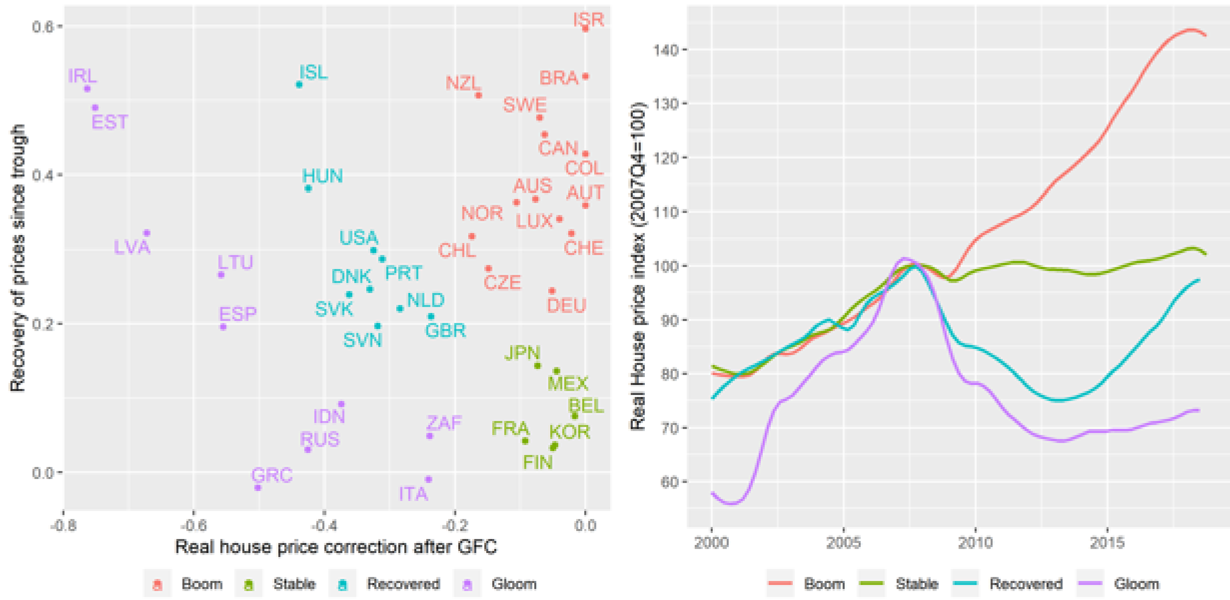
Are there ways to protect economies against potential future housing busts?

by Boris Cournède, Maria Chiara Cavalleri, Volker Ziemann, OECD

Housing, a large and volatile sector, is often at the centre of economic crises, as a trigger or amplifier. The current situation, which is characterised by house prices approaching or exceeding pre-crisis levels in many countries, raises questions as to whether these price levels may be indicative of a possible impending correction and what can be done to reduce housing-related macroeconomic risks.

Figure 1. House price developments since the global financial crisis



Note: The right panel depicts average price movements per country group using local regression techniques. "Boom" and "Stable" countries encountered a limited prices correction (<20%) during the global financial crisis. The former witnessed sharp increases thereafter (>20%) and the latter did not. "Recovered" and "Gloom" countries experienced a major real house price correction during the crisis (>20%). The former benefited from an equally strong rebound while the latter did not.
Source: Cavalleri, M. C., B. Cournède and V. Ziemann (2019), "Housing Markets and Macroeconomic Risks", *OECD Economics Department Working Papers*, No. 1555, OECD Publishing, Paris.

