



Cautious spring budget hides underlying tensions

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THIS WEEK THE SWEDISH GOVERNMENT WILL GET A NEW CHANCE TO PRESENT ITS OVERALL ECONOMIC POLICY APPROACH. After the drama of last autumn – when the populist Sweden Democrats helped push through the budget of the four opposition Alliance parties, leading Social Democratic Prime Minister Stefan Löfven to threaten a snap election – the December Agreement between the centre-left government and the Alliance created a certain calm. On Wednesday, April 15, the government will unveil its Spring Fiscal Policy Bill. This bill normally represents a first step towards the autumn budget bill for the following calendar year. It may also contain necessary adjustments for the current year. But this time around, it will attract substantially more attention than usual, because so far during 2015 the non-socialist Alliance’s budget has served as the basis for government economic policy.

THE GOVERNMENT IS CLEARLY BEING SQUEEZED FROM SEVERAL DIRECTIONS. Despite relatively strong economic growth in Sweden, unemployment remains high and there is heavy pressure on spending in such fields as defence, infrastructure, residential construction and integration of immigrants. A new government also normally faces high expectations, and now that the first six months after September’s parliamentary election have been characterised by great turbulence, pressure on the government to show decisiveness is even greater. But it is obvious that the government remains handicapped by its weak parliamentary base – even though the December Agreement is now in place, theoretically ensuring that even a minority government can push through its budget. There is also limited room for manoeuvre at present, since the public sector is showing a deficit of about 2 per cent of GDP while the now-established “krona-for-krona” principle means that active reforms must be fully funded. Also worth noting is that early in 2015, the government revised its economic growth outlook for the next few years downward, indicating that it wishes to clearly emphasise that the current situation is relatively tough.

IN KEEPING WITH TRADITION, MOST PROPOSALS IN THE SPRING BUDGET BILL have already been unveiled in recent weeks. These proposals are a mix of measures that can be implemented during 2015 and others that merely provide advance notice of the autumn budget bill

for 2016. The expenditure side includes an expansion of infrastructure projects as well as hikes in unemployment and other social benefits. These increases would be funded mainly by gradually phasing out the current reduction in employer social insurance fees for young employees. There would also be cutbacks in existing income tax deductions for home renovations, changes in interest rates on investment savings accounts and higher environmental taxes, although detailed proposals in these fields will not be unveiled until the autumn budget bill. The proposals now being put forward represent cautious attempts at a shift in economic policy, but it is obvious that the major issues related to taxation policy and the structure and financing of the health, education and social welfare system are being postponed.

Comparison of forecasts

Year-on-year percentage change

	2014	2015	2016
GDP			
Government	1.8	2.4	2.7
NIER	2.1	3.1	3.3
SEB	2.1	3.0	2.7
Unemployment			
Government	7.9	7.7	7.4
NIER	7.9	7.8	7.4
SEB	7.9	7.7	7.3
Net lending			
Government	-2.1	-1.3	-0.6
NIER	-2.1	-1.5	-0.9
SEB	-2.1	-1.2	-0.6

Source: Swedish government (January), National Institute of Economic Research (March), SEB (February)

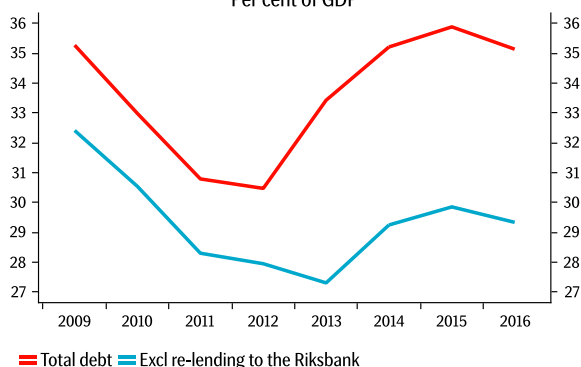
SINCE EXPENDITURE REFORMS WILL BE FULLY FUNDED, THE OVERALL DIRECTION OF FISCAL POLICY WILL BE NEUTRAL. However, in a situation of high unemployment and low inflation, there is room for a more expansionary policy. Since the Riksbank is now being forced into exceptional measures, including negative interest rates, this suggests that fiscal policy makers can play a larger role in official stabilisation policy.

Sweden’s low level of sovereign debt and the low interest rates paid by the central government also increase fiscal

policy manoeuvring room. In such a situation, it should be possible to find measures that facilitate economic recovery and are also structurally sound in the long term. Infrastructure investments are the most classic and accepted area, since most people agree that such investments are actually a task for the public sector and it is also relatively easy to set time limits on them.

