

# Experience of Fiscal Rules in Sweden

Meeting with the Budget Committee  
of the Armenian Parliament





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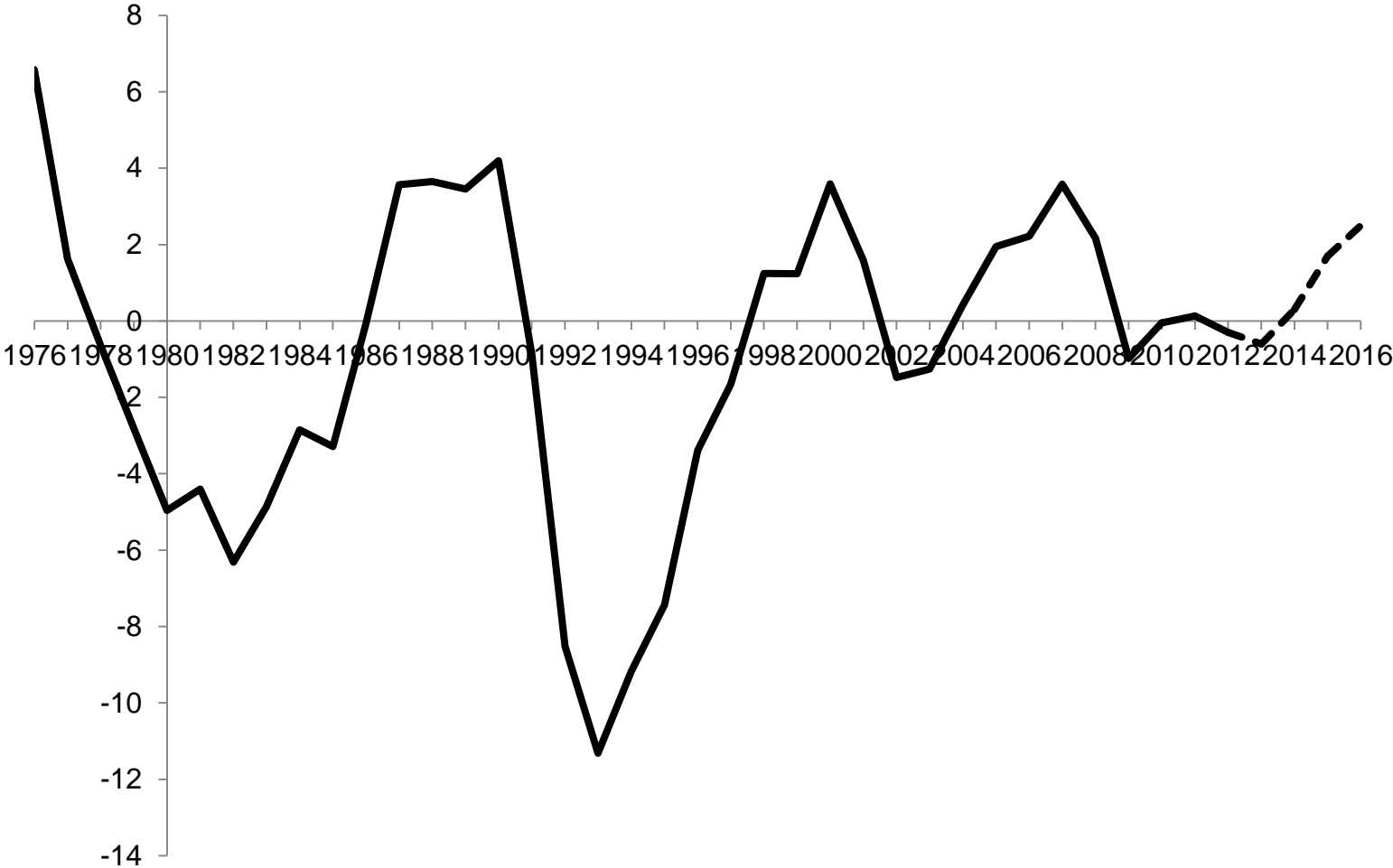
# Background

