

Economic Insights

SEB ECONOMIC RESEARCH

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Swedish Budget Bill Fiscal policy more expansionary

- **Expansionary measures in the Budget Bill presented today amount to SEK 17bn or 0.7% of GDP.**
- **Fiscal policy stance for 2005 is moderately expansive.**
- **Election year may lead to an even more expansive budget for 2006.**
- **Public finances deviate increasingly from the budget target.**

The final outcome of the budget negotiations is broadly in line with our assessment in *Nordic Outlook*. Net expansionary measures amounting to SEK 17 billion (0.7% of GDP) in 2005 are proposed.

Proposals for 2005 in the Budget Bill SEK billion

Higher expenditure

Grants to local government	6
Other	1

Lower income

Income taxes	11
Taxes on gifts and inheritance	3
Wealth tax	1

Financing

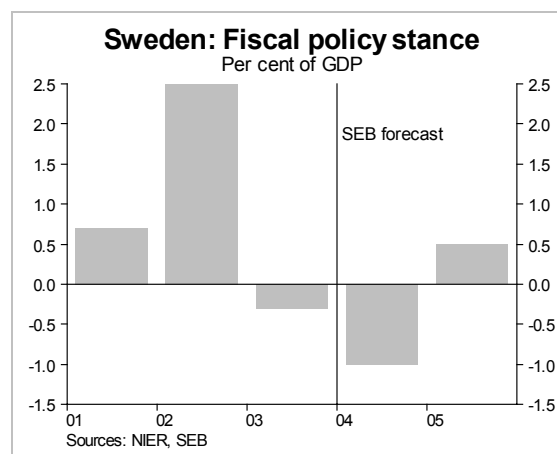
Energy ("green") taxes	3
Smaller than normal adjustment of tax brackets	1
Effective corporate taxes	1½

Total net 17

In 2005, tax reductions make up the lion share of the new proposals mainly through lower income tax. On the expenditure side grants to the municipalities will be

increased by SEK 6bn. This will allow the municipalities to increase employment by a little more than 10,000 persons, i.e. 0.2-0.3% of the labour force.

On the funding side, corporate tax will be tightened and energy taxes will be hiked as part of a "green swap" (to offset lower taxes on labour).



Moderately expansionary in 2005

Despite the new proposals the overall fiscal policy stance for 2005 is only moderately expansive, corresponding to 0.5% of GDP. The reason for the effect not being larger is that important parts of the expenditure side are fixed in nominal terms, while the revenue side to a higher degree follows growth in wages and prices. Hence, without

any discretionary new decisions, fiscal policy will be slightly contractionary.

Nevertheless, the government has initiated an expansionary fiscal policy at a time when the recovery is gaining momentum and GDP is set to grow by some 3%. In the short run, this does not need to be a problem. During 2005 the output gap is still open; i.e. there are still idle resources. A policy mix in which tax cuts stimulate labour supply are offset by higher interest rates that curb credit expansion and home prices thus seems quite reasonable.

Risks in 2006

Looking a bit further ahead, however, there are major risks. The political dynamic during the run-up to the 2006 election may lead to an even more expansive budget – at a time when the capacity situation is more strained. Already in this Budget Bill new expenditures are proposed for 2006, with higher benefit levels in social security systems as the most important part. Such an expenditure policy is hardly an appropriate way to prepare for the major demographic strains of future decades.

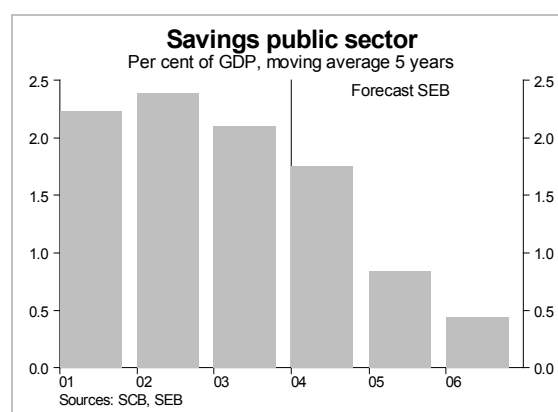
Where is the growth strategy?

Furthermore, it is difficult to discern any long-term growth strategy in this budget proposal. In the government declaration of 2003, the Prime Minister promised such a strategy.

But in this budget, the wealth tax is not abolished, corporate taxes are increased and the income tax cuts are to some extent shaped as a higher tax threshold for low-income earners – not as marginal tax cuts that can have a strong impact on labour supply.

Farewell to the surplus target

Also looking at the budget targets there are reasons to be worried. The public sector surplus will be around ½% of GDP both this year and next, and stay below 1 per cent also in 2006. The balance will thus have fallen short of 2% of GDP for several years, despite strong growth. Measured as a 5-year moving average the surplus will gradually fall to only 0.5% in 2006. Hence, the official target of 2% over a business cycle is far from achieved.



Klas Eklund
klas.eklund@seb.se
Håkan Frisen
hakan.frisen@seb.se
Olle Holmgren
olle.holmgren@seb.se