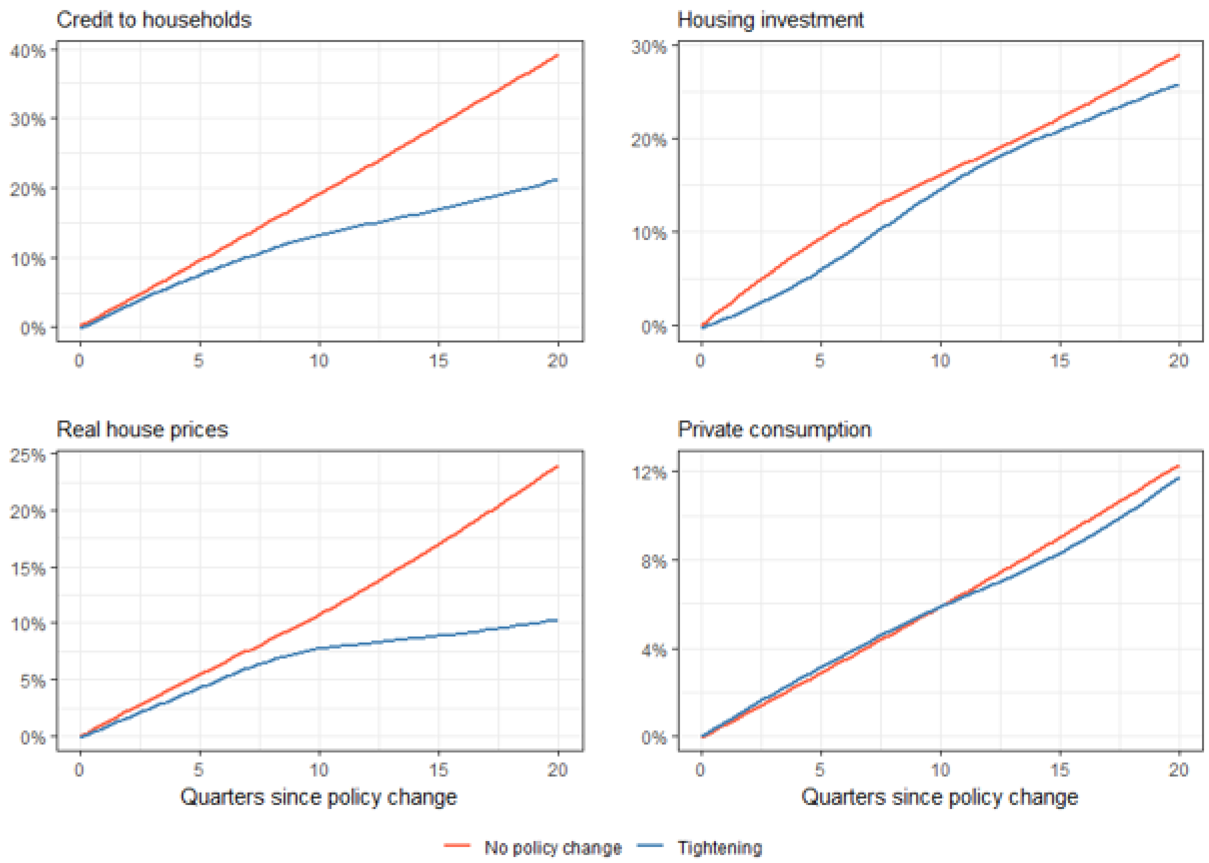
The OECD has been developing models that allow assessing to which extent economic trends associated with housing booms, such as steep house price increases or strong debt expansion, can fuel the risk of a severe economic downturn (Turner, Chalaux and Morgavi, 2018). About half of the countries covered by the models are estimated to face real yet limited risks (above 20% but below 30%) of experiencing a severe downturn over the medium term, with housing trends playing a significant role." Model results suggest that housing booms can fuel crisis risk domestically but also across borders as a consequence of international financial links (Cavalleri, Cournède and Ziemann, 2019).

Countries can reduce housing-related risks in particular by:

- Capping the size of loans relative to house prices. New evidence suggests that such caps are capable of containing house prices and mortgage lending incurring limited economic cost (Figure 2): housing investment is only marginally reduced and there is very little effect on consumption. Tighter loan-to-value ratios are also linked with a lower risk of severe downturns.

- Limiting the size of loans relative to income. This measure holds promising potential but has been seldom used so far, which means there is little scope yet to evaluate it ex post.
- Tightening bank capital requirements for riskier housing loans. Measures of this nature are linked to more moderate output fluctuations and stronger recoveries after downturns.
- Reducing the tax advantages given to housing assets. Higher effective taxation of housing assets (which can come from higher property taxes or lower income tax breaks for housing) favours smoother housing cycles.

Figure 2. Effect of tightening LTV caps



Note: The treatment group consists of episodes where countries tightened their LTV caps at time=0. The control group comprises episodes where countries did not implement such a policy change although their conditions were otherwise similar. This treatment group has been determined by propensity matching techniques using a probit model with real and financial variables as covariates. The lines show averages for each group.
Source: Cournède, B., S. Sakha and V. Ziemann (2019), "Housing Markets and Economic Resilience," *OECD Economics Department Working Papers*, forthcoming, OECD Publishing, Paris.

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Sweden's schools: lessons from history to build a better future

