

The 2012 Report of the Swedish Fiscal Policy Council

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Swedish Fiscal Policy Council

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Stabilisation policy innovations I:

Monetary policy

- Inflation targeting – “IT” (independent central banks with explicit inflation/price stabilisation targets).
- “Non-political” governance by independent experts – a new market for professors and doctors in economics.
- IT catchphrases: “Transparency, accountability and communication”.
- About 30 central banks build their strategy on inflation targeting.

Stabilisation policy innovations II:

Fiscal policy

- Fiscal policy councils – independent, “non-political” councils run by experts with the objective to monitor fiscal policy.
- About 15 countries have established some form of fiscal policy councils.
- The EU, IMF and OECD require/recommend fiscal policy councils.
- Note: Fiscal policy will **not** be managed by non-political experts in the same way as monetary policy since fiscal policy, to a great extent, involves issues of distribution and fairness/justice.

The Swedish fiscal framework

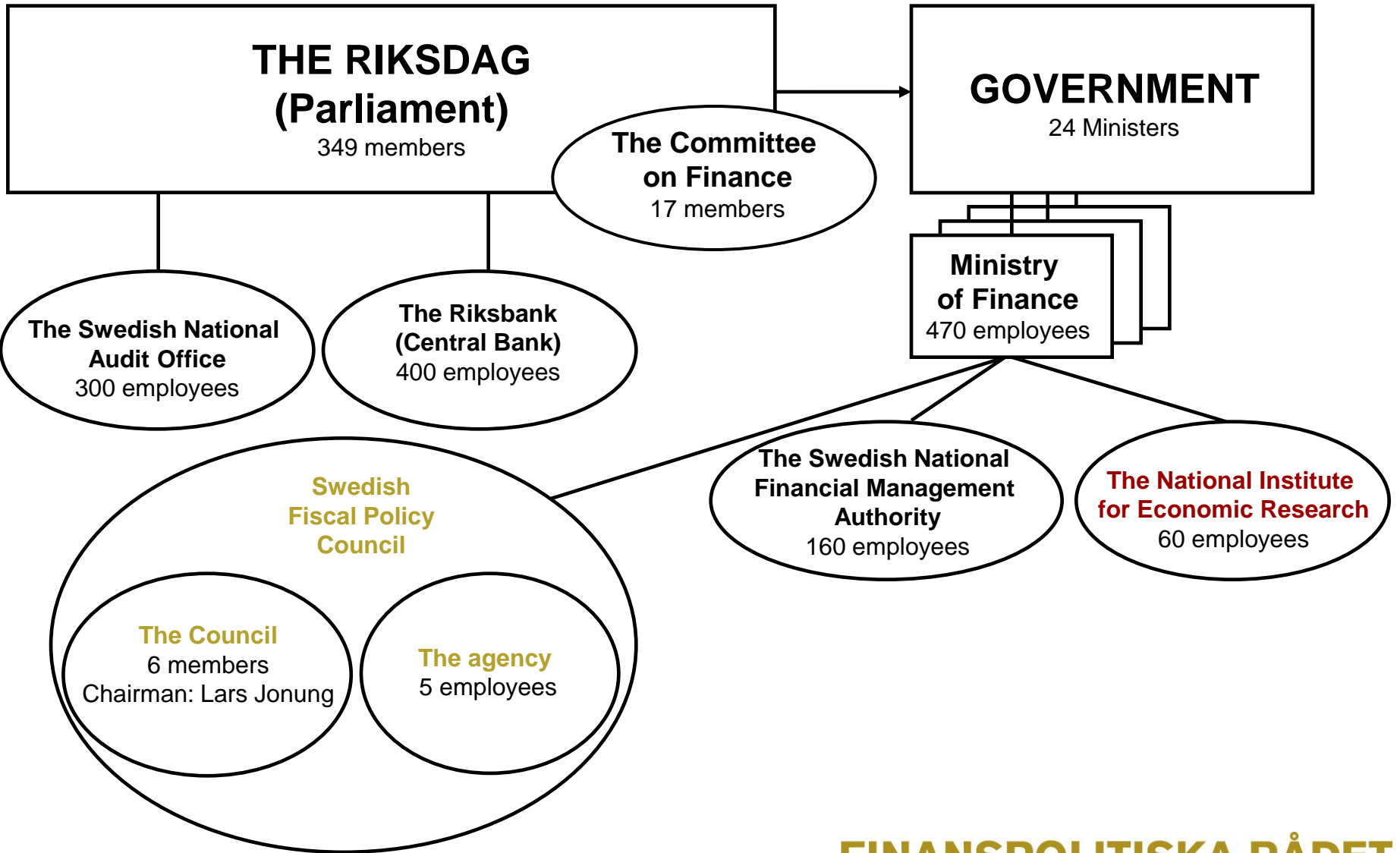
- Top-down approach for the central government budget.
- Surplus target (since 2000). Public finances are required to show a surplus of 1 per cent over the course of a business cycle for the whole public sector. A buffer for economic fluctuations and demographic changes.
- Central government expenditure ceiling (for the third year ahead in the Budget Bill, with a budget margin acting as a buffer).
- Balanced budget requirement for local governments (since 2000).
- A fiscal policy council.

