

The Swedish Fiscal Policy Council

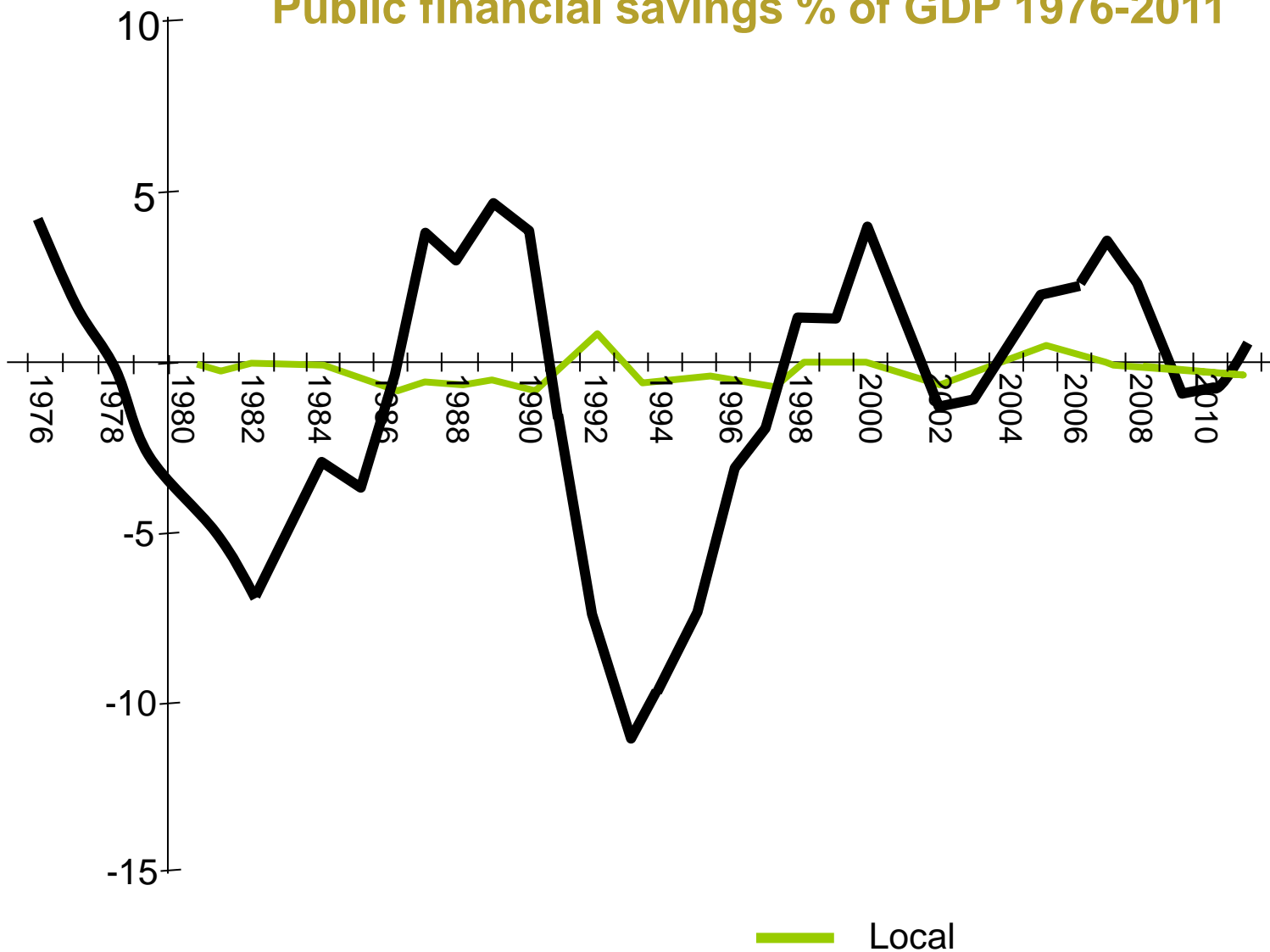
Meeting with *Professor Christian de Boissieu, Chairman of the
Conseil d'Analyse Economique.*

