

Stability, Cohesion and Growth

April 23, 2012

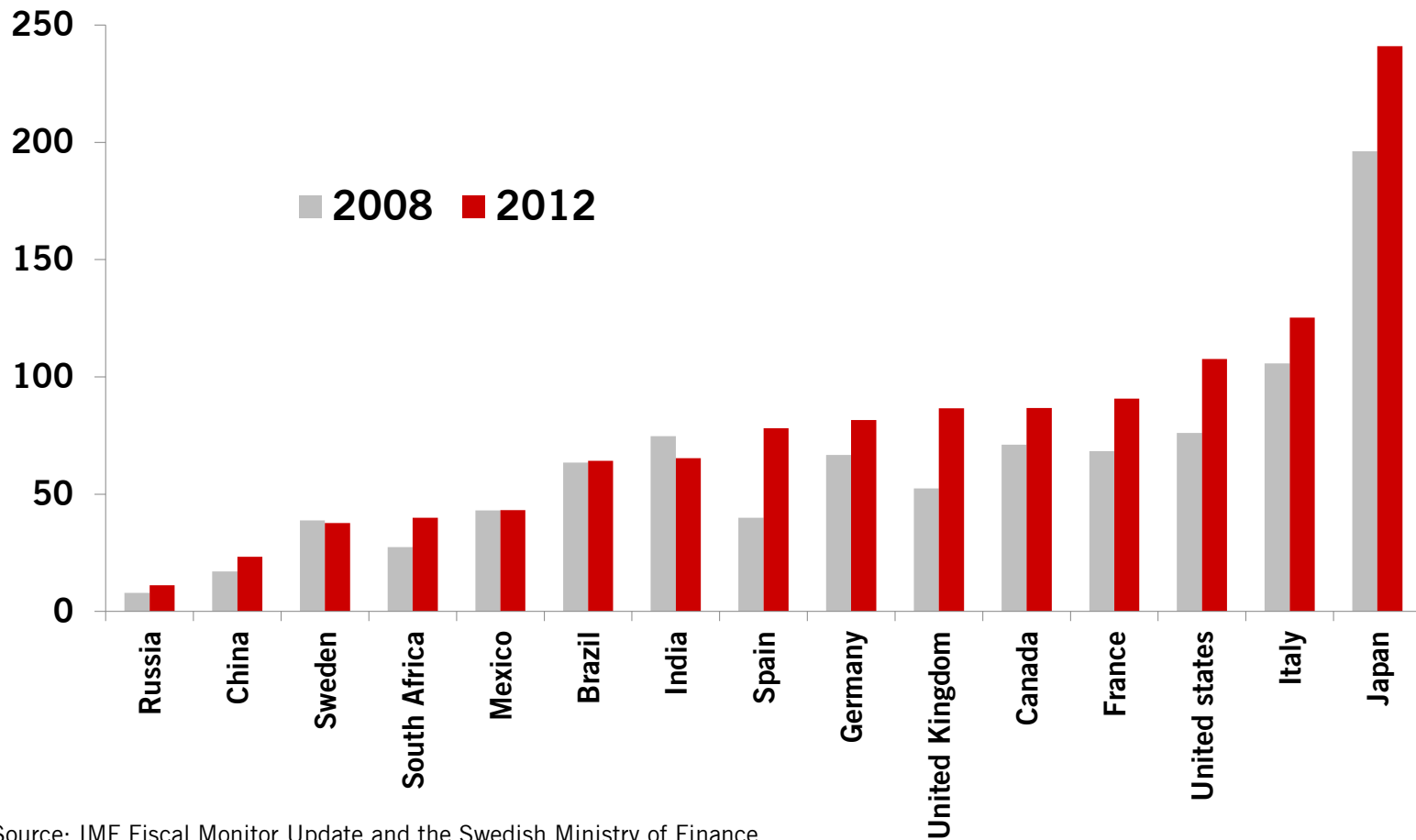
Swedish Minister for Finance Anders Borg

Agenda

- **Sweden has weathered the current crisis relatively well**
- Lessons from the crisis in the early 1990s
- Further reforms still necessary

