

Swedish Fiscal Policy 2011

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Meeting with IMF (article IV)

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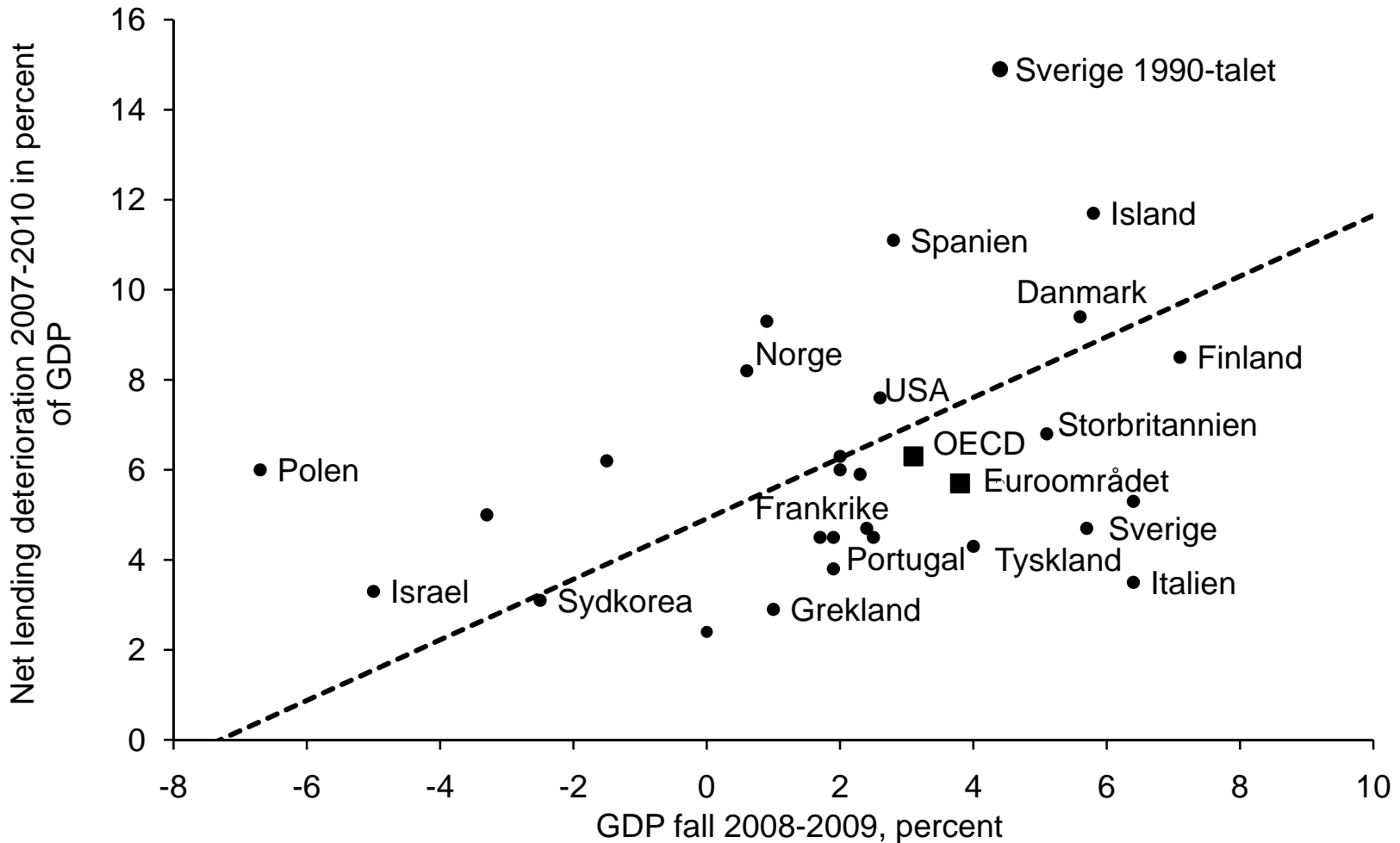
Government net lending and GDP gap, percent of GDP

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Net lending	3,6	2,2	-0,9	-0,3	0,3	1,8	2,8	3,6	4,4
GDP gap	1,8	3,2	0,5	-3,8	-1,9	-0,7	-0,1	0,1	0,0

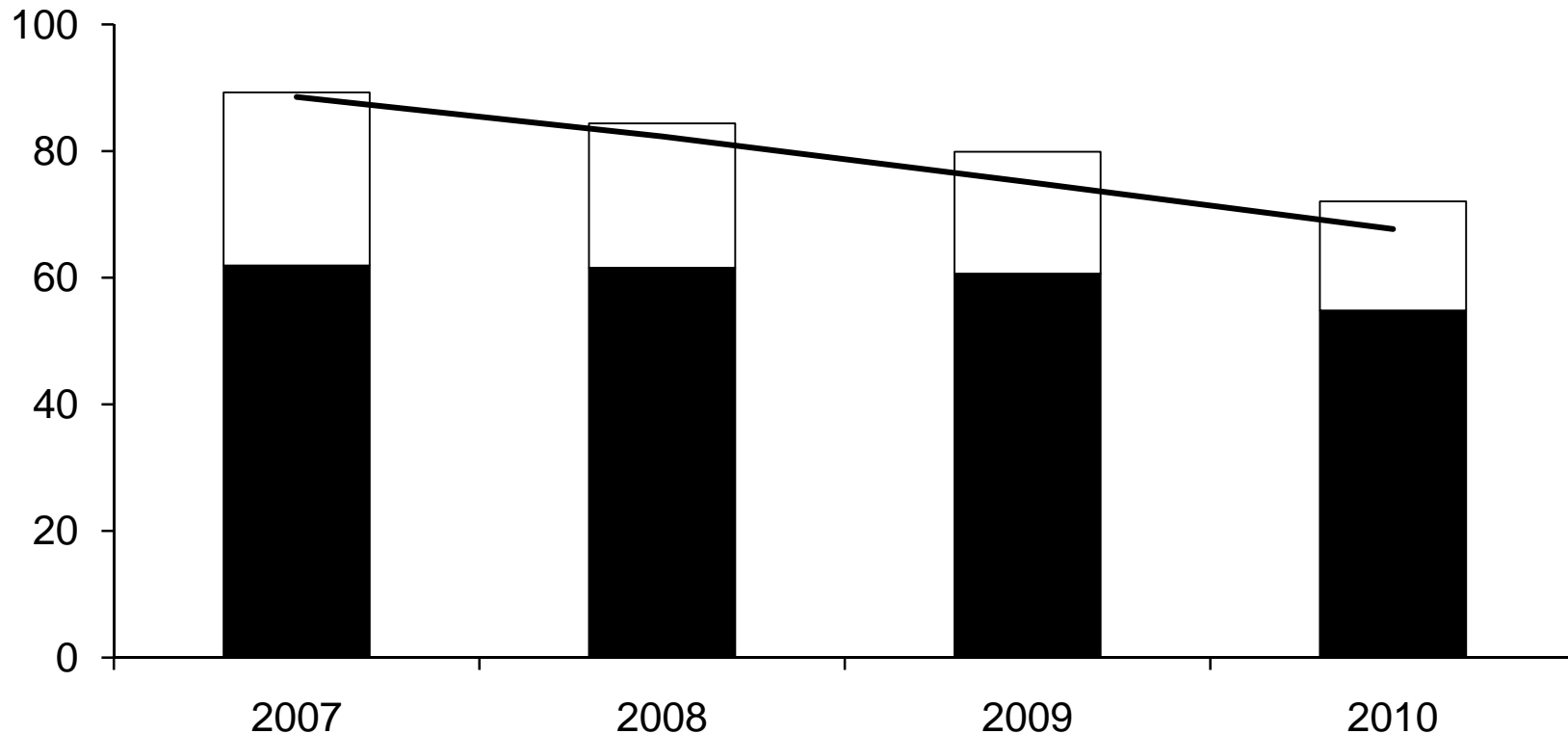
Difference in net lending between Sweden and OECD (Euro area), percent of GDP