UNFUNDED SPENDING IN AREAS SUCH AS DEFENCE, RESIDENTIAL CONSTRUCTION, EDUCATION AND INTEGRATION OF IMMIGRANTS could also be justified using similar arguments. Yet it is important that these measures should be genuinely temporary and can be phased out when stronger economic conditions warrant, thereby ensuring that fiscal policy makers are not hurt by credibility problems. Since it is mainly foreign investors and credit rating agencies that must be persuaded of the sustainability of such policies, it is also important that these policies be internationally perceived as responsible and not dominated by specifically domestic political calculations. Our view is that the government's intention to replace the 20-year-old official target of a budget surplus equivalent to 1 per cent of GDP with a balanced budget target is logical, in light of relatively low government debt and because – for demographic reasons – the pension system is no longer contributing a surplus to the public fiscal balance. At the same time, it is important that such a lowering of the ambition level should lead to greater willingness to actually meet the target in the medium term, so that this reform does not represent the first step towards poorer budget discipline. The opposition has now decided to push a more ambitious official study of the fiscal framework through the Finance Committee of Parliament, but it remains likely that we will finally end up with a shift in this direction.

Low central government debt
Per cent of GDP



Source: National debt office, SEB

HOW THE PARTIES INTERPRET AND ADMINISTER THE DECEMBER AGREEMENT will be crucial to political developments over the next few years. The main purpose of the agreement was to make it easier for a minority government to get its budget through Parliament and to block the ability of the right-wing, anti-immigration Sweden Democrats to act as a kingmaker. The technical criticisms presented by various observers when the

agreement was signed have faded in importance. Most political scientists and legal experts seem to concur that the agreement is a democratically legitimate way to deal with the problems of forming a government that often arise in proportional representation systems like Sweden's. But this will not prevent major practical and political strains from occurring. The long-term strategy of the Alliance under the December Agreement – perpetuating the red-green and Alliance political bloc system and forcing the Social Democrats into long-lasting, organised collaboration with the Green Party and/or the Left Party – may very well succeed, but apparently at a high price. Within the framework of the December Agreement, in many cases the Alliance parties may force the Social Democrats into compromise solutions with the (ex-Communist) Left Party that are far removed from the Alliance's own positions. Given this political logic, it is not surprising that the leaders of the Alliance parties are finding it hard to persuade their own organisations that serious, constructive opposition policies are possible.

THE FOUR ALLIANCE PARTIES HAVE NOW DECLARED THAT THEY WILL EACH PRESENT separate budget bills during the current parliamentary term of office and then join forces to present a common platform before the 2018 election. Their purpose is to use their budget proposals as a way of achieving more dynamic internal political and ideological development. In practice, this means that the December Agreement will become less important, since the Sweden Democrats will not be given an opportunity to defeat the government's budget in the way they did last autumn. In such a situation, the government does not need the support of the Left Party for its budget either. What is mathematically decisive for this is that the Social Democratic-Green Party coalition budget must win a final vote against the budget bill of the Moderate Party – which dominates the Alliance – even if the Moderates are supported by the Sweden Democrats. Put a bit provocatively, the December Agreement would never have been needed if the Alliance parties had immediately decided that they would present separate budget bills.

AT PRESENT, IT IS TOO EARLY TO DETERMINE WHETHER THE DECEMBER AGREEMENT WILL SURVIVE THIS ENTIRE PARLIAMENTARY TERM. Shifts in the public opinion situation, especially when it comes to support for the Sweden Democrats, will be important. But other factors, such as the general climate of political cooperation and macroeconomic developments, will also be of great significance. Both the government and the opposition face a balancing act. The Alliance parties must administer the right number of pin pricks to the government in order to show that they are actually pursuing active opposition policies. But they must also be watchful that the government will not use its budget bill to push through policies in areas that are not really covered by the December Agreement. This means that the government must genuinely dare to shape a clear economic policy strategy, despite the accompanying

difficulties. Simultaneously dealing with disputes inside the government, handling the process of ensuring the support of the Left Party and administering the December Agreement in a way that does not challenge the Alliance parties may prove to be an impossibly difficult task that paralyses the government's decisiveness. Swedish economic policy has rarely been as complicated as it is today. The spring budget will be an initial test of how it will work, but the major challenges lie further ahead.

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