# Swedish Fiscal Policy

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Meeting with IMF

28 May 2010

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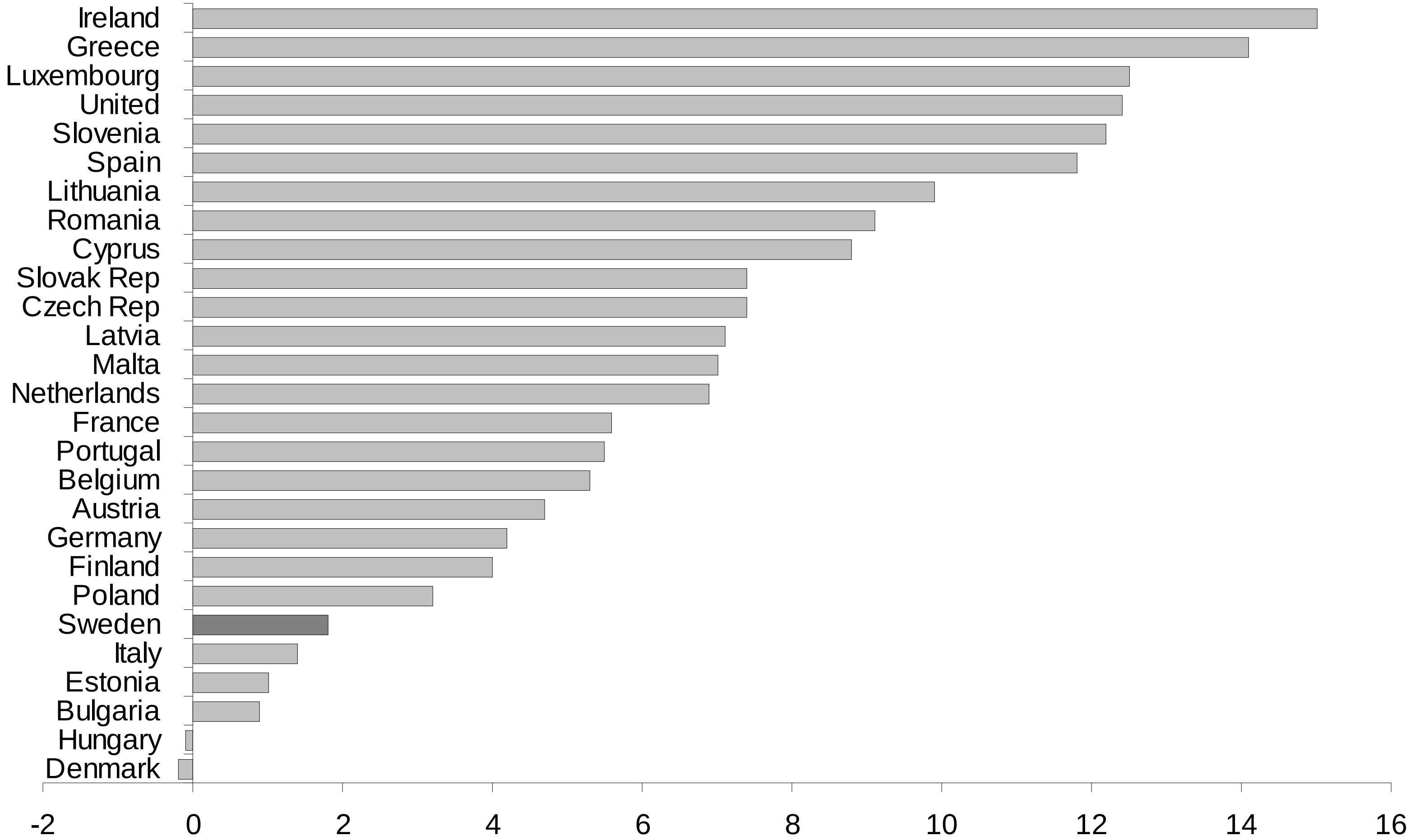
# The S2 indicator

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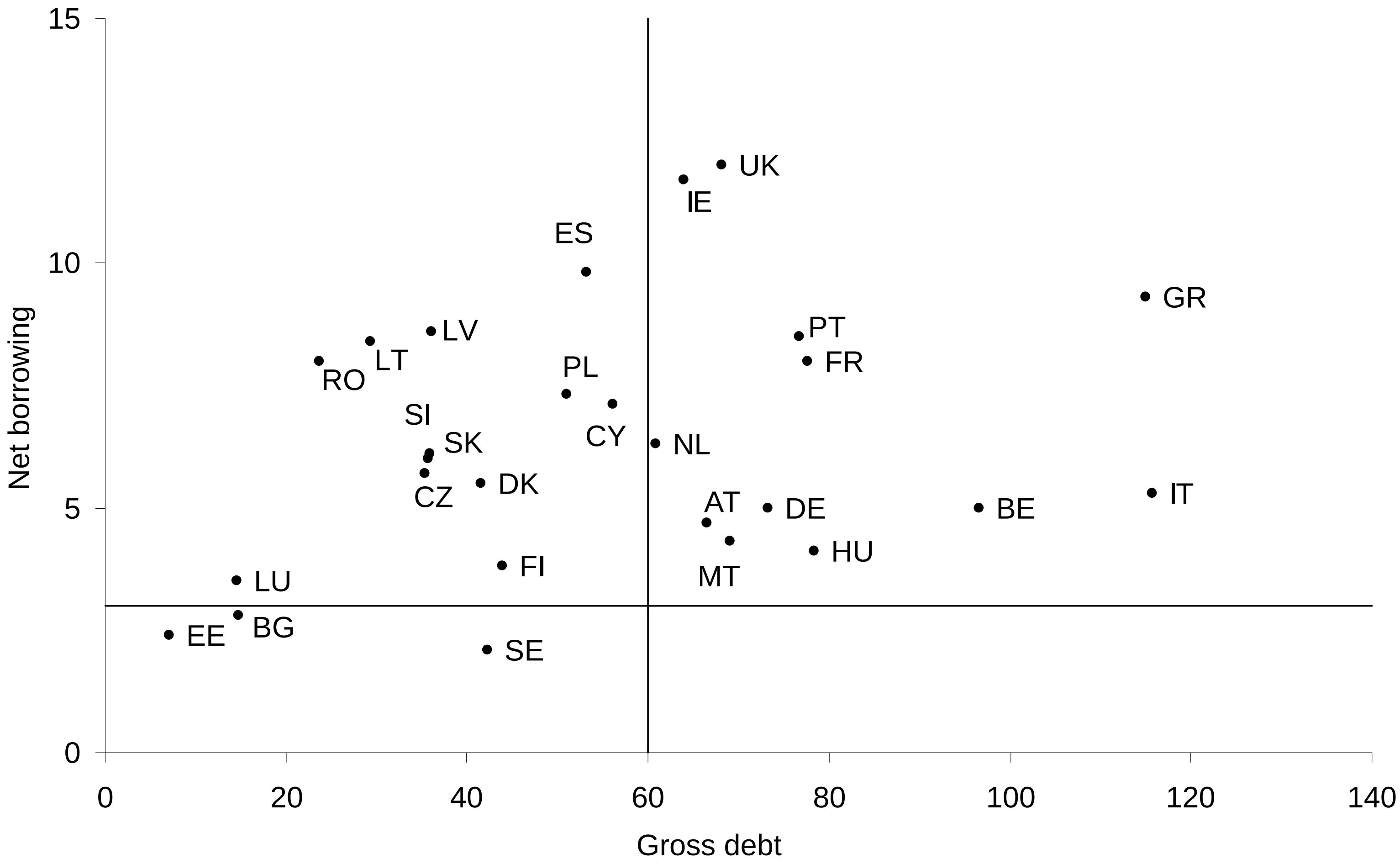
# Net lending and debt ratios, percent of GDP

| | Net lending | | Gross debt | |
|---|---|---|---|---|
| | 2009 | 2010 | 2009 | 2010 |
| France | -8.2 | -8.6 | 84.5 | 92.5 |
| Greece | -12.7 | -9.8 | 114.9 | 123.3 |
| Ireland | -12.2 | -12.2 | 65.8 | 81.3 |
| Italy | -5.5 | -5.4 | 123.6 | 127.0 |
| Japan | -7.4 | -8.2 | 189.3 | 197.2 |
| Portugal | -6.7 | -7.6 | 83.8 | 90.9 |
| United Kingdom | -12.6 | -13.3 | 71.0 | 83.1 |
| USA | -11.2 | -10.7 | 83.9 | 92.4 |

