

# The Swedish Fiscal Policy Council

Lars Calmfors

Norges Bank

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# Background

- Academic discussion on **Fiscal Policy Councils (Committees)**
- Exploit the lessons from the delegation of monetary policy to independent central banks
  - independent evaluation ex post
  - budget decisions based on independent forecasts
  - "authoritative" recommendations
  - delegation of actual decisions

# The Swedish Fiscal Policy Council

- Government agency since 1 August 2007
- Ex post evaluation of economic policy
- Eight members
  - six academic economists
  - two expoliticians
  - small staff: originally two, now four persons
- The government appoints members but on proposal from the council
- Annual report
  - majority decision
  - reporting of dissenting views
- Hearings of ministry officials and right to see internal working material

# The council's remit

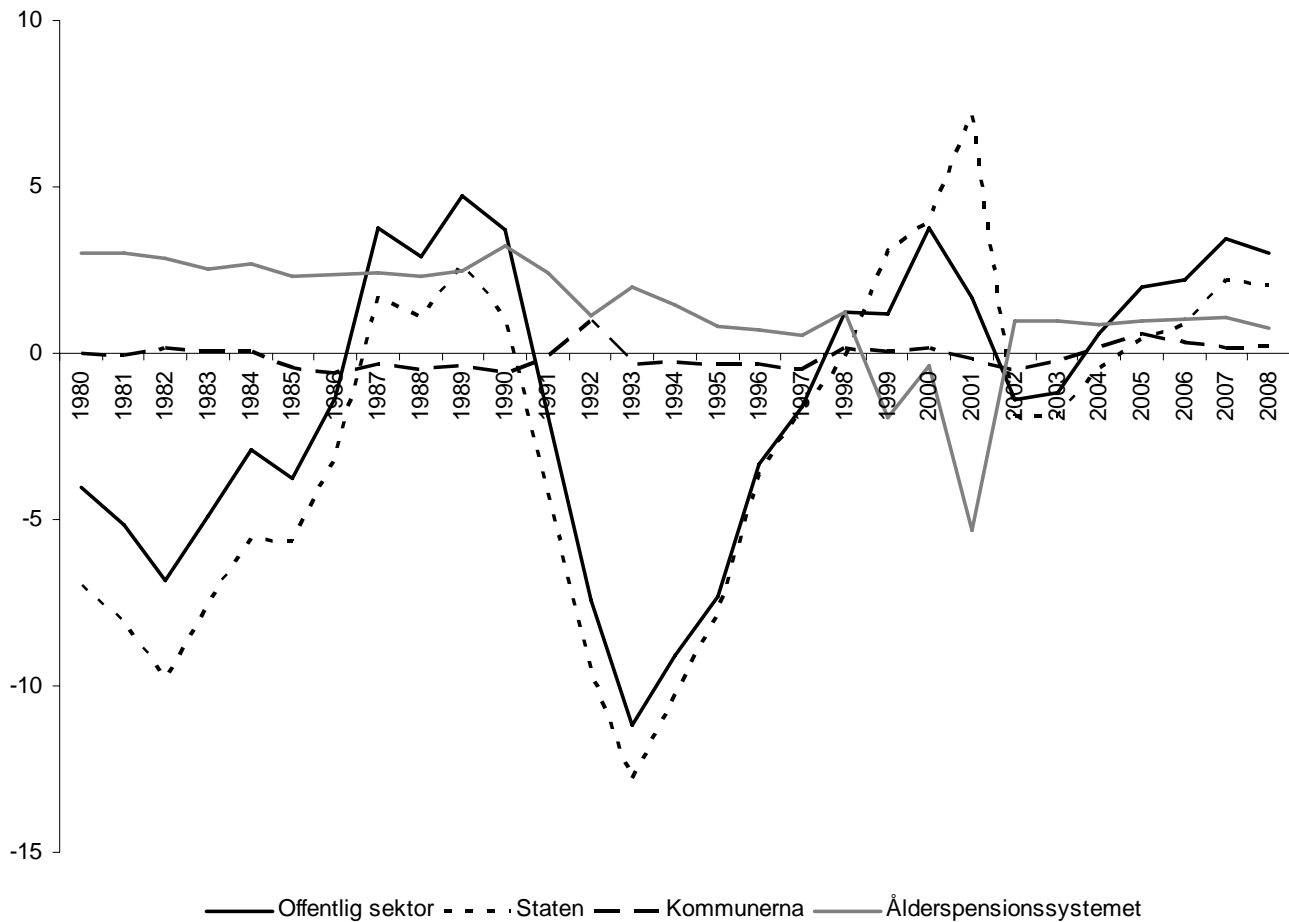
1. Evaluate whether fiscal policy meets its objectives
  - long-run sustainability
  - the budget surplus target
  - the ceiling for central government expenditure
  - cyclical considerations
2. Evaluate whether developments are in line with sustainable high growth and high employment
3. Monitor the transparency of the government budget proposal(s)
4. Evaluate the forecasts and models of the Ministry of Finance

