

The Swedish Experience of Fiscal Reform Lessons for Portugal

**Towards a comprehensive reform of public governance
Conference and workshop**

Organized by

*Banco de Portugal, Calouste Gulbenkian Foundation and Portuguese Public Finance Council
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Two challenges for stabilization policy

1. A challenge for monetary policy:

Inflation bias – “too high” inflation in the long run.

2. A challenge for fiscal policy:

Deficit bias - too high deficits and thus unsustainable public finances in the long run.

Both challenges are part of a political economy problem. How do you design proper institutions for policy-making in democratic societies?

Stabilisation policy innovations I:

Monetary policy

- Inflation targeting – IT (independent central banks with explicit inflation targets/price stabilisation).
- "Non-political" governance by independent experts – a new market for professors and doctors in economics.
- About 30 central banks build their strategy on inflation targeting.
- The basic idea: reduce the inflation bias.

Stabilisation policy innovations II:

Fiscal policy

- Fiscal policy councils – independent, "non-political" councils (or bodies or authorities) run by experts with the objective to monitor fiscal policy.
- The EU, IMF and OECD require or recommend fiscal policy councils.
- About 15 countries have established some form of fiscal policy councils.
- The basic idea: reduce the deficit bias.

Independent fiscal institutions as of 2012

- Austria – Government Debt Committee
- Australia – Parliamentary Budget Officer (PBO)
- Belgium – High Council of Finance
- Canada – Parliamentary Budget Officer (PBO)
- Denmark – Economic Council
- Ireland – Fiscal Advisory Council
- Korea – National Assembly Budget Office (NABO)
- Mexico – Centro de Estudios de las Finanzas Públicas (CEFP)
- The Netherlands – Bureau for Economic Policy Analysis (CPB)
- Portugal – Council on Public Finances (CPF)
- Slovak Republic – Council for Budget Responsibility
- Slovenia – Fiscal Council
- Sweden – Fiscal Policy Council (FPC)
- United Kingdom – Office for Budget Responsibility (OBR)
- United States – Congressional Budget Office (CBO)

Source: OECD. Finland and France should be added soon.

What is a fiscal policy council?

There are many types of fiscal councils: they differ according to size, activities and influence.

The basic mandate/idea: to be an independent public body (run by experts) that monitors fiscal policy and serves as a fiscal “watch-dog”.

Democracy vs. experts

Fiscal policy will ***not*** be managed by non-political experts in the same way as monetary policy.

Fiscal policy, to a great extent, involves issues of distribution and fairness/justice.

Democracy vs. experts

A fiscal policy council is a method to strengthen the workings of a democratic society.

It contributes to public discussion by publishing regularly a balanced analysis of the long run effects of the fiscal policies pursued by the government.

It represents an informed and new voice in public debate.

Can a fiscal framework (including a fiscal policy council) make a difference?

Let us look at Portugal and Sweden:

- Sweden has had a fiscal framework since the mid-1990s.
- Portugal has not had such a framework.

Portugal and Sweden

A comparison

Similarities:

- Portugal and Sweden are small open economies.
- About 10 million inhabitants.
- Export shares (40-50 per cent).
- Once members of EFTA and now of the EU.
- Placed in the periphery of the EU.

