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BUDGETARY POLICY AND THE STATE OF PUBLIC FINANCES IN THE EU SCANDINAVIAN COUNTRIES IN 2000 – 2018

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ABSTRACT

The subject of this paper is an analysis and evaluation of budgetary policy and the state of public finances in Scandinavian countries of the European Union (Denmark, Finland and Sweden) in 2000-2018. The adopted basis of assessment is budget deficit and public debt ratios to the GDP. The statistical data was drown from the AMECO and IMF databases. Comparison of the situation of the public finances in the analysed countries to the average situation in the euro area is an important aspect of the evaluation.

The goal of the paper is also to identify positive and negative changes in public finances in Denmark, Finland and Sweden and in particular the consequences of the economic slowdown in 2001-2003 and recession of 2009. The research revealed that before the crisis of 2008-2009 the situation in public finances of the analysed three countries was much more stable than in the euro area. However, the crisis resulted in a significant deterioration of the budgetary situation in Finland and in an increase of public debt up to over 63% of GDP (2015), while in Denmark it was only 39,9% of GDP and in Sweden 44,2% of GDP. Scale of the crisis in Finland was a consequence of the deep economic recession in 2009 and the prolonged second wave of recession in 2012-2015.

Keywords: Denmark, Finland and Sweden, budgetary policy, state of public finances, consequences of crisis

INTRODUCTION

The EU Scandinavian countries are an outstanding group in many respects. Firstly, they are among the most developed EU member states. Secondly, they are technological leaders. Thirdly, they are characterised by the most expanded public sector due to the broader scope of social protection than in continental Europe. Therefore, Denmark, Finland and Sweden are defined as model welfare states, i.e. with a high share of public expenditure in relation to GDP, which are an important component of total demand. The scope and forms of budgetary policy and the role of public finance in the economy are the subject of controversial discussions. Some authors of empirical studies argue that the growing significance of the public sector in the economy strengthens the performance of automatic stabilisers (AS), that is passive budgetary policy [7]. Then, the vulnerability of AS to fluctuations of macroeconomic indicators increases (e.g. in Denmark, Norway and Sweden). But other economists believe that an increase in budgetary expenditure in relation to GDP has a stabilising effect on the economic situation, but up to a limit which they set at 40% of GDP [2]. However, they stipulate that this limit should be used flexibly, as it depends on the structure and other individual characteristics of the economies.

Interesting research findings on AS performance under macroeconomic shocks during the last crisis were presented in 2010 and covered 19 EU countries and the US [3]. The aim of the simulation was to assess the impact of AS instruments on disposable income and household demand, and the subject of analysis was personal income taxes and social benefits. These studies confirmed that the mitigation of economic fluctuations thanks to AS had a greater impact in the EU than in the US. However, findings varied widely between EU countries, from high in Denmark, Finland, Sweden, Belgium and Germany to low in Eastern and Southern Europe [11].

A prime objective of fiscal policy is to create favourable conditions for economic growth and employment as well as to stabilise economic activity. But the functions of public finances are not limited to strictly economic objectives, but also include the provision of public goods and services and the redistribution of revenues.

The discussion on the optimal combination of the market mechanism with the social functions of the state is still open. The supporters of the free market believe that excessive public spending contributes to a far-reaching redistribution of income, weakening investment activity and, as a consequence, a slowdown in economic growth.

Welfare state models differ depending on the degree of state protectiveness, the degree of income redistribution and the participation of recipients of social benefits in their financing [6]. The highest level of protectiveness is represented by the Scandinavian welfare state, which is characterised by the desire of the state authorities to ensure work, social egalitarianism and a wide range of social protection. It is based on the redistribution of income through progressive taxes.

The maintenance of developed social welfare systems is associated with an increase in costs and public spending. The risk of collapse of the financial foundations of welfare state appears in periods of substantial slowdown in GDP growth, and in particular at a time of deep recession. The EU Scandinavian countries have experienced serious crises linked to the maintenance of developed welfare systems during the years of economic downturn. In particular, three cases need to be mentioned: 1) the collapse of the financial foundations of the welfare state in the 1970s, 2) a severe crisis of the welfare state occurred in Sweden in 1990-1993 and in other European countries that made substantial transfers from their budgets in order to meet social needs, 3) the recent financial and economic crisis of 2008-2009 and the sharp increase in budget deficits in most EU countries and the debt crisis.