*1990-2007: a summary*

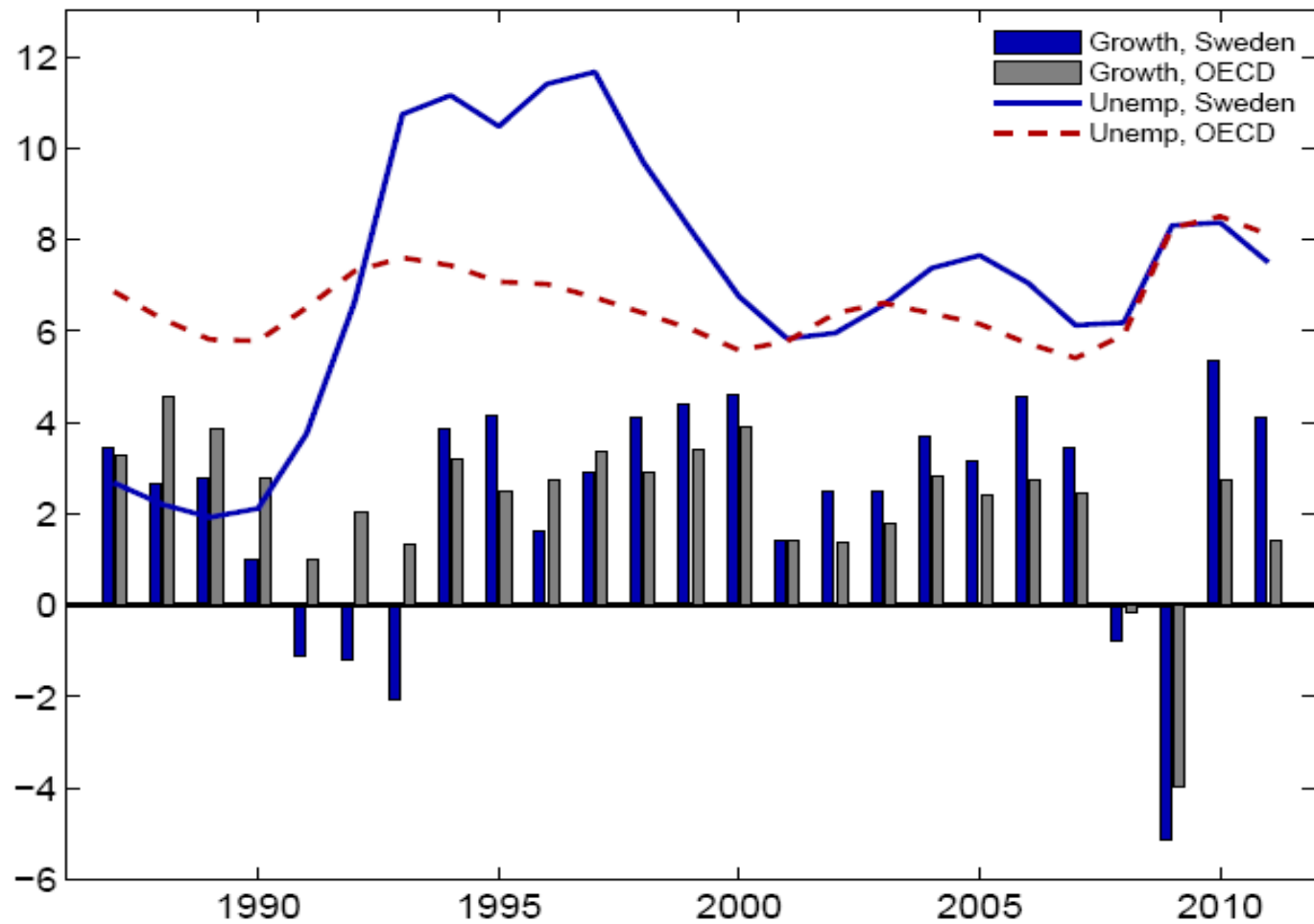
# Sweden during the Recent Crisis

- Despite a 5% drop in GDP in 2009 and a typically high fiscal balance elasticity, Sweden:
  - Moderate drop in the fiscal balance;
  - Modest maximum deficit of 1.0%. Now (more or less) in balance; 
  - Recovered to pre-crisis GDP in 2010.
- Very different from the crisis in the early 1990s: similar amplitude in GDP fall, *but* at that time an extreme deterioration of public finances and rise in unemployment. Long recovery. 
- Key explanations for Sweden's good performance:
  - Important reforms were undertaken during the 1990s;
  - No structural imbalances – no domestic amplification mechanisms;
  - Strong budget before crisis due to well-functioning fiscal framework;
  - A conservative Finance Minister determined not to repeat mistakes; 
  - Luck... 