The council's background

- In 2002, a government Commission on the role of fiscal policy, in the event of Swedish euro membership, discussed a fiscal policy council.
- Positive reactions from the liberal-conservative parties (Anders Borg) that came to power in 2006.
- The Swedish council was set up in 2007.
- Negative reactions initially from the Social Democrats, the Left and the Greens:
"another body providing false scientific clothing
for the government's right-wing policy"
- A new instruction for the council in 2011 supported by the Social Democrats, the Left and the Greens. The council is now well entrenched in the Swedish political system.
- Budget discipline and the fiscal framework are consequences of the fiscal crisis in the 1990s.
- Theoretical considerations rather than acute problems.

The set-up of the council

- Established 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 €
- Independence: no informal contact with the Government



Swedish Fiscal Policy Council

Council members (from July 2012)

Lars Jonung (Chairman), Professor, Lund; former Research Advisor,
European Commission

John Hassler (Deputy Chairman), Professor, Stockholm

Anders Björklund, Professor, Stockholm

Steinar Holden, Professor, Oslo (succeeds Torben Andersen, Århus)

Eva Lindström, former Auditor General; former Budget Director,
Ministry of Finance

Irma Rosenberg, former First Deputy Governor, Swedish Central
Bank; former Director of Forecasting, National Institute of
Economic Research

The tasks of the Fiscal Policy Council

1. Evaluate whether fiscal policy meets its objectives:
 - long-run sustainability
 - surplus target
 - the expenditure ceiling
 - stabilisation issues
 2. Evaluate whether developments are in line with “healthy” sustainable growth and sustainable high employment.
 3. Monitor the transparency of the government budget proposals and the motivations for various policy measures.
 4. Analyse the effects of fiscal policy on the distribution of welfare.
 5. Contribute to a better economic policy discussion in general.
- Annual report in May (this year May 14, 2012). The report is used by the Riksdag (the Swedish Parliament) and the Riksdag Committee on Finance as a basis for evaluating government policy.
 - More information on www.finanspolitiskaradet.se

Themes in the reports 2007-2011

- Increase the clarity of the surplus target:
 - underlying fundamental objectives
 - too many indicators
- Criticism of circumventions of the expenditure ceiling.
- Critical evaluation of fiscal sustainability calculations.
- Request for additional discretionary fiscal stimulus in the current recession (but less of permanent measures).
- Critical evaluation of the Government's labour market reforms.
- Critique of the economic reporting of the Government.

Report of the Swedish Fiscal Policy Council 2012

Presented to the Minister for Finance, May 14

Presented to the media, May 14

Meeting with economists and officials at the Ministry of
Finance, May 15-16

Presentation and hearing before the Committee on Finance
at the Riksdag (Parliament), May 24

