

Summary

The main task of the Fiscal Policy Council is to review and evaluate the extent to which fiscal and economic policy objectives are being achieved. The principal conclusions in this year's report are the following:

The economic situation and stabilisation policy

1. According to most analysts, capacity utilisation will reach equilibrium as early as 2016. Even the Government's slightly more pessimistic assessment indicates that the economy will come close to equilibrium next year. The prospects for a good economic development in Sweden are better than for several years, despite that there are still significant risks of a weaker international economy.
2. Fiscal policy should now focus on correcting the significant deficit which arose during the years of economic downturn. It is always tempting to refrain from necessary budgetary consolidation measures during a recovery phase. However, for an active stabilisation policy to be compatible with sustainable public finances, the deficit must be recovered when the economy rebounds.
3. The Government's plan for the period 2016–2018 involves an improvement in actual net lending by a total of 0.7 per cent of GDP and structural net lending by 0.3 per cent of GDP. With this, the budget will achieve equilibrium only in 2018. Such a weak improvement in net lending is not in line with the surplus target.
4. The Council is of the opinion that the fiscal framework requires fiscal policy to focus on achieving the target for net lending when the output gap is closed, unless there are compelling reasons to the contrary. In our opinion, such reasons exist for 2016 as the present major deficit means that it is not reasonable to plan for a 1 per cent surplus as early as 2016 even if the economy were to reach equilibrium by then.

5. A strengthening of structural net lending by approximately 0.5 percentage points per annum would be compatible with what is normally required in an economic recovery and hence be acceptable in terms of stabilisation policy. Such a development would result in net lending in line with the surplus target during the present mandate period.
6. A sustainable and responsible fiscal policy requires lasting budget weakening measures to be funded. The Council is of the opinion that the Government's commitment for all reforms to be funded according to the "krona for krona" principle is not sufficient to meet the requirements of the framework. To meet the surplus target, a commitment not to finance unexpected expenditure increases in fields such as health insurance with debt is also required.
7. The Government has proposed major increases in the expenditure ceilings. This is an expression of a political will on which we have no opinions. However, there is a risk that the disciplining role of the expenditure ceiling will be weakened unless there is a commitment to fund all lasting expenditure increases.
8. The Council is of the opinion that the weak improvement in planned net lending between 2016 and 2018, together with the absence of a commitment to fund unexpected expenditure increases, is a breach of the fiscal framework.

Long-term sustainability and retirement age

9. The Council is of the opinion that increasing retirement age by one month per year is necessary for future pensions to be at an acceptable level and for sustainable public finances. This is why stated age levels in pension systems, other social insurances and the Employment Protection Act (Lagen om anställningsskydd, LAS) should automatically be increased by one month per year.

Reappraisal of the surplus target

10. A system in which the level of the surplus target is appraised, infrequently but regularly, could help to give the target a certain degree of flexibility without harming its credibility. However, it

is important for any changes to the level of the target to be based on long-term considerations and political consensus.

11. We are of the opinion that there are good reasons for the surplus target not to include net lending within the pension system. The pension system is formulated to be financially sustainable. The system's net lending may be negative at times without this presenting a problem for the sustainability of the pension system. A surplus target for the entire public sector, however, means that variations in the pension system's net lending must be compensated by variations in central government's or local government's net lending. There is a risk of this creating unwanted effects for the stabilisation policy, and for the development of central government debt in the long term.
12. Until the last few years, the present surplus target has amounted to an implicit balance target for central government. We see no convincing arguments for departing from this implicit target for central government net lending. If the pension system were to be lifted out of the surplus target, in our opinion it would be reasonable for the net lending target for central and local government to be zero.

Employment and unemployment

13. The Council notes that Sweden has the highest rate of employment and the highest labour force participation in the EU in 2014. Unemployment is lower than average for the EU. However, it is considerably higher than in Germany, which has the lowest unemployment.
14. In the opinion of the Council, it will be very difficult to achieve the Government's target of the lowest unemployment in the EU by 2020. According to the EU Commission, structural unemployment in Sweden is 2.5 percentage points away from being the lowest within the EU. This is equivalent to approximately 130 000 jobs. For this target to be within reach, therefore, active measures will be required to significantly reduce structural unemployment. Measures which could lead to the

target being achieved will probably come into serious conflict with the Government's distributional policy ambitions.

