

Swedish Fiscal Policy

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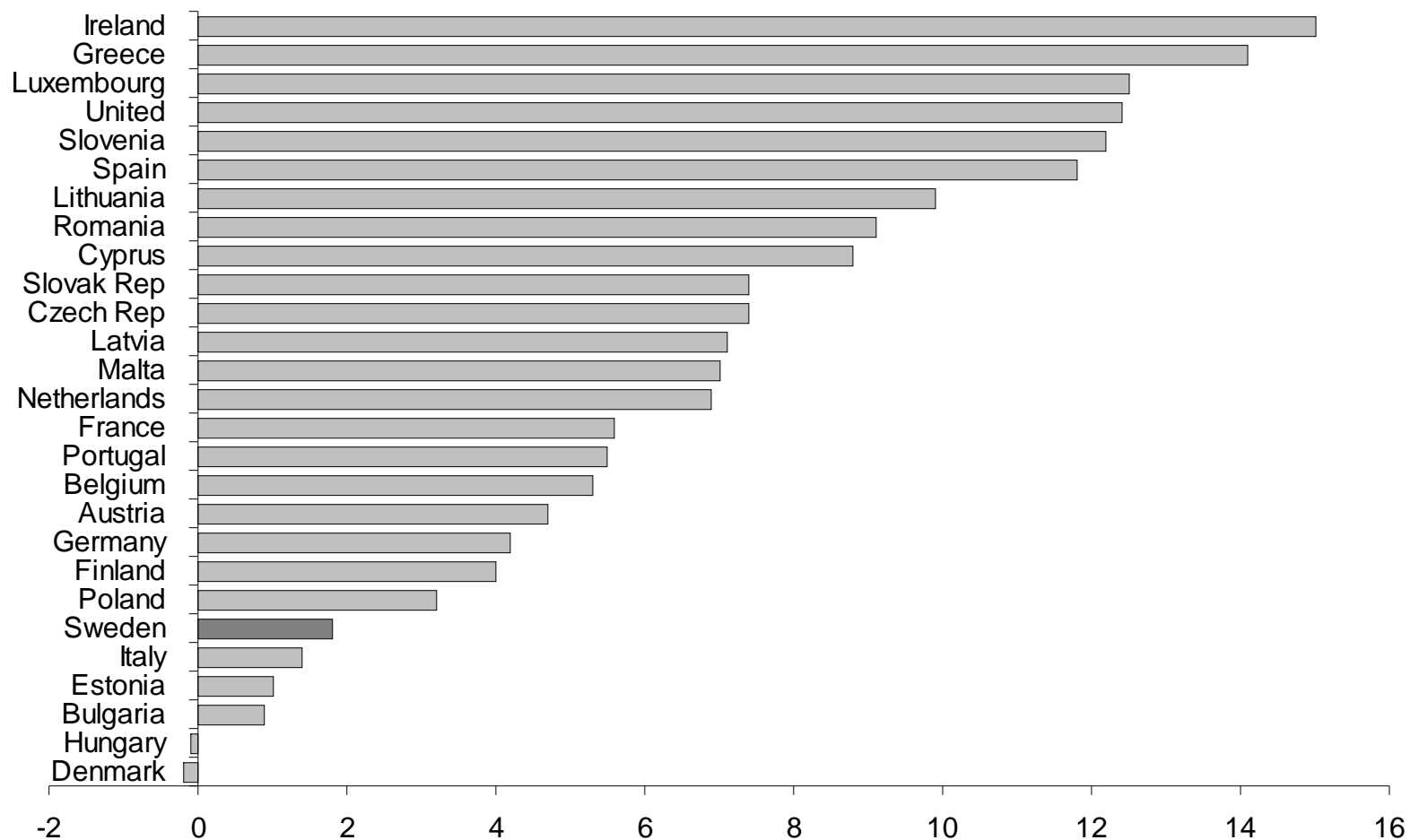
Meeting with IMF

28 May 2010

FINANSPOLITISKA RÅDET

SWEDISH FISCAL POLICY COUNCIL

The S2 indicator



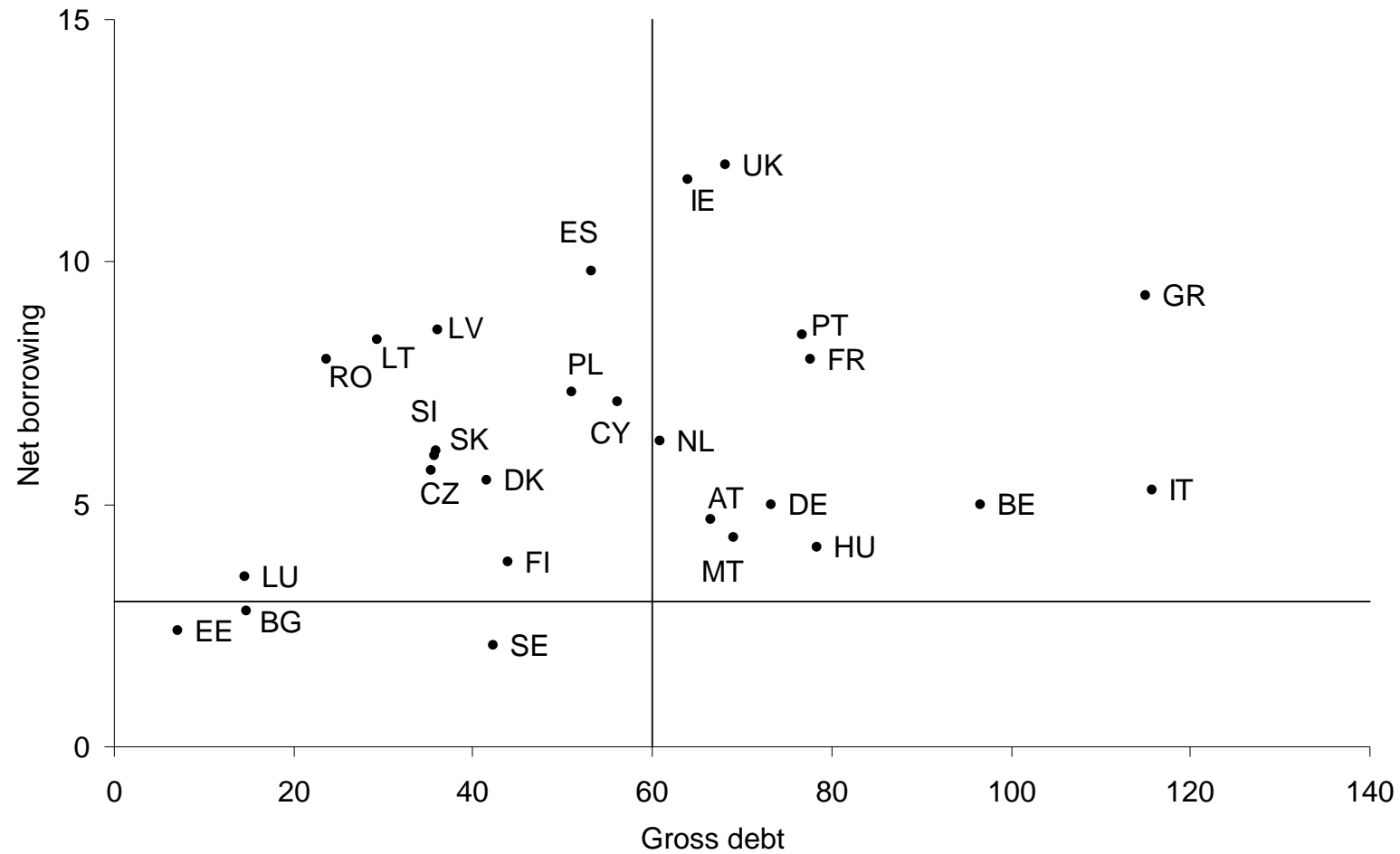
Net lending and debt ratios, percent of GDP