# Challenges for fiscal policy

- Need for clear and credible exit strategies
- Probably not possible to condition fiscal policy on business cycle developments
- Unconditional strategy: consolidation even if the slump continues
- Consolidations should be rapid
- Fine tuning not an option

# Public finances in the EU 2010 and the rules in the stability pact

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# Uncertain room for reform in Sweden

- Permanent reforms of SEK 7 000 million in Spring Fiscal Policy Bill
- Uncertainty on the long-run effects of the crisis on the public finances
- Additional promises of unfinanced **permanent** reforms unwise
- Announced reforms may have to be reconsidered

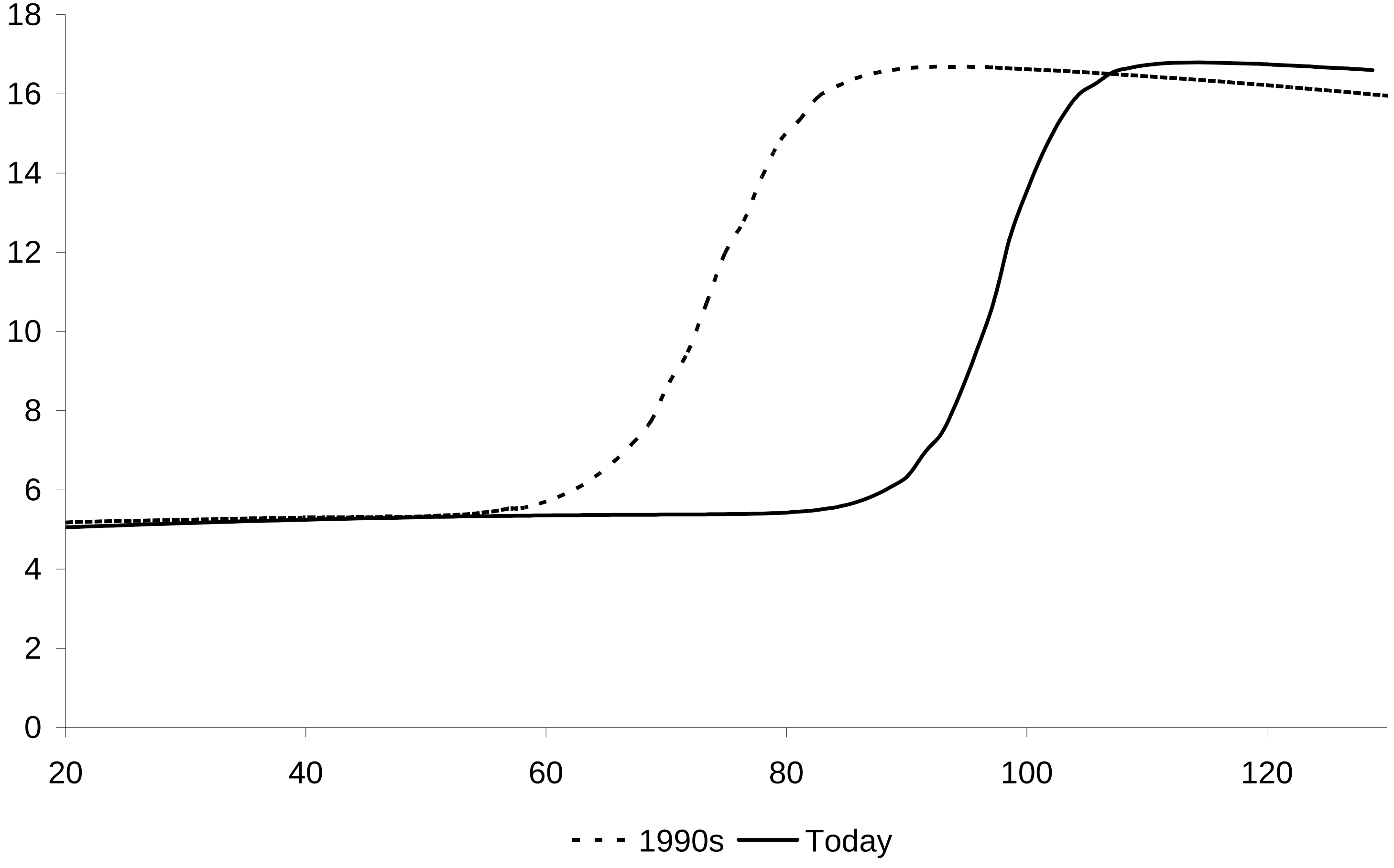
# But there is room for manoeuvre in stabilisation policy

- No binding sustainability restriction that prevents **temporary** stimulus measures
- There is a political choice between stabilisation and rapidly restoring public finance buffers for the future
- Extension of extra grants to local governments 2011?

  - could achieve some increase in employment

  - but risk that the grants are perceived as permanent
- Need for rules system to smooth local governments' incomes over the business cycle
- The government has acted too slowly in this matter

# Public sector debt-to-GDP ratio and interest rate on government debt, 1990s vs today

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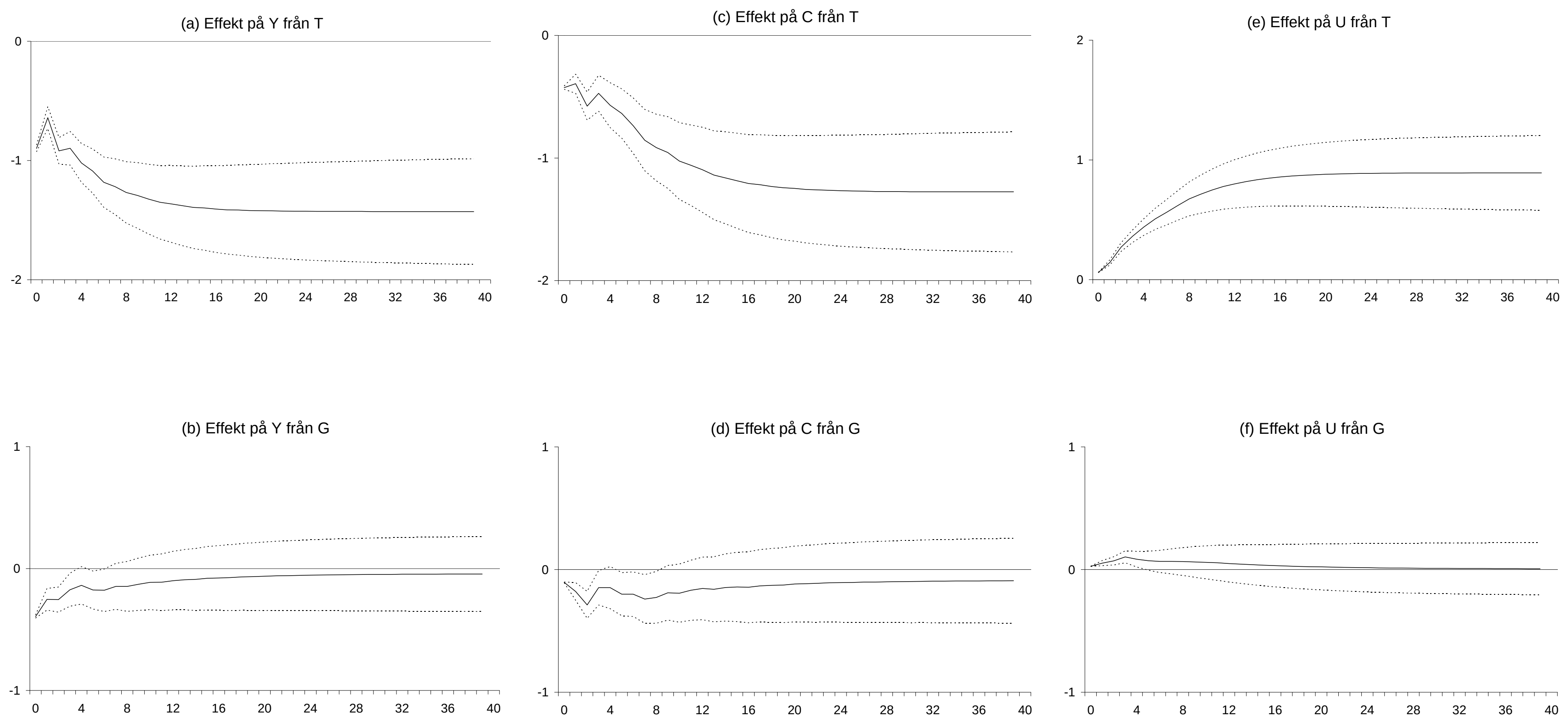
# Effect of higher taxes or lower gov't spending in "normal" times