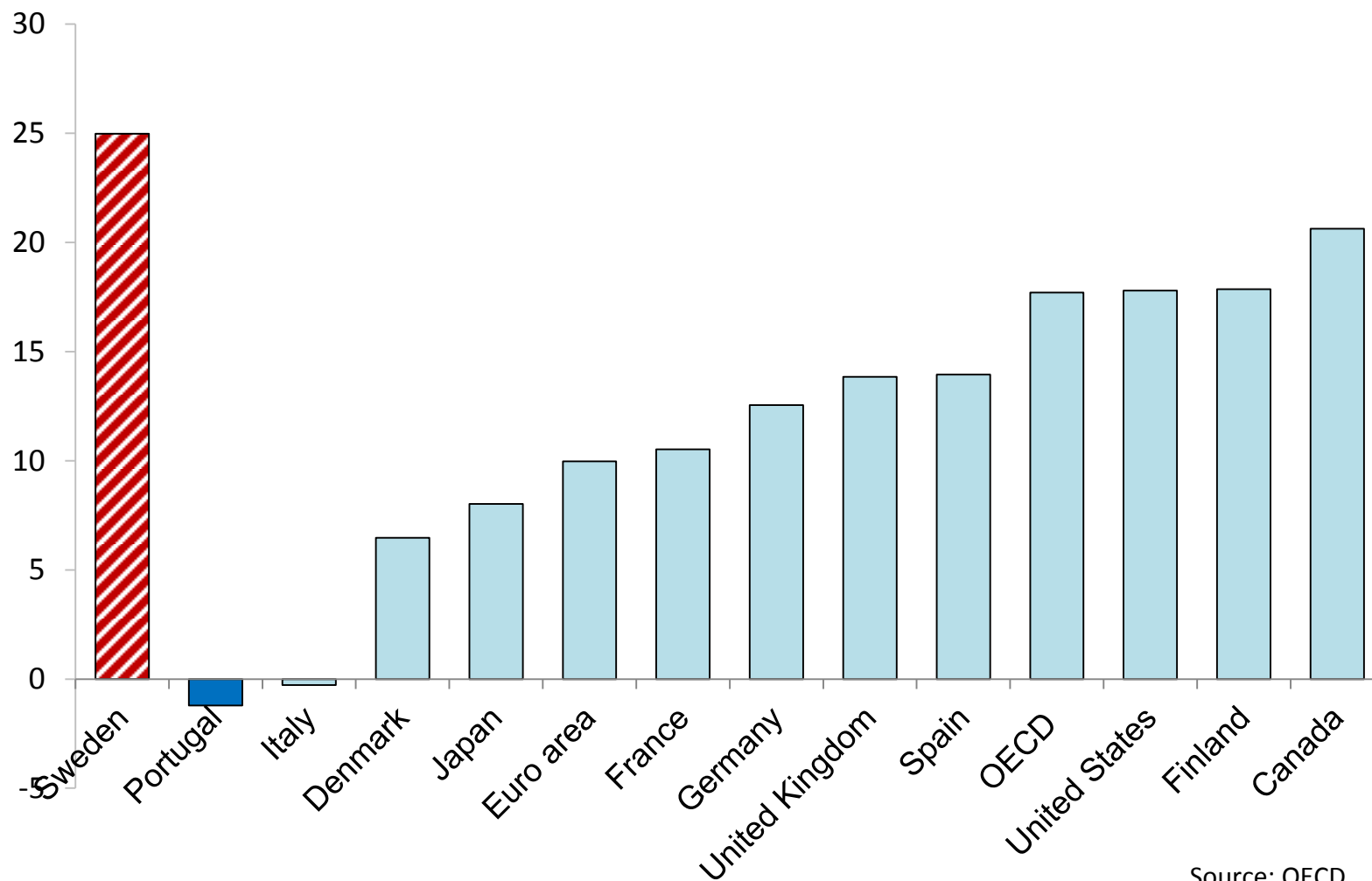
Key macroeconomic indicators

Portugal and Sweden 2012

	Portugal	Sweden
Population (millions)	10.7	9.5
GDP (millions euro)	166.3	411.0
GDP per capita (thousand euro)	15.6	43.2
GDP growth 2000-2012 (average annual %)	2.7	4.4
GDP growth 2008-2012 (average annual %)	-0.3	4.6
Inflation rate 2000-2012 (average annual %)	2.6	1.8
Inflation rate 2008-2012 (average annual %)	1.9	1.9
Nominal long-term interest rates on government debt (%)	11.4	1.6
Unemployment (%)	15.5	7.5
Exports of goods and services (% of GDP)	38.6	48.9
Current account balance (% of GDP)	-3.0	6.4
Government consolidated gross debt (% of GDP)	119.1	37.4
Government net lending/borrowing (% of GDP)	-5.0	-0.2
Government revenue (% of GDP)	41.7	51.4
Government expenditure (% of GDP)	46.7	51.6