General government gross debt

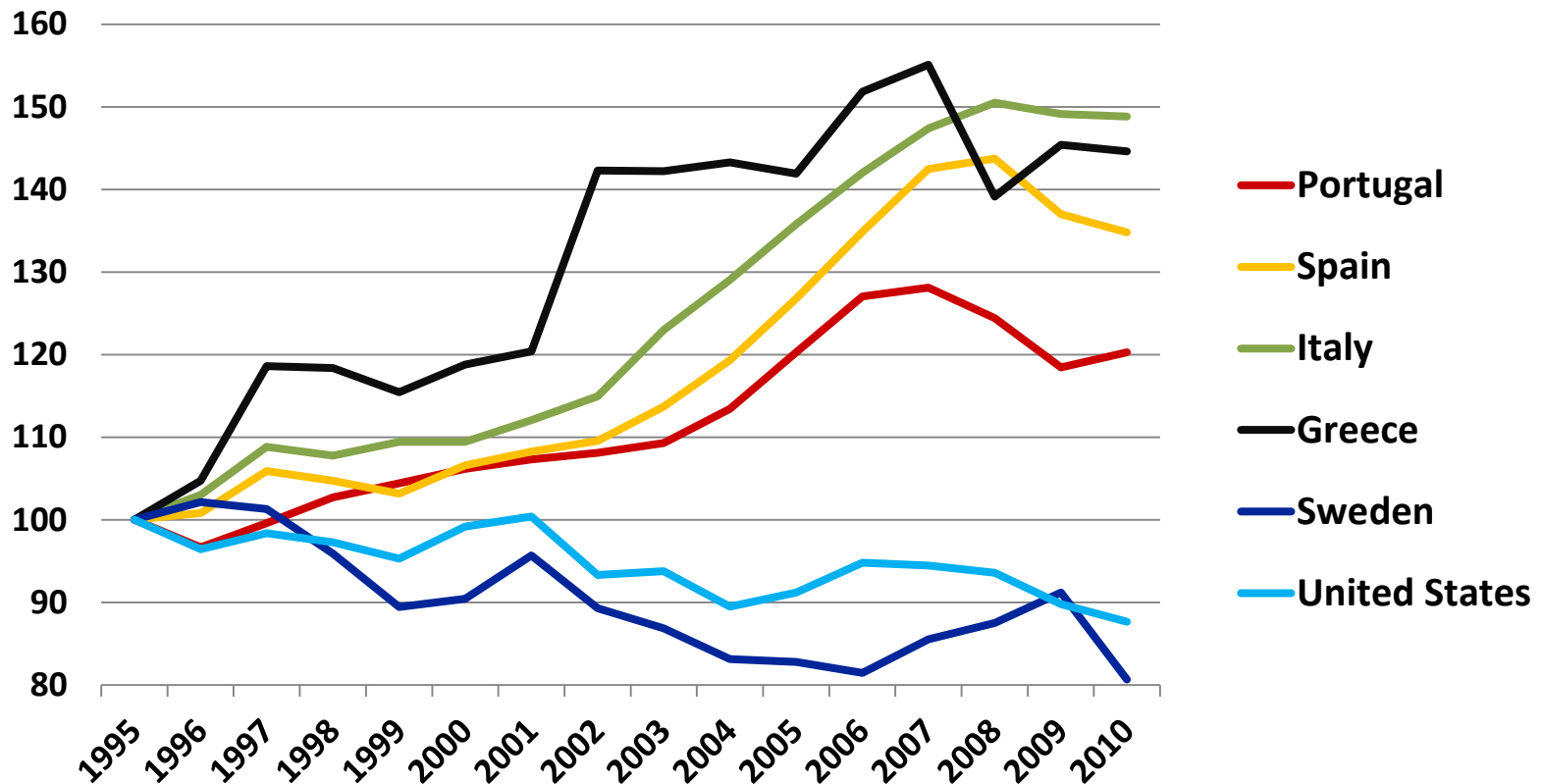
Percent of GDP



Source: IMF Fiscal Monitor Update and the Swedish Ministry of Finance

Europe today: competitiveness crisis

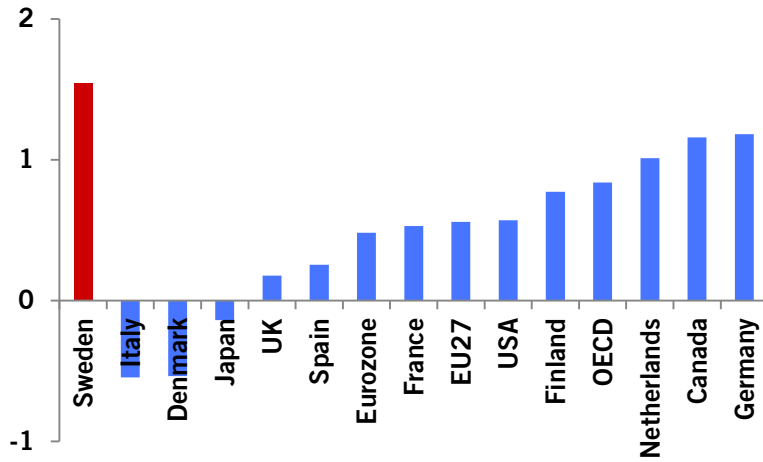
Unit labor cost relative to Germany. Index 1995=100



Source: OECD

GDP growth

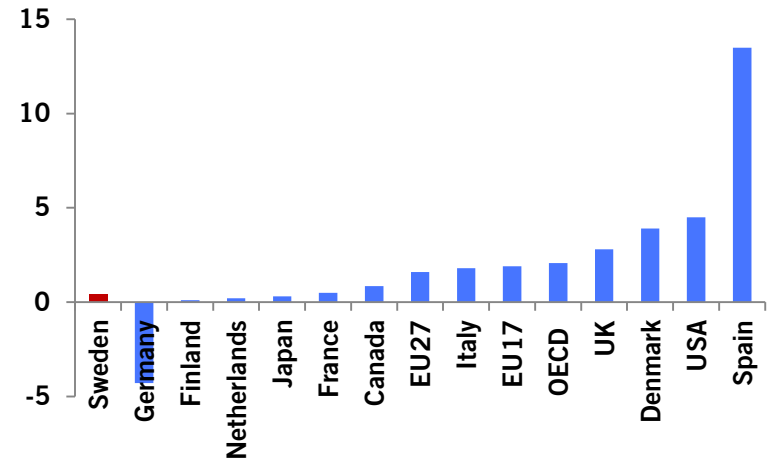
Average growth rate 2007-2011. Percent



Source: OECD

Unemployment rate

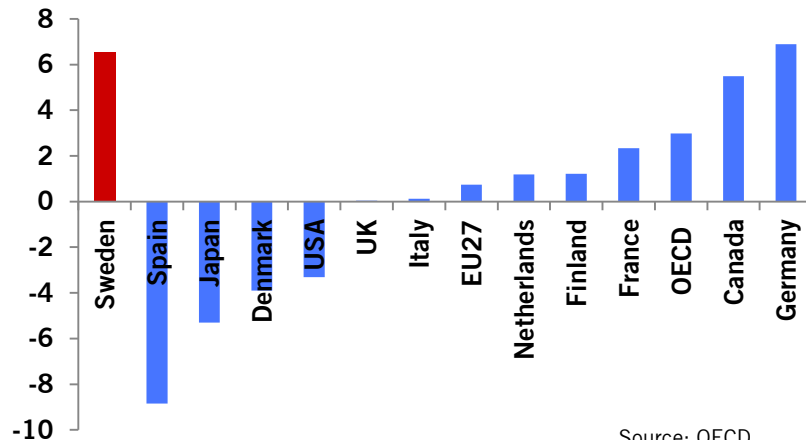
15-74 yrs. Change in percentage points Q3 2006-Q3 2011



Source: OECD

Employment growth

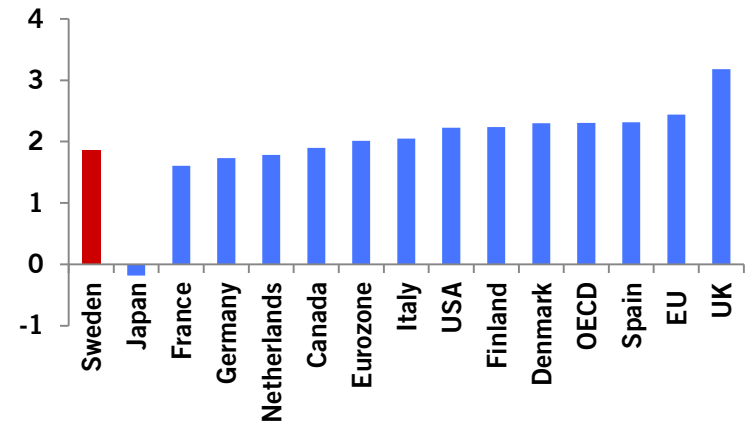
15-64 yrs. Growth Q3 2006-Q3 2011. Percent