# General Government Net Lending as % of GDP 1976-2016



# Growth and Unemployment 1985-2011

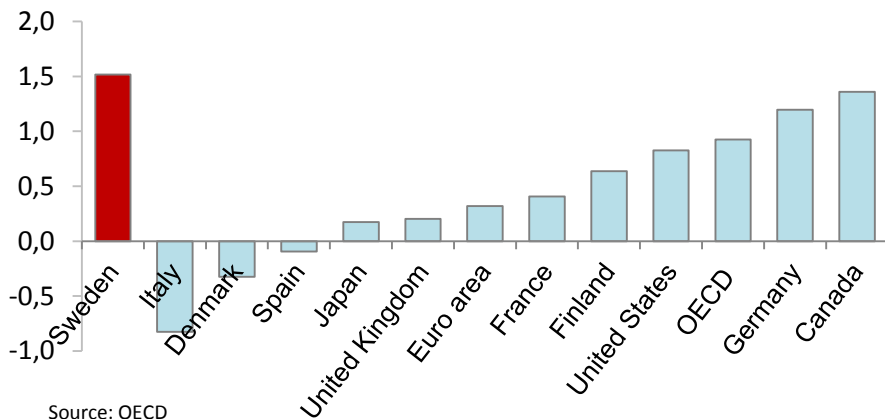


**Note:** Growth rate of GDP (percent) in Sweden and weighted average of 19 OECD countries.

**Source:** OECD Economic Outlook December 2011.

## Annual average real GDP growth

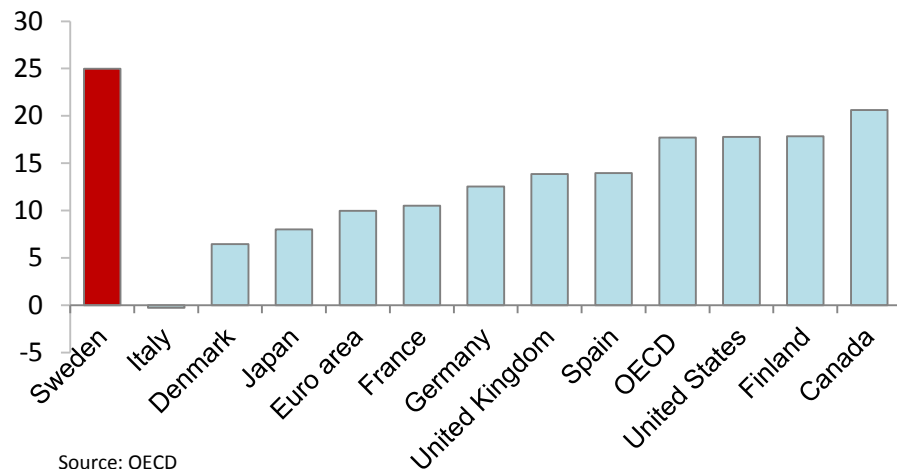
(%) 2007-2012



Source: OECD

## Total real GDP growth

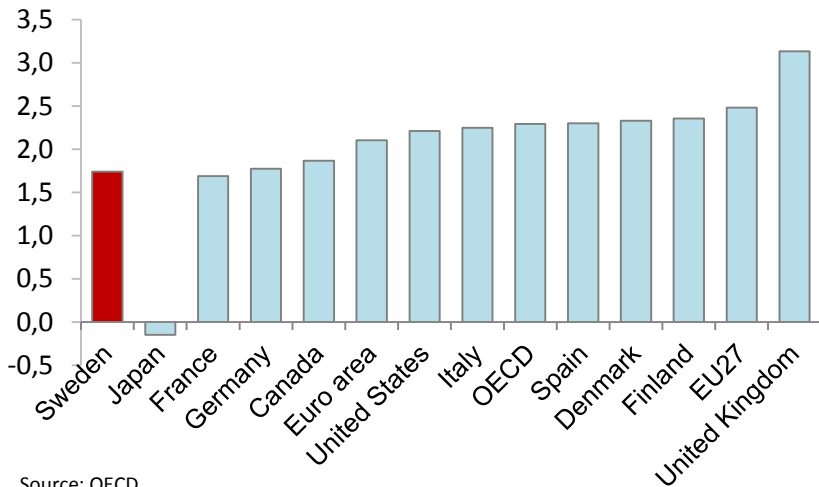
(%) 2002-2012



Source: OECD

## Annual average inflation rate

(%) 2007-2012

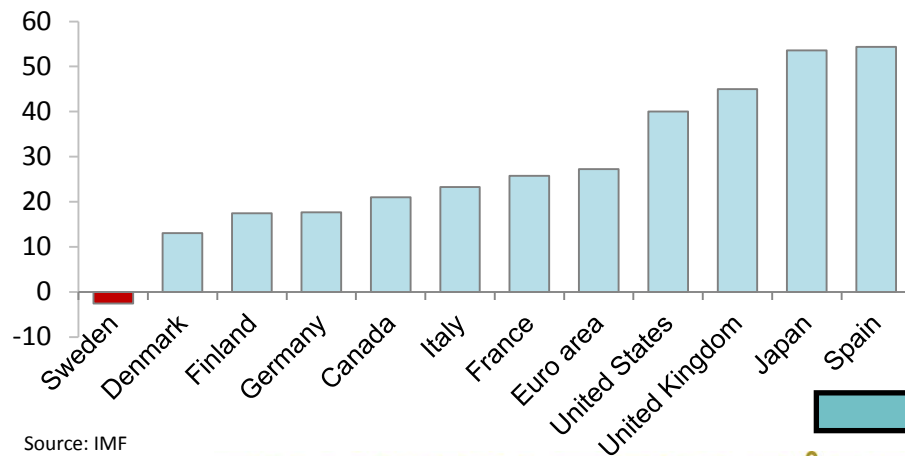


Source: OECD

## Change in government gross debt

(as % of GDP)