Stimulate the general public discussion on economic policy

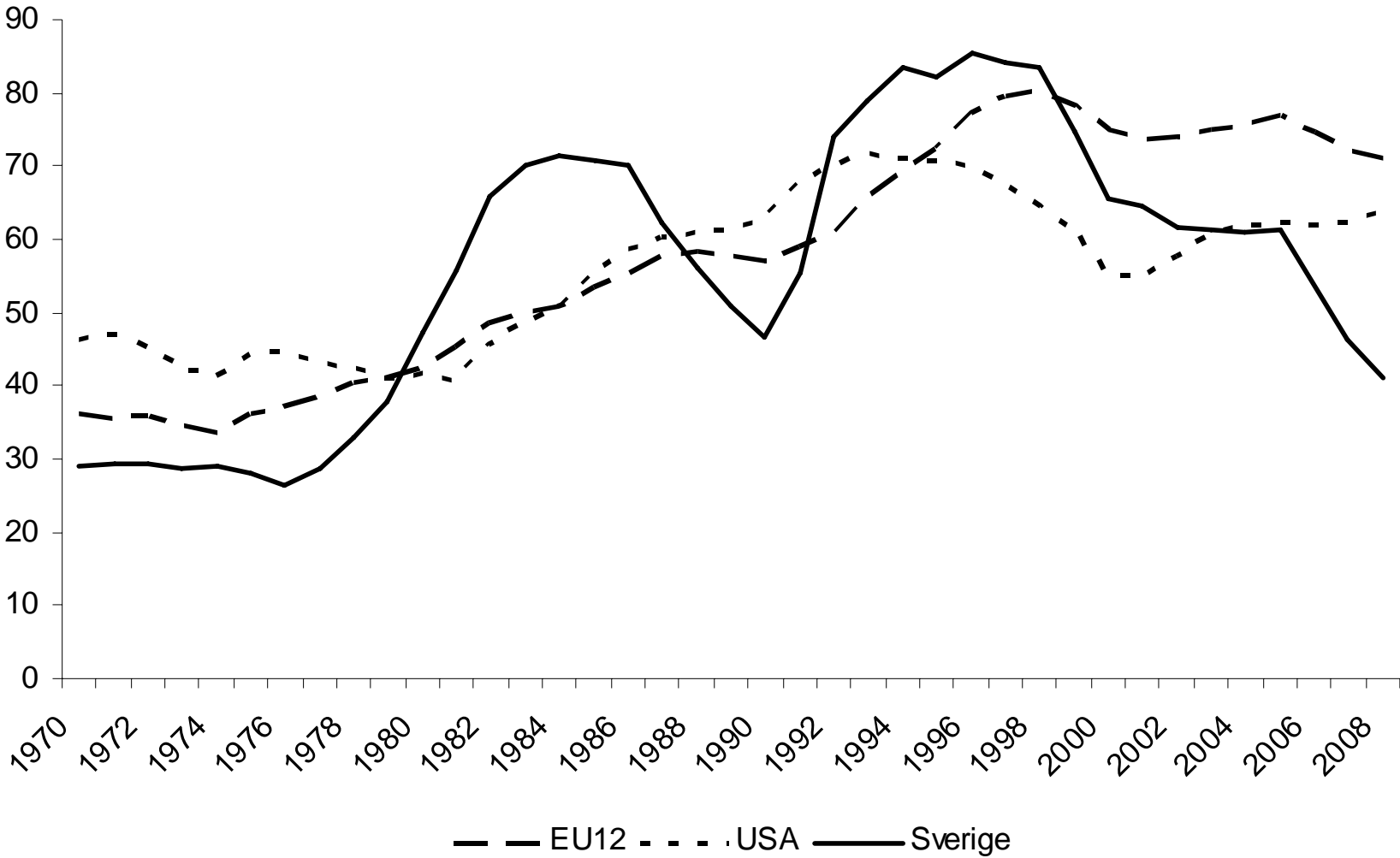
# The fiscal policy framework

- **Long-run sustainability** is a fundamental objective
- The **surplus target** and the **expenditure ceiling** are intermediary targets with the aim of facilitating the achievement of the fundamental objectives
- The quantification of the surplus target:
  - welfare distribution among generations
  - social efficiency (tax smoothing)
  - precautionary motive
- **Demographic pressures** on public finances