Source: OECD

Inflation

Average 2007-2011. Percent



Source: OECD and Eurostat

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Sweden in 1980s: a slow train wreck

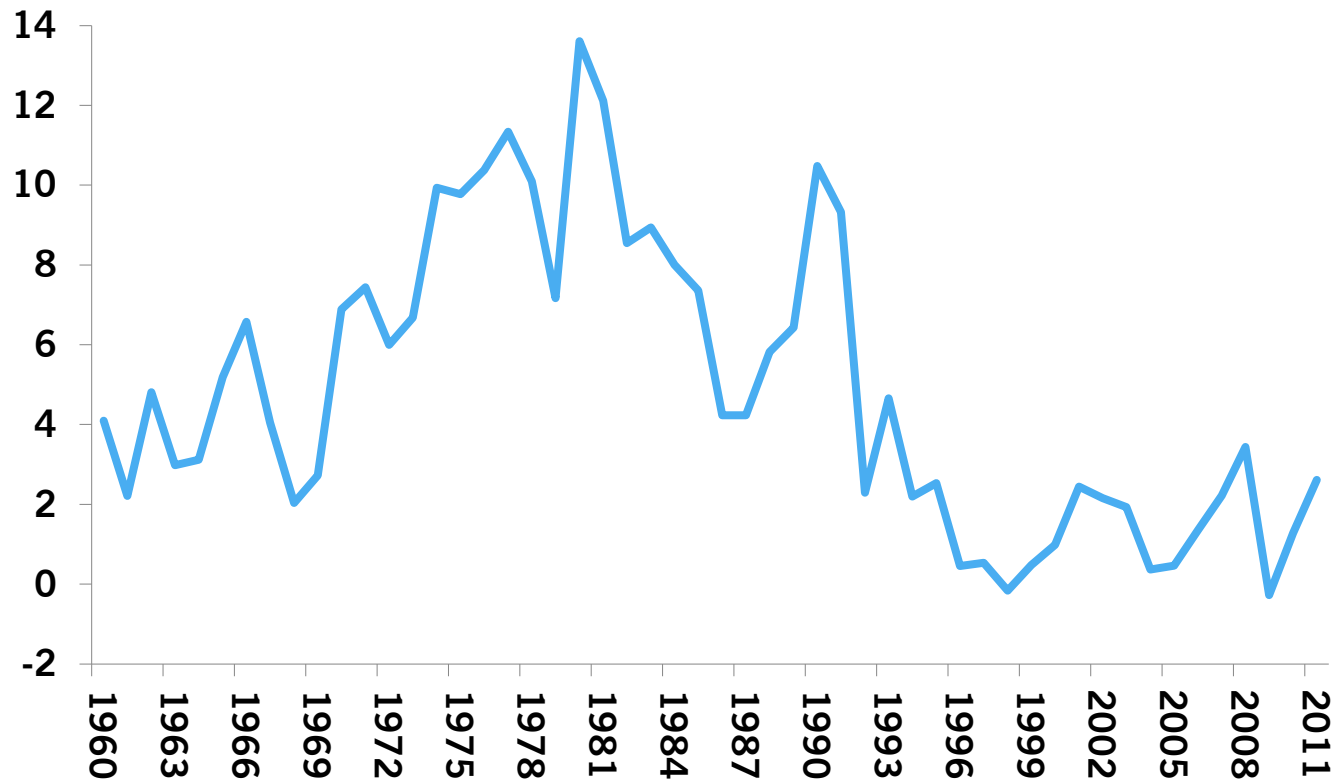
- Heavily regulated markets
- High taxes and high threshold effects
- Poor business climate
- Dysfunctional wage setting
- Unsustainable fiscal policy

Severe macroeconomic imbalances

- High inflation
- Poor real wage growth
- Repeated devaluations
- Rising public debt levels
- Persistent current account deficit

