

Swedish Fiscal Policy

Annual report

Swedish Fiscal Policy Council 2009

Two main questions

1. How well has the government adjusted policy to the economic crisis?
2. How should the economic-policy framework be developed?

The government's measures to handle the financial crisis

- Mainly adequate
- Good effects of the bank guarantee programme
- Legal framework to deal with insolvent banks should have been put in place earlier
- Establish a government agency to administer the support for the financial markets
 - unfortunate double role for the National Debt Office
 - both business transactions and administration of support programme

Financial risks

- The spring bill reports the government's commitments
- But it is difficult to get an overview
- Need of analysis of different risk scenarios
- Such analyses should be developed as soon as possible

Need of more fiscal stimulus?

- Drastic revisions of the business cycle forecasts: from GDP rise of 1.3 percent to GDP fall of 4,2 percent
- Less generous unemployment insurance
- Tax cuts in the budget bill were not designed to stabilise the business cycle
- The automatic stabilisers been weakened, but only marginally
- Risks for the sustainability of fiscal policy
- More difficult to stimulate the economy at later stages of the slump.
- Households may save more
- Long-term interest rates may rise

Automatic stabilisers

$$f = f^* + \tilde{f}$$

f = net lending

\tilde{f} = automatic stabilizers

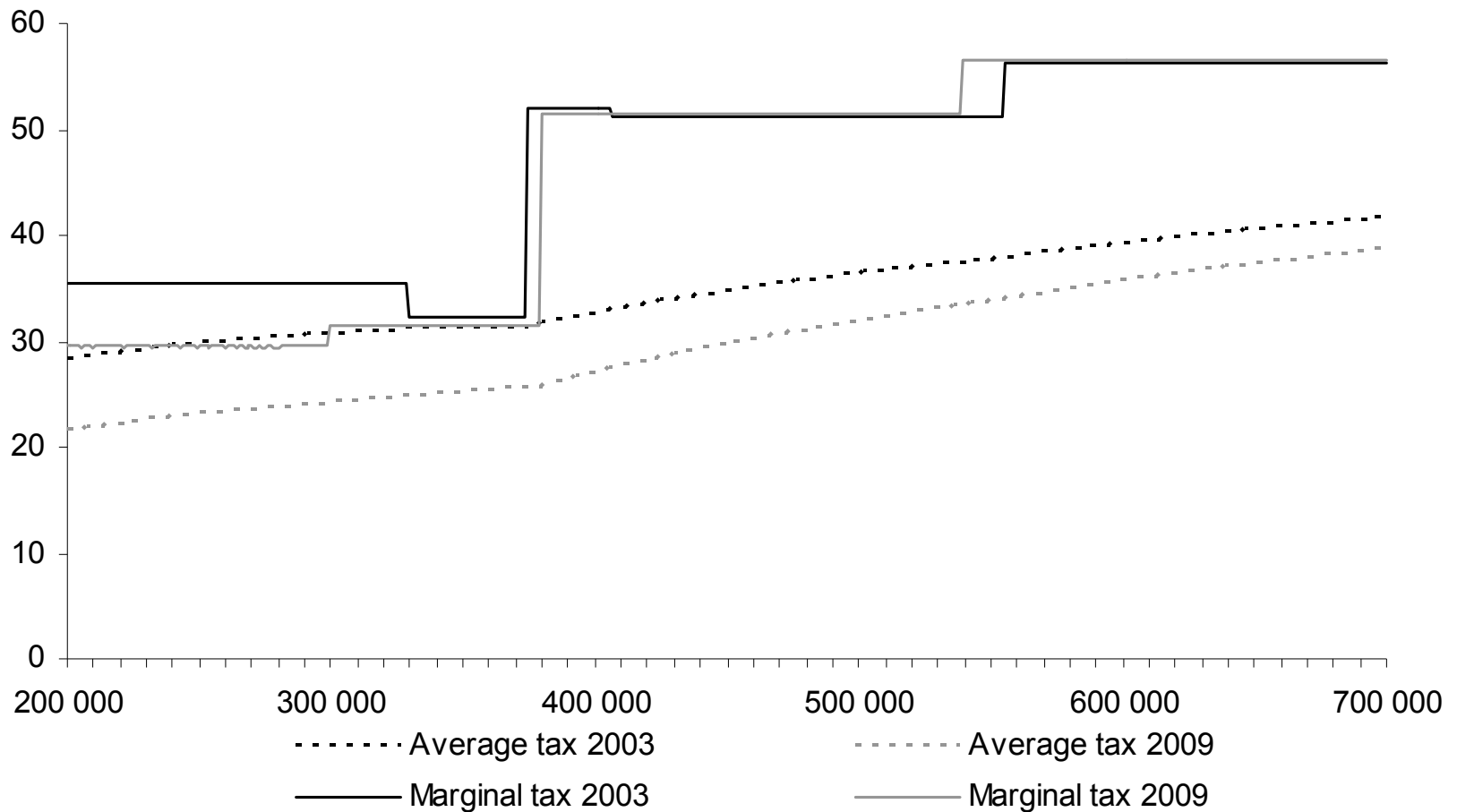
f^* = discretionary component

$$\tilde{f}_t = \alpha + \varepsilon(y_t - \bar{y}_t)$$

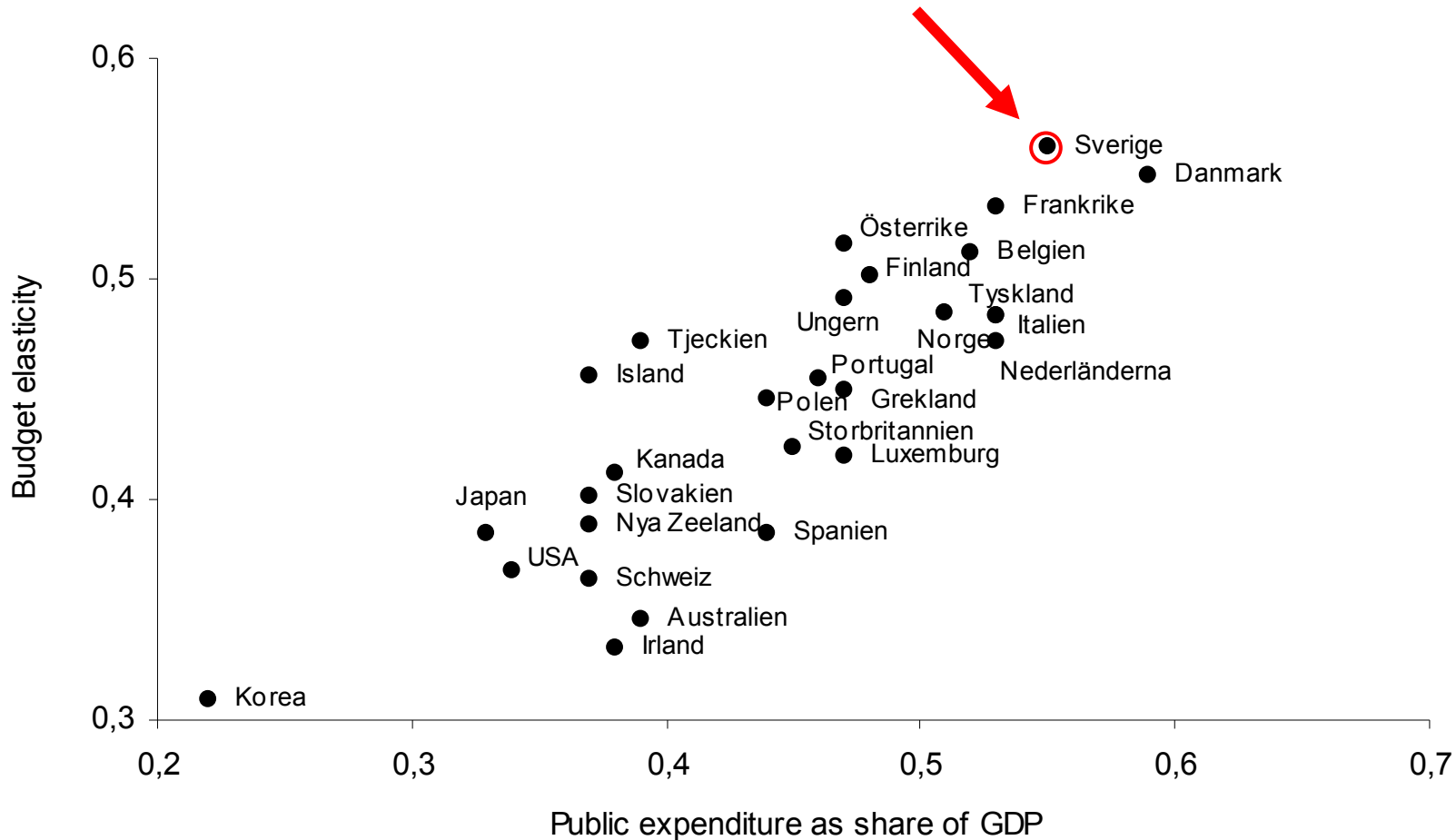
Contributions to the budget elasticity

	Inkomst- skatt	Sociala avgifter	Moms	Bolags- skatt	Arbetslöshets -försäkring	Budget- elasticitet
1998	18,0	12,8	12,0	3,5	12,1	58,4
1999	17,7	13	12,8	3,8	11,1	58,4
2000	17,2	13,1	12,7	4,9	11,3	59,2
2002	16,5	13,3	12,9	2,7	19,3	54,7
2003	16,9	12,6	13,0	2,9	19,0	54,4
2004	16,8	12,3	12,9	4,1	18,3	54,4
2005	16,9	12,2	13,1	5,2	18,0	55,4
2006	16,8	11,9	12,9	5,2	17,2	54,0
2007	17,0	12,0	13,0	5,0	17,3	54,3
2008	17,6	12,2	13,5	4,6	15,4	53,3
2009	17,4	12,2	13,3	4,9	15,4	53,2

Average and marginal tax rates 2003 and 2009



Budget elasticity and size of the public sector



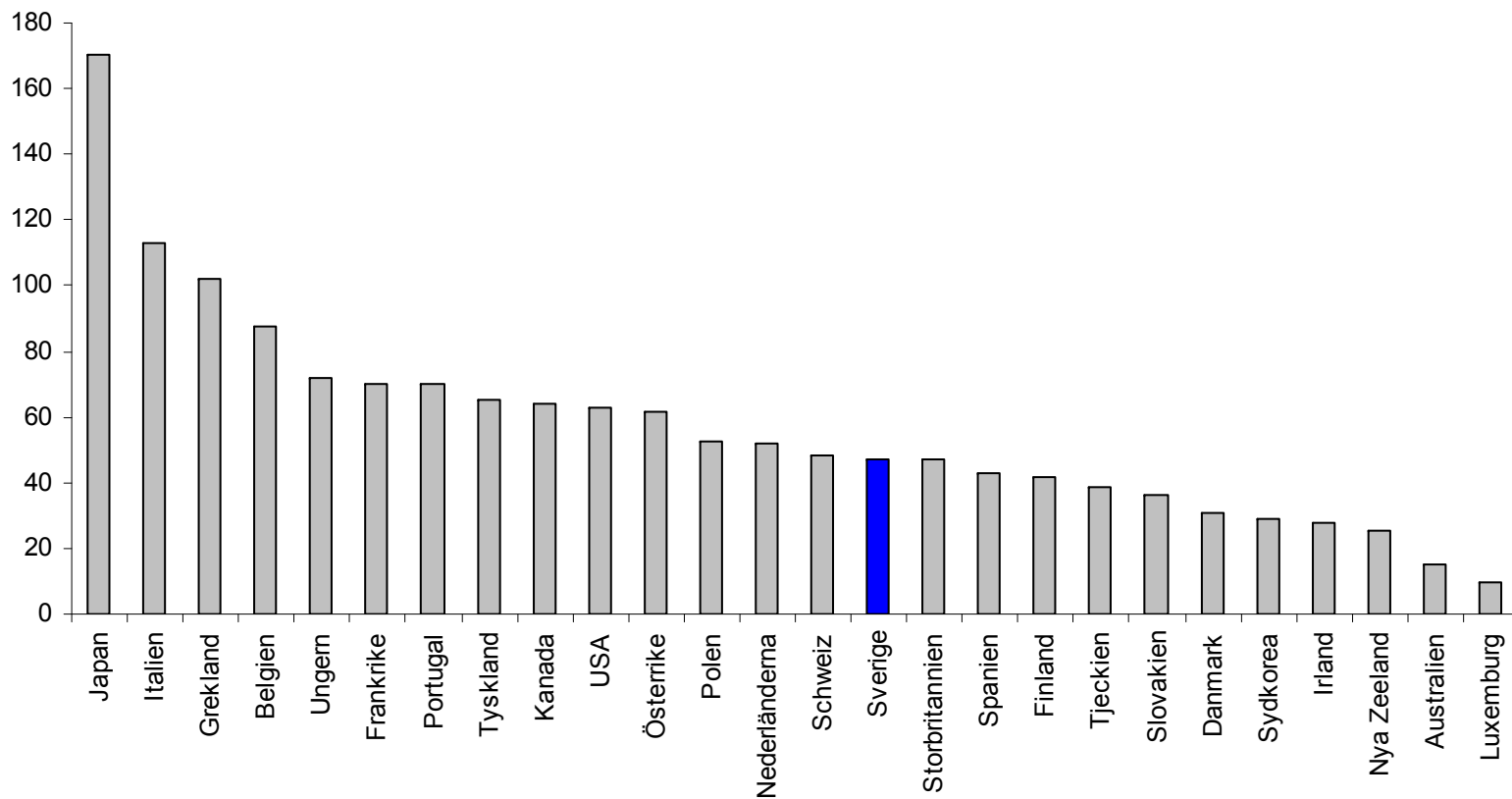
More stimulus desirable

- Up to SEK15 bn 2009 (0,5 percent of GDP), SEK30 bn (1 percent of GDP) next year

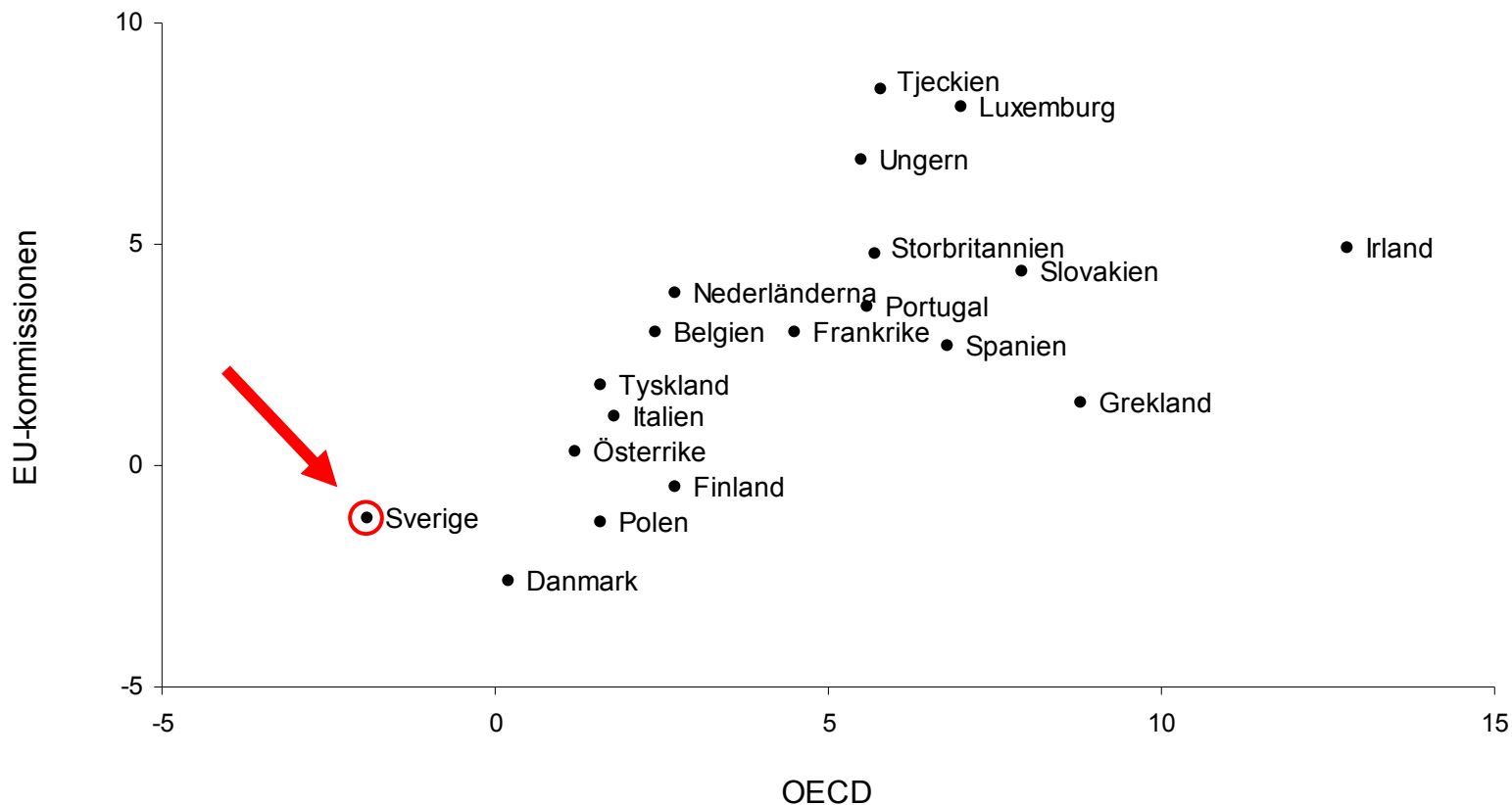
Reasons

- Still no structural deficit according to the government's calculations.
- Stronger public finances than in most other countries
- Stronger public finances than in the beginning of the economic crisis in the 1990s
- Stable fiscal policy framework
- Political consensus on strong public finances