by Jon Pareliussen, Sweden Desk, OECD Economics Department

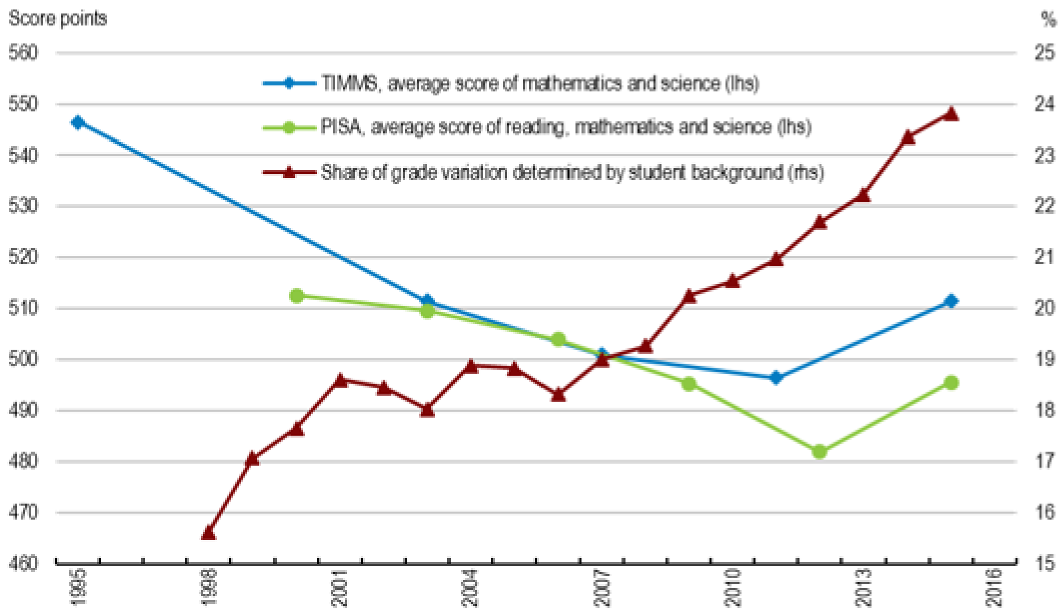
Swedish schools entered the 1990s from a position of strength, as one of the top performers in early international school surveys, including the OECD Programme for International Student Assessment (PISA). School governance was centralised, and implemented locally by regional education boards. A suite of sweeping reforms in the early 1990s decentralised the school system from the central to the municipal level and introduced choice, competition and management by objectives. The general direction of reform was common to several OECD countries at the time, some of which perform well in international comparison.

However, the reforms seem to have contributed to weakening results in Sweden. Implementation was not optimal, as some municipalities were ill-prepared to take on the new tasks, and key stakeholders, notably among teachers and school principals, were opposing the new model. The reform design also had weaknesses. Regional education boards

were closed and municipalities were granted full autonomy over school funding, weakening governance structures considerably, at a time
when the introduction of liberal entry for private (for-profit and non-profit)
school providers would have called for stronger governance and control.

The latest vintage of PISA points to a brighter future for Sweden’s schools. Average results improved, reflecting at least partly recent government interventions. However, today is no time for complacency, as Sweden’s educational performance only climbed back to close to the OECD average. Inequalities across pupils and schools are widening, and children are increasingly segregated into schools with pupils from similar backgrounds. These developments are partially driven by broader societal trends, notably increasing income inequality and immigration. Nevertheless, the school system reinforces segregation instead of counteracting it, running the risk of depriving pupils of equal opportunities.

School results and equity have declined



Source: OECD Economic Survey of Sweden (2019).

Against this backdrop, the special chapter of the [OECD Economic Survey of Sweden 2019] describes and analyses the challenges facing primary and lower secondary education in Sweden. A set of recommendations is outlined, focussing on three main areas:

- Economies of scale and the need for coordination calls for a partial recentralisation of some aspects of education policy. A centrally set minimum funding norm based on pupils' socio-economic caracteritics would target funding better to needs and equity objectives. The norm should be non-binding and integrated in the existing system for cost- and income equalisation between municipalities, in line with established governance principles in Sweden. A regional arm of the central government governance structure should be re-built to enhance cooperation, improve skill development, promote continuous quality improvements, and instil accountability at every level of the school organisation.

- Competition and school choice can be powerful tools to improve school quality, but private interests in many cases differ from the interests of society as a whole. Effective regulation and governance therefore need to steer private providers to deliver for the public good. Ensuring that grades fairly represent pupils' skills and knowledge would reduce information asymmetries. Private schools' admission procedures need regulation to hold back school segregation. Municipalities should adjust how they assign pupils to schools by promoting more socially mixed pupil groups while toning down the current strong focus on proximity. Investments in new school capacity can help counteract segregation, notably if coordination between municipalities and private providers improves.
- High-quality teachers are a school's most important asset, and Sweden faces teacher shortages. Teaching needs to become more attractive to recruit motivated and skilled students and retain high quality teachers in the profession. Better teacher education with a stronger research base and more teaching practice would help. Once in a job, teachers should face clearer career paths, incentives to

progress, perform and take on challenging tasks as well as clear accountability for key outcomes, coupled with more cooperation, feedback and support between colleagues. A new regional arm of the central government governance structure should have a central role.

Sweden is now moving towards a new round of school reforms, largely along these lines. A clear lesson from the previous three decades of Swedish education history is that reforming complex systems, warranted or not, can also be a risky undertaking. The end result depends on reform design, implementation and intricate interactions within the system undergoing reform as well as with the external environment.

The need to adjust to unintended consequences as complex reforms progress is inevitable, but accurately identifying strengths, weaknesses and causality is challenging in hindsight, and even more in real time. Not knowing exactly where you are and how you got there reduces the likelihood of ending up where you want to be. Therefore, decision makers should integrate experimentation, quantitative research and evaluations into reform design in the next round of Swedish school reforms.