Government reply in the Budget Bill, September 20

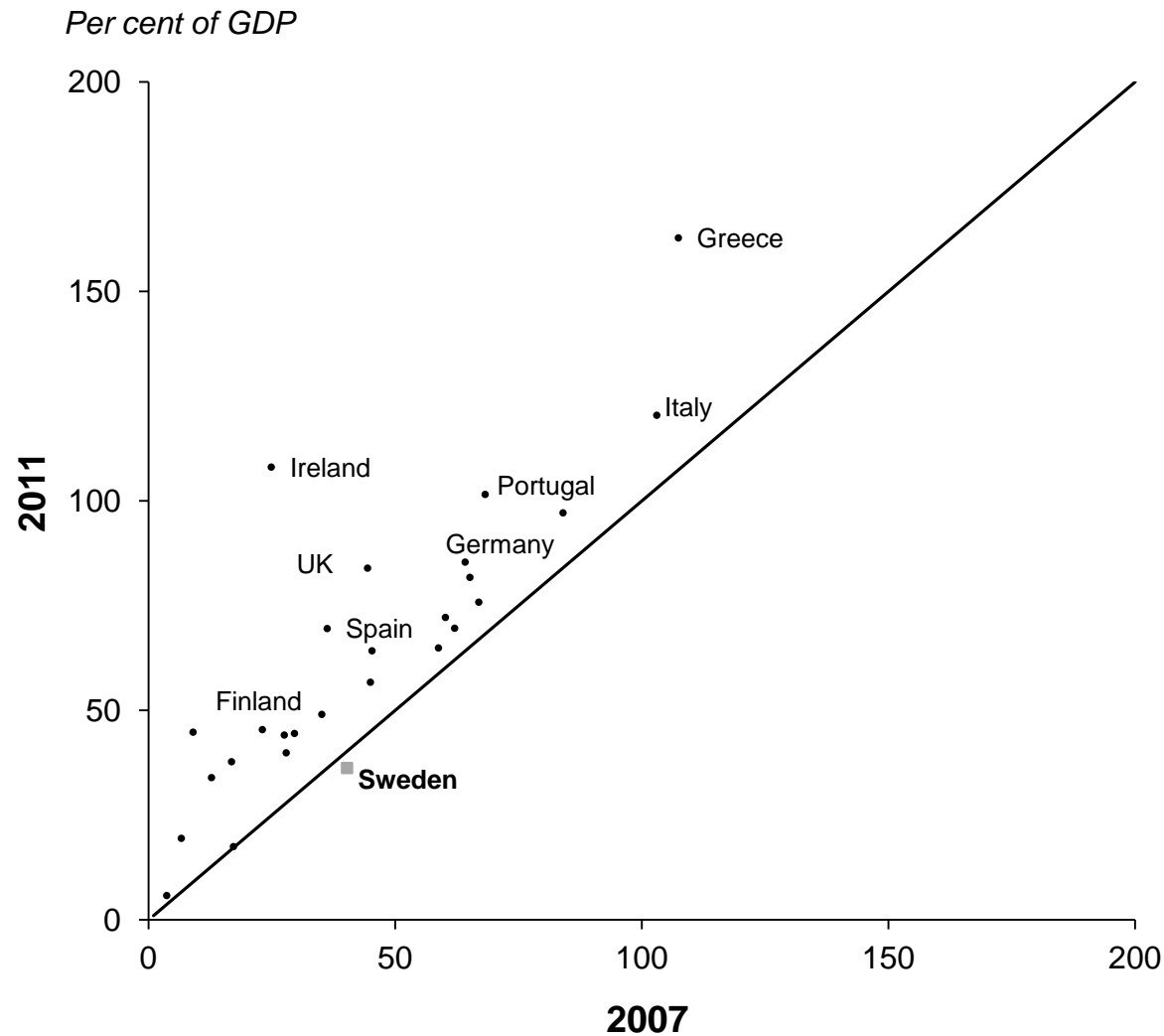
Content of the report 2012

- Evaluation of fiscal policy (chapter 1)
- Fiscal instruments and analytical methods (chapter 2)
- The long-term debt ratio (chapter 3)
- Generational accounting (chapter 4)
- The labour market (chapter 5)
- Reduced VAT on restaurant and catering services (chapter 6)

The economic situation

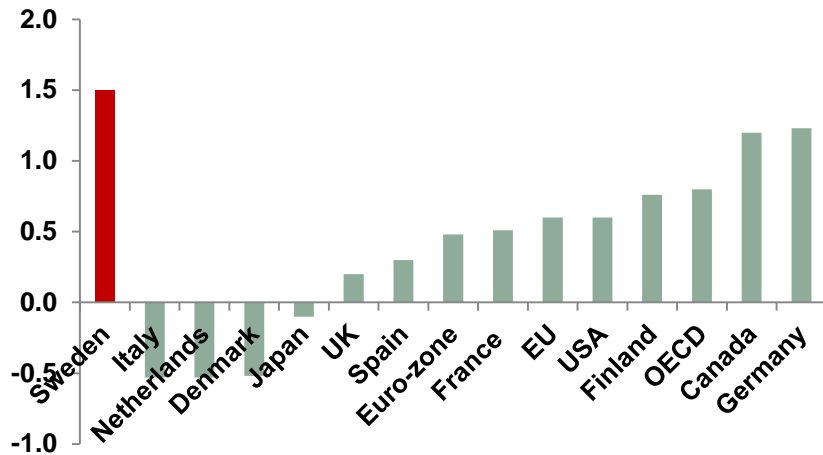
- The Swedish economy has coped well with the global crisis that began in 2008.
- The fiscal policy generally appears to be successful and, on the whole, well balanced.
- A comparison with other countries' economic policy experiences and developments since the crisis began supports this conclusion.

Gross government debt in the EU in 2007 and 2011



GDP growth

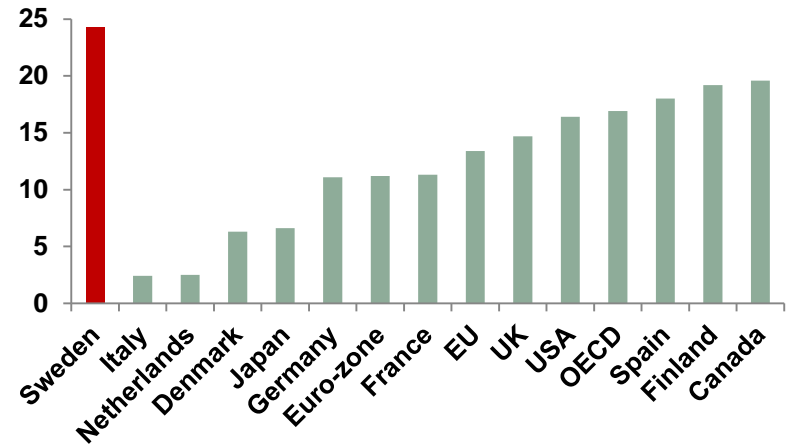
Average 2007-2011. Per cent.



Source: National sources and OECD

Accumulated GDP growth

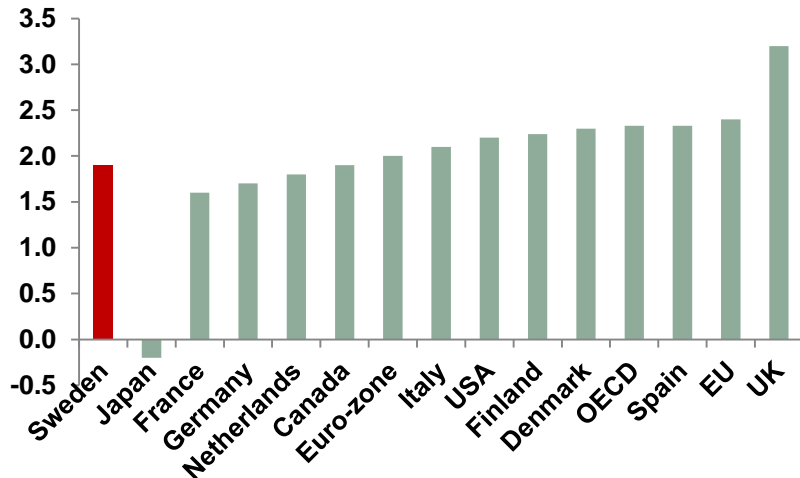
Total 2002-2011. Per cent.



