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. The principal conclusions in this year's report are the following:

1. The Swedish economy has thus far coped well with the global crisis that began in 2008. The fiscal policy generally appears to be successful and, on the whole, well balanced considering the shocks that have affected the Swedish economy. A comparison with other countries’ economic policy experiences and developments since the crisis began supports this conclusion.

2. In the Council’s opinion, the fiscal policy pursued in 2011 and 2012 has complied with the current fiscal framework. We think that there is little risk of expenditures exceeding the expenditure ceiling in the next few years. We take the view that the fiscal policy is compatible with long-term sustainable public finances.

3. The Council recommends that the Government provide a better explanation of how the scope for new policy initiatives arises and how it is divided between taxes and expenditures over the next few years. Decisions on the expenditure ceiling are of major importance not only for the expenditure level, but also for the level of taxes collected in the future. A clearer account of the connections between the expenditure ceiling, the surplus target and the taxes collected would be an important contribution to improved fiscal transparency.

4. The Council notes that the tax cuts announced in spring 2011 were not proposed in the 2012 Budget Bill. We think that the position taken by the Government lacked and still lacks a stabilisation policy basis. Rather, the worsened economic situation argued in favour of a more expansive fiscal policy.

5. The Government has referred to the economic crisis and the macroeconomic uncertainty as an argument for larger safety margins in fiscal policy. This argument has caused some confusion about whether the Government thinks that the fiscal framework is adequate. Regular use of safety margins risks
creating an undesirable procyclical element in fiscal policy and causing average government net lending to exceed the surplus target.

6. The global crisis shows the danger of underestimating the macro-financial risks associated with rapidly expanding credit, large public debt ratios and rising property prices. In the Council’s opinion, these risks to the Swedish economy should not be underestimated. We recommend that the Government soon decide how macroprudential regulation and supervision should be strengthened to reduce the risk of future financial crises.

7. It is important for Sweden that confidence in the sustainability of the public finances in the euro area be restored. The Council therefore welcomes Sweden’s participation in the EU financial compact. There is, however, no reason to change the Swedish fiscal framework in the direction of the rules in the financial compact. The framework we have has a sounder foundation and is better suited to Swedish conditions.

8. The Council has given the National Institute of Economic Research the task of making estimates of the public finances in a scenario in which Sweden would experience a deep economic crisis on the same scale as the 1990s crisis. The calculations show that a drop in domestic demand would have larger repercussions on the public finances than would a drop in export demand. The Council’s estimates indicate that Swedish public finances would not be seriously affected by a temporary decline in exports. But a serious escalation of the European crisis could have extensive adverse consequences for Sweden’s economy.

9. It is the Council’s opinion that the Government should develop better methods of calculating structural net lending. The method currently used gives misleading results. The method should be disaggregated and be based on a measure of the output gap that is on average zero.

10. The surplus target results in the stabilisation of general government net financial wealth as a percentage of GDP. The level at which it stabilises depends on valuation changes outside
the fiscal framework. Net wealth will likely continue to increase from the current level of about 20 per cent of GDP.

11. In the Council’s opinion, the Government should clarify its view of what an appropriate size of government net wealth is. The Council’s view is that a further build-up of net wealth exceeding the current 20 per cent of GDP is difficult to justify with the need for safety margins for a future economic downturn.

12. The public finance portfolio contains both large debts and substantial assets. The Government should more clearly define what an appropriate gross debt is and what overall principles should apply in the trade-off between the portfolio’s risk and its expected return.

13. In a special appendix to this year’s Spring Fiscal Policy Bill, the Government discusses public investments in real capital and developments in general government real capital stock. This is a significant first step towards better analysis of public investment. The Council shares the Government’s view that a quantitative target for public investment should not be introduced. But we do not share its opinion that it has been established that the volume and composition of government real capital investments are advantageous from an economic perspective.

14. The Council has given a research institute at the University of Freiburg the task of conducting an intergenerational accounts analysis for Sweden. Their results indicate that Sweden’s public finances are sustainable in the long run. A strong contributing factor is the design of the pension system. As the Council has pointed out in earlier reports, intergenerational accounts represent a valuable tool for analysing the sustainability of public finances over the very long term. The method is also able to show how taxes and public expenditure affect the intergenerational distribution using a life cycle approach.

15. How well the labour market functions is particularly important for the public finances. The Government has a more positive view of labour market developments than the National Institute of Economic Research. The Council does not take a position on which labour market forecast is more credible. If the Government’s forecast proves to be too optimistic, fiscal policy
must take this into account to avoid compromising the surplus target.

16. The Council notes that youth unemployment rose sharply during the recent crisis and is now at a high level. But the description of youth unemployment should be nuanced. Young people generally find a job much more quickly than older workers. They thus on average have shorter unemployment spells than older workers. Young people’s chances of finding a job are also more cyclical than older workers’. Young people often combine work and studies. Regarding young people as a homogeneous group may lead to ineffective labour market measures. It is important to target initiatives at those groups that have difficulty finding employment. We would like to point out that the unemployment period for older workers has risen in recent years.

17. The Council describes a method for measuring mismatch in the labour market. The method makes it possible to quantify how much more efficiently the labour market would function with a better matching process, for example, by more geographic mobility.

18. The Government’s most costly measure in the 2012 Budget Bill is the reduction of the VAT on restaurant and catering services. It is the Council’s opinion that the estimated effects of the reform on unemployment and employment are exaggerated. We also think that the reduced tax rate is an inefficient way of reducing the administrative costs. The lower VAT on restaurant and catering services is rather more like sectoral support.

19. A common problem with differentiated VAT rates is that they risk increasing the incentives for interest groups to lobby for sectoral support. If more sectors were to benefit from reduced VAT rates, there is a risk of undermining the consumption tax as a tax base. The Government should instead consider introducing a uniform VAT. This would most likely have large positive economic effects.