In the context of a general deterioration of the economic situation and public finance crisis in the European Union, the following countries are particularly interesting for analysis: Sweden, Denmark and Finland. Firstly, because the scale of the recession and the possibility of recovery varied. Secondly, the impact of the crisis on public finances was small and short-term in Sweden and Denmark, while in Finland the budgetary balance was significantly affected and public debt almost doubled (tab. 2). Thirdly, Sweden and Denmark have not introduced the common currency (euro) and they are more free to pursue macroeconomic policy than Finland, which has abandoned the national currency and could therefore use only budgetary instruments in counter-cyclical policy.

The aim of the paper is to assess the budgetary policies and state of public finances of the three countries which, having budget surpluses and low public debt, incurred differentiated costs in terms of losses in GDP and deterioration of public finances during the crisis of 2008-2009. Main research question is: Which factors have contributed to maintaining the sustainability of public finances in Sweden and Denmark and to the severe economic downturn and destabilisation of public finances in Finland. Statistical data were obtained from AMECO and IMF databases.

LONG-TERM ANALYSIS AND ASSESSMENT OF THE BUDGETARY POLICY AND THE STATE OF PUBLIC FINANCES IN SWEDEN, DENMARK AND FINLAND

Statistical data characterising the dynamics of GDP growth/decline, changes in budget balances and the size of public debt in relation to GDP in the analysed countries and in the euro area are presented in tables 1 - 3 and figures 1 - 2. Finland had the highest budget surpluses before the recession (2009), with an average annual surplus of 4.04% of GDP between 2000 and 2008. Denmark ranked second with a surplus of 2.57% of GDP and Sweden third: 1.27% of GDP. In the same period, the average deficit in the euro area exceeded 2% of GDP. Analysis of the annual rates of changes in budgetary balances indicates the reason for Finland's high budget surpluses. In the years of the economic slowdown 2001-2003, Sweden recorded a budget deficit (2002-2003), and in Denmark the balance was close to zero. The deterioration of the budget balance in Sweden and Denmark in 2002-2003 did not lead to an increase in public debt as a share of GDP. On the contrary, with the improvement in economic growth since 2004-2005, public debt in all three countries has been declining and was significantly lower in 2007-2008 compared to 2000 (tab. 2). A positive consequence of the improvement of the budget balance was a reduction in the debt servicing costs. To sum up, all three countries had budget surpluses before the recession (2009) and very low public debt: Finland 32.7% of GDP, Denmark 33.3% of GDP and Sweden 37.8% of GDP. The average annual GDP growth rate in 2000-2007 was as follows: Finland 3.48%, Sweden 3.25% and Denmark 1.90% and the euro area 2.22%. Despite a significantly lower GDP growth rate in Denmark than in Finland and Sweden, Denmark's budget was balanced during the economic slowdown, with high surpluses and low public debt in 2004-2008. Taxes deriving from North Sea oil production and taxes on profits from pension funds are an important source of fiscal revenue in Denmark. The average annual revenue from oil production taxes in 2004-2009 accounted for 1.6% of GDP [13, 14].