	OECD - Sweden	Euro area - Sweden
Difference in deficit 2010	6,4	5,1
whereof		
Difference in deficit 2007	4,8	4,1
Difference in contribution from GDP fall	-1,8	-1,3
Residual	3,4	2,3

Falls in GDP an in government net lending



Sickness and disability benefit expenditures, SEK bn

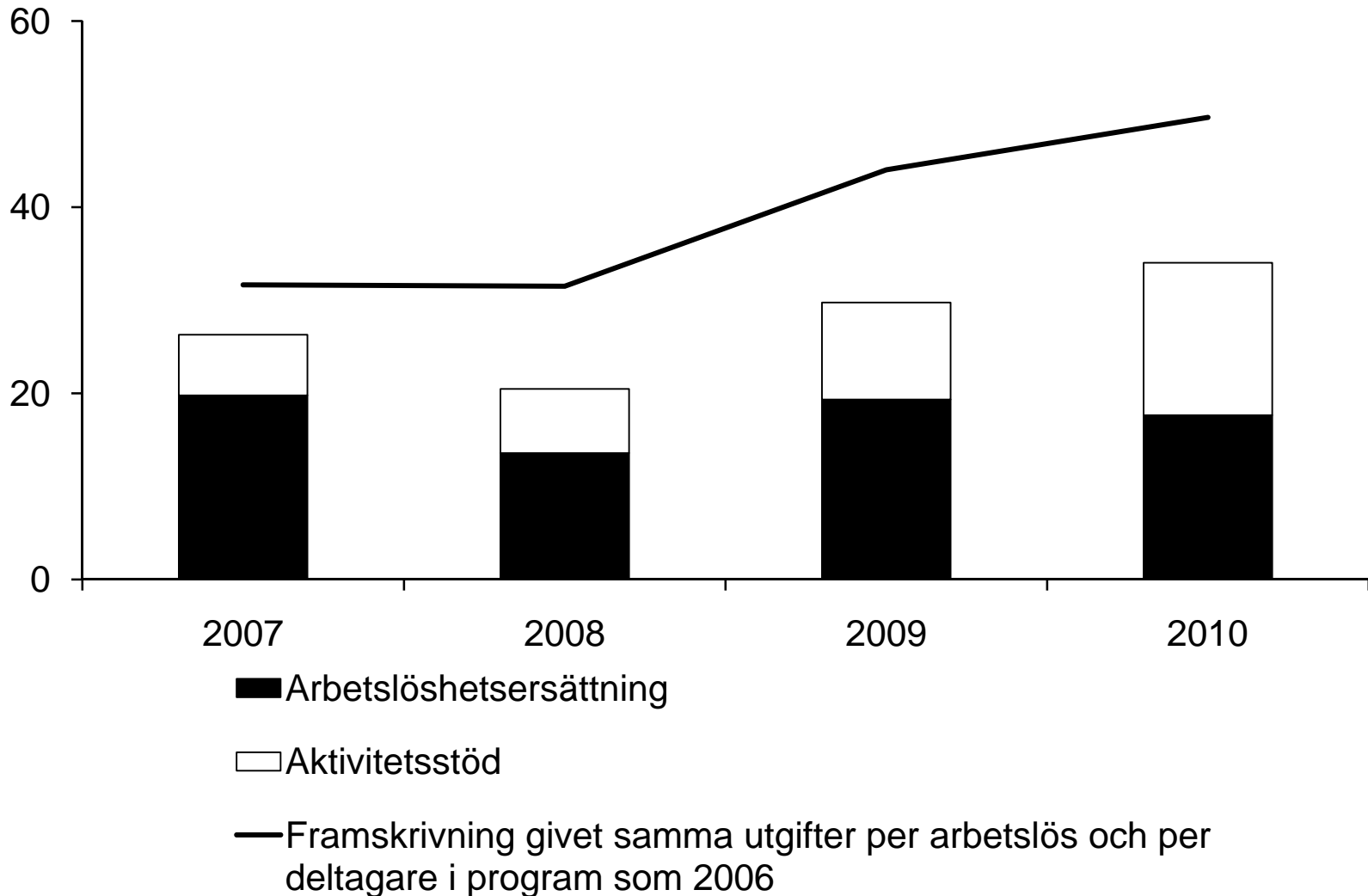


■ Förtidspension

□ Sjukförsäkring

— Framskrivning av totala utgifter givet samma utgifter per förtidspensionär respektive sjukskriven som 2006

Expenditures on unemployment benefits and compensation in labour market programmes, SEK bn



