

for wage drift being lower than it has been in the past.

There are grounds for wage drift being lower than it has been in the past.

At the same time, firms seem to be having some difficulty in obtaining labour with the appropriate qualifications. Survey data from the National Institute of Economic Research show shortages of salaried technicians in manufacturing and of personnel with the requisite competence in business and computer services. A high degree of flexibility in wage formation is needed to prevent the expected wage drift in these sectors from spreading throughout the labour market.

The overall annual rate of wage increases in the period 1998–2000 is expected to be between 3.5 and 4 per cent (Annex: Table 1).

One of the central components of efficient wage formation—low inflation expectations—seems to be established. It is conceivable, however, that the stability-oriented policy needs to be supplemented with reforms in wage formation in order to achieve an appreciable and lasting improvement in employment.

Productivity growth in recent years has been good; in 1997 the increase in total labour productivity was as high as 2.8 per cent (Annex: Fig. 28). A reasonable assessment is that the increasingly long period with good productivity growth stems from more permanent improvements in productivity as a result of structural changes in Sweden's economy in recent years. In the forecast period, moreover, productivity will benefit from the upswing in investment and rising economic activity. All in all, productivity growth and hence the development of unit labour costs are judged to be more favourable than assumed in the March report. The assessment of productivity does, however, contain a large element of uncertainty (see "Uncertainties in the inflation assessment" on p. 33).

To sum up, the annual wage rise in the period 1998–2000 is expected to be between 3.5 and 4 per cent. For 1999 and 2000 the wage increases are judged to be somewhat lower than envisaged earlier. Together with the prospect of higher productivity, this implies that unit labour costs are likely to be lower than expected in the March report.

19 A rule whereby, if the negotiating parties fail to agree on the allocation of local wage settlements, all employees receive the same percentage amount.

UNDERLYING GROWTH

In economics, the concept of growth generally differs from its conventional meaning in public debate. Growth theory in economics refers to the economy's long-term or underlying productive capacity, which is determined by such fundamental structural factors as technology and the growth and skills of the labour force. The focus is thus on trend GDP, which represents the long-term supply, rather than on cyclical fluctuations, which tend to be caused by short-run shifts in demand.

A typical issue in growth theory is why, over a period of decades, some economies tend to grow more rapidly and steadily than others. In public debate, on the other hand, growth often denotes the change in

GDP from one year to the next; this is highly susceptible to occasional demand-driven fluctuations and does not necessarily have any immediate connection with the economy's underlying production capacity. The discussion here concerns the former, long-term notion of growth.

Economic research has identified a number of factors that affect economic growth. It has been found, for example, that a large fund of knowledge in the labour force is associated with higher growth and that growth tends to be lower in countries that are politically unstable or have inefficient markets.²⁰ But the forces behind the growth process are still very incompletely under-

stood. There is still no agreement, for instance, about which factors were most important for the slackening of growth that was observed in most industrialised countries in the early 1970s.²¹

The lack of detailed insights into the growth process makes it difficult to arrive at exact estimates of a country's underlying growth potential. But historic domestic growth, as well as historic and expected growth in other countries, does provide some guidance as to the growth potential by serving as rough standards for comparison.

The average annual growth rate for the Swedish economy since 1950 is 2.7 per cent. This figure is backed up by an initial period of high growth (an average annual GDP growth rate of almost 4 per cent for 1950–69). For the period since 1970 the average annual rate is 1.9 per cent and for the last twenty years it is about 1.5 per cent.

Growth also slackened in most other western economies in the early 1970s but the trend in Sweden in recent decades does seem to have been notably weak (Fig. B2). For the period 1970–97, annual growth averaged 2.6 per cent in the EU area as against 1.9 per cent in Sweden. In the United States annual growth averaged 2.7 per cent and in the total OECD area 2.8 per cent. This suggests that in the past three decades the Swedish economy's growth potential has been lower

than that of most other countries, an impression that is supported by Sweden's decline in the "prosperity league".²² It should be added that even in the period of overheating in the late 1980s, Sweden's GDP growth did not exceed the EU average.

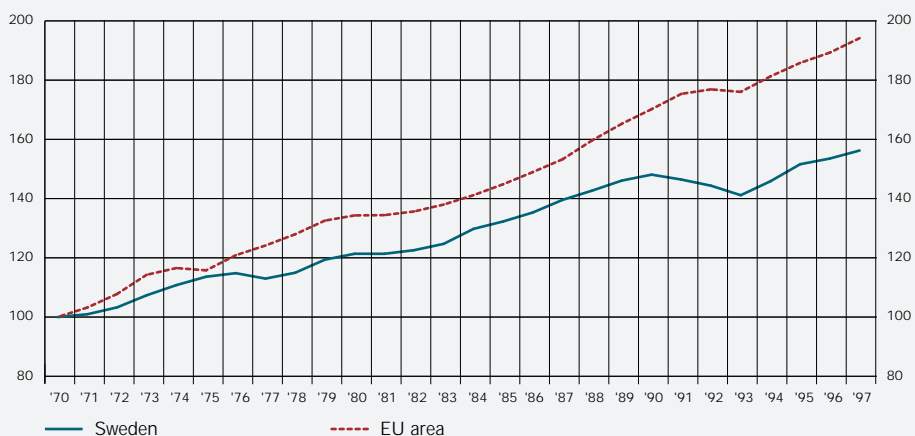
Economic growth in Sweden has thus been modest in recent decades, in both a historical and an international perspective. In recent years, however, there have been a number of structural reforms, for instance the tax reform, EU membership and the change-over to low inflation. An explicit purpose behind many of these changes has been to improve the workings of Sweden's economy in various respects. Even if the problems remain, it is not unreasonable to expect that in future the Swedish economy will be capable of higher growth

