Summary

Preliminary version

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. Our principal conclusions in this year's report are as follows:

Economic conditions and stabilisation policy

1. The Swedish economy has been strong for several years and this trend appears to continue in 2018–2019, even if a certain downturn is to be expected. Domestic factors, especially housing investments and public consumption, have had a positive effect on growth. Due to the upturn in the global economy, the activity level in Sweden is likely to be maintained for a while longer.
2. At the same time, there are imminent risks to the economic trend. Housing investments have already started to decline. High asset prices and high levels of debt make many businesses and households vulnerable. There are also many structural problems that risk inhibiting growth in the long term, such as an ageing population and weak productivity development.
3. The active fiscal policy over the last few years has been pro-cyclic; structural net lending has decreased despite the current economic upturn. For this reason, the fiscal policy cannot be considered well-balanced in relation to the business cycle. The Government has not sufficiently prioritised the surplus target when it comes to adapting its fiscal policy to the business cycle. The fiscal policy should be more restrictive so that it reduces the risk of overheating and increases the future scope for economic stabilisation measures.
4. Unlike the Government, the Fiscal Policy Council believes there is currently no reason for the fiscal policy to support the monetary policy. Inflation is close to the target and the capacity utilization is high.

The surplus target and the expenditure ceiling

5. The surplus target is being changed from 1 to 1/3 per cent of GDP per year over one economic cycle as of 2019. Retrospectively, the current target has not been attained. Nor has the surplus reached an average of 1/3 per cent of GDP per year in the last eight years.
6. To assess whether the fiscal policy is in line with the surplus target looking ahead, the Council uses the structural net lending in the current year and the next year. The Council believes there is no significant deviation from either the current surplus target or the new target. The Council consequently deems the fiscal policy to be consistent with the surplus target.
7. However, the Government appears to be optimistic in its estimation of structural net lending: its calculation assumes that equilibrium unemployment is lower and potential GDP higher than what is assessed by other forecasters.
8. The expenditure ceilings for 2018–2020 are high enough to allow for significant increases in expenditure. The scope allowed by the expenditure ceiling is substantially larger than the expenditure allowed within the surplus target according to current forecasts. If the scope allowed by the expenditure ceiling is used, government revenue needs to be higher, or the expenditure ceiling loses its steering function. We believe that the Government should provide more detailed arguments regarding its views on the desirable expenditure and revenue development over the next three years as part of the guidelines for fiscal and budgetary policy.

Principles of the stabilisation policy

9. In spring 2018, the Government presented a new framework document, which unlike the previous document does not contain an account of the principles for the division of responsibilities for the stabilisation policy. A clarification of the division of responsibilities between fiscal and monetary policy should be included in the framework document.

10. The division between fiscal and monetary policy that has provided the foundation of the fiscal policy framework since the mid-1990s should not be revised in our opinion. The main responsibility for the stabilisation policy lies with the Riksbank. In normal circumstances, the fiscal policy contributes to the stabilisation policy through automatic stabilisers. In exceptional cases the monetary policy may require active support from the fiscal policy, for example, when lowering the Riksbank's policy rate is no longer a sufficient or possible measure.

The debt anchor and long-term sustainable public finances

11. The Council makes the assessment that the public finances are sustainable in the long term. The estimations made by the National Institute of Economic Research (NIER) regarding the sustainability of the public finances up until 2030 indicate small risks of an unsustainable development.

12. Our assessment is that the gross public debt will stay within the target range for the debt anchor until the next review in eight years.

13. If the Riksbank discontinues its borrowing to reinforce the international reserves, which is a possibility, the gross debt ratio will decrease by around 5 percentage points (without affecting net debt). This should then lead to a technical adjustment of the debt anchor.

14. The Council views the Pension Group's agreement as a welcome addition. It is in line with the Council's previously stated opinion that the retirement age needs to be gradually raised for public finances to be sustainable in the long term and for pensions to be at a reasonable level.

Unemployment and employment

15. The Council believes several labour policy measures in the Budget Bill for 2018 are appropriate. However, we deem the effects on the equilibrium unemployment to be small and that extensive efforts remain to lower labour market thresholds, improve matching and reduce the discrepancies between native-born and foreign-born individuals.

16. Our assessment is that the Government will not attain its target of Sweden having the lowest unemployment rate within the EU by 2020. The target is not appropriate. The Government should, as previously proposed by the Council, reformulate its unemployment target into separate targets closely linked to the problems evident in the domestic labour market. This relates to the labour market prospects of those with no upper secondary education, individuals born outside of Europe and newly arrived migrants.

17. Employment is still the highest in Europe. It is positive that the employment rate has risen for many years, in particular for foreign-born individuals. The high level of immigration in 2015–2016 means that a larger part of the work force has a weak connection to the labour market. This places large demands on labour market policy.

18. For many, temporary and subsidised employment will not be sufficient for firm establishment in the labour market. The Council therefore sees a continued need for the social partners to also be open to the idea of regular low-skilled jobs.

19. In the long term, the Adult Education Initiative can contribute both to reinforcing the employment prospects of those with a weak connection to the labour market and to addressing the current shortage of labour. There is currently no comprehensive follow-up of the measures within the Initiative. The Council would like to see such a follow-up.

Income distribution and taxation of household investment income

20. The income spread has widened in the last decades. The main explanation is that capital income has increased and become more concentrated to the high-income brackets. Another explanation is that transfer payments have not increased at the same rate as general income. Structural changes have also contributed, such as an increased proportion of single households, an increased proportion of elderly in the population and an altered employment composition.

21. Following the 1991 tax reform, many changes have been implemented in terms of capital taxation: the inheritance, wealth and gift taxes have been abolished; the property tax has been replaced by a property charge; investment savings accounts have been introduced; and changes in the 3:12 regulations have increased the opportunities to take out earnings in the form of dividends from closely held companies. All in all, these reforms have entailed a lower average taxation on capital income, greater differences between the taxation of various forms of capital income and a greater asymmetry in relation to the rate at which interest rate expenditures can be deducted. These changes have primarily benefited high-income households.

22. The concept of investment savings accounts (ISK) was introduced in 2012 with the aim of stimulating direct ownership of funds and shares by households. The taxation has been considered highly beneficial and was raised from 2018. However, ISK investments entail a greater risk for the holder compared with investments subject to conventional taxation. The Council deems the tax benefit to be small.

23. While the current taxation on property was lowered in 2007, the taxation on realised capital gains on property was tightened. This has likely contributed to reduced mobility in the housing market. A future tax reform should be formulated so that property taxes are levied on a current basis in relation to the value of the property and to a lesser extent based on the realised capital gain.