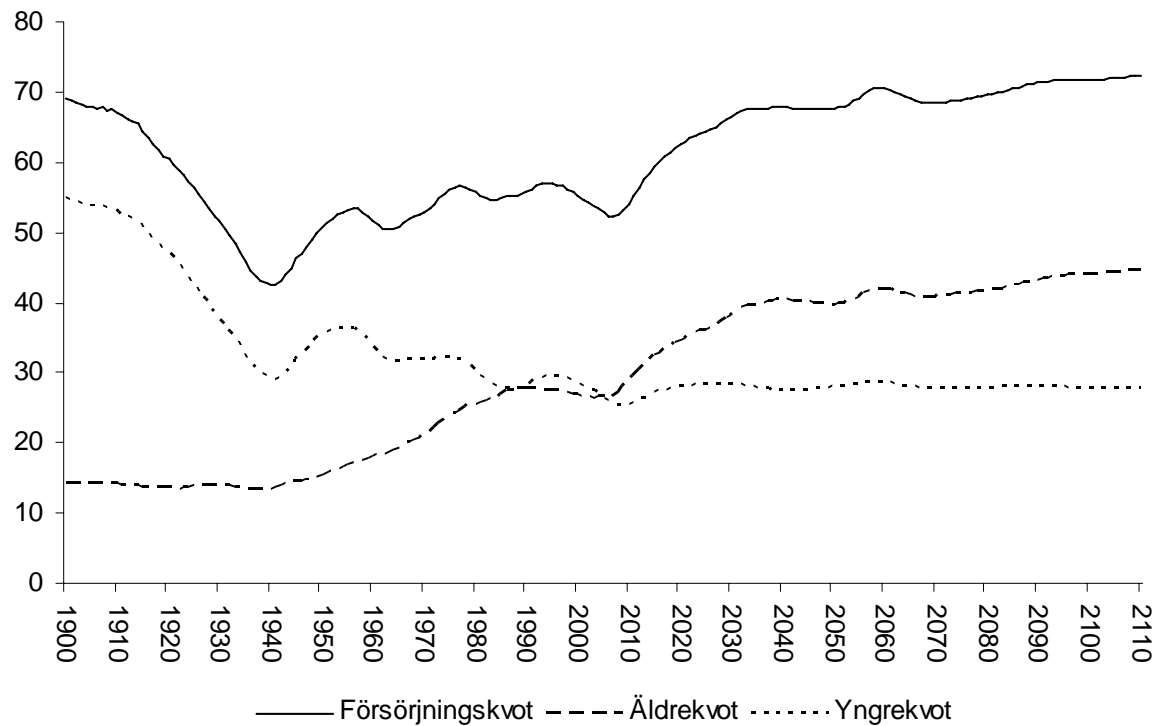
## General government net lending and its parts (percent of GDP)



# Consolidated general government gross debt (percent of GDP)



## Försörjningskvot, äldrekvot och yngrekvot (procent)



*Anm.* Försörjningskvoten anger antalet personer 0-14 år och 65 år och äldre som andel av antalet personer 15-64 år. Äldrekvoten anger antalet personer som är 65 år och äldre som andel av antalet personer 15-64 år, medan yngrekvoten anger antalet personer 0-14 år som andel av antalet personer 15-64 år.

*Källa:* SCB.

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# The government should better motivate the quantification of the surplus target

- The relative weight of different fundamental objectives
- Goal conflicts and trade-offs need to be discussed
- Need for **generational analyses**
  - how is the distribution across generation affected by different budget outcomes?

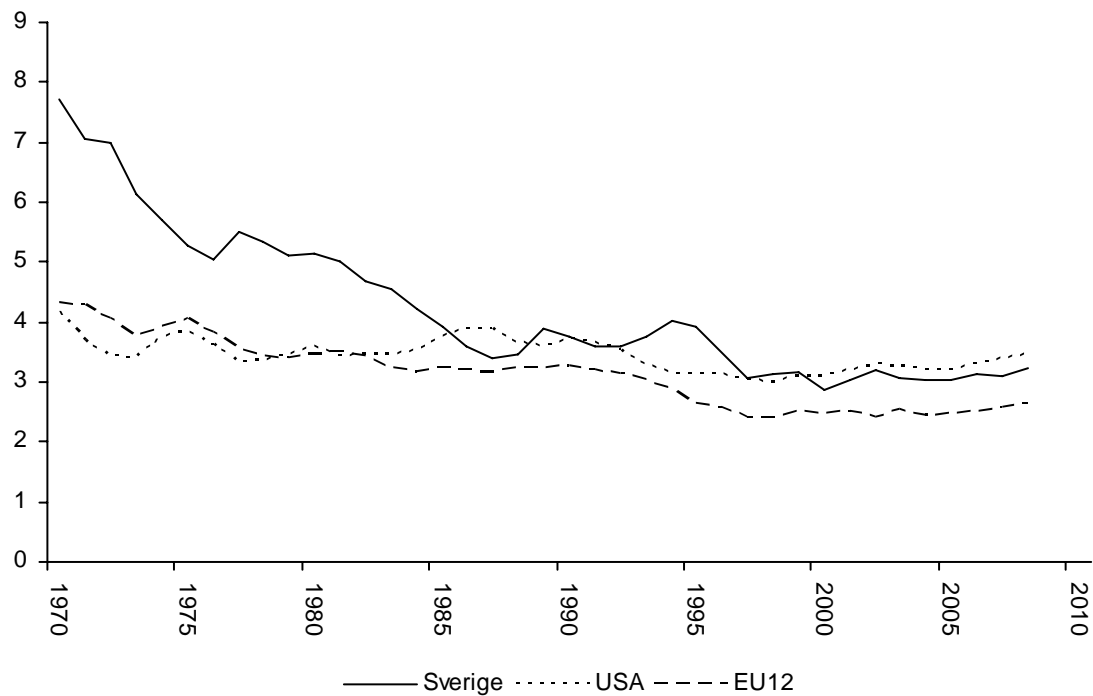
# Need for future revisions of the surplus target

- According to the government's own sustainability calculations it applies only to 2015
- After that the surpluses fall and turn to deficits
- The surplus target was introduced to lock in the fiscal consolidation of the 1990s
- Today more scope for fine tuning of the target
- A serious problem of legitimacy

# A golden rule?

- Should the surplus target apply to **total savings** and not just to financial savings (net lending)
  - total savings is the sum of net lending and net investment
  - a target for financial savings can hold back government investment
- A parliamentary commission?
  - need to prevent abuse
  - lower threshold for minimum financial net wealth?