15. The Council is of the opinion that some of the measures presented by the Government to date in respect of labour market policy and the education system may have positive effects on employment. However, these effects are most likely small compared with what is needed to achieve the unemployment target.
16. The Government has also announced measures – the revoked reduction in social security contributions for young people and the increased benefit levels in unemployment insurance – which can be expected to increase unemployment. Previous evaluations indicate that the increase in social security contributions may reduce employment among young people by 6 000–10 000. Conventional estimation methods indicate that the improvement in unemployment insurance will increase unemployment in the order of 27 000 people.
17. As before, the Council is of the opinion that the employment gains of the reduced social security contributions for young people are small in relation to the costs. The proposed phasing-out of the reduction is therefore justified in our opinion, despite the adverse employment effects.
18. There are good arguments in favour of increasing unemployment benefits, as there is otherwise a risk of these losing their position as readjustment insurance. However, it is unfortunate that the Government has chosen not to disclose any employment effects from the increase. In order to have a constructive discussion on the focus of fiscal policy, the Government has to disclose various conflicts of targets and clarify policy trade-offs.
19. The Council perceives a risk of an elusive target for unemployment potentially leading to measures which reduce unemployment in the short term or in purely statistical terms, but which have negative effects on employment in the long term. A debt-financed fiscal policy may temporarily reduce unemployment but has minor or no permanent effects on unemployment.

Fiscal policy and income distribution

20. Income differences increased between 1995 and 2007. The development since then is not as clear. As measured with the Gini coefficient, the income distribution has remained largely unchanged since 2007. The share of people in absolute poverty has remained approximately constant, while the share of people in relative poverty has increased substantially during the same period. Average income in all decile groups increased between 2012 and 2013. The greatest income increase took place in decile group 10, with the smallest increase taking place in decile group 1.
21. Our analysis indicates that the transfers have become less redistributive over time, while the redistributive effect of direct taxes has not changed. Other studies of the development of social insurance over time point in the same direction. Overall, this indicates that the fiscal policy today is less redistributive than in the mid-1990s.

Productivity

22. The Council notes that the measured productivity increase in the Swedish economy has been weak for almost a decade. The economic crisis and the Euro crisis, as well as long-term weak development in the construction sector, are probably the most significant explanations for this. When other countries have recovered from the crisis and the demand for Swedish goods and services gains momentum, we expect productivity in the Swedish economy to begin to grow again. However, this development should be monitored closely.

Infrastructure

23. From a European perspective, Swedish investments in transport infrastructure are neither high nor low. Investments in railways have been relatively large, and railway capital stock per capita has more than doubled over the past two decades. Based on available statistics, it is not possible to draw the conclusion that the investment volume in roads and railways is neglected.

24. General knowledge of the need for road and railway repairs and maintenance is highly inadequate. Therefore, it is not possible to determine whether resources are insufficient, or whether they are being utilised ineffectively. The Government should present a coherent analysis of the maintenance requirement for the Swedish road and rail network and the resources this will require.
25. An analysis of the roads investment plan decided upon for 2010–2021 indicates that the priorities of the then Government were economically inefficient. Better prioritisations within the plan, comprising SEK 95 billion, could have increased estimated net benefits for society from SEK 7 billion to SEK 42 billion. In our opinion, this is something which has characterised the field of infrastructure for a long time. The shortcomings in the decision-making model mean a great waste of resources and may explain why the transport infrastructure is perceived to be inadequate. A larger budget is then not the correct solution to the problems.
26. The economic significance of infrastructure and the obvious shortcomings in the system for prioritising various projects indicates a need for a framework for infrastructure decisions. The objective should be to clarify the economic trade-offs but not to restrict the political power of decision. A framework should include requirements for all decisions on infrastructure investments to be preceded by a cost-benefit analysis. A follow-up estimate must be carried out following decisions and implementation.

The Fiscal Policy Council's access to information

27. The Government should reinforce the Council's formal rights to gain access to the information required to fulfil its task. According to the OECD guidelines for fiscal policy councils, the Government must ensure in the regulatory framework that the councils are given access to all the information they consider necessary to fulfil their tasks. No such regulations exist in Sweden.