The Swedish Fiscal Policy Council

Meeting with Carsten Schneider, economic political spokesperson, with a special responisbility for budgetery issues, SPD, Germany*.*

May 15, 2012

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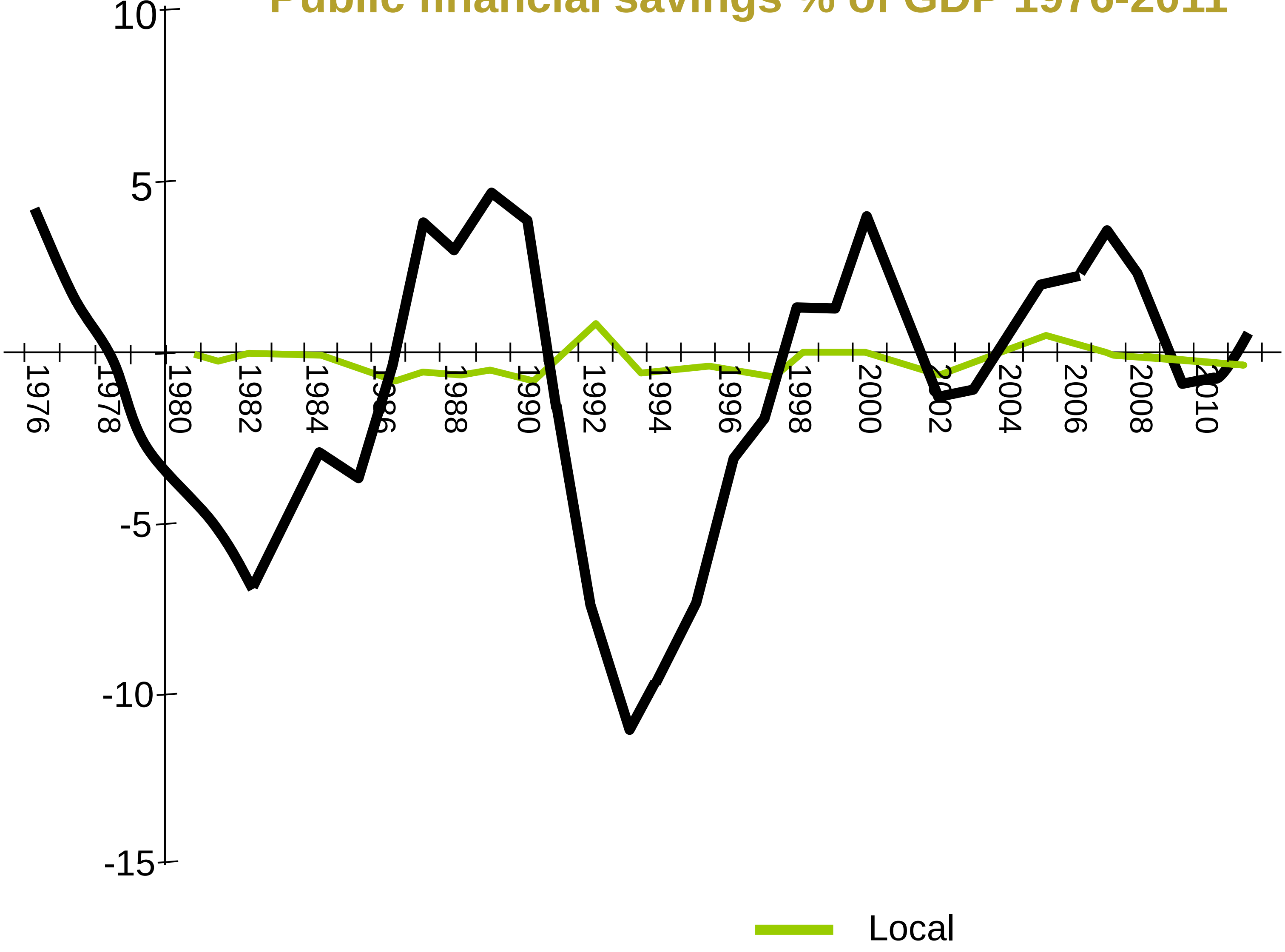
Sweden during recent crisis

- Despite a drop of GDP of 7% and a typically high fiscal balance elasticity, Sweden
  - Moderate drop in the fiscal balance.
  - Modest maximum deficit .7%. Now surplus
  - Recovered to pre-crisis GDP in 2010.
- Very different from crises in early 1990s. Similar amplitude in GDP fall, but then an extreme worsening of public finances and unemployment. Long recovery.
- Key explanations for the good performance of Sweden’s
  - Strong budget before crisis due to well-functioning fiscal framework.
  - No structural imbalances – no domestic amplifications mechanisms.
  - A conservative finance minister determined not to repeat mistakes
  - Luck.