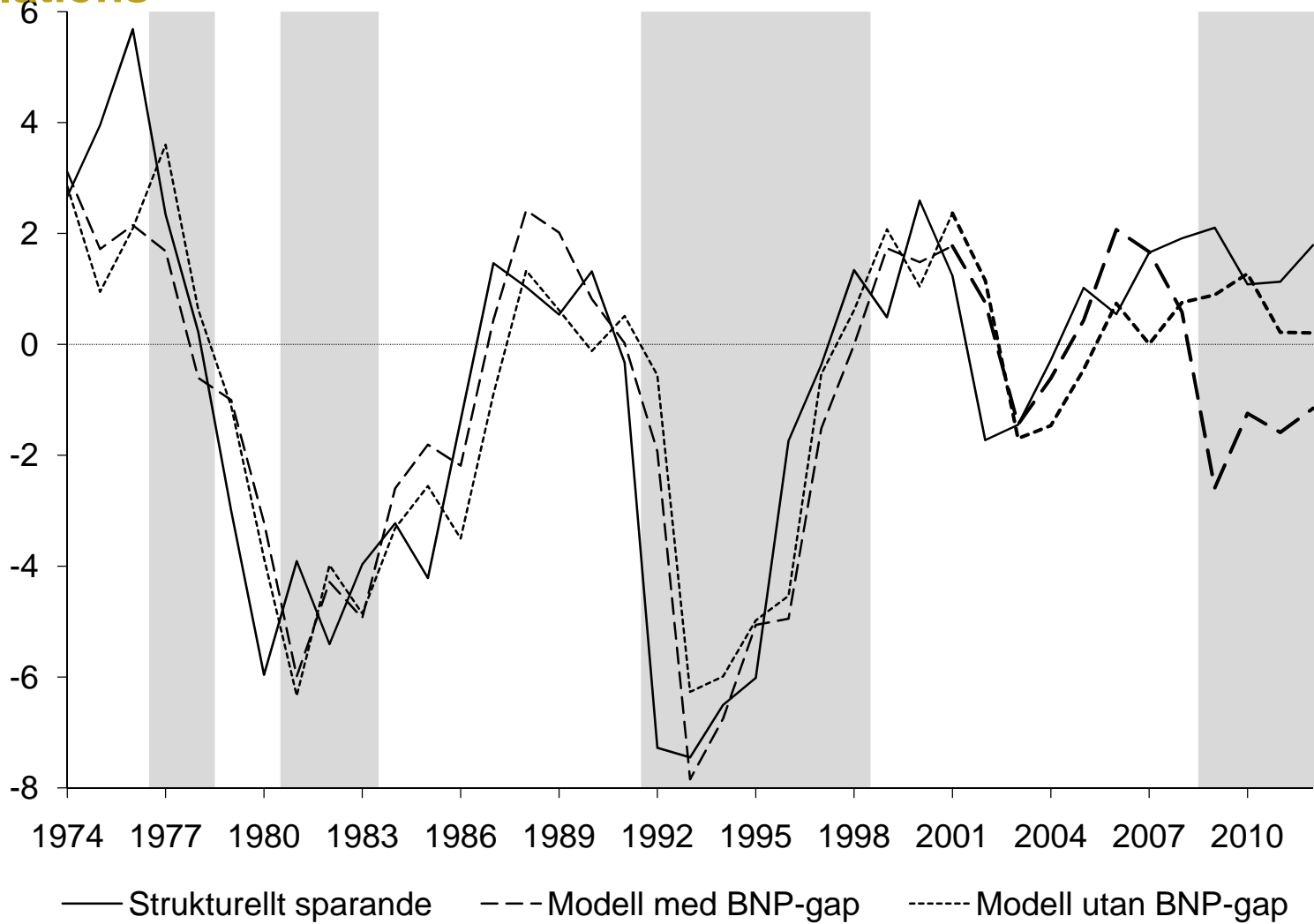
Structural net lending

- Structural net lending = Actual net lending – 0,55*GDPgap – one-off effects – extraordinary capital gains
- 'Budget elasticity' of 0,55 based on OECD-calculations
- Government has emphasized the structural net lending in its evaluations of the surplus target

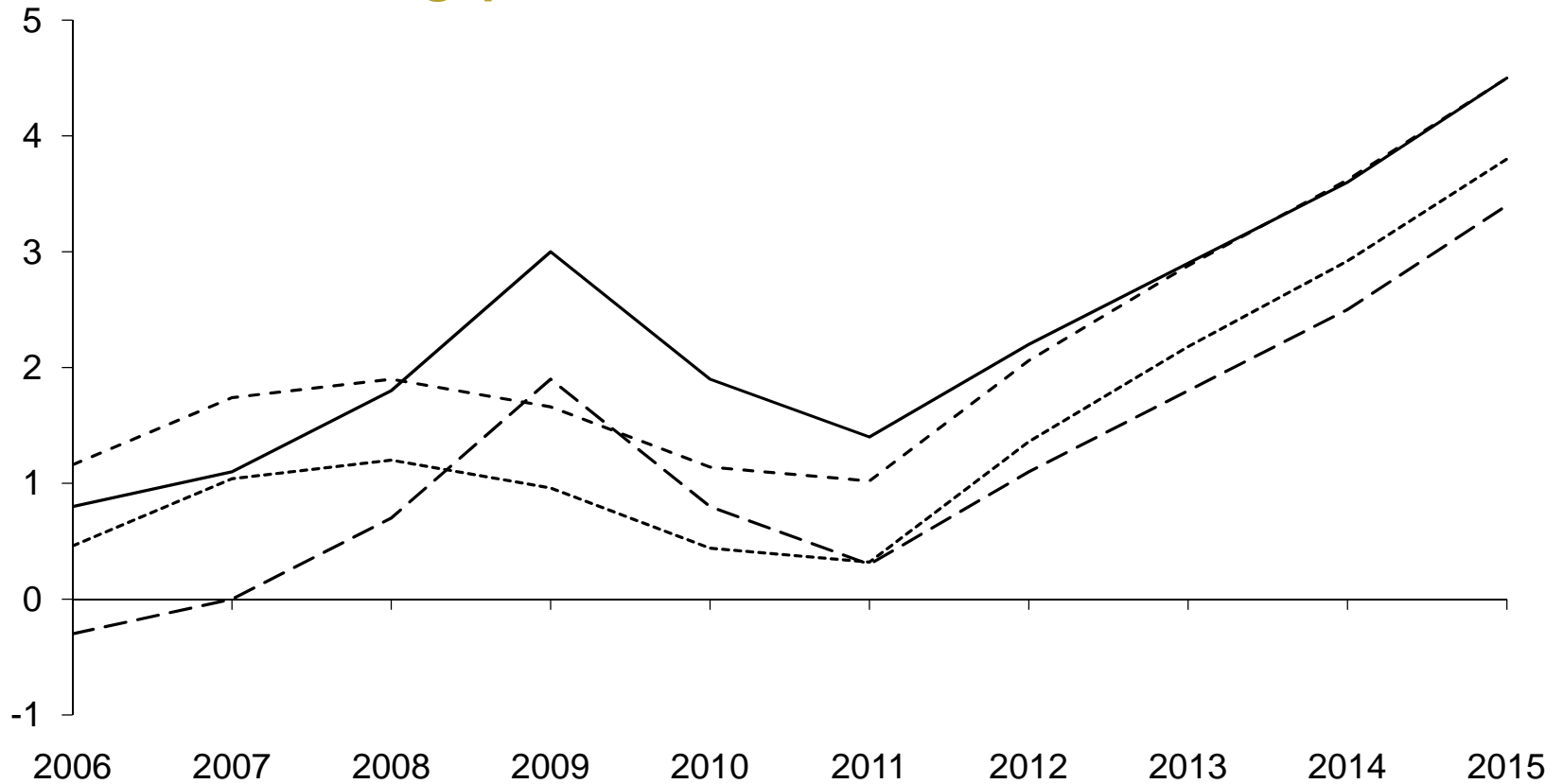
Problems with the government's calculations

