

Swedish Fiscal Policy Council

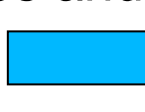

Background and organization

Meeting with Jean-Philippe COTIS

Stockholm

November 12, 2012

Sweden during the Recent Crisis

- Despite a 5% drop in GDP in 2009 and previously high fiscal balance elasticity, Sweden:
 - Moderate drop in fiscal balance;
 - Modest maximum deficit of 0.7%. Now surplus;
 - Recovered to pre-crisis GDP in 2010.
- Very different from the crisis in early 1990s: similar amplitude in GDP fall, *but* then an extreme deterioration of public finances and rise in unemployment and 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... 



Background to Reforms

- Sweden suffered a deep economic crisis in the 1990s:
 - Credit market deregulation in 1980s led to rapid credit expansion;
 - Rapidly increasing property prices, then collapse;
 - Banking crisis;
 - Large real appreciation leading up to crisis;
 - Exploding unemployment rates;
 - Very high interest rates;
 - Structural problems became apparent (tax system, pension system, wage formation, long run growth...).
- Similar to the current crisis in Spain.
- Crisis created a wide consensus on 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 taken over and split into good and bad banks. Ultimately not 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 independent central bank with inflation target. Large initial depreciation. Then more stable development of prices and wages. 
- New contributions-defined pension system, immune to variation in growth and demographics; 
- New Fiscal Policy Framework. (FPC much later)

The Swedish Fiscal Framework

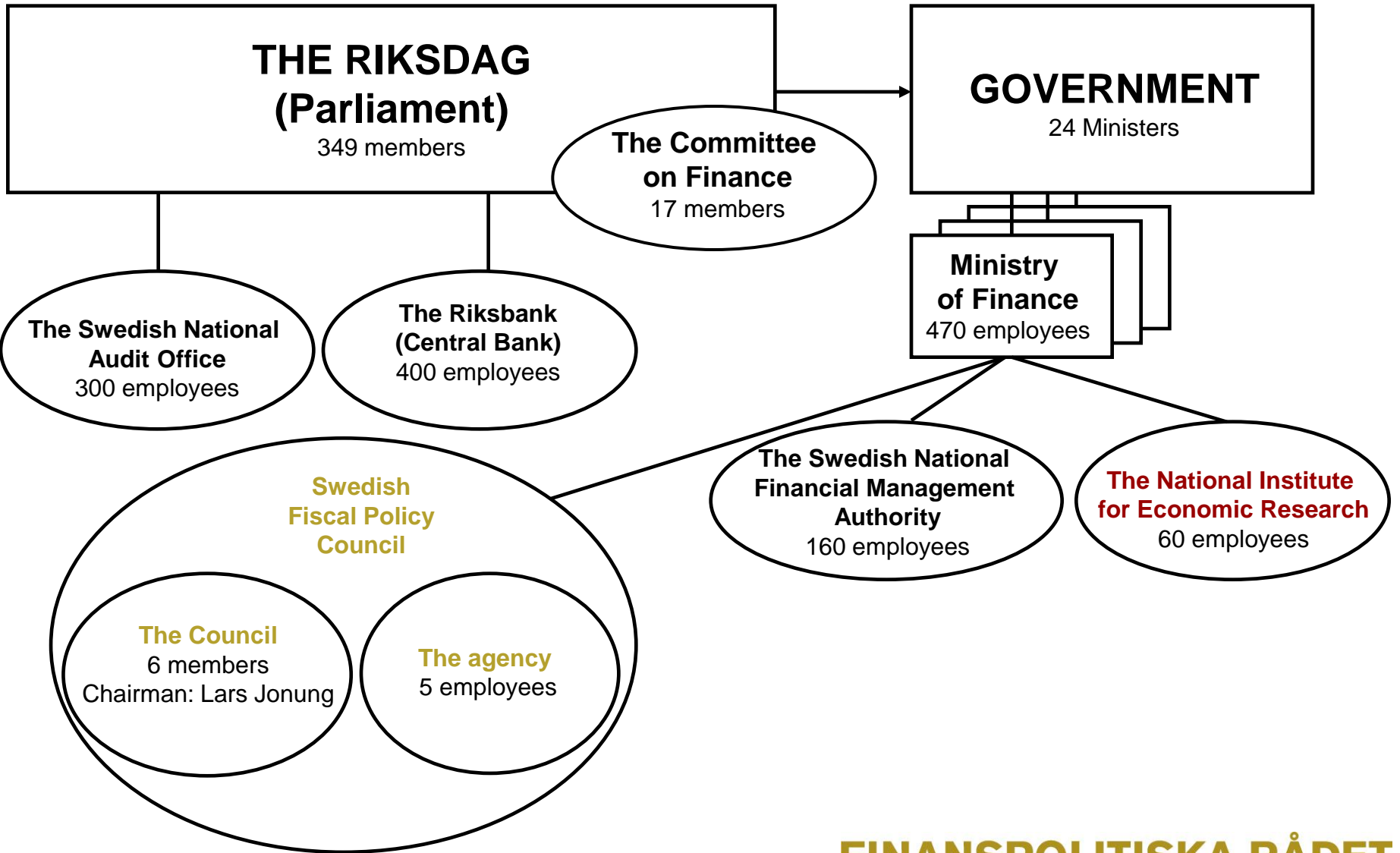
- Top-down budget process;
- A fiscal *surplus target* for general government net lending of 1% of GDP, on average, over the business-cycle. Involves judgment;
- Central government *expenditure ceiling* set 3 years in advance;
- Balanced budget requirement for local governments;
- Since 2007, a Fiscal 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...*