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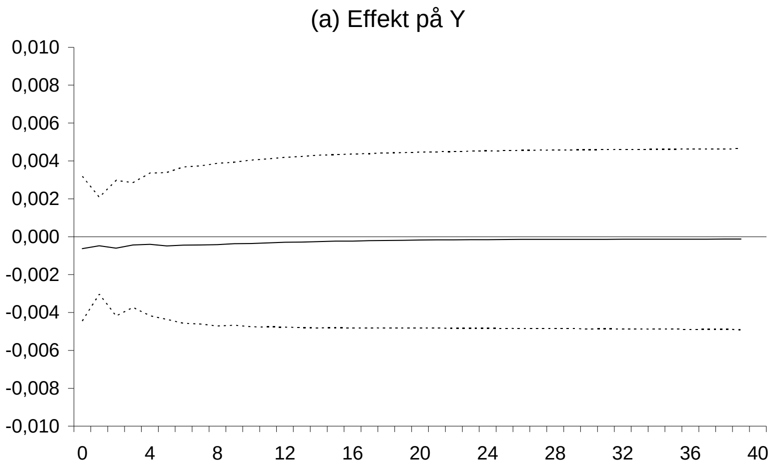
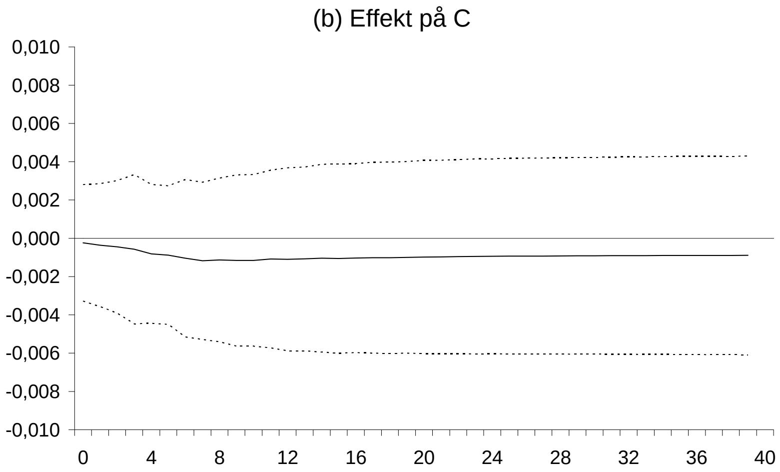
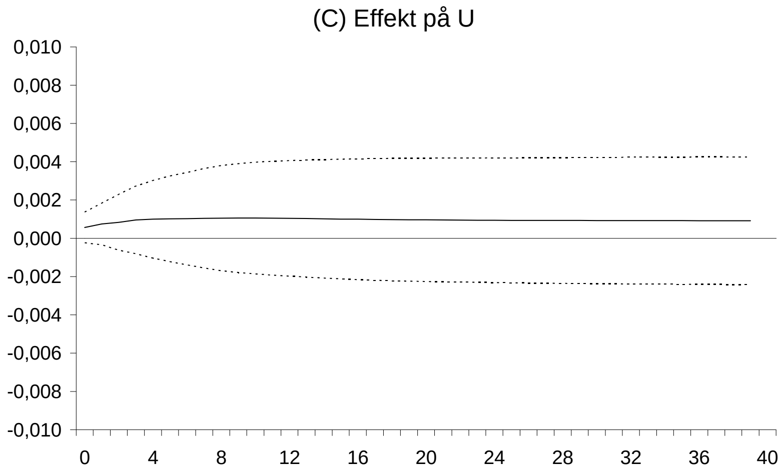
# Effect of fiscal consolidation

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# The surplus target

- Financial net lending of one percent of GDP **over the business cycle**
- Statutory goal increases credibility
- Good that the government makes clear that pre-funding should not be used to meet future costs of higher life expectancy or higher quality of welfare services
- But the government (as well as the opposition) avoids the question of how future welfare services should be financed

# Evaluation of the surplus target

- Not clear if deviations should be compensated
- The government seems to think it is more important to **try** to fulfil the goal in the future than to **actually** fulfil it in a specified period
- Confusion of backward and forward-looking perspective
  - evaluation of whether the goal is met
  - planning tool for future fulfilment of the goal
- Only **two** indicators should be used!
- **Special communication to the parliament if deviation from (at least one of) the targets by some magnitude** (0.5 percent of GDP?)

