers should not be offered the most ambitious programmes, which should target those with poor labour market prospects (SOU, 2010).
- Job subsidies are widely used in Sweden, but training programmes are less developed (OECD, 2011d; Figure 1.24). Job subsidies for large groups of unemployed help some of

them to find a job but have generated displacement effects as a significant share of these jobs would have been created anyway. Hence, a key issue is to ensure that these subsidies benefit those most in need. The efforts of the PES to actively build contacts with employers, including large firms, so as to “place” the unemployed in exchange for some form of support, can help make up for the lack of contacts of some groups of unemployed but may create displacement effects. The Budget Bill for 2013 includes a doubling of the subsidy under the New Start Jobs programme for young unemployed (Annex 1.A1). While raising the subsidy is estimated to reduce the time spent in unemployment, this programme is expected to lead to displacement effects (Liljeberg *et al.*, 2012). Therefore, it would be important to assess the effect of the profiling tool used at the beginning of the unemployment spell to identify the unemployed who will receive active job-search help.

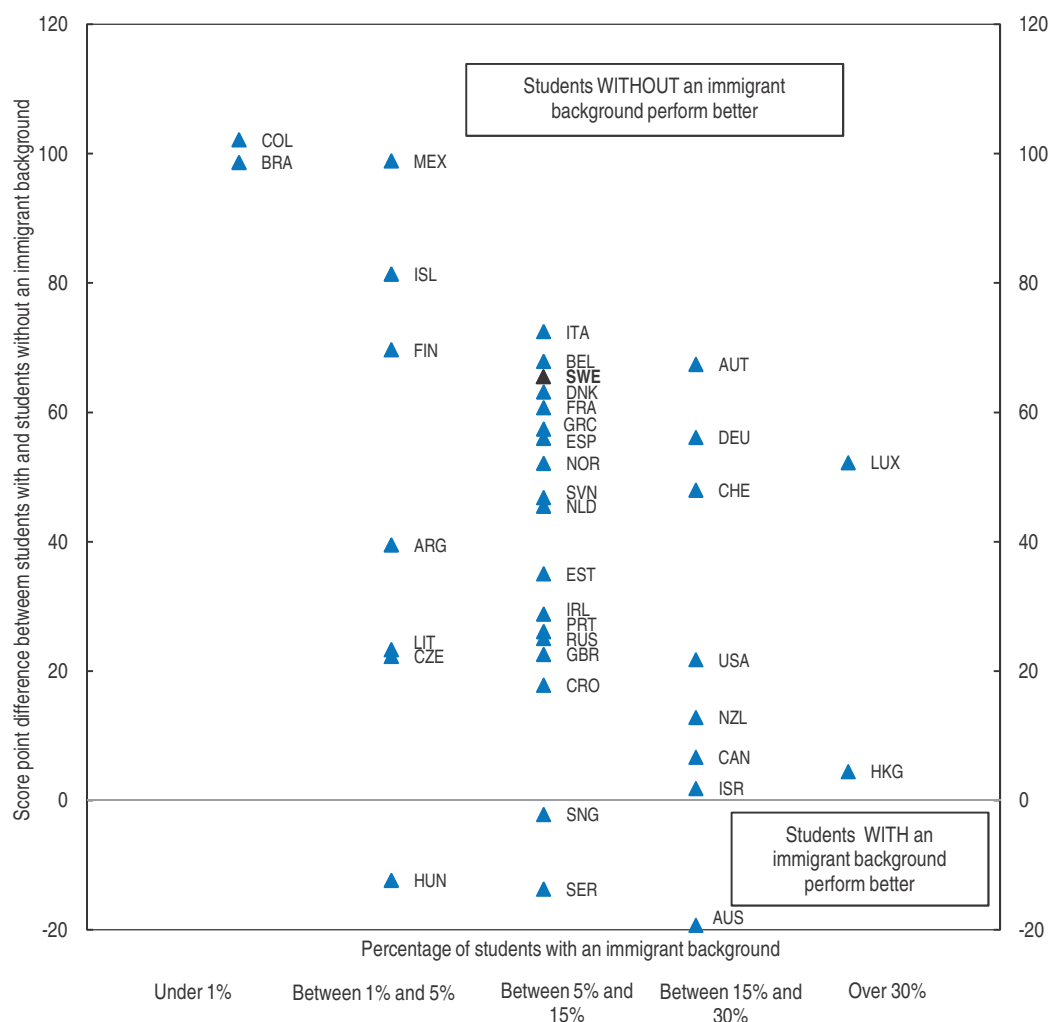
- An open question is how to help those who are the most at the margin of the labour market to become durably employed. The Swedish experience with placing the unemployed on positions with no payment from employers, as part of the third phase of the job development guarantee, has not been successful as these persons seem to retain no benefit from these experiences. The literature suggests that lock-in effects can be sizeable with a compulsory programme targeting a large group, as is the case with the job guarantee. Recent studies call for more individualised service provision that would, for instance, include intensified matching efforts and subsidies targeted to small groups of workers (Sabel, 2012).

The education system has a key role to play

Education has a key role to play to ensure that new potential entrants have the necessary skills. The risk of becoming unemployed was much higher for those who have not completed upper secondary education in 2010 (Table 1.3).

Enrolment rates for early childhood and primary education are high in Sweden, but graduation rates for upper secondary education are below the OECD average. Furthermore, learning outcomes are below the OECD average in science and close to average in mathematics even though education spending per student ranks among the highest across OECD countries (OECD, 2010c). PISA results indicate that disadvantaged students are more at risk of being low performers in Sweden than in a number of other countries. For instance, learning outcomes at age 15 for the foreign-born are much lower than for the natives, with the gap wider than in other countries with similar shares of foreign-born students (Figure 1.26). Compared with other OECD countries, drop-out rates are lower in Sweden despite the prominence of the issue in the public debate, but they are rising. This evidence suggests that weaknesses in the education system may contribute to the relatively weak labour market performance of low-educated youth.

In 1992, Sweden implemented a major reform of compulsory education by introducing a system of school choice. The share of students enrolled in an independent lower secondary school rose from below 1% in 1992 to 12.5% in 2011-12. Independent schools receive public funding on the same basis as municipal schools in the same area. Empirical studies find that competition between schools and the increase in the share of students enrolled in independent schools have improved education outcomes (Bergström and Sandström, 2001; Björklund *et al.*, 2004). This concerns average performance at the end of compulsory school, but also in tertiary education (Böhlmark and Lindahl, 2012). However,

Figure 1.26. **Gap in learning outcomes at age 15 between natives and foreign-born**

Note: Countries are classified on the horizontal axis according to the share of students with an immigrant background in all students. The vertical axis indicates differences in reading performance according to PISA results in 2009 between students with an immigrant background and native students. A positive gap shows lower performances for students with an immigrant background than for the natives and a negative gap, lower performances for the natives. Sweden, for instance, has a share of students with an immigrant background between 5% and 15% of overall students, who have learning outcomes around 70% of the natives' ones.

Source: OECD Programme for International Student Assessment (PISA).

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students from wealthy and highly educated families have benefited more from the reforms than students with disadvantaged backgrounds (Böhlmark and Lindahl, 2007). There are signs that segregation has increased, as have differences in resources between schools. Higher students per teacher ratios also seem harmful for immigrant students. Intergenerational mobility, which has been relatively high in the past, may decline over time as a result of rising inequalities in the education system (Björklund et al., 2011).

A number of further reforms have taken place in recent years in compulsory education, not least to improve weaker students' performance. A new curriculum was introduced in 2008. The overall framework of education policies was reviewed and the major goals of the educational system were restated in the 2011 new "Education Act". A reform of upper secondary education was introduced in 2011 with the aim of limiting drop-

outs and easing transition to tertiary education and the labour market. The 2011 Budget also included measures to improve teacher quality. These reforms go in the right direction but may take time to deliver benefits and should therefore be monitored closely.

For many youth, combining study and work is more efficient to ease the transition from school to work than the traditional model of “study first, then work” (OECD, 2010a). On-the-job training helps students acquire the skills required by employers. In addition, new entrants should continue to learn on the job and, if necessary, be prepared to resume a more academic education to reinforce their employability, particularly when they have low skills. In this area, the Swedish system lacks flexibility and co-operation between schools on the one hand, and employer and labour market institutions on the other hand. In particular, vocational education and training (VET) in Sweden has long been considered as a preparation for the labour market rather than for a job (OECD, 2008).

As part of the 2011 reform of upper secondary education, VET education was reviewed and efforts have been made to target it better to labour market needs, while the evaluation and assessment framework was strengthened. Some of these measures are in line with OECD recommendations (Box 1.6). However, as VET education now focuses more on specific subjects, students no longer complete the same core curriculum as those in academic upper secondary programmes and are not automatically eligible to tertiary education anymore. This may stigmatise VET education as being for the less able (Kuczera *et al.*, 2008). A pilot project aiming at developing apprenticeships in VET started in 2008 and was made permanent in 2011 (Swedish National Agency for Education, 2012). The Budget Bill for 2013 includes measures to develop further apprenticeship programmes through higher subsidies for employers and training for supervisors and to temporarily increase the number of training places (Annex 1.A1). These measures are welcome.

International experience with VET shows that several elements underpin successful apprenticeship systems (OECD, 2010d). There should be incentives to sustain the commitment of both students and firms, calling for subsidies or tax breaks and efforts to develop these programmes in various sectors – not only in building and construction, as is mainly the case in Sweden, but also in rapidly expanding sectors. Close links between schools and local employers will contribute to efficient career guidance and to preparing apprentices’ supervisors in companies. Strong institutions to engage employers, unions and students, and to carefully monitor these programmes are also important. It is welcome that the National Agency for Education has been given more responsibilities in the areas of VET but it should also work closely with other institutions including the PES. The Swedish social partners also have a major role to play.

Box 1.6. **Improving vocational education and training in Sweden**

The OECD review on vocational education and training in Sweden (Kuczera *et al.*, 2008) made the following recommendations:

- Maintain the same core curriculum as those in academic upper secondary programmes.
- Introduce a stronger mechanism through which the social partners can convey labour market requirements to VET providers. To this end a National Commission for VET should be established, composed of different government ministries and the social partners.

Box 1.6. Improving vocational education and training in Sweden (cont.)

- Information on the labour market outcomes of VET should be published on a school and programme basis. The National Register should be fully exploited, and possibly supplemented by regular surveys of recent leavers.
- The 15-week work placement that is part of upper secondary VET should be subject to quality control and made mandatory for all upper secondary VET programmes. Only VET programmes capable of attracting work placements should be provided.
- Develop an apprenticeship system to complement school-based VET on the grounds of both cost and quality. It should be developed jointly by the government and the social partners and take full account of international experience.

Access to health care could be made more equal

Health problems can impede labour market integration and lead to exclusion and poverty. A well-performing healthcare system is important to maintain those with health problems in the labour market. At the same time, equal access is needed so that the healthcare system does not add to inequality.

In terms of health status, Sweden tends to outperform similar countries and the OECD average (Table 1.7). These good results can be ascribed to relatively high spending on health (mainly public) and an efficient system (Joumard et al., 2010). The health care system is decentralised and a set of indicators covering medical results, patient experience, availability of care and costs allows comparisons of local performance (National Board of Health and Welfare, 2008a).

Table 1.7. Health status indicators

2010

| | Life expectancy at birth ¹ | Life expectancy at 65, ¹ Women | Life expectancy at 65, ¹ Men | Infant mortality ² | In-hospital case-fatality rates ³ | | |
|--------------------------|---------------------------------------|---|---|-------------------------------|--|-----------------|--------------------|
| | | | | | Acute myocardial infarction | Ischemic stroke | Hemorrhagic stroke |
| Sweden | 81.5 | 21.1 | 18.2 | 2.5 | 2.9 | 3.9 | 12.8 |
| Denmark | 79.3 | 19.7 | 17.0 | 3.4 | 2.3 | 2.6 | 16.4 |
| Finland | 80.2 | 21.5 | 17.5 | 2.3 | 4.8 | 2.8 | 6.5 |
| France | 81.3 | 22.5 | 18.2 | 3.6 | | | |
| Germany | 80.5 | 20.9 | 17.8 | 3.4 | | 4.0 | 13.8 |
| Norway | 81.2 | 21.2 | 18.0 | 2.8 | 2.5 | 2.8 | 11.6 |
| OECD average | 79.7 | 20.5 | 17.2 | 4.1 | 4.3 | 5.2 | 19.0 |
| Best performing country | 83.0 | 23.9 | 19.0 | 2.2 | 2.3 | 1.8 | 6.5 |
| Worst performing country | 74.3 | 16.1 | 13.8 | 14.1 | 6.6 | 17.6 | 38.6 |

1. Years.

2. Per 1 000 births.

3. Age-sex standardised rates within 30 days after admissions, 2009 or nearest year.

Source: OECD (2012), *Health at a Glance 2012*, Paris.

Equal access to care is one of the main goals of the Swedish health care system. In this area, Sweden's outcomes are mixed. On the one hand, unmet needs for care and for medical examination due to cost, and exposure to large out-of-pocket spending are relatively low for lower incomes (OECD, 2011e). On the other hand, access to doctors and

dentists is more unequal in Sweden than in many other OECD countries (van Doorslaer *et al.*, 2006; OECD, 2011e). Swedish studies confirm that there are some inequalities in access to medical care (Anell *et al.*, 2012). In 2001, the National Board of Health and Welfare reported a greater number of health care visits among individuals with higher education, even though health needs were more severe for less-educated individuals (National Board of Health and Welfare, 2001). In 2006, the same institution indicated that inequity across groups based on educational background had worsened (National Board of Health and Welfare, 2007). Lower access to health for immigrants coming through the asylum channel is also a source of concern (National Board of Health and Welfare, 2008b).

Various reasons may explain unequal access (OECD, 2005; Anell *et al.*, 2012). Access differs geographically depending on the density of the population and the distance to the point of service. While specialised services are easy to access in large cities, this can be a problem in rural areas with shortages of physicians. Geographical inequalities can reflect inequalities in terms of socio-economic background insofar as low incomes tend to be concentrated in some areas. Another reason could be the user charges that apply for all types of health services. While co-payments are capped, they may still restrict access for some vulnerable groups. Besides, user charges for dental care can be high for groups with costly treatments such as older people. Finally, waiting times are relatively long for specialists, which may contribute to inequalities in access to health care (OECD, 2011e).