	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



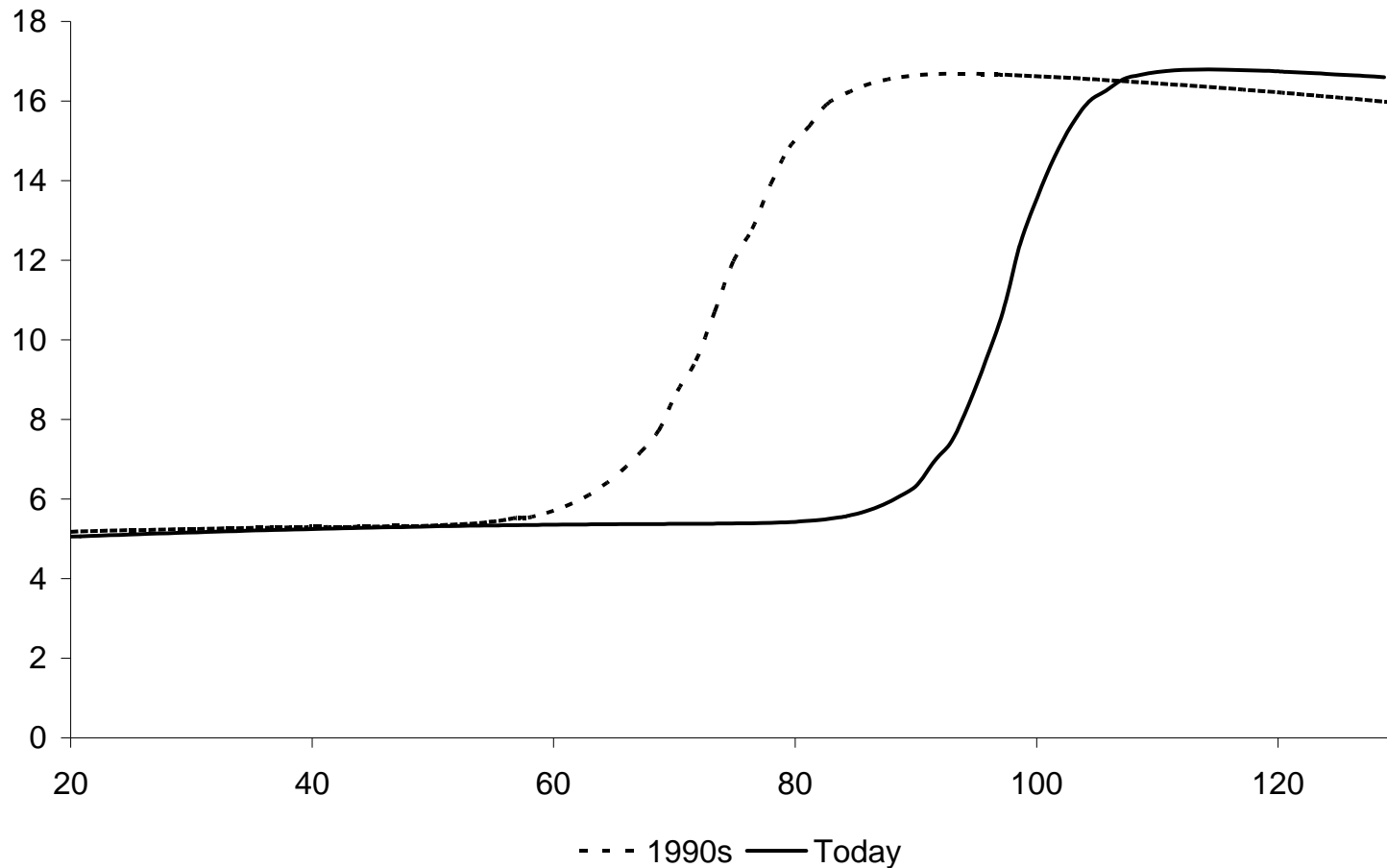
Uncertain room for reform in Sweden

- 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

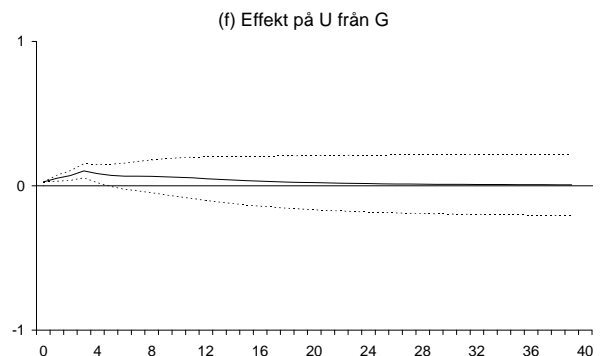
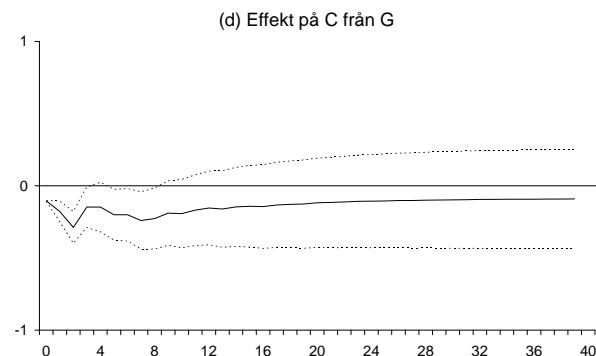
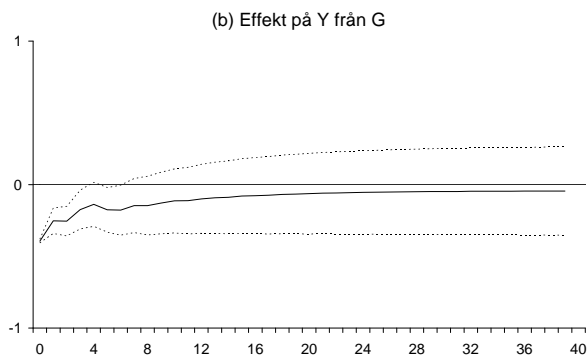
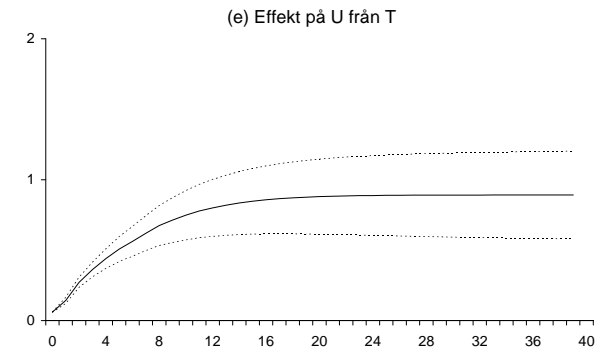
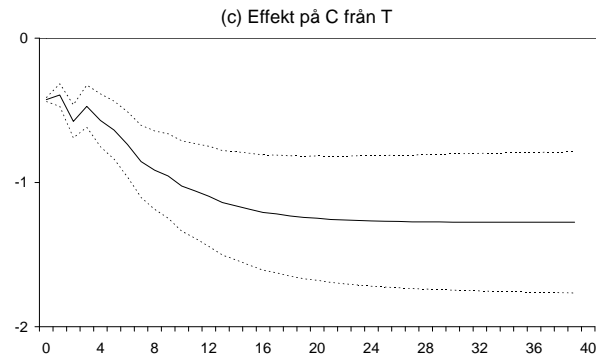
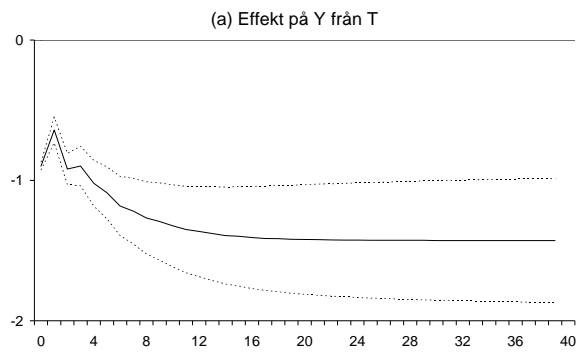
But there is room for manoeuvre in stabilisation policy