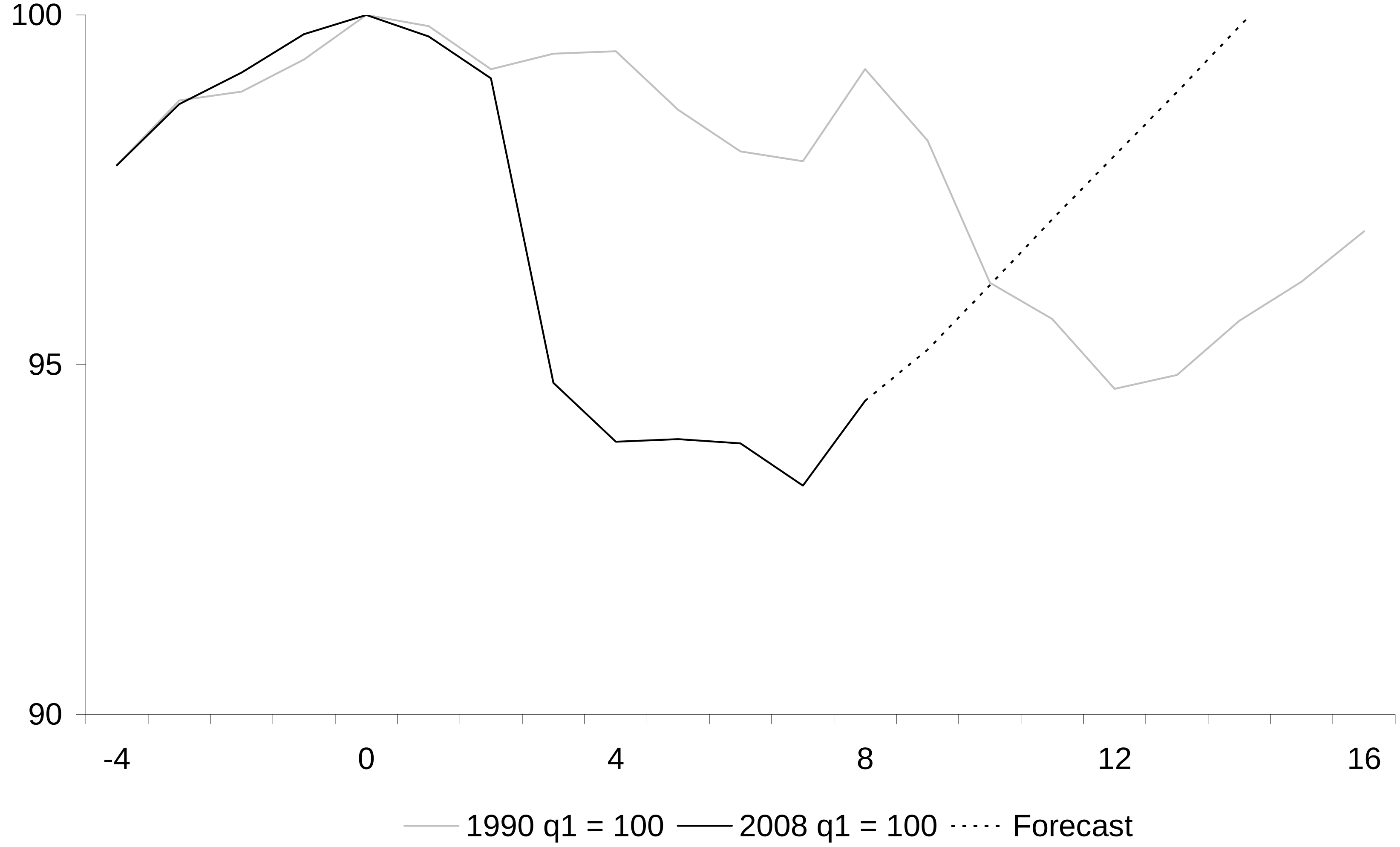
# Indicators used by the government to assess if surplus target is met, percent of GDP

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|
| **Backward-looking ten-year average** | **1.3** | | | | | |
| **Cyclically adjusted backward-looking ten-year average** | **1.4** | | | | | |
| **Forward-looking seven-year indicator** | **0.7** | **0.5** | **0.3** | | | |
| **Cyclically adjusted seven-year indicator** | **1.4** | **1.6** | **1.6** | | | |
| **Structural net lending** | **2.2** | **0.4** | **0.7** | **1.5** | **2.0** | 2.4 |
| **Forward-looking ten-year indicator** | **0.7** | **0.9** | **1.1** | | | |

# The labour market

- Smaller decrease in employment, given the fall in output, than in the 1990s crisis
- Private service sector has fared well compared to the manufacturing sector
- No large public sector layoffs
- The government’s labour market reforms?

# GDP compared to crisis in the 1990s

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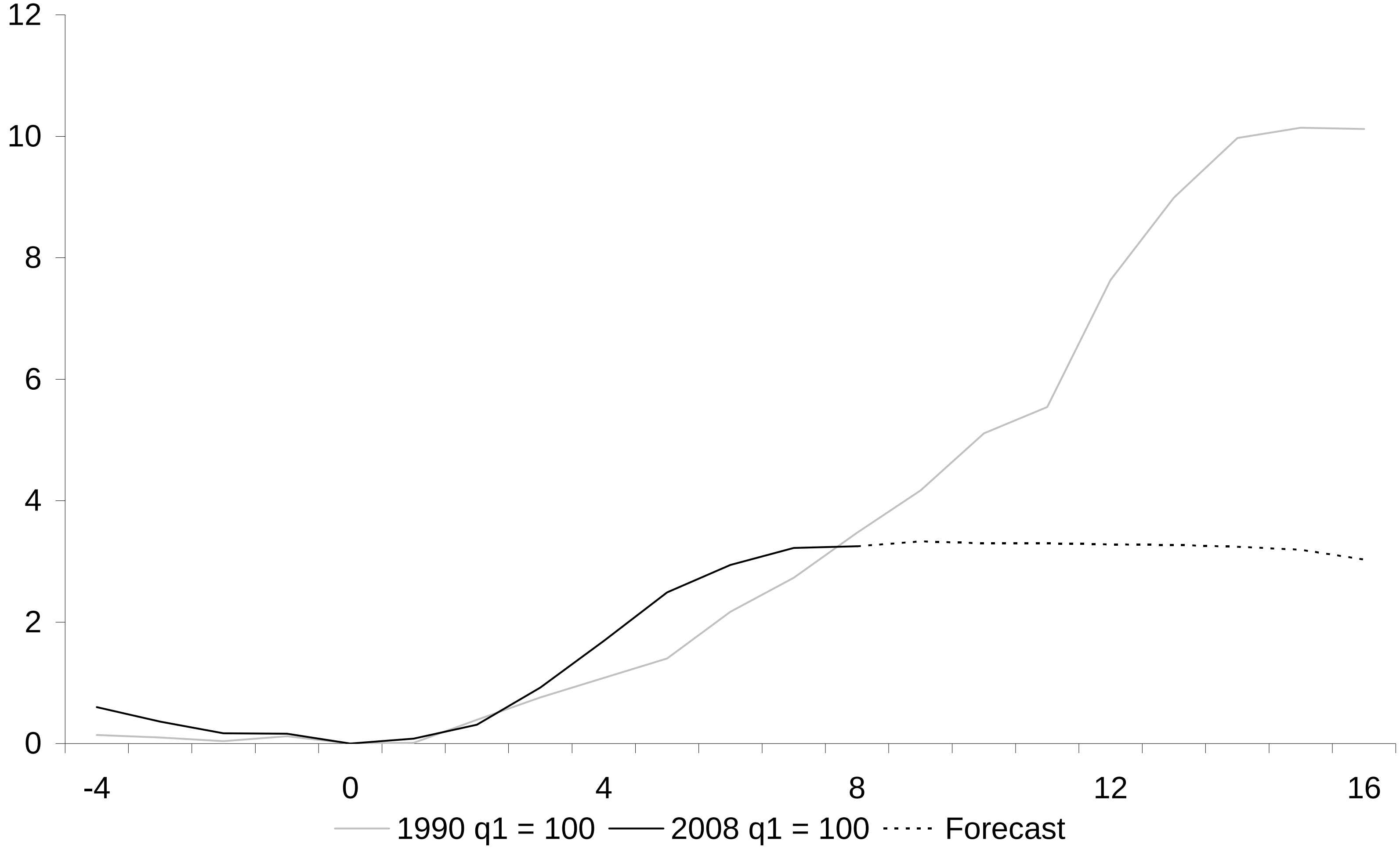
# Unemployment compared to crisis in the 1990s, difference in percentage points