Ref**erences:**

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A balancing act: Why inequality increased in the Nordics

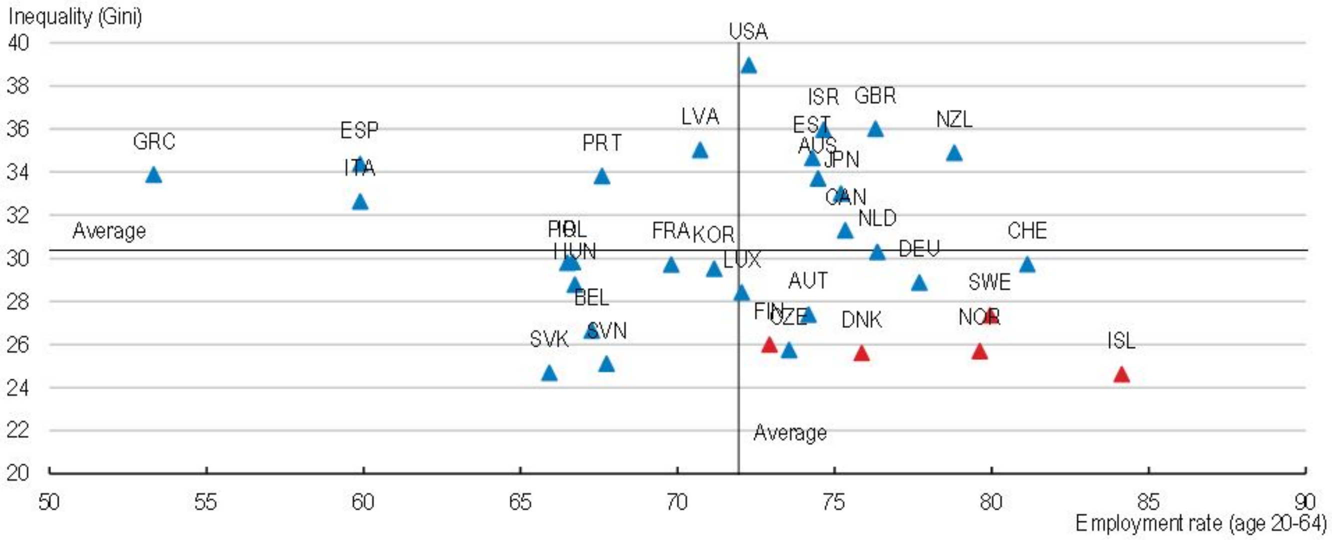
Mr. Jon Pareliussen, Economist, Sweden/Finland desk, Economics Department

The Nordics are rightly renowned for being inclusive societies with low inequality compared to other OECD countries. However, some of the largest inequality increases over the past few decades took place in Sweden, Finland and Denmark. A newly released article building on previous OECD work discusses how market forces, demographic trends and redistribution together shaped the income distribution of the Nordics.

It may seem like a paradox that the Nordics, which are very open economies, heavily integrated in global value chains and front-runners in the use of new technologies, have not seen even more widening distributions of market incomes. However, the extent to which skill-biased technological change and other forces widening the earnings distribution of workers will actually drive up inequality depends on a number of factors, and key policies and institutions in the Nordics play a dampening role. First, institutions such as unions and collective bargaining, employment protection legislation and minimum wages dampen the direct effect of market trends on earnings. Second, higher demand for skills are met by publicly-funded higher education, increasing the supply of skilled workers and thus holding back skills premiums. Third, a widening earnings distribution among workers coincided with increasing employment, limiting the overall effect on inequality.

Low income inequality in the Nordics is only sustainable if employment is high

Gini index for household disposable income and employment rates, 2014 or latest available year



Note: All OECD countries included except Chile, Mexico and Turkey. Data refer to 2012 for Japan; 2015 for Finland, Israel, Korea, the Netherlands, the United Kingdom and the United States; and 2014 for the rest.
Source: OECD Income Distribution Database; OECD Labour Force Statistics.

With a relatively modest overall impact from market forces, explanations for increasing inequality must be sought elsewhere:

- Demographic trends have been relatively strong drivers of inequality in the Nordics. Household structure, with more single-headed households has widened income dispersion in Denmark, Finland, Norway and Sweden. Ageing has increased inequality significantly in Finland, and immigration has increased inequality in Norway, Denmark and Sweden.
- Redistribution through taxes and transfers has weakened significantly in Denmark, Finland and Sweden, notably due to less insurance transfers (i.e. unemployment,

sickness, disability insurance) and only partially offset by more assistance (i.e. means-tested) transfers. Income taxes have played a less important and more heroegneous role, as progressivity increased in Sweden while it decreased in Denmark and Iceland.

