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# The Swedish Experience in Reducing Budget Deficits and Debt

*By Goran Persson*

It is with mixed feelings that I participate in this overview panel. On the one hand, it is a real honor for me to participate in this year's symposium with such distinguished participants. On the other hand, I understand that the reason for my invitation lies in the enormous financial problems Sweden has experienced in the past few years.

The topic of this year's symposium is "Budget Deficits and Debt: Issues and Options." The first—and maybe the most obvious—question we face, is whether we lack the knowledge of how to balance the budget. My answer is no.

The second question is, if we know what has to be done, why do we not do it? This is a political question.

In a deficit situation, politicians face a difficult task. Representatives are usually elected to make the voters better off. But when there is a deficit problem, they have to deal with questions they are not familiar with, and perhaps not prepared

for. Expenditures have to be cut. Taxes have to be raised.

These questions are extremely difficult to handle. That is why a successful consolidation process must have strong support from the people. As a politician, you have to be able to turn the edge of the debate against those who do not want to take harsh measures.

I would like to make three general observations as to what I believe is needed to make a consolidation program effective. But before that, let me say that dealing with such a program is not only difficult, but also dangerous. The politician who stands behind a consolidation process must be prepared to put his or her office at stake.

First, the consolidation program must be designed so that the burdens of consolidation are shared fairly. Otherwise, support for the harsh policy would quickly deteriorate, and Parliament would lose the political will to make tough decisions. Without reasonably strong public support and understanding, no policy can be very successful.

Second, the consolidation program has to be designed as a comprehensive package; an ad hoc hodgepodge of measures will only have a limited

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*Goran Persson is Sweden's finance minister. He made these comments during the Overview Panel session at the Federal Reserve Bank of Kansas City's 1995 symposium, "Budget Deficits and Debt: Issues and Options," in Jackson Hole, Wyoming, August 31–September 2, 1995.*

chance of success. By presenting the measures together, it becomes clear to all interest groups that they are not the only ones asked to make sacrifices.

Third, the whole process must be as transparent as possible. Honesty toward the citizens—never play down the effects of the measures. Honesty toward the market—always clarify assumptions and calculations. Never try to fool anybody by using gimmicks or bookkeeping tricks. Only then can credibility be recovered; only then can the program earn legitimacy.

A consolidation process consists of two phases: doing it, and holding on to it. Even if the first phase is successful, renewed resistance will appear when the measures affect the voters' own pockets. The government has to be able to say, "This is not news. We have said all along that getting public finances in order is extremely harsh and that it requires large sacrifices from everybody throughout society." Otherwise the whole process can be threatened by different interest groups.

Never say that it won't hurt. Never say that this is peanuts.

Let me now turn to the particular Swedish situation. In the early 1990s, Sweden experienced its deepest recession since the 1930s. To cut a long story short, in three years public debt doubled, unemployment tripled, and public deficit increased tenfold. In 1994, the general government budget deficit was the largest in the Organization for Economic Cooperation and Development (OECD) area, 10 percent of GDP.

Basically, the reason for this explosion of public debt was a collapse in domestic demand. One important factor was an increase in the household savings ratio by no less than 13 percentage points.

The new government that took office in October 1994 had to react, and act firmly.

Only by substantially reducing the deficit could Sweden achieve stability and sustainable growth. The reinforcement program will strengthen public finances by 7.5 percent of GDP per year. I want to underline that this refers only to measures already passed by Parliament.

The program is front-loaded; 3.5 percentage points have taken effect this year and a further 2 percent will come into force in 1996. Almost two-thirds of the measures are spending cuts. The main part relates to transfers and central government consumption.

Even though there is a general public understanding of the seriousness of the budget situation, a positive and long-run acceptance of the consolidation program presupposes that the burden is distributed fairly among different groups in society. This is extremely important in Sweden where the election participation ratio is over 90 percent.

So what are the results of our consolidation program?

With modest assumptions on growth and interest rates, we expect a gradual reduction of the deficit. In 1996 we will stabilize public debt relative to GDP. Our goal is to meet the Maastricht criteria of a deficit of 3 percent in 1997, and to balance public finances by 1998.

This goal is supported by 94 percent in Parliament.

Even though Sweden has a large budget deficit, the economy is running smoothly. We have a current account surplus of almost 3 percent for this year, private investments are up 20 percent, and employment has increased by 2.5 percent this year.

Of course there is a political cost associated with spending cuts and tax increases. But it would have been even harder if we had not done anything at all. The opinion polls are now pointing in the right direction for the government.

Now we have taken a grip on public finances. This was the first phase of our consolidation program. But there is also a second phase—the phase of sticking to the program. This phase consists of monitoring public finances, taking care of institutional weaknesses, and fighting inflation.

According to the Maastricht Treaty, Sweden must submit a so-called “convergence program.” In this program, we monitor public finances once a year in order to put them in order. This convergence program is public, as is everything relating to our consolidation program.

Yesterday, Rob Johnson from Moore Capital Management told us that when something unexpected takes place in Mexico, it will spill over to other countries with problems, such as Sweden. This vulnerability can only be reduced by being transparent and extremely open toward the capital markets. One budget gimmick and we lose confidence that could take years to regain. So far, I have never had to revise a budget deficit estimate in the wrong direction. It is of great importance that the Ministry of Finance is conservative in predicting deficits and debts.

In order to avoid unsustainable budgetary outcomes in the future, the institutional framework has been improved recently. Parliament has passed a resolution according to which the total volume of expenditure, as well as expenditures for specific areas, will be established in the initial stage of the budget preparation in Parliament. That means that Parliament cannot pass a budget that is weaker than the one presented by the government.

Parliament has decided to extend the period between elections from three to four years. This is likely to provide a better basis for a consistent and responsible fiscal policy.

The government has proposed the imposition of a multiyear ceiling on public expenditure. An expenditure ceiling is more operational in nature than a deficit target and is possible to monitor on a continuous basis.

The government will also prohibit local governments’ borrowing for consumption.

Sweden experienced high inflation in the 1970s and 1980s. This did not work then, and I am even more confident that it will not work in the 1990s. I believe that the single most important factor in fighting inflation is to create public resistance to it. I have started a process of education on the dangers of inflation. My message to the Swedish people is that, in order to avoid unemployment and further cuts in the social security system, inflation has to be kept low.

Last year the Swedish economy followed a very dangerous road with public finances out of control, high unemployment, and an increasing mistrust among the public about the ability of democratic institutions to deal with the problems. It is not an exaggeration to say that the rapid increase in the public debt challenged the whole idea of democracy. Since the government had to borrow money from the capital markets, power was shifted from the elected representatives to the owners of capital.

This is a very strong political message. And it is this message that has made the prospects for sound public finances look much better now than they did just a year ago.