Since 2007, a series of reforms have been launched, county by county, to introduce choice and privatise primary care providers. In 2010, the Health Care Act was changed to account for these new developments, and now stipulates the freedom of choice of primary care provider for the population and the freedom of establishment for providers accredited by the local county councils. The purpose of these reforms was to develop primary care and improve its efficiency, notably in terms of access, as recommended in the chapter on health care in the 2005 *OECD Economic Survey*.

Early evaluations of the introduction of choice and competition in primary care suggest that access has improved in some areas (Glenngård *et al.*, 2011; Anell *et al.*, 2012). Between 2007 and mid-2010, the number of primary care centres increased by 23%. An evaluation of the reform in Stockholm indicates that the use of primary care has increased for all age groups but more so for patients with multiple chronic illnesses and in low-income areas. Productivity is found to vary considerably across providers but there is no significant difference between public and private providers. Further evaluations are required to assess the overall impact of the reform. Payment systems differ between counties, so that the impact of the reform can also differ. Recent debates surrounding large private providers of elderly care making big profits while unduly lowering the quality of services suggest that the impact of the reform in terms of prices and quality of service, equality in access, and public finances needs to be closely monitored. The creation of a new independent health care supervisory authority, as announced in the Budget Bill for 2013, could help ensure a successful outcome of the reform.

Women's employment opportunities could be improved further

Various factors can impede women's rise to leadership and make them choose or be trapped into relatively low paid positions and in jobs with limited career progression. General norms and cultural practices, lack of role models and of flexible work conditions are estimated to be among the most important barriers to women's leadership (OECD,

2012b). The government should continue to help address cultural barriers and stereotypes about the role of women in society and business through collaboration with business, schools or the media. These can include reports and statistics about women in business as well as support to awards for women in business and to good management practices.

Family policies improve gender equality by raising female labour force participation, but may not be fully effective in ensuring career prospects (Hakim, 2000; Halldén, 2009). Child care mainly takes the form of centre-based care. While this may be explained by child development objectives, centre-based care may provide less flexibility to households than or may require to be complemented by some other forms of child-care. Relatively high wages at the bottom of the wage distribution make it costly to hire professional household service providers (Albrecht *et al.*, 2003). In Sweden, both men and women spend more time on household services than in the United States since their high cost and social norms against buying household services encourage people to perform their own household tasks rather than relying on market provision. Policies to improve wage flexibility at the lower end of the wage distribution, as proposed earlier in the Chapter, would lower the cost of in-house child-care. In 2007, a tax deduction for up to 50% of expenses for domestic household-related services was introduced, mainly to reduce informal economy. The fact that the tax deduction covers various domestic services including house renovation makes it hard to assess its impact on female employment outcomes. The impact of the tax deduction on female employment outcomes should be monitored.

The differences in the use of flexible working-time arrangements and parental leave between men and women might also contribute to persistent divergences in their career profiles (OECD, 2011f). Parental leaves are relatively long in Sweden, with women taking most of them. Empirical analysis shows that women taking 16 months leave have been less likely to see a progress in their careers once back on the job again (Evertsson and Duvander, 2010). Parental leaves have been changed on a number of occasions to achieve a more gender-equal division of these leaves (Duvander and Johansson, 2012). However, in 2010, women were still taking almost 80% of them. Efforts should continue to encourage both parents to use parental leave to improve gender equality.

Conclusions

Sweden is an egalitarian country but inequalities are rising and some groups tend to struggle more to integrate the labour market. To some extent, this reflects that the benefits of labour market and social policy reforms take time to fully emerge, especially as regards potential employment. This is especially the case for education system reform. However, the rise in inequalities and lasting unemployment problem may also come from the fact that reforms have mainly addressed the supply side of the labour market while less has been done on the demand side. Past unemployment insurance reforms have addressed some issues but have created other problems such as a fall in coverage and differences in incentives and support between groups of unemployed.

To achieve inclusive growth in future years, it is important to continue with structural reforms. A comprehensive strategy is required, with the main recommendations summarised in Box 1.7. The main idea is to have structural reforms boost labour demand as the EITC can at least partly offset the impact of these reforms on individual income. The asymmetry in EPL between temporary and permanent contracts needs to be reduced. UI could be reformed to make it more uniform between groups with stronger requirements

for the unemployed. Reforms of the education system need to continue to ease the transition from education to employment and to raise the productivity of new entrants. The effects of recent reforms of the health system would have to be closely monitored to ensure that access does not become more unequal.

Box 1.7. Key labour market and social policy recommendations to make growth more inclusive

- Reduce the gap between the labour cost and productivity of workers at risk. The government should continue talks with social partners to develop employment contracts that improve employment opportunities for such workers. Studies on the impact of minimum wages on employment should be commissioned and published regularly.
- Reduce the gap in job protection legislation between temporary and permanent contracts. This can be achieved in various ways. Under the current system, job protection on permanent contracts needs to be eased.
- Consider extending the coverage of unemployment insurance by easing the entitlement conditions in terms of duration of past work and moving to a system with mandatory contribution to unemployment insurance.
- Continue to strengthen the obligations of the unemployed and the Public Employment Service's power of sanction. Make sure that all unemployed are actually covered by the Public Employment Service regardless of the type of support they receive. Implement plans to shift the burden of proof of job-search activity to the unemployed and develop an efficient control system of job-search.
- Improve the use of profiling to identify individuals at risk of becoming long-term unemployed. Continue efforts to develop small-scale individualised services. Improve co-operation between the PES, the Social Insurance Agency and the education system.
- Develop further apprenticeship programmes and work placement in vocational education.
- Assess the impact of recent reforms of primary health care in terms of quality, equality of access and cost.
- Continue efforts to reduce the differences in the use of parental leave between men and women.

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ANNEX 1.A1

Labour market and education measures recently proposed by the government

The main structural reforms to combat long-term unemployment were launched in 2006 with the introduction of a compulsory guarantee programme for long-term unemployed, starting after the individual had been unemployed for 300 days (see the chapter on labour market policies in the 2011 *OECD Economic Survey*). Most unemployed were not supposed to benefit from specific programmes before this period. In parallel, a new subsidised job scheme was introduced (“New Start Jobs”) and the unemployment insurance was reformed to strengthen incentives to take a job. At the beginning of 2012, a statistical profiling tool was introduced to identify the unemployed most at risk of becoming long-term unemployed.

This Annex reviews the main (labour market, education and social) measures proposed recently by the government to improve labour market outcomes either as part of the Budget Bill for 2013 or other initiatives.

Long-term unemployed

- Temporary provision of ALMPs from the first day of unemployment for the unemployed most at risk.
- Increase in subsidies for some subsidised jobs and training places for individuals in the third phase of the guarantee.

Unemployment insurance and other social benefits

- Increase in the number of sanctions for not complying with obligations but decrease in their severity.
- Unemployed will have to provide evidence of their job-search activities. An “activity report” is introduced for this purpose.
- Measures will be prepared to harmonise rules and requirements within different benefit systems, such as the unemployment insurance, the activity support and social assistance, and to improve information exchange between the PES and the municipalities.
- Clarification of the requirements that apply to all recipients of labour market-related benefits or other types of income support.
- Change in the calculation of social assistance to increase incentives to take a job.

Youth

- The subsidy to employers under the apprenticeship programme is doubled.
- More places in special schools (folk high-school) for those who did not complete upper secondary education.
- The increase in the study grant is extended. Increased funding for VET, including to increase the number of vocational teachers and to improve career guidance in school. Increased funding and responsibilities for the National Agency for Education in the area of VET. More places in the regular education system, with a special focus on VET. Launch of an investigation on the performance of the current VET system and how to improve it.
- Increase in the subsidy under the New Start Jobs for youth unemployed more than a year.
- Increased support to the PES for youth unemployment.
- Appointment of an inquiry (to report in August 2013) on how to reduce the share of youth in the NEET group.

Immigrants

- Introduction of a “practical year” for immigrants above 30 with a maximum of nine years of schooling including on-the-job-training, vocational Swedish language studies and theoretical education.
- Enlargement of the group that can benefit from the “Introduction Act”. Increased requirements to accept a job offer for those under this programme.
- Extension of the subsidy under the “Step-In Jobs” targeting recently arrived immigrants.

Talks with social partners

With the social partners, the government is discussing how to improve the functioning of the labour market. The talks concern:

- *Short-time working schemes*. In some parts of the industry, short-time working schemes were introduced during the crisis in 2008-09. The government is looking at how to support these schemes in exceptional downturns.
- *Youth unemployment (“Job Pact”)*. In some sectors the social partners have agreed on contracts that include 75% of the time on the job and 25% of the time in education with compensation equal to 75% of the minimum wage. The government has indicated its willingness to support these types of contracts.
- *Transition in the labour market*. The social partners have started negotiations on a wide range of topics, including EPL and adult education.

Chapter 2

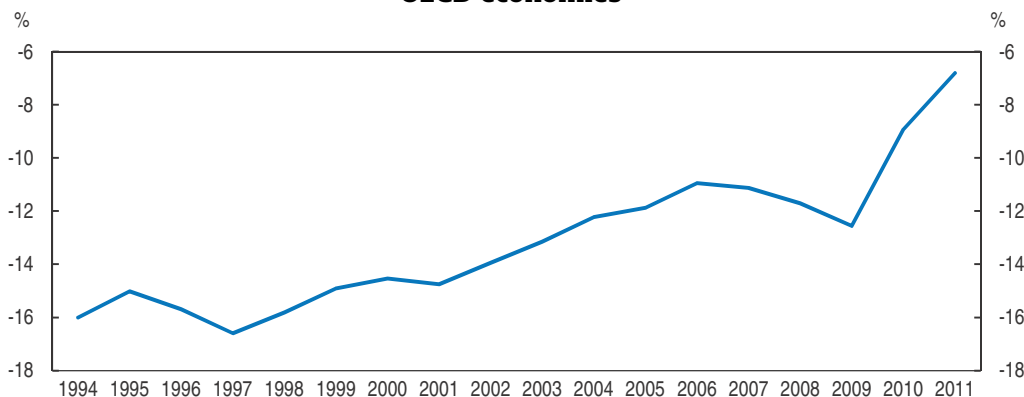
Housing, financial and capital taxation policies to ensure robust growth

Extensive structural reforms since the early 1990s have strengthened the resilience of the Swedish economy to shocks. However, more needs to be done to better manage near-term risks and ensure that growth remains sustainable in the longer run. Reforming the housing market would reduce the risks associated with high house prices, ensure adequate residential investment and improve labour mobility and well-being. Clarifying the division of responsibilities in financial regulation and improving the macroprudential toolkit would reduce the risks to stability and the contingent fiscal liabilities arising from a large, concentrated banking system. Better aligning the taxation of different types of assets would make taxation more neutral.

Sweden is well placed to achieve robust growth but faces some challenges


Thanks to sound macroeconomic and structural policies, the Swedish economy has performed well. The GDP gap vis-à-vis the highest-income OECD economies continues to narrow, reflecting robust productivity and employment growth (Figure 2.1). Going forward, Sweden is well placed to achieve sustainable long-term growth, but faces some challenges. However, the international environment is less supportive than before the global crisis, and the build-up of some domestic imbalances creates further risks, that could be aggravated by spillovers from the euro area crisis.

Figure 2.1. **GDP per capita gap between Sweden and the highest-income OECD economies¹**



1. The highest-income OECD economies are the upper half of the OECD countries in terms of GDP per capita expressed in PPP terms at constant 2005 international US dollars in 2010. The gap is computed as the percent difference between Sweden's GDP per capita and that of a simple average of the highest-income OECD economies.

Source: OECD, Analytical Database.

StatLink  <http://dx.doi.org/10.1787/888932757314>

Higher real incomes, low interest rates and lower property taxes have boosted demand for housing, but structural problems such as strict rent regulation, zoning laws and high construction costs have restricted the supply response, leading to a steep rise in real house prices. Increasing housing prices coupled with high household indebtedness have made households vulnerable to labour and housing market as well as interest rate shocks. The banking sector is large and concentrated, with high potential contingent liabilities for the government. Capital taxation favours institutional savings and investment in owner-occupied housing and might have decreased the efficiency of the allocation of savings.

Addressing the shortcomings of housing and mortgage markets would both limit risks in the short run and strengthen growth prospects in the long run. Enhancing financial stability by filling in the gaps in the institutional set-up of financial supervision and the macroprudential toolkit would help address the problems that might arise from a disorderly deleveraging by households and disruptions in international capital markets. Making the tax system more neutral and uniform would reduce the risk of imbalances building up in the future.