Gross public sector debt 2007 (percent of GDP)



The sustainability of fiscal policy (the S2-indicator)



$$V_{t_0} \geq \sum_{t=t_0+1}^{\infty} (G_t - T_t) / (1+i)^{t-t_0}$$

$$v_{t_0} \geq \sum_{t=t_0+1}^{\infty} (g_t - \tau_t) \beta^{t-t_0}$$

$\beta = (1+\gamma)/(1+i)$ = growth adjusted discount factor

V = net financial wealth

v = net financial wealth relative to GDP

f = intertemporal financial net wealth relative to GDP

$$f = v_{t_0} - \sum_{t=t_0+1}^{\infty} (g_t - \tau_t) \beta^{t-t_0}$$

s = s2-indicator = permanent annual budget improvement that fulfills intertemporal budget constraint exactly

$$-f = s\beta + s\beta^2 + \dots s\beta^n + \dots = \frac{s\beta}{1 - \beta}$$

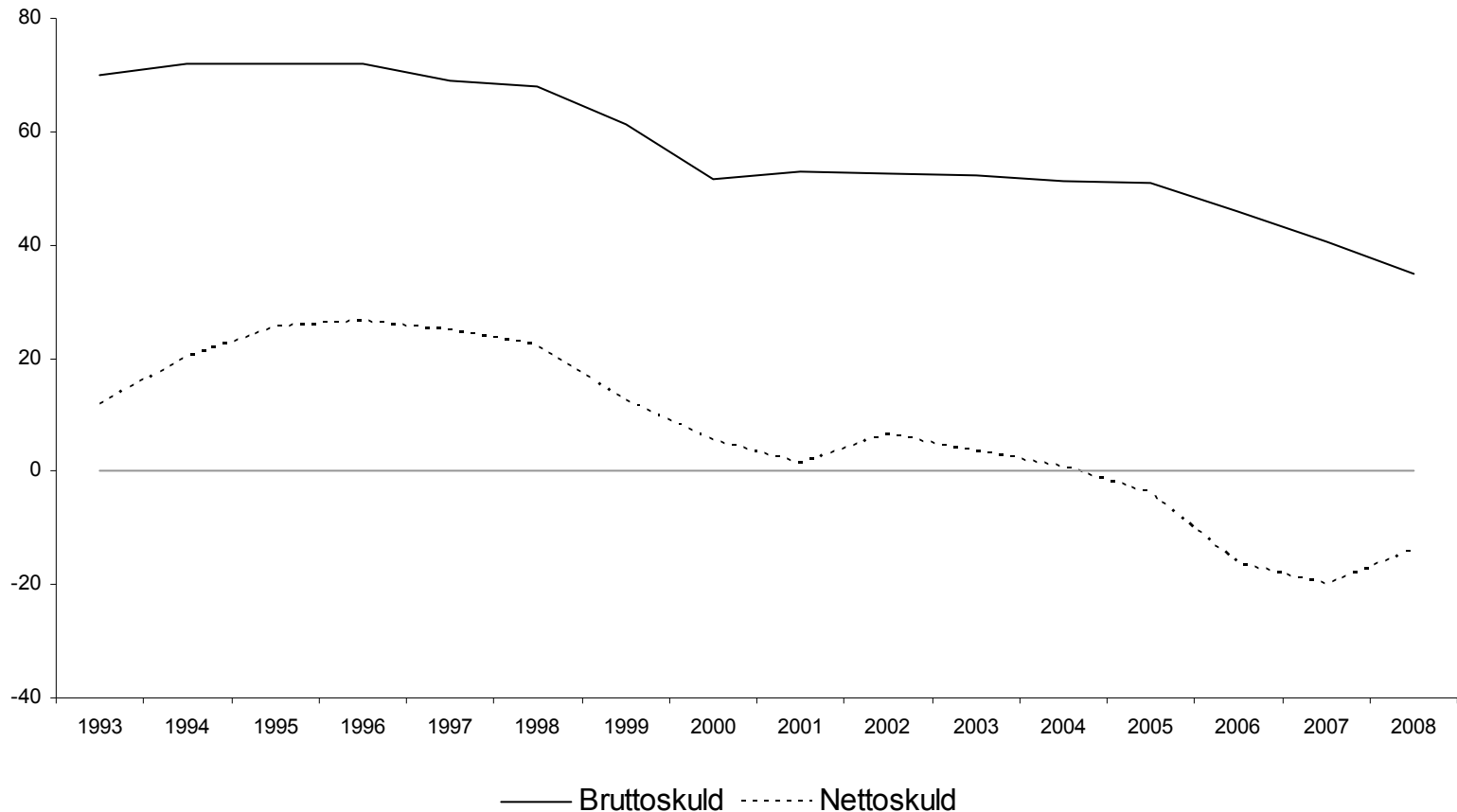
$$s = -\frac{1 - \beta}{\beta} f = -\frac{i - \gamma}{1 + i} f$$

$$s > 0 \Leftrightarrow f < 0$$

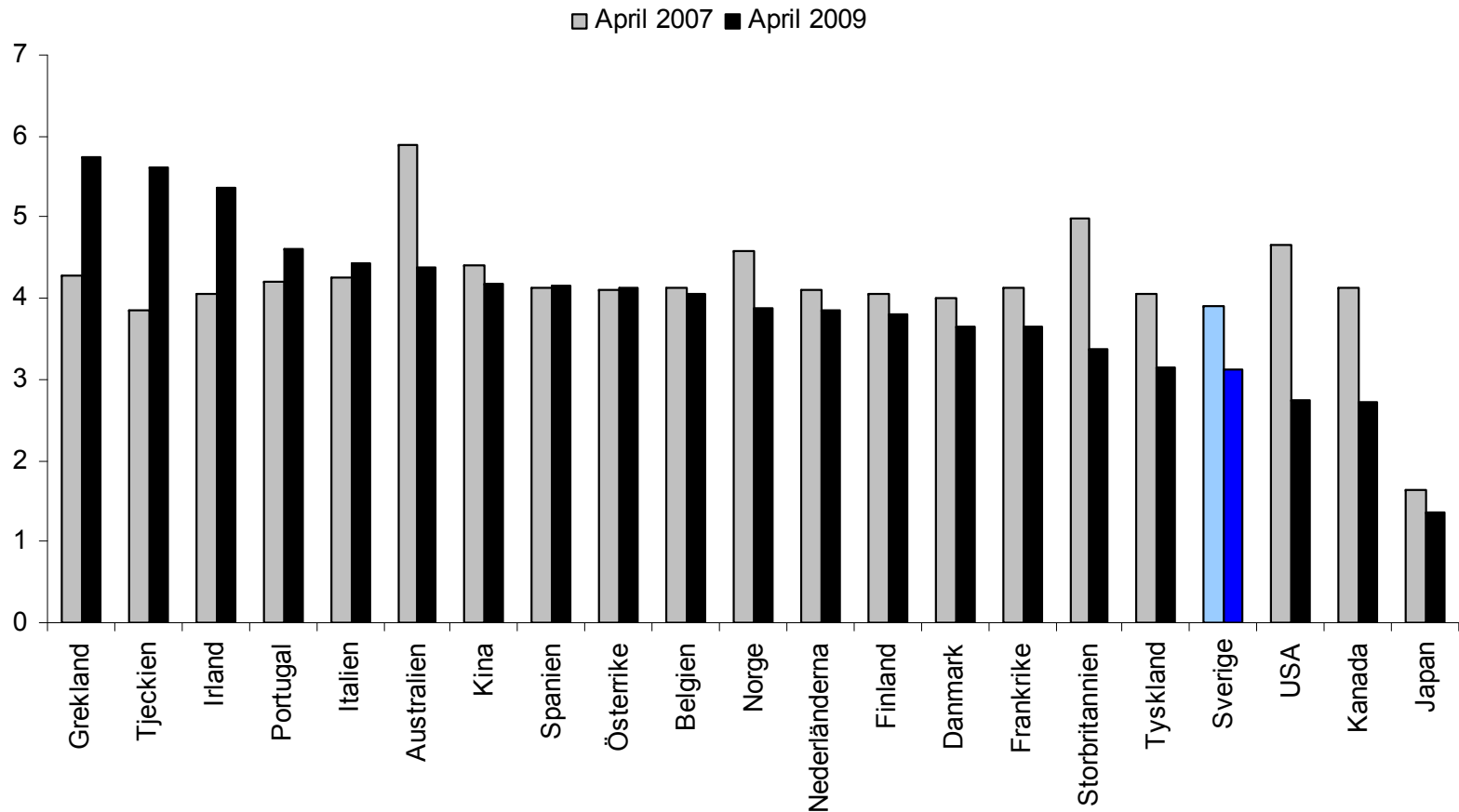
The S2-indicator and intertemporal financial net wealth, percent of GDP