Source: National sources and OECD

Inflation

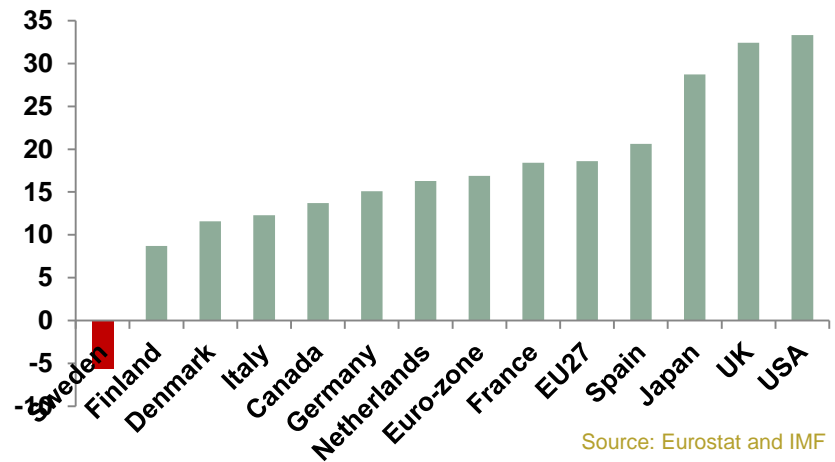
Average 2007-2011. Per cent.



Source: OECD and Eurostat

Government gross debt

Change 2006-2010. Per cent of GDP.



Source: Eurostat and IMF

FINANSPOLITISKA RÅDET

SWEDISH FISCAL POLICY COUNCIL

The current fiscal policy

- The fiscal policy pursued in 2011 and 2012 has complied with the current fiscal framework.
- There is little risk of expenditure exceeding the expenditure ceiling in the next few years.
- We take the view that the fiscal policy is compatible with long-term sustainable public finances.

General government net lending in Sweden



General government gross debt in Sweden

Per cent of GDP



Is all well, then?

The answer is NO:

The Council has expressed critical viewpoints on the economic policy,

in regards to at least 19 issues. For a summary:

<http://www.finanspolitiskaradet.se/download/18.6f0598d1373db0746a111/Summary+2012.pdf>

Transparency in the fiscal policy

- A clearer account of the connections between the expenditure ceiling, the surplus target and the taxes collected would be an important contribution to improved fiscal transparency.
- The Government should provide a better explanation of how the scope for new policy initiatives arises and how it is divided between taxes and expenditures over the next few years.

A lack of stabilisation policy basis

- The tax cuts announced by the Government in spring 2011 were not proposed in the 2012 Budget Bill (presented in September 2011).
- This change lacked a stabilisation policy basis. Rather, the worsened economic situation in 2011 argued in favour of a more expansive fiscal policy.

Safety margins

The Government has referred to the macroeconomic uncertainty as *an argument for larger safety margins* – in addition to the margin already built into the fiscal framework.