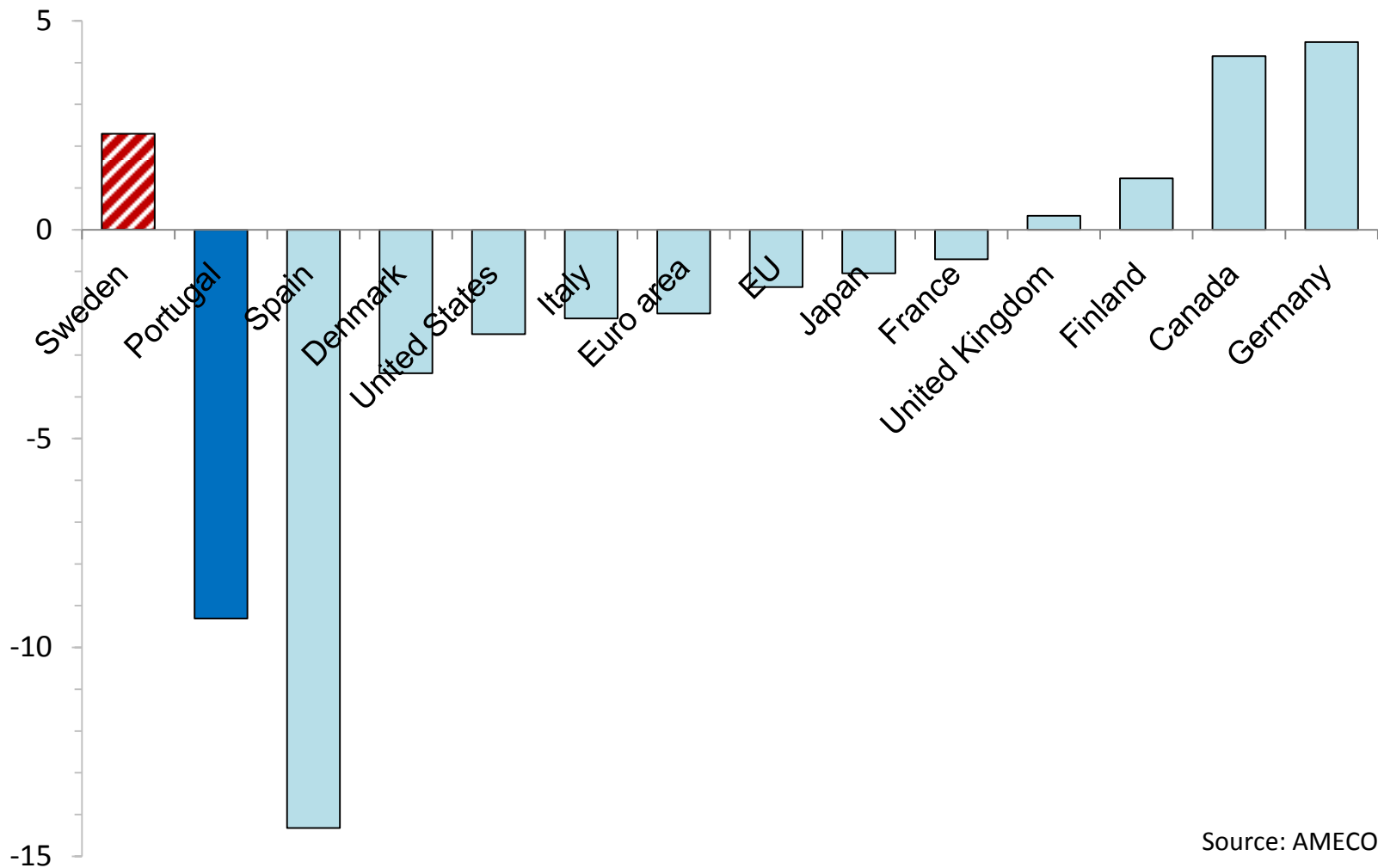
Source: AMECO and OECD

Total real GDP growth (%) 2002-2012



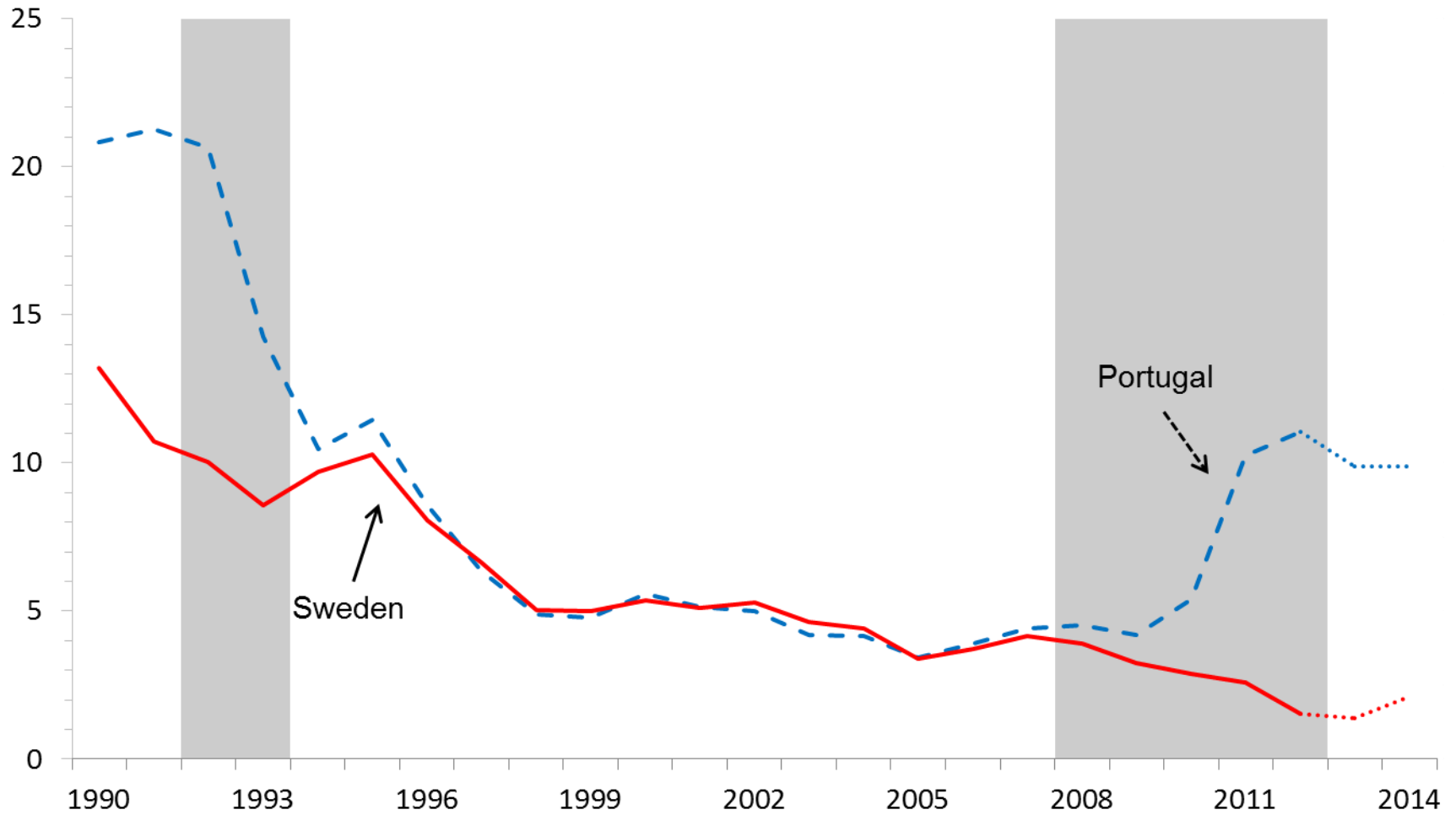
Source: OECD

Employment growth (%) 2007-2012



