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

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

**Employment growth**

**Inflation**
Average 2007-2011. Percent

Source: OECD

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
- Dysfuntional 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


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


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
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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

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