## Den offentliga sektorns bruttoinvesteringar i Sverige, EU12 och USA (procent av BNP)



*Anmär.* Data för 2007-2008 är prognoser. Data för EU12 före 1991 är exklusive tidigare Östtyskland.

*Källa:* OECD Economic Outlook 2007/2.

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## "Math" of capital stock decumulation

$$k_t - k_{t-1} = i_t - \frac{g+d}{1+g} k_{t-1}$$

$$i_t = 0.03$$

$$g = 0.03$$

$$d = 0.04$$

$$k_{t-1} = 0.5$$

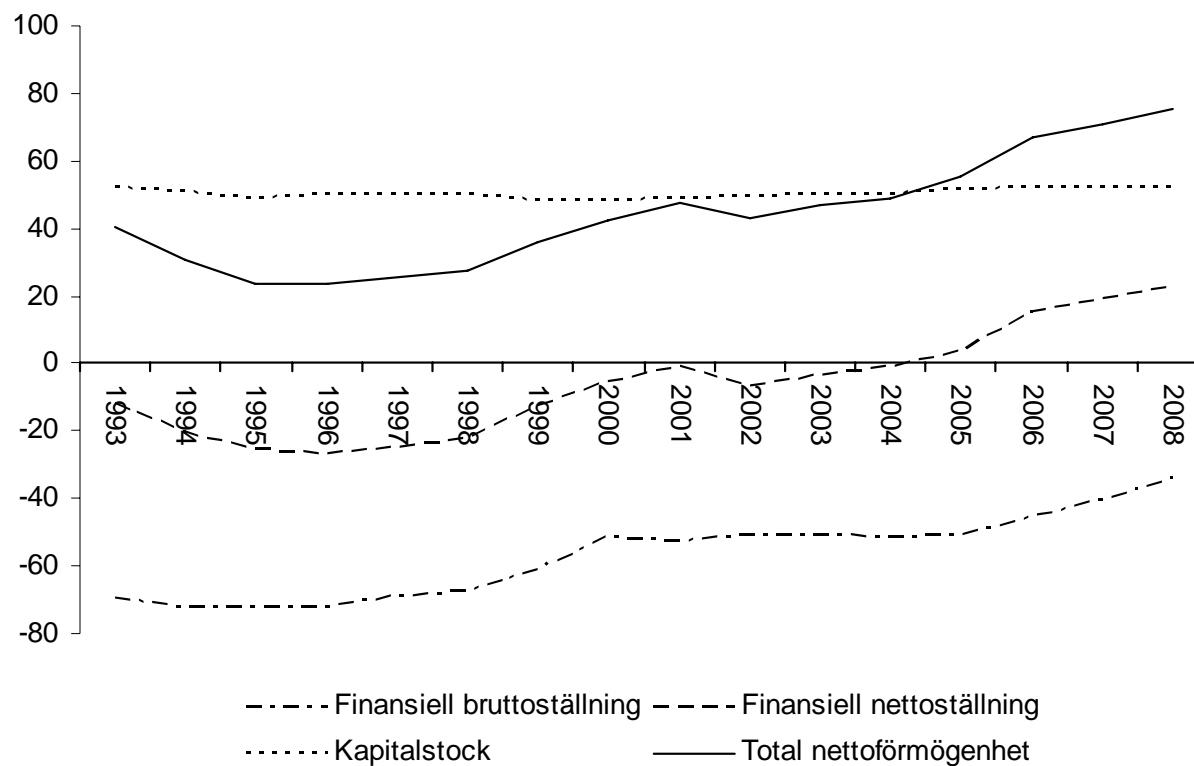
$$k_t - k_{t-1} = 0.03 - \frac{0.03 + 0.04}{1.05} \cdot 0.5 = -0.33 \text{ percent}$$

$$k_t = k_{t-1} = k^* \Rightarrow k^* = 0.45$$

# Public sector accounting must be improved

- No reporting of government **net worth** in the government budget bills
- Impossible to get complete picture of the government's financial position
- Only in **Årsredovisning för staten**
  - but the central government's net worth is 800 billion SEK lower there than according to the financial and national accounts
  - the government's "årsredovisning" goes unnoticed

## Offentlig sektors finansiella ställning och förmögenhet (procent av BNP)



*Anm:* Data för 2007–2008 är prognoser.

*Källa:* Konjunkturinstitutet.

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## Need for large surpluses in the coming years?