The essential research problem refers to the impact of the crisis of 2008-2009 on public finances in Denmark, Finland and Sweden. At the earliest, the economic downturn occurred in Denmark as a result of the collapse of the real estate speculative bubble in 2007. Symptoms of overheating of the economy contributed to a progressive decline in business activity and the GDP growth rate dropped to 0.9% (in 2007). The recession began in 2008, and in its main phase in 2009, the decline in GDP was 0.4 percentage points higher than in the euro area and amounted to 4.9%. The fiscal situation in Denmark changed radically in 2009, when a surplus of 3.2% of GDP turned into a deficit amounting to 2.8% of GDP. It was the result of a fall in budget revenues and an increase in expenditure on intervention aid for banks and was largely due to the reform of the state administration carried out in 2007. The powers of local authorities, which have been given the possibility of indebtedness, have increased. Budgetary expenditure was expected to increase as more powers were delegated to lower tiers of government. They were given the ability to set tax rates and decide on expenditures [12]. The budgetary systems of Denmark and Sweden have the highest degree of decentralisation in the EU. The deficit increased mainly due to local government expenditures, while the central government budget was balanced. The increase in government expenditures and the relatively high deficit between 2009 and 2012 led to an increase in Denmark's public debt from 27.3% of GDP to 46.1% of GDP over four years (2007-2011). Consolidation of public finances in Denmark has been initiated since 2013 with a sustained economic recovery and stabilisation of GDP growth in the range of 1.6% - 2.1% (tab. 1). Generally, the budget balance has been achieved and public debt has been declining. According to the Danish government's forecasts, public finances by 2025 will be characterised by [15]: 1) a deficit below 1% of GDP and the balance in the last year of the forecast, 2) public debt may decrease to 34.2% in 2020 and increase to 39.5% of GDP in 2025, 3) the possibility of a safe loosening of fiscal policy in the case of a drop in economic activity is envisaged.

Analysing Sweden's budget balance and public debt, it seems that the crisis has bypassed that country. However, the recession was even deeper than in the euro area, the second wave of recession was also observed, but generally the GDP growth rate in Sweden in 2008-2017 was high, the average annual GDP growth rate was 1.77%, in Denmark 0.62% and in Finland 0.4%. The recession of 2009 was a shock that caused many economic problems, including longer periods of stagnation and difficulties in recovering and sustaining demand growth in most EU countries.

There are two extreme cases in the group of analysed countries. The first is Sweden, which has shown a high resilience to financial and economic shock and a high capacity to preserve sustainable GDP growth, without jeopardising the sustainability of public finances. Moreover, from 2015 the budget balance has been in surplus and public debt has been reduced. The debt is expected to fall below 40% of GDP in 2018. Therefore, the question arises about the sources of economic success in the conditions of a developed social security system and the stability of public finances. The most important of these sources are as follows: 1) innovative economy based on modern technologies, 2) development potential of the economy is strengthened by high competitiveness, high employment rate (81.8% in 2017) supported by immigration policy; the redistribution policy, which reduces inequalities by redistributive power of the tax and benefit system, is crucial in the creation of internal demand (in 2014 the Gini coefficient after taxes and transfers fell from 45 to 25) [5], 3) the high sustainability of public finances, which are based on: surplus target in general government of 1% of GDP on average over the cycle, 2) expenditure ceiling – nominal maximum for central government expenditures defined three years in advance etc. [10].

The second extreme case is Finland, where the crisis of 2008-2009 caused a severe collapse in economic growth and public finance destabilisation. It is worth to remind that before the crisis Finland had the highest GDP growth rate and the highest budget surpluses in the group of analysed countries. Finland is the only Scandinavian country that has abandoned its national currency and adopted the euro. Therefore, in counter-cyclical policies it is no longer possible to use monetary policy instruments. Conversely, Sweden's effective macroeconomic policy aimed at stimulating demand in 2009-2010 has been pursued through a full set of monetary and fiscal instruments. The depreciation of the krona facilitated the development of Swedish exports and the maintenance of a trade surplus. While Finland lost its position on foreign markets due to the appreciation of the real exchange rate. Table 1 shows that the recovery in Finland was temporary (2010-2011) and since 2012 the economy has entered the second wave of recession. GDP growth has occurred since 2016. The protracted recession resulted in a relatively high budget deficit until 2015 and the inability to reduce public debt. The deep collapse of Finland's economy was fundamentally affected by the decline of the electronics industry (mobilephone business) and exports. The foundations of the welfare society were threatened. The budgetary situation also deteriorated as a result of the increase in pension expenditure [9]. Forecasts of the Finland's government foresee a modest economic growth in the next decade, what will not be sufficient to improve the state of public finances in short term.