- 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

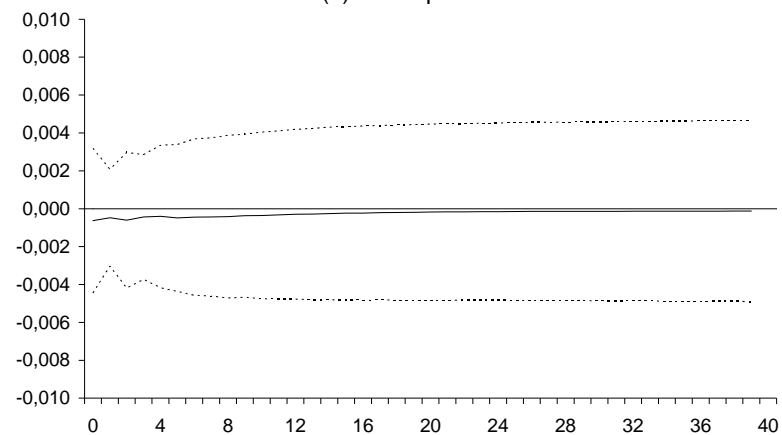


Effect of higher taxes or lower gov't spending in "normal" times

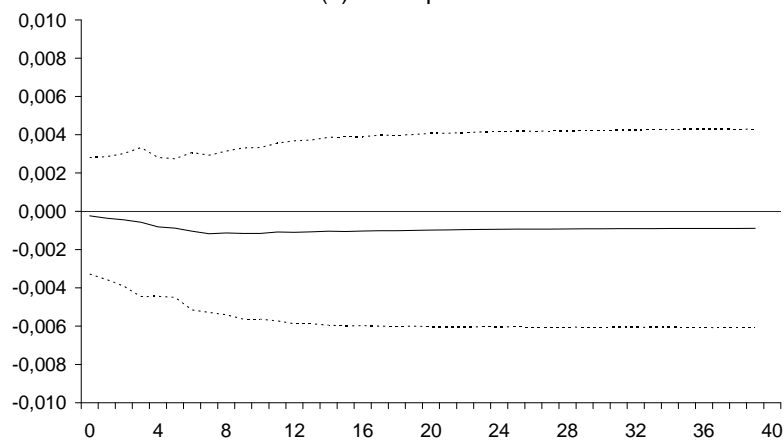


Effect of fiscal consolidation

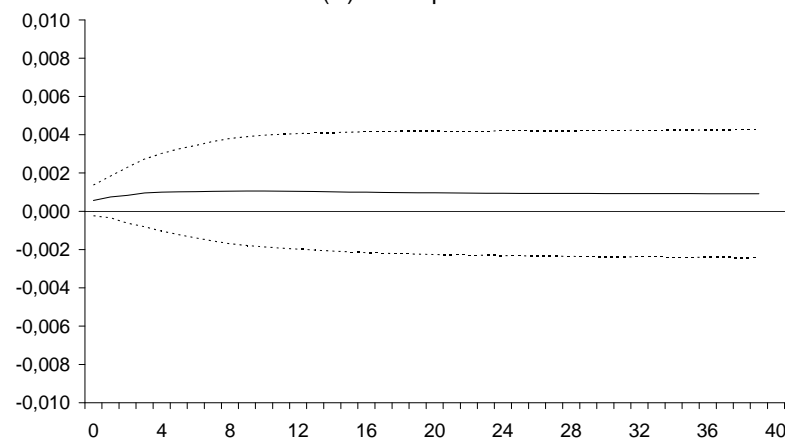
(a) Effekt på Y



(b) Effekt på C



(C) Effekt på U