Source: AMECO

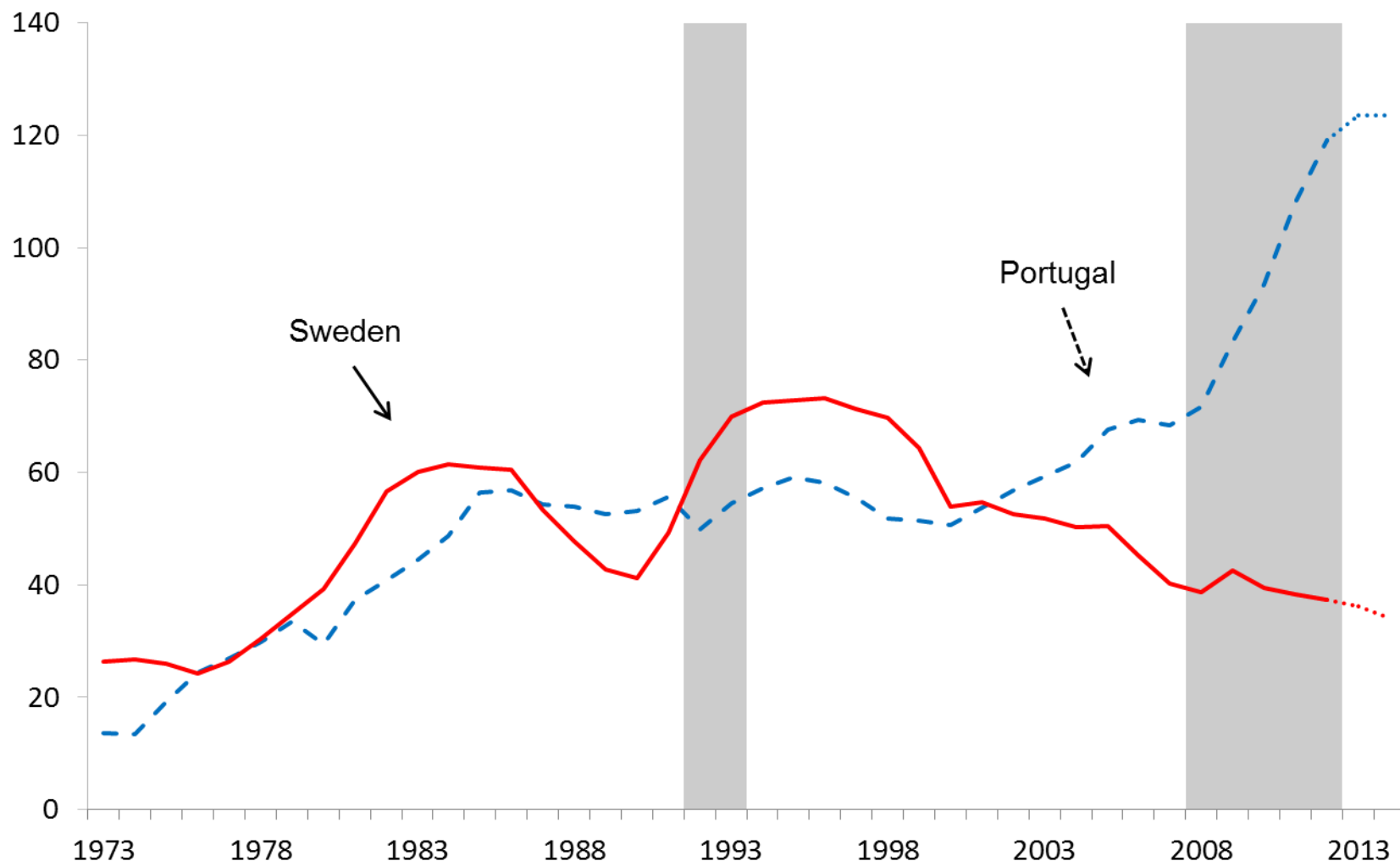
Long-term interest rate on government bonds (annual %)



Source: OECD

■ Crisis years - - - Portugal — Sweden

Government gross debt (% of GDP)