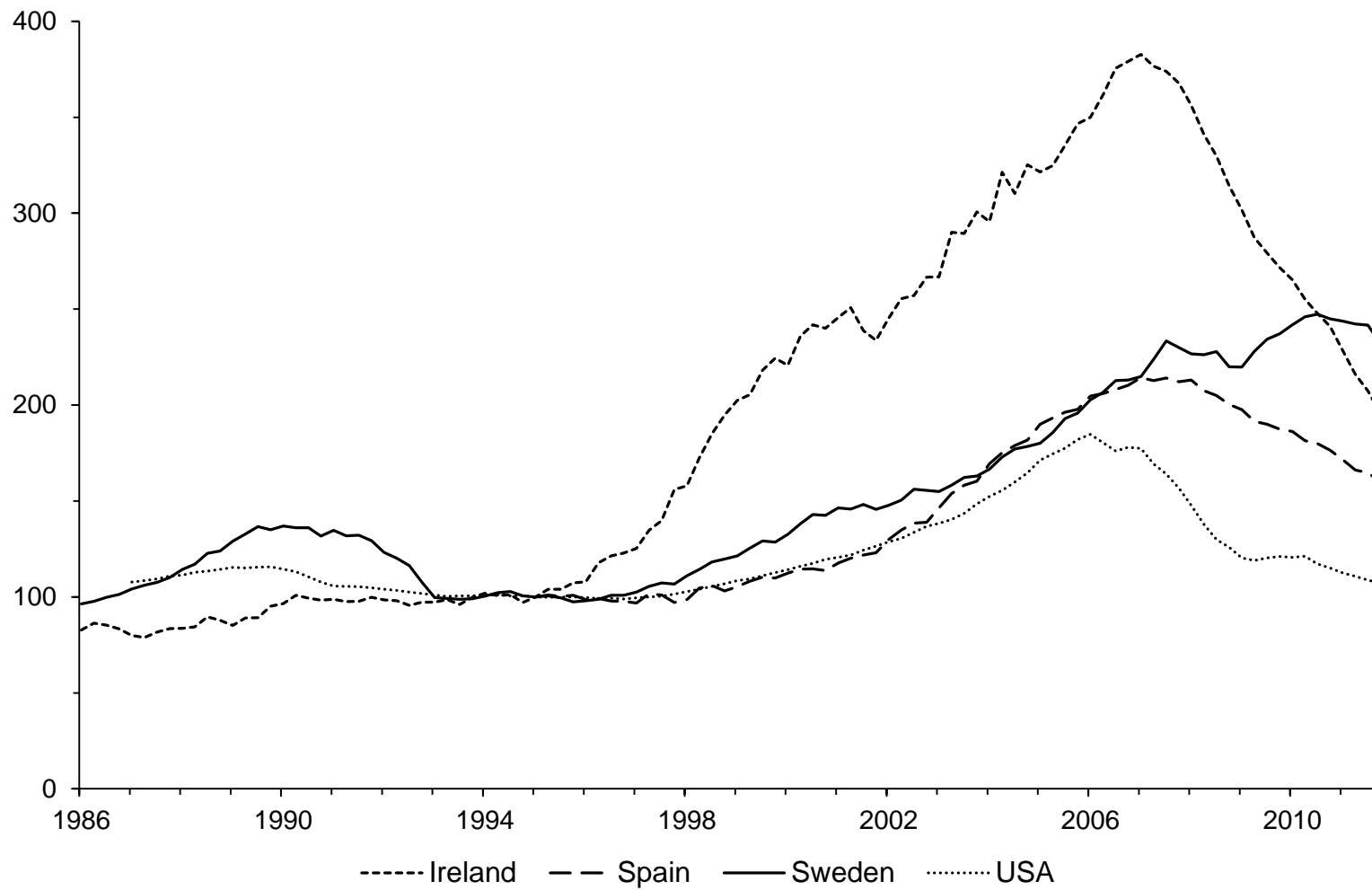
Confusion regarding safety margins

Regular use of safety margins risks:

- a) Creating an undesirable procyclical element in fiscal policy and
- b) Causing average government net lending to exceed the surplus target.

Real estate prices

Index 1996 = 100



Macro financial risks

- Rapidly expanding credit, large public debt ratios and rising property prices imply macro financial risks for the Swedish economy which should not be underestimated.
- The Government should decide how macro prudential regulation and supervision should be strengthened to reduce the risk of future financial crises.

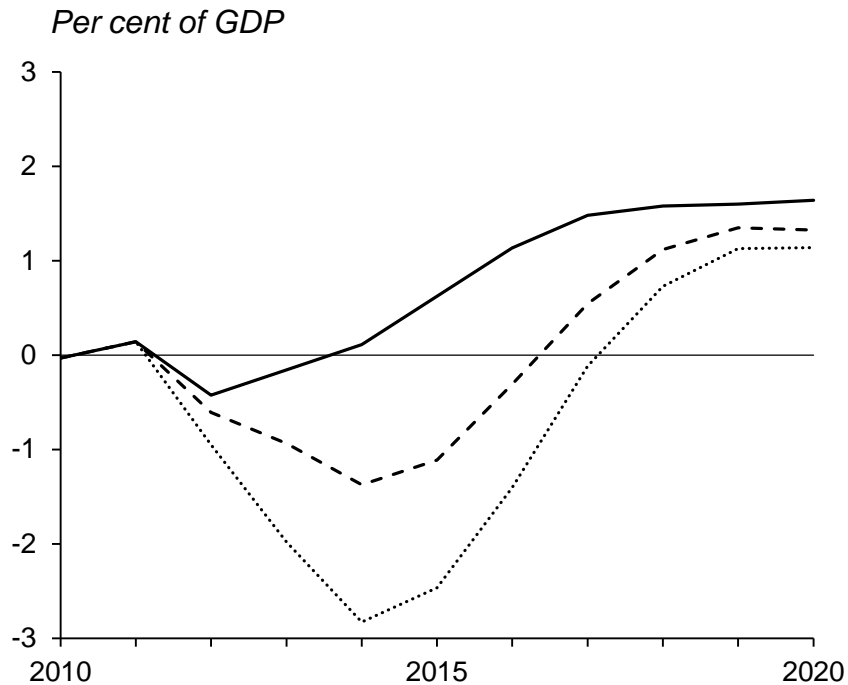
Warning indicators of the EU Commission

External imbalances and competitiveness	Limit	Sweden
3-year average of the current account balance, as a percentage of GDP	-4/+6	7,5
Net international investment position, as a percentage of GDP	-35	-6,7
3-year change in real effective exchange rate	±5 & ±11	-2,5
5-year change in export market share	-6	-11,1
3-year change in nominal unit labour cost	+9 & +12	6,0
Internal imbalances		
Annual change in real house prices	+6	6,3
Private sector credit flow, as a percentage of GDP	15	2,6
Private sector debt, as a percentage of GDP	160	237
General government debt, as a percentage of GDP	60	40
3-year average of unemployment	10	7,6