- The estimates of the GDP gap are highly uncertain
- The GDP gaps are asymmetric, i.e. negative on average
- The estimates do not account for the balanced budget requirement for local governments
 - local government expenditures are reduced when tax incomes fall
 - hence they should not be regarded as independent of the cycle
 - G/Y is an approximation of the budget elasticity
 - taking the balanced budget requirement for local governments into account one should instead look at $GREST/Y$
 - this reduces the budget elasticity from around 0,55 to 0,35
- Ill-advised to rely as heavily on these calculations as the government does

Structural net lending, percent of GDP, government calculations



Structural net lending, percent of GDP



— Vårpropositionen 2011

- - - - - Justerat för asymmetriskt BNP-gap

- - - - - Justerat för lägre budgetelasticitet

- · - · - · - Justerat för både asymmetriskt BNP-gap och för lägre budgetelasticitet

FINANSPOLITISKA RÅDET

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Scope for reform

Scope for reform = The total sum of permanent tax reductions and expenditure increases that can be actively decided by the Riksdag (the Swedish Parliament) and that are compatible with the target that general government net lending should show a surplus of one per cent of GDP over a business cycle.

How does the scope for reform come about?

- Taxes are approximately proportional to GDP
- Only some public expenditures are indexed to wages
- Others are indexed to wages but with productivity deductions (grants to public agencies)
- Yet others are only indexed to prices
- Some grants are fixed in nominal terms

Politically attractive that earlier reforms deteriorate in the absence of new decisions

Scope for reforms, percent of GDP

	2012	2013	2014	2015
Change in cyclically adjusted net lending(1)	1,06	0,86	0,80	0,39
Contribution from nom. fixed taxes (2)	-0,02	-0,02	-0,02	-0,02
Contribution from nom. fixed transfers to local government, business sector etc. (3)	0,28	0,22	0,18	0,18
Contribution from that gov't agencies' grants are not indexed to GDP(4)	0,25	0,15	0,15	0,07
Contribution from that transfers to households are not indexed to GDP(5)	0,41	0,40	0,31	0,21
whereof				
<i>volume change(6)</i>	0,29	0,25	0,17	0,07
<i>lower real benefits(7)</i>	0,04	0,04	0,02	0,03
<i>other(8)</i>	0,09	0,12	0,12	0,11
Contribution from change in financial net (9)	0,00	0,11	0,11	0,19
Other (10)	0,13	0,00	0,06	-0,24
Sum of contribution due to limited adherence to GDP(2+3+4+7+8)	0,64	0,51	0,45	0,37

Implications of the surplus target

- Government **net financial worth** is currently about 20 percent of GDP
- An average yearly surplus of one percent of GDP implies that net financial worth stabilises at the current level as a percentage of GDP
 - at that level a one percent surplus 'compensates' for nominal GDP growth of 5 percent

Scope for reform 2012-2014

- “Slightly more” than SEK 48 bn according to the government
- Budgeting margin under the expenditure ceiling of almost SEK 60 bn
- Tax cuts in excess of SEK 20 bn planned for 2012
- More tax cuts the coming years
- This poses a risk that **tax cuts and spending increases** taken together may be too large
- Problematic when business cycle improves rapidly

Central government expenditure ceilings

	2011	2012	2013	2014	2015
Expenditure ceiling	1 063	1 083	1 093	1 103	1 123
Expenditures subject to ceiling	997	1 009	1 025	1 045	1 066
Budget margin	65,8	74,3	67,9	58,3	57
<i>percent of expenditures subject to ceiling</i>	6,6	7,4	6,6	5,6	5,3
<i>percent of GDP</i>	1,9	2,1	1,8	1,5	1,4
Public sector expenditures, percent of GDP	49,8	48,5	47,4	46,6	45,9