High inflation

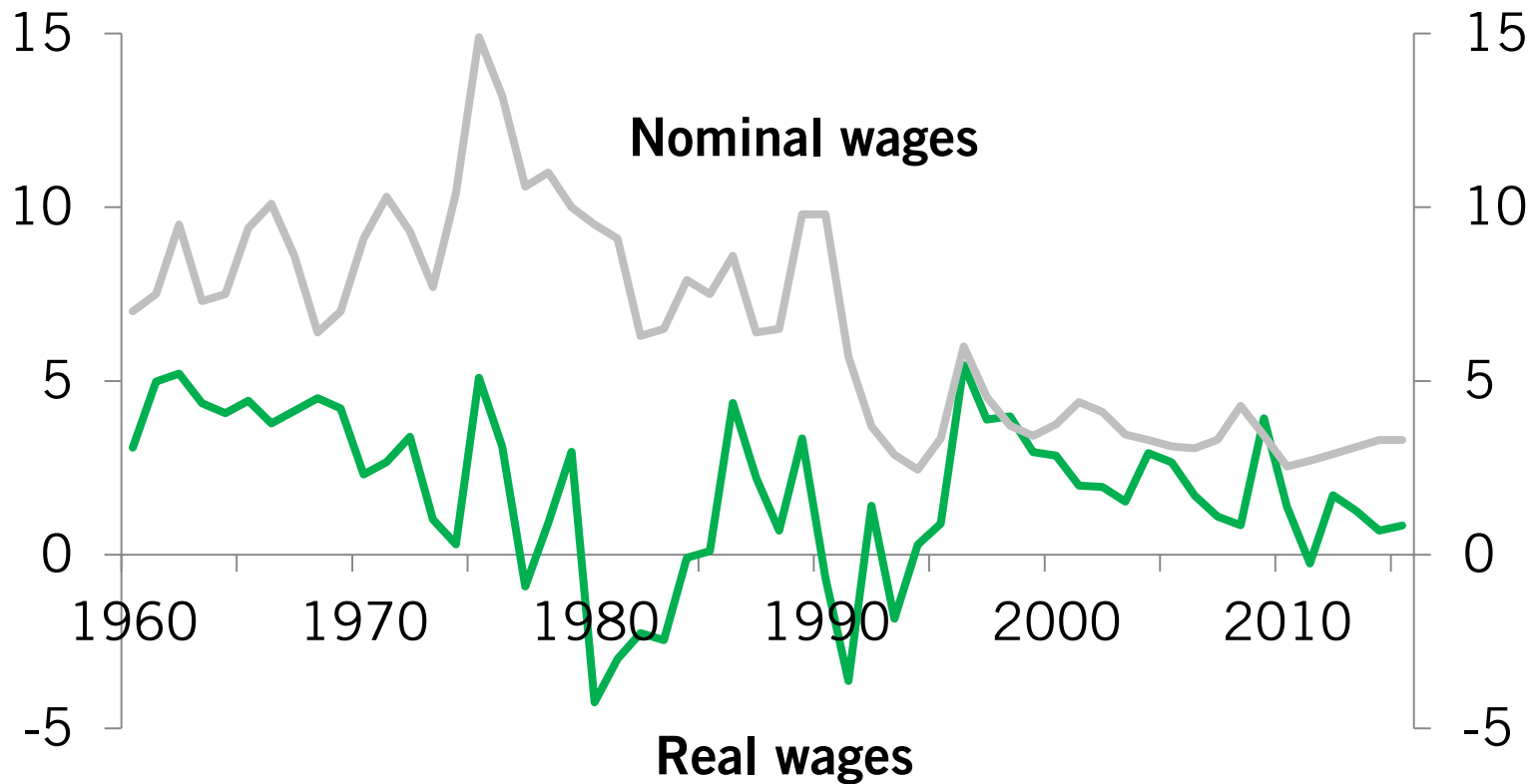
Annual percentage change in CPI



Source: Statistics Sweden

Poor real wage growth

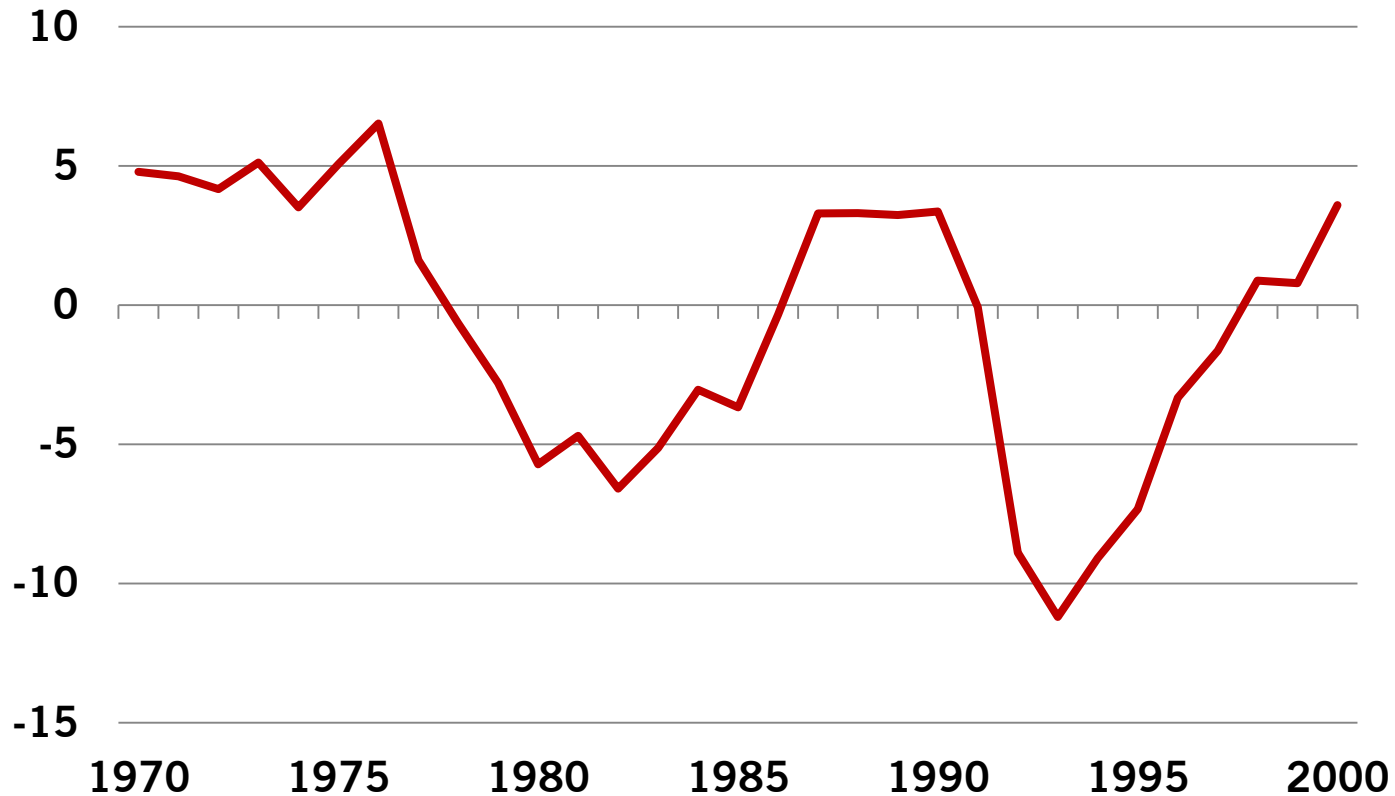
Real and nominal wage growth. Annual growth rates. Percent



Sources: Medlingsinstitutet and the Swedish Ministry of Finance. 2011-2015 are forecast values