(percentage points) 2007-2012



Source: IMF

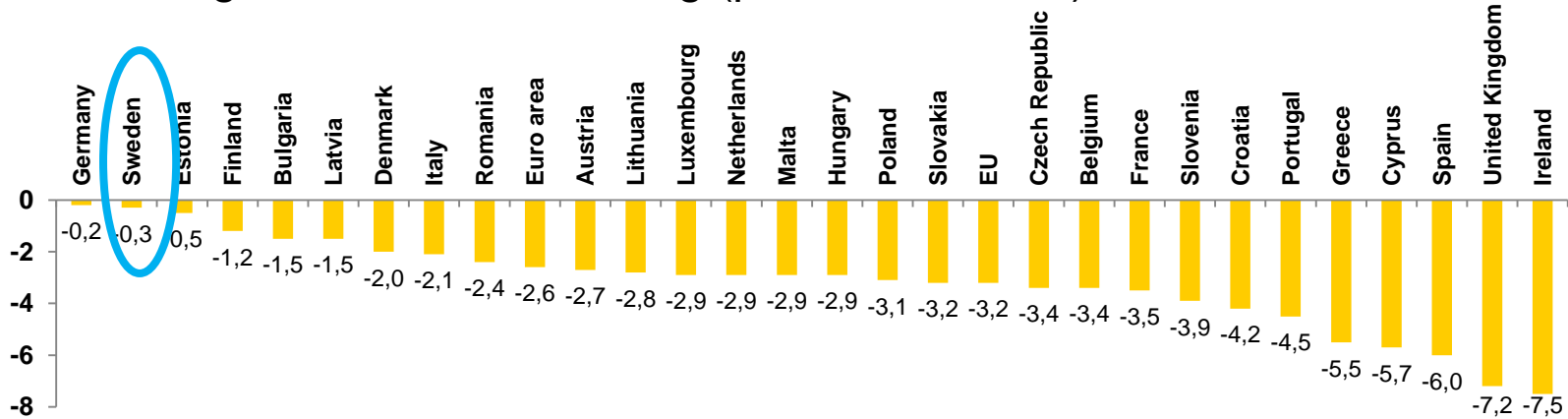


**FINANSPOLITISKA RÅDET**

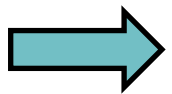
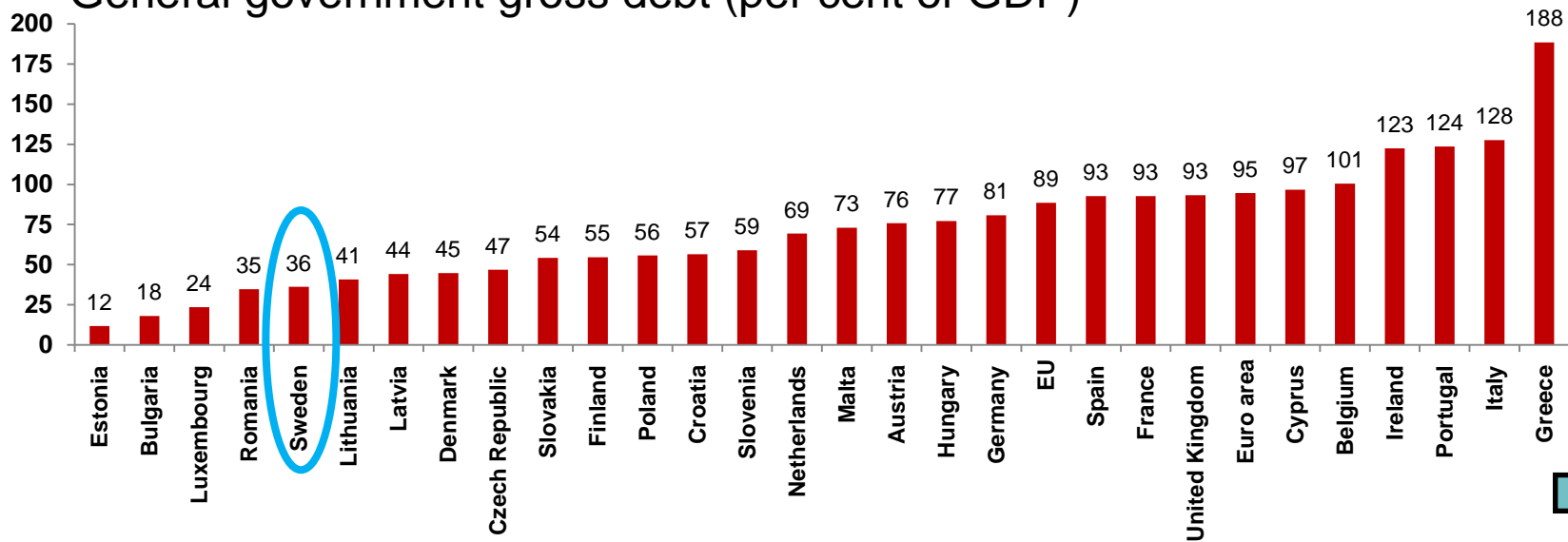
SWEDISH FISCAL POLICY COUNCIL

