

Comments on the upcoming review on the fiscal framework and on the prospects for adopting the euro

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IMF Article IV consultation

8 November, 2023

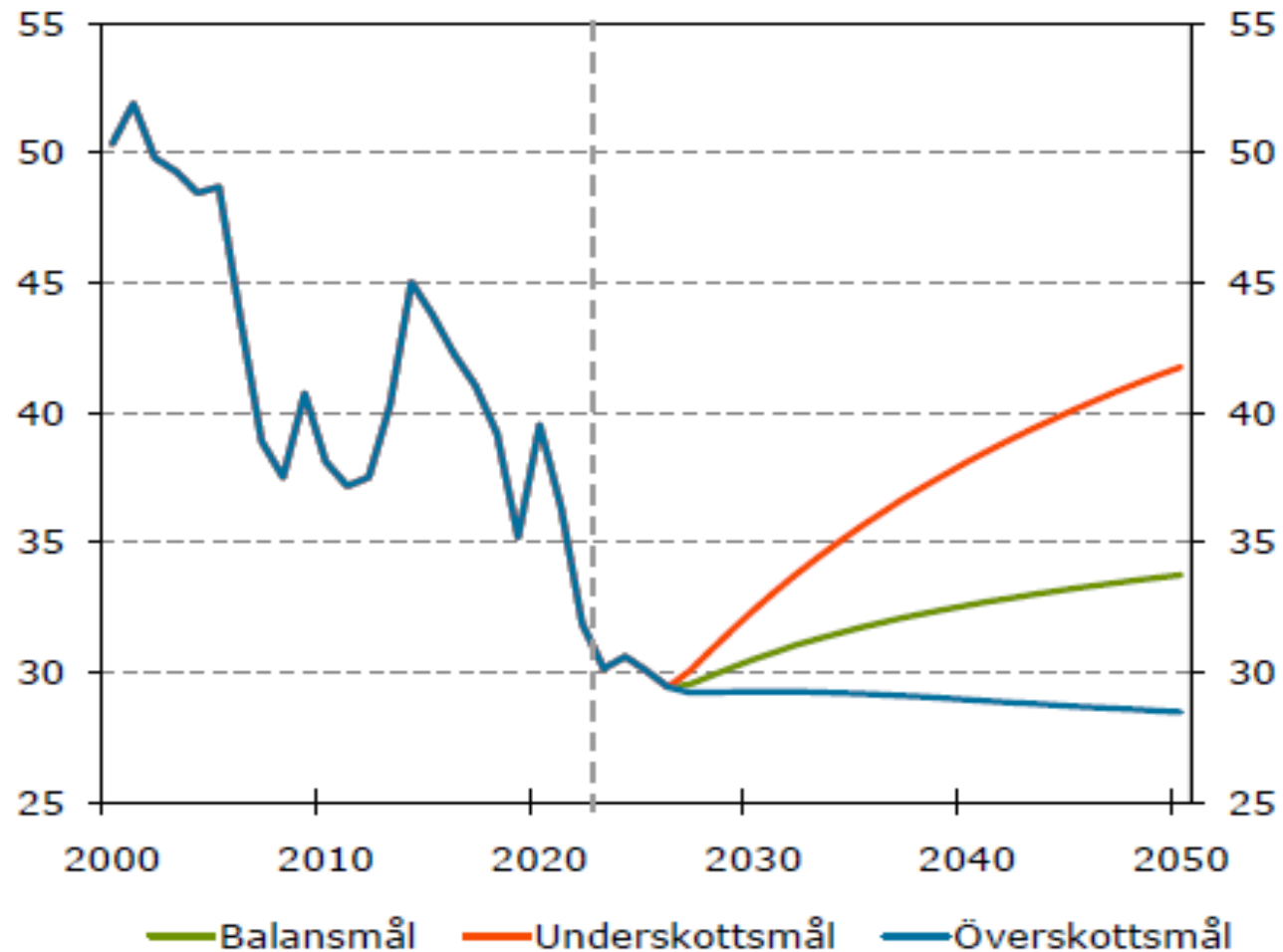
Less ambitious fiscal-balance target?

- Today's surplus target gives lower debt than debt anchor
- Negative interest-growth differential?
 - No free lunch in Blanchard sense (unchanged net financial wealth with net borrowing) as government net financial wealth is positive
 - But lower fiscal-balance target would lower the long-run primary fiscal balance
 - Take into account that the interest rate depends on debt
 - Minimum long-run primary fiscal balance at negative fiscal balance