The increase in house prices partly reflects structural problems

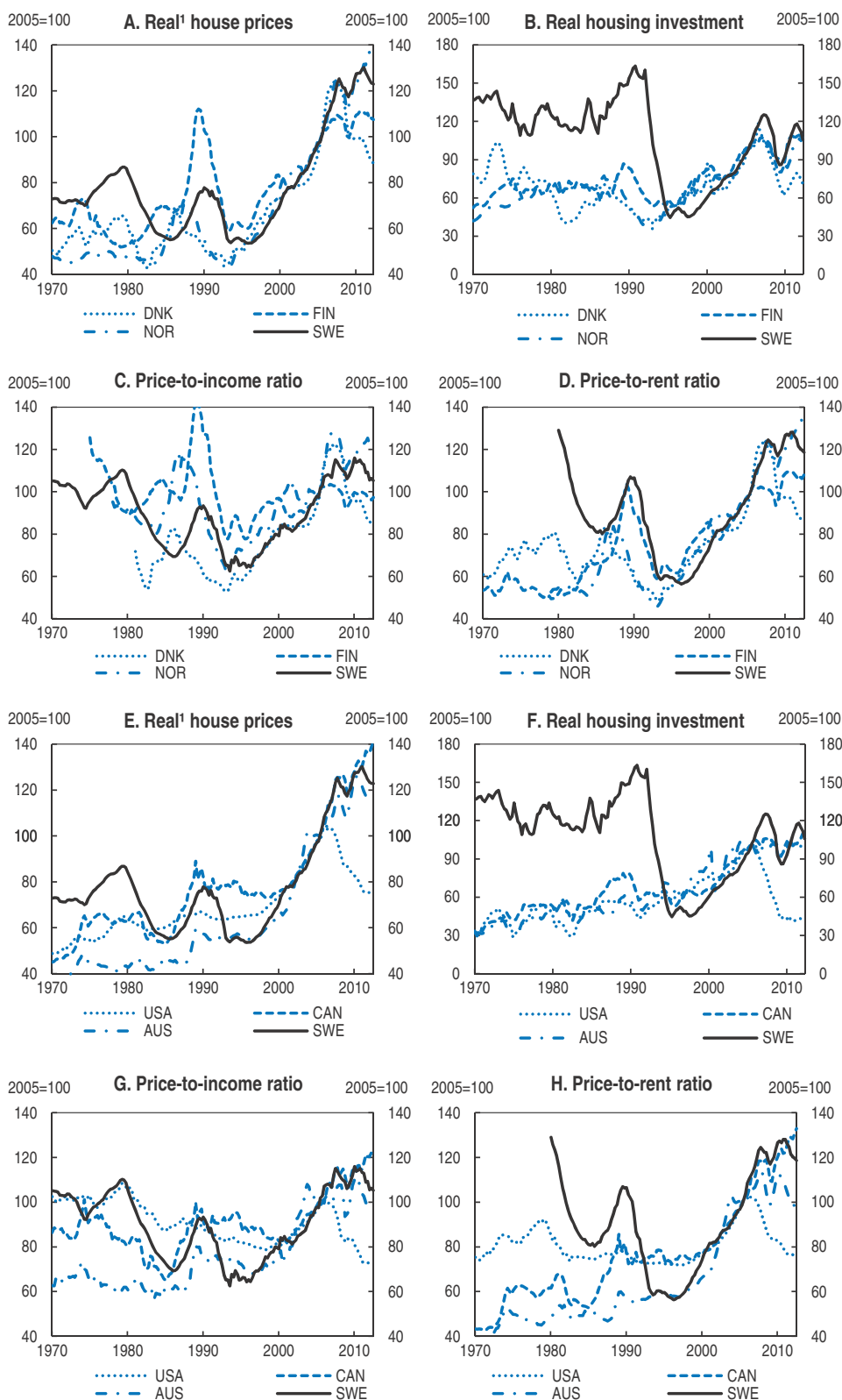
Real house prices have risen markedly over the past 15 years and remain high in historical perspective, notwithstanding some recent declines, while residential investment is low (Figure 2.2, Panels A and B). Riksbank analysis of the housing market shows that economic fundamentals and limitations on housing supply explain most of the house price increases (Riksbank, 2011a). Other studies and models yield a range of results as to whether house prices are overvalued in Sweden. Those that find some overvaluation still suggest that a potential correction may not severely impact the financial system (IMF, 2012a; European Commission, 2012a). Nevertheless, addressing the structural problems that have pushed up house prices would improve the resilience of the housing market and of the economy more broadly. The predominant demand factors driving house prices include rising real disposable incomes, even during the crisis due to the stimulus and resilient labour markets, the decrease in property taxes and deductions for home improvements, rental regulation, and falling mortgage rates and amortisation requirements. The supply side factors include the reforms in the 1990s that caused a decline in new construction, weak competition in the construction sector and administrative uncertainties related to zoning and building permits.

Housing affordability has been negatively affected by rising prices, but has been aided by low interest rates and new financial instruments that have improved access to finance, especially for first-time buyers. Price-to-income and price-to-rent ratios have risen and remain above historical averages, although the rental regulations that keep rents below market values make the second indicator less reliable (Figure 2.2, Panels C and D). Overall, thanks to increasing incomes and lower interest rates, mortgage payments as a share of income have remained low. However, labour market and interest rate shocks could reverse the situation. Lower affordability can limit family formation, reduce mobility, make it hard to hire and retain workers in regions of high house prices, increase the cost of living and lead to social inequalities.

Housing supply is restricted by a complex, lengthy and uncertain planning process. Municipalities play a leading role and apply different building permit requirements, which may be detrimental to construction firms by decreasing predictability and limiting the possibility to carry out the same projects in different parts of the country. As a result, companies tend to work in municipalities they are familiar with rather than nationwide, which restricts competition and pushes up building costs (Swedish Ministry of Social Affairs, 2011; Swedish National Board of Housing, Building and Planning, 2011). In 2012, the government set up a committee to harmonise the application of the Planning and Building Act by all municipalities. As in many other countries, there are geographical differences in house price developments, with higher house price increases in urban areas compared to rural ones (Figure 2.3). This partly reflects the lack of supply response. The supply response in urban areas with high demand for housing can be damped by the authorities' preference for a lower population density, blockage by current residents, restricted availability of land or lack of incentives for municipalities to provide land. Streamlining the planning process and making it faster as well as eliminating the obstacles to increase the capacity of the construction industry would contribute to a better match of demand and supply.

Progress has been achieved with respect to the building planning and zoning process, but it can be improved further. The May 2011 Planning and Building Act cut the decision time for a building permit to 10 weeks and made the production of development plans

Figure 2.2. **Housing market developments**



1. House prices are deflated using national accounts private consumption deflator.
 Source: OECD Economic Outlook 92 Database; national sources and OECD calculations.


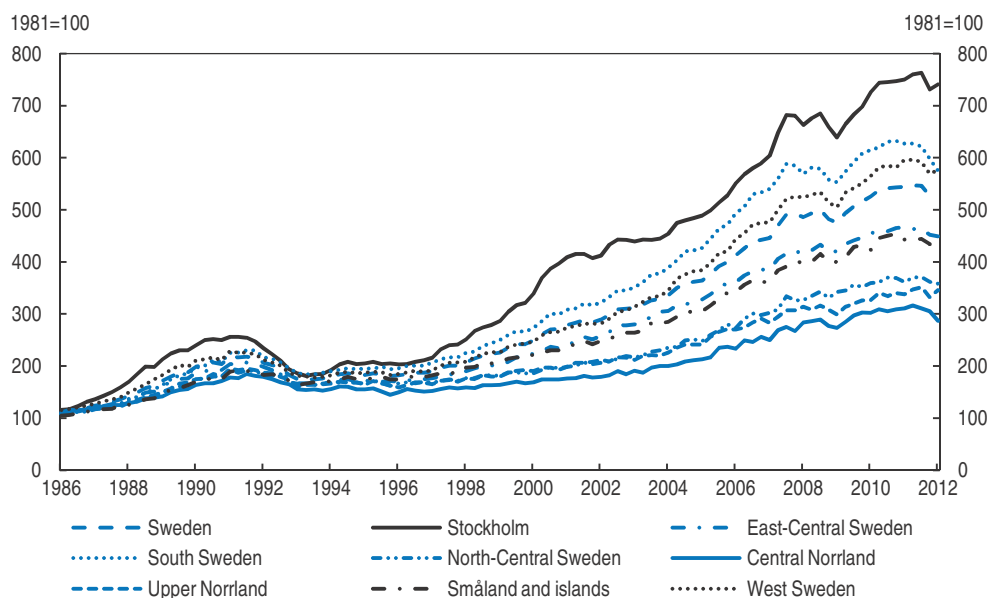
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Figure 2.3. **Regional real house prices**¹

1. House prices are deflated by the consumer price index.

Source: Statistics Sweden.

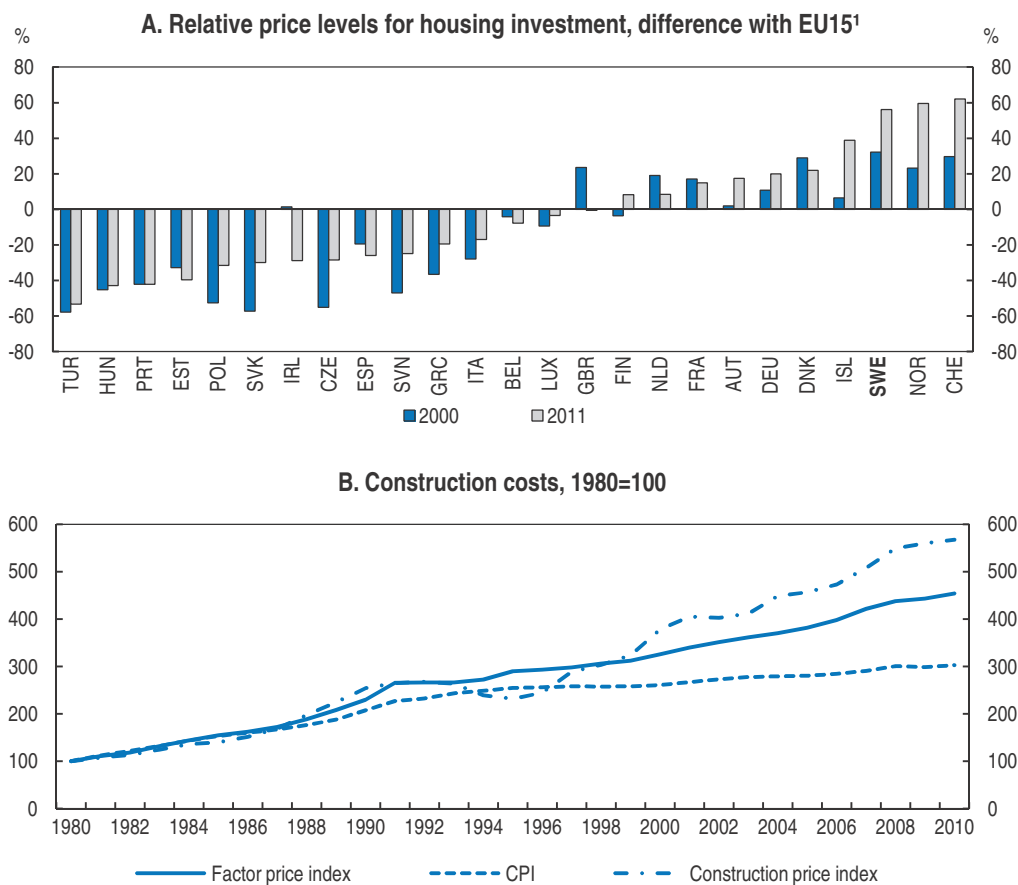
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(designating residential, commercial and industrial areas) simpler and shorter by dropping the construction plan requirement, which defined the type of building to be built. However, the appeals in cases of building plan rejections remain lengthy. The Budget Bill for 2013 increases the resources for processing appeals at the country administrative boards. Furthermore, the government has commissioned studies of the municipal land design policy with a view to increase the availability of municipal land for housing, but more can be done. Recently, the fastest-growing source of new construction has been tenant-owner apartments, but the process of setting up co-operatives is slow and cumbersome (see below). Co-operatives typically own one apartment building and a new one is formed for every project, including new buildings, conversions or modernisation of old ones. Relaxing these rules would increase the responsiveness of housing supply.

Swedish housing investment is sensitive to house prices and construction costs (Andrews *et al.*, 2011; National Housing Credit Guarantee Board, 2011). The rapid increase in house prices over the past decade has been accompanied by an expanding construction sector, albeit rising from very low initial levels. It is hard to establish the causality between construction costs and house prices, but in Sweden both have increased rapidly.


Construction prices have risen fast and are now among the highest in Europe, at about 55% above the European average (Figure 2.4, Panel A). This is partly due to an increase in land costs, driven by a lack of supply. The factor price index, which measures costs of inputs, including labour, materials, transport and machinery, is a better indicator of construction costs and has risen by 2.2% per year over the past decade on average, compared to 1.3% per year in the decade prior to that (Figure 2.4, Panel B).

High construction costs can be explained by limited competition and heavy regulations regarding input materials (see the chapter on housing in the 2007 *OECD Economic Survey of Sweden* and Swedish Competition Authority, 2009). The construction

Figure 2.4. **Construction prices and costs**

1. Housing investment refers to gross fixed capital formation in construction. Based on purchasing-power parity exchange rates.

Source: Statistics Sweden and Eurostat.

StatLink  <http://dx.doi.org/10.1787/888932757371>

sector is concentrated, with considerable horizontal and vertical integration. A few large firms hold the largest share of the market and have been found to engage in cartel-like behaviour and bribery (see the chapter on competition in the 2004 *OECD Economic Survey* and Sjöblom, 2011). This creates high entry barriers, including for foreign firms. The prospects of small and foreign firms are further restricted by a land distribution process that tends to favour established large domestic companies, and the nature of the tendering process where certain tenders are too large, not well-specified and take a long time between submission and results. Accordingly, the access of small and foreign firms to the public procurement process should be enhanced by improving its timeliness, predictability and clarity. It is also important to ensure that the high cost of building materials does not disadvantage smaller firms who rely on larger vertically-integrated companies for the provision of building materials.

The Swedish housing market displays several idiosyncratic features (Box 2.1). One is that tenant-owner co-operatives (*bostadsrätter*) have long been a widely-used institutional arrangement to own an apartment in Sweden. The co-operatives own the buildings and take out mortgages to fund part of the value of the land and buildings, while the rest is financed by contributions from members in return for tradable occupancy rights. Under

Box 2.1. Main features of the housing market and recent reforms

Housing market structure

The Swedish housing market, which consisted of 4.5 million dwellings in 2010, has four segments: single family owner-occupied housing and tenant-owner co-operatives, making up 41% and 20% of the total housing stock, respectively, and private and public rentals, accounting for 22% and 17%, respectively. The growing popularity of tenant-owner co-operatives has contributed to the rise in owner occupancy rates, with combined ownership rates reaching 61% in 2010, up from 53% in 2007. The largest decrease from 2007 to 2010 was observed in private rentals, which made up 29% of the housing stock in 2007, while public rentals only decreased by 2 percentage points in the same period.

Rent regulation

The rent regulation system, introduced in the 1940s to avoid unfair rent increases, has been softened since. Until recently, the price was determined by a collective bargaining system between the tenants association and the municipal housing companies, which set a price ceiling for the whole rental market. In 2005, the Swedish Property Federation initiated a complaint to the European Union (EU) that the municipal housing companies receive unlawful state aid since they get implicit credit guarantees from their respective municipalities, making it possible for them to charge below market prices. The complaint was found justifiable by the EU and in January 2011, the rent regulations were adjusted such that there are now separate negotiations between the local tenants association on the one hand and private and public housing companies on the other.