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?)**

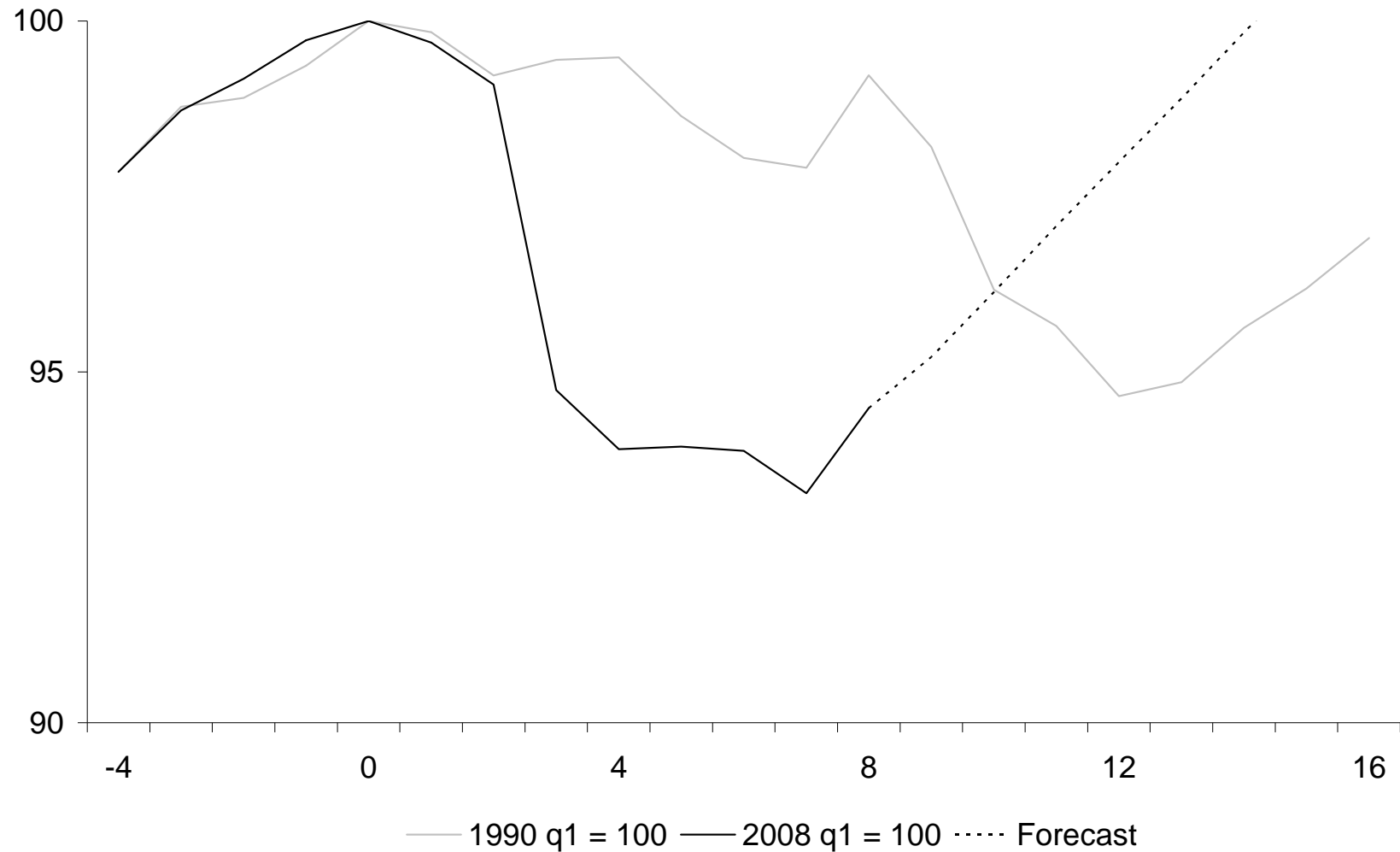
Indicators used by the government to assess if surplus target is met, percent of GDP

	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			

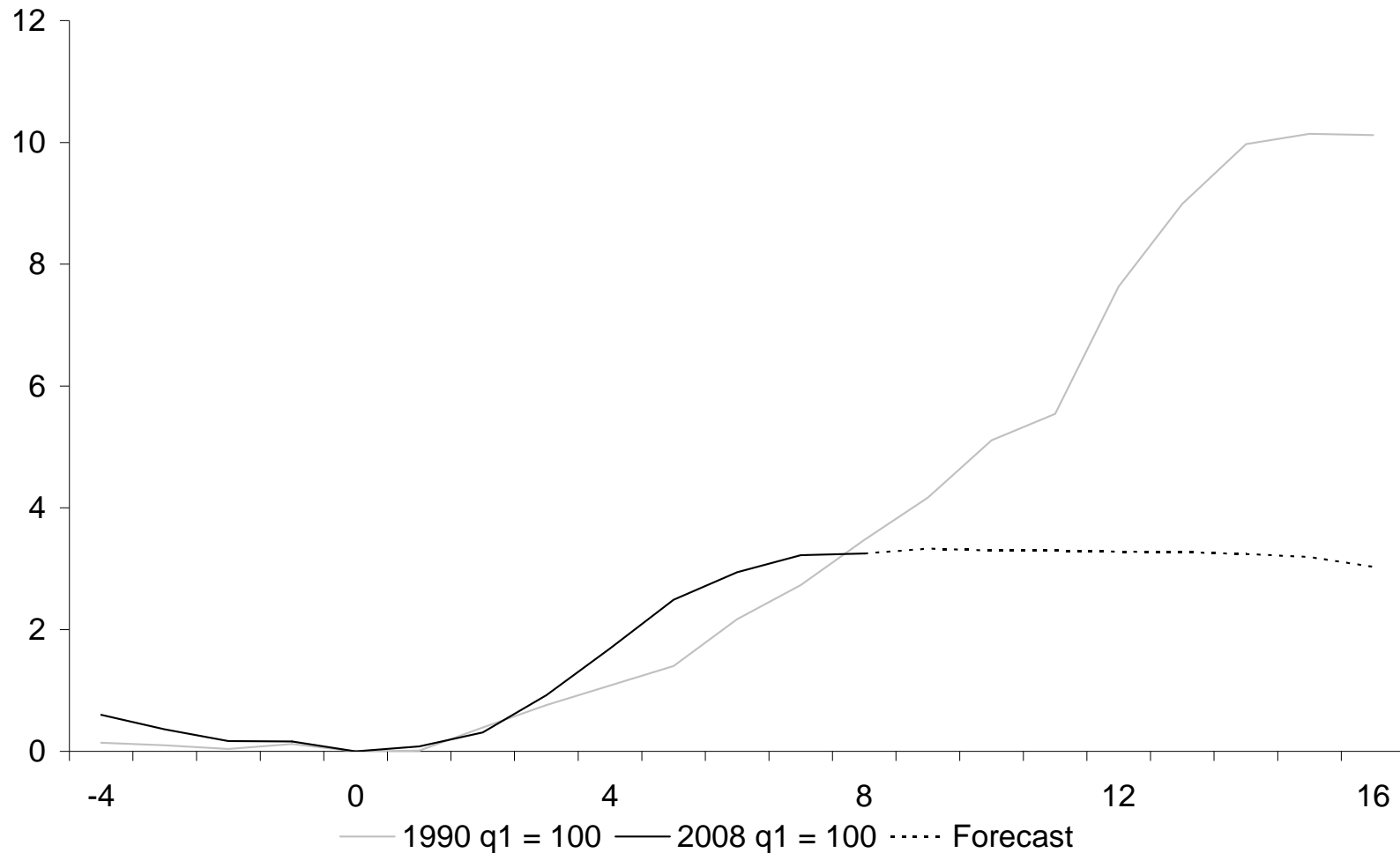
The labour market

- 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?