Public finances under severe stress

Government net lending 1970-2000. Percent of GDP



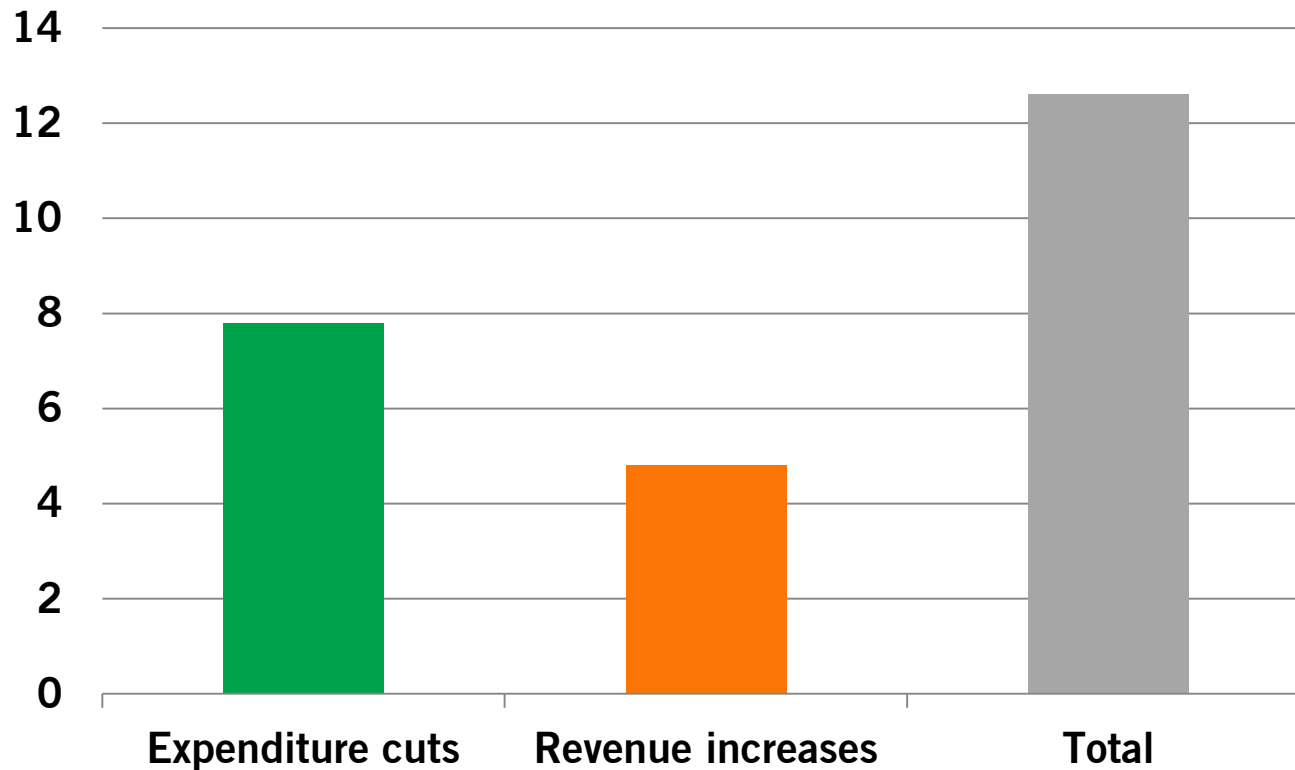
Source: Statistics Sweden

Consolidation in Sweden

- **Broad political support**
- **Broad consolidation in all areas raised revenues and maintained social cohesion**
- **Structurally appropriate pro-growth measures where possible**

Consolidation in all areas

Consolidation measures 1991-1998. Percent of GDP



Source: Swedish Ministry of Finance

Major expenditure cuts

Pensions (reduced indexation)

Early retirement pension

Government transfers to local authorities

Unemployment insurance

Health insurance

Child allowance

Family support

Parenting insurance

Child maintenance allowance

**Real public consumption held constant
absent discretionary changes**

**Public administration costs subject to
annual productivity growth adjustment**

Reduced subsidies for pharmaceuticals

**Interest rate subsidies and other
housing subsidies**

Housing benefits

Old age housing benefits

Major revenue increases

- **Uniform capital income taxation**
- **Indexation of environmental and excise duties**
- **Increased payroll tax**
- **High tax on petrol**
- **Income tax increase for high income earners**
- **Increased tax on tobacco**
- **Social security contributions for self-employed**
- **Amended rules for income tax deductibility of expenses**

Lessons from successful consolidations

- **Expenditure cuts preferable to tax hikes**
- **Broaden tax bases rather than raising tax rates**
- **Consolidation measures must have acceptable effects on distribution of income**
- **Prioritize pro-growth consolidation measures**

The Swedish fiscal policy framework

- **Firm top-down budget process (1994-1996)**
 - Initial decision on binding expenditure restrictions (frameworks) for expenditure areas
 - Proposed appropriations balanced by reducing other appropriations in the same expenditure area
- **Three budgetary targets**
 - Central government expenditure ceiling (1996)
 - Surplus target for general government (2000)
 - Balanced budget requirement on local govts (2000)
- **Fiscal Policy Council (2007)**

Improved budget process

- **Bottom-up budget processes are problematic**
 - Driven by demand, not by economic growth
 - High expectations for new spending reforms
 - Ministry of Finance involved at a late stage in the process
- **A strict top-down process resolves much of these problems**
 - Entire draft budget governed by expenditure ceiling, surplus target and available room for reforms
 - Medium-term context separates budget's total size from issues of needs and desirable expenditures
 - Minority governments can avoid cost-push negotiations with opposition parties

Rules are important but will only work if backed by political commitment

- **Broad support in the Swedish parliament on the importance of the fiscal framework**
- **No major deviations from fiscal framework**
 - Has created a positive path dependence where deviations from the framework are politically costly
 - External evaluation from fiscal council and others to increase cost of deviating from framework
- **National ownership over the construction of fiscal framework is a pre-condition for success**

Structural reforms

- **Major tax reform, lower marginal tax rates on labour**
- **Stricter regulation of competition and public procurement**
- **Extensive deregulation of important markets**
 - banking and finance, air travel, taxi, buses, rail freight, power production and distribution, telecom, postal services, retail including food retail
- **Increased private production of welfare services, e.g. school vouchers**

Structural reforms (continued)