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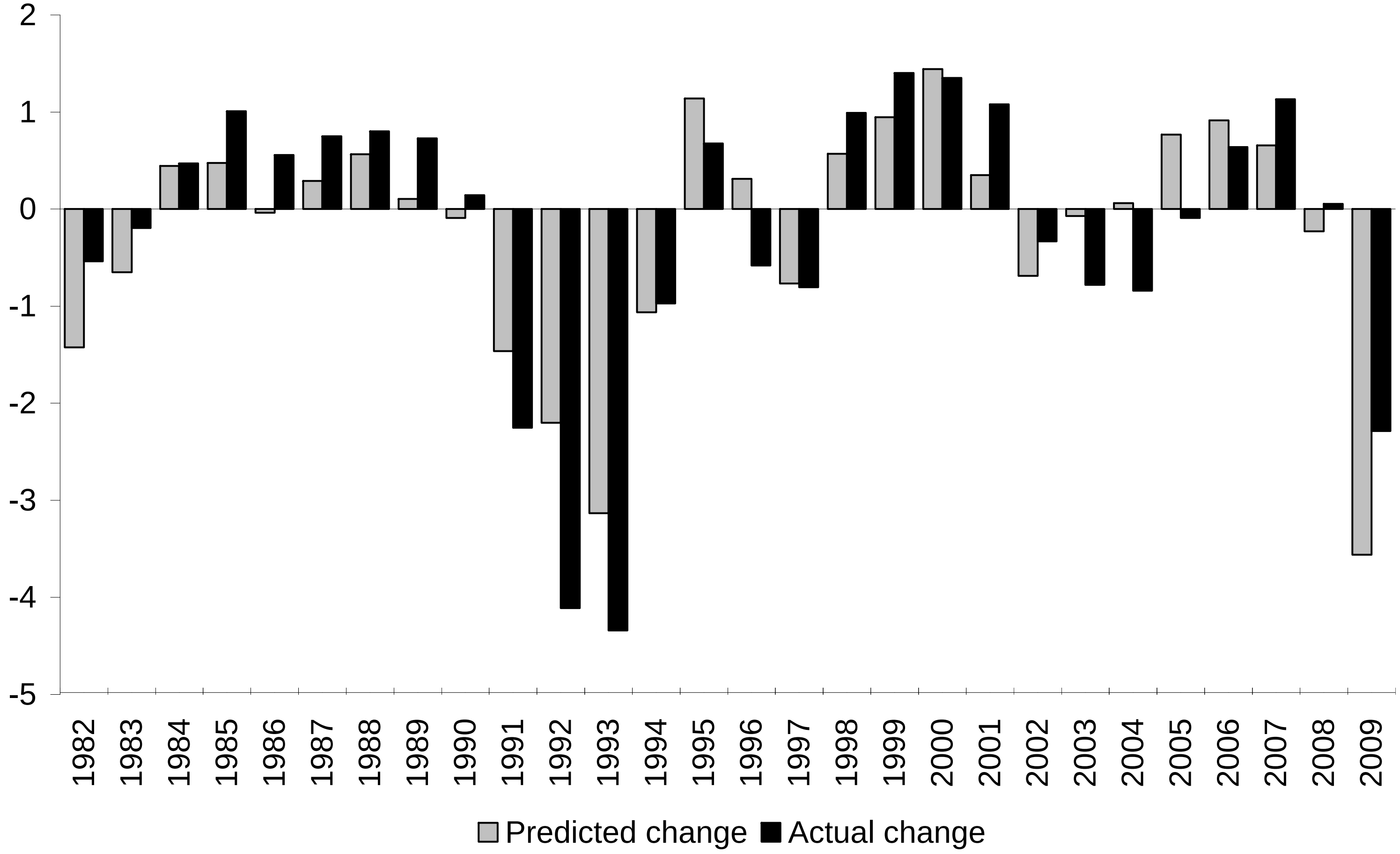
# Actual and predicted (using Okun's law) change in employment

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# Change in employment rate, percentage points

| | All | Young | Old (55-64) | Born outside Europe | No upper secondary education |
|---|---|---|---|---|---|
| 1990–1992 | -5.8 | -13.9 | -2.4 | -12.7 | -8.0 |
| 1990–1997 | -12.4 | -26.4 | -6.8 | -20.0 | -14.0 |
| 2001–2004 | -1.8 | -5.1 | 2.6 | -2.5 | -4.4 |
| 2008 Q1–2010 Q1 | -2.8 | -5.7 | 0.6 | - | - |
| 2007–2009 | -2.2 | -5.0 | 0.0 | -2.4 | -5.1 |

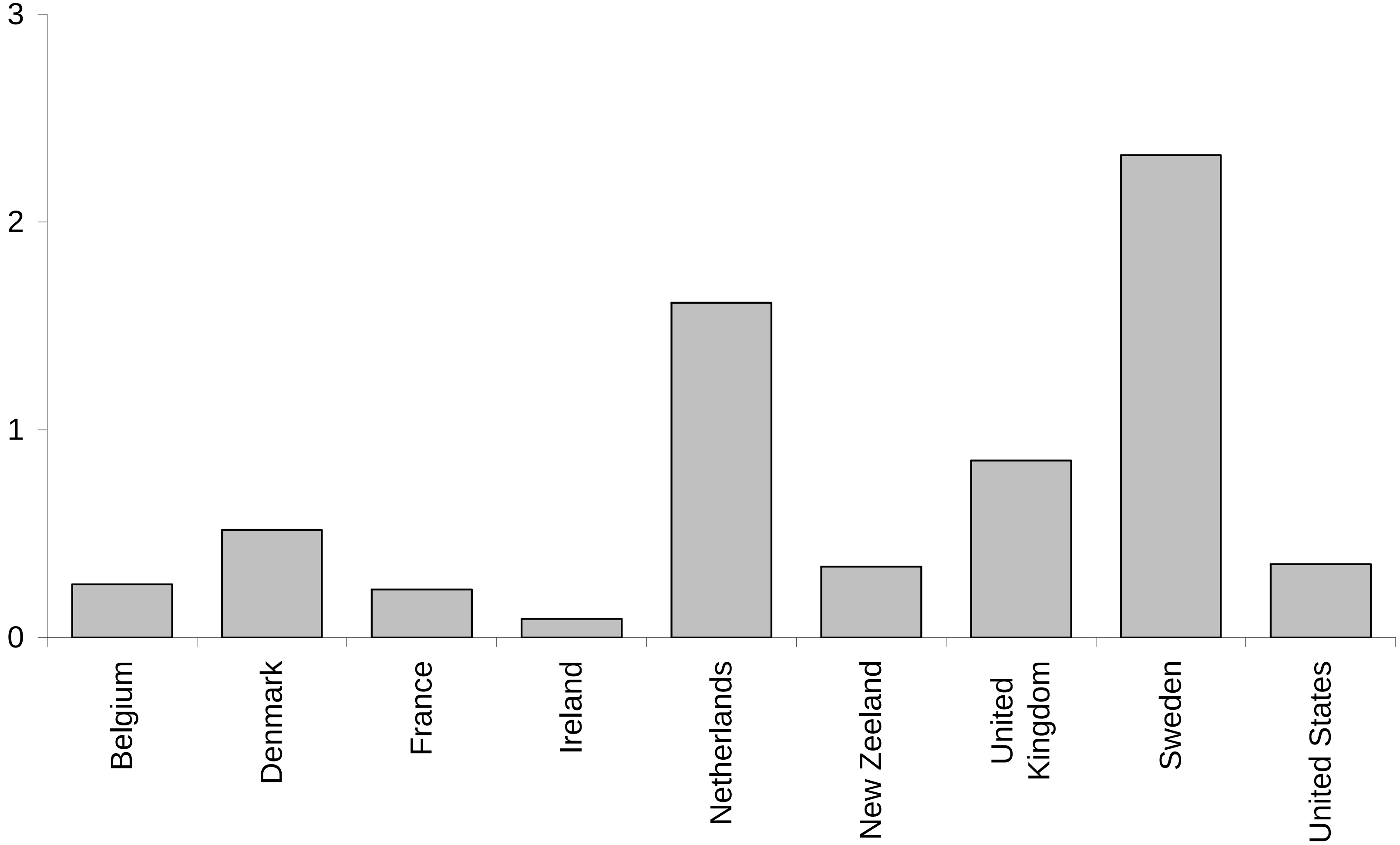
# Relative change in employment rate

| | Young | Old (55-64) | Born outside Europe | No upper secondary education |
|---|---|---|---|---|
| 1990–1992 | 2.4 | 0.4 | 2.2 | 1.4 |
| 1990–1997 | 2.1 | 0.5 | 1.6 | 1.1 |
| 2001–2004 | 2.8 | -1.4 | 1.4 | 2.4 |
| 2008 Q1–2010 Q1 | 2.0 | -0.2 | - | - |
| 2007–2009 | 2.3 | 0.0 | 1.1 | 2.4 |

# The earned income tax credit

- 17 of 30 OECD-countries have such credits in some form
- Everyone with an earned income receives credit in Sweden
  - only Denmark and the Netherlands have the same construction
  - common to phase out credit with income
- But a phase-out would imply large marginal effects in Sweden due to high marginal taxes

# Direct cost of earned income tax credit in different countries, percent of GDP

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# How does the earned income tax credit work?