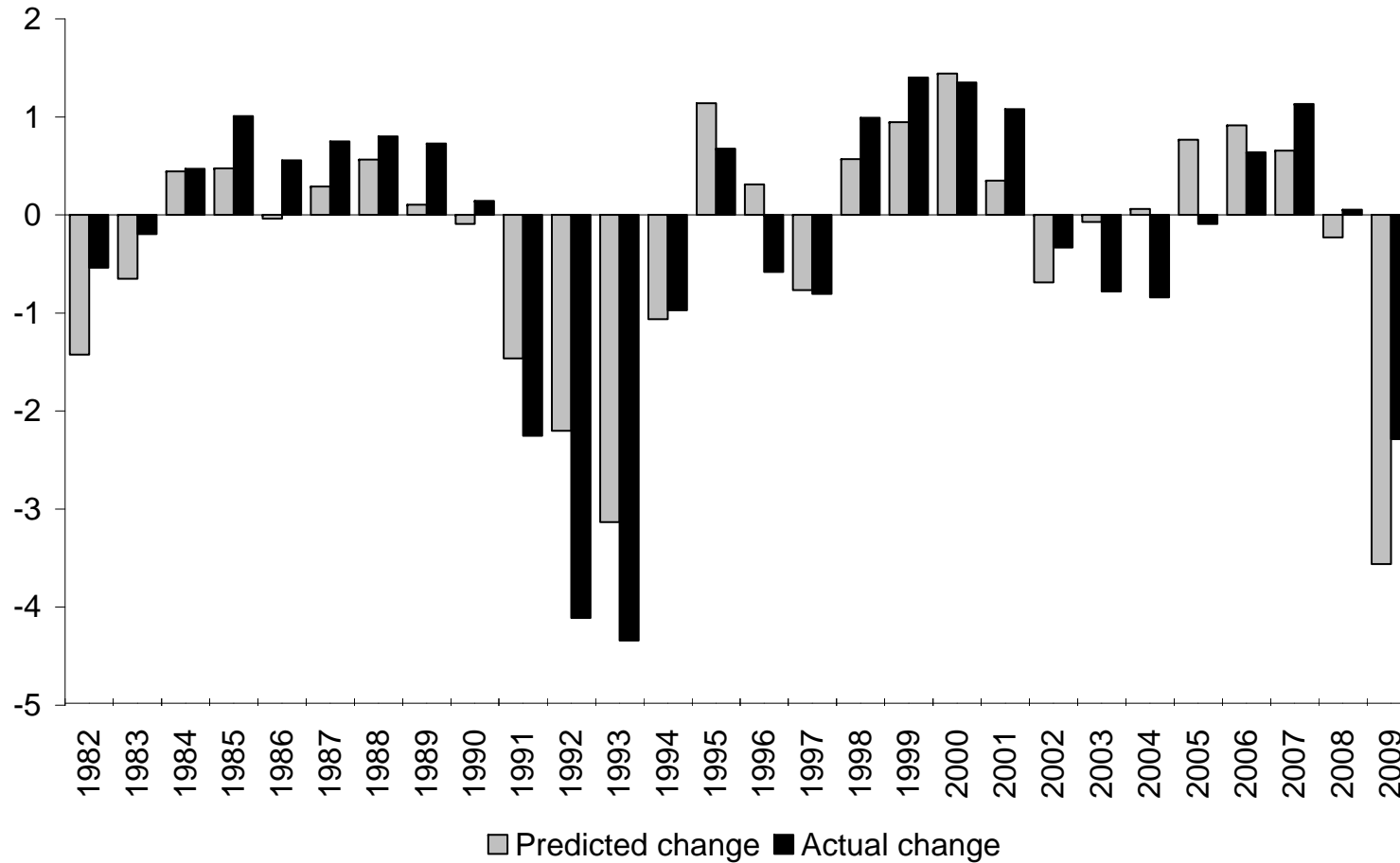
GDP compared to crisis in the 1990s



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



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



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

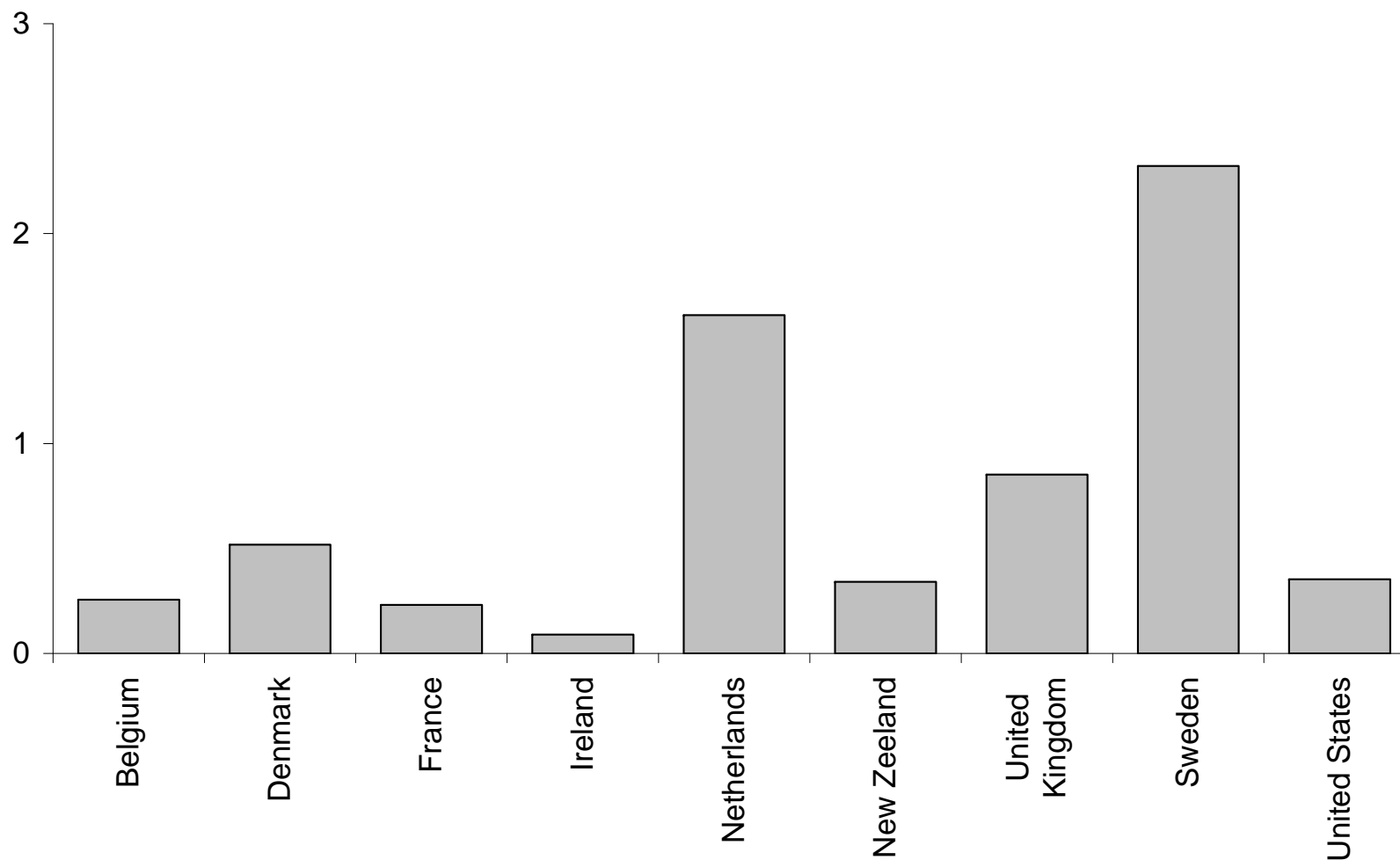
Relative change in employment rate