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 but not when problems are structural.
- **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, but broad political *and* popular support for reform necessary. A political *story* is needed;
 - Institutional reform should be politically neutral.
 - Institutional reforms can peg down and enhance institutional memory.
- **Competitiveness is key for fiscal adjustment.**
 - Fiscal adjustment largely after growth had resumed.

The set-up of the council

- Established in 2007, at first politically controversial.
- An agency under the Government;
- Six members:
 - Academics (typically well-known and resting on tradition of strong public standing);
 - Policy-making experience;
- Supplementary activities to ordinary jobs (mainly academic positions);
- Small secretariat: five persons;
- Annual budget 900 000 €;
- Some provisions to safeguard the Council's independence, but more important is strong outside option of academics. Not a career path.



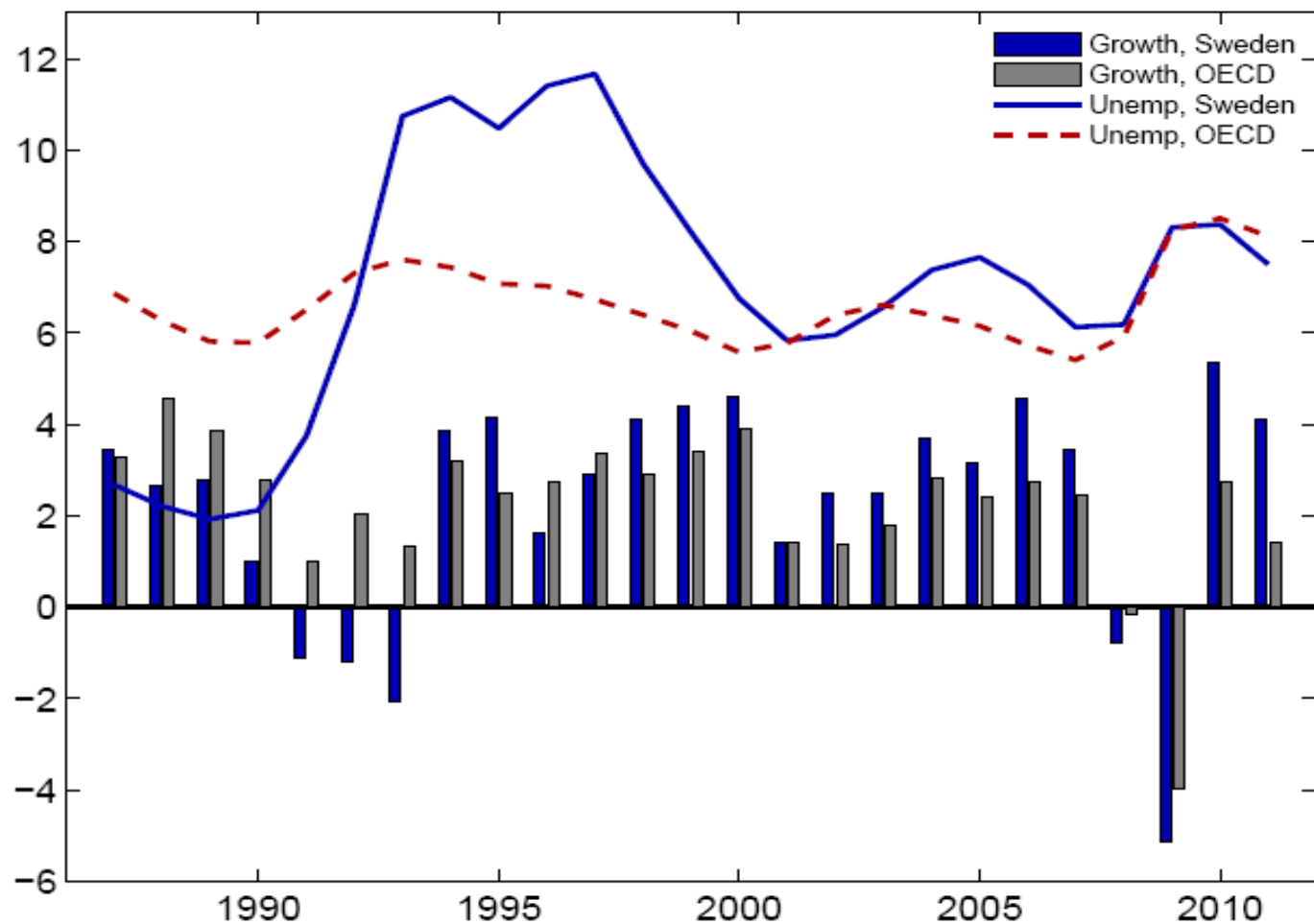
The tasks of the Fiscal Policy Council

1. Focus on *ex post* evaluation, with some *ex ante* evaluation;
2. Quite broad remit with substantial freedom to interpret.
3. Evaluate whether fiscal policy meets its objectives:
 - Long-run sustainability, surplus target, expenditure ceiling;
 - Fiscal stance wrt business cycle.
4. Evaluate if developments are in line with healthy sustainable growth and sustainable high employment;
5. Monitor transparency of government budget proposals and motivations for various policy measures;
6. Analyze effects of fiscal policy on distribution of welfare;
7. Contribute to better economic policy discussion in general:
 - Annual report in May (this year May, 14);
 - More information on www.finanspolitiskaradet.se.

Has the fiscal policy framework worked?

- Generally successful implementation:
 - Top-down approach is followed;
 - Spending ceilings have not been passed (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 (and FPC!) 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.