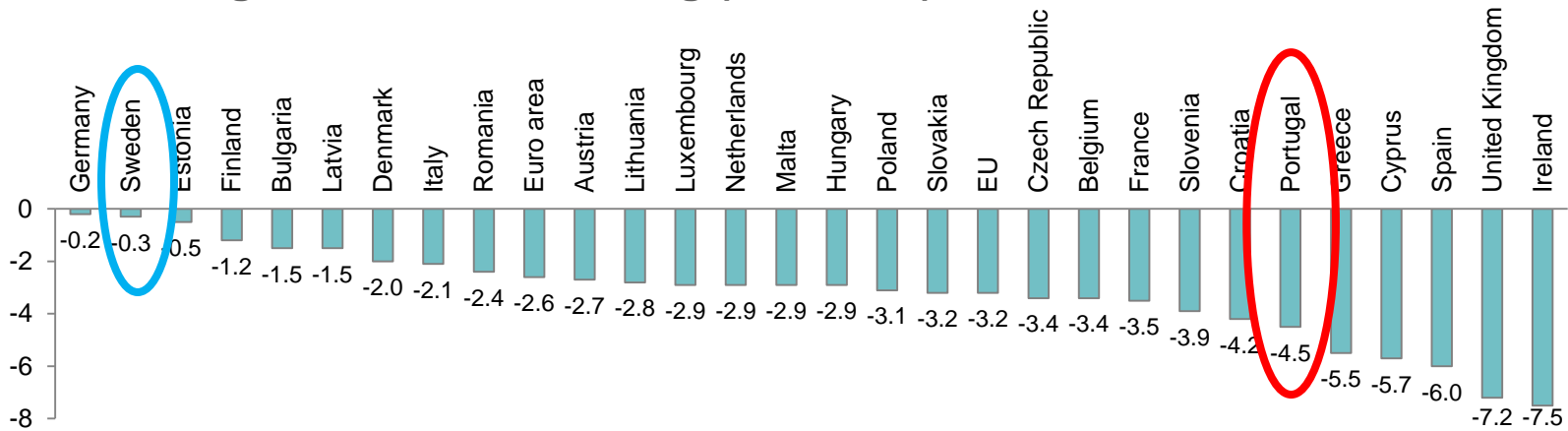


Source: AMECO

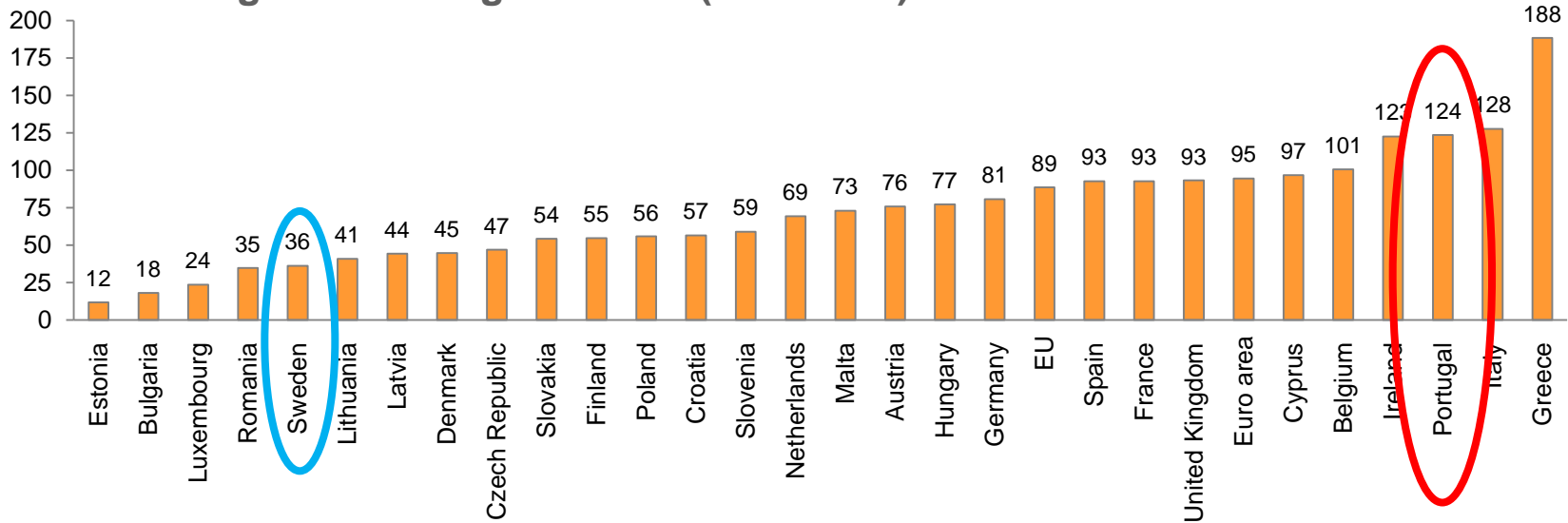
■ Crisis years - - Portugal — Sweden

Public finances 2013

General government net lending (% of GDP)



General government gross debt (% of GDP)



Portugal and Sweden

A comparison

Differences:

- Sweden has had a higher growth rate and stronger public finances during the recent global crisis.

“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.”

(OECD, December 2012)

Portugal and Sweden

A comparison

Stronger government finances in Sweden:

What is the role of the fiscal framework?

The evolution of the Swedish fiscal framework

1995-2007

Since 1995: *Top-down approach* for the central government budget.

Since 2000: *Surplus target* – Public finances are required to show a surplus of 1 per cent over the course of a business cycle, for the whole public sector. A buffer for economic fluctuations and demographic changes.

Since 1997: *Central government expenditure ceiling* set in nominal terms (for the third year ahead in the Budget Bill, with a budget margin acting as a buffer).

Since 2000: *Balanced budget requirement for local governments* (since 2000).

Since 2007: *A fiscal policy council*.