	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



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

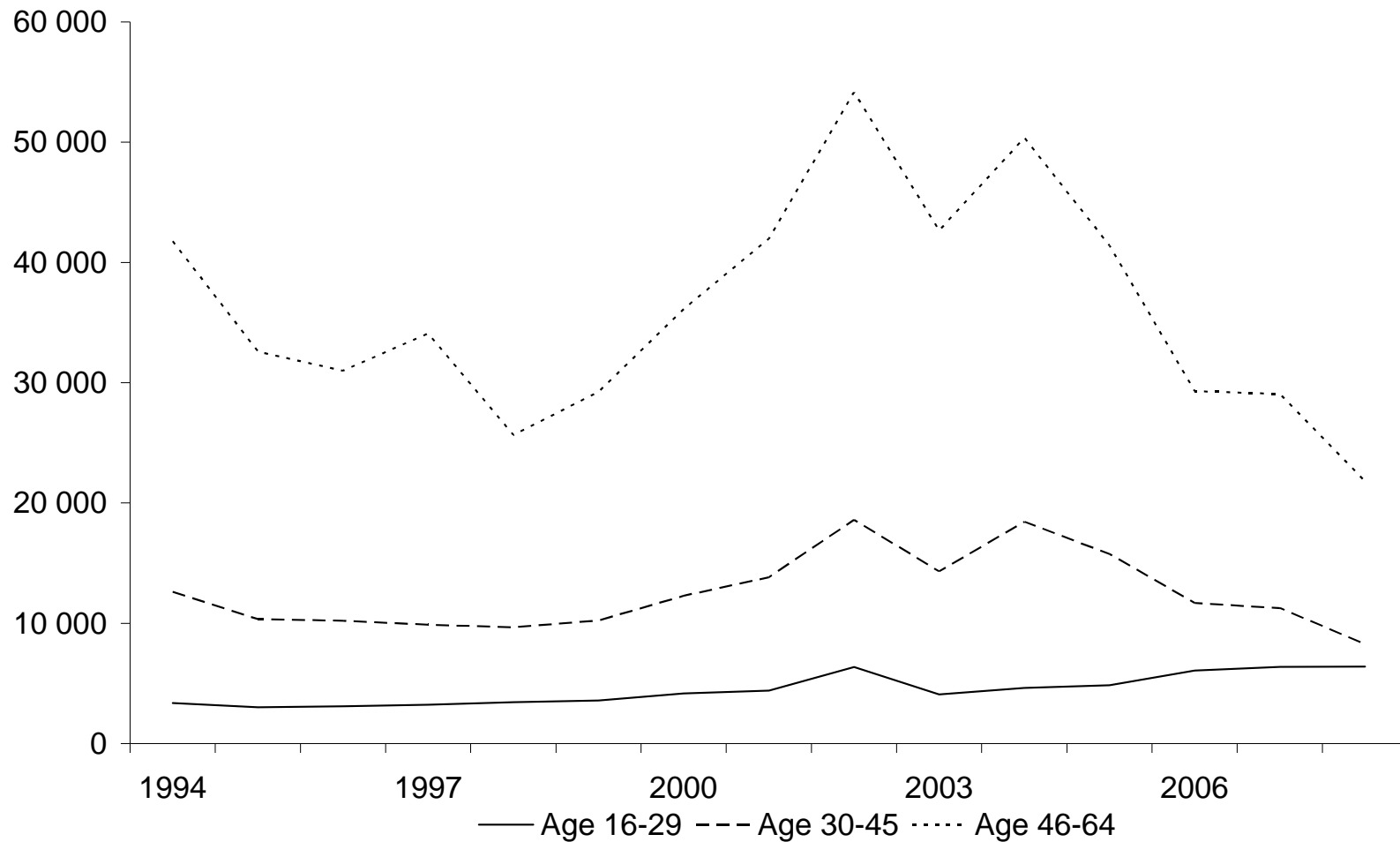
Sickness insurance reforms

- 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

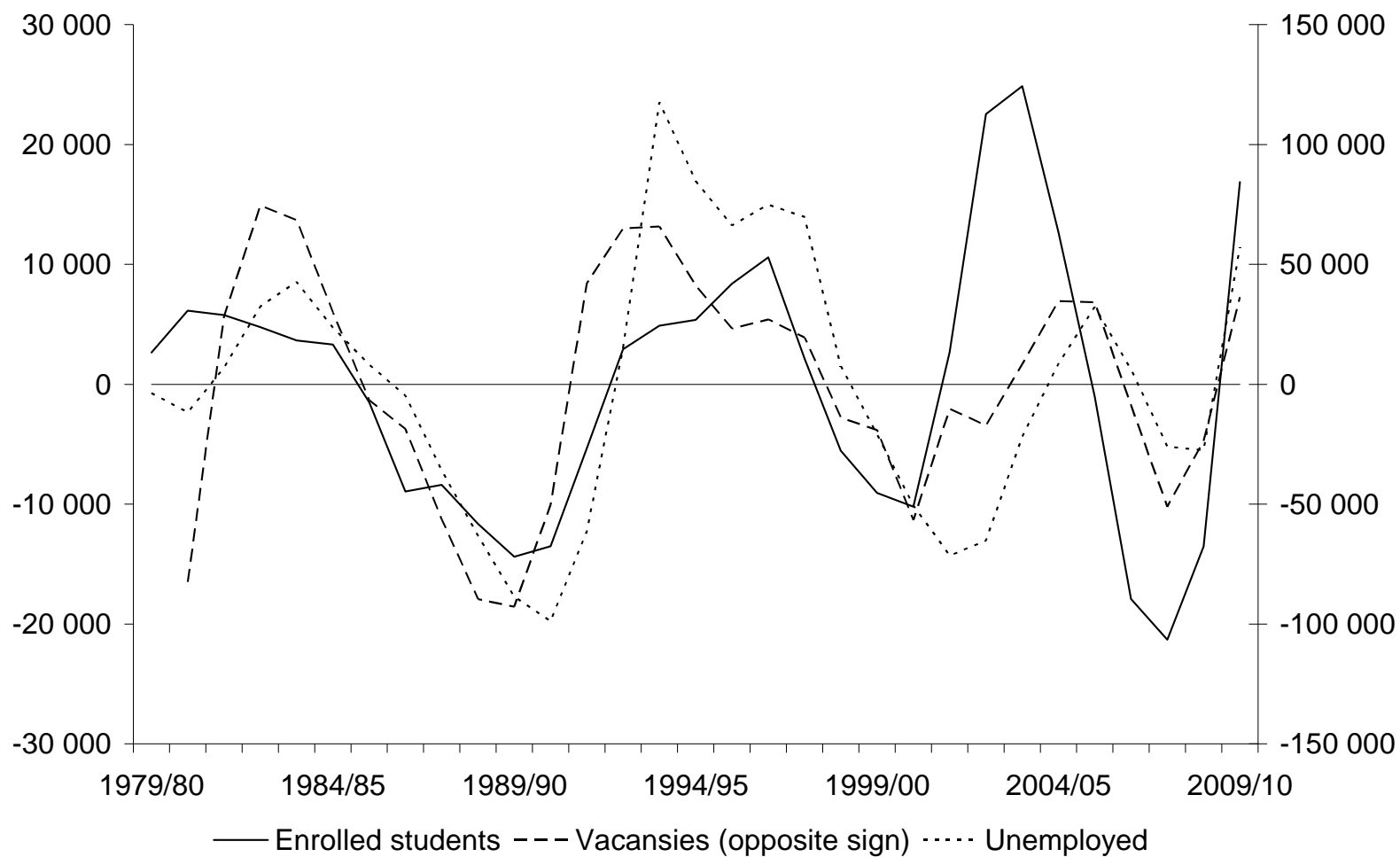
Employment rate and sick-leave, percent of the labour force and employment respectively