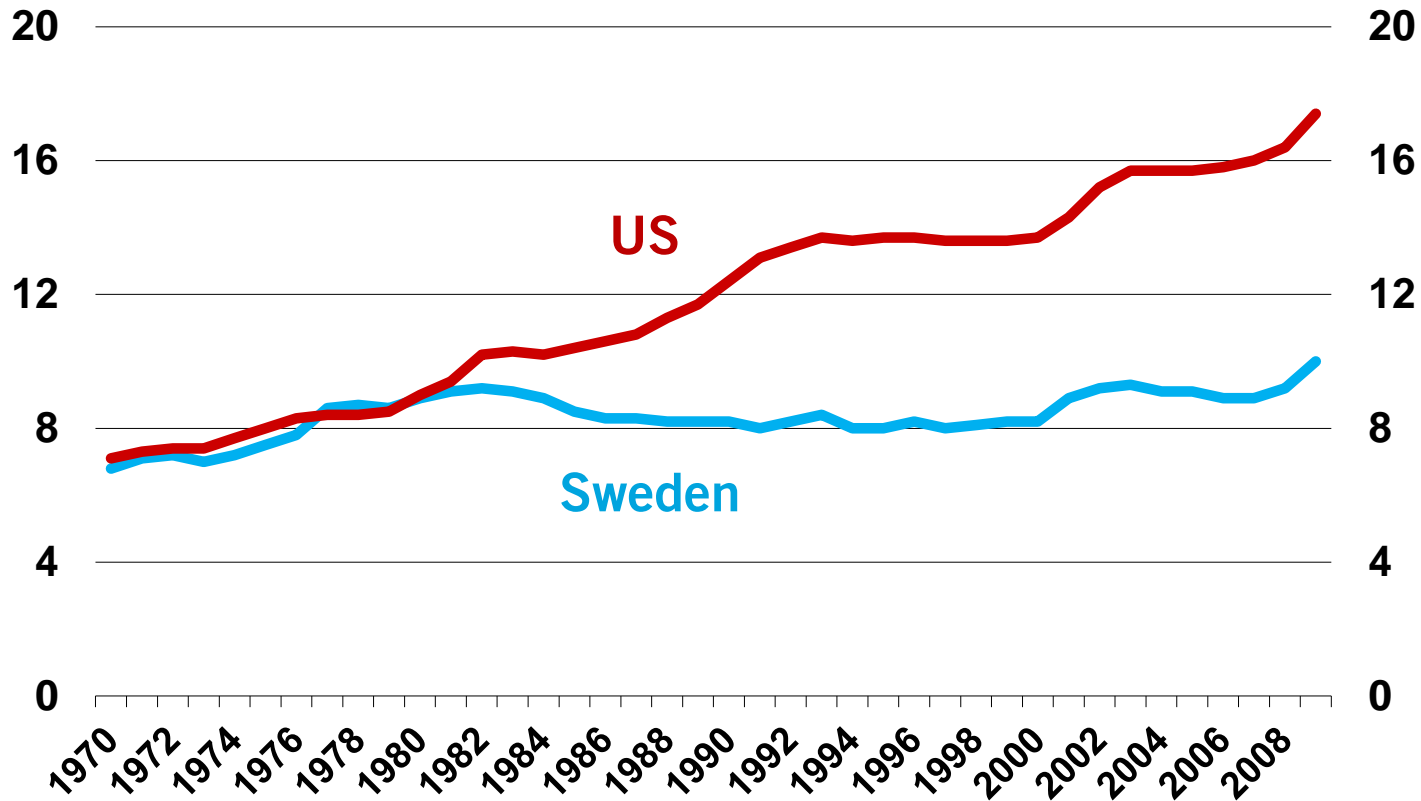
- Pension reform
- European Union membership
- Inflation targeting
- Central bank independence
- Reformed wage setting process
- Increased labor market flexibility

Reforming health care

- **Balanced budget requirement**
- **Modernised budget system: diagnosis related payments**
- **Co-payments**
- **Reformed prescription drug subsidies and use of generic drugs**
- **Competition between providers inside and outside public sector**

Health care costs

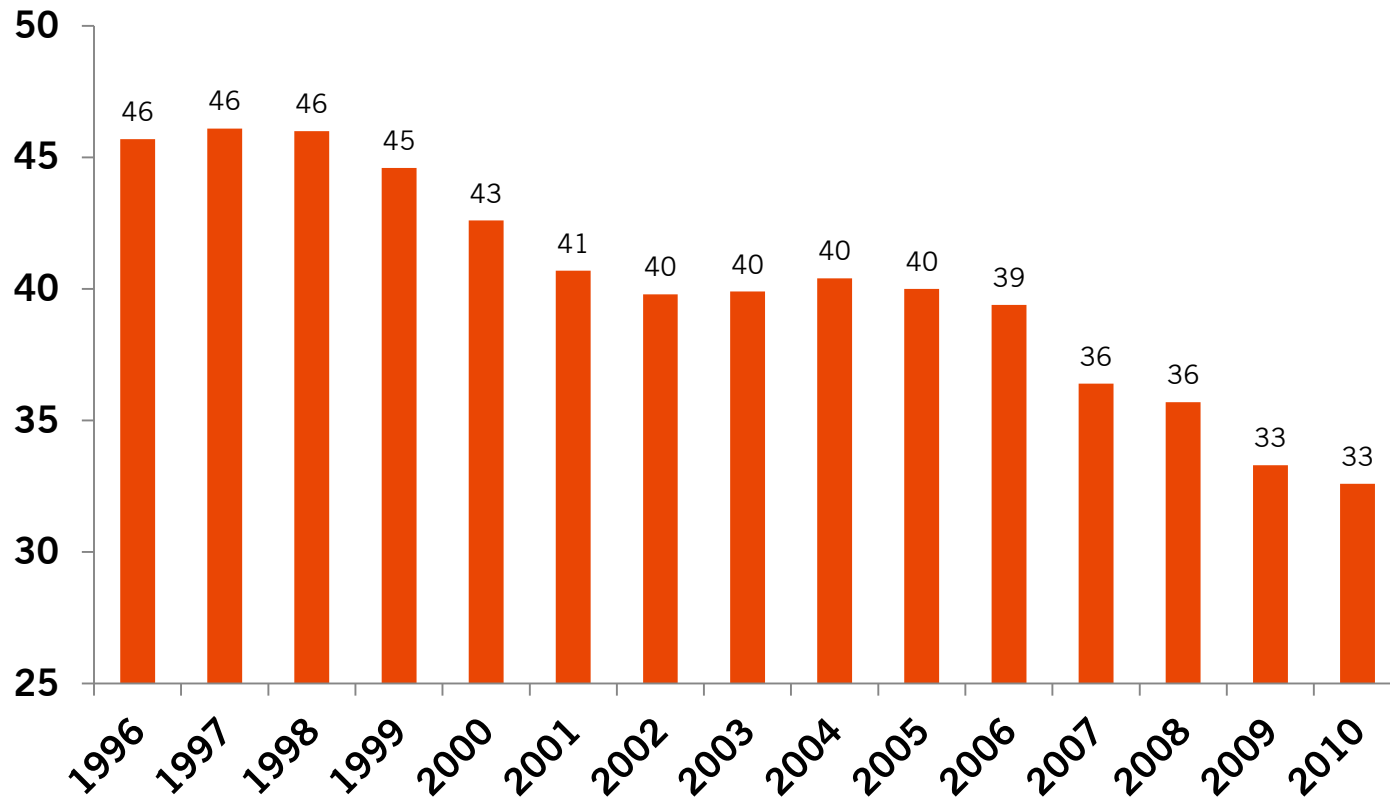
Total health care expenditure. percent of GDP