- "At present" large surpluses
- Great uncertainty in sustainability calculations gives strong **precautionary** motives for larger surpluses than one percent of GDP till 2015
- The appropriate size of **safety margins** is a political issue
- Net lending of 1 percent of GDP keeps net financial wealth **constant** at current 25 percent of GDP (2 percent real growth and 2 percent inflation)
- The natural adjustment would be to index retirement age to longevity



## Hållbarhetsindikator (S2) och implicit överskottsmål för olika scenarier (procent av BNP)

	S2	Minsta hållbara finansiella sparande
	år 2009	2009-2015
Budgetpropositionen 2008	0,1	-
<i>BP08 utan teknisk justering</i>	<i>-3,8</i>	<i>-0,7</i>
Högre standard i offentlig sektor	-0,4	3,8
Högre standard i vård och omsorg	-0,3	3,5
Större effekt av arbetsmarknadsreformer	-4,3	-1,1
Mindre effekt av arbetsmarknadsreformer	-3,3	-0,5
Minskning av arbetstid	-2,1	1,4
Ökning av pensionsåldern	-5,0	-2,0

*Källa:* Finanspolitiska rådet baserat på Finansdepartementets kalkyler i Budgetpropositionen för 2008.

# Indicators

## Historical average from 2000

- path of net financial wealth
- “stock target”
- like price level targeting for a central bank

## Current average

- centered sliding seven-year average
- “flow target”
- like inflation target for a central bank

# Indicators of net lending

	2003	2004	2005	2006	2007	2008
Actual net lending	-1,2	0,6	2,0	2,2	3,5	2,8
Historic average	0,7	0,7	0,9	1,1	1,4	1,5
Current average	0,9	0,9	1,0	1,4	1,8	2,1

# What formulation should be preferred?

- Historic average (the path of net financial wealth) if the focus is on distribution across generations
  - but different profiles give different paths
- The current indicator if the focus is on "tax smoothing"
  - temporary reduction of government expenditures
  - reduce tax ratio according to the **permanent** reduction of expenditures (increase in net interest income)

# The stabilisation policy role of fiscal policy

- Earlier no clear principles
- The Spring Budget Bill
  - The Riksbank has the primary responsibility for cyclical stabilisation
  - fiscal policy should normally be confined to the automatic stabilisers
  - discretionary fiscal policy only under specific circumstances
- Need for further clarifications
  - **large** cyclical disturbances
  - discretionary fiscal policy should imply **value added** to monetary policy

# Fiscal policy in coming recession

- Good illustration of the value of precautionary savings
- Monetary policy and automatic stabilisers will probably not be enough
  - lower interest rate bound
  - interest rate spreads
  - quantitative rationing because of credit crunch
  - weaker automatic stabilisers
- Fiscal policy is more effective with strong than with weak public finances

# Criteria for appropriate fiscal policy measures

- Earlier timing of structurally "correct" measures
- Temporary measures

# Possible measures

- Higher public investment
- Temporary cut of value added tax
- One-shot transfer to households
- Higher transfers to local governments to stimulate public consumption
- Lower payroll taxes



## Fiscal policy stimulus and the fiscal framework

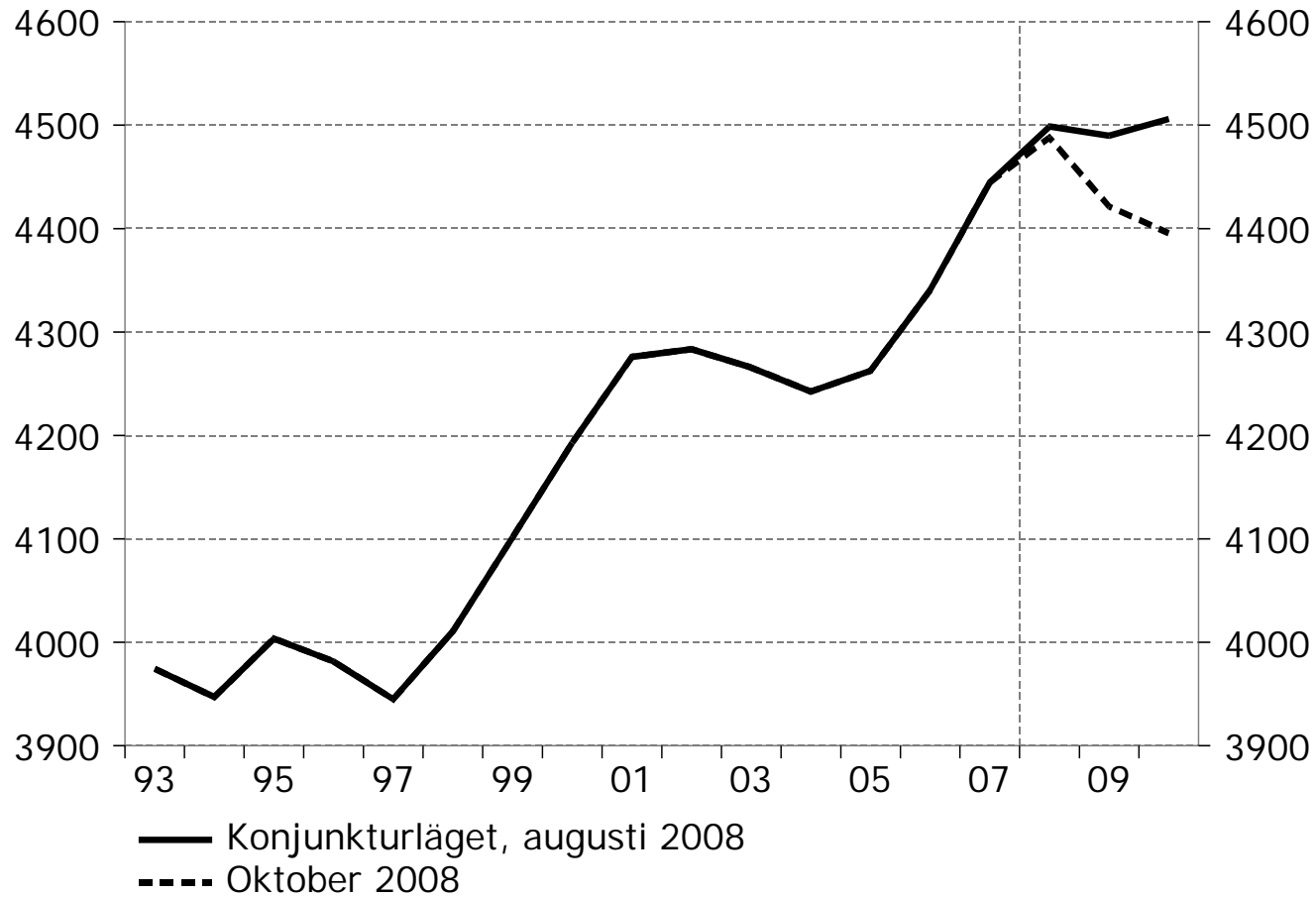
- The surplus target does not bind
- But the expenditure ceiling might
- But if very deep recession, exceptions should be possible
- Better to formulate **escape clause** ex ante than to improvise in concrete situation