- Stronger incentives to **supply** labour
- Why does labour **demand** increase?
  - **smaller** wage gains **before** tax
- But **larger after-tax** wage gains
- Why should this be controversial?

# The government's estimates of the effects of the EITC

- Increased employment of 80 000 persons in the long run
- The calculations follow best practice
- But best practice is not that good

  - supply effects

  - many effects not accounted for
- Hard to determine if the estimates are too optimistic or too pessimistic
- The government should acknowledge the great uncertainty

# Taxation of earned incomes and pension incomes

- Lower taxes on earned incomes than on pension makes sense if the policy goal is to increase employment
- One could in principle grant EITC to the part of the pension which constitutes deferred pay

  - complicated system
- Redistribution between individuals

  - current retirees did not get the earned income tax credit

  - special tax cut as compensation?

  - but no motive for permanently lower taxes for those over 65

  - tax cut linked to year of birth

  - automatic phase-out in that case

# Sickness insurance reforms

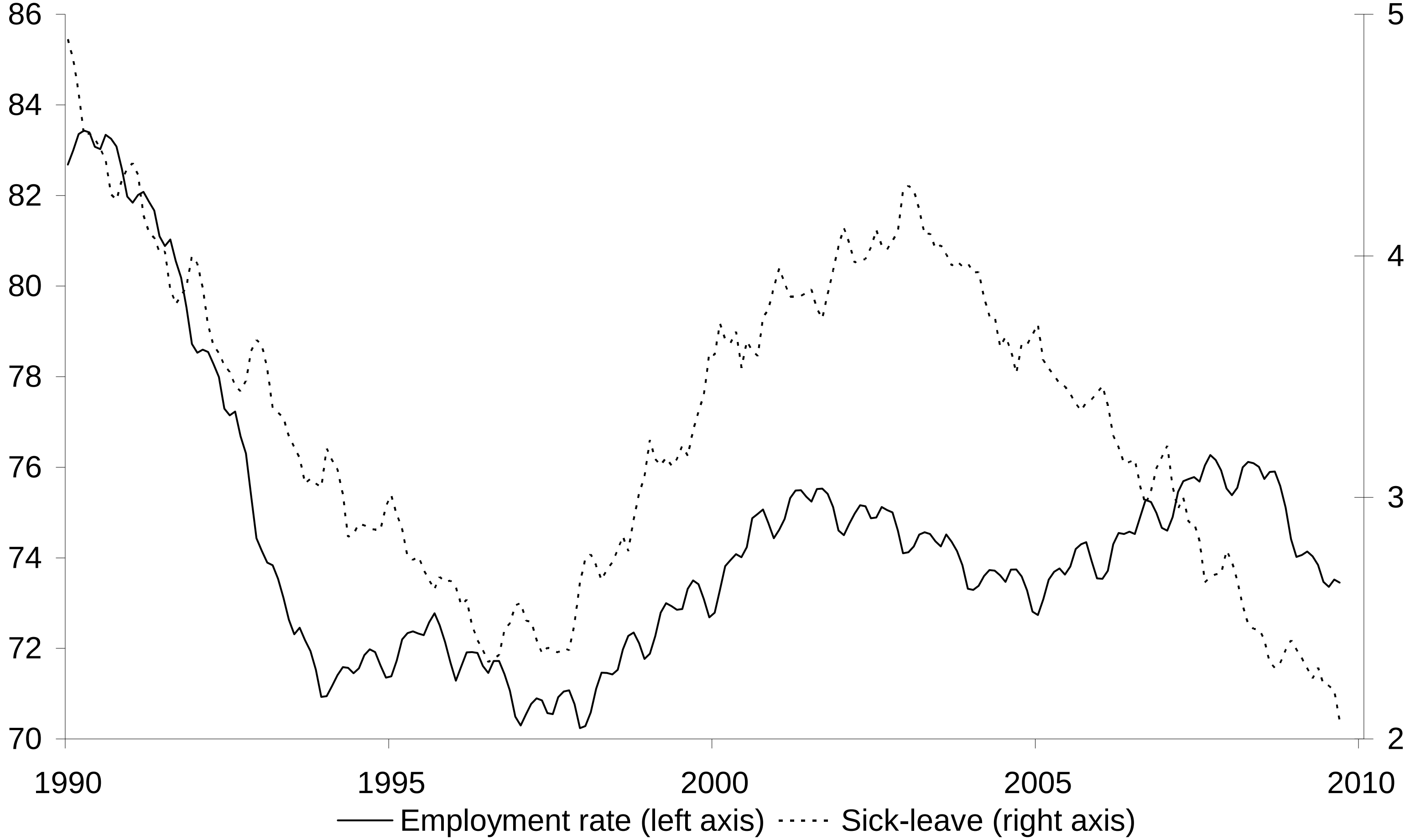
- The government has tackled a difficult problem
- Mistakes are inevitable
- But they have been too many
- Differentiate between **stock** and **flow**

  - new rules could have applied only to the inflow

  - this would have implied experimentation on a smaller scale
- Disability pensions for young people still increasing
- Are the requirements for disability pension too strict for old people?

  - **permanent** instead of **long-lasting** disability

# Employment rate and sick-leave, percent of the labour force and employment respectively

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# Newly-granted disability pensions


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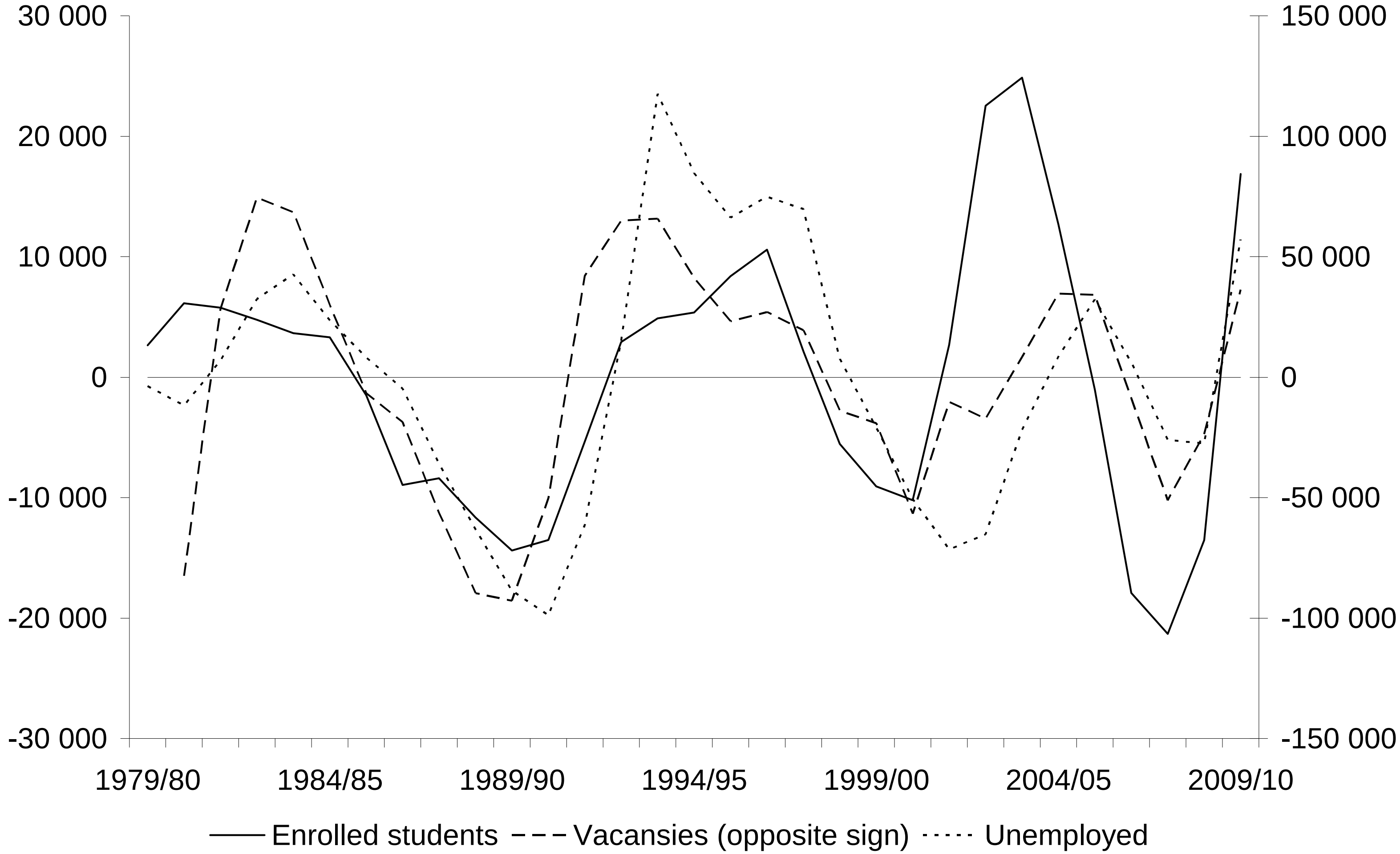
# Enrolled college students, vacancies and unemployed, deviations from trend