20 See, for example, Mankiw, N. (1995), "The Growth of Nations," *Brookings Papers on Economic Activity*.

21 The explanations that have been put forward (see, for example, *Drivkrafter för produktivitet och välbästand* ('Forces for productivity and prosperity'), *Official Swedish Government Report, SOU 1991:82*) include: (i) oil price hikes and cost crises in the 1970s entailed a massive elimination of production capacity and thereby a sharp fall in productivity, (ii) the fading way of growth-promoting factors that had contributed to exceptionally high growth in the 1950s and '60s, (iii) distortionary tax systems and regulations, and (iv) short-term corporate managements and outdated labour organisations. Studies differ as to which of these (or other) factors are most important and there is no consensus.

22 A more detailed account of Sweden's growth problems is to be found, for example, in Lindbeck, A. (1997), *The Swedish Experiment*, SNS Förlag.

Figure B2.
GDP growth in Sweden
and EU area.
Index: 1970=100



Sources: Statistics Sweden and OECD.

than in the past two decades; an underlying growth potential of over 2 per cent does not seem improbable.²³ At the same time, it should be underscored that assumptions about the future growth potential are bound to be uncertain. The fact, for example, that inflation has been low in recent years even though average GDP growth has been comparatively high by historical standards is not necessarily a sign of a higher potential output; it could be that after the recession in the early 1990s, output has been below the long-term potential for a longer period—with plenty of surplus capacity, demand and thereby production can grow more rapidly without generating inflationary pressure.

Despite the great uncertainty involved in estimating an economy's potential growth rate, the fact remains that, all else equal, a long period of actual growth that is higher/lower than the potential rate will sooner or later lead to a continuous increase/decrease in inflationary pressure. In the former case, resources are overutilised to a growing extent, in the latter there is an

accumulation of surplus capacity. Inflation is then liable to be above/below the targeted rate and monetary measures will be called for. Monetary policy with an inflation target can be said to aim for a rate of economic growth that matches the underlying production capacity. While knowledge about the Swedish economy's potential output is very incomplete at present, it will grow as insights are gained into how the economy is functioning after the structural reforms in recent years.

23 For comparison it can be noted that in the period 1980–89, which ended with a phase of overheating, annual GDP growth in Sweden averaged 2 per cent. Among international studies of potential growth it can be mentioned that Barrell, R. & Sefton, J. (1995), "Output Gaps. Some Evidence from the UK, France and Germany," *National Institute Economic Review*, 1, presents potential growth estimates of 2.0–2.1 per cent for the United Kingdom, 2.5–2.6 per cent for France and 2.3–2.6 per cent for Germany, while De Masi, R.R. (1997), "IMF Estimates of Potential Output: Theory and Practice," *Staff Studies for the World Economic Outlook*, IMF, estimates a potential growth rate of between 2 and 2.5 per cent for the G7 countries.

CAPACITY UTILISATION IS HIGH IN SOME SECTORS

The statistics on capacity utilisation differ somewhat about recent tendencies. Industrial capacity utilisation as measured by Statistics Sweden was 88.0 per cent in the fourth quarter of 1997; this was 1 percentage point higher than in the previous quarter and around 2 percentage points below the highest figure in this series, which goes back to 1980. According to the business tendency survey from the National Institute, on the other hand, capacity utilisation in March this year was 1 percentage point lower than a quarter earlier; however, the level is relatively high (Annex: Fig. 30).

The business tendency survey also shows that in manufacturing, machinery and plant capacity is the primary obstacle to increased production for more than one firm in four. The predicted increase in investment should help to mitigate this. Labour supply does not appear to be a general problem in

manufacturing; only 4 per cent of the sector report it as the primary constraint. However, as much as 33 per cent of the sector report a shortage of salaried technicians, which is the same proportion as in 1995 but still below the high of 40 per cent from 1985. In other parts of the business sector the March survey indicates high capacity utilisation and a shortage of personnel with the requisite competence in certain areas, for example business services, computer services and computer consultancy.

Machinery and plant capacity is the primary obstacle to increased production for more than one manufacturing firm in four.

The strong GDP growth in the fourth quarter of 1997 leaves its mark in the econometric estimates of the output gap. In the various approaches, the output gap estimates range from 1 to –1.5 per cent (Annex: Fig. 29). The time profile during 1997 was very special in that seasonally-adjusted GDP growth in the