	S2	Intertemporal finansiell nettoförmögenhet
Basscenario	0,5	-52,5
Högre utträdesålder	-0,8	84,0
Högre vårdkostnader	8,2	-861,0

Public sector gross and net debt as percent of GDP



Interest rate on 10-year government bonds



Possible additional measures

- Higher *temporary* central government grants to local governments
- Subsidies for renovation of municipal housing stock
- Avoid that pensioners' incomes fall
 - temporary tax rebate?
- temporary tax rebate to low-income households in general?
- Increase study grants permanently

The government expenditure ceiling should not stand in the way

- The purpose of the ceiling is to prevent that high tax revenues in good times lead to excessive spending
- Deviations should be possible under *exceptional* circumstances: *escape clause*
- The government has already manipulated the expenditure ceiling
 - central government grants for 2010 payed out in 2009
- Open and clear escape clause preferable

Balanced budgets for local governments

- Procyclical behaviour of local governments amplify cyclical fluctuations
- Central government grants should compensate for swings in the aggregate tax base of local governments

The Swedish business cycle 1995-2008

Variabel, x	Genomsnitt relativt BNP ^a	Volatilitet (%) ^b	Korrelation med Δy_t			Cyklikalitet
			Δx_{t-4}	Δx_t	Δx_{t+4}	
BNP	1,00	1,88	-0,03	1,00	-0,03	procyklisk
Konsumtion	0,75	1,26	0,02	0,68	-0,09	procyklisk
offentlig	0,26	1,83	0,15	0,16	-0,32	-
statlig	0,08	3,54	-0,00	-0,11	-0,24	kontracyklisk
kommunal	0,18	2,18	0,18	0,28	-0,23	-
Investeringar	0,17	4,69	-0,03	0,55	0,29	procyklisk
offentliga	0,03	7,36	0,05	0,08	-0,01	acyklisk
statliga	0,01	11,44	0,09	0,15	-0,16	-
kommunala	0,01	8,03	-0,03	-0,08	0,22	-
Anställda	0,66	1,29	-0,28	0,29	0,59	procyklisk, eftersläpande
offentligt	0,23	-	0,17	0,21	0,17	procyklisk
statligt	0,04	-	-0,01	0,05	-0,07	acyklisk
kommunalt	0,19	-	0,20	0,23	0,20	procyklisk

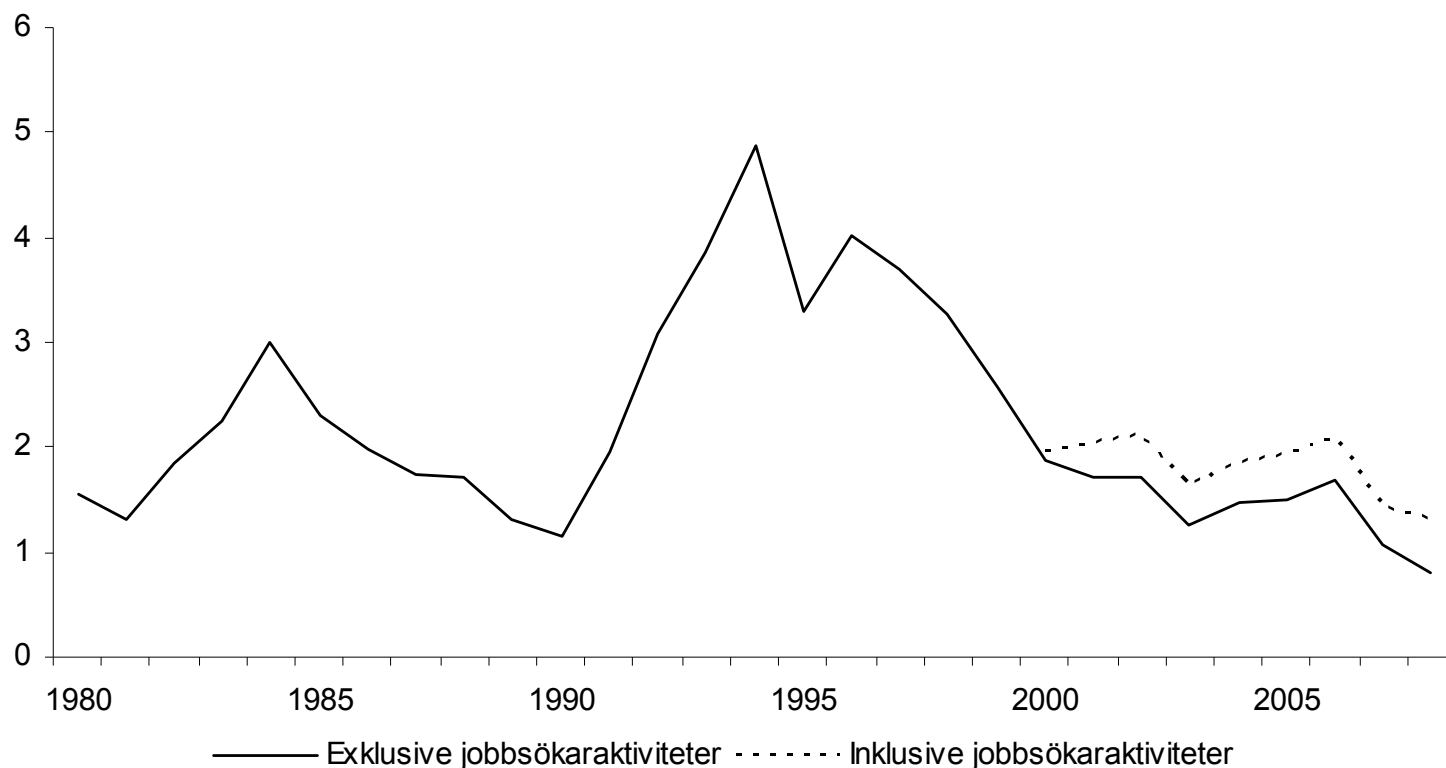
Unemployment insurance

- Benefit reductions will reduce unemployment in the long run
 - stronger incentives for job search
 - stronger incentives for wage moderation
- But these factors are less important in slumps
- Generosity of unemployment insurance should vary with the cycle
 - such systems exist in the US and Canada
- Initial steps:
 - extend the period with benefits of 80 percent
 - increase both minimum and maximum benefits (floor and ceiling)
- Unemployment insurance should be mandatory and administered by the government
- Need for political consensus

Strategies for active labour market policy

- The government's initial strategy: reduce persistent high unemployment in the boom
- Currently: handle a large *inflow* into unemployment and prevent long-term unemployment.
- Good with more measures directed towards the short-term unemployed
- Good to double the subsidy to start-up jobs