Recent and proposed reforms

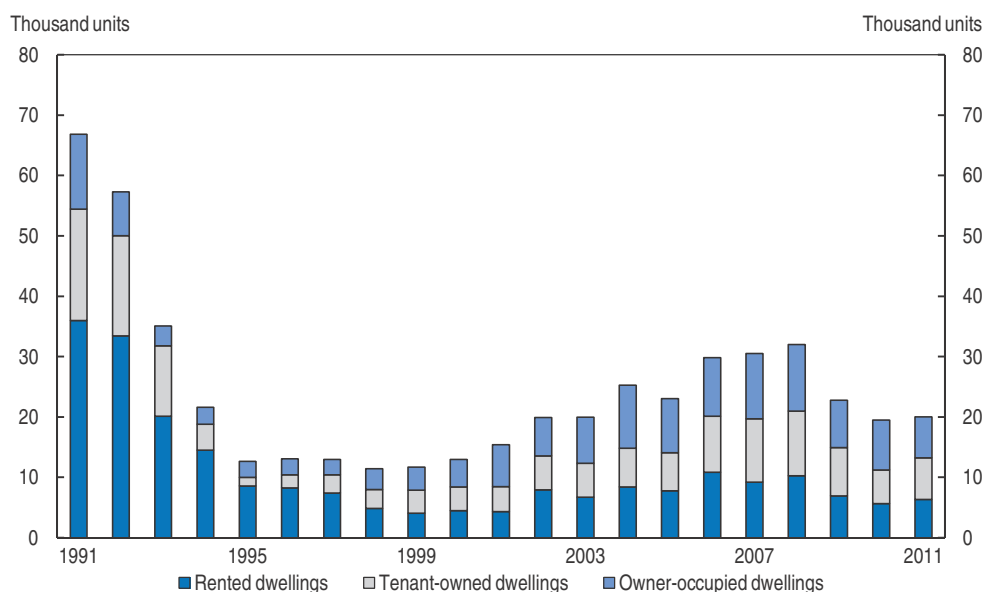
An inquiry was announced in the 2012 Spring Budget Bill to look into how to durably improve the conditions for investing in and managing rental housing. In the Budget Bill for 2013, measures were announced that are expected to increase housing construction and improve the utilisation of the existing housing stock. New measures to relax some of the restrictions in rent setting relate to the rules concerning tenant co-operatives' right to veto subletting, periods of notice and reclaiming rights of a tenant after the expiry of the rental contract. Furthermore, an increase in the standard deduction for a person letting their own home to SEK 40 000 per year, an increase in the length of time when apartment rents are not subject to a review by the regional rent tribunal (which mediates in disputes regarding rents, subletting and transfers) and relaxing the restrictions on renting out one's own apartment are proposed in order to increase the supply of rentals. Measures in the Budget Bill for 2013 expected to raise housing construction include a reduction in the municipal property tax for rental units, an extension of the reduction of the municipal property tax on new residential housing construction to 15 years and an extension of the permitted period for market-based rents for newly-built housing to 15 years.

this arrangement, there are tight restrictions on an owner who wishes to sublet or rent an apartment, as the tenant co-operatives have a veto right. Another specificity concerns the rental sector, with a large share of public housing and relatively strict rent controls. Furthermore, so far there have been strong restrictions on purchasing an apartment with the purpose to rent it out, curtailing the supply of rentals.

These features have created a number of problems:

- With rents not in line with costs, the return on construction of new rental dwellings is low, especially in high-growth areas where land prices and construction costs are high. This impedes the supply response to demand changes, resulting in low levels of construction of rental houses (Lind, 2003). Actual rents that are lower than market-clearing rents, especially in attractive areas in larger cities, have encouraged property owners to sell to housing co-operatives, leading to an increase in the conversions of rental apartments into tenant-owner co-operatives (Johansson, 2006). As a result, the share of rental housing has decreased and that of tenant-owner co-operatives has increased in the past two decades (Figure 2.5). Low property taxes on owners have also contributed to this trend (Fastighetsägarna *et al.*, 2010). These developments have generated segregation issues as higher-income families can more readily afford to purchase tenant-owner apartments (Magnusson and Turner, 2008).
- Rents have been historic-cost based, dependent on management and maintenance costs and reflecting the age of the buildings while geographical location plays a minor role. This does not provide incentives to develop rental houses where they are most demanded, which may dampen labour mobility.
- High demand and low supply in popular areas have led to inefficient queuing and black market activities (Ball, 2012). The system lacks transparency and in some municipalities, allocation of rental housing depends on queuing time or vaguer criteria, such as matching the right apartment to the right tenant. Private rental companies can use their own criteria regarding rent-to-income ratios, number of household members or children to allocate vacant apartments, which can be restrictive and discriminatory. Tenants also have the legal right to exchange leases with each other, creating a secondary market and making the regular rental queues even longer.

Figure 2.5. **New construction of dwellings by tenure**



Source: Statistics Sweden.

StatLink  <http://dx.doi.org/10.1787/888932757390>

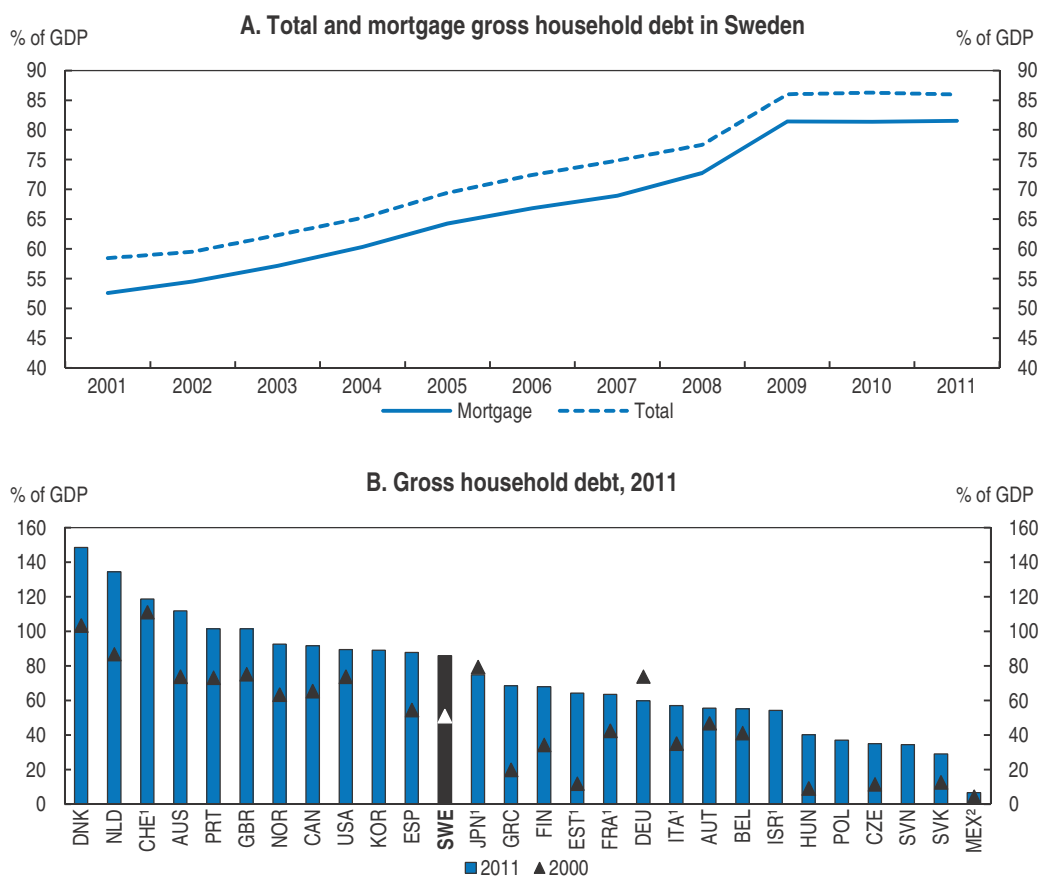
Overall, the rent regulation framework may have generated inequities. It favours insiders at the expense of outsiders (Wahlström, 2011). Furthermore, residents in rent-controlled apartments in attractive locations typically are born in Sweden to Swedish parents and they are likely to have a higher income than residents in rent-controlled apartments in less attractive locations (Brogren and Fridell, 2006). Nonetheless, studies have found no direct link between segregation and rent regulation (Lind and Hellström, 2003).

Progress has been made to address the housing market's shortcomings (Box 2.1). Rents set by public housing companies are no longer the standard for all rents and there are separate negotiations between local tenant associations and private housing companies. This should help align rents with market fundamentals. As a result, the number of private rental companies has increased slightly as private pension funds and construction companies have started entering the rental business. However, this has not been reflected in house prices yet partly because the strict rules for taking disputes to rent tribunals have prevented rents from rising. Legislation allowing the construction of owner-occupied apartments was introduced in 2009, which was expected to contribute to increasing the size of the rental property market since owners can rent out these apartments. However, by January 2012, only four owner-occupied apartments had been formed in Stockholm, suggesting that their effect on the long-standing problem of insufficient supply of rental apartments has been limited so far. The measures in the Budget Bill for 2013 will contribute to increasing the supply of rentals and are a welcome move towards easing the rental market. However, the remaining restrictions, such as those on an owner to rent an apartment and on a person to buy an apartment to rent it out, should be phased out completely. Efforts to phase out rent controls and align rents with market values should also continue.

High household and corporate debt create vulnerabilities

Over the past two decades, household debt has risen to historically high levels, reaching 174% of disposable income and 84% of GDP in 2011 (Figure 2.6). High private sector debt in Sweden has been flagged as a vulnerability in the European Commission's Alert Mechanism Report in 2011. Debt can help smooth consumption and investment by households, firms and governments, improve the efficiency of capital allocation and lower macroeconomic volatility (Levine, 2005). However, high debt levels may have a negative impact on the economy both in the short and long run.

Highly indebted households may cut back consumption and increase savings in the face of adverse shocks, including a fall in house prices, aggravating downturns (Bouis *et al.*, forthcoming; Box 2.2). An analysis of past crises shows that housing booms accompanied by high household debt lead to larger economic losses (IMF, 2012b). There could also be implications for financial stability since the exposure of the financial system to the household sector is high and the share of mortgages in total loans to households increased from 68% in 2002 to 81% in 2012. High household debt can result in a higher probability of default and make repayment ability sensitive to shocks (Cecchetti *et al.*, 2011). However, the more likely transmission channel of a house price fall on financial stability is through its effect on banks' costs and access to funding rather than major credit losses on mortgages (Janzén *et al.*, 2011). Financial stability could also be affected through lower household demand leading to credit losses in the banks' corporate lending (Jönsson *et al.*, 2011).

Figure 2.6. **Household debt**

1. 2010.

2. 2009.

Source: OECD, Analytical Database.

StatLink  <http://dx.doi.org/10.1787/888932757409>**Box 2.2. Consumption and wealth**

Developments in housing wealth and private consumption are closely related, partly due to a relaxation of the borrowing constraints of households in the face of increases in housing wealth. High house prices and household debt make the Swedish economy vulnerable to shocks. An error-correction model is used to assess the impact of the increase in household gross and net wealth on private consumption. In the long run, trends in consumption are closely related to trends in income and wealth. Consumption deviates from this long run equilibrium in the short term but will tend to gradually revert to equilibrium over time.

A long-term equation relates private consumption to household disposable income, financial and housing wealth, while a short-term equation captures the dynamics and adjustment to temporary deviations from the long-term equilibrium.

Box 2.2. **Consumption and wealth (cont.)**Table 2.1. **Short-term and long-term impact of wealth on consumption**^{1, 2}

| 2001Q1-2011Q3 | | | | 1982Q1-2011Q3 | | | | | |
|----------------------|------------------|----------------|------------------------------------|------------------|----------------------|-----------------|------|------------------------------------|------------------|
| Long-term | | Short-term | | Long-term | | Short-term | | | |
| In C | MPC ³ | $\Delta \ln C$ | | In C | MPC ³ | $\Delta \ln C$ | | | |
| In Y | 0.49 (12.40) | 0.56 | $\Delta \ln Y$ | 0.16 (2.28) | In Y | 0.51 (9.67) | 0.57 | $\Delta \ln Y$ | 0.16 (3.66) |
| In NFW | 0.11 (3.75) | 0.08 | $\Delta \ln NFW$ | 0.11 (3.37) | In GFW | 0.00 (0.06) | 0.12 | $\Delta \ln GFW$ | 0.14 (5.69) |
| In NHW | 0.11 (4.91) | 0.04 | $\Delta \ln NHW$ | 0.06 (2.11) | In GHW | 0.19 (25.67) | 0.00 | $\Delta \ln GHW$ | 0.07 (4.18) |
| Constant | 11.16 (12.39) | | Constant | 0.00 (2.20) | Constant | 10.95 (9.12) | | Constant | 0.00 (2.56) |
| | | | ε | -0.42 (-3.35) | | | | ε | -0.13 (-3.62) |
| R² | 0.99 | | R² | 0.45 | R² | 0.99 | | R² | 0.42 |

1. Δ denotes first order differences; t values are reported in parentheses. C = real private consumption, Y = real net household disposable income (excluding property income), NHW = net real housing wealth (housing assets minus households' mortgages), NFW = net real financial wealth (financial assets minus non-mortgage financial liabilities), GHW = gross real housing wealth, GFW = gross real financial wealth and ε = error term.
2. There is a break in the data series for mortgage loans in 2001 as the data only included mortgage loans from mortgage institutes and not from banks prior to 2001. The net financial and housing wealth definitions can only be used for the 2001Q1-2011Q3 period, while gross financial and housing wealth definitions are used for the 1982Q1-2011Q3 period.
3. The marginal propensity to consume out of net housing wealth varies over time, but its current value can be calculated as the product of the net housing wealth elasticity and the ratio of private consumption to net housing wealth at the end of the sample. The relatively low marginal propensity to consume out of household disposable income is partly due to the fact that the latter is highly correlated with household wealth. Dropping the housing or financial wealth variable increases the coefficient on real net disposable income. Other studies also find a low marginal propensity to consume out of household disposable income (Chen, 2006).

According to the regressions from the sample period starting in 2001Q1 shown in Table 2.1, the long-run marginal propensity to consume out of net housing wealth, at 0.08, is high compared to a number of other countries (Catte *et al.*, 2004; André and Garcia, 2012). The long-run marginal propensity to consume out of net financial wealth is 0.04, which is more in line with other countries. Similar to other countries, the results thus suggest that household consumption is far less sensitive to changes in financial wealth than to changes in housing wealth. This is in line with some of the other studies that investigate the links between consumption and different types of wealth in Sweden (Barot, 2007; Guo and Unal, 2011). One potential explanation may be that increases in property values are perceived to be more permanent by households (Bostic *et al.*, 2009). Moreover, the effect of increasing house prices on consumption is strengthened by the use of housing equity withdrawal. However, when the sample period starts in 1982, the marginal propensity to consume out of gross housing wealth is insignificant. This is similar to results found in Berg and Bergström (1995) and Johnsson and Kaplan (1999), suggesting that the chosen time period and model yield different results on the links between wealth and consumption and that the effect of housing wealth on consumption might have increased over time.