Alternative scenarios

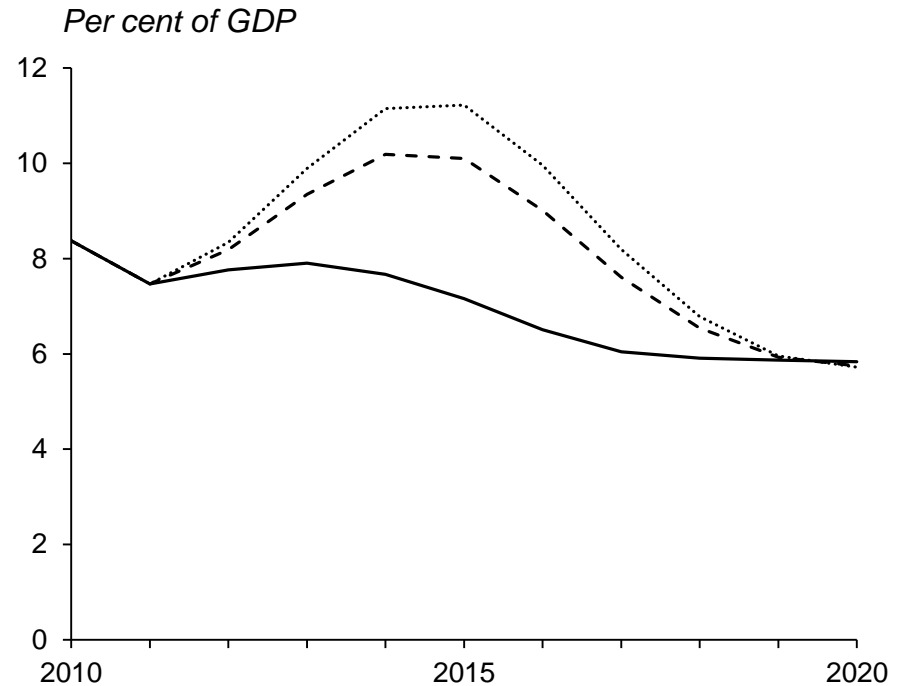
- A deep economic crisis on the same scale as the 1990s crisis.

General government net lending



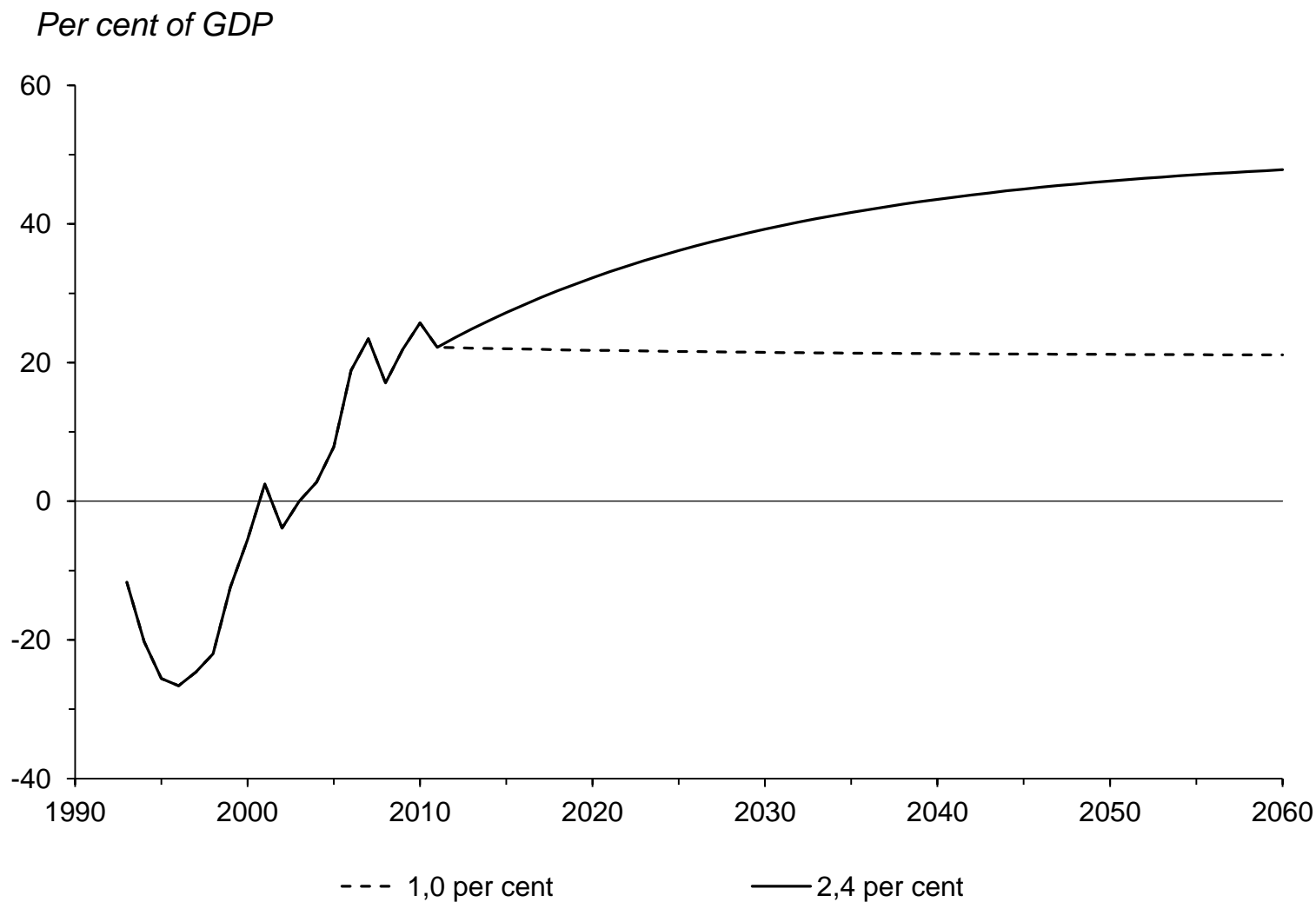
- Forecast, Dec. 2011
- - - Scenario 1 Reduced export demand
- Scenario 2 Reduced domestic demand

Unemployment



- Forecast, Dec. 2011
- - - Scenario 1 Reduced export demand
- Scenario 2 Reduced domestic demand

General government net financial wealth



The long-term debt ratio

- The surplus target results in the stabilisation of general government net financial wealth as a percentage of GDP.
- The level at which it stabilises depends on *valuation changes* outside the fiscal framework.
- Further accumulation of net wealth exceeding the current 20 per cent of GDP is difficult to justify with the need for safety margins.
- The Government should clarify its view of the appropriate size of government net wealth.