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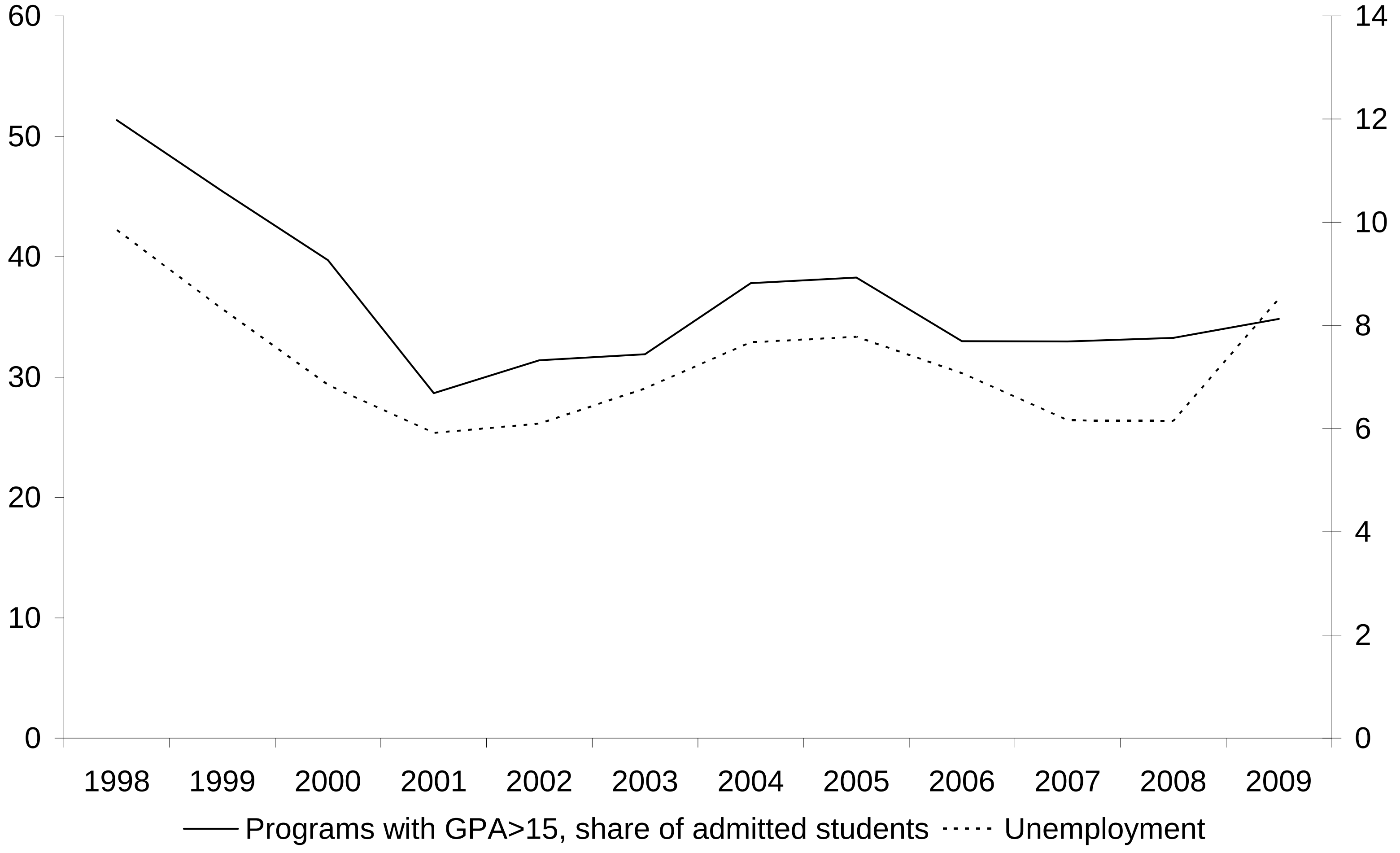
# Unemployment and share of admitted to programs where lowest GPA among admitted was above 15 (PwD)

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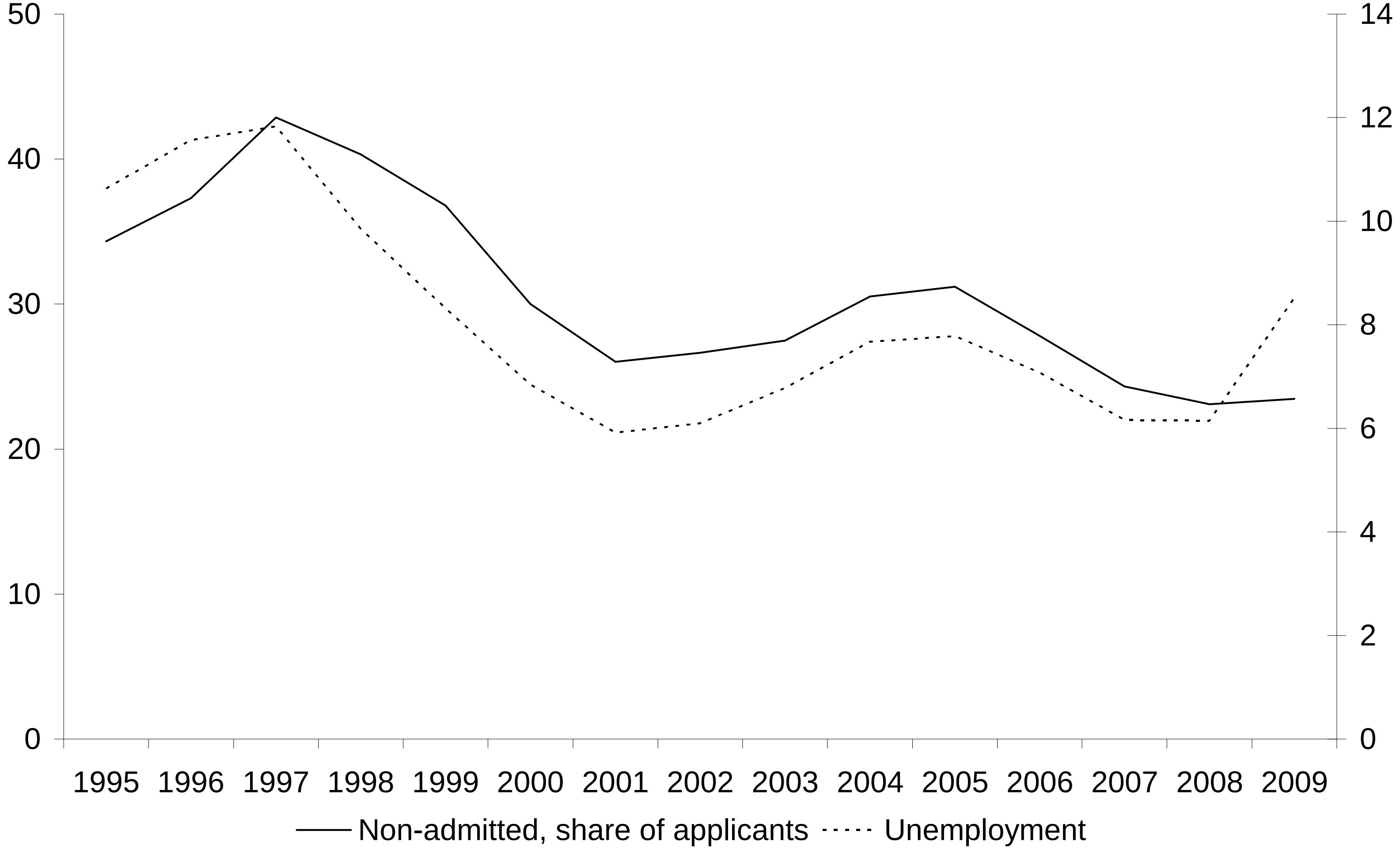
# Unemployment and share of non-admitted first-choice applicants