May 4, 2012

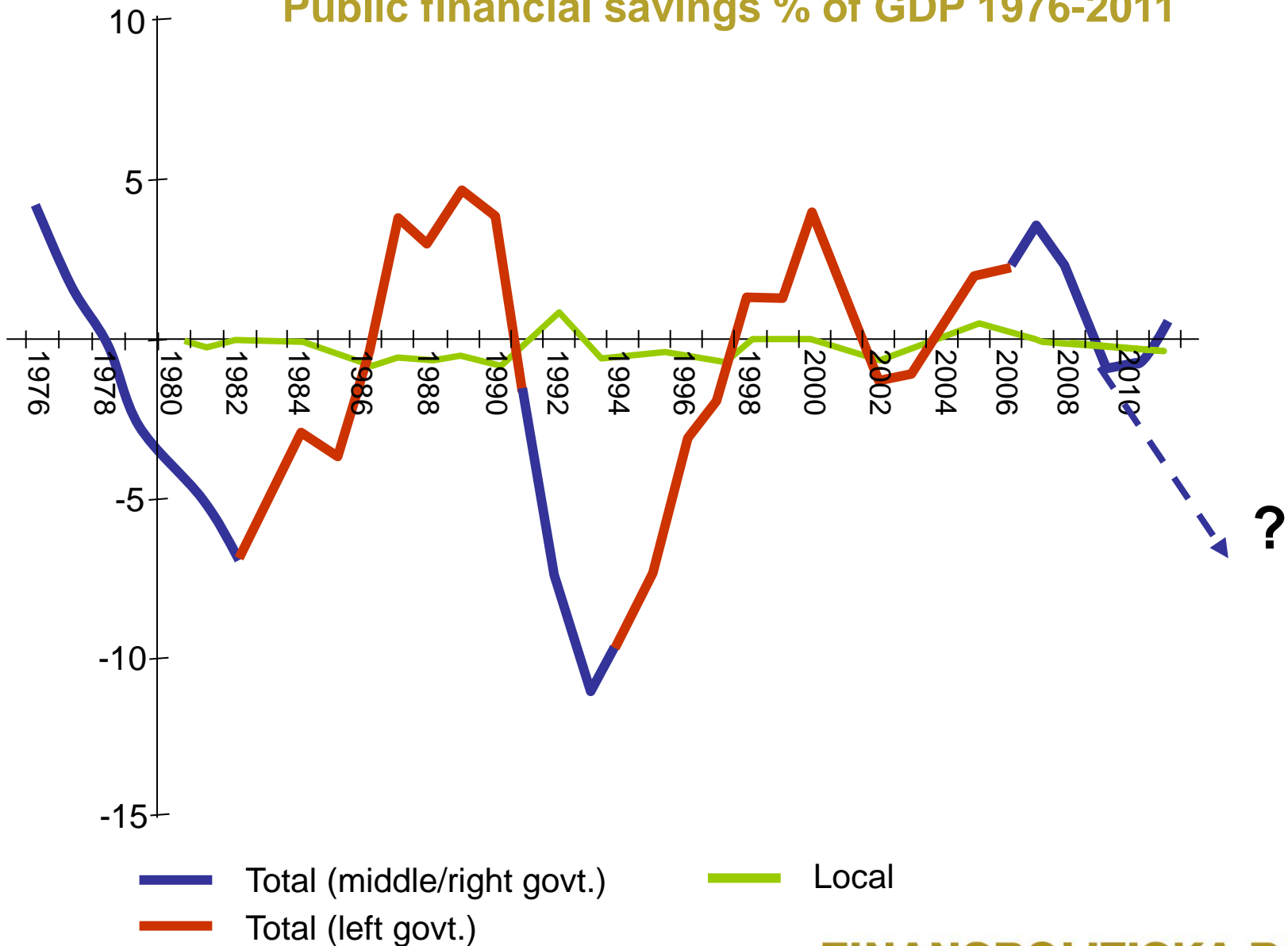
Sweden during recent crisis

- 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



Public financial savings % of GDP 1976-2011



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 average 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.