# Labour market reforms

- **Our question:** have targets for employment and hours worked been met?
- We don't evaluate whether reforms are **desirable or not** when trading off employment effects versus income distribution effects
- Evaluation based on existing research and model calculations

# Employment

Tusental



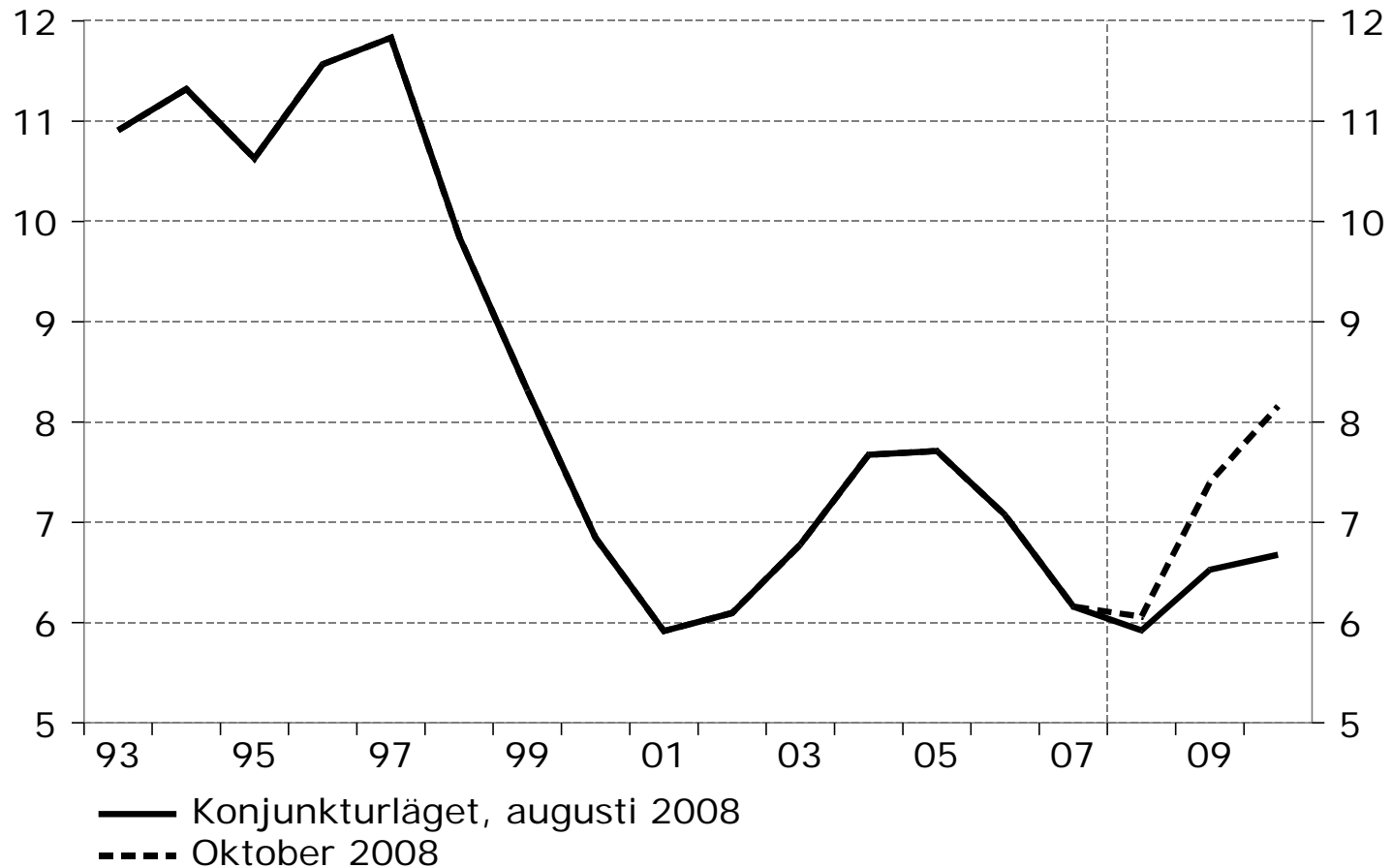
Källa: Konjunkturinstitutet oktober 2008