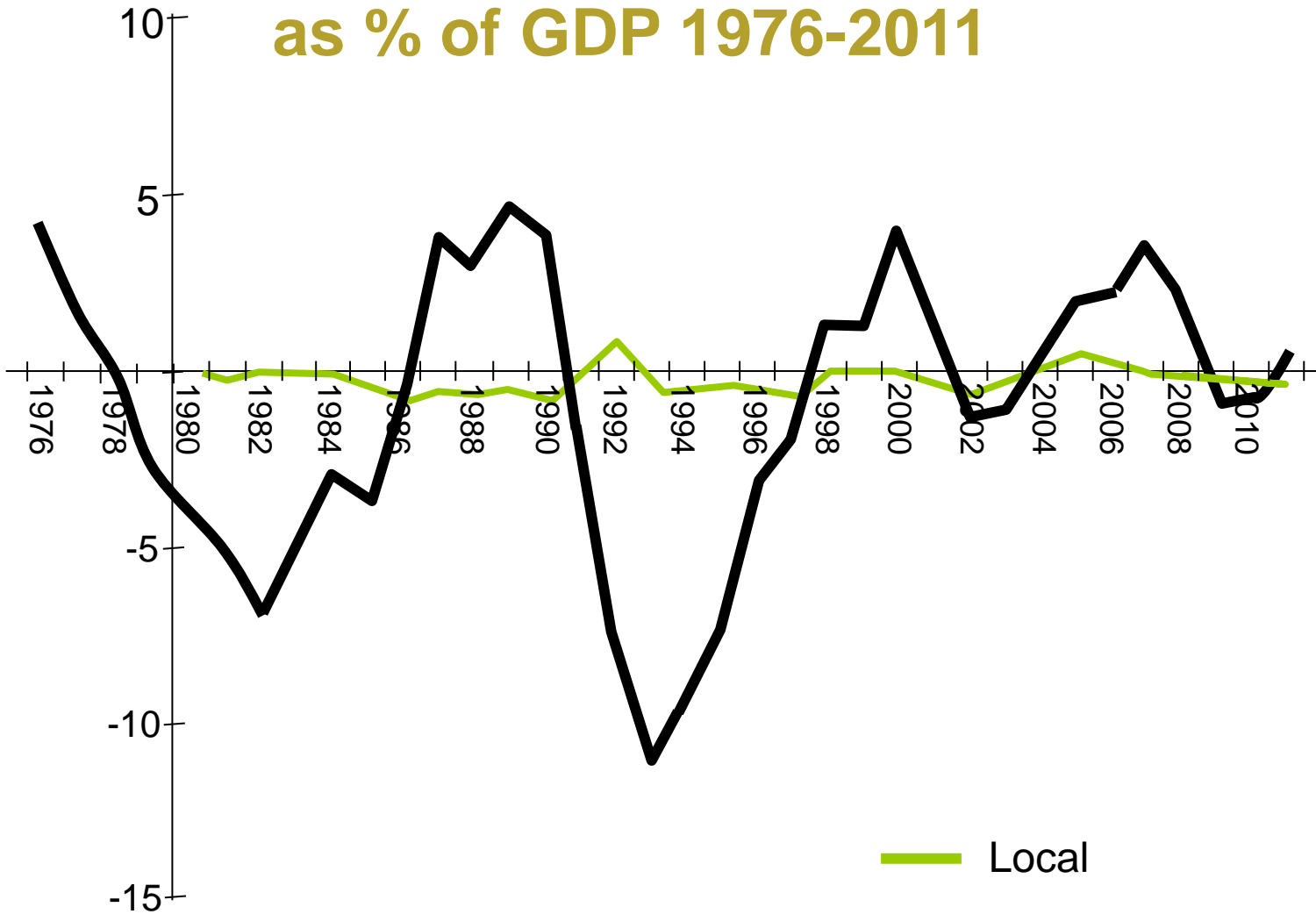
Growth and Unemployment 1985-2012



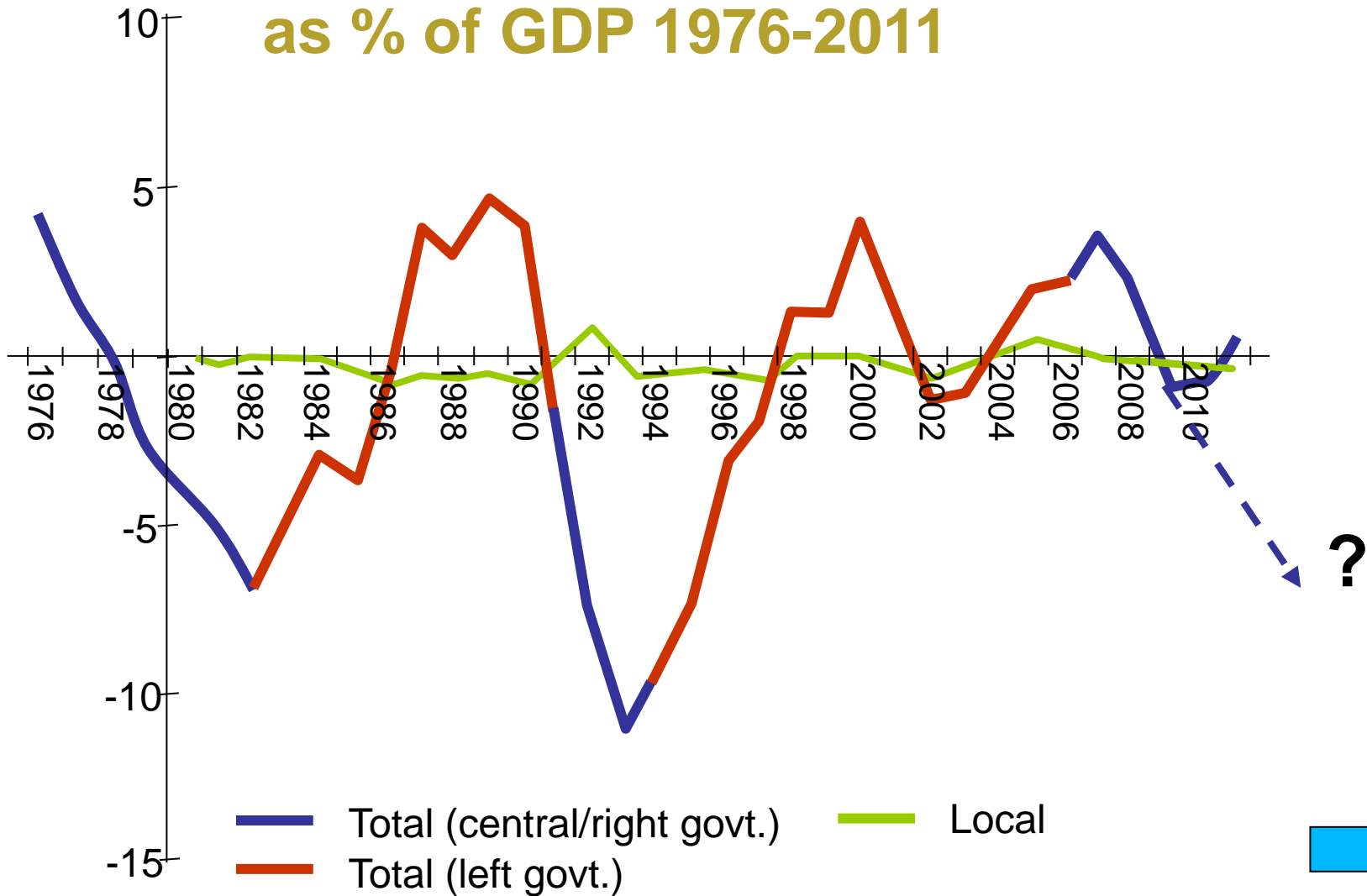
Note: Growth rate of GDP (percent) in Sweden and weighted average of 19 OECD countries.

Source: OECD Economic Outlook December 2011.