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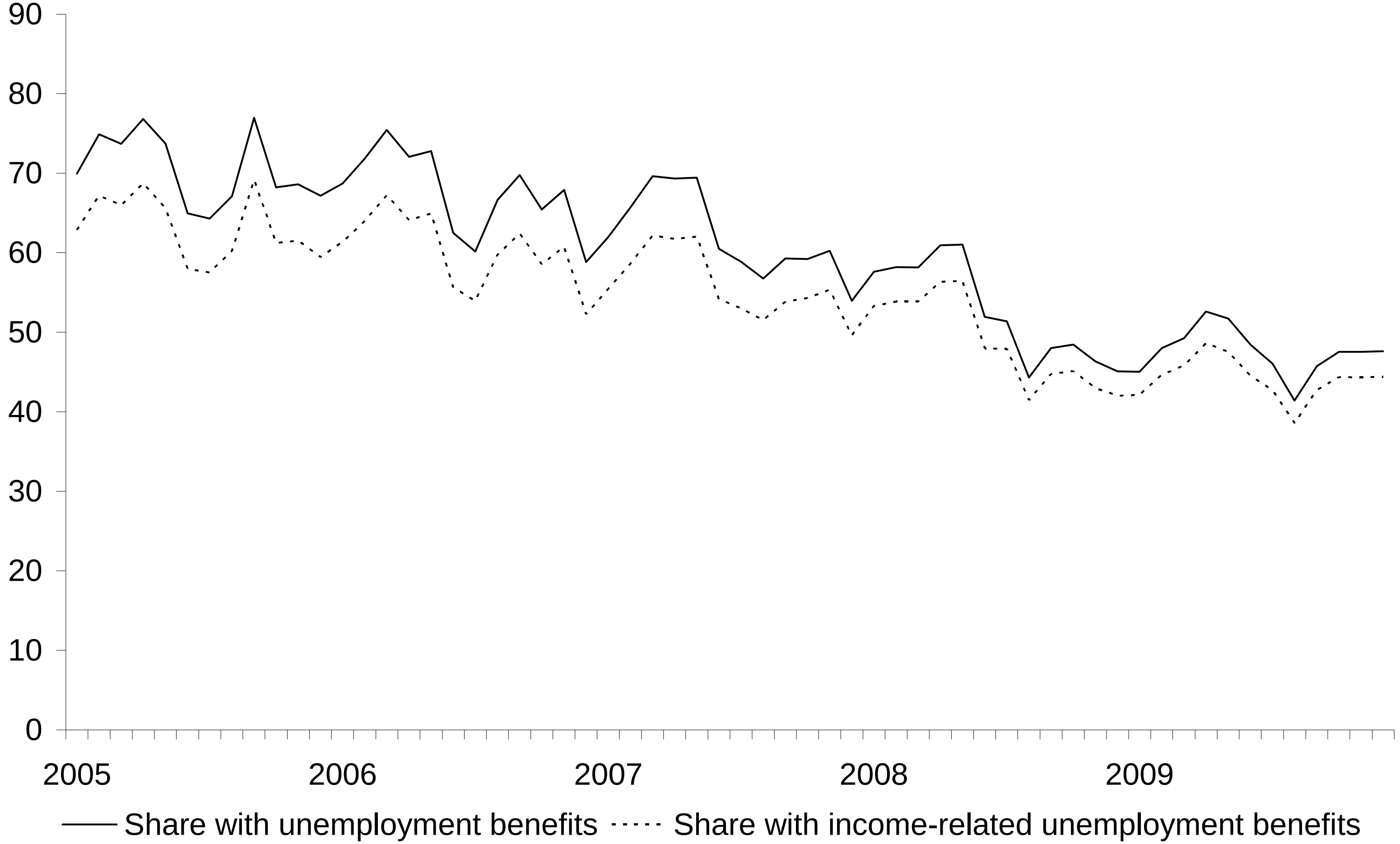
# Income insurance during unemployment

- Insurance vs incentives
- What is the role of supplementary insurance through unions and collective agreements?
- Surprisingly few unemployed have supplementary insurances
- Reservation wages are affected by unemployment compensation, especially for the long-term unemployed

# After tax replacement rate 2006 and 2010; contributions to change, one year of unemployment

| Monthly wage (SEK) | 15 000 | 20 000 | 25 000 | 35 000 | 50 000 |
|---|---|---|---|---|---|
| Replacement rate 2006 | **82.3** | **81.8** | **71.3** | **51.8** | **39.9** |
| Replacement rate 2010 | **73.1** | **68.7** | **56.5** | **42.6** | **33.4** |
| **Change** | **-9.2** | **-13.1** | **-14.8** | **-9.2** | **-6.5** |
| 80 to 70 percent | -1.9 | -0.7 | - | - | - |
| Reduced ceiling first 100 days | - | -1.7 | -1.5 | -1.1 | -0.8 |
| EITC | -7.0 | -6.5 | -5.4 | -3.2 | -1.9 |
| Increased income threshold for central gov't tax | - | - | - | -0.6 | -0.3 |
| Price / wage increases | -0.1 | -4.0 | -7.0 | -4.2 | -2.9 |

# Share of unemployed with unemployment benefits

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# Prevalence of supplementary insurances, percent

| | All unemployed and participants in ALMP | Those with unemployment benefits | High income earners |
|---|---|---|---|
| Have supplementary insurance | 9.4 | 15.1 | 23.8 |
| Do not have supplementary insurance | 83.6 | 79.4 | 72.6 |
| Not sure | 7.0 | 5.5 | 3.5 |
| Total | 100 | 100 | 100 |
| "Do not have.." or "not sure" but members in a trade union where insurance comes with membership (share of total) | 21.1 | 24.6 | 20.8 |
| Claim that they collect benefit from supp. insurance (share of total) | 3.9 | 9.1 | 11.3 |
| Interviewees | 1 472 | 551 | 499 |