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# Unemployment

Procent av arbetskraften



Källa: Konjunkturinstitutet oktober 2008

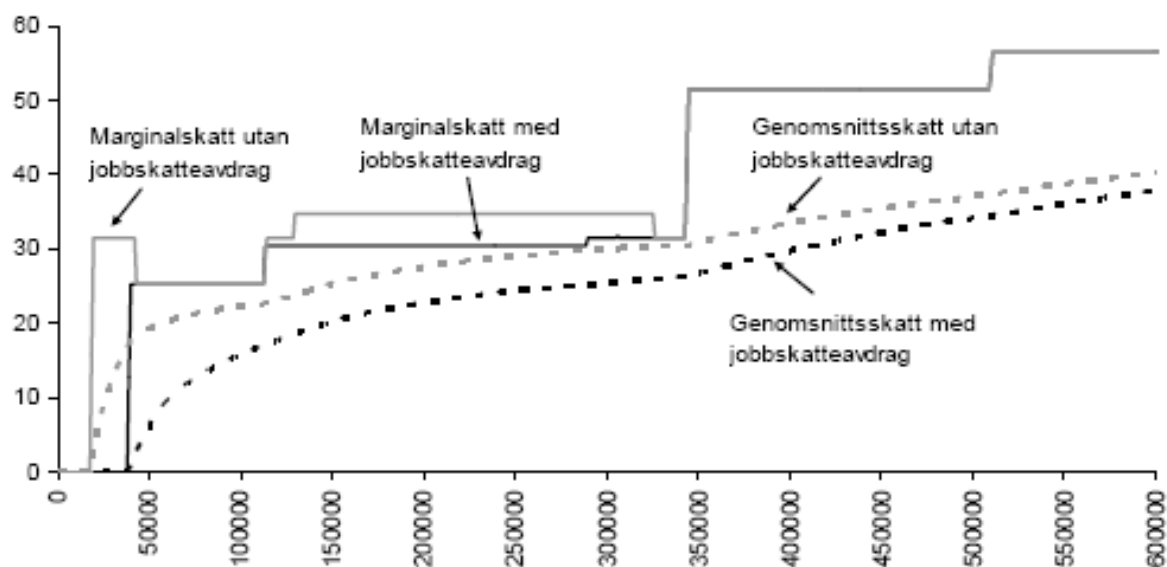
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# Lower unemployment benefits

- 80 percent for 200 days
- 70 percent for additional 100 (250) days
- After that 65 percent
- Faster reduction for young people
- Time in ALMPs is also counted
- Lower ceiling

**Figur 8.2 Marginal- och genomsnittsskatt med och utan jobbskatteavdrag 2008**



# Conclusions

- Substantial positive employment effects from lower unemployment benefits and earned income tax credits in the long run
  - the equilibrium unemployment rate might fall by up to one percentage point in the long run
- But the rise in employment in 2007-08 was mainly cyclical
- And expected fall in employment in the coming recession is not a sign of failed labour market reforms

# The earned income tax credit is superior to a more targeted approach

- The earned income tax credit is appropriate if the main objective is to raise the number of **employed persons**
- It is better than a tax credit that is phased out with higher earnings
- But the tax credit is **too complicated**
- A rise in the threshold for central government income tax has a high degree of **self-financing** but income differences would increase
- The lowering of the property tax has used up "distributional room"