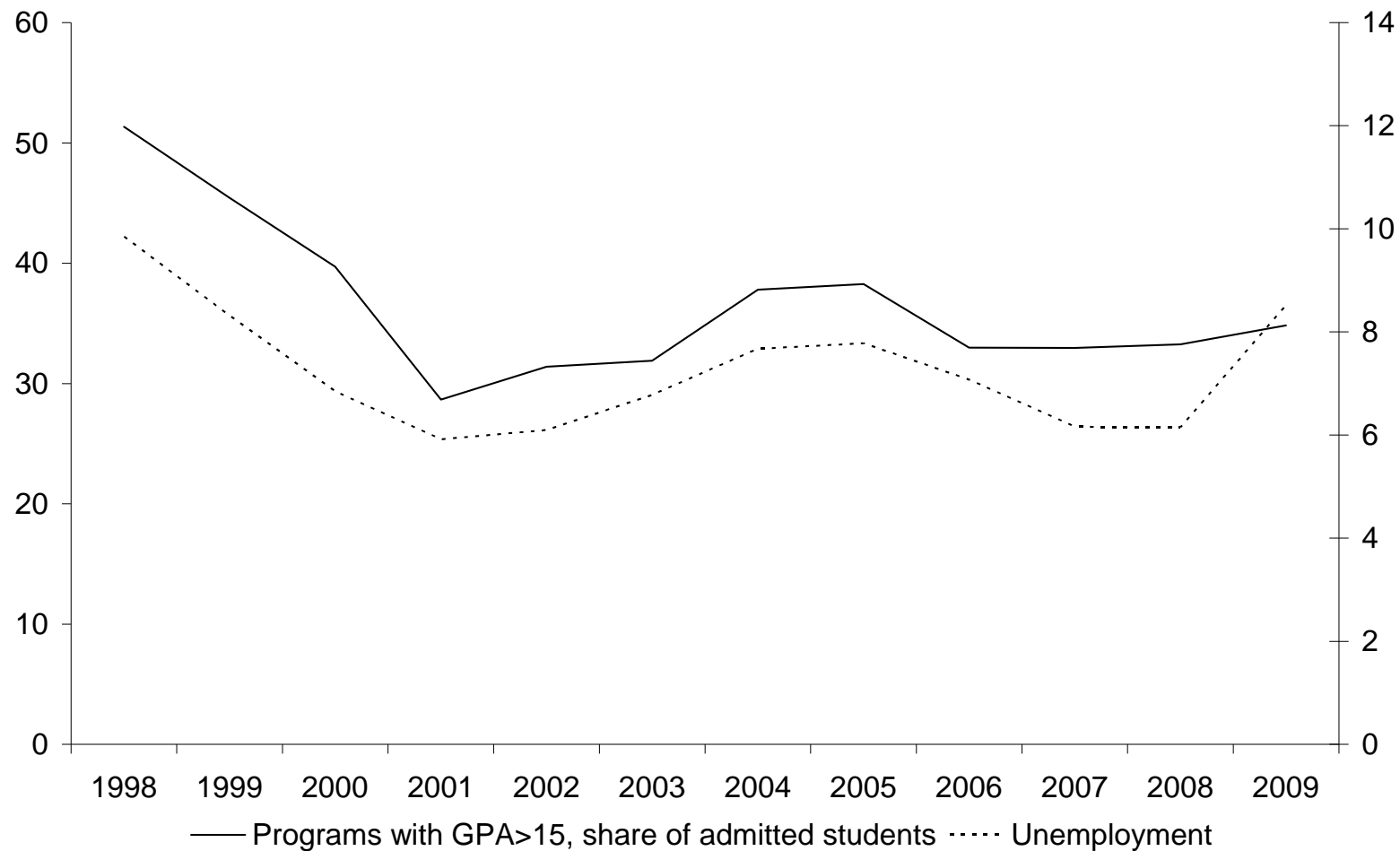
Newly-granted disability pensions



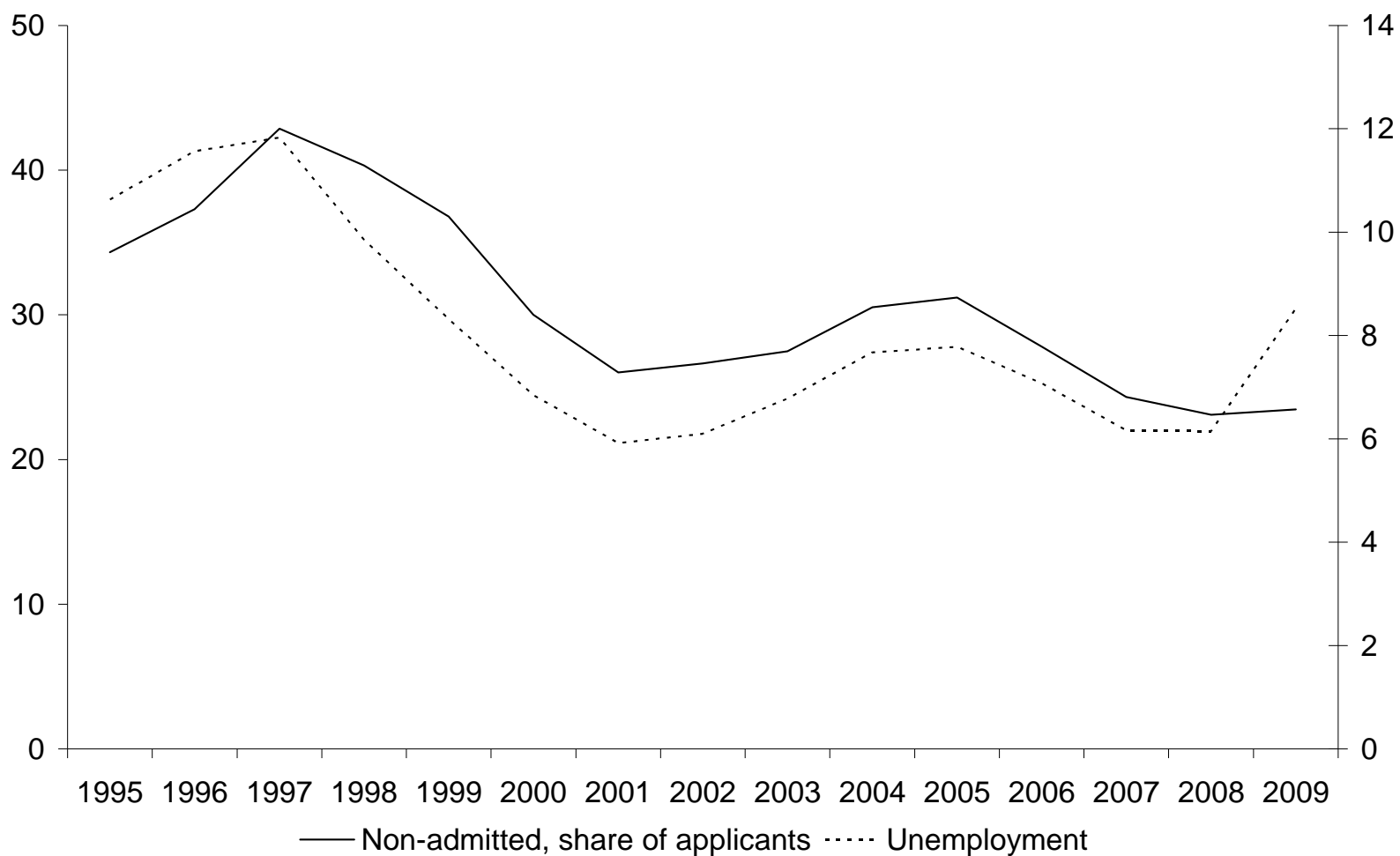
Enrolled college students, vacancies and unemployed, deviations from trend



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



