Flash Economics

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How did Sweden manage to eliminate its public deficit between 1993 and 1998?

The situation of France's public finances prompts us to look at the experience of countries that have succeeded in the past in significantly reducing their public deficit. We look at the example of Sweden.

Sweden's public deficit fell from 10.6% of GDP in 1993 to a surplus of 0.8% of GDP in 1998. This very sharp reduction in the public deficit was not the result of an increase in the tax burden, but of a profound change in the organisation of the public sector.

Agencies were set up to deal with specific areas (transport, health, education, etc.); these agencies have multi-year targets for productivity gains and investment. Agency employees have private law status.

In addition, health spending, family allowances and unemployment benefits were reduced, and a pension reform aimed at automatically balancing pension schemes was introduced, with a target of an average budget surplus over the economic cycle.

The implementation of this reform of public finances has also led to a fall in the savings rate of Swedish households due to the disappearance of expectations of tax increases in the future.

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A reduction in Sweden's public deficit in the 1990s that was not due to an increase in the tax burden

France must now reduce its public deficit from 7% of GDP (which is the deficit forecast for 2025) to 3% of GDP. The need to reduce France's public deficit prompts us to look at the experience of countries that have sharply reduced their public deficit in the past. We look at the experience of Sweden in the 1990s. **Chart 1** shows Sweden's **public deficit** in the 1990s, while **Chart 2** shows its tax burden and public spending.

Chart 1
Sweden: Fiscal surplus or deficit (as % of nominal GDP)

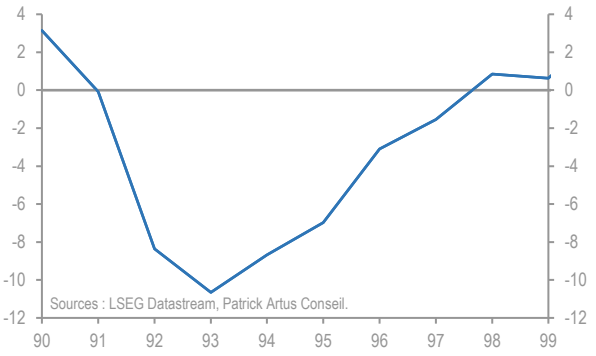
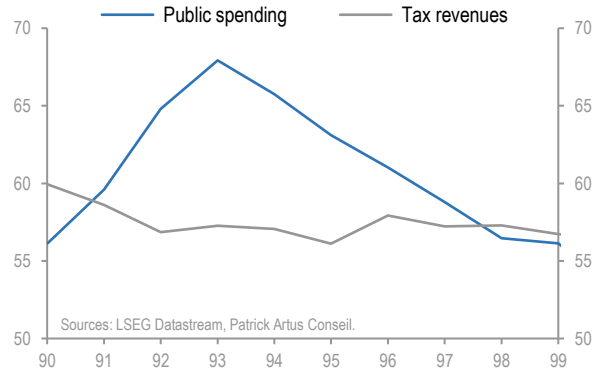


Chart 2
Sweden: Public spending and tax revenues (as % of nominal GDP)

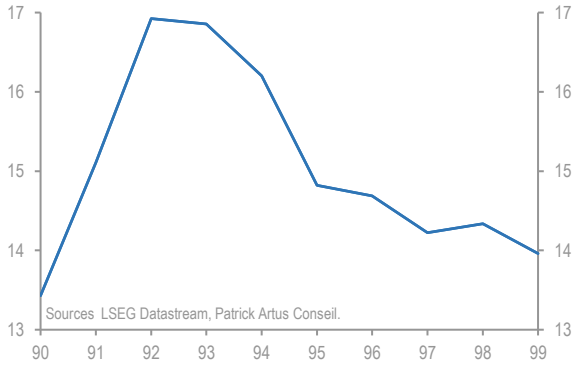


One can see that the reduction in the public deficit was due to a fall in public spending and not to an increase in the tax burden.

A reduction in social welfare spending

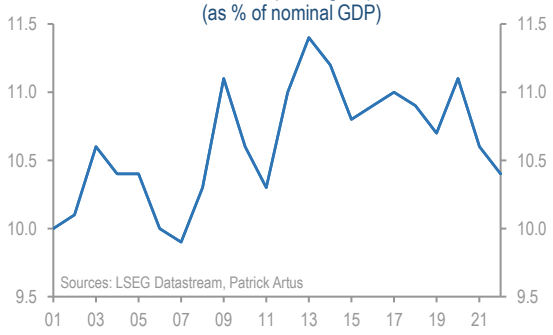
Following the recommendations of the Lindbeck Commission, the Swedish Conservative government **reduced social welfare spending** (health spending, family allowances, unemployment benefits) from 1993 onwards (**Chart 3**).

Chart 3
Sweden: Public spending on labour markets, family benefits and healthcare (as % of nominal GDP)



A complete reform of the pension system was introduced in 1994. From that date onwards, the pension system comprises a pay-as-you-go system and a funded system. Each employee has a notional account that gives them the amount of their pension depending on the age at which they decide to retire (from the age of 61). The balance of the pension system is ensured, year after year, by determining the level of pensions. As a result, pension spending in Sweden (**Chart 4**) has remained stable at around 11% of GDP.