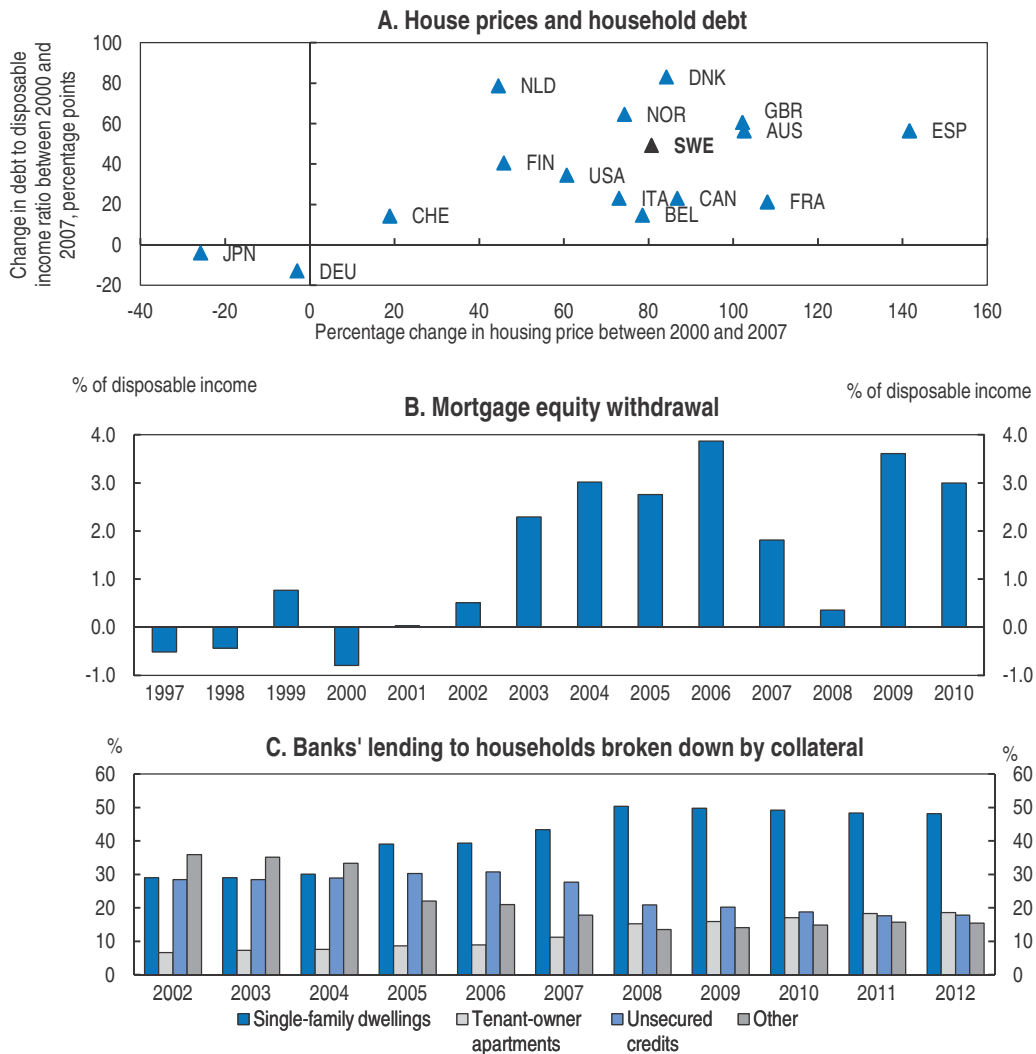
Despite recent increases in the saving rate in response to uncertain economic conditions, household debt continues to rise in line with disposable income. There has been no major deleveraging in recent years, even though credit growth has gradually slowed down, and is currently below 5% per year. However, some of the factors contributing to household borrowing have reversed or may do so in the near future. Mortgage rates have increased, a guideline for a loan-to-value ratio (LTV) cap has been introduced (see below), and house prices have decreased and may decrease further.

Several factors contributed to the rise in household indebtedness. Fiscal reforms and credible inflation targeting bolstered economic growth and household and business confidence, and therefore, stock prices, which increased household financial wealth. This, in turn, encouraged them to take on more leverage. Financial innovations allowing variable rate and non-amortised loans also helped fuel the borrowing boom, especially for first-time home buyers. The share of outstanding loans with an interest rate fixed for less than one year in total household mortgages increased from 40% in 2004 to 66% in 2011, though it has fallen back since, to 54% by August 2012. Furthermore, the feedback effects between household debt and house prices are quite strong. The rise in house prices forces households to borrow more in order to buy a house. Once they own a house whose value appreciates households use the rising value of collateral to borrow and spend more, as evidenced by the growth of mortgage equity withdrawals (Figure 2.7).


High household debt is accompanied by even higher household assets, at 510% of disposable income, and the saving rate is high, creating fairly large financial buffers (Figure 2.8). Household assets are three times their liabilities, suggesting that households have enough room in aggregate to withstand shocks. However, a large part of household financial portfolios are in equities, which are subject to volatile movements, and pension rights and property, which are illiquid, making households vulnerable to shocks.

The risks associated with high aggregate household debt are limited by several factors. The bulk of the debt stock is held by households with high income and wealth: in 2007, the top 20% income earners held 57% of the debt and 44% of the assets. Mortgage debt has also mainly been incurred by those with higher incomes, with the top 20% income earners holding 60% of all mortgages, compared to 3% for the bottom 20% income earners. The welfare system and the widespread existence of two-income families support households' debt servicing ability in the face of unemployment spells. Swedish bankruptcy law is full recourse, decreasing defaults (Andersson and Lindh, 2011). Overall, credit standards have been high thanks to banks' vigilance after the 1990s crisis and the covered bond markets used to finance mortgages is resilient. Finally, unlike other countries with high house prices, highly regulated rental markets and structural factors restricting housing supply have held back the buy-to-let market and commercial lending exuberance, preventing the build-up of a speculative house price bubble.

However, notwithstanding the presence of buffers at the aggregate level, individual households may still face risks. Increased indebtedness, the widespread use of variable-rate mortgages and amortisation-free (interest-only) loans in the past decade make households more sensitive to interest rate, labour market and housing shocks (Figure 2.9). Between 2009 and 2011, the share of amortisation-free loans increased by 6 percentage points to 65%, while the average actual repayment period increased by four years to 70. Stress testing by the financial regulators tends to suggest that most households would be able to repay their loans even in the face of extreme shocks. However, non-performing

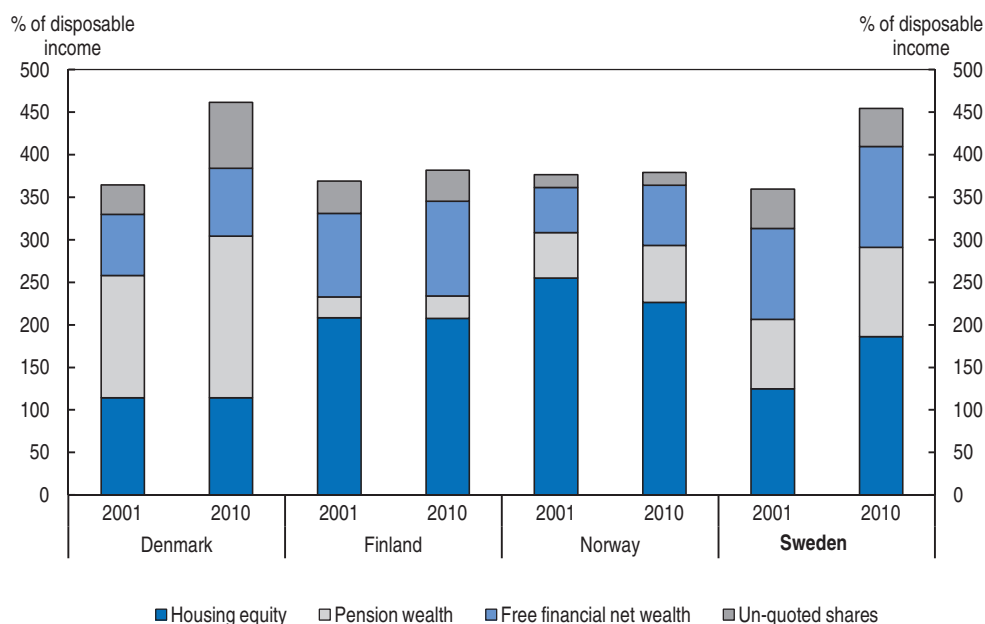
Figure 2.7. **Housing market and household indebtedness**

Source: OECD, *Analytical Database*; National Housing Credit Guarantee Board; the Riksbank and Statistics Sweden, *Financial Market Statistics*.


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household loans would cause losses for the financial system as banks are highly exposed in this regard (Riksbank, 2012a; Swedish Financial Supervisory Authority, 2012). Moreover, recent international experience has illustrated the limitations of stress tests, insofar as they rest on assumptions reflecting historical loan losses in quieter times and as they fail to fully capture feedback mechanisms between different sectors of the economy and the interaction of different types of shocks (see below). For that reason, the Riksbank is trying to improve its stress testing methods so as to better capture the uncertainty surrounding parameter estimates.

Heightened competition among mortgage providers, high house prices and low interest rates led to ever-increasing LTVs. Higher LTVs are more common amongst more vulnerable households with lower incomes, who are more sensitive to interest rate shocks. Against this backdrop, the Financial Supervisory Authority (FSA) introduced a guideline of

Figure 2.8. **Household assets**

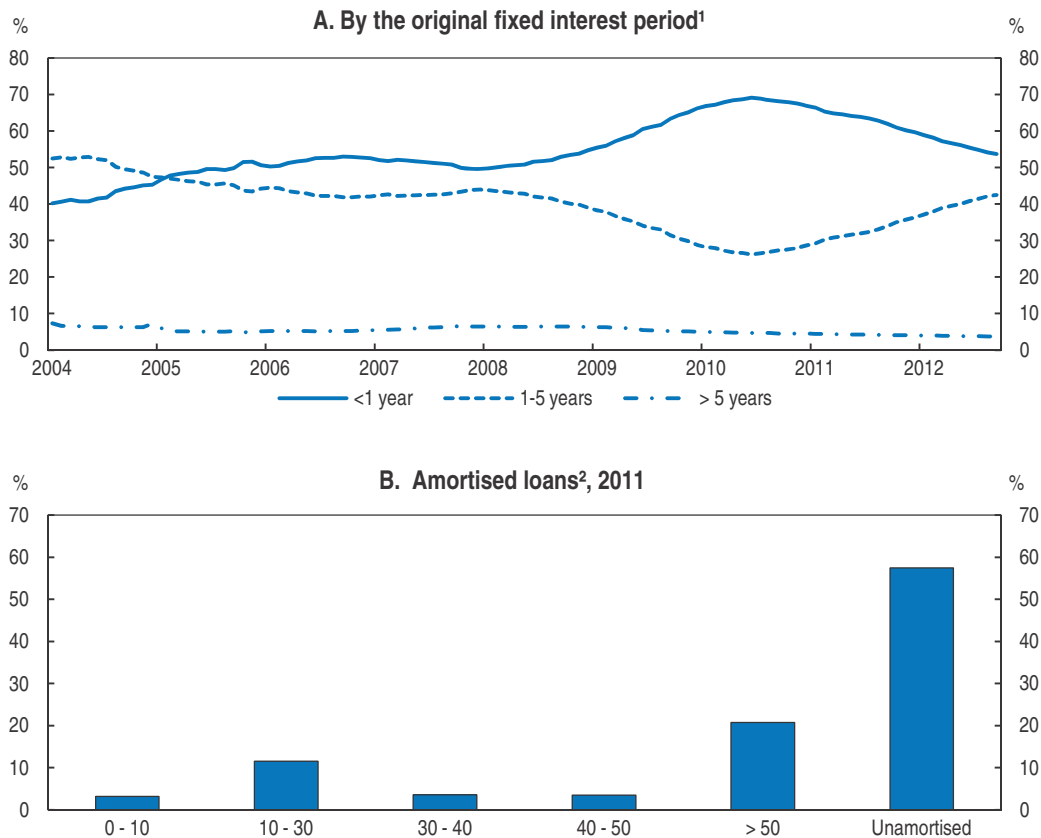
Source: Danish National Bank.

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a 85% LTV cap on new loans and extensions to existing loans using property as collateral in October 2010.


The impact of the guideline for the LTV cap is uncertain. According to a survey conducted by the FSA, in 2011 LTVs for new loans decreased for the first time since 2002. Only 9% of the new mortgages had a LTV exceeding 85% – a 50% decline from the previous survey conducted in 2009. Fourteen per cent had a LTV of exactly 85%, suggesting that the mortgage cap has been binding. With the introduction of the cap, unsecured lending increased slightly, but remains small. On the other hand, circumvention of the LTV cap is possible and greater use of fixed-rate mortgages and amortisation are better ways to reduce household risk. LTV caps can be circumvented by borrowing against collateral other than property or through unsecured lending (Bryant *et al.*, 2011). Hence, the effects of the LTV cap and the characteristics of households that use variable-rate and non-amortised loans should be monitored closely. The FSA's survey in progress focusing on the amortisation of loans is a welcome step. Swedish banks already apply strict lending conditions as part of their standard operating procedures, which are monitored by the FSA. However, the supervisors should consider more formal and binding measures to ensure sound underwriting practices for non-amortised and variable-rate loans. For example, a binding requirement could be imposed that in order to get such loans the borrower should show they could afford the corresponding fixed-rate or amortised loan.

Corporate debt on the basis of consolidated data, at 139% of GDP in 2010, is more than twice as high as in the rest of the European Union. To some extent, this can be attributed to the large number of multinational companies operating in Sweden but with a debt not directly linked to the Swedish economy (European Commission, 2012b). This partly stems from the fact that many large multinational companies take advantage of the interest rate deductibility in the Swedish Tax Code by lending to their affiliates in Sweden to finance operations outside Sweden (Blomberg *et al.*, 2012). Furthermore, the debt-to-asset ratios, at

Figure 2.9. **Types of loans, as a share of mortgages**

1. Panel A shows the share of outstanding mortgages according to the original fixed interest period. For example, the share of mortgages with an original fixed interest period of less than one year peaked at 69% in June 2010.
2. Panel B shows the share of new loans according to their amortisation period in years. For example, in 2011, 20.7% of the new loans in the sample had an amortisation period of more than 50 years. Random sample based on Swedish Financial Supervisory Authority (2012), *Swedish Mortgage Markets*.