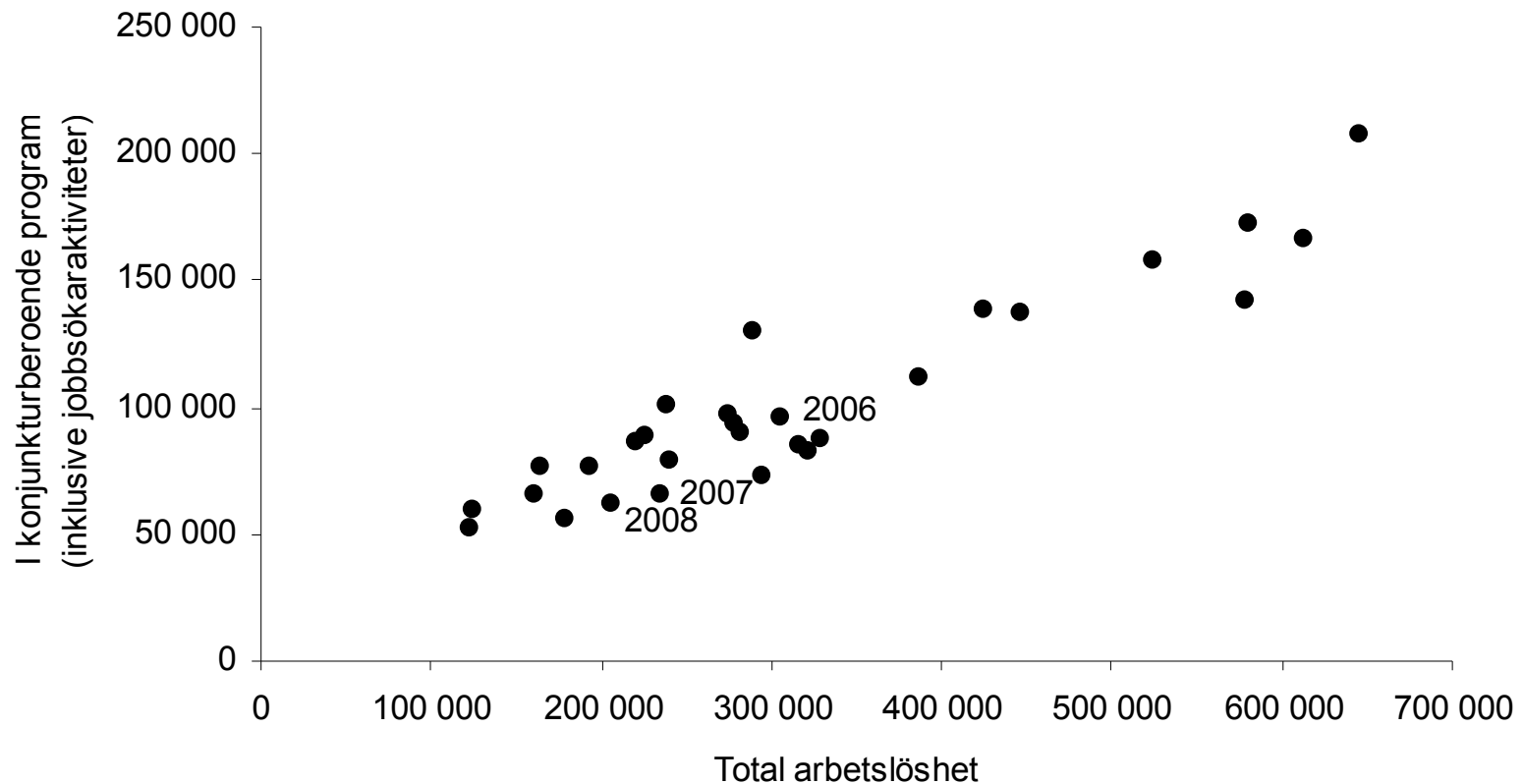
Participants in active labour market programmes, yearly averages, percentage of the labour force



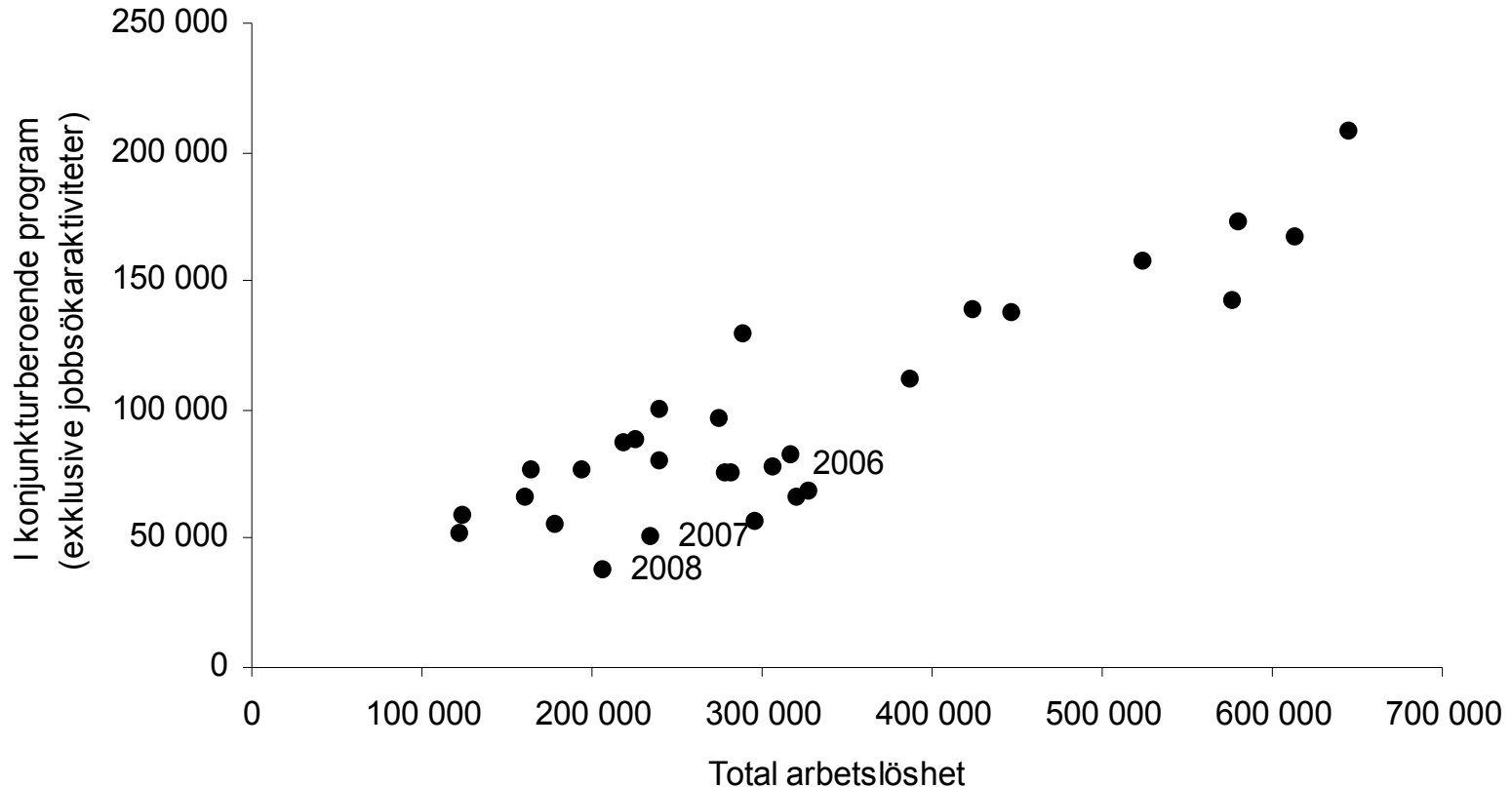
Accommodation ratio, percentage of the unemployed who participate in labour market programmes



The ratio between programme participation (including job search activities) and total unemployment, 1980-2008