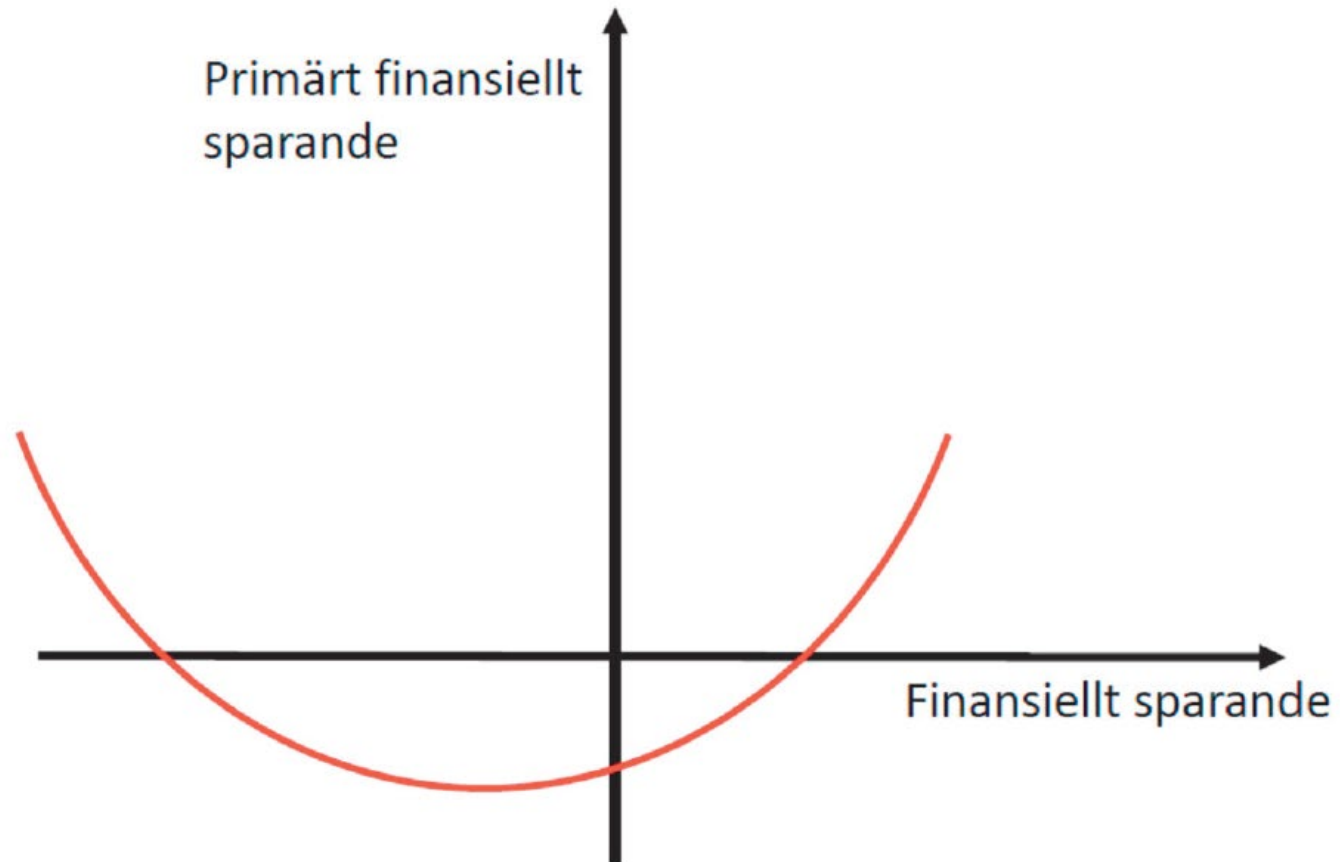
Long-run levels of net financial wealth and Maastricht debt with different fiscal-balance targets, percent of GDP

Net lending	Net financial wealth	Maastricht debt (a)	Maastricht debt (b)
0.33	33.1	28.4	30.1
0	24.1	37.4	35.6
-0.5	10.4	51.1	43.9
-1	-3.2	64.2	51.8

Maastricht debt according to NIER, percent of GDP



Fiscal balance and long-run primary fiscal balance



Less ambitious fiscal target? Cont.

- Calculation of debt limit on the basis of maximum primary surplus that can be attained
 - 2 percent of GDP maximum primary surplus
 - Interest rate depends on net financial wealth (1 percent interest-growth differential at 0 net financial wealth)
 - Debt limit – safety margin for financial crisis (35–75 percent of GDP) far above today's debt level

Less ambitious fiscal target? Cont.

- Tax-smoothing considerations could motivate higher debt anchor if need for temporary expenditure increases
 - Climate investments
 - Defence expenditure hump
 - Support to Ukraine
 - Investment in justice system (correction facilities)
 - Critical infrastructure: transport system, water and sewage systems
- Distinguish between target over the business cycle and target for structural fiscal balance
 - Average fiscal balance < average structural fiscal balance
 - Because of asymmetric cycles and ELB

Less ambitious fiscal target? Cont.

- Adjust fiscal target for variations in net lending of the pension system in an asymmetric way
 - Pension system is supposed to be autonomous
 - Hence surpluses in the pension system are likely to be used for higher pensions: Adjust fiscal target upwards with such surpluses
 - But deficits in the pensions system may have to be covered by the central government: do not adjust fiscal target for such deficits
- Better to have target for net lending than net expenditure rule (= change in primary net lending)
 - Debt path depends on the level, not the change, of net lending
- Debt anchor of 45 -55 percent of GDP and fiscal target of -0,5 percent of GDP?
- Stronger role for Fiscal Policy Council
 - Move under parliament instead of government
 - Ex-ante recommendations in addition to ex-post evaluations

Adoption of the euro?

- Calmfors Commission recommended Sweden not to join at the start in 1999
 - Fear of asymmetric shocks in a situation with high unemployment and fiscal policy that could not be used to offset a cyclical downturn
- Much has changed since then
 - Much stronger public finances – substitute for own monetary policy
 - Symmetric shocks seem to have become more common
 - Greater interest sensitivity in the Swedish economy, but could be handled by fiscal policy
 - Larger trade effects than we thought then

Other changes

- Pattern with weaker krona in international crises
 - Good for us earlier when no inflation problems
 - Bad now as it makes it harder to bring inflation down
- The euro crisis occurred
 - Greater risk to pay for fiscal crises in the euro area
 - But we had to pay for the EU recovery funds anyway
- The banking union
 - Both pros and cons

What will happen?

- My evaluation: The balance of arguments have shifted in favour of euro adoption
- Public opinion has become more in favour of euro adoption
 - Weak krona
 - Re-evaluation of Sweden's role in the world in the wake of the war in Ukraine
 - But still a majority who would vote against
- But not really on the political agenda
 - Only the Liberals (2%) and the Center Party (4%) want a new government commission
 - The co-operation between the government and the Sweden Democrats would be destroyed
 - The Social Democrats fear internal divisions