Source: The Riksbank and Statistics Sweden, *Financial Market Statistics* and the Swedish Financial Supervisory Authority.

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53% and 83% for consolidated and non-consolidated data, respectively, are below the EU average, and the total debt-to-equity ratio has fallen from 2.2 in 2000 to 1.7 in 2010. Nevertheless, the high level of corporate debt relative to the size of the Swedish economy needs to be monitored closely.

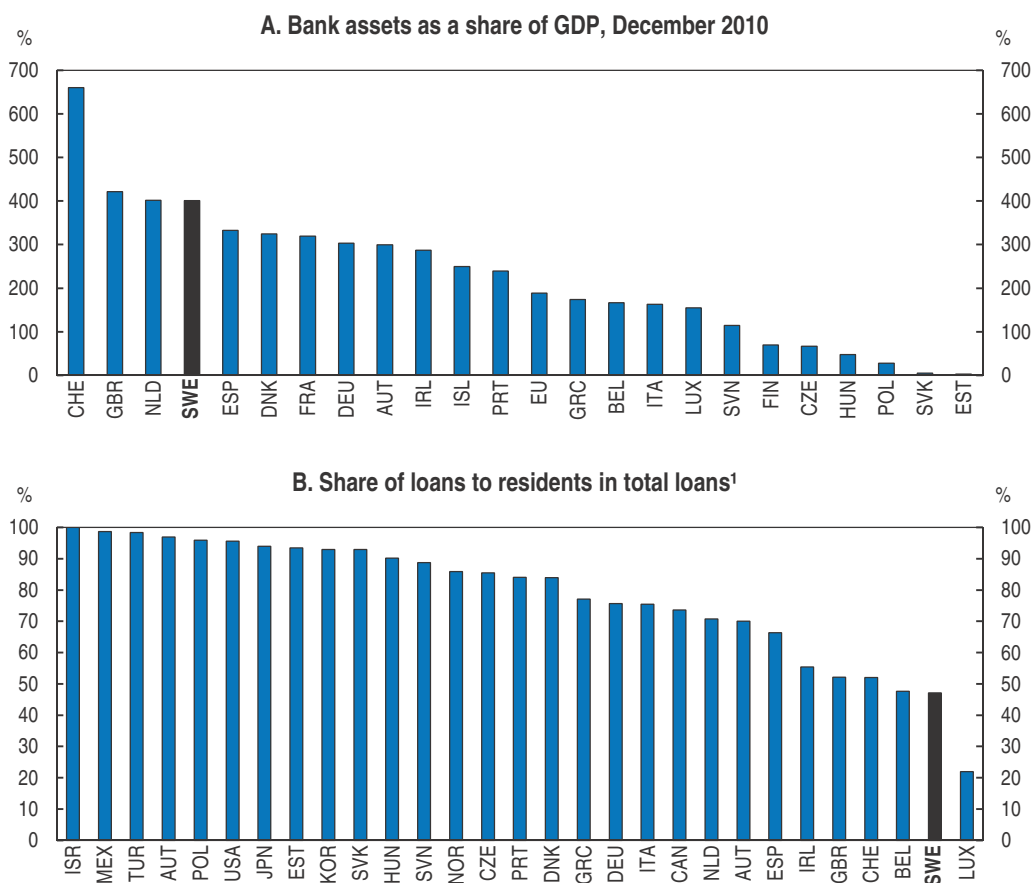
Addressing potential risks in the banking sector

Financial stability is crucial for growth to be resilient and sustainable. Indeed, financial distress affects citizens as taxpayers if government resources need to be used to bail out part of the financial system, as borrowers if lending costs increase and as workers if economic growth is weakened and lending and investment channels are disrupted. Although the Swedish financial sector was hit by the 2008 crisis, through the drying up of funding markets and higher borrowing costs as well as its exposure to the Baltics (OECD, 2011), it coped relatively well thanks to the swift reaction of the authorities, a low exposure to toxic assets and the fact that house prices held up. However, some risks remain due to the nature and structure of the banking system, domestic imbalances and the institutional set-up.

The banking system is large and concentrated


The total assets of the Swedish banking system are equivalent to four times GDP (Figure 2.10, Panel A). The implicit guarantees on bank debt reduce the funding costs for Swedish banks and might result in excessive risk taking by banks and large contingent liabilities for the government (Schich and Lindh, 2012; IMF, 2012a). The intimate links between certain banks and non-financial firms and the associated connected lending may also add to these risks, though action has been taken to limit such lending (IMF, 2011). Furthermore, the banking system is very concentrated and dominated by four major banks, which are exposed to a small number of large clients (Box 2.3). They account for three fourths of deposits and domestic lending, making them of systemic importance domestically. Moreover, they are connected through interbank deposits, making contagion a risk.

Figure 2.10. The size of the banking system



1. 2011Q4 or latest available year.

Source: The Riksbank (2012), *Financial Stability Report 2012:1*, Stockholm and IMF, *Financial Soundness Indicators*.

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Another important feature of the large Swedish banks is their regional banking hub role. Their foreign claims totalled 164% of GDP in March 2012 (BIS, 2012), and a relatively high share of lending to non-residents (Figure 2.10, Panel B). The banks' exposure to the Baltics was a major reason the authorities intervened in the financial system in the most recent crisis (Swedish National Audit Office, 2011; see also the chapter on the financial

Box 2.3. The four major banks have different business models

Handelsbanken, Nordea, SEB and Swedbank accounted for about 75% of overall deposits and lending in 2011. Nordea depends on non-deposit sources of funding more than the others and has the highest exposure outside Sweden. Swedbank has the highest share of mortgages in its lending portfolio (Table 2.2). Such differences in business models make it all the more important to monitor a range of indicators when assessing the healthiness of banks.

Table 2.2. Characteristics of the major banks, end-2011

| | Handelsbanken | Nordea | SEB | Swedbank |
|---------------------------------------|---------------|--------|------|----------|
| <i>Total assets in % of GDP</i> | 70.3 | 185.1 | 67.6 | 53.2 |
| <i>Share of total liabilities (%)</i> | | | | |
| Deposits | 29.5 | 26.5 | 36.5 | 30.2 |
| Debt securities | 46.5 | 25.1 | 25.0 | 42.1 |
| Other | 24.0 | 48.3 | 38.6 | 27.7 |
| <i>Share of total loans</i> | | | | |
| Mortgage loans | 36.5 | 36.2 | 31.6 | 53.9 |
| Other loans | 8.2 | 9.2 | 3.8 | 3.2 |
| Corporate loans | 55.3 | 54.6 | 64.6 | 42.9 |
| <i>Geographical exposure (%)</i> | | | | |
| Sweden | 71.0 | 23.3 | 67.1 | 86.3 |
| Nordics | 20.4 | 71.3 | 6.6 | 10.2 |
| Baltics | 0.0 | 2.1 | 7.5 | 2.5 |
| Others | 8.6 | 3.3 | 18.8 | 1.0 |

Source: Banks' annual reports.

system in the 2011 OECD Economic Survey). Although this exposure has since been reduced, risks remain (Riksbank, 2011b). The FSA also points to spillover risks from EU countries. One reason for the problems associated with banks' exposure to the Baltics was that regulation did not keep up with the expansion of bank activities outside Sweden. Since then, there have been many efforts to improve cross-border banking regulation. At the EU level, co-operation between home and host countries has been facilitated by the so-called supervisory colleges and the European Banking Authority has the mandate to mediate between home and host countries. However, there are as yet no fully effective international crisis management and resolution tools or institutions, creating uncertainty and potential high costs (OECD, 2012a). Hence, cross-border financial supervision co-ordination through the Nordic-Baltic Memorandum of Understanding should continue to be enhanced.

Financial supervision tools can be further strengthened

Swedish banks are well capitalised both in international comparison and compared to 2008. Since then, capital ratios have been boosted by increased profits, rights issues and a decline in corporate loans in favour of mortgages, which carry a lower risk weighting (see below). Core capital ratios in the four largest banks already range from 12% to 18% of risk-weighted assets (based on Basel II methodology), well above the Basel III minimum standards. However, overall leverage ratios for some banks imply that capitalisation is less strong although by exactly how much depends on the definition of capital that is used (Riksbank, 2012b; Blundell-Wignall and Roulet, 2012; IMF, 2012a). The authorities' decision

to implement higher capital requirements than envisaged by Basel III for the major banks in steps, in 2013 and 2015, and the forthcoming countercyclical capital requirements are welcome. However, relying solely on capital ratios, which weigh assets by risk, is not sufficient because banks can adjust their asset mix to reduce the required capital. As discussions on implementing a leverage ratio are on-going at the EU level, the authorities should consider introducing an overall leverage ratio (capital over total assets, non-risk-weighted) as a backstop to the risk-weighted capital measures.

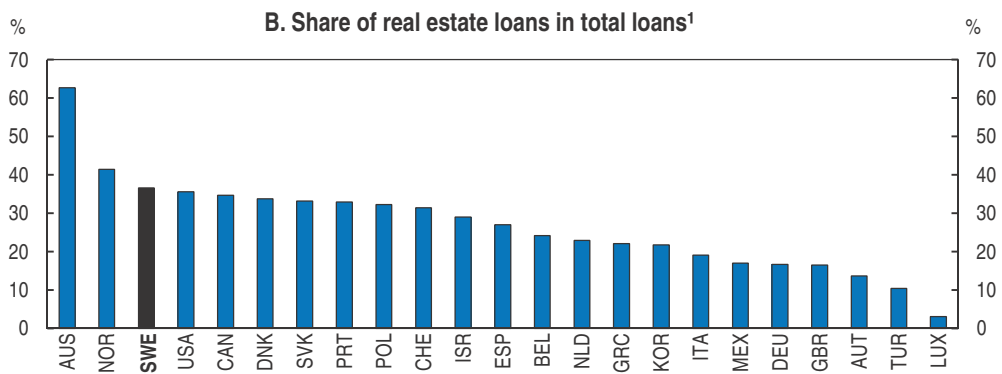
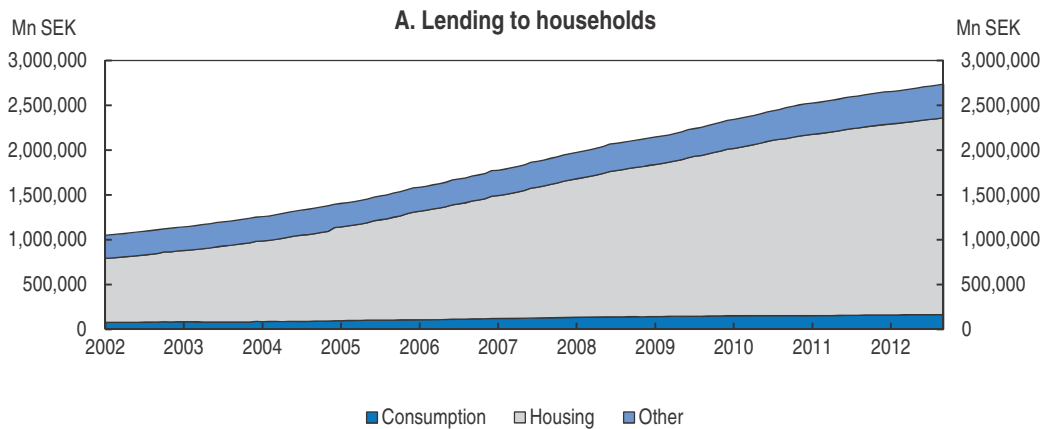
Higher capital ratios have benefits and costs. They reduce risk taking and the probability of a crisis. However, they may weaken profitability and bank competitiveness in the short run, which could be reflected in higher lending rates and lower lending volumes. In Sweden, some of the costs of the new regulations are already being passed onto bank customers as evidenced by the recent widening of the spread between the repo rate and the banks' variable mortgage rates. However, banks have also focused on increasing earnings by cutting costs and as risks decline, shareholders' expected rate of return on equity due may diminish. A recent OECD study suggests that in general the cumulative GDP loss from higher capital and liquidity requirements is probably quite small (Slovik and Cournède, 2011). In the case of Sweden, the real economy effects of higher capital requirements are estimated to be small as capital ratios are already high (Riksbank, 2011c).

Expanding the toolkit to monitor different aspects of developments in bank balance sheets is important for crisis prevention. The recent crisis has shown that relying mainly on capital adequacy can be misleading and banks with low impaired loans and high capital adequacy ratios can face problems (White, 2012). Private credit growth and leverage are considered good predictors of crises and they have risen to high levels over the past decade in Sweden, with a large share of mortgage lending (Lane and Milesi-Ferretti, 2011; Figure 2.11). Studies point to the deviation of the ratio of credit to GDP from its trend, the deviation of credit growth from its long-term average and property prices as good advance warning indicators (Drehman *et al.*, 2010; Repullo and Saurina, 2011). Thus, in the risk assessment made by banks and regulators, it is important to closely monitor private credit growth and its components. Tools similar to the ones introduced in Denmark and Norway, which set thresholds on variables that signal risks, such as lending growth, and link automatic actions to their breach, could be considered.

Historically, low residential loan losses due to the strong welfare state, double-income households and full-recourse loans that lead to higher payment incentives have resulted in among the lowest risk weights for mortgage lending used by banks in Europe (Figure 2.12). According to Basel II, banks could determine the size of their risk-weighted assets according to their internal models (Bank of International Settlements, 2005). However, the risks to loan repayment arising from high household indebtedness and LTVs are not fully reflected in those risk weights. The FSA plans to increase the capital adequacy requirement for mortgages by imposing a floor on risk weights at 15%. Higher risk weights for mortgages should be implemented as soon as feasible, together with the forthcoming EU regulations on risk weights, to increase the resilience of the financial system.