Table 1. Growth of GDP in Denmark, Finland, Sweden and the euro area in 2000 – 2023 (constant prices, in %)

Year	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Denmark	3,7	0,8	0,5	0,4	2,7	2,3	3,9	0,9	-0,5	-4,9	1,9	1,3
Finland	5,6	2,6	1,7	2,0	3,9	2,8	4,1	5,2	0,7	-8,3	3,0	2,6
Sweden	4,7	1,6	2,1	2,4	4,3	2,8	4,7	3,4	-0,6	-5,2	6,0	2,7
Euro area	3,8	2,1	1,0	0,7	2,3	1,7	3,2	3,0	0,4	-4,5	2,1	1,6
Year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Denmark	0,2	0,9	1,6	1,6	2,0	2,1	2,0	1,9	1,8	1,8	1,7	1,7
Finland	-1,4	-0,8	-0,6	0,1	2,1	3,0	2,6	2,0	1,5	1,3	1,2	1,2
Sweden	-0,3	1,2	2,6	4,5	3,2	2,4	2,6	2,2	2,1	2,0	1,9	1,9
Euro area	-0,9	-0,2	1,3	2,1	1,8	2,3	2,4	2,0	1,7	1,5	1,5	1,4

Source: [8]

Table 2. General government consolidated gross debt in Denmark, Finland, Sweden and the euro area in 2000 – 2019 (% GDP)

Year	Denmark	Finland	Sweden	Euro area
2000	52,4	42,5	50,8	68,1
2001	48,5	41,0	52,3	67,0
2002	49,1	40,2	50,3	66,9
2003	46,2	42,8	49,8	68,1
2004	44,2	42,7	48,9	68,4
2005	37,4	40,0	49,2	69,2
2006	31,5	38,2	44,0	67,4
2007	27,3	34,0	39,3	65,0
2008	33,3	32,7	37,8	68,7
2009	40,2	41,7	41,4	79,2
2010	42,6	47,1	38,6	84,8
2011	46,1	48,5	37,9	87,3
2012	44,9	53,9	38,1	91,7
2013	44,0	56,5	40,7	93,9
2014	44,3	60,2	45,5	94,2
2015	39,9	63,5	44,2	92,1
2016	37,9	63,0	42,1	91,1
2017	36,4	61,4	40,6	88,8
2018	33,6	60,4	38,0	86,5
2019	32,3	59,6	35,5	84,1

Source: [1]

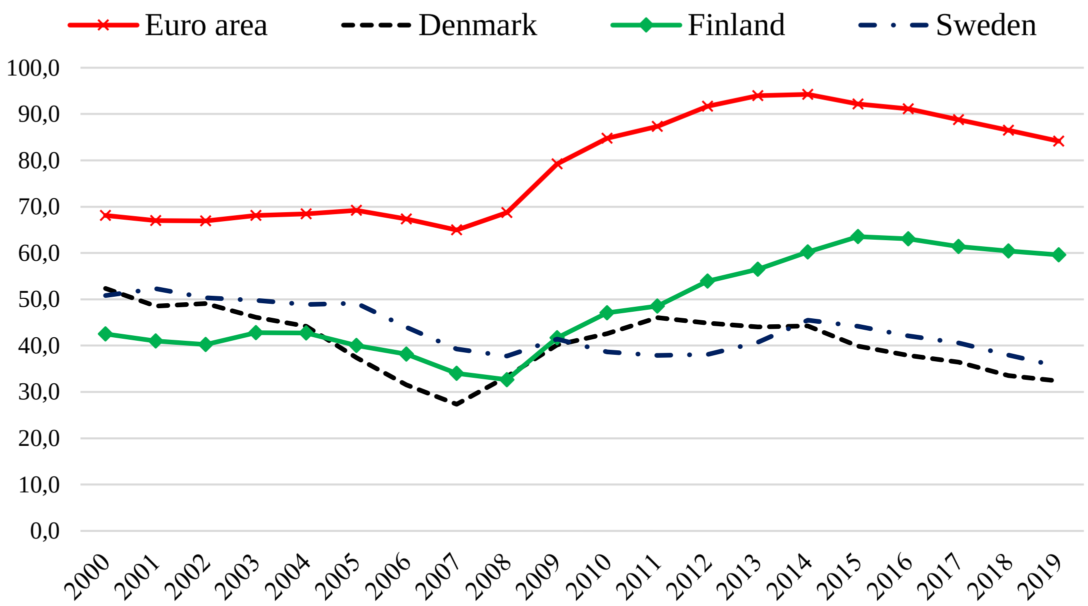

Figure 1. General government consolidated gross debt in Denmark, Finland, Sweden and the euro area in 2000 – 2019 (% GDP)