Technological and demographic pressures are set to continue going forward, and these challenges need to be embraced. Continued flexibility and constructiveness of the social dialogue and improvements to education are essential to seize opportunities from technological change and avoid a widening wage distribution. Making social insurance and welfare transfers more flexible and agile would improve workers' protection in a rapidly changing world of work. Improving benefit system design so that work always pays, notably in Denmark and Finland, and linking benefits to real-time income registries are important steps to this end.

The Nordics demonstrate that equity and efficiency can be compatible if incentives are right. Low inequality and strong safety nets can even be an advantage in today's globalised world, which requires constant adaptation. Reaping the full benefits from globalisation and technological progress requires broad support, which is easier to muster when the social dialogue is constructive and representative, when everyone is given opportunities to fulfil their potential, risks are shared and losers compensated.

References:

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Structural Inequality – The Case of Sweden

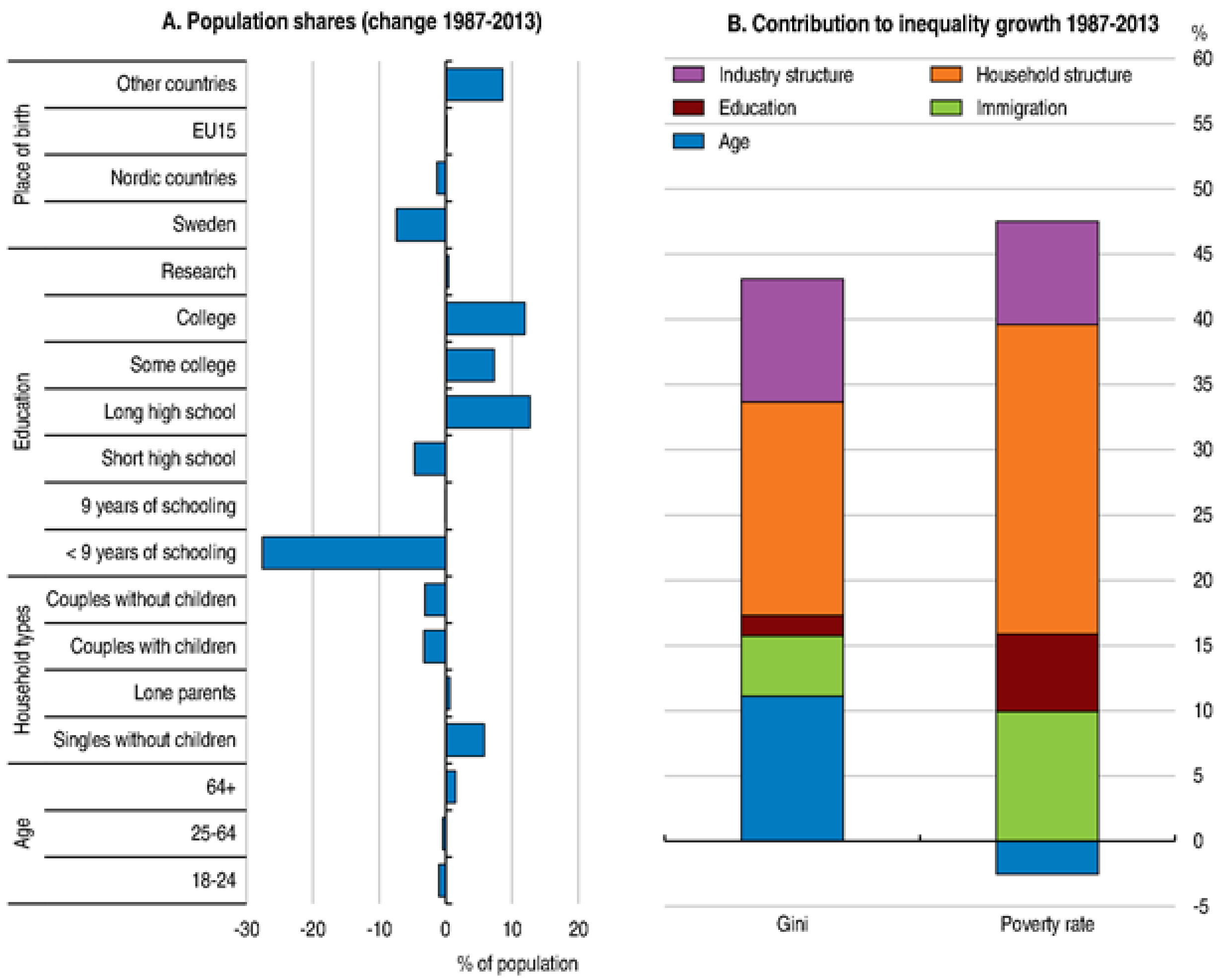
by Jon Pareliussen, Sweden Desk, OECD Economics Department

Income equality is perceived by many as steadily embedded in Swedish society, as solid as a Volvo's tyres firmly clinging to a narrow country road on a Småland's bright midsummer night. However, the Gini coefficient has increased more in Sweden than in any other OECD country since the 1990s. But who is responsible when you suddenly find your Volvo wheeling off course? You, holding the wheel, or the rough northern weather?