# Public finances 2013

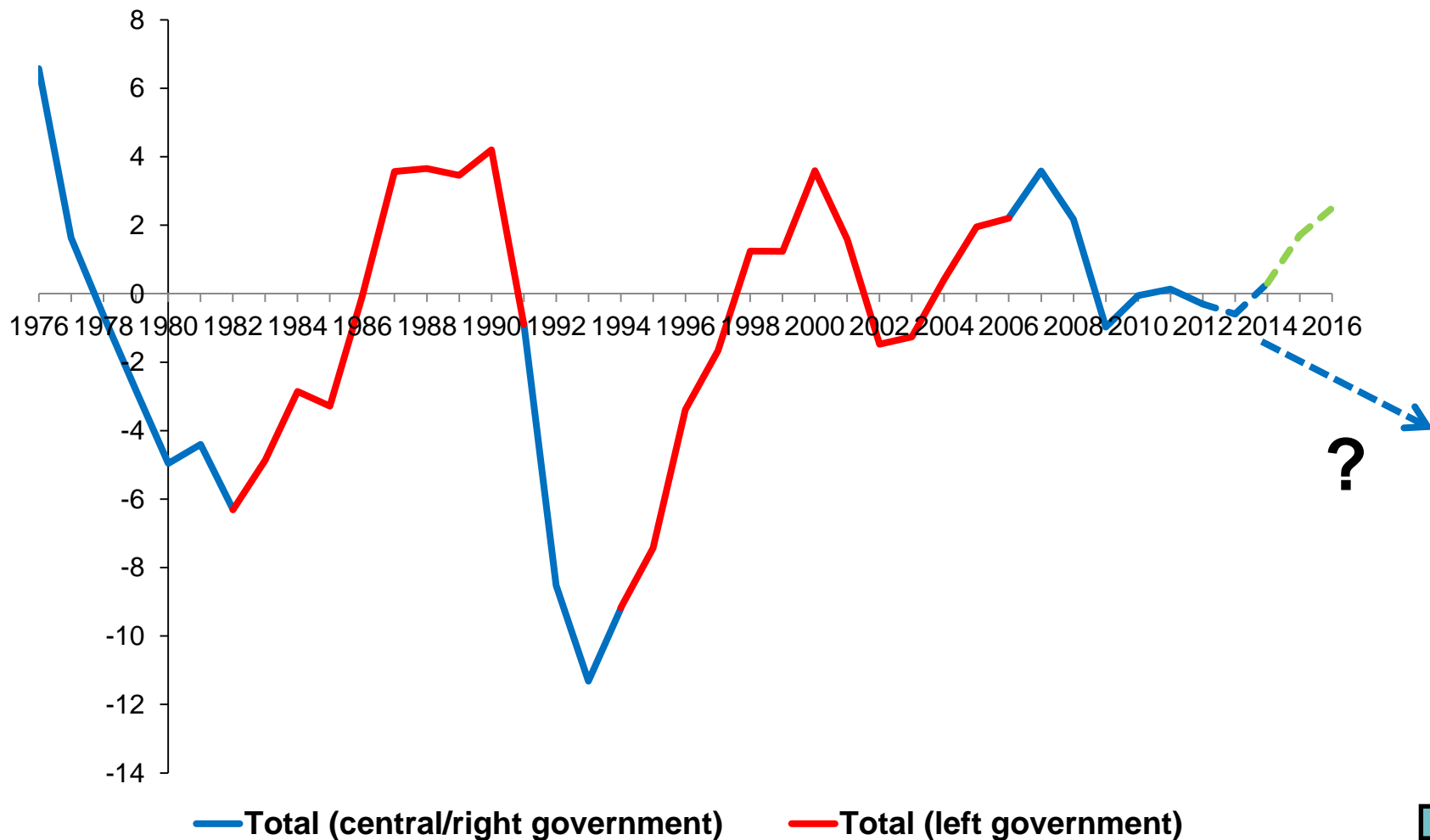
## General government net lending (per cent of GDP)



## General government gross debt (per cent of GDP)



# General Government Net Lending as % of GDP 1976-2016





# Background to Reforms

- Sweden suffered a deep economic crisis in the 1990s:
  - Credit market deregulation in the 1980s led to rapid credit expansion;
  - Rapidly increasing property prices, then a collapse;
  - Banking crisis;
  - Large real appreciation leading up to the crisis;
  - Exploding unemployment rates;
  - Very high interest rates;
  - Structural problems became apparent (tax system, pension system, wage formation, long run growth...).
- Relatively similar to the current crisis in Spain.
- Crisis created a wide consensus on the need for a major *makeover*.