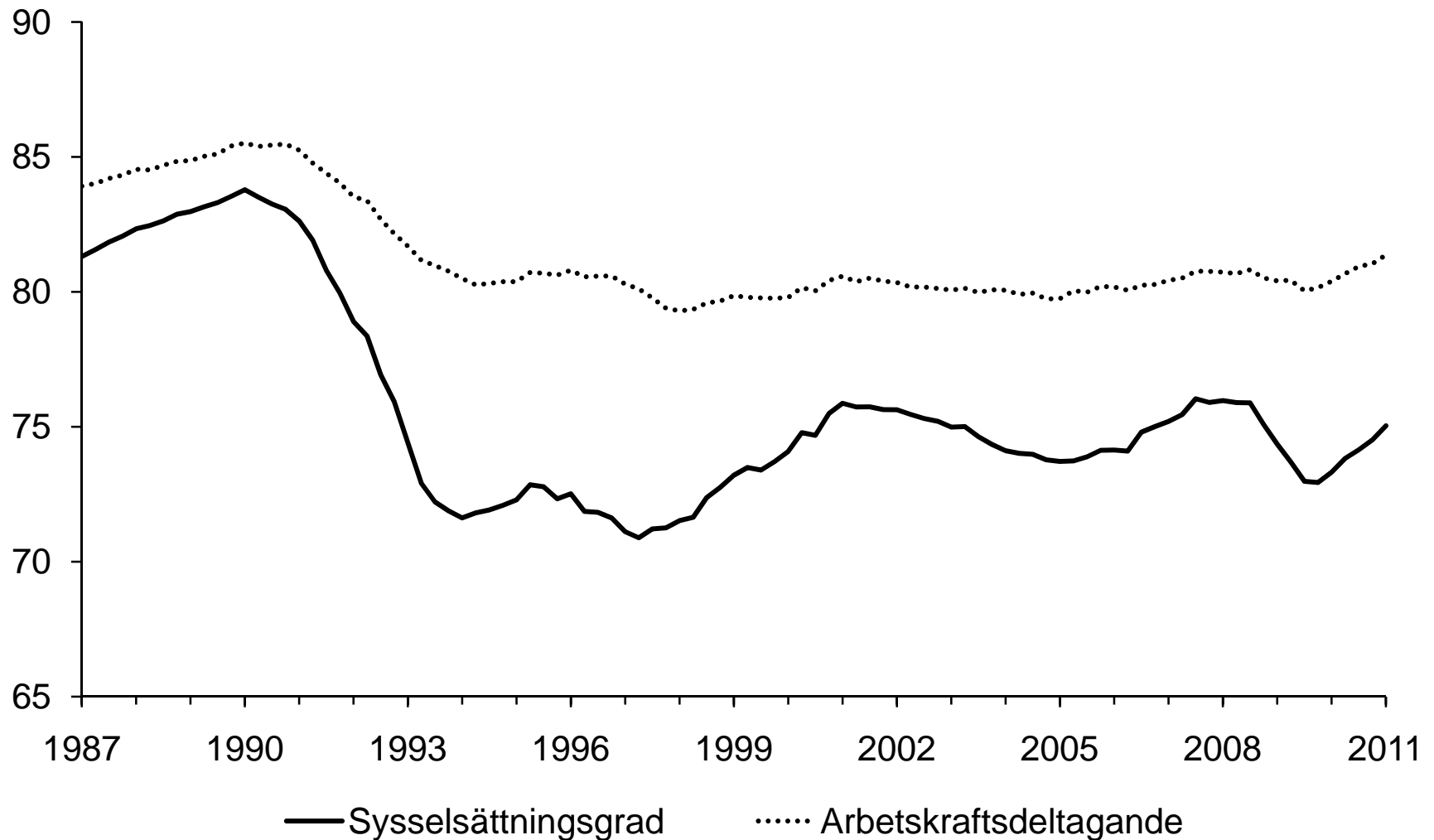
Our recommendation

- If taxes are cut – lower the expenditure ceiling!
- If expenditure ceiling is not lowered – taxes should not be cut!

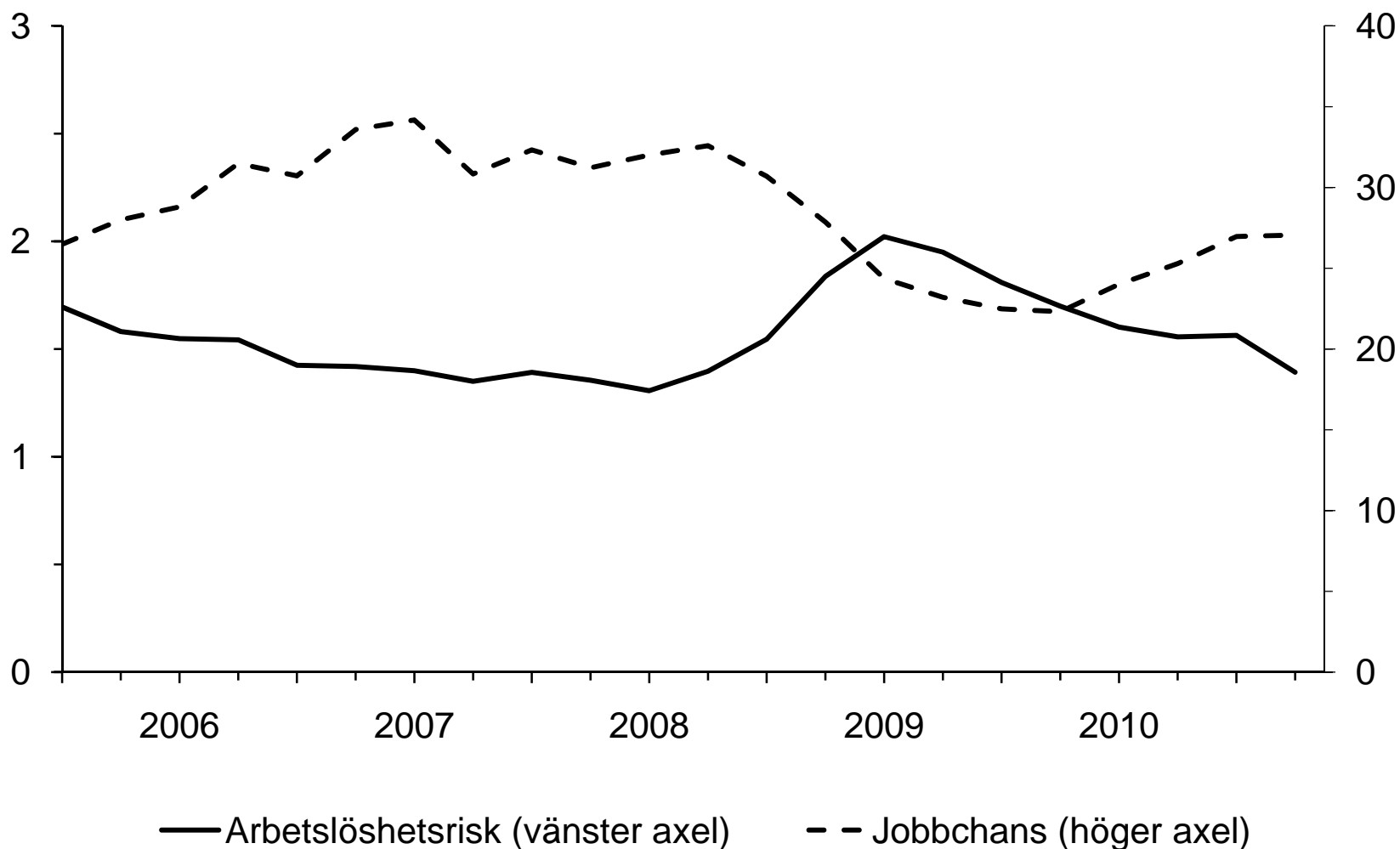
Financial stability

- Sovereign debt crises are often related to financial crises
- No public body currently in charge of **macrofinancial** stability
- Two alternatives
 - The Riksbank
 - Financial Stability Council

