Summary

The main task of the Fiscal Policy Council is to review and evaluate the extent to which fiscal policy objectives are being achieved. Its remit includes scrutinising fiscal policy to see whether it is compatible with long-term sustainable public finances. Its remit also includes analysing the effects of fiscal policy on the distribution of welfare in the short and the long run. In this year's report, the Council for the first time presents a more detailed review of the distributional aspects of economic policy. The principal conclusions of this year's report are the following:

1. The Council notes that the Swedish economy so far has fared comparatively well in the economic crisis that spread around the world starting in 2008. Employment has increased. Government debt measured as a percentage of GDP has remained relatively stable. However, the Council does see problems in the immediate future with inadequate growth, high unemployment and continuing international economic and financial instability.

2. The Council considers Swedish fiscal policy to have been successful from an international perspective. The Council notes that the deep and protracted international crisis poses a difficult trade-off for fiscal policy and puts the fiscal framework to the test.

3. The Council notes that the indicators reported by the Government suggest that the surplus target will not be met. The Council's evaluation, like those of the National Institute of Economic Research and the Swedish National Financial Management Authority, shows that correcting the deviation from the surplus target presents a considerable challenge for fiscal policy. To maintain credibility in the fiscal framework, the Government should present a clear plan for meeting the surplus target during the relevant business cycle.

4. It is the Council's view that fiscal policy is compatible with long-term sustainable public finances and that the expenditure ceilings are not threatened. The Council welcomes the Retirement Age Inquiry's proposal on raising the retirement age and is of the

opinion that this should help strengthen long-term sustainability in the public finances.

5. The Council concludes that the fiscal policy in the Budget Bill for 2013 and the 2013 Spring Fiscal Policy Bill does not provide any further stimulus to total demand. From a purely stabilisation policy perspective, a more expansive policy would have been justified in 2013.

6. The Council endorses the Government's preparedness to take temporary measures in the event that an acute need for an economic stimulus emerges in 2013 and 2014. But the scope for a more expansive fiscal policy is limited. Further expansive measures in the current economic environment need to be supplemented with budget improvements when the economic upturn has begun in order not to jeopardise the surplus target.

7. The Council's overall assessment is that fiscal policy is generally well balanced. In the Council's opinion, however, the conflict between the short-term stabilisation policy perspective and a surplus target formulated over the business cycle should be given more attention in the Government's bills.

8. In the Council's opinion, Swedish housing prices are probably in the interval from being in line with fundamental factors to some overvaluation. The risk of a major and abrupt price correction is currently considered limited.

9. The Council notes that a better functioning housing market helps increase mobility in the labour market and contributes to higher economic growth. Making better use of the existing housing stock should be an important goal. In the Council's opinion, the Government should pursue an integrated approach to housing policy covering all factors crucial to the performance of the housing sector such as the legal rules concerning new construction, real estate and capital gains taxes, interest deductibility in private income taxation and the utility value system (bruksvärdesystemet – a form of rent control).

10. The Council notes that the 2013 Budget Bill was based on a macro forecast for 2013 that deviated sharply from other institutions' forecasts. In the Council's opinion, significant

deviations from other forecasters should be reported and justified in detail in the budget bills.

11. The Council notes that potential GDP plays a key role in assessing the cyclical situation and the fiscal stance in relation to the surplus target. There is no generally accepted method of estimating potential GDP and revisions are often made ex post, making evaluations more difficult.

12. The Council welcomes the improved reporting of the revision of potential GDP in the 2013 Spring Fiscal Policy Bill, compared with the 2013 Budget Bill. The Government should also report and comment on significant deviations from other forecasters such as the National Institute of Economic Research, the Riksbank, the European Commission, the OECD and the IMF.

13. As the Council has previously stressed, the methods for estimating structural net lending in the public sector should be reviewed. A disaggregated approach is more relevant, particularly in the event of large shocks to the economy. The aggregated method used by the Government has obvious weaknesses. Simple estimates based on NIER's disaggregated method indicate that the difference in individual years may exceed 1 per cent of GDP – a difference that may be of considerable significance when assessing fiscal policy.

14. The Council recommends that the description of the expenditures subject to the ceiling be supplemented with an assessment of expenditure risks. The budget bills for the most part completely lack assessments of this kind. The Government should also report the forecasting methods for the rules-based transfer expenditures, preferably in a special appendix, and more clearly describe changes in appropriations in terms of volume and average cost where relevant.

15. The Council notes that in the 2013 Budget Bill, the reduction of the corporate income tax is the single most costly measure in nominal terms. The Council does not have any decisive objections to this measure. The Government chose not to wait for the Corporate Tax Committee, but the reduction should be seen against the backdrop of declining corporate tax rates in many countries. Therefore, it would have been difficult for

Sweden to postpone a tax cut. Along with the corporate tax cut, the rules limiting corporate interest deductibility were tightened. The estimates of the revenue due to this tightening must be considered very uncertain.

16. The Council notes that the current best estimates of the economic consequences of climate change for Sweden at this point in time do not call for any changes in the fiscal framework. As in the case of the storm Gudrun, costs may occur that are quite considerable for private and municipal actors, but they are not so high that they risk threatening public sector financial stability or the sustainability of public finances in the long run.

17. The Council has reviewed the FASIT model used by the Government to analyse income distribution policy, including the effects of the earned income tax credit on the distribution of income. The Council notes that the model is based on sound scholarly research, but that the results need to be interpreted with considerably more caution than the Government has shown when evaluating its policy. The Council supports further development of the model.

18. The Council has conducted a number of simulations to study the income distribution effects of the indexing technique in the budget process, i.e. the fact that a number of allowances do not automatically keep up with income growth over time. These simulations show that this indexing technique has not led to an increase in income dispersion, judging by the Gini coefficients for different scenarios.

19. The simulation results show that the earned income tax credit has a substantial effect on employment at the margin. But we do not find any support for the Government's claim that the earned income tax credit has reduced the spread in disposable income among households.

20. Data available from Statistics Sweden show that the spread in disposable income has increased since the 1990s crisis but that this increase mainly took place in the 1990s. The spread in disposable income measured by the Gini coefficient has largely been constant since 2006.

21. The Council asks for current and reliable statistics on wealth in the private sector. Data of this kind would be a valuable source for both macroeconomic risk assessments and income distribution analysis. The Council recommends that the Government examine the possibilities of producing such data in a cost-effective way.