Source: OECD

Making work pay

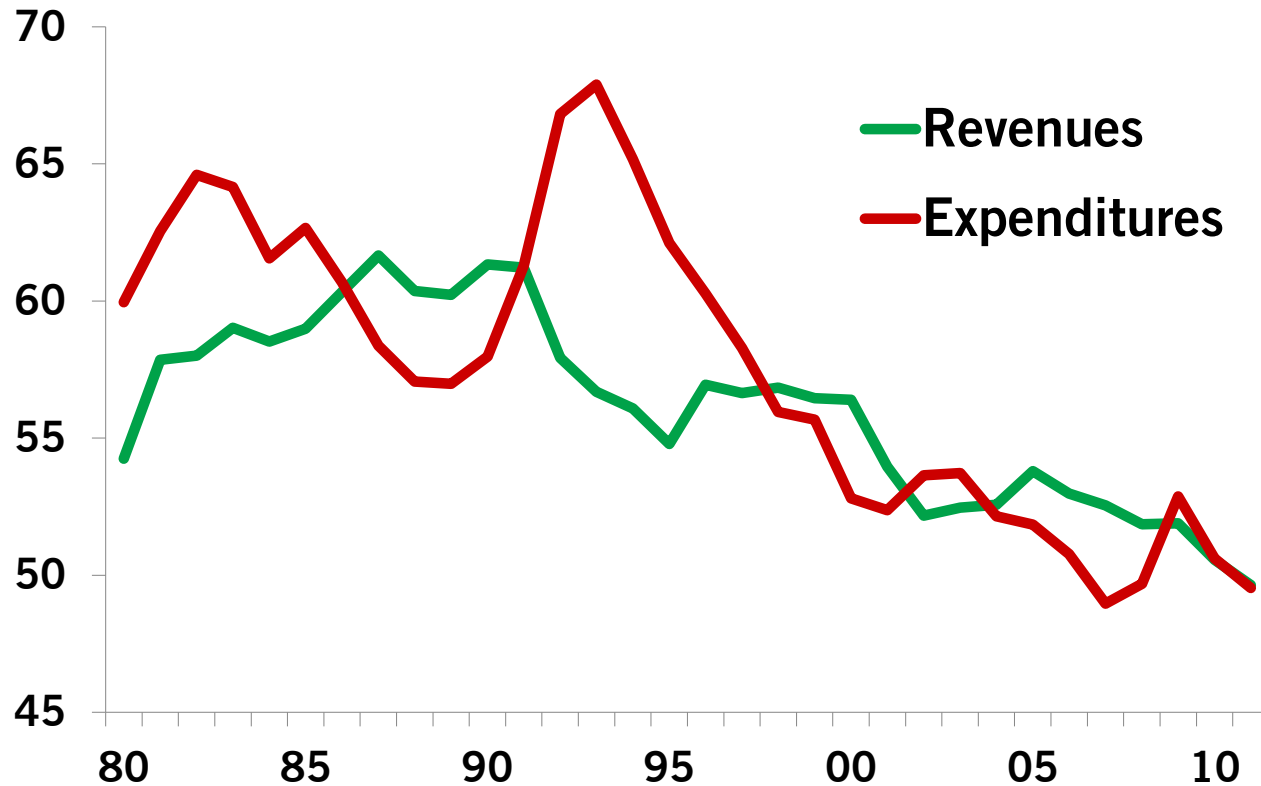
Average marginal effects 1996-2010. Percent



Source: Statistics Sweden and the Swedish Ministry of Finance

Public finances in order

Public revenues and expenditures. Percent of GDP



Source: Statistics Sweden

Lessons from the recent crisis

- **No stability without financial stability**
 - Higher capital requirements on banks
 - Stronger rules for sufficient liquidity ratios
 - Better financial supervision
 - Improved stress tests
- **International cooperation is crucial**