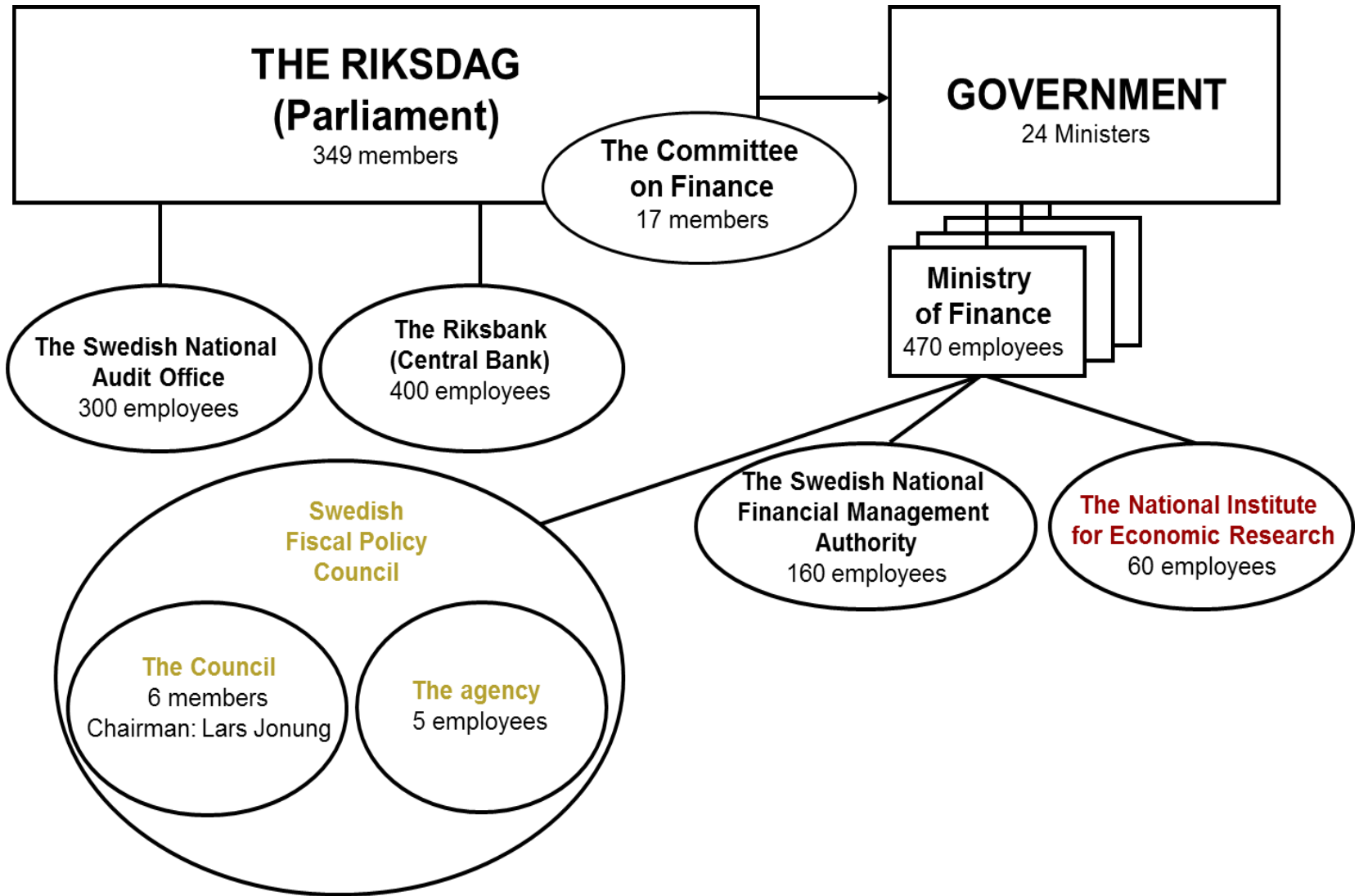
The council's background

- A government Commission in 2002 on the role of fiscal policy in the event of Swedish euro membership discussed a fiscal policy council.
- Positive reactions from the liberal-conservative parties that came to power in 2006.
- The Swedish council was set up in 2007.
- Negative reactions initially from the Social Democrats, the Left and the Greens:
 - ”another body providing false scientific clothing for the government’s right-wing policy”
- A new instruction for the council in 2011 supported by the Social Democrats, the Left and the Greens. The council is now well entrenched in the Swedish political system.

The set-up of the council

- Established in 2007
- An agency under the government
- Six members – one from outside Sweden
 - academics
 - policy making experience
- Supplementary activities to ordinary jobs (mostly academic positions)
- Small secretariat: four-five persons
- Annual budget 900 000 €
- Independence: no informal contacts with the government

The Swedish Fiscal Policy Council



The remit of the Fiscal Policy Council

1. Evaluate whether fiscal policy meets its objectives:
 - long-run sustainability
 - surplus target
 - the expenditure ceiling
 - stabilisation issues
 2. Evaluate whether developments are in line with “healthy” sustainable growth and sustainable high employment
 3. Monitor the transparency of the government budget proposals and the motivations for various policy measures.
 4. Analyze the effects of fiscal policy on the ***distribution of welfare***.
 5. Contribute to a better economic policy discussion in general.
- Annual report in May (this year May 14, 2013). The report is used by the *Riksdag* (the Swedish Parliament) and the Riksdag Committee on Finance as a basis for evaluating government policy.
 - More information on www.finanspolitiskaradet.se

Evaluations by the Council 2007-2012

- Increase the clarity of the surplus target: net lending of one per cent of GDP over a business cycle
 - underlying fundamental objectives
 - too many indicators
- Criticism of circumventions of the expenditure ceiling
- Critical evaluation of fiscal sustainability calculations
- Request for additional discretionary fiscal stimulus in the current recession (but less of permanent measures)
- Critical evaluation of the government's labour market reforms
- Critique of the economic reporting of the government

The independence of the Council

1. Members are independent from the Government
2. The Council recruits itself
3. Swedish tradition of open public debate
4. Swedish tradition of strong position for economists and the economics profession

The Council has to produce professional reports to build and maintain its credibility

The impact of the fiscal framework and the council

- Difficult to empirically estimate the effects of fiscal frameworks including fiscal policy councils. In which direction does the causality run?
- The fiscal framework has been part of the fiscal consolidation process since the mid-1990s. It is an outcome of the crisis of the early 1990s.
- A dialogue: The government responds in the budget of September on the report of the Council from May the same year.
- The Swedish council has established a solid credibility and is supported by almost all the political parties.
- A new innovation – time will tell which role the fiscal policy council will play.

Lessons for Portugal from Sweden

The Swedish evidence:

1. A country gets a fiscal policy after a severe fiscal shock. The task of the council will then be to keep the memory of this fiscal shock alive in the policy debate and in the policy framing. It serves as a vaccination against future deficit financing.

Thus, we should not expect a fiscal policy council to be effective until after a major episode of fiscal profligacy.

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

The effectiveness of a fiscal council depends on several factors:

2. The task of a fiscal council is facilitated by the existence of a fiscal framework. The council uses such a framework as a benchmark for its analysis and recommendations concerning fiscal policy.