The management of public financial assets

- The public financial portfolio contains both large debts and substantial assets.
- The Government should more clearly define what an appropriate gross debt is and what overall principles should apply in the trade-off between the portfolio's risk and its expected return.
- Sweden is becoming an "oil country"
– without the oil.

Generational accounting: Long-term fiscal policy

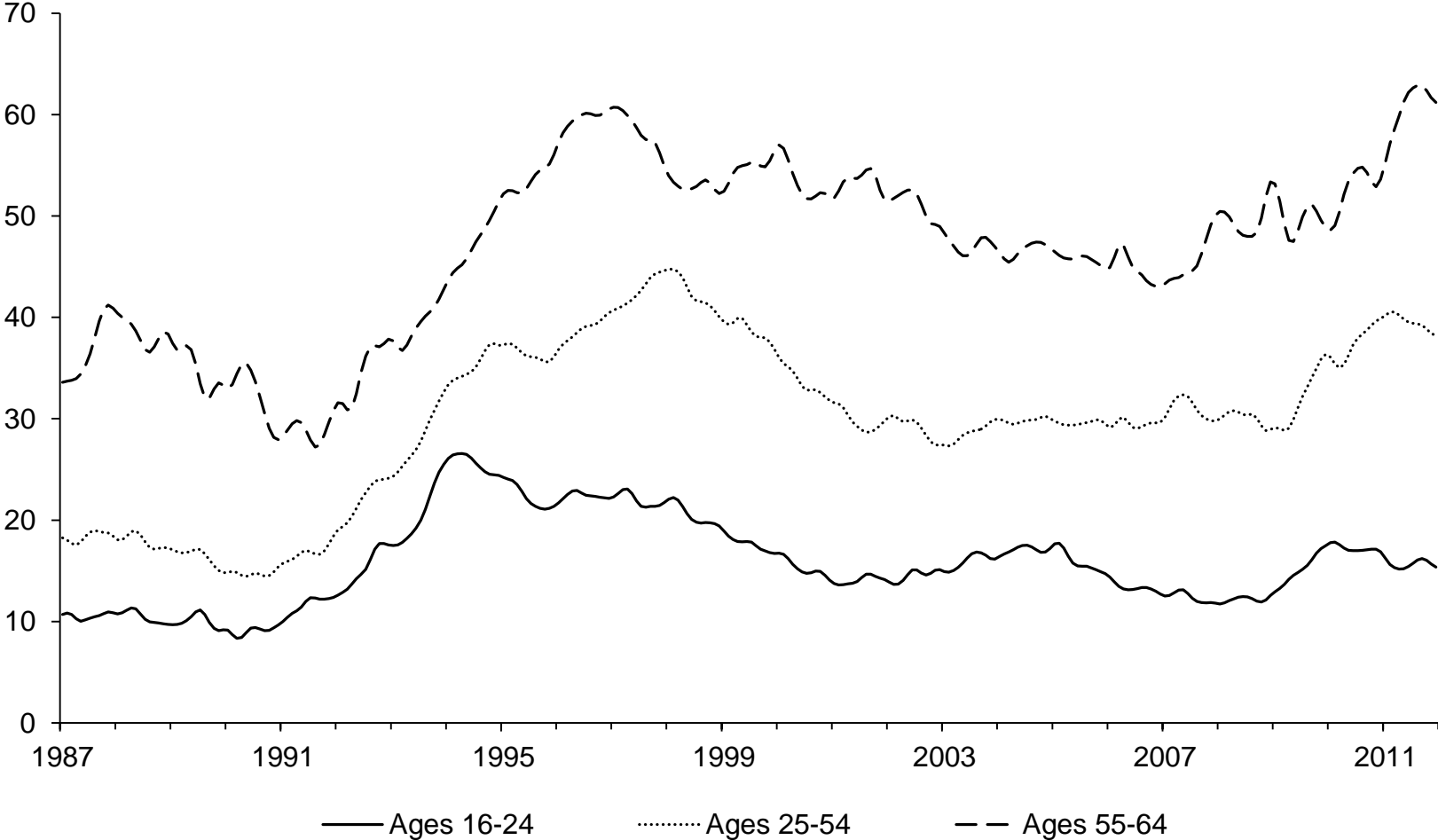
- The analysis indicates that Sweden's public finances are sustainable in the long run. A strong contributing factor is the design of the pension system.
- The pension system is financially stable – but is it politically stable?
- Generational accounting is often subject to extensive methodological problems.

Youth unemployment

- The description of youth unemployment should be nuanced:
 - Young people generally find a job more quickly than older workers.
 - Long-term unemployment among young people in Sweden is comparatively low in international terms.
- Regarding young people as a homogeneous group may lead to ineffective labour market measures.
- It is important to target initiatives at those groups that have difficulty finding employment.