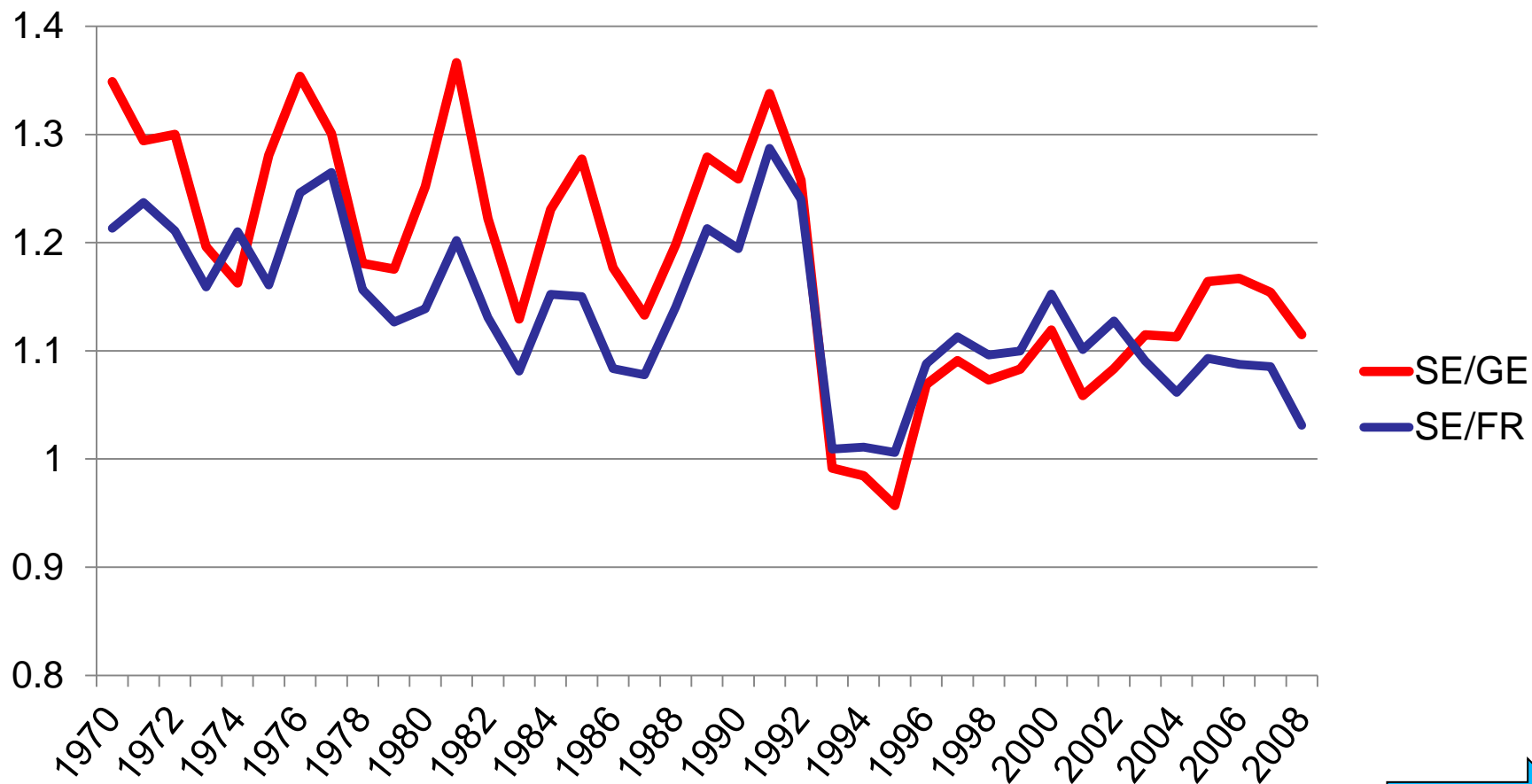
General Government Net Lending as % of GDP 1976-2011