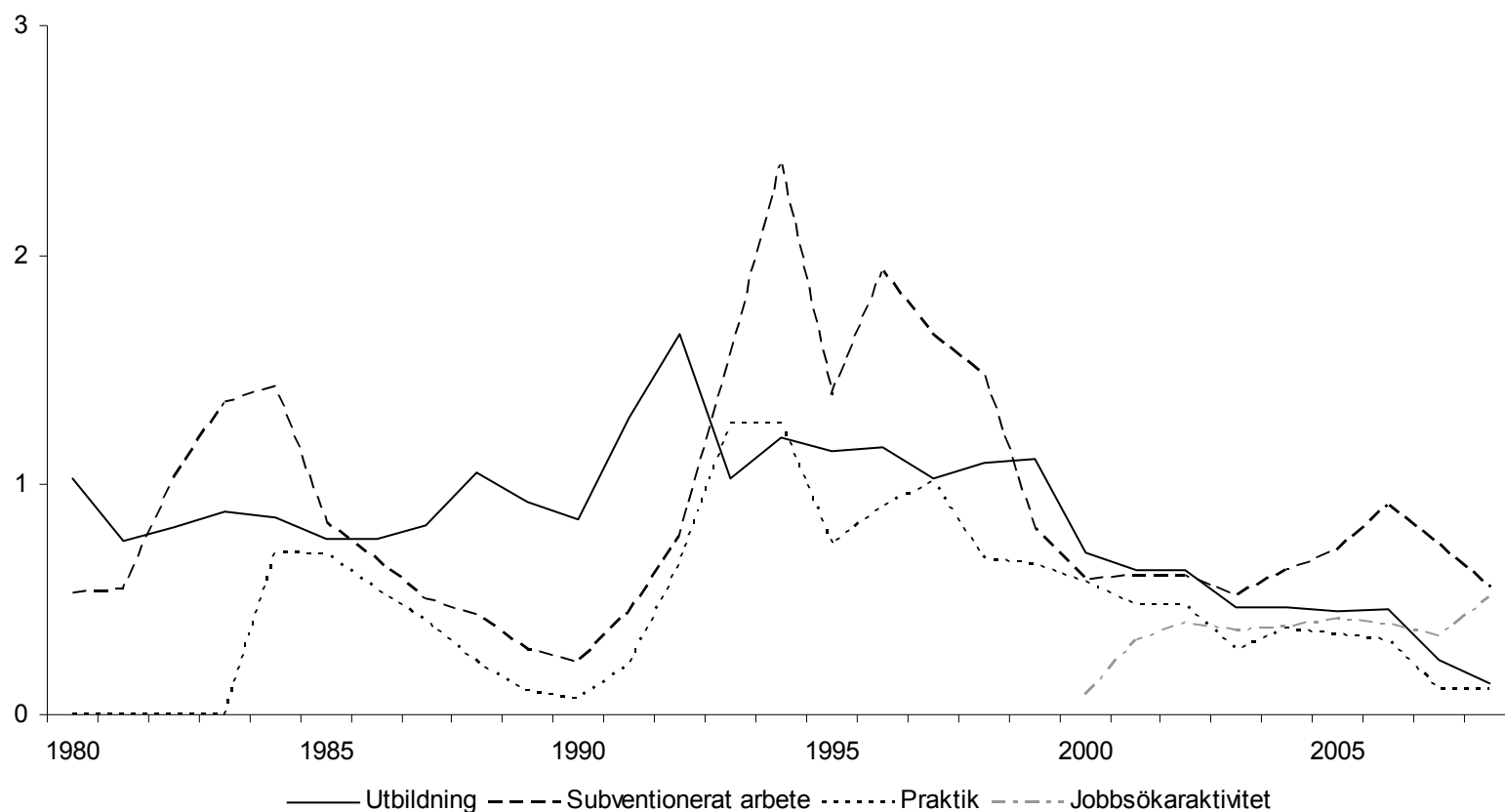
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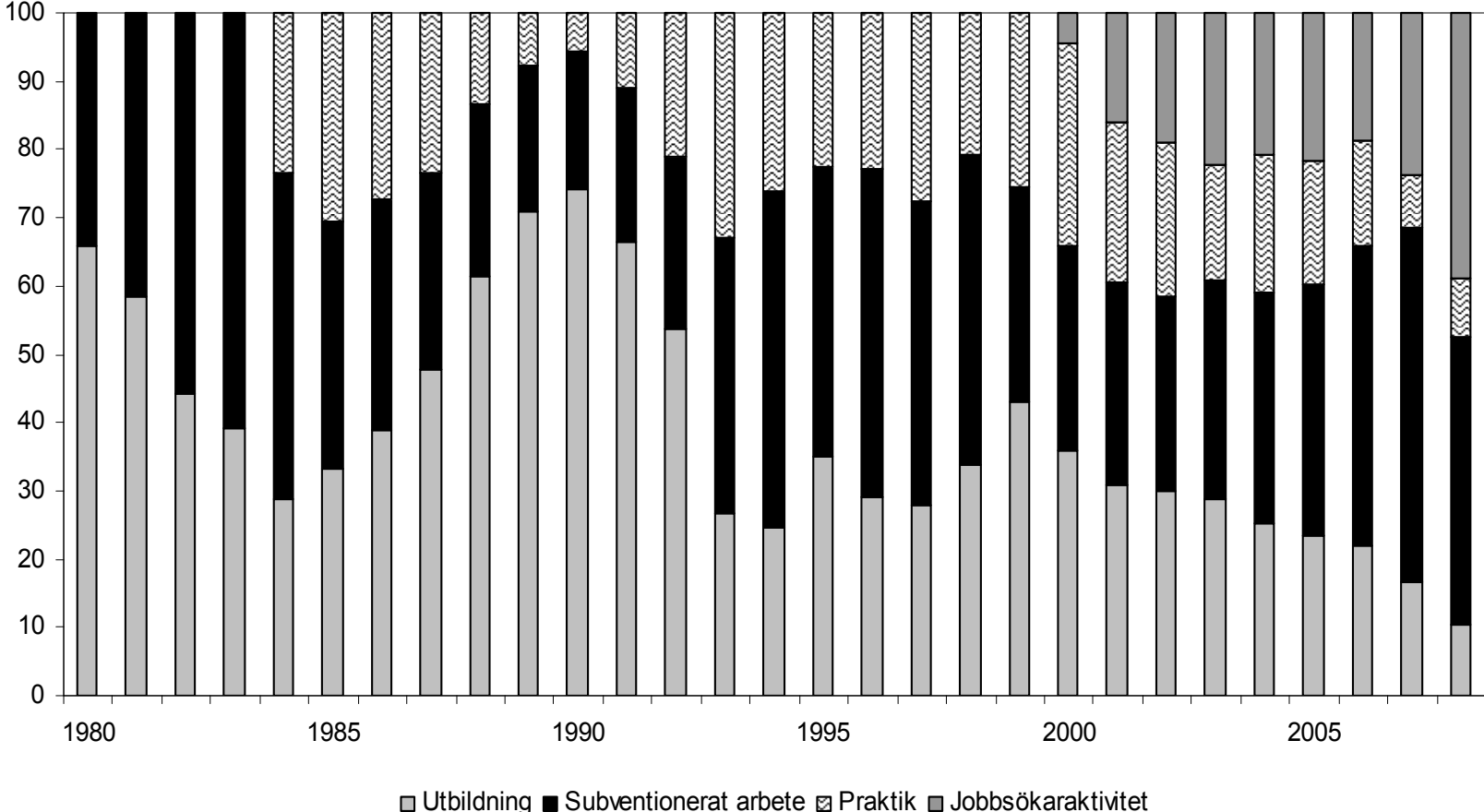
Critique of the labour market policy

- Too optimistic view on what job search activities can achieve in a deep recession
- Volumes in labour market training are too low
- Support for education within firms if agreements of working time and pay reductions exist
- The expansion of the job- and development guarantee is **not** a very active policy
- Difficult to find meaningful activities

Participants in different programmes, percent of the labour force



Composition of programmes



Activities within the job- and development guarantee, percent of participants in different activities at different periods of an unemployment spell

Antal kalenderdagar	1-104	105-209	210-419	420-
Arbetsträning	4	8,5	13,7	17,2
Projekt	0,7	1,1	0,8	0,6
Kartläggning	25	14,6	11,3	6,9
Förstärkt arbetsträning	2,7	5,8	11,8	13,8
Arbetslivsinriktad rehabilitering	0,8	1,4	3,1	3,6
Arbetspraktik	7,3	13,9	18,3	18,4
Start av näringsverksamhet	0,5	1,5	2,2	2,4
Jobsökaktivitet med coachning	69,3	78	76,6	79,2
Utbildning	2,2	4,9	8,6	7,5
Förberedande insatser	2,1	3,3	4,5	4,7
Fördjupad kartläggning/vägledning	4,8	4,5	7,3	9,2
Praktisk kompetensutveckling	0	0	0	0
Ingen registrerad aktivitet	24,1	21,8	10,2	3,6
Antal individer	22 878	14 273	12 879	6 747

Public sector accounting

- Accounting of the public sector capital stock and total wealth has improved, but only marginally
- Unsatisfactory accounting of public investment
- Insufficient basis for parliamentary decisions on the level of public investment