Average unemployment spell

Weeks



Reduction of VAT on restaurant services – the most costly "reform" in the 2012 Budget Bill

- We assess that the estimated effects on unemployment and employment are exaggerated.
- The lower VAT on restaurant and catering services works rather like a subsidy to a specific sector. This increases the risk of other interest groups lobbying for sectoral support.
- If more sectors were to benefit from reduced VAT rates, there is a risk of undermining the consumption tax as a tax base.
- A uniform VAT, instead, would most likely have large positive economic effects.

The Council's influence on government policies?

- In some areas, we have noticed an effect.
- Difficult to empirically estimate the effects of fiscal policy councils. In which direction does the causality run?
- A dialogue: In the budget of September, the Government responds to the report of the Council from May the same year.
- The Swedish council has established a solid credibility and is supported by almost all the political parties.
- A new innovation – time will tell which role the fiscal policy council will play.

The 2013 report of the Council?

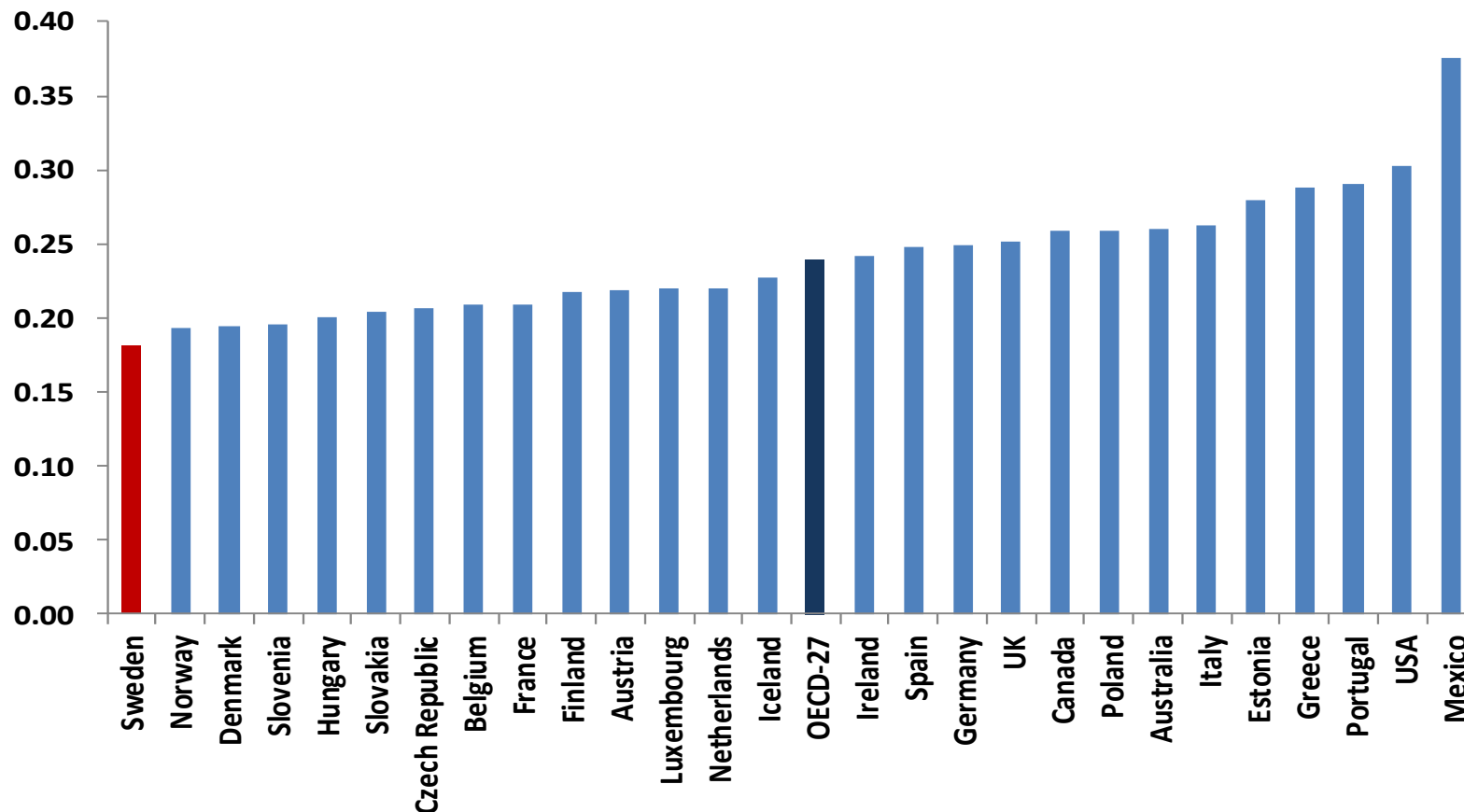
A new Swedish model:

- No wealth tax
- No inheritance tax
- No real estate tax
- No gift tax
- A small open de-regulated economy

- Which are the challenges?

The 2013 report: Fiscal policy and distribution

Inequality of income distribution, including publicly financed services:
The Gini-coefficient.



Source: OECD, 2011

Can the Swedish Fiscal Policy Council be copied?

Sweden has a unique history:

1. Strong position of the economics profession in public debate and among voters, media and policy-makers. Wicksell, Cassel, Heckscher, Myrdal, Ohlin, Lindbeck – household names, recognised and respected.
2. High quality of government. Open and transparent society.
3. Strong trust in government and in the honesty of policy-makers. Consensus society with no extreme political movements.
4. Do we need a council?

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