Chart 4
Sweden: Public spending on pensions (as % of nominal GDP)



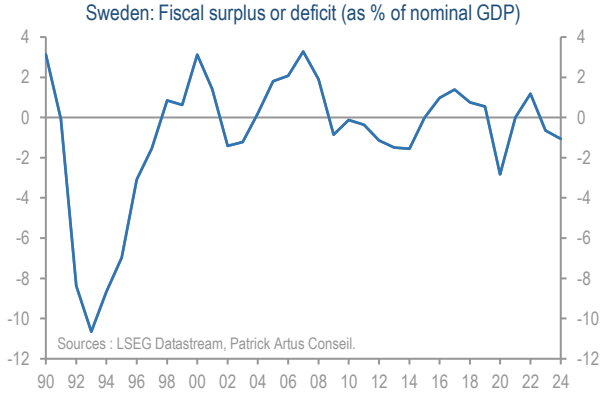
A strict budgetary rule

This budgetary rule includes:

- **No public deficit for local authorities;**
- **A budget surplus target of 1% of GDP calculated on average** over the economic cycle;
- **A ceiling on public spending calculated over 3 years.**

If one can look at **Sweden's public deficit since the 1990s (Chart 5)**, we can see that this rule of a small surplus over the economic cycle has been respected.

Chart 5
Sweden: Fiscal surplus or deficit (as % of nominal GDP)



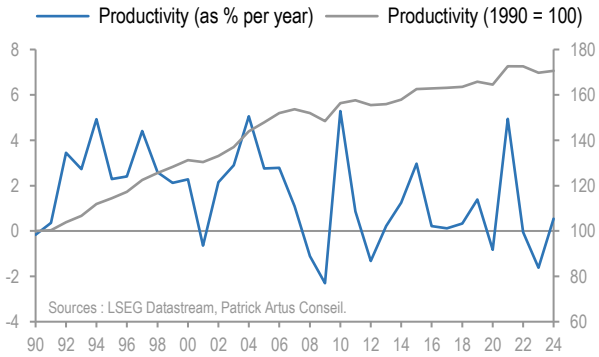
Opening up to competition

Since 1991, **many sectors have been opened to competition**: air transport, retirement homes, taxis, post offices, telecommunications, railways, rail freight, electricity, pharmacies, employment agencies, nursery schools. The opening up of these sectors to competition, together with a major R&D effort (**Chart 6**), led to a rapid increase in productivity (**Chart 7**).

Chart 6
Sweden: Total R&D spending
(as % of nominal GDP)



Chart 7
Sweden: Productivity per head



Public agency system

Central administration in Sweden comprises around fifteen ministries and around 250 agencies, each responsible for a public service mission. For example, there is an agency responsible for schools, transport, the budget, vocational education, health, etc... The number of civil servants is very low (4,600), and there are 250,000 agency employees, who have private law employment contracts and are paid on an individual basis. The agencies have their accounts audited, they are regularly evaluated, they report quarterly on their activities to the ministry in charge, and they have a multi-year budget. In addition, public policies are constantly evaluated by 35 evaluation agencies.

Consensus-building

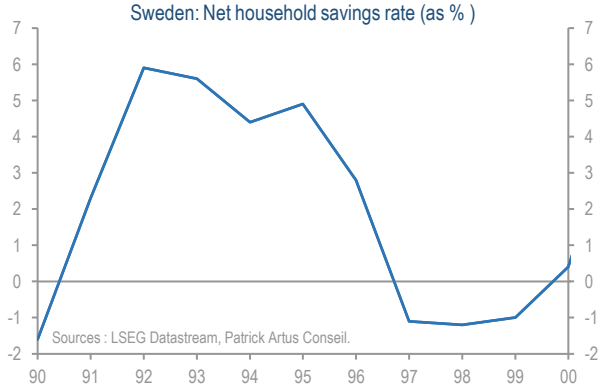
The various reforms, particularly the pension reform, were preceded by a long process of appraisal and negotiation between the government and the social partners. The social partners negotiate with a view to maintaining the country's competitiveness. In addition, Sweden has an efficient public sector, which means that Swedes are willing to pay high taxes.

Mechanisms that helped reduce the public deficit in the 1990s

Two mechanisms contributed to the success of policies to reduce the public deficit in the 1990s:

- **On one hand, the Ricardian neutrality**. The expectation that there would be no increase in the tax burden due to the reduction in public spending led to **a fall in the household savings rate** (**Chart 8**), which supported domestic demand;

Chart 8
Sweden: Net household savings rate (as %)



- On the other hand, the **devaluation of the Swedish krona exchange rate** in 1992 **(Chart 9)** supported foreign trade.

Chart 9
Sweden: Exchange rate against the deutsche Mark
(100 SEK = … DM)



Summary: Lessons from Sweden (in the 1990s) for France (today)

In the 1990s, Sweden eliminated its public deficit by reducing public spending:

- The introduction of budget management rules (budget surplus on average over the economic cycle);
- Improving the efficiency of public services (with the agency system);
- Reductions in social spending (health, unemployment, family) and pension reform involving freedom of choice of retirement age and automatic balancing of the pension system;
- Research and Development and technological investment leading to rapid productivity growth;

It seems to us that France could now draw inspiration from the budgetary policies pursued in Sweden since the 1990s.

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