Even though consecutive governments over the past few decades must take some of the responsibility for increasing inequality, we show in a newly released paper that they also faced rough conditions (Robling and Pareliussen, 2017). Since the late 1980s the population has been ageing; traditional family structures have weakened, leading to more single and single parent households; people spend more time in school and reach higher educational attainment than they used to; employment has shifted away from manufacturing, mainly towards high-skilled services; and Sweden receives more migrants than before, migrants who increasingly come from poorer countries and seek residence for humanitarian and family reunion reasons.

By re-weighting micro-data from Statistics Sweden, we find that these demographic and structural trends are behind more than 40% of the increase in the Gini coefficient of disposable income from 1987 to 2013, and about half of the increase in the relative poverty rate, defined as individuals living on less than 60% of the median disposable income (Figure 1). We show that understanding these underlying trends, common to many countries, is vital to fully grasp why inequality is on the rise. To date, however, with skill-biased structural change as a notable exception, such trends tend to be overlooked in the income inequality debate.

Figure 1. Structural change increased disposable income inequalities



Source: Robling and Pareliussen, 2017.

So when you find yourself in the middle of a meadow, fighting the airbag off your face while curious cows consider your slightly bruised Volvo, is it fair to place the full blame on the sudden thunderstorm or the icy road? Of course not. The driver should adapt to weather conditions, and neither police nor insurance would accept anything else for all the butter in Småland. Likewise, structural trends that are largely outside political control, driving up inequality, make redistribution and labour market policies all the more important as countermeasures. Compared to most countries Sweden is still safely on the road, but caution calls for tapping the brakes.

References:

Robling, P. and J. Pareliussen (2017), "Structural inequality – The case of Sweden", *OECD Economics Department Working Papers*, forthcoming, OECD Publishing.

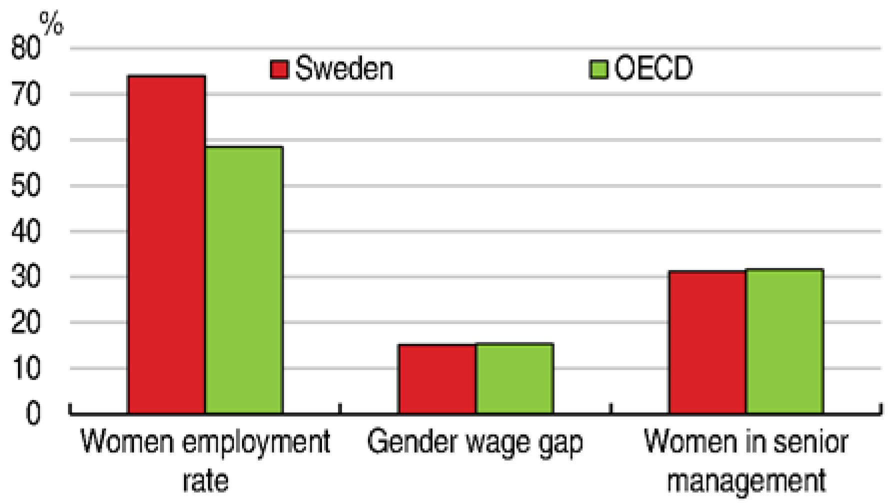
Sweden is a champion of gender equality, but parity is not reached yet

by Christophe André, Swedish Desk, Country Studies Branch, OECD Economics Department

As shown in the Economic Survey, Sweden ranks among the OECD's frontrunners in terms of gender equality. Women have a high employment rate, outperform men in education and are well represented in government and parliament. These achievements were made possible by policies which for decades have been promoting equality, notably through childcare and parental leave arrangements, individual taxation and mainstreaming gender issues.

Nevertheless, without further policy measures, achieving parity is still a distant prospect in several areas. Wage differences between genders persist, even though a large part of the gap results from differences in age, education, occupation, sector of employment and hours worked. Women are under-represented on private company boards, in senior management positions, in many well-paid and influential professions and among entrepreneurs.

Gender wage gaps and the glass ceiling remain



Source: OECD Employment database and ILO KILM database.

Hence, there is scope for further progress on gender equality. Paid parental leave has facilitated the rise in women's employment rate, which is now close to that of men. However, 75% of the leave is still taken by women, which has a detrimental impact on their careers. Last year's extension of the share of the parental leave reserved for each parent to three months is a move in the right direction, as it sends a signal which will contribute to shift social norms. Nevertheless, it would be desirable to move further in that direction to reduce the stigma associated with long leaves, even though there is a trade-off with the benefits of free choice.