Unemployment and share of non-admitted first-choice applicants



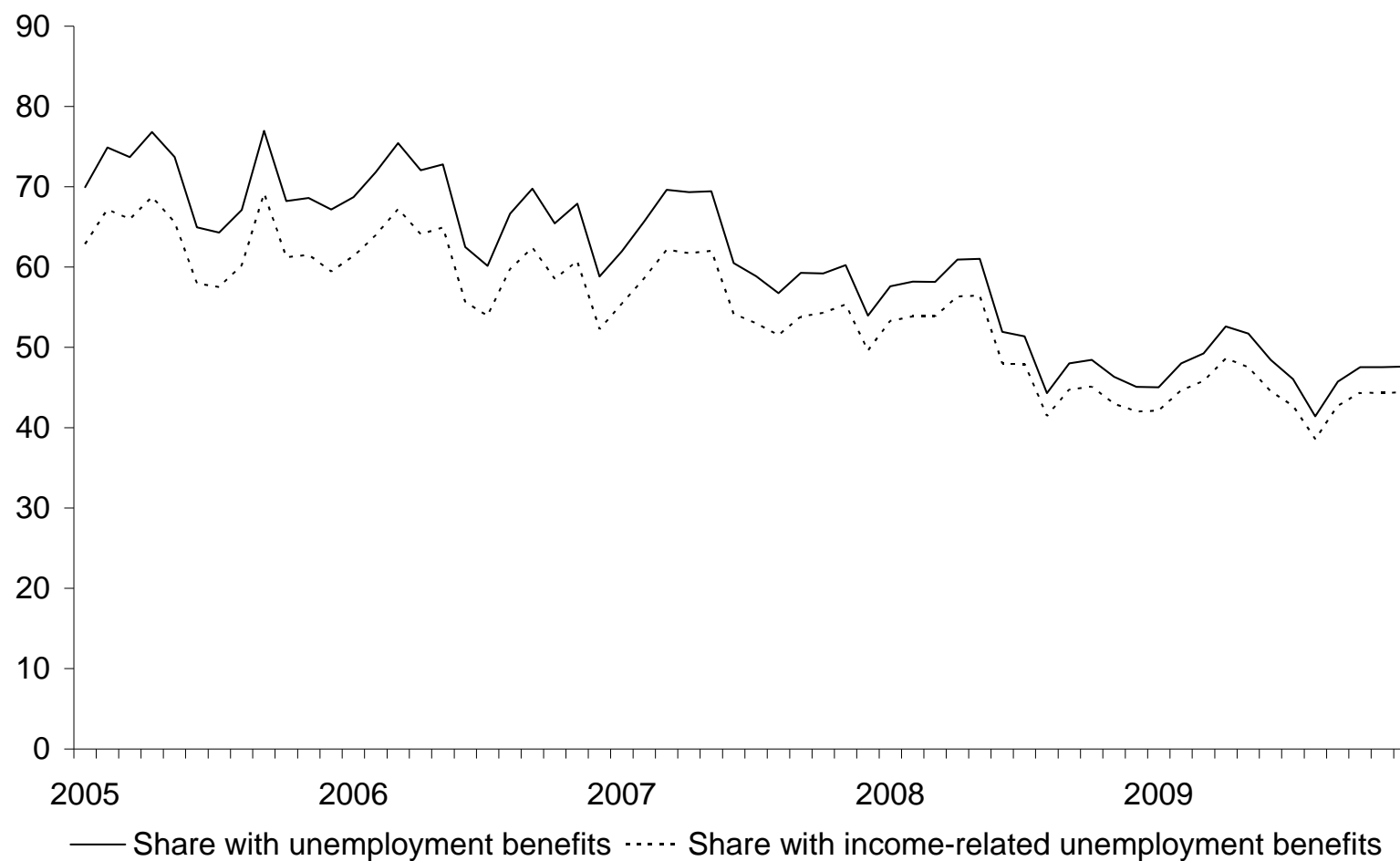
Income insurance during unemployment

- 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



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