Despite a good capacity to handle loan losses, Swedish banks face larger liquidity risks than other European banks due to their reliance on market funding (Riksbank, 2011b). In May 2012, Moody's downgraded the long-term debt ratings for Nordea and Handelsbanken, partly on account of their reliance on wholesale funding. As pension funds absorb a large part of savings, the ratio of loans to deposits is high in Sweden. Swedish banks have

Figure 2.11. **Private credit growth**

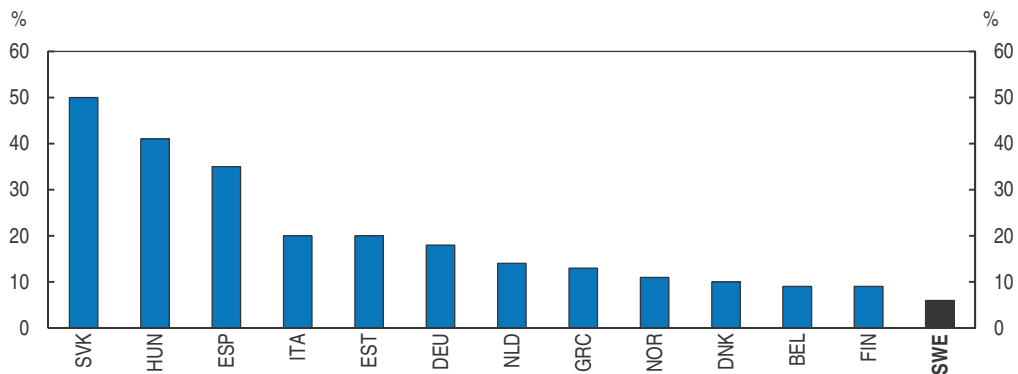


1. 2011Q4 or latest available year.

Source: The Riksbank and Statistics Sweden, *Financial Market Statistics* and International Monetary Fund, *Financial Soundness Indicators*.

StatLink <http://dx.doi.org/10.1787/888932757504>

Figure 2.12. **Risk weight of mortgages under Basel II¹**



1. Risk weights for different types of assets have been determined by banks according to their internal models, at different times, in line with Basel II rules.

Source: The Riksbank (2012), *Financial Stability Report 2012:1*, Stockholm.

StatLink <http://dx.doi.org/10.1787/888932757523>

improved their liquidity buffers since the start of the crisis by increasing their deposits with the central bank and their holdings of liquid securities. Assessing the risk and liquidity exposures of the financial system is important to limit vulnerabilities.

During the crisis, the Riksbank increased its holdings of foreign exchange reserves to provide liquidity support in foreign currencies, especially in dollars. Although swap agreements with the US Federal Reserve worked well, there is a need to have a more permanent way to deal with foreign liquidity risk. Making banks bear some of this cost by imposing liquidity requirements in foreign currency to reduce their short-term dollar funding or charging a fee for the use of the foreign exchange reserves at the Riksbank would lower this vulnerability. Hence, the forthcoming introduction of an aggregate domestic liquidity requirement similar to the Basel III liquidity coverage ratio (which ensures that banks hold sufficient high-quality liquid assets) by the FSA in January 2013 is welcome. In addition, large banks will be required to meet liquidity requirements separately in euros and US dollars. The maturity mismatch in the balance sheets, that is greater than for many other European banks, should be reduced by lengthening the maturity of market funding. Banks also need to get ready for stricter rules in the form of the net stable funding ratio, which aims at ensuring a sustainable maturity structure of assets and liabilities. In sum, the financial supervisors should continue to monitor banks' progress in reducing their dependence on wholesale funding. More transparent liquidity reporting by banks, as recommended by the Riksbank and stipulated by the new liquidity reporting framework of the FSA, will help.

The institutional set-up and crisis management tools should be enhanced

As the cost of financial crises can be very large, the quality of financial regulation and effectiveness of supervisory arrangements are essential. During the 2008 crisis, co-operation between the Riksbank, the FSA, the National Debt Office (NDO) and the Ministry of Finance worked well (OECD, 2011). However, as in many other countries, the crisis brought into focus some of the longstanding gaps in the financial stability framework. No institution had the authority to review the overall risks in the financial system and the necessary macroprudential tools. Although the Riksbank raised concerns regarding the Baltic exposures of Swedish banks, it did not have the mandate or the tools to address them. The FSA used the argument of consumer protection to introduce the LTV cap to deter consumers from taking on more debt than they can manage. But, given its lack of mandate for macroprudential regulation, it was not possible to refer to the risks of disruption to the financial system as a reason for this measure. Although the exchange of information between the four institutions worked well during the crisis, they were based on a complex set of explicit and implicit arrangements. The division of responsibilities between the NDO and the Riksbank regarding liquidity assistance were not clear. Addressing these gaps is important to enhance financial stability.

The financial supervisory framework – described in Box 2.4 – is under review. In February 2011, a Financial Crisis Committee (*Finanskriskommittén*) was set up to make recommendations on bank resolution schemes, the division of responsibilities for macroprudential regulation, liquidity support, and the financing of deposit guarantee and stabilisation funds. Its report is expected by May 2013. In the meantime, the establishment of a council for co-operation on macroprudential policy in January 2012 by the Riksbank and the FSA is welcome. The eventual macroprudential authority will need to have a clear mandate, enforcement powers, and a toolkit that is appropriate for the major risks in the Swedish financial system. It will also need to be accountable. Macroprudential policy should also pay attention to the risks that might arise from related-party lending and the non-separation of investment and commercial banking.

In general, the choice of institutional set-up will depend on the country's financial structure, regulatory architecture and historical experience. It is generally argued that

Box 2.4. Institutional set-up of financial supervision and crisis management

Crisis management involves four main institutions and is governed by a variety of explicit and implicit agreements.

- The FSA has the objective of a stable and sound financial system and of effective consumer protection within the financial system. It authorises and supervises financial institutions.
- The Riksbank has the task of promoting a safe and efficient payment system, which in practice means that it has a broad responsibility for financial stability. The Riksbank oversees the development of the financial system as a whole, provides emergency liquidity assistance, if needed, and oversees systemically important payments, clearing and settlement systems.
- The National Debt Office manages the depositor insurance and investor protection systems and co-ordinates public support to a distressed financial institution.
- The Ministry of Finance bears the political responsibility for financial stability as the fiscal authority. It is also responsible for financial sector legislation and makes the ultimate decision to provide public support to banks in trouble.

The Financial Crisis Committee shall propose measures to improve the regulatory framework so that future financial crises can be avoided by preventive measures and if needed, resolved in an efficient manner. The mandate of the Committee is to:

- analyse and draw conclusions from the handling of the recent global financial crisis, both in Sweden and abroad;
- analyse the regulation of takeover and liquidation of financial institutions;
- analyse the interaction of the Riksbank, the National Debt Office and the Financial and Government Offices (primarily the Ministry of Finance) and the ability to exchange information;
- analyse and propose improvements in the regulatory framework for interventions that apply to the FSA;
- analyse and propose improvements to the framework for the Riksbank's management of issues related to financial stability, including the provision of liquidity support; and
- investigate and propose a risk-differentiated fee stabilisation fund.

given their expertise in macroeconomic and financial analysis and their role in emergency liquidity provision, central banks should play a leading financial stability role (European Systemic Risk Board, 2012). In Sweden, the feasibility of five different models has been discussed (Berntsson and Molin, 2012). Among these, the establishment of a council with the different agencies involved is favoured by some (Swedish Fiscal Policy Council, 2011; IMF, 2012a). Such a council would add another layer to an already crowded institutional framework, and therefore would need to be designed carefully. If this option is not chosen and, instead, the responsibilities of the Riksbank in terms of financial stability are enhanced, a committee separate from the monetary policy committee should be established to maintain the credibility of both objectives, but communication channels between them should be clearly defined. If the responsibility were to mainly lie with the FSA, its resources would have to be increased further than has been the case to date and the links between its financial stability and consumer protection objectives should be clarified further.

In 2008, a Stabilisation Fund was created to finance government costs associated with providing support to financial institutions, with a target size of 2.5% of GDP on average by 2023. Setting the target size as a percentage of the total eligible liabilities of the contributing institutions, rather than GDP, would better address the risks arising from the large size of the Swedish banking system (European Commission, 2012c). An alternative could be to charge fees on an ongoing basis rather than fixing a target fund size. The financial institutions pay a special fee of 0.036% of their balance sheet total excluding equity capital and subordinated debt. Fees should be based in part on the riskiness of institutions, as judged by the supervisors. For example, the fees could be made progressive to reflect the greater risks stemming from the size and composition of balance sheets and dependence on wholesale funding. Furthermore, increasing the share prefunded by banks would limit the government's share of the fund, and thus lower the contingent liabilities of the state. An investigation is under way to assess whether the Deposit Guarantee Fund and the Stabilisation Fund should be merged and use risk-based fees. Given the highly concentrated nature of the Swedish financial system, it might be more practical to merge the two funds, but it might create confidence issues especially for depositors of small banks. A merger would also limit problems arising from the fact that the size of the deposit guarantee fund, at 2.4% of insured deposits, is relatively low compared to other countries, whose funds range from 1.25% to 5% of insured deposits (IMF, 2011).

As the authorities wait for the EU Directive and the Financial Crisis Committee decisions on resolution schemes, banking problems would be addressed via the provisions of the Government Support to Credit Institutions Act. Unlike in many other countries, banking supervisors cannot initiate bankruptcy proceedings for financial institutions (IMF and World Bank, 2009), which can create uncertainty and could cause delays. A bank resolution scheme, which ideally has special provisions for systemically important banks and is consistent with EU decisions, should be introduced as soon as is feasible.

Improving the efficiency of capital taxation

The design of capital taxation is important for efficiency and growth (OECD, 2012b). Capital taxation influences investment incentives, the allocation of savings and the degree of intergenerational mobility (Arnold *et al.*, 2011). A tax system that is neutral with respect to the type of asset avoids encouraging investment in unproductive uses. The large-scale 1991 tax reform, based on principles of uniformity (*i.e.* that economically equivalent incomes should be taxed in the same manner), brought the dual income tax system to Sweden: earned income is taxed at a progressive rate and capital income, including capital income and corporate profits, at a flat 30% rate. In the case of negative capital income, 30% of the deficit is deducted from the tax on earned income in that year. There have been many changes to the tax system since 1991, including changes to the marginal personal income tax rates, property taxes, the corporate tax rate and the value-added tax in different sectors, and the abolition of the wealth and inheritance taxes.

Sweden is one of the few countries that do not have either a wealth tax or an inheritance and gift tax. The arguments for the abolition of the wealth tax were relatively strong because taxation of wealth distorted savings and created incentives for capital flight (Sørensen, 2010; Swedish Fiscal Policy Council, 2011). The motivation for the abolition of the inheritance and gift tax were less clear, but one argument was that this tax could be an obstacle to the smooth transfer of ownership of small businesses from one generation to the next. Inheritance and gift tax revenues were primarily motivated by distributional

concerns, but generated low revenues in the post-war period, at around 0.25% of GDP, casting doubt on their effectiveness (du Rietz et al., 2012).

Capital taxation favours institutional savings and investment in owner-occupied housing, which creates distortions in the allocation of savings and may have adverse effects on long-term growth (Swedish Fiscal Policy Council, 2011). Savings are high in Sweden, mainly because the government and households accumulate considerable assets in pension funds. Housing also absorbs a large part of savings. The concentration of private savings in pensions and property make household balance sheets risky, as these are relatively illiquid assets. Furthermore, as noted above, the preference for savings in pension funds reduces the deposit base and increases the dependence of the financial system on wholesale funding. Finally, favourable tax treatment of pensions and property may have implications for wealth inequality, as top incomes have risen steeply in Sweden in the past two decades, driven mainly by realised capital gains (Box 2.5). Given the large

Box 2.5. The rise in top incomes

The share of wealth held by the top decile dropped from 90% in the early decades of the 20th century to 53% in 1980, and has increased slightly to 60% in recent years. Both the pre-1980 decline and the post-1980 rise have been due to changes in the top percentile, which has been mainly driven by realised capital gains. Not including realised capital gains underestimates the actual increase in inequality, especially the share of top incomes (Roine and Walderström, 2011). Over 1990-2008, the income share of the top percentile is 40% higher than if they are not included, suggesting that the primary driver of wealth inequality has been the increase in asset prices in the post-deregulation era. Including them leads to a Gini coefficient that is on average 20% higher since 1991 (Statistics Sweden, 2010).

Furthermore, since 1990, there have been many changes to the tax system, leading to average tax rates often lower at the very top than at income levels just below the top (Table 2.3). This partly reflects the fact that taxes on income from capital, which is a major income source at the top percentile, are relatively low compared to taxes on earnings.

Table 2.3. Distribution of income and taxes, 2009^{1, 2}

| Percentile | Total income | Final taxes | Tax rates | | | | | Final average tax rate |
|------------|--------------|-------------|----------------------|------------------|--------------------|-----------------|-------------|------------------------|
| | | | Municipal income tax | State income tax | Capital income tax | Real estate tax | Payroll tax | |
| 0-40 | 117 | 38 | 19.7 | 0 | 0.4 | 0.5 | 14.8 | 32.3 |
| 40-60 | 332 | 130 | 21.5 | 0 | 0.2 | 0.4 | 21.6 | 39.2 |
| 60-80 | 431 | 175 | 21.9 | 0 | 0.3 | 0.4 | 22.4 | 40.6 |
| 80-90 | 548 | 231 | 21.8 | 0.8 | 0.6 | 0.4 | 22.2 | 42.2 |
| 90-95 | 690 | 311 | 21.4 | 3.3 | 1.2 | 0.4 | 21.9 | 45.0 |
| 95-99 | 961 | 467 | 20.7 | 6.5 | 2.4 | 0.4 | 21.0 | 48.6 |
| 99-99.9 | 1 807 | 911 | 18.1 | 9.4 | 6.0 | 0.3 | 17.9 | 50.4 |
| 99.9-100 | 7 866 | 3 237 | 10.8 | 7.6 | 13.0 | 0.2 | 9.8 | 41.1 |

1. Total income and final taxes are in thousand SEK and tax rates in per cent. Percentile rankings based on pre-tax total income. The final tax rate is net of deductions, tax credits and fees, but includes the payroll tax. Sample: all individuals aged 20-64.