Agenda

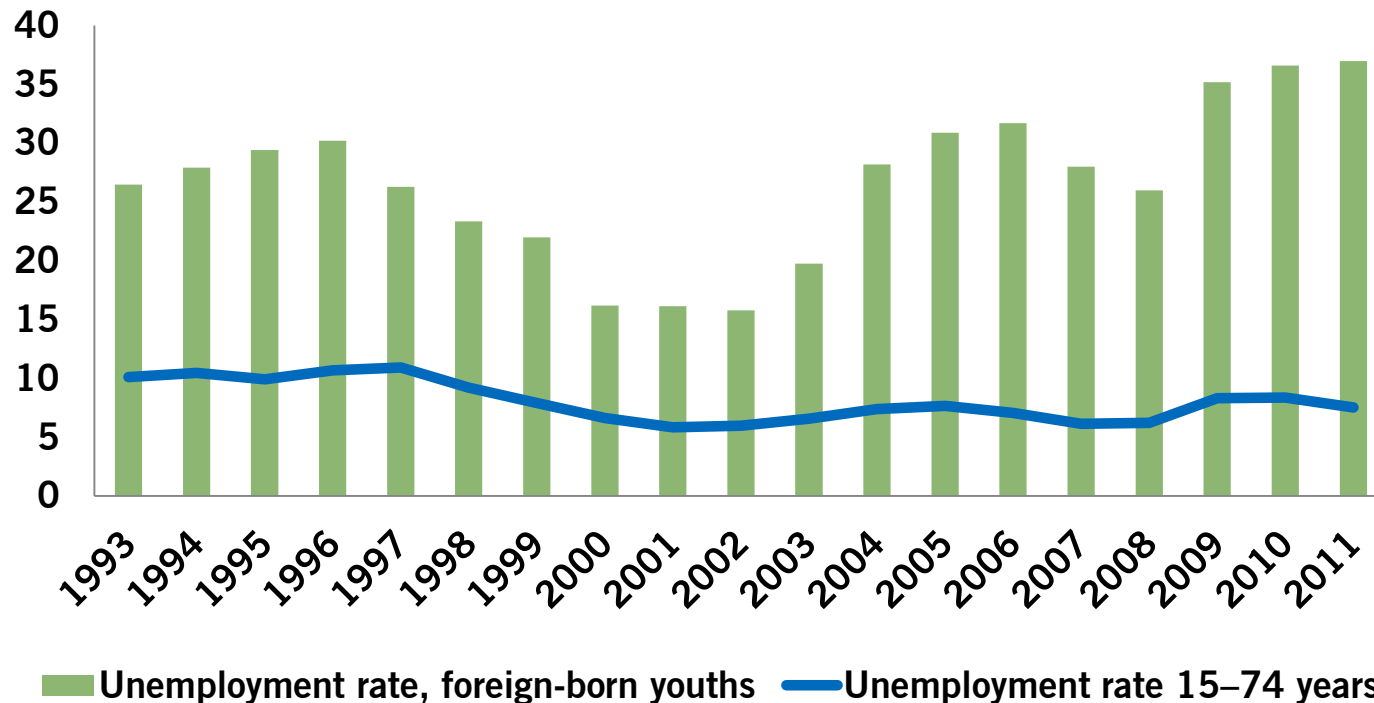
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Sweden's Achilles heel

- Tax wedges and compressed wage distribution destroy jobs
- High barriers when entering labor market
- Youth and immigrants bear a large share of the burden

Difficulties entering the labour market

Unemployment rate among foreign-born youth. Percent of labour force



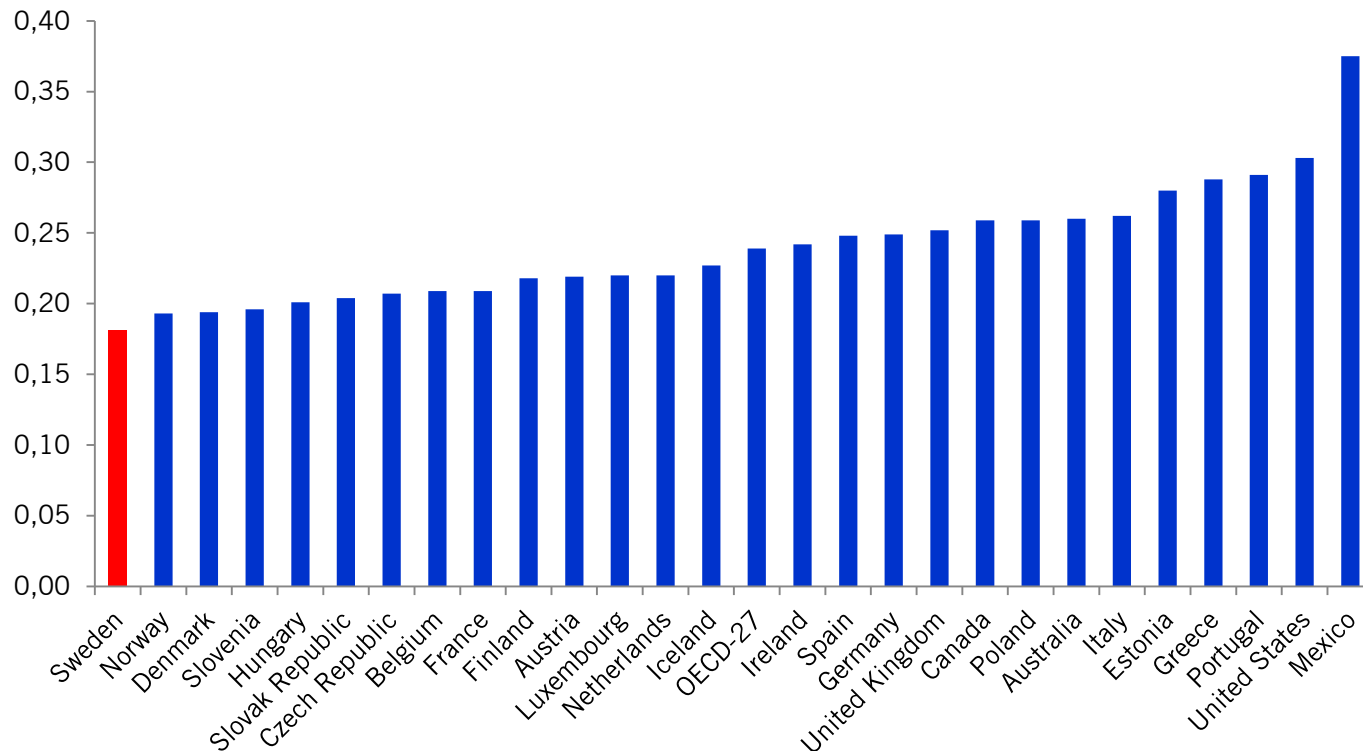
Source: Statistics Sweden. Note: Time series break. 1993-2004: 16-24 years, previous definition. 2005-2011: 15-24 years, international harmonized definition.

The road ahead

- Lower barriers and make work pay
- Increase labor demand for weaker groups
- Consider subsidies to some employment forms
- Education: Raise quality and job market relevance
- Expand vocational training and on-the-job learning
- Increase flexibility while safeguarding security

Prosperity and equality

Inequality in income distribution including public services. Gini coefficient



Source: OECD (2011), *Divided We Stand*

Summary: sustainable fiscal strategy

- **Consolidation requires credibility**
- **Strong fiscal framework boosts credibility**
- **Structural reforms necessary for long-term growth and competitiveness**
- **Stability, cohesion and growth**