Without a fiscal framework, a council will face a much more difficult mandate. It would be forced to decide on a proper a fiscal framework to use by itself when judging the performance of the government. Whatever it chooses, it will be open for criticism and counter-arguments. It is like a court first setting the rules and then sentencing after these rules.

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

3. The independence of a fiscal council is supported by the council being at a distance from the government.

Independence is promoted by not being directly involved in policy-making, for example by supplying the ministry of finance with forecasts or other recommendations. It should only provide ex post analysis of the government's economic policies.

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

4. Independence is fostered by recruiting a majority of the members of the council from academia, preferable also non-domestic members.

Members could also be taken from policy-makers who have left active engagement and are expected to have no career plans in the political system.

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

5. Consensus in society about a council is facilitated by a strong position of the economics profession in public discourse.

The council will then be recruiting members who by themselves have a respected background.

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

6. A fiscal council can be a strong voice in the public debate, serving as an educator of the public and the political system on fiscal policy, if the existence of a council is supported across party-lines.

A council that is viewed as partisan will find it hard to gain credibility.

A consensus society serves as a better background for a council than a country deeply divided across political party lines.

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

7. The impact of a fiscal policy council depends on the *economic policy culture* or traditions of governance of a country.

If a country has a culture where the public holds a strong trust in public institutions, in government effectiveness and honesty, in the accountability of elected politicians, in the democratic process and in the rule of law, such an environment probably makes a fiscal council more effective.

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

7. (contd.)

Public trust in the government, in the parliament and in the political system differs across countries, reflecting different history and traditions.

See the most recent Eurobarometer (fall of 2012).

See cross-country differences in a set of indicators of governance performance.

Public opinion in Portugal and Sweden on the political system, Fall 2012

<i>Per cent of respondents</i>	Portugal		Sweden	
	Tend to trust	Tend not to trust	Tend to trust	Tend not to trust
Political parties	17	79	35	61
The Government	22	74	59	38
The Parliament	23	73	68	29
	Very/ Fairly	Not very/ Not at all	Very/ Fairly	Not very/ Not at all
Satisfaction with the way democracy works	25	74	86	13

Source: European Commission, Eurobarometer 78

Governance indicators

Portugal and Sweden 2011

[min -2.5 max 2.5]	Portugal	Sweden
Government effectiveness	1.0	2.0
Voice and accountability	1.1	1.6
Regulatory quality	0.7	1.8
Rule of law	1.0	1.9
Control of corruption	1.1	2.2
Do you have confidence in the national government? (% yes)	24.6	67.2
Do you think that most people can be trusted? (% yes)	27.9	56.1

Source: The World Bank World Governance Indicators and the 2012 Legatum Prosperity Index

Can fiscal policy council reduce the deficit bias?

Lessons from Sweden

8. Finally, creating new institutions and making them trustworthy in the eyes of the public is a time-consuming process. Mistakes will be made.

We should not expect a new fiscal policy council to have an immediate impact regardless of where it is established, neither in Sweden nor in Portugal.

We should be optimistic. A new council is a way of maintaining the collective memory of fiscal excesses and of fostering the workings of the democratic process.