Source: [1]

Table 3. Net lending (+) or net borrowing (-) in Denmark, Finland, Sweden and the euro area in 2000 – 2019 (% GDP)

Country	Denmark	Finland	Sweden	Euro area
2000	1,9	6,9	3,2	-0,5
2001	1,1	5,0	1,4	-2,0
2002	0,0	4,1	-1,5	-2,7
2003	-0,1	2,4	-1,3	-3,2
2004	2,1	2,2	0,4	-3,0
2005	5,0	2,6	1,8	-2,6
2006	5,0	3,9	2,2	-1,5
2007	5,0	5,1	3,4	-0,7
2008	3,2	4,2	1,9	-2,2
2009	-2,8	-2,5	-0,7	-6,3
2010	-2,7	-2,6	0,0	-6,2
2011	-2,1	-1,0	-0,2	-4,2
2012	-3,5	-2,2	-1,0	-3,7
2013	-1,2	-2,6	-1,4	-3,0
2014	1,1	-3,2	-1,6	-2,5
2015	-1,5	-2,8	0,2	-2,0
2016	-0,4	-1,8	1,2	-1,5
2017	1,0	-0,6	1,3	-0,9
2018	-0,1	-0,7	0,8	-0,7
2019	0,0	-0,2	0,9	-0,6

Source: [1]

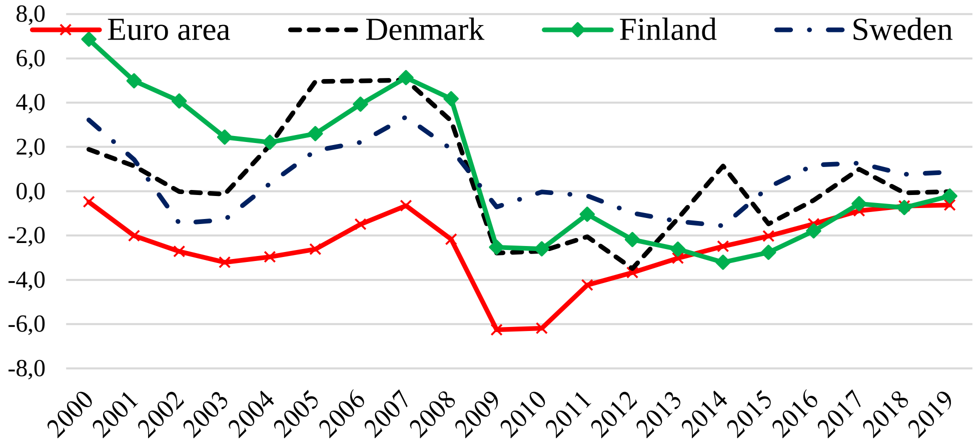

Figure 2. Net lending (+) or net borrowing (-) in Denmark, Finland, Sweden and the euro area in 2000 – 2019 (% GDP)

Source: [1]

CONCLUSION

Each economic recession causes GDP losses and upsets the economic balance. However, most of them do not leave problems with long-term consequences, but several recessions have passed into history as economic shocks that have severely constrained countries' development as a result of the collapse of the sectors that underpin their economic specialisation and exports. The recent crisis of 2008-2009 was such a shock, and Finland is an example of the country that has suffered heavy losses caused by the collapse of the electronics industry and exports. Finland's development potential was additionally constrained by the destabilisation of public finances. The adoption of the euro was not conducive to Finland's effective counter-cyclical policies and adjustments through a nominal exchange rate mechanism that enables export competitiveness improvement.

Sweden and Denmark, with monetary and fiscal policy instruments, budget surpluses, low public debts and autonomy in their implementation, have simultaneously achieved two objectives: stabilising GDP growth as well as sustaining budget balance and low public debt.

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