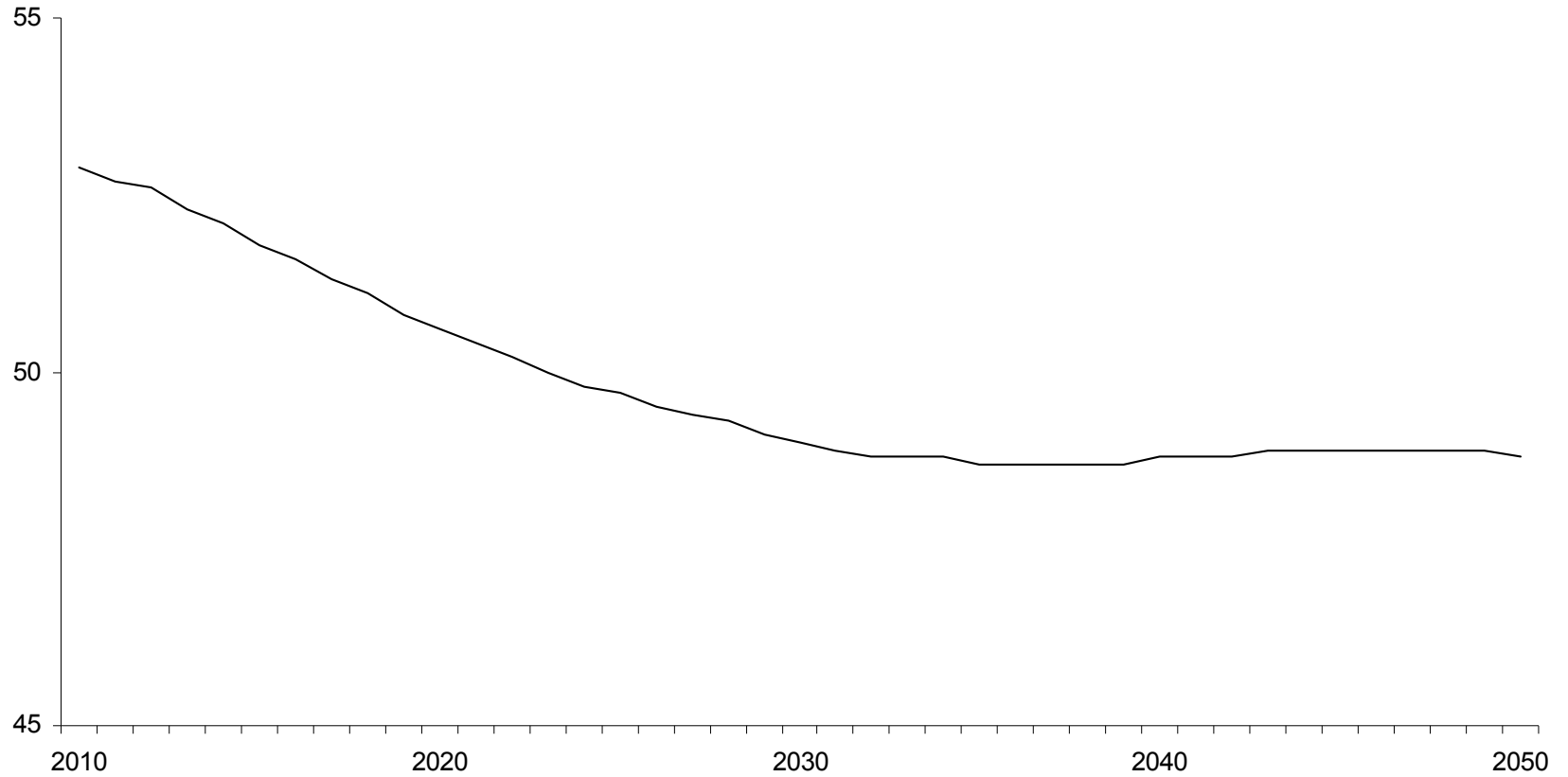
The fiscal policy framework and the surplus target

- Unclear interpretation of the surplus target
 - *five* different indicators
- Need to motivate the surplus target
- *Pre-funding* or *longer working-life* to handle the fiscal consequences of an aging population
- Surplus and employment targets are mutually dependent
- The fiscal and employment frameworks should be integrated
- Interdependent decisions on fiscal and employment targets

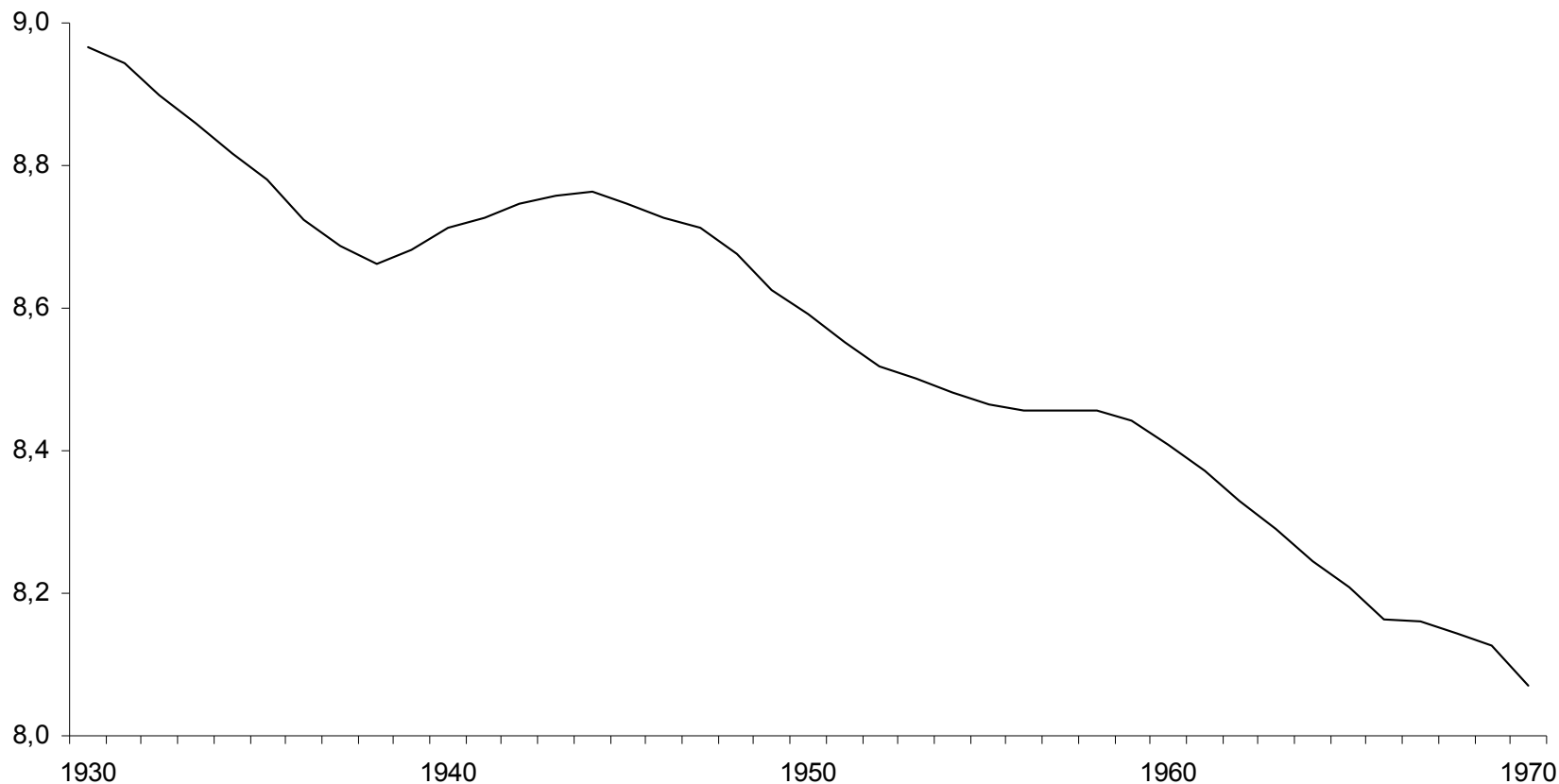
Budget surplus indicators

	Budgetpropositionen för 2008				Budgetpropositionen för 2009				Vårpropositionen 2009			
	2007	2008	2009	2010	2008	2009	2010	2011	2009	2010	2011	2012
Net lending	2,9	2,8	3,1	3,6	2,8	1,1	1,6	1,5	-2,7	-3,8	-3,1	-2
Average historical net lending	1,3	1,5	1,7	1,8	1,5	1,5	1,5	1,6	1,1	0,7	0,4	0,2
Average current net lending	2,3				2,1				-0,5			
Structural net lending	2,2	2	2,8	3,6	2,8	1,9	2,2	2,7	1,2	1	1,2	1,4
Average historical structural net lending									1,5	1,5	1,5	1,5
Average current structural net lending									1,7			

