

Whitehall studies Swedish recipe for debt reduction

While Brown was speaking to the TUC about cuts and plugging the fiscal hole, senior Whitehall figures were gathering to listen to a former Prime Minister who had already done it. Göran Persson was Sweden's Prime Minister during its fiscal crisis in the mid-90's. He is widely credited as the man who saved the country from bankruptcy, but managed to keep the essential elements of its precious welfare state intact. Now that Brown has acknowledged that cuts might be necessary – not least in the eyes of the public – Whitehall can begin to roll up its sleeves and look at the real choices that face us. Sweden is a pretty good place to start.

The early 90's recession plunged Sweden deeply into debt. By 1994, Sweden was running a deficit of close to 10% and an expanding public debt of nearly 80% of GDP. It was close to broke, and the financial markets were punishing the country with high interest rates. Unemployment rates hovered around 10%.

Like Canada at around the same time, the Swedish government realized it was at the brink. It had to act decisively to mend its battered finances. Both Sweden and Canada did turn their finances around, but their approaches were very different. The contrast is an important one for Britain and the coming election, and illustrates the very real choices that we face – a debate that is only now beginning in earnest.

A key difference, that tensions with the unions has laid bare, is how much of the gap to plug with cuts versus tax increases. The Canadians slashed their deficit with a ratio of cuts to tax increases of 7:1. In contrast, the Swedes ratio was around 2:1 – tax increases greatly softened the adjustment for public services, though were much harder on the pockets of the electorate. Current Treasury figures for the UK, as analysed by the Institute for Fiscal Studies, show a ratio for the next Parliament roughly in between, at around 4:1. In the Swedish case this meant increases in wide variety of taxes including – in rough order of the scale their contribution – increased individual national insurance contributions, capital taxes, production taxes (VAT), and income tax on high earners.

Another key choice is around how you go about cutting – with an axe or a scalpel. The Swedes went for across-the-board cuts. The Canadians went for a much more differentiated approach, for example cutting transport spending by 69% but actually increased spend in some areas. The Canadian-style approach is arguably more 'scientific', but the Swedish approach may make for better politics. As one of Persson's key aids later wrote, 'When one strong interest group complains, you are in trouble. But if everybody complains, you are not....'

In both countries, the fiscal crisis also created opportunities for radical innovations that had previously been in the 'too difficult' box. For example, the Swedes introduced private sector competition into their famous school and healthcare systems, and encouraged employers to co-fund computers for employees at home enabling among other things the government to much more rapidly switch to a system of online tax returns.

In the end, the efforts undertaken by each country paid political dividends. Both Prime Ministers Jean Chrétien and Göran Persson remained in office for over a decade. But there is a twist. Work by the economist José Tavares, in a study of all the major fiscal consolidations of the last 40 years, found that successful consolidations by the governments on the left were marked by spending cuts, but on the right by tax increases. This is because markets and voters look for sincerity. So puzzling though it may seem, we may face the prospect of either an Osborne pushing up taxes, or a Darling pushing through cuts. Curious times indeed – and certainly difficult material for a PM's speech to the TUC.

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Notes

Former Swedish PM Göran Persson will be delivering a lecture at the Institute for Government discussing his experience in designing and managing large scale government programmes to tackle budget deficits and government debt. Jocelyne Bourgon has recently produced a report with the Institute for Government on Program Review: The Government of Canada's Experience Eliminating the Deficit, 1994-99.