# A Comprehensive Makeover

- A new tax system:
  - Corporate taxes cut in half;
  - Marginal top income taxes reduced from 70% to 50%;
  - VAT tax base broadened.
- Insolvent banks were taken over and split into good and bad banks. Ultimately not a bad deal for tax payers;
- EU membership in 1995;
- Election periods extended to 4 years;

## ...A Comprehensive Makeover

- Stricter competition law; deregulation and privatizations of rail, telecom, taxi, schools, post, electricity;
- Tough fiscal consolidation (1993-1998, ~ 11% of GDP);
- Delegation of monetary policy to an independent central bank with an inflation target. Large initial depreciation;
- A new contributions-defined pension system, immune to variation in growth and demographics, was introduced;
- A new Fiscal Policy Framework.

# Lessons from the Crisis in the 1990s

- **Structural problems must be identified early**
  - Crisis often reveals structural problems;
  - Automatic stabilizers, fiscal policy and social safety nets work well for temporary shocks in countries with no structural problems.
- **All reasons for deficit bias need to be identified and addressed**
  - Common pool, information, time consistency.
- **Mandate for change**
  - Crisis creates a window of opportunity for change;
  - A broad political *and* popular support for reform is a necessary precondition. A political *story* is needed;
  - “Someone” else is not going to pay;
  - Institutional reforms can peg down and enhance institutional memory.

# Are the Swedish Experiences Relevant for Current EU Crisis Countries?

- Key issues to take into consideration:
  - Export-led growth through currency depreciation and strong external demand were key components in the Swedish recovery;
  - The substantial consolidation of public finances was implemented after rapid growth had resumed in the Swedish economy (1995-1997).

## *Note that:*

- Strict Swedish monetary and fiscal policy implemented around 1995 had contractionary effects on the economy.

# The Swedish Fiscal Framework

# The Swedish Fiscal Framework

- Top-down budget process (preparation in Government as well as decision in Parliament);
- A fiscal *surplus target* for general government net lending of 1% of GDP, on average, over the business-cycle;
- Central government *expenditure ceiling* set 3 years in advance; decision by Parliament;
- Balanced budget requirement for local governments;
- Since 2007, a Fiscal Policy Council with a broad remit (to facilitate transparency and accountability).
- *Note: The strength of this framework depends on the political will to respect it...*