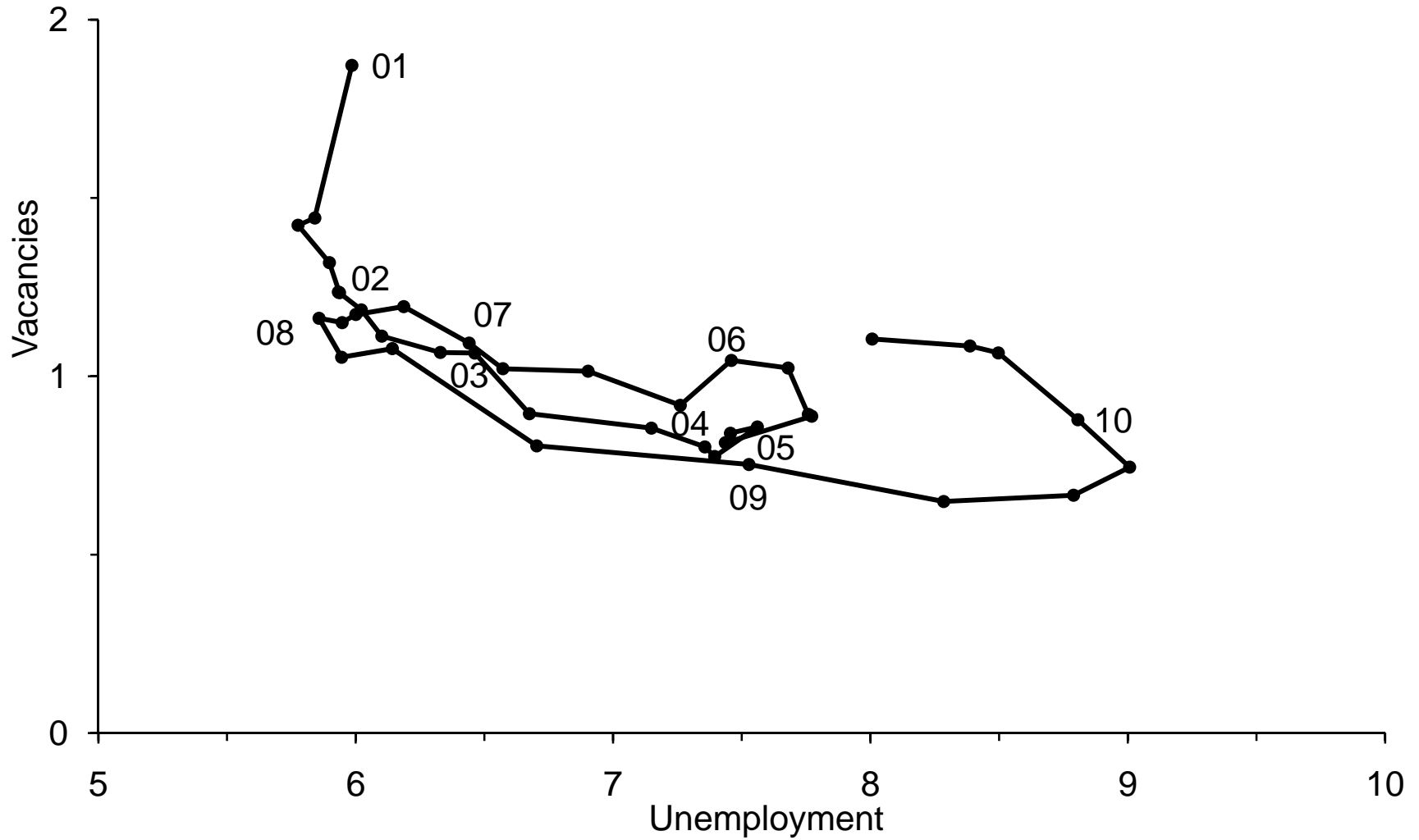
Labour market participation and employment, percent of population