## Beräknad självfinansieringsgrad och fördelningseffekt av olika reformer

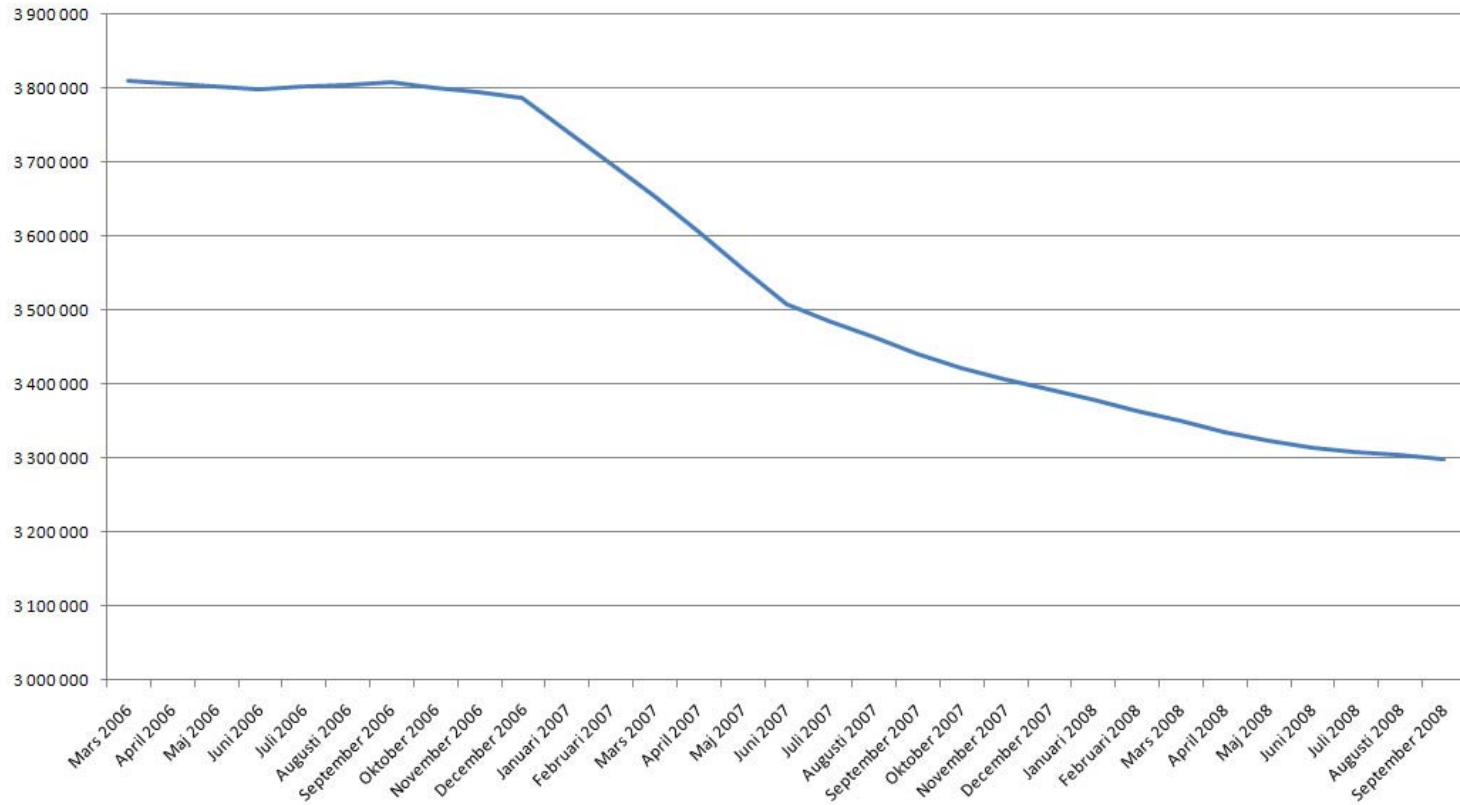
	Självfinansieringsgrad	Fördelningseffekt (P90/P10)
<i>Utan reform</i>	-	2,92
Jobbskatteavdrag I	0,71	2,86
Jobbskatteavdrag II	0,69	2,84
Jobbskatteavdrag I med utfasning	0,40	2,82
Borttagande av värnskatt	0,56	2,94
Höjd inkomstgräns för statlig skatt	0,80	2,99

*Källa:* Beräkningar av Konjunkturinstitutet på uppdrag av Finanspolitiska rådet

# Failed reforms of the financing of unemployment insurance

- Likely positive, but small, employment effects of differentiation of employee contributions
- But higher employee contributions have reduced membership in unemployment insurance funds
- Many wage earners have too low protection against unemployment

## Antal medlemmar i A-kassorna



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# Lack of coordination between different policies

- Higher contributions to unemployment insurance were to finance given earned income tax credit
- But higher contributions only for the employed counteract the earned income tax credit
- Same effect on the return to work from lower earned income tax credit if no rise in contributions to unemployment insurance
- **Mandatory unemployment insurance** would be a solution
  - not probable

# The macroeconomic forecasts of the Ministry of Finance

- No worse than other forecasters – but no better either
- Underestimation of GDP growth and public sector surpluses
- This made it easier to get large surpluses
- Potential risk of overestimating the benefits of the current fiscal framework

# The analytical basis for the government's decisions

- In general high-quality work in the Ministry of Finance
- But need for better internal and external documentation
- Allow civil servants to publish relevant analytical material in their own name in publication series
- Report analysis of alternative proposals in the budget bill
- The ambitions to base decisions on economic analysis must extend to all areas of economic policy

# The reception of our report

- The political opposition was against the establishment of the council
  - "yet another agency to lend scientific credibility to ideologically motivated policies"
- No such critique after the publication of the report
  - but some criticism from the government
- Public hearing in the Finance Committee in Parliament
- Great media attention – continued references in the public debate
- Reactions in Budget Bill
- What quality can we attain in the future?
- How should we act in the ongoing public debate on economic policy?