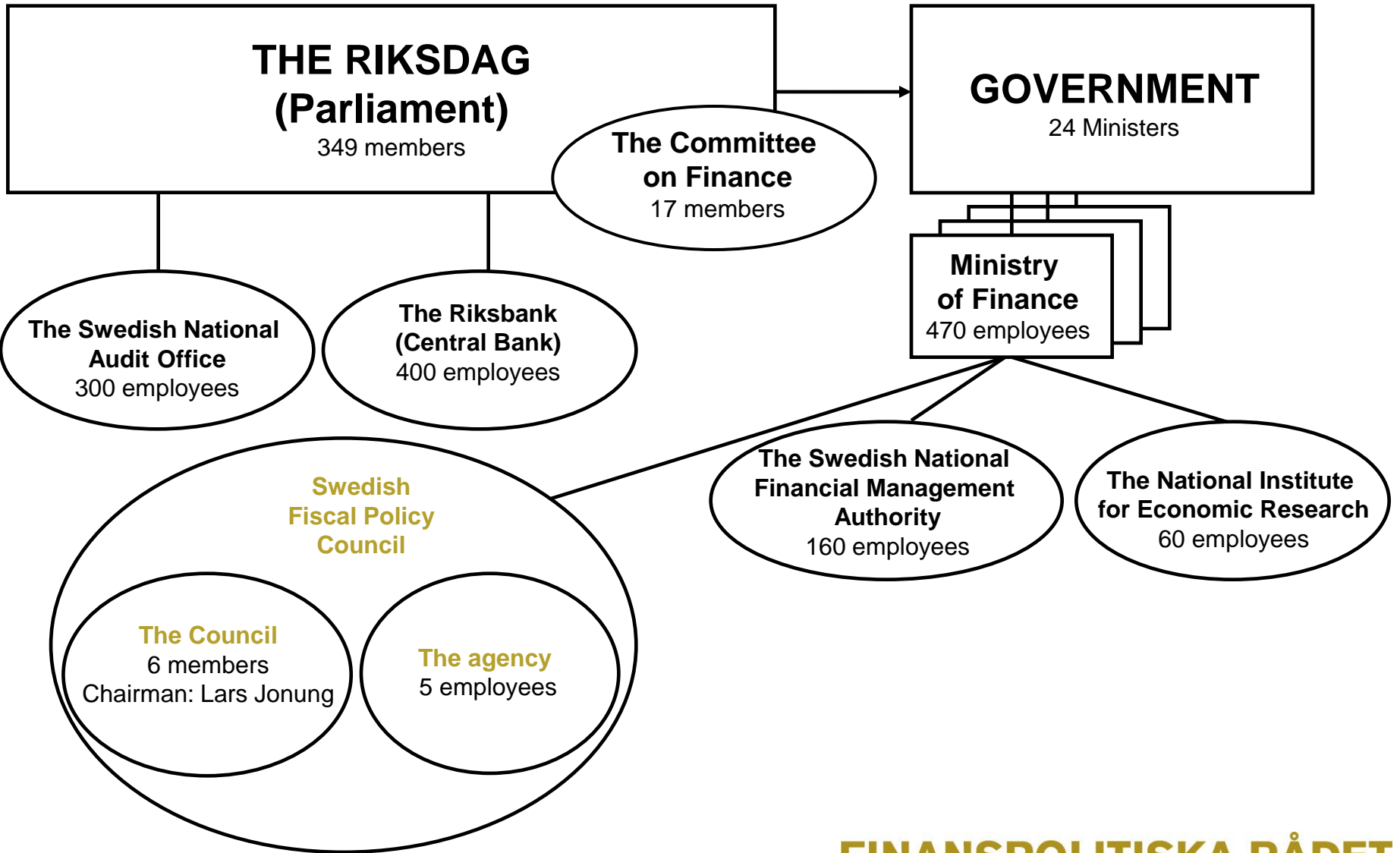
# The Council's background

- Theoretical considerations rather than acute problems;
- Government Commission in 2002: requirements on fiscal policy in the event of euro membership;
- Positive reactions from the liberal-conservative parties (Anders Borg);
- Negative reactions from the Social Democrats, the Left and the Greens:
  - another body providing false scientific clothing for the government's right-wing policy
- However, the liberal-conservative government reached an agreement with Social Democrats, the Left and the Greens in May 2011 on the existence of the Council (including a new remit).



# The set-up of the council

- Established in 2007;
- An agency under the Government;
- Six members:
  - Academics;
  - Policy-making experience;
- Supplementary activities to ordinary jobs (mainly academic positions);
- Small secretariat: five persons;
- Annual budget 900 000 €;
- Provisions to safeguard the Council's independence, such as a stipulation that the Council itself proposes its members to the Government.



# The tasks of the Fiscal Policy Council

1. Focus on *ex post* evaluation
2. Evaluate whether the fiscal policy meets its objectives:
  - Long-run sustainability;
  - Compliance with Surplus target and expenditure ceiling
  - Stabilization issues.
3. Evaluate whether the developments are in line with sustainable growth and a sustainable high employment;
4. Monitor the transparency of the budget proposals and the motivations for various policy measures;
5. Analyze the effects of fiscal policy on the distribution of welfare;
6. Contribute to a better economic policy discussion in general:
  - Annual report in May (this year May, 15);
  - More information on [www.finanspolitiskaradet.se](http://www.finanspolitiskaradet.se).

# Themes in the reports

- Increase the clarity of the surplus target (net lending of 1% of GDP over a business cycle):
  - Underlying fundamental objectives
  - Methodology for monitoring
- Criticism of circumventions of the expenditure ceiling;
- Critical evaluation of the fiscal sustainability calculations;
- Request for additional discretionary fiscal stimulus in the current recession (but less of permanent measures);
- Critical evaluation of the Government's labor market reforms.

# Has the fiscal policy framework worked?

- Generally successful implementation:
  - Top-down approach is followed;
  - Spending ceilings have not been breached (albeit some minor, and politically costly, examples of creative bookkeeping);
  - Surplus target has been met – at least until now... (various indicators used);
  - Broad political support: opposition wanted more spending during crisis, but less than 1% of GDP;
  - The Fiscal Policy Council has increased the transparency and facilitated a higher quality of the political discussion.