Job finding rate and unemployment risk, percent



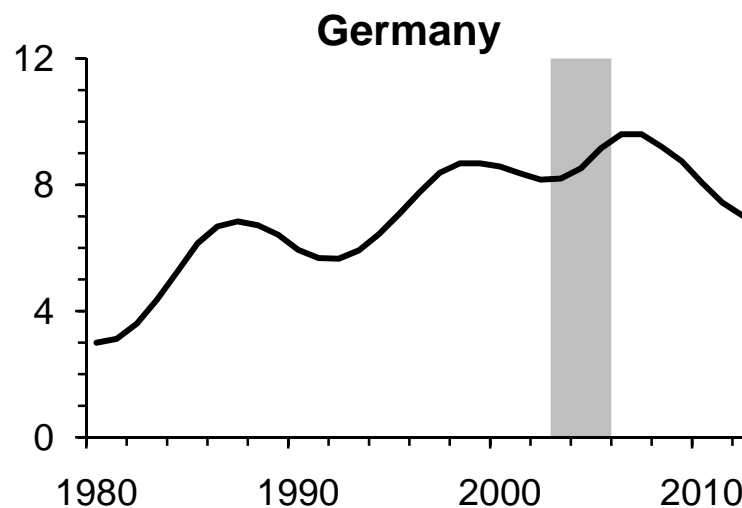
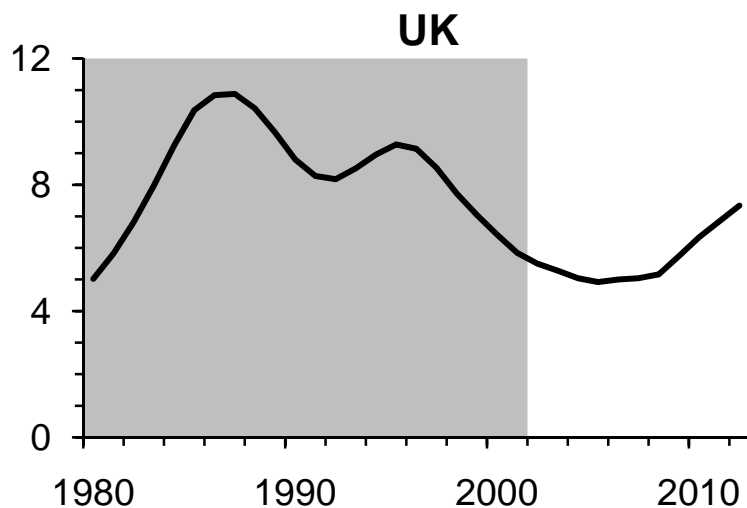
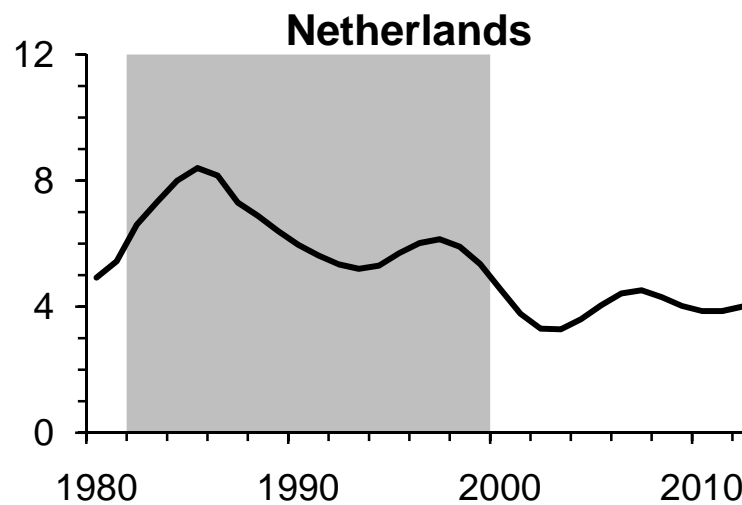
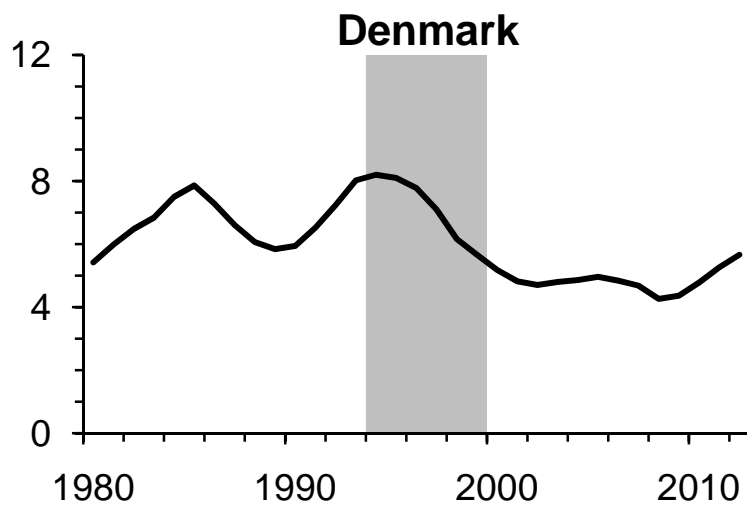
Beveridge curve 2001-2010



Ministry of Finance estimates of the effects of the labour market reforms, percentage points

	Eq. Umempl.	Labour market participation	Employment rate
Level 2006	6,6	71	66
Demography	0,4	-2,1	-2,2
Unchanged ceiling	-0,6	0,1	0,5
Structural reforms	-1,4	2,2	3,0
Earlier structural reforms	0,0	0,1	0,1
Level 2020	5,0	71	68