2. Taxes, such as VAT, consumption taxes and corporate taxes, not considered here may also have a distributional impact.

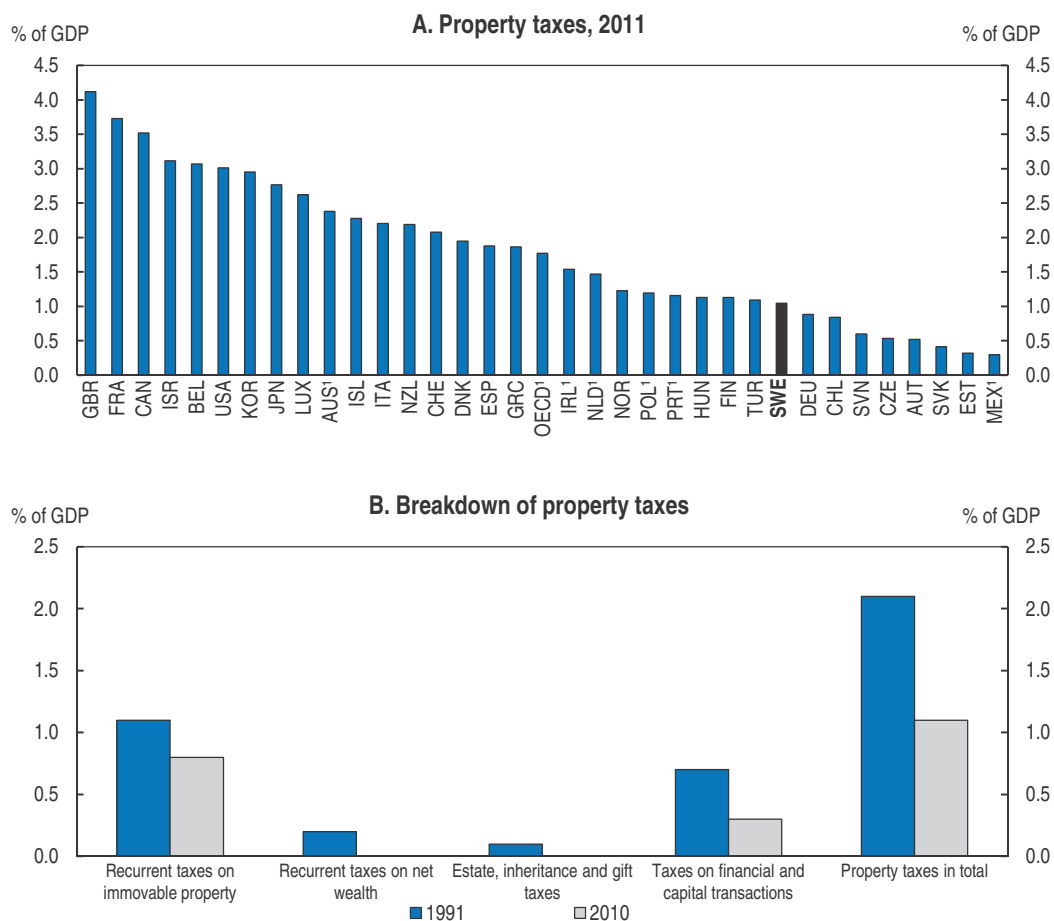
Source: Bengtsson et al. (2012).

role of capital gains in the rise in top incomes, it is important to monitor developments in wealth distribution. The abolition of the wealth tax in 2007 has eliminated an important source of data. Hence, getting other sources of wealth information, including that on pension wealth, which constitutes a large part of household wealth in Sweden, should be a priority.

Property taxation

Property taxes as a share of GDP are low in Sweden in international comparison and changes over the past two decades have resulted in a decline in their overall level (Figure 2.13). The provision of tax incentives favouring investment in owner-occupied housing, combined with a restricted supply, has contributed to the increase in house prices and household debt whose potential correction could have adverse effects on the economy (Igan and Loungani, 2012). In 2008, the central government tax on property was abolished and replaced by a municipal fee, which is index-linked and adjusted annually. In 2012, the latter amounts to SEK 6 825 per house and per year, with a cap of 0.75% of the assessed property value. For apartments, it stands at SEK 1 365, with a cap of 0.4% of the property value. This change severed the link between the tax and the market value of the property,

Figure 2.13. **Property taxation**



1. 2010.

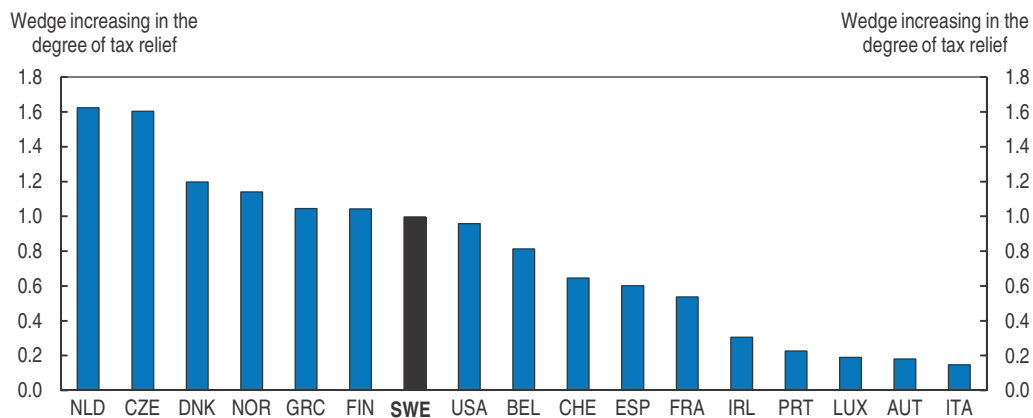
Source: OECD, Revenue Statistics.

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lowered overall recurrent taxes on immovable property and weakened municipalities' incentives to provide more land for construction. To provide some financing for this, the tax rate on realised capital gains on owner-occupied housing and apartments was raised from 20% to 22% and changes were made to the deferral of capital gains. Despite these new rules on capital gains taxation, the 2008 reform has increased the bias in favour of investing in housing relative to other assets (Sørensen, 2010). This reform was driven by a lack of public support for property taxation and increasing property taxes remains politically difficult.


Non-neutral taxation of property encourages owning rather than renting, and housing consumption rather than consumption of other goods and services (Figure 2.14). Shifting the tax structure towards property, which is immobile, would remove some of the incentives to own rather than rent. Together with strict rent regulations, tax incentives have contributed to the rise in house prices. There is some evidence that reducing tax subsidies for mortgage payments can improve the resilience to housing boom-bust cycles (Crowe *et al.*, 2011). Linking the assessment value to the market value may also increase incentives for developing land as low taxes on vacant property and undeveloped land can encourage under-utilisation of land, which may lead to a reduced supply of land for housing, especially in urban areas (Arnold *et al.*, 2011). A higher rate of recurrent taxation of the market value of residential property could also be used to reduce taxes on real estate transactions, thereby improving labour mobility.

Figure 2.14. **Gap between market interest rate and after-tax debt financing cost¹**
2009



1. This indicator takes into account if interest payments on mortgage debt are deductible from taxable income and if there are any limits on the allowed period of deduction or the deductible amount, and if tax credits for loans are available. For countries that have no tax relief on debt financing costs, this indicator takes the value of zero.

Source: Calculations based on OECD Housing Market questionnaire.

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A regime that taxes imputed rent from owner occupation, making allowance for maintenance costs, while providing a full deduction for mortgage interest costs would provide neutral property taxation. However, this may result in higher administrative and compliance costs and given the difficulty in implementing such a regime, and in particular of assessing imputed rent, such a policy is not widely used. A property tax can be thought of as a substitute, if it is assumed that the value of the property, the tax base, is proportional to the flow of imputed rent. Alternatively, abolishing mortgage interest relief

would improve the uniformity of the tax system, although it would be second best. Given the lack of public support, any change to property taxation would best be made gradually.

Shifting the tax mix from personal and corporate income taxes towards recurrent taxes on immovable property should raise economic growth. However, there could be a trade-off with the income distribution objective since personal income taxes are progressive while real estate taxes in place in OECD countries often absorb a larger share of the income of poorer households (OECD, 2012c). Targeted transfers, however, can reduce the severity of this trade-off. The cutting back of tax expenditures that mainly benefit high-income groups, such as tax relief on mortgage interest, and regular updating of property valuation would strengthen the progressivity of taxation (Arnold *et al.*, 2011; OECD, 2012d). To ease the increase in real estate taxation, special arrangements could be made to reduce the liquidity constraints that the tax may imply for those with low incomes and illiquid assets. The 2007 OECD *Economic Survey* offered recommendations on alternative mortgage tools to address these types of households, who are mostly pensioner homeowners.

Financial capital taxation

The taxation of capital income favours institutional savings: the tax rate on imputed returns on institutional financial savings (managed by pension funds and life insurance companies) is 15%, as against the 30% on the return to other financial savings. While there is dispersion in the tax rates of different types of savings, Sweden is among the few OECD countries that tax both pension scheme benefits and pension fund earnings. The imputed rate of return is applied on the value of the net assets held by pension funds and life insurance companies at the start of the year and is the average nominal interest rate on long-term government bonds in the previous year. The lower tax rate tends to distort portfolios towards institutional savings, with potential negative impacts on investment. Furthermore, the contributions to pension schemes mandated by collective bargaining agreements are exempt from ordinary social security tax and are subject to a reduced wage income tax, lowering the effective tax rate on pension savings for high-income earners. Finally, pensions are taxable, while contributions to pension schemes are deductible, lowering the effective tax rate on the return to pension savings to the extent that the marginal income tax at the time of contribution is higher than the marginal tax rate when the pensions are received.

Favourable tax treatment of pensions may be motivated by an objective to increase total savings for the whole population or to provide incentives for those who would not have saved at all for retirement. The pension system rests on three pillars: public pensions, mandatory occupational pensions and individual private pensions. The public pension system is a so-called notional defined contributions system that has an automatic link between benefits and demographic and economic developments to ensure the system remains balanced. However, this system may also lead to a substantial fall in pension incomes. Occupational pension plans, based on collective agreements between the unions and employer confederations and covering 90% of employees, have been expanding, fuelling the accumulation of assets by households.

For the tax system to promote overall household savings, a low uniform tax rate on all forms of private savings is the best solution. However, total savings are not low in Sweden and tax subsidies to institutional savings may only reallocate savings rather than increasing the overall savings level (Bergstörn *et al.*, 2010). By removing these tax subsidies, it would be possible to lower the tax rate on other financial savings. This would

boost total tax revenue without reducing the average after-tax return of aggregate financial savings (Sørensen, 2010). It could be argued that favourable taxation of pension saving helps to address the lower replacement ratio from public pensions for above-average wage earners due to the income ceiling in the public system. However, the mandatory nature of contributions to these private pensions is the best way to serve this objective and contribution rates could be changed if pension saving appears to be insufficient.

The reform of the pension system starting in 1994, which included the conversion from a defined benefit to a notional defined contribution system and an increase in the role of occupational pensions, might have favoured high and stable income earners. Occupational pensions are more important for high-income earners since they not only provide a pension as supplement to the public system, but also pension compensation for incomes above the public system pension ceiling earners (Palmer and Wadensjö, 2004). Evidence that better-off households benefit more from the design of the pension system, without saving more overall, suggests that tax incentives for institutional savings could lead to distortions (Bergström *et al.*, 2010). A more extensive investigation of which people participate in the tax-favoured pension scheme and the impact of the taxation of institutional savings on their total saving would be useful.

Revising the taxation of assets to make the tax system simpler and more neutral and transparent would improve the allocation of saving and investment. Since the main distortion comes from the reduced tax rate on the imputed rate of returns on institutional savings, one option to make taxation of financial savings uniform is to reduce the gap between the tax rate on pension savings and that on other financial assets.

The Budget Bill for 2013 includes a reduction in corporate taxes from 26.3% to 22% starting in January 2013, bringing it below the OECD average of 25.5%. Corporate income taxes affect investment and growth. A cut in the corporate tax especially benefits productivity growth of the most innovative firms. Furthermore, relying less on corporate income taxes relative to personal income taxes, taxes on consumption and recurrent taxes on residential property could increase efficiency. However, as the corporate tax rate is well below the top personal income tax rates, it might lead to tax evasion by high-income individuals who will attempt to shelter their savings within corporations (Arnold *et al.*, 2011). In Sweden, there is some evidence of income shifting from labour to capital due to the difference in marginal tax rates on capital and labour income, especially by high-income individuals, contributing to after-tax inequality (Alstadsæter and Jacob, 2012). Thus, the effects of the new tax reform on all tax bases should be evaluated to see if it exacerbates the problem of income shifting.

Conclusions

Despite a strong macroeconomic and financial performance over the past two decades, Sweden faces vulnerabilities going forward. Box 2.6 sets out this chapter's main recommendations to ensure growth remains sustainable and resilient. As a small open economy, highly exposed to international turbulence, Sweden should continue to carefully monitor potential internal imbalances, notably with respect to household indebtedness and house prices. Tackling the structural problems in the housing market and altering the tax system to improve the allocation of savings would lead to a more efficient housing market and help guard against imbalances that may impede future growth. Monitoring household indebtedness and enhancing financial stability to improve the resilience of the

banking system would help limit the economic, fiscal and social costs that could arise in the event of external or internal shocks. These reforms would not only address short-run risks, but also contribute to providing a sound framework to make sure growth remains sustainable in the long run.

Box 2.6. Key recommendations on housing, financial stability and capital taxation policies

The housing market and household indebtedness

- Phase out the restrictions on apartment rentals, including on buying an apartment to rent it out. Continue to phase out rent controls so as to more closely align rents with market values.
- To reduce supply rigidities in the housing market, streamline building requirements across municipalities and ease the process of setting up co-operatives. Enhance the access of small and foreign firms to the public procurement process by improving its timeliness, predictability and clarity.
- Monitor closely the effects of the loan-to-value cap and the characteristics of households that use variable-rate and non-amortised loans. Introduce binding measures to ensure sound underwriting practices for non-amortised and variable-rate loans.

Financial stability

- Consider introducing a leverage ratio as a backstop to the risk-weighted capital measures. Continue to closely monitor banks' progress in reducing their wholesale funding dependence and further improve their liquidity reporting framework.
- Address gaps in the macroprudential toolkit to supervise and influence financial institutions. Clarify the role of and relationship between the Riksbank, the Financial Supervisory Authority, the National Debt Office and the Ministry of Finance.
- Change the Stabilisation Fund to target a size that reflects that of the banking system and a fee structure based on risks.
- Introduce a transparent bank resolution scheme as soon as is feasible, consistent with European Union developments.

Capital taxation

- Move towards more neutral taxation across types of assets. In particular, to tax owner-occupied housing like other assets, a tax on imputed-rent would be first best. A property tax based on market value could proxy imputed-rent taxation. Alternatively, abolish mortgage interest deductibility.
- Evaluate further which people benefit most from the lower tax rate on institutional savings and how the taxation of institutional savings affects their total saving. Consider reducing the gap between the tax rate on pension savings and that on other financial assets.

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