Labour force participation, percent of population



Fraction of life devoted to market work, percent



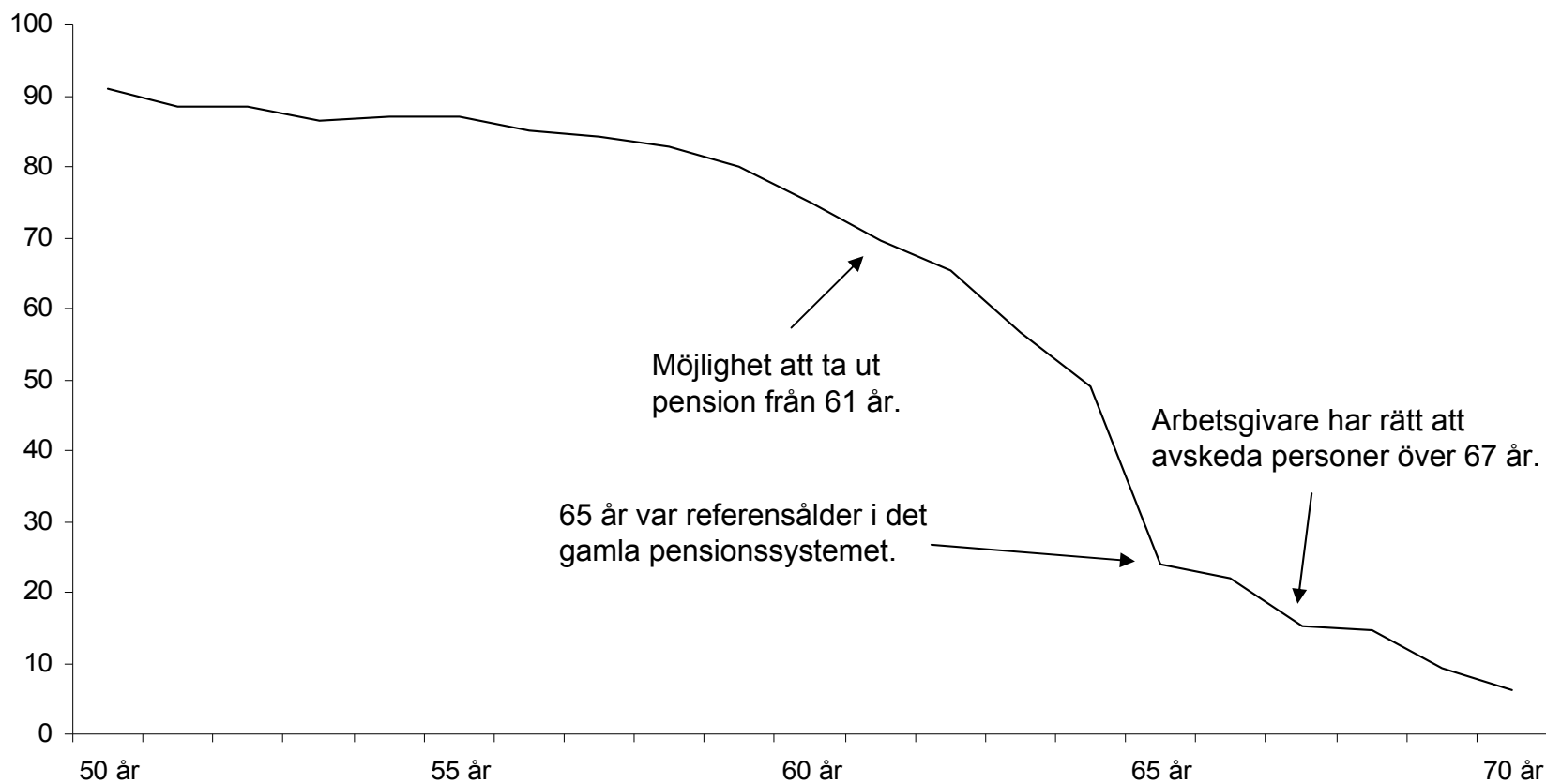
Automatic indexation of retirement age to life expectancy?

- Danish model
- But Sweden has no *formal* retirement age
 - the lowest age of retirement (61 years)
 - the age at which social insurance benefits are lost (65 years)
 - compulsory retirement age (67 years)
- Can the surplus target be revised downwards?

Estimated age of retirement with indexation to life expectancy

	Förväntad återstående livslängd vid 65 års ålder	Pensionsålder vid samma förväntade antal år med pension som under 1970-talet vid 65 års ålder	Pensionsålder vid samma förväntade kvot mellan pensionsålder och livslängd som under 1970-talet vid 65 års ålder
1971-1980	15,8	65,0	65,0
1981-1985	16,6	65,7	65,6
1986-1990	17,1	66,2	66,0
1991-1995	17,7	66,8	66,4
1996-2000	18,2	67,4	66,9
2001-2005	18,7	67,9	67,3
2006	19,0	68,3	67,7
2007	19,2	68,4	67,7
2008	19,3	68,5	67,8
2009	19,4	68,5	67,8
2010	19,5	68,6	67,9
2015	20,0	69,1	68,3
2020	20,4	69,5	68,6

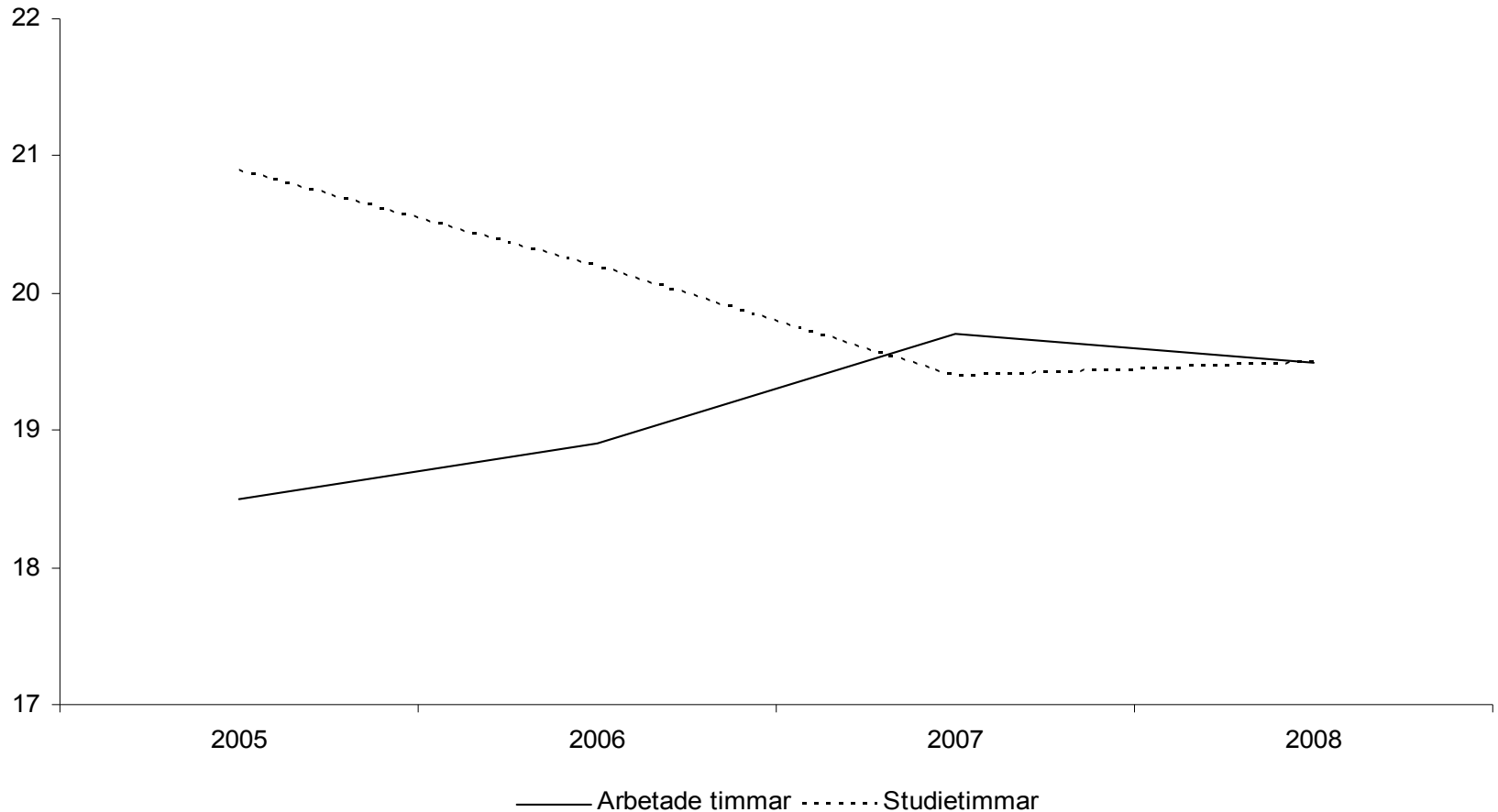
Labour force participation at older ages 2008, percent



Earlier entry

- Stronger incentives to begin and finish collage studies earlier
 - higher study grants
 - *lower* maximum labour income
 - more generous study grants for younger than for older students

Average working and study hours per week for employed students



Study grants in percent of blue-collar and white-collar compensation