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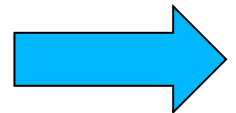
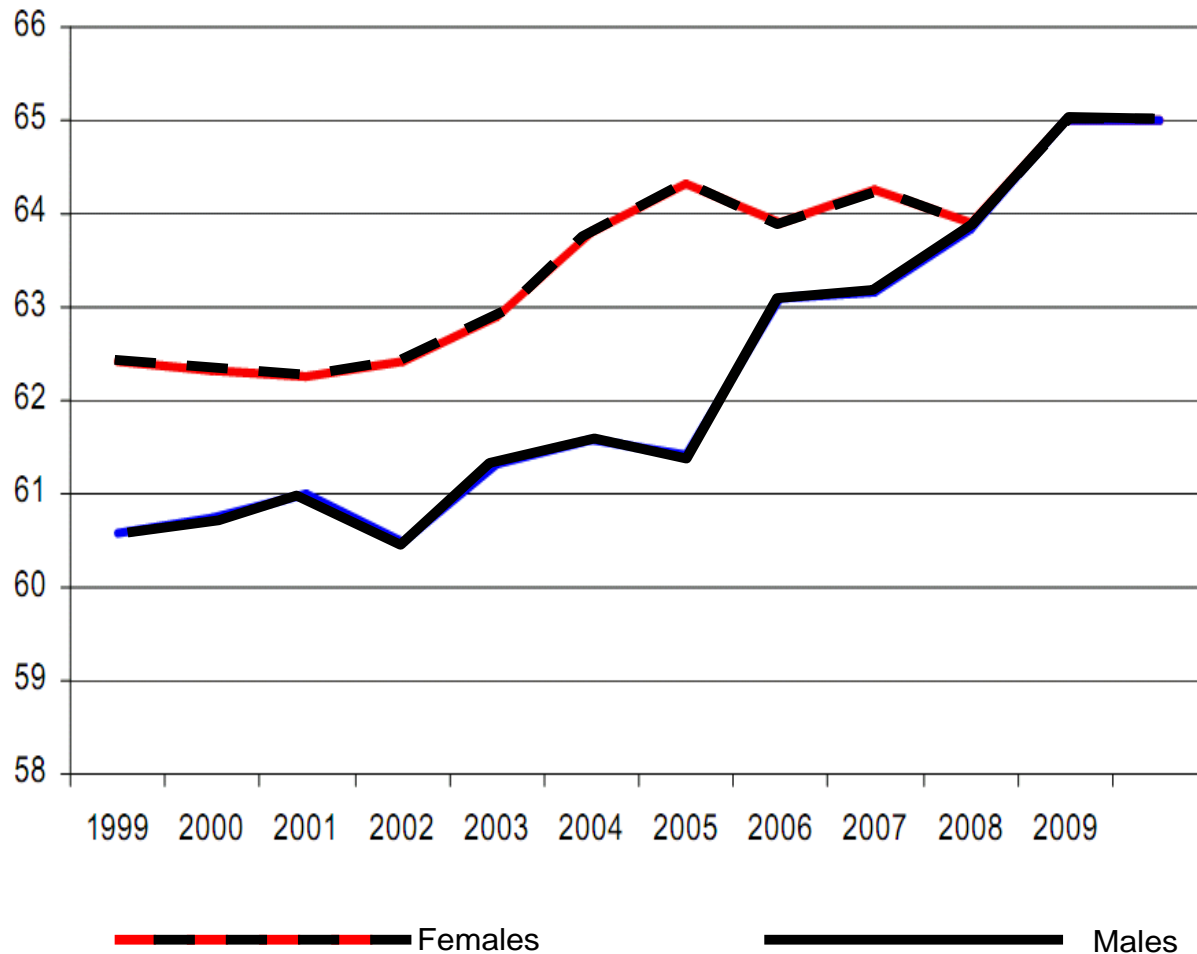


Swedish prices relative to French and German



Average retirement age – state employees

Retirement age



Themes in the reports

- Increase the clarity of the surplus target (net lending of 1% of GDP over a business cycle):
 - Underlying fundamental objectives
 - Too many indicators
- 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;
- The economic reporting of the Government.