Unemployment following major labour market reforms



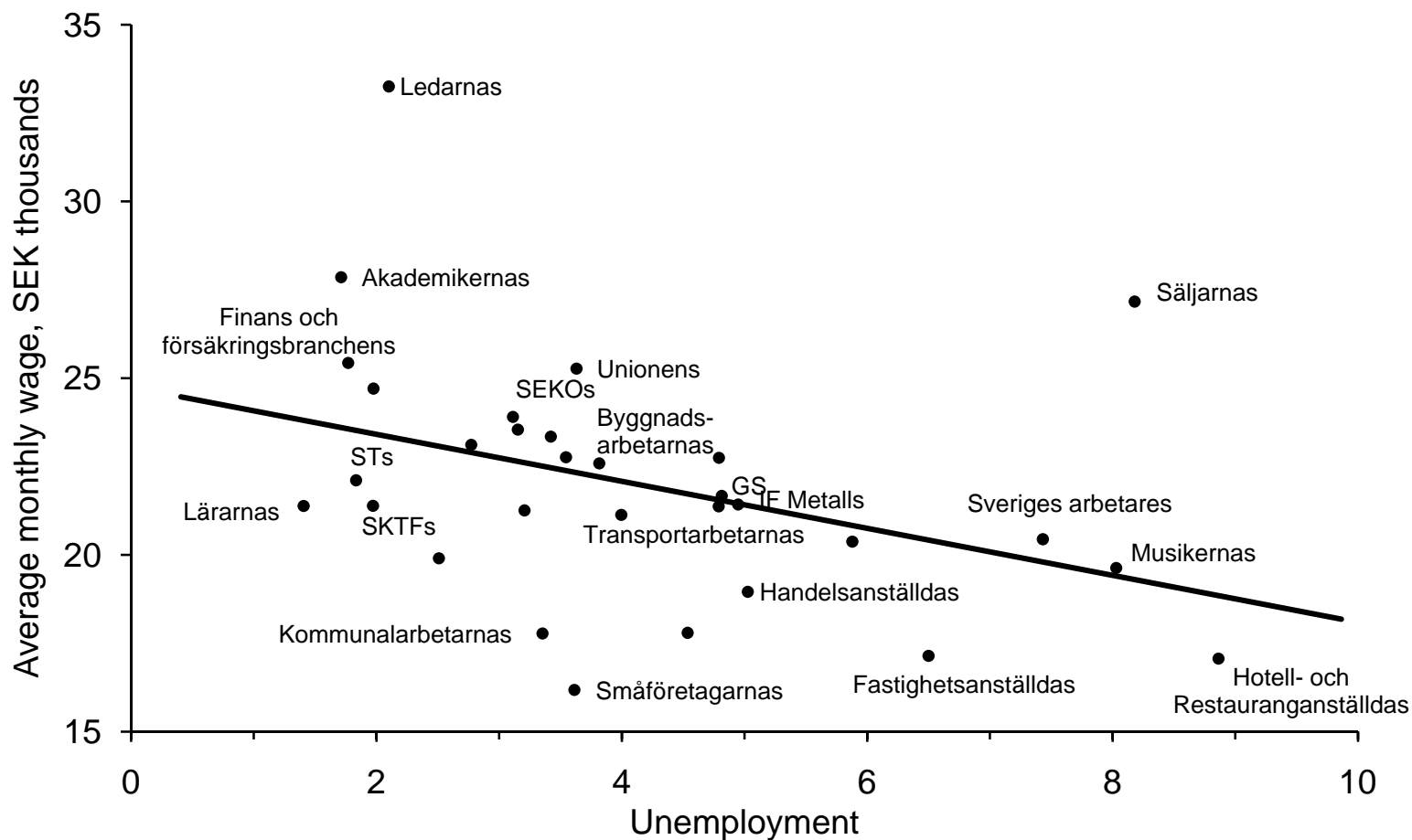
Wages and labour market reform

- The government acknowledge in this year's Spring Fiscal Policy Bill 2011 that the EITCs and reduced UI-benefits put downward pressure on wages
- But according to the government these effect are neutralised by the reduction in social contributions
- This argument is not convincing
- A report commissioned by the council finds a strong **negative** correlation between wages and after-tax unemployment benefit replacement rates for individuals

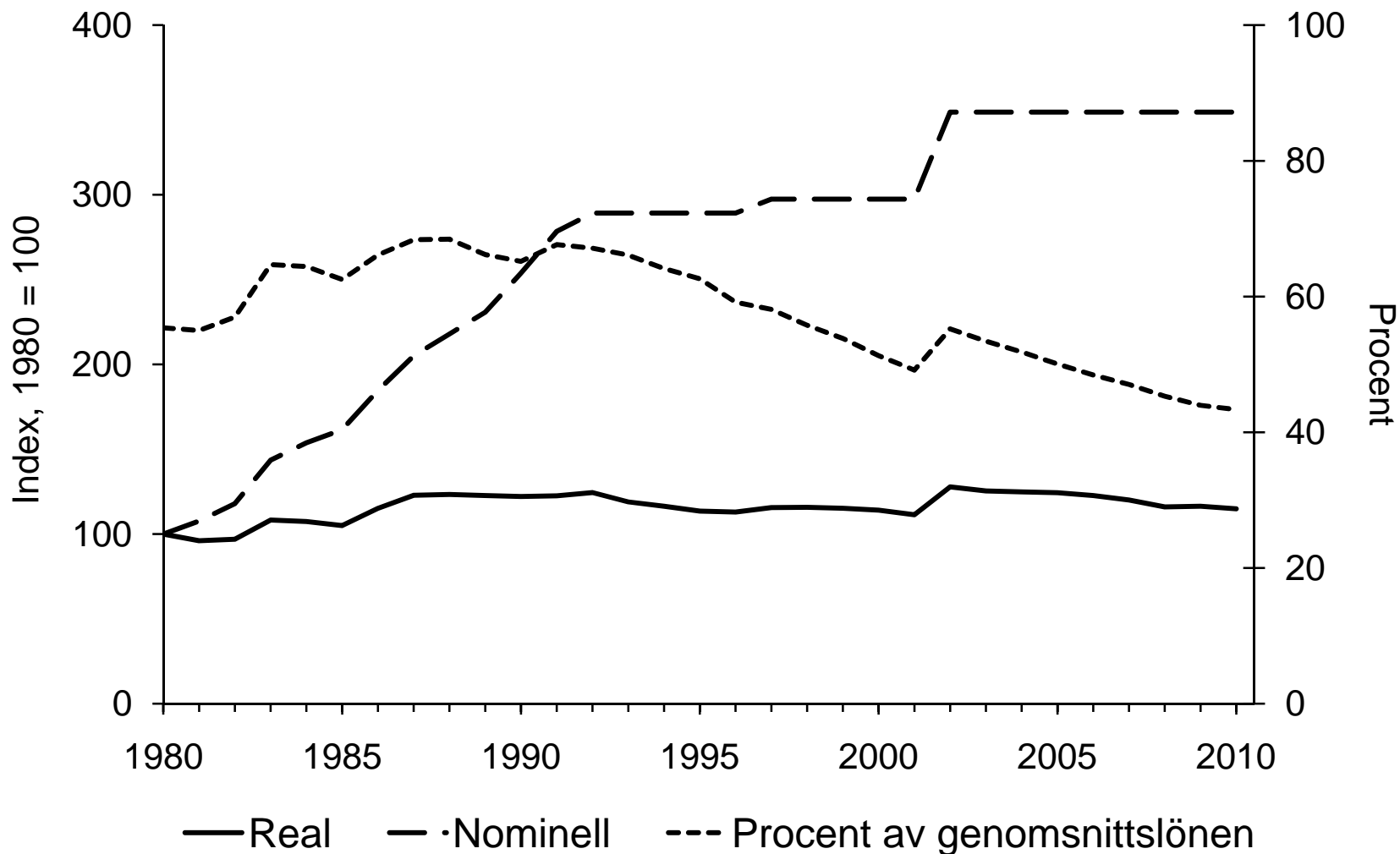
Differentiated employee contributions to unemployment insurance

- Theory suggest that differentiation leads to wage restraint under certain conditions
- But those conditions are not fulfilled in practise:
 - incomplete overlap between unemployment insurance funds and trade unions (2/3)
 - insurance funds do not finance long-term unemployment
 - high degree of informal coordination
- **Lite ull för mycket skrik (Little wool for much screaming)**
- Abolish differentiation if UI is kept voluntary!
- Strong arguments for mandatory system
- Differentiation can be strengthened in a mandatory system
- But is it worth the administrative hassle?

Average wage and unemployment in unemployment insurance funds



Highest daily benefits



The tax system

- 1990/91 tax reform – tax system should be **simple, uniform** and **neutral**
- Probably too little consideration of **optimal taxation theory**
- Large changes relative to the 1990/91 tax reform
- EITC, tax relief for RMI work, and abolished wealth tax can be motivated by social efficiency considerations
- Lower VAT on food, culture, and ski-lifts cannot be motivated by neither efficiency nor equity concerns
- At most small gains from reducing VAT on restaurants and catering services
- Uniform VAT preferable

Tax system should be reviewed

- Large social efficiency gains from lowering the top marginal income tax for high earners
- But this has distributional effects
- The distributional effects can be compensated by increasing the real estate tax
- Additional EITCs may not have diminishing effects
- Degree of self-financing of about 20 percent for EITCs
 - no separate estimate of step 5 in EITC
 - EITCs forces the government to reduce taxes for older people
- EITCs are costly – more difficult to finance public expenditures