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End of presentation

Extra slides

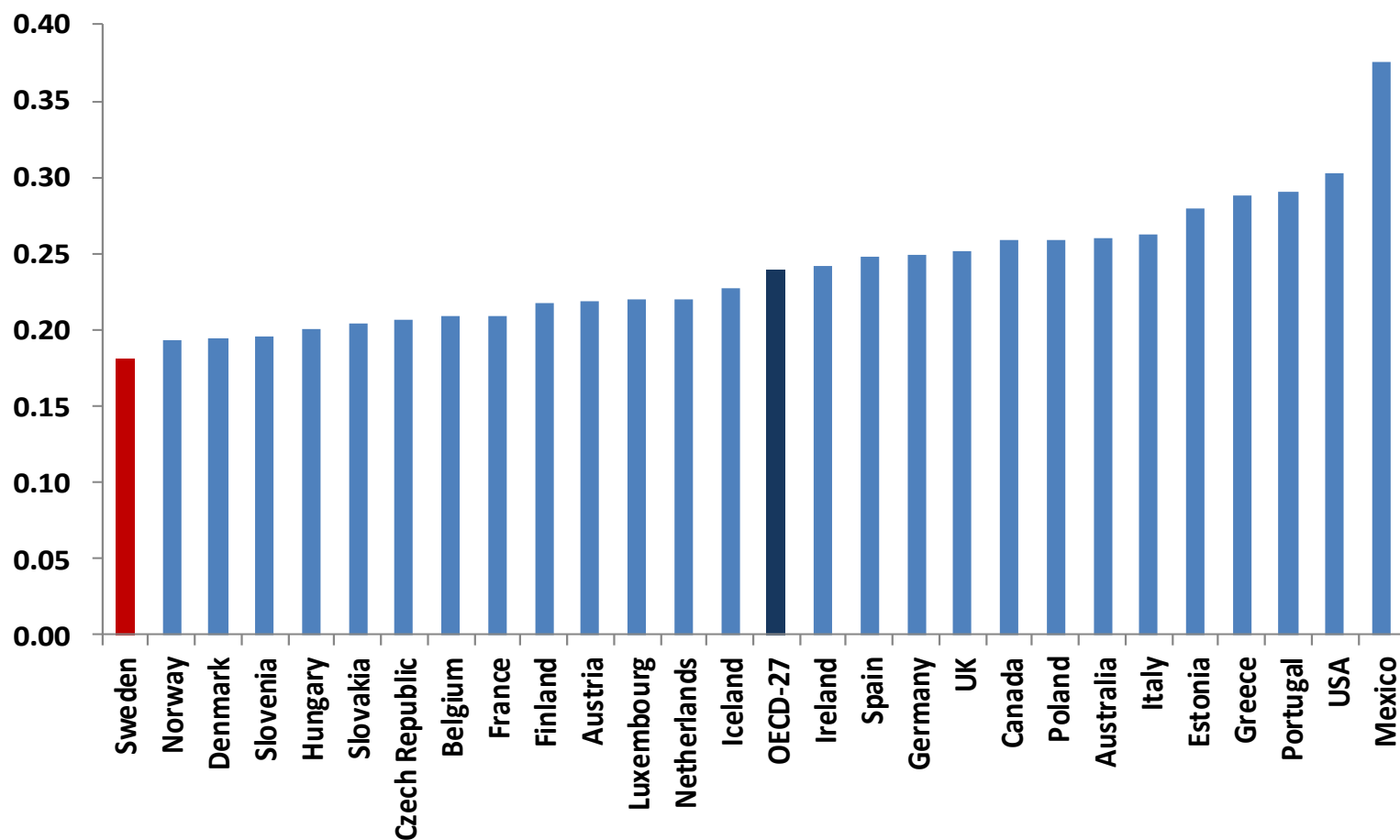
Challenges for the Council 2013

To analyze the design of economic policies fit for a new Swedish model:

- No wealth tax
- No inheritance tax
- No real estate tax
- No gift tax
- A small open de-regulated economy

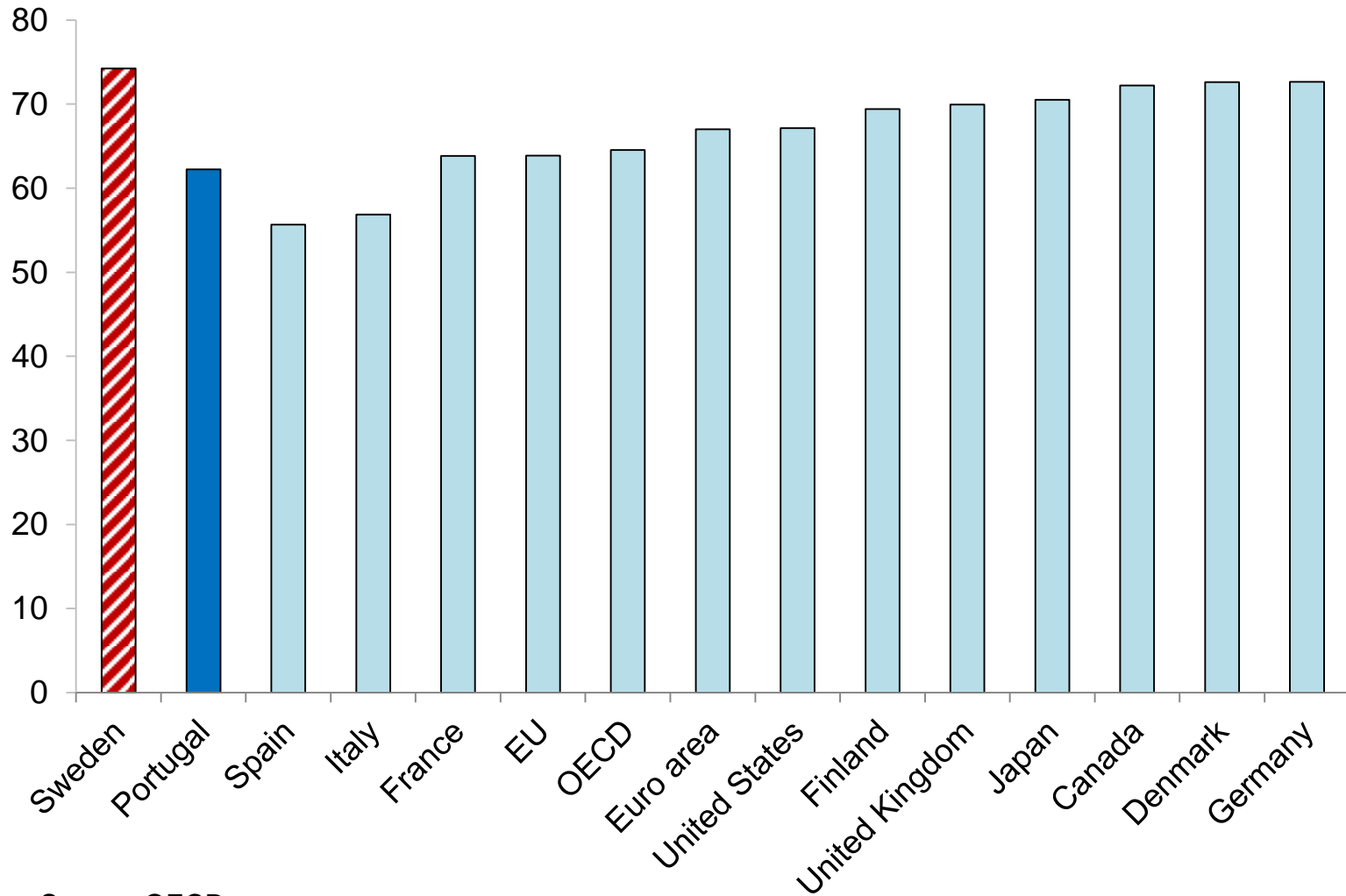
The report 2013: Fiscal policy and distribution

Inequality of income distribution, including publicly financed services:
The Gini-coefficient.



Source: OECD, 2011

Employment rate, 15-64 years (%) 2012



Source: OECD