

## 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:

1. The Council notes that in the recent year, there have been clearer signs of an economic recovery, both globally and in Sweden. But there are still risks that could lead to slower growth.
2. Given the Government's assessment of the cyclical situation in the 2014 Budget Bill, estimated general government net lending for 2014 was consistent with a well-designed fiscal policy.
3. The Council's analysis shows that since 2006, the Government's active stabilisation policy has been well timed.
4. Since autumn 2013, the stabilisation policy outlook has changed. The Council now sees a risk that government net lending for 2014 may be lower than the level justified by stabilisation policy considerations. As the measures in the 2014 Budget Bill permanently weaken the budget, a return to a 1 per cent budget surplus will be more difficult. The low net lending in 2014 does not present any threat to long-term fiscal sustainability.
5. The Government's view of how much the economy can grow before equilibrium capacity utilisation is reached is considerably more positive than that of the National Institute of Economic Research and other forecasters. This is mainly due to a more optimistic view of equilibrium unemployment. The Government also has a more optimistic view of how rapidly the public finances will improve when capacity utilisation increases. The uncertainty indicated by various forecasters should have been discussed by the Government and may have justified more prudence with respect to permanent budget weakening.
6. The Council does not expect that the surplus target will be met in the current business cycle. In the Council's opinion, the Government should have declared a deviation from the surplus target.

7. The Council is also of the opinion that the deviation from the surplus target may be justified by the long and deep downturn. In such circumstances, a deviation need not damage the credibility of the surplus target. Nor is long-term fiscal sustainability threatened.
8. In the 2014 Spring Fiscal Policy Bill, the Government makes an explicit commitment that net lending will return to 1 per cent of GDP in 2018. The Government makes it clear that this commitment entails a very tight policy that excludes unfinanced reforms and presupposes that other budget weakening measures are fully financed. This commitment is a valuable contribution to maintaining confidence in the fiscal framework.
9. The Government has on a number of occasions postponed the time when net lending is to reach 1 per cent, referring to the more protracted than expected downturn. In the 2014 Spring Fiscal Policy Bill, there is another postponement, even though the economic situation has improved more rapidly than the Government previously expected. In the Council's opinion, the Government should have provided more justification for this postponement.
10. The Council thinks that the link between the fiscal policy proposed and the surplus target should be made clearer. It therefore proposes that structural net lending for the current and following years be used to assess whether there is a deviation from the target. If there is a deviation, the Government should explain it and present a realistic plan for meeting the target. Such a plan should be tailored to the business cycle.
11. The estimates of structural net lending can and should be improved. In the Council's opinion, the estimates should be disaggregated and formulated so that the average output gap is equal to zero. Improving the estimates is absolutely essential if, as the Council recommends, structural net lending is given a key role in assessing how fiscal policy relates to the surplus target.
12. Estimates by the Council and the National Institute of Economic Research show that neither general government net worth nor gross debt would develop in an unacceptable way if the surplus target were reduced to zero. But a lower surplus

target leads to smaller margins for tackling a sharp economic downturn. The consequences of not meeting the target also worsen if the target is lowered. Reducing the target also provides only a temporary increase in resources for higher expenditures or lower taxes. The Council's overall assessment is that the current level of the surplus target should be maintained for the time being.

13. The expenditure ceiling is tight for the next few years. In 2014 and 2015, there is no space beyond what is needed for managing the normal variations in expenditures, and even in the following year, the space is limited. It is important to maintain adequate margins for the expenditure ceiling in order not to be forced to take short-term expenditure measures, which risk harming the effectiveness of government activities.
14. The Council notes that expenditures for the sickness benefit have been underestimated for the past few years. In the Council's opinion, fiscal space may be limited if sickness absence continues its rapid rise. It is the Council's view that the Swedish Social Insurance Agency can and should improve its forecasting methods for the sickness benefit appropriation. The Government should also report the basis for its own estimate of sickness benefit expenditures.
15. Labour force participation, the employment rate and the number of hours worked have grown relatively well during the downturn. This is particularly true if demographic changes are taken into account. Good public finances have made an effective stabilisation policy possible and this has probably played a role in this growth. The Government's reforms, particularly the earned income tax credit, have also probably contributed.
16. Employment has not developed as positively as the labour force. Unemployment is thus higher than before the crisis. The increase in long-term unemployment is particularly worrisome. There are also indications that the percentage of unemployed who belong to vulnerable groups with job finding rates considerably below average has increased. This could lead to a permanent level of unemployment higher than the Government's forecasts for equilibrium unemployment.

17. The Council considers it inappropriate to use unemployment among 15–24-year-olds as a measure of young people's problems getting established in the labour market, as it often is in the public debate. In the Council's opinion, the measure of inactivity among young people that Eurostat estimates is generally a better measure of young people's difficulties getting established in the labour market. This measure includes young people who are not in employment or education. The share of inactive 18–24 year-olds has declined slightly since 2006.
18. Inactivity among young people is most common among 19–20-year-olds. This indicates that the transition between school and working life functions poorly. This suggests that the Government's support for vocational introduction for young people is a step in the right direction in making it easier for young people to get established in the labour market.
19. Between 2006 and 2012, disposable incomes in constant prices have risen by about 13 per cent. The aggregated measure of income inequality, the Gini coefficient, has increased marginally between 2006 and 2012. Incomes at the top and bottom of the income distribution have increased more slowly than those in the middle. This has led to less income inequality at the top of the distribution and a greater spread in the lower part of the distribution. The latter is reflected in the increase in relative poverty after 2006.
20. The earned income tax credit has contributed to higher average incomes for households. Analysis with the simulation model FASIT shows that the earned income tax credit has also contributed to a slight increase in the spread between the lower incomes in the income distribution and median incomes. The change is not large, but it should be part of the Government's description of the earned income tax credit's income distribution consequences.
21. The Council welcomes the Government's initiative to reform the housing market, but it notes that serious problems remain. Reviewing the utility value system, interest deductions, the property tax and the capital gains tax must be part of a

comprehensive approach to achieve a better functioning housing market in Sweden.

22. The Riksdag's discussions of the 2014 Budget Bill have made clear that there is political disagreement on how the Riksdag's framework model for budget decisions is to be interpreted. This disagreement has weakened this model and made it more difficult for minority governments to conduct a consistent economic policy. A broad political consensus on how the Riksdag's rules for budget decisions are to be interpreted and implemented is important.