Public financial savings % of GDP 1976-2011



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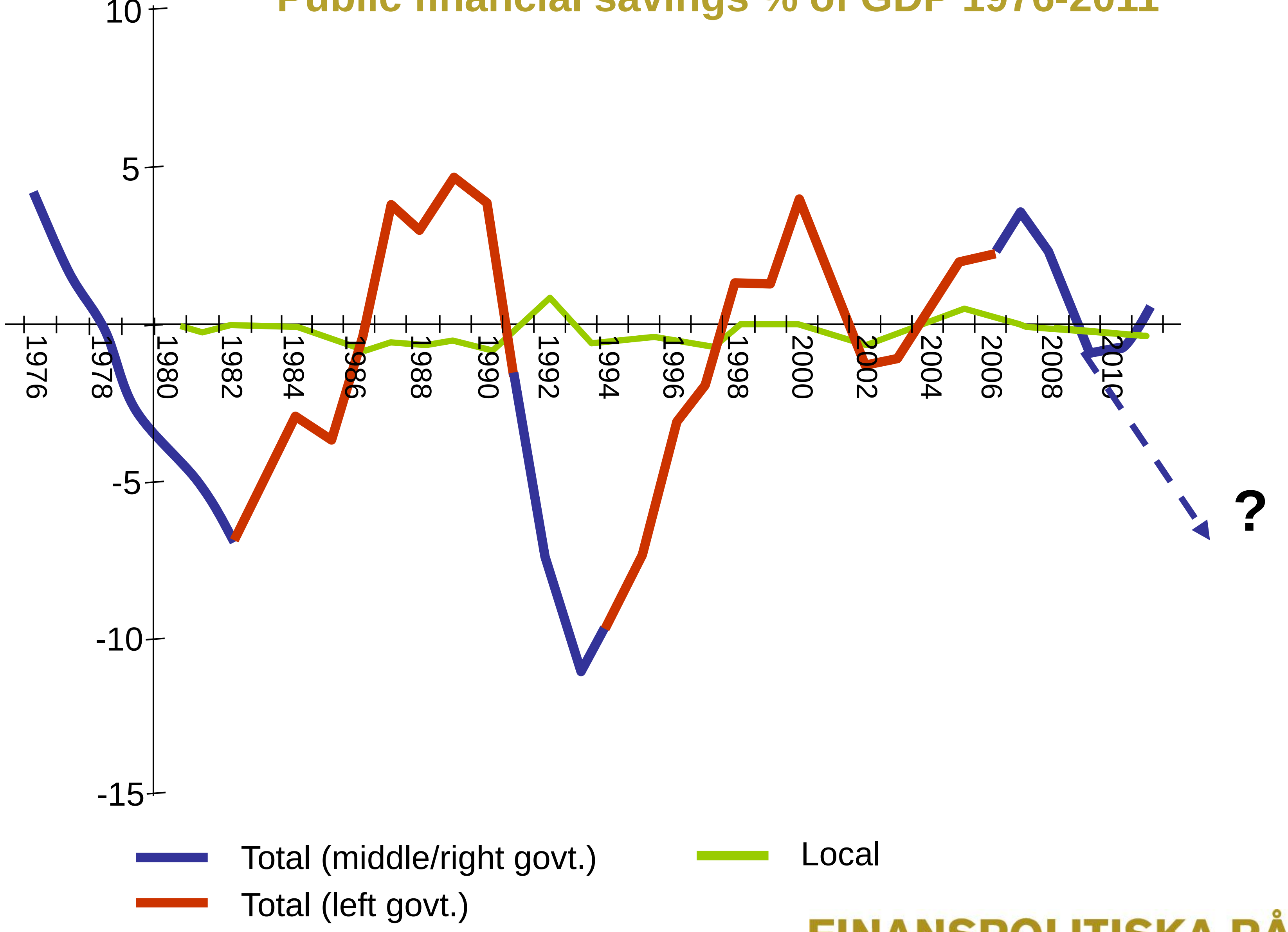

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Background to reforms

- Sweden suffered a deep economic crisis in the 90s.
  - Credit market deregulation in 80's led to rapid credit expansion.
  - Quickly rising 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 …)
- Quite similar to the current one in Spain.
- Crisis created a wide consensus on the need for a major *makeover.*

A Comprehensive Makeover

- Tough fiscal consolidation.
- Insolvent banks were taken over and split into good and bad banks. Eventually not a bad deal for tax payers.
- Delegation of monetary policy to an independent central bank with an inflation target. Large initial depreciation.
- A new tax system, corporate taxes cut in half, marginal top income taxes reduced from 90% to 50%, VAT tax base broadened.
- A new contribution-defined pension system immune to variation in growth and demographics was introduced.
- Large privatizations of rail, telecom, taxi, schools, post, electricity.
- A new Fiscal Policy Framework.

The Swedish fiscal framework

- Top-down budget process;
- A fiscal surplus target of 1 % of GDP on averaege over the business-cycle;
- 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. (facilitate transparency and accountability). Only academics, nominates successors. Formally an agency under the government.

The set-up of the council

- Established 2007
- An agency under the government
- Six members
  - academics
  - policy making experience
- Supplementary activities to ordinary jobs (mostly 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, with some *ex ante* evaluation;
2. Evaluate whether fiscal policy meets its objectives:
   - long-run sustainability
   - surplus target
   - the expenditure ceiling
   - stabilisation issues;
3. Evaluate whether developments are in line with healthy sustainable growth and sustainable high employment;
4. Monitor the transparency of the government 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, 14).
   – More information on www.finanspolitiskaradet.se

Themes in the reports

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

Has FPF worked?

- Generally successful implementation;
  - Top-down approach is followed.
  - Spending ceilings have not been passed (albeit some minor, and politically costly, creative bookkeeping).
  - Surplus target also met. (Various indicators used)
  - Broad political support. Opposition wanted more spending during crisis, but less than 1% of GDP.
  - FPC has increased transparency and facilitated a higher quality of political discussion.
  - Some recent heated controversies between finance minister and FPC, but with the latter proposing *higher* spending.

Lessons from crisis in 1990s

- **Structural problems must be identified early**
  - Automatic stabilizers, fiscal policy, social safety nets work well for temporary shocks to countries without structural problems.
  - Crisis often reveals structural problems.
- **All reasons for deficit bias need to be identified and addressed.**
  - Common pool, information, time consistency.
- **Mandate 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.
  - Crisis creates a window of opportunity for change.
  - Institutional reforms can cement and increase institutional memory.