The women's share of board members of listed companies is still below one third. The recent government proposal to impose quotas, as Norway did more than a decade ago, has not received the necessary support from other parties. Notwithstanding, firms should continue to increase their share of female board members, and perhaps even more importantly, to increase the representation of women in senior management, which research shows to generally enhance economic performance. Gender inequalities can also be reduced through the fight against stereotypes in education and further promotion of women's entrepreneurship.

Last but not least, special attention should also be paid to the integration of foreign-born women, whose employment rate is much lower than for their male counterparts. Helping foreign-born women to strengthen their contribution to the economy and society has to be a key ingredient of a more inclusive Sweden.

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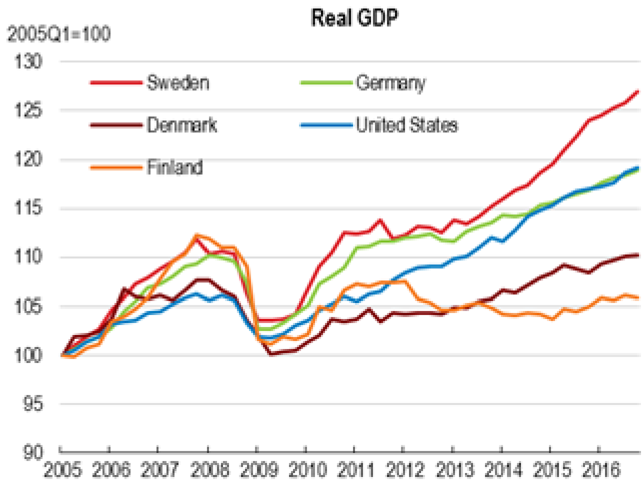
The Swedish economic boom: can it last?

By Christophe Andre, Swedish Desk, Country Studies Branch, OECD Economics Department

The Swedish economy has been growing at over 3% over the past two years. Output is now more than 25% above its 2005 level, which dwarfs the achievements of the major advanced economies, including Germany and the United States, and its Nordic neighbours alike (see figure). As shown in the Economic

[Survey](), Sweden's out-performance is not just about GDP. The employment rate is the highest in the European Union, productivity is picking up, income inequality remains low and well-being indicators compare favourably.



Note: For Denmark, Germany and Sweden, OECD projections for 2016 Q4.
Source: OECD Economic Outlook database.

This begs the question of how a small open economy depending heavily on foreign trade is able to prosper in today's sluggish global environment. Even though economic growth is always the result of a complex alchemy, we can point to two sets of explanations. First, the structural reforms which followed the crisis of the early 1990s have allowed a competitive and diversified business sector to flourish, while preserving the social safety net required to foster inclusive growth. Second, macroeconomic policies have been prudent and counter-cyclical. Prudent fiscal policy in the run-up to the global financial crisis created space allowing temporary deficits to dampen the impact of the subsequent recession, without putting the long-term sustainability of public finances at risk. Excessive optimism may have led to untimely monetary policy tightening in 2010-11, resulting in an extended period of low inflation. Nevertheless, the Riksbank reacted by reverting to an expansionary stance, bolstering the economy and pushing back inflation towards the 2% target.

How long will the current expansion last? Many clouds on the horizon, including geo-political tensions, financial instability and rising protectionism, hold the potential to harm Sweden, but on these the national authorities have little influence. The main domestic challenges will be to cool the housing market and to successfully integrate immigrants into the labour market and society. Macro-prudential and tax measures can dampen the rise in household debt. However, the structural causes of housing shortages need to be addressed to stabilise the housing market and provide adequate housing for all in locations where they see opportunities. Immigrants can make a significant long-term contribution to the economy provided integration and skills are enhanced. In sum, sticking to prudent macroeconomic policies, tackling housing market imbalances and investing in immigrants would pave the way for more years of inclusive growth in Sweden.

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Conquering utopia anew – Income inequality in Sweden

by Jon Pareliussen, Swedish Desk, Country Studies Branch, OECD Economics Department

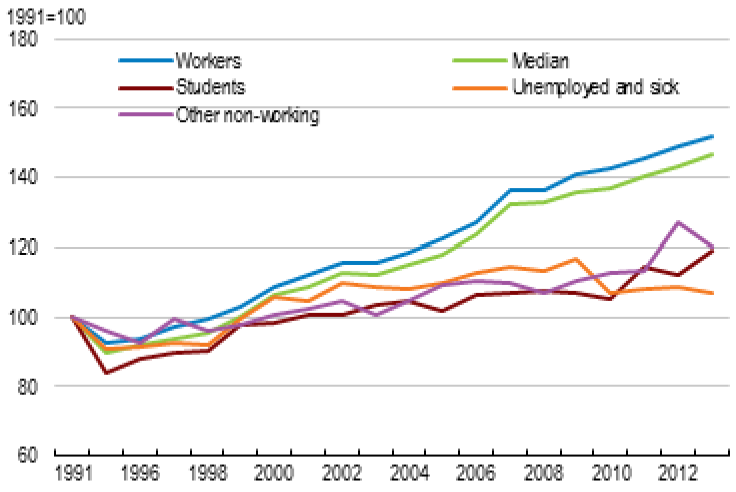
"Equality is a utopia (…) that must be constantly redefined and constantly conquered anew."

-Olof Palme, 30 July 1965.

Equality, a long-standing hallmark of Swedish society, carries multiple benefits in terms of economic performance, trust, opportunity and well-being. Income inequality is relatively low in Sweden compared to the OECD average, but a rapid rise from the 1990s calls for new efforts to redefine and re-conquer equality once again. Chapter one in the new [Economic Survey] is dedicated to understanding and addressing the rise of inequality in Sweden (OECD, 2017).

Top incomes grew strongly from the 1990s, mainly as a result of increasing capital gains and dividends, but the collection of wealth statistics was discontinued from 2007, which makes analysing the underlying causes challenging. In the bottom end of the income distribution, working-age benefits were cut or frozen following the economic crisis of the early 1990s. Decades of slow uprating led to a gradual decline of benefits relative to earnings. Analysing the distributional consequences of different uprating scenarios annually would highlight the consequences of inaction, but leave actual increases at the heart of political debate and decision-making, where it firmly belongs.

Figure 1 Stagnating working-age benefits increased inequality[1]



1. Median equivalised disposable income within each group.

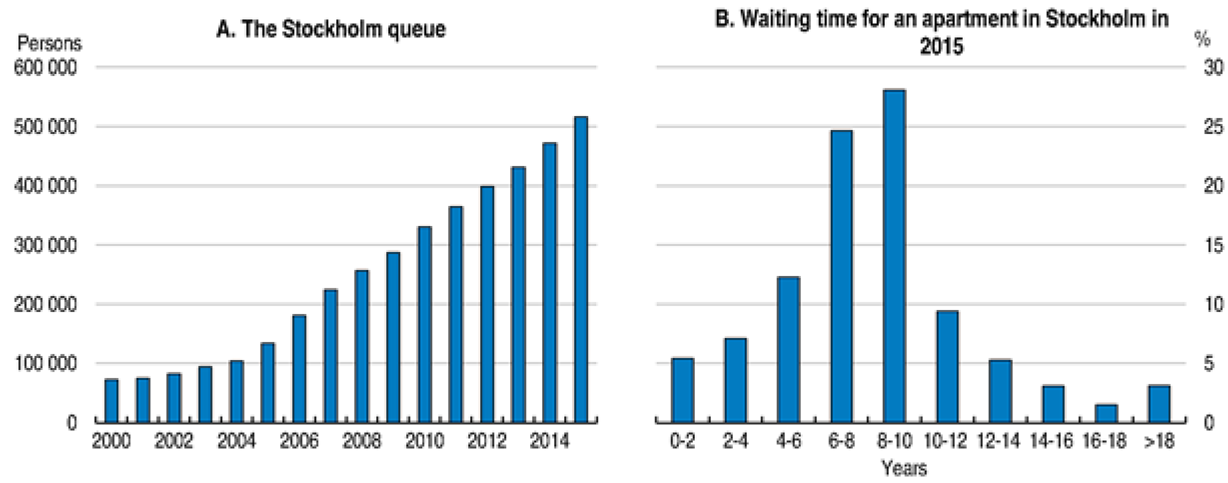
Source: OECD Economic Surveys: Sweden 2017.

Significant demographic and structural changes, with ageing, more single and single parent households, higher educational attainment, a shift away from manufacturing, and higher, mostly non-labour, immigration, are behind more than 40% of the increase in the Gini coefficient from 1987 to 2013 (Robling and Pareliussen, 2017). These trends increase the importance of redistribution and labour market policies as countermeasures.

One such trend is the increasing number of humanitarian and family reunion migrants, who have lower incomes than natives and less adequate housing. Furthermore, residential segregation leads to school segregation. With low skills compared to natives, partly as a result of lower education attainment, partly due to difficulties with language and culture, many struggle finding employment (OECD, 2015; Bussi and Pareliussen, 2015). Relatively well-developed integration policies can be further harnessed by learning from successful experiences at the local level, continuing to individually adapt upskilling activities, shortening the time it takes to get residence and work permits, simplifying and consolidating wage subsidy schemes.

Finally, housing market inefficiencies hit the least well-off. The difference in housing conditions between the rich and the poor is high in Sweden. Tightening the generous tax treatment of owner-occupied housing would increase affordability. Easing strict rental regulations while maintaining tenant protection against abuse would increase mobility for those who cannot afford to buy, incentivise rental housing supply and lead to better utilisation of the housing stock. Some prioritisation to municipal housing with well-designed allocation rules could help low-income households and limit residential segregation.

Figure 2. Rental regulations are ripe for reform



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